SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Punjab, a general category state (GCS),[1] recorded a compound annual growth rate of 6.5% in its real gross state domestic product (GSDP) during FY2007–FY2012. This was considerably lower than the national average of 7.5%; as a result, Punjab's rank in per capita income among the GCSs declined from fourth in FY2004 to seventh in FY2012. This slide in per capita GSDP rankings has been associated with a very low and declining government investment (capital outlays) in social and economic infrastructure (as a percentage of GSDP). The reduction in capital outlay has been necessitated by the inadequate fiscal flexibility in state finances after meeting the committed expenditures. While Punjab has demonstrated a relatively robust own-tax effort with an own-tax revenue to GSDP ratio of almost 8% in FY2012 driven by good performance in value-added tax (VAT), excise, stamps, and registration, burgeoning revenue expenditure has resulted in a fragile fiscal situation.[2] Committed expenditure on salaries, pensions, and interest payments increased from 69.8% of own revenue receipts in FY2006 to 119.6% in FY2011, against an average of 87.9% for the GCSs. However, Punjab showed some improvement in committed expenditure in FY2012. Committed expenditure, as a percentage of own revenue receipts, declined to slightly above 100% in FY2012. Ad hoc expenditure planning and management, across-the-board transfer payments, and subsidies have contributed to the deteriorating fiscal consolidation. At 1.8% of GSDP in FY2012, Punjab accounted for higher budgeted power subsidies than most other large states. Consequently, Punjab's revenue deficit of 1.6% of GSDP (revised estimate) in FY2012 was the second highest among the GCSs.[3] The revenue deficit constituted 50% of the fiscal deficit in FY2012 compared with only 12.6% (average) for the GCSs, implying that the Government of Punjab (GOP) is borrowing primarily to finance the deficit and not for any productive value. While the primary deficit was a moderate 0.8% of GSDP in FY2012, the fiscal deficit was a relatively large 3.2%. Accordingly, the resulting large interest payment has resulted in Punjab being classified by the 13th Finance Commission as a debt-stress state. The precarious situation of state finances is outlined in Table 1, which focuses on the revenue deficit, fiscal deficit, and primary deficit.

Table 1: Key Fiscal Indicators
(% of gross state domestic product)

Fiscal Indicator	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012[a]
Revenue deficit	2.5	2.2	2.7	2.3	2.7	1.6
Fiscal deficit	3.0	3.8	3.1	3.2	3.3	3.2
Primary deficit	0.1	1.0	0.7	0.7	0.9	0.8

FY = fiscal year.
[a] = revised estimate
Source (basic data): Finance accounts and budget publications for calculating revenue balance, fiscal balance, and primary balance; central statistical organization for gross state domestic product at current prices.

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1 States are divided between general category and special category based on geographic terrain and inherent infrastructure difficulties.
2 Despite having an own-tax revenue to GSDP ratio comparable with the best-performing states, like Karnataka and Andhra Pradesh, Punjab, along with West Bengal and Kerala, are the three states in India with poor fiscal situations.
3 The revised estimates have been used to facilitate comparisons with other states although actuals are available for Punjab for FY2012. Actual revenue deficit was 2.6% of GSDP in FY2012 (Table 1 in the RRP).

2. The stressed fiscal position has had negative consequences for the GOP development agenda. In particular, the increase in revenue expenditure has significantly reduced its ability to meet its policy priorities. This led to the capital outlay to GSDP ratio dropping from 2.1% in FY2006 to 0.6% in FY2011, against an average of 2.3% for the GCSs; Punjab was the lowest among these states.[4]

3. While large committed expenditure relative to revenue is one source of the fiscal imbalance, fiscal analysis also indicates that state budget subsidies are a major contributor to the recurrent expenditure. An overwhelming majority (96%) of budgeted subsidies are in the form of power subsidies, which averaged around 1.6% of GSDP during FY2007–FY2012 (Table 2).[5] An analysis of implicit subsidies indicates that power subsidies account for a disproportional amount of total implicit subsidies and exceed the combined implicit subsidy for social welfare, elementary education, and rural and public health.[6]

Table 2: Expenditure Items
(% of gross state domestic product)

Item	**FY2007**	**FY2008**	**FY2009**	**FY2010**	**FY2011**	**FY2012**
Total expenditure	17.99	17.11	17.68	18.26	17.07	19.76
Revenue expenditure	15.15	14.12	13.88	14.54	12.89	13.76
Interest payment	2.97	2.82	2.54	2.44	2.45	2.38
Salaries	4.15	3.88	4.12	4.26	4.79	4.79
Pension	1.60	1.63	1.70	2.35	2.21	2.08
Other revenue expenditure	4.56	4.30	4.07	4.01	2.20	4.51
of which power subsidies	1.87	1.49	1.46	1.49	1.25	1.76
Capital disbursements (excluding public accounts)	2.85	2.99	3.80	3.72	4.18	6.00
Capital outlay	1.44	1.64	1.10	1.05	0.62	0.67
Lending or disbursement of loans and advances	0.02	0.03	0.01	0.03	0.07	0.07
Discharge of internal debt	1.15	1.22	2.60	2.55	3.42	5.18
Repayment of loans to the center	0.24	0.10	0.09	0.08	0.07	0.09

FY = fiscal year.
Source (basic data): Finance accounts and budget publications for calculating revenue balance, fiscal balance, and primary balance; central statistical organization for gross state domestic product at current prices.

4. Agricultural consumers with access to unlimited free power for agricultural operations consume about 87% of the power subsidy. Untargeted power subsidies are entailing a huge cost on both the environment and the fiscal health of the state through a vicious cycle, which cannot be sustained. Unlimited free power has resulted in overconsumption of groundwater leading to a fall in the water table. This, in turn, necessitates the use of higher-capacity pump sets to draw water from greater depth. This leads to a further decline of the water table and the consumption of more power results in higher power subsidies. Moreover, during FY2002–

[4] If the revised estimate for FY2012 is considered, then Punjab's figure was 1.5% as against the GCS average of 2.4%. However, Punjab's actual figure was only 0.7% in FY2012 (Table 2).

[5] In addition to budgeted subsidies, off-budget subsidies are reflected in the operating losses of the state power distribution companies.

[6] This implicit subsidy (different from the budgeted subsidy or explicit subsidy) is defined using the following formula (Government of India. 2004. *Central Government Subsidies in India*. Ministry of Finance):

$$S = RX + i^* (K+L) + d^*K - RR - R - T$$

Where, S is the total subsidy in the sector; RX is the variable cost or revenue expenditure on the service; K is the capital stock in the sector; L is the stock of investments outside the government by the sector in the form of loans/equity; i is an imputed interest rate representing the opportunity cost of money for government; d is the depreciation rate; i* (K+L) and d*K together capture the fixed cost incurred in providing the subsidy; RR is the revenue receipts by the sector; R is income by way of interest or dividend on loans and equity; and T is a transfer payment from the sector to individual agents. The analysis suggested that total implicit subsidy averaged around 3.3% of GSDP covering power, irrigation, roads and bridges, water supply and sanitation, industry, road transport, and non-poor housing.

FY2010, nearly all the districts in Punjab experienced a drop in food-grain yield per unit of power consumption, raising questions about the efficacy of the power subsidies. Supplying free power to the agriculture sector during the daytime contributes to the demand curve peak and procurement of expensive peak-hour power adding to the fiscal demands. Many unmetered connections and lack of data from segregated feeder makes accurately estimating the number of units consumed by unmetered consumers difficult.

5. While the total outstanding debt to GSDP ratio declined from 40.2% in FY2006 to 31.7% in FY2012 (revised estimates) and is below the target recommended by the 13th Finance Commission, Punjab continues to be the third most indebted GCS in the country. The high debt has resulted in the ratio of interest payments to revenue receipts persisting above the threshold prescribed by the Finance Commission. The high debt has led to an impending spike in repayment obligations after FY2018 (Table 3). Thus, the state is likely to spiral into an unsustainable debt trap unless immediate steps are taken to mitigate this risk.

Table 3: Maturity Profile of State Government Securities
(outstanding as of 31 March 2011, Rs billion)

Item	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
Punjab	106.1	101.5	93.3	87.7	115.6	118.8	108.9	106.6	130.7	223.9

FY = fiscal year.
Source: Asian Development Bank staff calculations.

2. Government's Sector Strategy

6. The GOP has been focusing on augmenting its revenues and rationalizing its expenditures so that adequate fiscal space can be created to support enhanced capital investment. The government's main measures are to mobilize revenue and rationalize expenditure.

7. **Revenue mobilization.** The relative importance of the proceeds of different components of revenue receipts of the state is shown in Table 4.

Table 4: Various Components of Revenue Receipts
(% of gross state domestic product)

Item	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Revenue receipts	12.64	11.90	11.22	12.21	10.23	11.18
Own-tax revenue	6.50	6.41	6.10	7.44	7.35	7.88
Value-added tax	3.23	3.54	3.68	4.26	4.19	4.61
Excise	1.22	1.04	1.06	1.05	1.07	1.16
Taxes and duties on electricity	0.40	0.36	0.12	0.63	0.36	0.71
Stamp duties	1.03	0.99	0.79	1.02	1.20	1.02
Motor vehicle tax	1.03	0.99	0.79	1.02	1.20	0.35
Other taxes	0.29	0.17	0.17	0.18	0.18	0.03
Own-non-tax revenue	3.45	3.32	2.86	2.36	0.55	0.92
Grants from central government	1.39	0.97	1.17	1.06	0.95	0.97
Share in central taxes	1.30	1.20	1.09	1.35	1.39	1.41

FY = fiscal year.
Source (basic data): Finance accounts and budget publications for calculating revenue balance, fiscal balance, and primary balance; central statistical organization for gross state domestic product at current prices.

8. The GOP has been pursuing several own-tax augmentation measures to try to contain the fiscal deficit. Since 2005, Punjab had in place a computerized VAT information system to strengthen VAT administration. This is now being expanded to provide more effective and efficient tax administration aided by a robust tax management system for informed decision-

making and tax policy formulation in the state to strengthen VAT administration and ensure revenue augmentation. The electricity duty, which used to be levied at an average rate, has been revised to an ad valorem rate, allowing each tariff hike to translate into an increase in the amount of electricity duty levied on consumers, eventually providing greater impetus for tax collections. In 2012, the stamp duty rates were increased to include an additional levy of social infrastructure assessment for health and education at a rate of 1% on property transactions. The state has fast-tracked computerization of land records, which is about 90% complete in rural areas.

9. **Expenditure rationalization.** Measures include reducing the staff government replacement ratio from 51% in FY2004 to 34.7% in FY2009, leading to salary savings and lowering future pension burden for the government. In FY2011, the state government undertook several measures to reduce expenditure including (i) restrictions on the purchase of new vehicles; (ii) reduction of fuel, maintenance, and repair expenses of government vehicles; (iii) reduction of electricity consumption and telephone bills of the government offices; and (iv) decreased office expenses and complete ban on renovation and/or furnishing of government offices.

3. ADB Sector Experience and Assistance Program

10. Given its long and successful experience in assisting states with fiscal consolidation, the Asian Development Bank (ADB) is in a good position to help Punjab fulfill its goals.[7] While earlier public resource management loans (i.e., before 2009) focused mainly on fiscal stabilization through expenditure rationalization and revenue augmentation, the Mizoram Public Resource Management Program, approved in 2009, combines fiscal consolidation with improvements in service delivery in health and education. The West Bengal Development Finance Program, approved in 2012, develops human and institutional capacity of key departments, leading to better financial management.

11. Drawing on lessons from previous interventions, the key objective of the loan is to assist the GOP with the design of a fiscal consolidation program that would be consistent with the state's fiscal responsibility and the budget management objectives, while providing enough fiscal headroom to increase spending on development expenditure. The twin-pronged strategies of additional revenue mobilization through rationalization of various tax rates coupled with expenditure rationalization measures (including rationalization of power subsidies) are expected to create a discernible effect in stimulating economic growth and improving the social and economic conditions of Punjab citizens. Support for improved debt management and cash management will also help the GOP sustainably manage its borrowing requirements.

12. ADB will provide technical assistance to build the state's capacity for implementing the program and sustaining various reform initiatives under the program, including preparation of medium-term expenditure frameworks, project appraisal and evaluation, subsidy targeting, implementation of the public awareness strategy, development of a system for effective debt management, introduction of profession tax, and other such initiatives.

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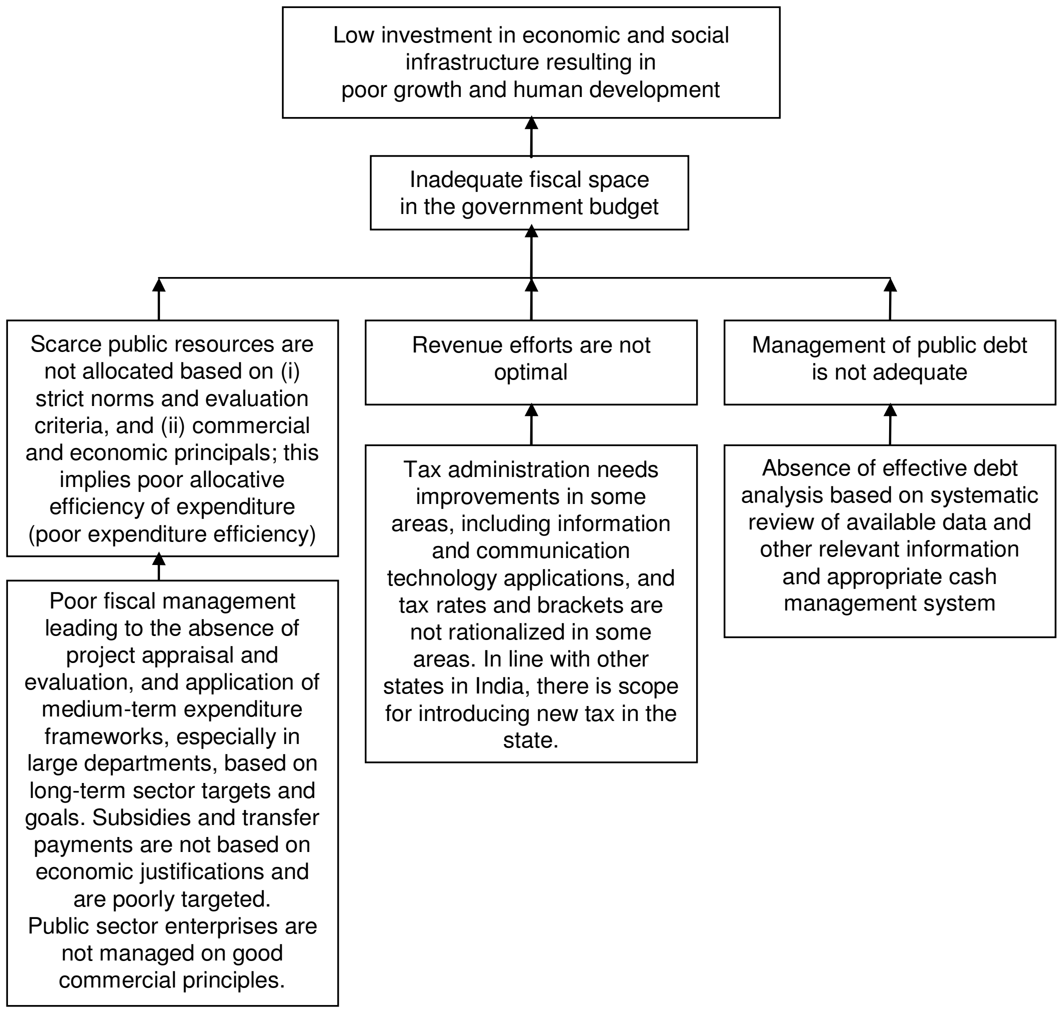
[7] As of 31 December 2012, ADB had provided program loans for public resource management to six states: Gujarat (1996), Madhya Pradesh (1999), Kerala (2002), Assam (2004 and 2008), Mizoram (2009), and West Bengal (2012). In Assam, ADB helped the state transform the fiscal deficit into a surplus in 6 years. Similarly, several public sector enterprises were closed with ADB assistance. While in Mizoram, a noteworthy achievement was to introduce a universal health insurance scheme. In West Bengal, an integrated financial management system was introduced, public officials' salary accounts were computerized, and drug procurement for public hospitals strengthened.

PROBLEM TREE

Problem Tree for the Punjab Development Finance Program



Source: Asian Development Bank.

Sector Results Framework (Public Sector Management FY2014–FY2018)					
Country Sector Outcomes		**Country Sector Outputs**		**ADB Sector Operations**	
Sector Outcomes with ADB Contribution	**Indicators with Targets and Baselines**	**Sector Outputs with ADB Contribution**	**Indicators with Incremental Targets**	**Planned and Ongoing ADB Interventions**	**Main Outputs Expected from ADB Interventions**
Larger and more sustainable fiscal space of GOP	Own-tax revenue is at least 9% of GSDP (Baseline: 7.9% in FY2012). Revenue deficit contained at around 0.7% of GSDP by FY2016 (Baseline: 2.6% of GSDP in FY2012)	Improved fiscal management	Major public investment approvals of the state government are vetted by FPMU by FY2016 (Baseline: FPMU does not exist)	**Ongoing operations** Loan 2926: West Bengal Development Finance Program was closed in July 2014 (2012, $400 million) Loan 2536: Mizoram Public Resource Management (2009, $94 million) **Planned Operations** Additional support for state policy-based loans programmed for FY2014	Additional revenue mobilization and expenditure rationalization, and expenditure targeting support for state governments Capacity development for improved tax administration, debt management, project evaluation and monitoring, pension reform, budget reforms, and implementation of service delivery improvements
		Rationalized expenditure with a focus on power subsidies	Well-documented gender responsive MTEFs in place for major spending departments by FY2016 (Baseline: no MTEF in place) The cash management system is developed by FY2016 (Baseline: the system is not in place) Power subsidy per hectare of gross cropped area declines by at least 4% over no reform scenario (No reform scenario: Rs11,920 in FY2016).		
		Improved revenue efforts of GOP	Agricultural power supply data disaggregated at feeder levels are properly documented (Baseline: not available) Profession tax bill is introduced in the state assembly by FY2016 (Baseline: none)		

FPMU = fiscal policy and management unit, FY = fiscal year, GOP = Government of Punjab, GSDP = gross state domestic product, MTEF = medium-term expenditure framework, VAT = value-added tax.
Source: Asian Development Bank.