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INTER-STATE INEQUALITY IN THE POST REFORM PERIOD (With Special Reference To State Public Finances)

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ABSTRACT

Chances are that any conversation about India today will turn into a discussion of the rapid rise in income and reduction in poverty, or the phenomenal rise of information technology (IT) and Information Technology – Enabled Services (ITES) sectors in the global market, or the spectacular growth in cellular telephony, or the imminent dawn of India's golden age, that is propelling India into the ranks of the world's leading economies in the not – too – distant future.(Kochhar 2006). It is undeniable that, during the last fifteen years, India has made remarkable strides in raising living standards and reducing poverty as a result of wide – ranging reforms to liberalize and open up the economy. (Hansda and Ray 2006).

KEYWORDS:*information technology (IT) and Information Technology – Enabled Services (ITES) , global market.*

INTRODUCTION:

The Indian reform program began in the middle of a macro – economic crisis that erupted in early 1991. The crisis was brought to a head by a steep fall in foreign exchange reserves to about USD 1 billion (equal to 2 weeks imports), a sharp downgrading of India's credit rating and a cut off of private foreign lending. It's basic features were high inflation (12% and rising), large public and current account deficits and a heavy and growing burden of domestic and foreign debt.

The new government, which took office at the end of June 1991, committed itself to a program of structural reform, but its first priority was to stabilize the economy (Joshi and Little 1996). A prime requirement of macro economic stability in the medium and long run is the sustainability of the fiscal deficit of the government and more broadly the deficit of non financial public sector (NFPS) which is an aggregation of Central and State governments, public sector enterprises and Reserve Bank of India, excluding other Public Sector Financial Institutions such as Nationalised Commercial Banks. (Bajaj and Joshi 2000). Starting from a position of near bankruptcy in 1990 - 91, India now has reserves of over US $ 200 billion and so the vulnerability to external shocks has been reduced significantly. Though services continue to lead the charge, the considerable acceleration of industry, particularly manufacturing makes the growth spread across various sectors (Chaudhari 2007). Thus the macro picture looks rosy and it appears to be a successful reform strategy. However, a closer look reveals some disturbing trends.

The benefit of growth has not affected every state in the country in an even manner. Though the overall performance of the economy has been impressive, the rates of economic growth of different states of the country vary substantially and this therefore requires detailed investigation.

Recent studies of development of various regions of the country reveal some disturbing trends. A study by Dasgupta et al (2000) reveals that inequality between states has widened. Kurien (2000) talks of increasing inter – state economic and social disparities and growth being limited to a few regions of the country. A study by R.H. Dholakia (1994) for the period 1960 – 61 to 1989 – 90 talks of high growth rate being achieved by only by six state economies and the existence of a sharp north – south divide in the Indian industrialization. Ghosh et al (1998) say that there is strong statistical evidence showing divergence across Indian states over the period 1960 – 61 to 1995 – 96.

A study by S Mahendra Deve (2002) says that almost all the states have experienced a decline in the proportion of population falling below the poverty line since 1983 both in rural and urban areas. In spite of the decline in poverty over the last two decades, the regional disparities are high even in 1999 – 2000 States like Punjab, Gujarat and Andhra Pradesh had rural poverty that was below 15%. But there were State like Bihar, Orissa and Madhya Pradesh where over 35% of rural population continue to remain poverty stricken.

In a recent survey of the trends in regional disparity, Govinda Rao (2006) concludes "Despites 50 years of planning the Governments have failed to enable poorer states to catch up with more advanced states in literacy, infant and maternal mortality and eradication of poverty. …. Ironically ….. some of the well endowed states like Bihar, Orissa, Madhya Pradesh and Uttar Pradesh are the poorest:" (Rao 2006).

Sachs et al (2002) have carried out both the sigma and beta tests of convergence for the 14 major states using per capita gross state domestic product (GSDP) data for the period 1980 to 1998. They found that 14 major states for the period are diverging over time. Major states in India exhibited a lack of both sigma and beta convergence. Their analyses leads them to suggest that the forces of convergences are weak in India.

Ahluwalia (2001) in his comparative evaluation of the economic performance of states observed that the estimated Gini-coefficient (a key measure of income inequality) has increased from about 0.16 in 1986 – 87 to 0.23 in 1997 – 98.

Ramaswamy (2007) has estimated the Gini-coefficients for two years 1993 – 94 and 2004 – 05, using per capita GSDP data for 14 states having large populations (Bihar, Orissa, Uttar Pradesh, Rajasthan, Madhya Pradesh, West Bengal, Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Gujarat, Haryana, Maharashtra and Punjab) which together have a share of more than 93% of India's population. He found that Gini-coefficient has risen from 0.28 in 1993 – 94 to 0.34 in 2004 – 05.

If this situation is allowed to continue, future growth would benefit only a small section of the population. This will surely have adverse social and political consequences. This has happened because under economic liberalization, there has been a dismantling of an array of controls, and an adoption of a more market oriented economy. The Central government has given up exercising many of its inherent power in the economic field. It's dominance in several industries has diminished considerably with the entry of private sector and the termination of price control in several areas. Not only the private sector but also the State governments are now freer to take the initiative and formulate their own policies. Further, liberalization has reduced the degree of control exercised by the Center in many areas leaving much greater scope for State level initiatives. This is particularly true with regard to attracting foreign and domestic investments, which impact the growth of any state. With the shrinking role of the Public Sector and the tight fiscal position of the Central Government the states are now largely dependent on private investments and initiatives. (Chelliah 1998)

1.2 Determinants of growth of an economy of a state

So what are the determinants of growth of the economy of the state? Some of the socio – economic determinants could be:

1.Stage of Demographic Development of a state: Rate of growth of population and rate of growth of economy are highly inter-related, and the negative implication of higher population burden on growth of a region is self-evident. Population growth is believed to retard the prospects for a better life for the already born by reducing saving rates at the household and national levels. It also severely draws down limited government revenues simply to provide the most rudimentary economic, health and social services to the additional people. This, in turn, further reduces the prospects for any improvements in the level of living of the existing generation and helps transmit poverty to future generation of low income families (Todaro et al 2007).

2.Literacy Rates in various states and prevalence of higher education : This factor is of crucial importance as the presence of skilled labour is an important variable in attracting investments. According to Martin Revallion (2000) "Gains to the poor from non-agricultural growth varies greatly between states, reflecting past achievements in human and physical resource development. The new jobs generated by recent economic reforms in India require higher attainment in schooling and health. Otherwise illiterate will be left out of the development process".

3.Scale of Private Investment : In the wake of economic reforms initiated in 1991, the role of private investments has acquired a special significance in the context of economic development of various states of the Indian Union. Roughly two thirds of the total output of the Indian economy is generated in the private corporate sector. (Nayar 2007).

4.Geography of different states: This parameter is difficult to quantify. However in today's world of freer trade, the presence of a big coast line is a big boon to a particular state. This is especially true, given the sorry state of our roads and rail systems which put the hinter land states to a big disadvantages. Coastal States have a location advantage in globalizing world as they suffer less from the disadvantages imposed on hinter land states by our poor transport infrastructure. (Marjit et al 2007). This is similar to green revolution technology that was peculiarly well suited to conditions in Punjab and Haryana and led to spurt of growth in these states in 1970s. (Ahluwalia 2000). In fact, a similar situation is prevalent in China, with their growth being predominantly limited to coastal areas and interior China remaining relatively backward (Sachs et al 2002).

5.Quality of governance, law & order, speed of clearance of investment proposals etc. : Number of surveys carried out among private investors indicate that it is the efficiency of administration and availability of infrastructural facilities which are more attractive to them rather than various tax incentives and concessions offered by the state government. The state has to provide an investment climate and the regulatory institutions. According to Lakshmanasamy (2004) the lesson of the development experience of last few decades has been that both the market and state are complement to each other in economic development (Lakshmanasamy (2004).

6.Infrastructure facilities present in the states : Infrastructure facilities can be divided into three broad categories viz economic, social and financial

Importance of this parameter cannot be over – emphasized. Availability of assured power supply, developed transport systems and modern telecom facilities are important factors to attract private investment in the states. Similarly the development of irrigation potential fully will go a long way in improving the productivity of agriculture and engaging unemployed rural labour which will improve rural incomes and reduce rural poverty (Joshi and Little 1996).

9.Public Finances of Indian States : The state of public finances make up the environment within which investment decisions are taken and there is sufficient (international) evidence to show that adverse fiscal balances act as a deterrent to investment. Acoording to Karnik and Sawant (2001) healthy conditions of state finances implies that states can undertake investment in creation of physical, social and economic infrastructure which is very important for attracting private foreign and domestic investment. It has been found out that public sector capital formation has crowded in private investments in the Indian economy (Pattanaik et al 2004).

Ample empirical evidence supports the assertion that fiscal equilibrium is a necessary, although not sufficient, condition for achieving sustainable growth (Guardia and Sonder 2006). This is even more the case in emerging market economies, which are more susceptible to external shocks that affect critical macroeconomic variables, such as exchange rate, interest rates and capital flows. Because these economies are more exposed to these risks of the global economy, their internal economic foundations have to be strong and steady (Kochhar et al 2006).

This paper intends to concentrate on the "Public Finance at the State Level", since it is undoubtedly the most important parameter that can shed light on the different growth experiences of various states of India in the Post Reform Period.

1.3 Review of Literature

Bagchi et al (1996) cover various dimensions of state public finances in India. Under the federal system, as set forth in Constitution, the Indian states have important responsibilities in various economic and social sectors, in addition to their government roles. They also have access to substantial revenue flows, including taxes they collect themselves, a share in certain taxes collected by the Central Government and various transfers from the central government which augment the state's own revenues. State governments have been facing a worsening budgetary squeeze which has severely affected their development expenditure. .

According to the Bimal Jalan (1996), deficits at the Centre and State levels are rising. They are reaching the limits of borrowing to finance revenue deficits as well as to undertake capital formation. The sources of borrowing are drying up because a substantial part of borrowing is being used to finance revenue expenditure. Consequently interest rates are being pushed up. Also fiscal deficit is also eroding capital formation as well as resources for expansion of social services, anti poverty programs and employment programs. The main burden of India's fiscal problem is falling on state - provided social services as well as on plan investments. Spending on social services has actually declined as a percentage of total revenue expenditure while interest payment and administrative outlays have gone up. The picture for capital expenditure is even bleaker, with the biggest short fall in areas like irrigation, flood control, power, water supply and sanitation.

Rakesh Mohan (2000), in his article "Fiscal Correction for Economic Growth", says that rapid economic growth is the only solution to the problem of poverty and such growth is not possible without significant fiscal correction. State governments are responsible for most public expenditure like the provision of social services. They are responsible for most infrastructure services except for telecommunication, civil aviation, railway and major ports. They are also responsible for law & order. Thus a deterioration in the state's ability to invest is very serious for human development and hence for internal security, in addition to the harmful effects on economic growth.

A study by Buddhadev Ghosh and Prabir De (2004) investigated the role played by various categories of infrastructure in determining the level of development across Indian states. The authors were able to conclude that physical and social infrastructure facilities have proved to be highly significant factors in determining the inter-state levels of development. Differentials in infrastructure facilities across the states are primarily responsible for the widening of income disparity.

Nayak (2007) examines the determinants of private corporate investment in India in post – reform period. Public investment in infrastructure is found to be a significant determinant of investment by private firms in India.

It is argued that secondary education is crucial for economic growth (Lewin and Caillods 2001). Education is a state subject in India. A state with sound finances, can divert more resources towards this critical area and influence its future growth.

Ramaswamy (2007) tried to show the relationship between educated workforce and economic development. His study considered 14 states in India. His study covered the ten year period from 1993 – 94 to 2004 – 05. He has divided the states into 3 groups by ranking each state based on its per capita GSDP for the year 1993 – 94. In the bottom five are states with relatively low income (Bihar, Orissa, Uttar Pradesh, Rajasthan, Madhya Pradesh), the middle four are medium income states. (West Bengal, Andhra Pradesh, Karnataka, Kerala) and the top five are the relatively rich states (Tamil Nadu, Gujarat, Haryana, Maharashtra, Punjab). There are large inter state variation in their educational attainments. The bottom five states suffer from a serious shortage of educated persons. In these states only 17% are found to be educated and more seriously only 12% are found to have secondary education or higher secondary education as against the all India average of 24% & 16% respectively. Next, Ramaswamy has investigated the relationship between secondary education and growth of labor productivity and has found a positive relation between them. Labor productivity is the key proximate determinant of output and employment. States with better supply of secondary school educated workers are likely to get more investment and jobs in their way. It is now well established that a major chunk of investment, domestic and foreign direct investment has gone into five selected states namely Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu (Bagchi and Kurian 2005). All these are relatively well endowed states with an educated work force.

Bosworth, Collins and Viramani (2007) in their detailed study of sources of growth in India, covering the period 1960 – 2004, call attention to the low levels of educational attainment of Indian population and workforce. They point out that India has recently attained an average level of schooling comparable to that achieved in other Asian countries a quarter century earlier.

Ahluwalia (2002) in his study says that in the post liberalization period the degree of control exercised by Centre on States has reduced. Hence state level policies and their fiscal positions explain the differences in performance among states. To increase their growth rate they have to increase the level of investment and the efficiency of resource use. However, there are resource constraints that limit their growth potential. Fiscal restructuring is a must to break these constraints. He suggests privatization of State Public Sector Units, downsizing the size of state governments, rationalization of State Electricity Boards, and the widening of the tax net as some of the measures to break the constraints.

According to Lahiri and Kannan (2002) it is not only the speed but the quality of fiscal consolidation that is very important. The brunt of fiscal correction is often borne by compression in capital and social sector expenditures which has negative consequences for growth prospects.

A study by Ajit Karnik and Archana Sawant (2001) holds worsening of state finances as an important cause of Maharashtra's growth lagging behind some other states of India (Andhra Pradesh, Karnataka, Tamil Nadu & Kerala) in the the period after 1990.

Rangarajan and Srivastava (2005) examine the long term profile of the fiscal deficit and debt relative to India's GDP. It is argued that a large structural primary deficit and large interest payments relative to GDP have had an adverse effect on growth in recent years. Also there is asymmetric treatment of Central and sub-national debt. They believe "constraints on sub-national deficit must be stronger than those pertaining to the Central government. The interest rates applicable to the borrowing by the State, both on the average and marginal are higher as compared to those of the Center. Hence stringent norms are required at the state level which is very important for stabilization and sustainability of debt at national level".

1.4 OBJECTIVE OF STUDY

Higher economic growth requires concerted action on all fronts. Major improvements have to be made in the provision of public health services, education, nutrition and the like. In the areas of physical infrastructure, large investments have to be made in areas such as roads, railways, ports, power, telecom, civil aviation, urban infrastructure, irrigation and the like. In some areas private investment can form a significant proportion of the needed investment, in other areas, it is the state that will continue to play a dominant role. Even in areas where private investment is relatively easy, public investment will continue. As the economy grows and industrializes, urbanization will also grow apace. A critical area for increased investment is in urbanization i.e. water supply, sanitation, sewerage, roads and transportation. All these are difficult areas of investments and require large amounts of resources. The lack of basic facilities in our towns and cities give rise to high degrees of alienation leading to social unrest. This, in turn, necessitates higher expenditure on internal security. Thus, a renewal of public investment in a wide variety of areas in the social and physical infrastructure field is essential for higher economic growth and sustained national security.

State governments in India are responsible for most public expenditures for provision of social services. Further, they are responsible for most infrastructure services except for telecom civil aviation railways and major ports. They are also responsible for law and order. Thus, a deterioration of state finances, is not only harmful for economic growth, but is also harmful for human development and internal security. Therefore, the aim of my study is to concentrate on the "Public Finances at the State Level". It is undoubtedly the most important parameter that can shed light on the different growth experiences of various states of India in the Post Reform Period. This study is an attempt to assess the public finances of fourteen major states of India, which together accounts for 95% of total population of the country. None of these states are special category states and are thus, not entitled to any relatively liberal transfers from Central Government. The aim is to draw attention to the deterioration in the state finances, and its implications. Overview and review of literature, reveals that most of the inter – state comparative studies on public finances which have been done before have limited coverage to three to four states. This study attempts to do a much broader comparative study on a much broader scale covering as many as fourteen states. Given the size and diversity of our country, we believe that such an extensive study will give a meaningful insight into the issue. The fourteen states have shown different rate of growth. The study would like to investigate whether states that have done well have managed their public finances better. If yes, there is a lesson to be learnt for the other states and success stories of better off states can be repeated in other regions too.

1.5 METHODOLOGY

Government expenditure can be classified in two categories viz developmental and non-developmental categories so as to assess their welfare impact. The developmental expenditure includes mainly spending on economic services (agriculture,industry,energy,communication,transport,science,technolog and environment) and social services (education, health, employment, nutrition, housing and others).The remaining categories such as government administration, interest payments, pensions, defence, and other non-productive services constitute non-developmental expenditure. The economic growth is more responsive to developmental expenditure in general and capital outlays in particular. The achievement of equity goal depends on the social expenditure such as poverty alleviation, education, health and employment generation which also forms part of developmental expenditure. Government expenditures have to be balanced so as to pursue the goals of growth and equity while at the same time keeping a vigil on the overall size of the expenditure to contain the deficit within levels consistent with macroeconomic stability (Pattnaik et al2002).

For the purpose of our analysis, we have taken Total Development Expenditure on the following categories.
(a)Education, Sports, art and culture.
(b)Medical and Public Health
(c)Energy
(d)Transport

The figures of developmental expenditure is presented in Table 1(a) and ratio of developmental expenditure to SDP is presented in Table 1(b).

From Table 1(b), we can see on an average for all states the value of DE/SDP remains stagnant for all states for the time period chosen. The ratio of DE/Sdp is less than 1% for all states for all years in the Post-Reform period except for some states in some years like for Karnataka in 1991-92(ratio was 1.15%), Karnataka in 1993-94 (ratio was 1.03%), Madhya Pradesh in 1997-98(ratio was 1.8%), Maharashtra in 1994-95(1.8%), and in 2000-01 (1.4%), Uttar Pradesh in 2003-04 (4.5%), West Bengal in 1995-96 (1.31%), and in 1996-97 (1.29%).

The ROG of Development expenditure is given in Table 1(c). The result is not significant for many states. Among the states, where we have got significant result, Uttar Pradesh has the highest ROG of Development Expenditure (this is a surprising result- one reason for the surprising result could be the big jump in the level of Development expenditure in UP in the year2003-04-fromRs. 1634 crores to Rs. 8411 crores. If we ignore this figure the ROG of development expenditure works out much lower, 109 instead of340) followed by Punjab, Haryana, Gujarat, Kerala and least is Bihar. For other states, we have not got significant results. The Linear Trend Analysis for The ROG of Development expenditure/SDP given in Table 1(d) does not yield significant result for any state.

In spite of the fact that development expenditure is so critical for growth and creating an environment for attracting investments, they remain stagnant throughout the period.

What we can conclude from our complete analysis is that budgetary position of the states has been deteriorating due to their stagnant receipts and increasing expenditure and that the situation has worsened with committed non-plan expenditures being financed by cut backs in development expenditure. These expenditure responsibilities are often met from borrowed resources which create a vicious cycle of debt, interest payments, deficit and further debt. These dynamics indicate the unsustainability of the public finance which may spill over to adversely affect overall macroeconomic stability.

Table 1(a) : Development Expenditure (DE) for 1991-92 to 2003-04 (in Rs.Crores)

States	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal
1991-92	-63.68	60.3	183.94	61.63	335.6	95.43	186.75	280.84	299.81	67.31	719.65	62.41	305.7	127.56
1992-93	121.86	92.74	105.72	68.22	175.53	100.68	239.42	334.81	283.13	66.39	123.4	88.21	336.33	112.33
1993-94	287.87	70.52	130.79	80.92	381	128.91	246.69	447.37	292.02	66.74	153.06	291.87	321.76	155.63
1994-95	1107.62	59.41	120.82	68.14	260.06	150.45	270.77	2138.42	281.93	45.88	181.26	387.35	435.25	387.63
1995-96	1597.43	60.61	163.44	68.74	305.9	183.07	269.78	680.14	119.58	57.52	586.18	240.96	477.41	880.6
1996-97	-705.15	104.14	111.46	54.45	128.34	188.72	292.24	1015.52	384.93	64.86	342.99	558.99	481.49	961.28
1997-98	143.94	15.34	155.47	69.24	206.86	275.49	955.01	1021.08	164	47.48	1042.46	1042.44	468.22	196.58
1998-99	285.14	167.76	236.68	412.48	362.81	240.55	236.64	1231.56	204.83	77.4	267.26	522.39	917.82	246.61
1999-00	591.82	336.68	394.94	410.97	283.56	260.68	311.08	1178.98	157.53	76.05	158.08	-139.87	701.16	480.89
2000-01	874.31	121.12	466.21	346.72	367.93	213.72	393.89	2950.09	189.19	82.35	276.46	199.22	1475.27	804.89
2001-02	911.56	122.76	217.27	309.17	348.16	275	445.18	1139.99	221.33	307.29	520.11	550.9	1025.68	634.02
2002-03	961.25	209.67	495.56	429.38	442.14	415.27	602.66	940	353.54	636.82	796.33	496.38	1623.51	614.59
2003-04	1174.68	212.19	668.44	506.95	774.65	225.79	740.16	1240.15	543.37	684.93	882.75	1030.91	8410.98	540.33

Table 1(b) : Development Expenditure / SDP (DE/SDP) for 1991-92 to 2003-04

States	Andhra Pradesh	Bihar	Gujarat	Haryana	Karnataka	Kerala	Madhya Pradesh	Maharashtra	Orissa	Punjab	Rajasthan	Tamil Nadu	Uttar Pradesh	West Bengal
1991-92	-0.0017	0.0036	0.0065	0.004	0.0115	0.0052	0.0076	0.0042	0.00229	0.0034	0.00306	0.0017	0.0053	0.0032
1992-93	0.0029	0.0052	0.0028	0.0042	0.0055	0.0048	0.0087	0.004	0.00202	0.0029	0.0044	0.0021	0.0053	0.0027
1993-94	0.0056	0.0034	0.0031	0.0042	0.0103	0.0054	0.0073	0.0044	0.0018	0.0025	0.0053	0.0057	0.0045	0.0032
1994-95	0.0179	0.0025	0.0022	0.0029	0.006	0.0052	0.0072	0.0184	0.00166	0.0015	0.0049	0.0063	0.0053	0.0069
1995-96	0.0222	0.0028	0.0026	0.0026	0.0061	0.0052	0.0064	0.0048	0.0067	0.0017	0.00141	0.0035	0.0051	0.0131
1996-97	-0.0087	0.0035	0.0015	0.0017	0.0022	0.0046	0.006	0.0064	0.00233	0.0017	0.0067	0.0071	0.0043	0.0129
1997-98	0.0017	0.0005	0.002	0.002	0.0032	0.0061	0.0018	0.0059	0.0087	0.0011	0.00183	0.0112	0.0039	0.0022
1998-99	0.0027	0.0048	0.0026	0.0108	0.0046	0.0047	0.0039	0.0066	0.00105	0.0016	0.0041	0.0049	0.0069	0.0023
1999-00	0.0052	0.0088	0.0043	0.0096	0.0033	0.0046	0.0045	0.0054	0.0076	0.0014	0.0023	-0.0012	0.0049	0.0041
2000-01	0.0069	0.0029	0.0052	0.0072	0.0039	0.0034	0.0061	0.014	0.0093	0.0014	0.004	0.0016	0.0098	0.0062
2001-02	0.0067	0.0029	0.0022	0.0058	0.0036	0.0042	0.006	0.0048	0.00103	0.0049	0.0067	0.0043	0.0065	0.0045
2002-03	0.0065	0.0043	0.0042	0.0074	0.0041	0.0056	0.0084	0.0036	0.00167	0.0097	0.00107	0.0036	0.0095	0.004
2003-04	0.007	0.0042	0.0047	0.0078	0.0065	0.0028	0.0083	0.0042	0.00221	0.0095	0.0096	0.0069	0.0451	0.0031

Table 1(c) : Regression Results tor Development Expenditure (DE) 1991-92 to 2003-04

Stales	Coeff (b1)	Coeff (b2)	T-stat (b1)	T-stat (b2)	Adj.R2	F-stat	Prob.F
Andhra Pradesh	83.7	68.14	0.2421	1.564	0.1076	2.447	0.146
Bihar	29.26	13.77	0.6957	2.603	0.3249	6.774	0.02456
Gujarat	2.883	37.51	0.04392	4.535	0.6199	20.57	0 0008507
Haryana	-57.5	39.94	-1.041	5.742	0.7271	32.97	0.00013
Karnataka	169.1	23.9	2.138	2.399	0.2839	5.756	0.03528
Kerala	83.51	18.33	2.737	4.758	0.6443	22.74	0.0005822
Madhya Pradesh	155.9	3.488E+01	1.354	2.398	0.2831	5.739	0.0355
Maharashtra	538.3	83.52	1.335	1.644	0.1243	2.703	0.1284
Orissa	224.7	6.309	3.281	0.7313	-0.04033	0.5348	0.4799
Punjab	-119.9	42.19	-1.258	3.514	0.486	12.35	0.004852
Rajasthan	266.7	28.38	1.48	1.25	0.04477	1.562	0.2372
Tamil Nadu	120.7	41.35	0.6345	1.725	0.1413	2.974	0.1125
Uttar Pradesh	-1074	340	-1.011	2.539	0.3123	6.449	0.02751
West Bengal	217.2	36.48	1.352	1.816	0.1606	3.296	0.09676

Table 1(d) : Regression Results for Development Expenditure /SDP 1991-92 to 2003-04

States	Coeff (b1)	Coeff (b2)	T-stat (b1)	T-stat (b2)	Adj.R2	F-stat	Prob.F
Andhra Pradesh	0.005031	0.0001044	1.058	0.1742	-0.08791	0.03034	0.8649
Bihar	0.003354	0 00006374	2.879	0.4343	-0 07252	0.1886	0.6725
Gujarat	0.003142	0.00003352	3.477	0.2943	-0.08238	0.08664	0.774
Haryana	0.002277	0.0004462	1.558	2.422	0.2886	5.868	0.03385
Karnataka	0.008265	-0 0004027	5.963	-2.306	0.2647	5.319	0.04157
Kerala	0.005586	-0.0001192	11.94	-2.021	0.2046	4.086	0.06825
Madhya Pradesh	0.008019	-6.429E-05	3.792	-0.2413	-0.08517	0.05823	0.8138
Maharashtra	0.007138	-5.703E-05	2.632	-0.1 962	-0.0871	0.03849	0.848
Orissa	0.01815	-0.0004725	4.989	-1.031	0.005249	1.063	0.3246
Punjab	0.0002846	0.0004352	0.1896	2.301	0.2636	5.295	0.04196
Rajasthan	0 01389	-0.0006473	3.047	-1 127	0.02199	1.27	0.2838
Tamil Nadu	0.004154	0 00004066	2.153	0.1673	-0.08814	0.02799	0.8702
Uttar Pradesh	-0.00195	0.001558	-0.3451	2.188	0.2399	4.788	0.05113
West Bengal	0.006015	-0.0001077	2.659	-0.3778	-0.07693	0.1428	0.7127

Our analysis shows that on an average the ratio of Development Expenditure/SDP remains stagnant for all states for the post reform period. The ratio is less than1% for all states for all years except few exceptions. We, work out the correlation between Development Expenditure/SDP and Growth Rate of real SDP to understand linkages between the two. The results are presented in Table 2.

Table 2: Correlation between growth of real SDP and Development Expenditure / SDP

States	Correlation Coefficient
Andhra Pradesh	0.42
Bihar	0.23
Gujarat	0.5
Haryana	0.35
Karnataka	0.43
Kerala	0.4
Madhya Pradesh	0.25
Maharashtra	0.14
Orissa	0.51
Punjab	0.27
Rajasthan	0.38
Tamil Nadu	0.09
Uttar Pradesh	0.24
West Bengal	0.37

The correlation between Development Expenditure and Growth Rate of SDP is positive for all states, which indicates that growth impulses are generated by the development expenditure. Thus, stagnancy of development expenditure has serious consequences for growth of a state economy.

1.6 CONCLUSIONS

The budgetary position of the states has been deteriorating due to their stagnant receipts and increasing expenditure. The situation has worsened with committed non-plan expenditures being financed by cut backs in development expenditure. These expenditure responsibilities are often met from borrowed resources which creates a vicious cycle of debt, interest payments, deficit and further debt. These dynamics indicate the unsustainability of the public finance which may spill over to adversely affect overall macroeconomic stability.

Rapid industrial growth depends upon the availability of physical, economic and social infrastructure

(Ahluwalia 2002). The states have entered a vicious circle where by their poor fiscal health limits their ability to create a conducive environment for attracting investments in their state and where new and additional investment in turn is needed for helping the State out of their financial mess (Bidisha and Abhijeet 2002).

This implies that, in these state economies, fiscal imbalances adversely affect growth. Thus, these states seen to be caught in a vicious circle poor -state finances implies poor growth which implies lower per capita income, which implies lower resource mobilization by government which worsens deficits, which worsens growth and so on. Thus, special policy reforms are needed to break the vicious circle in these state economies.

India is one of the rapidly growing emerging market economies. It is one of the leaders of the developing world and is, in so many ways, beginning to reap the benefits of reform and global integration. It would be a great pity if such accelerating economic growth were to be retarded because of lack of fiscal balance and the consequent build up of debt. A Paper by Easterly (Easterly 2005), presents very convincing empirical evidence that fiscal deficits matter. The coefficient of fiscal deficits is around 0.1, that is, with each percentage point decline in fiscal deficit, there will be a sustained (at least for five years) increase in growth rate of 0.1%. Thus there is an urgent need for fiscal reforms at centre and state level to break the fiscal constraints and realize the growth potential.

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