Chapter V
Financial Justification for Special Category Status to Pondicherry

A situational analysis of Pondicherry and its immediate prospects, particularly on its financial position brings out the following aspects:

1. **Even as UT receiving its central assistance in the form of one-third loan and two-thirds grant, its debt servicing is tending to be unsustainable as evident from following analysis:**

    i. **Its interest burden to Non-Plan Revenue expenditure (after adjusting power charge item) is in the range of 15% to 16% during last few years quite close to 17% average of all states indicated in the Tenth Finance Commission Report (para 3.52, page 14 of EFC)**

    ii. **Even as % of revenue expenditure (after adjusting power charge cost), it is around 13 % to 14%.**

    iii. **Interest charges as % of Revenue receipts is also in the range of 13% to 14% in the recent past, as entire capital expenditure of the UT is met by Central loans. In contrast due to 90% grant and 10% loan of central assistance, four of the special category states have contained such interest burden within 10% of revenue receipts and 3 of them within 10% to 15%. (Table 11.4, page 102 of EFC).**

    In view of the above even as UT, Pondicherry has a case to request for shift of the proportion of loans to well below 30% and grants well above 70%. On the other hand, if it attains statehood and central plan assistance is extended as 70% loan and 30% grants, then debt servicing would become unsustainable.

For Pondicherry as normal state with additional slant on loan form of central assistance, it would be quite difficult to meet the following steps considered generally desirable by EFC (Page 102 of EFC Report):

a. **Incremental revenue receipts should meet incremental interest burden and incremental primary expenditure.**
b. **Surplus to be generated on revenue account to meet future repayment obligations**
c. **Maintain a balance in its revenue account.**

The present ballooning effect of interest and principal installments being rolled over through additional grants-in-aid and central loan would not augur well for future financial stability of the state. As a first measure, the interest burden as on date needs to be waived (as in the case of Arunachal Pradesh) and balance loans consolidated and repayment considered on easy terms. More importantly fresh central assistance should be more in the form of grants than loans.

2. **It is quite clear that even if Pondicherry is considered as normal state (Chapter IV) it would have Non Plan deficit throughout 2000-05 as in the case of special category state. At present Non Plan deficit of normal state has been considered only for the first few years (upto 2002-03). Subsequent revised recommendations of EFC contemplates 15% of Non Plan revenue deficit grants (Rs35,359 crores) being set apart to provide incentives to states.**

3. **More importantly for Pondicherry, net debt addition of Rs. 100 crore as normal state would entail the following debt servicing position by 2000-05:**

   i. **Interest as % of non plan revenue expenditure: 16%**
   ii. **Interest as % of total revenue expenditure: 13%**
   (assuming annual plan revenue expenditure of Rs 200 crores approx.)
   iii. **Interest as % of non-plan revenue receipts (including devolution of central taxes and duties): 16 %. At present all special category states are able to contain it within 15% of revenue receipts mainly because of substantial grant form of central plan assistance.**

   In short as a new state Pondicherry should be facilitated to keep its interest burden as % of revenue receipts within 10%, if it also has to meet repayment obligations on its own without present rollover

facility. Thus it can then plan and meet future loan repayment obligations on its own as envisaged by EFC.

iv. **Public debt of Pondicherry as on 31-3-2000 is around Rs. 700 crore. If Rs. 100-150 crore of additional annual debt is added, then level of public debt will nearly double itself by 2005 which does not augur well.**

4. **With the gradual implementation of UFR (Uniform Floor Rate) of sales tax scheme including 25-30 sensitive commodities on the anvil and advent of VAT regime by April 2002, Pondicherry would suffer sizeable decline in its ST revenue. More importantly it would affect cost competitiveness and growth of industries in the state. One could foresee a reverse swing not only of depletion of commercial tax revenue base, but also a stagnant or declining growth in its commerce and industries sector of the economy. This will affect its GSDP growth (more likely to decline to 12-13% p.a. in future as against well above 14% p.a.in recent past), particularly in its secondary sector ,which is anchored to cost effective and quality oriented SMEs and some large units providing gainful employment to skilled and semi-skilled labour.**

Pondicherry is not a raw material producing state and everything has to be procured. It has to depend for Energy/Power on other states' and central electric utilities with attendent problems of added power cost. As all incoming raw material suffer CST of 4% under UFR, products of the state will be costlier by that much in UFR scheme. Under such circumstances Pondicherry needs to be placed under G2 cluster group category (13% GSDP growth rate) and tax revenue growth rate of 15.6 % (tax buoyancy of 1.2) allowed for slightly better placed special category states at present by EFC.

The financial projections of Pondicherry as special category state with 13% GSDP growth rate and tax revenue growth rate of 15.6%, Central plan assistance in the form of 90% grants and availability of non-plan revenue deficit grants is as follows:

	2000-01	2001-02	2002-03	2003-04	2004-05	2000-05 (5 years)
A. Revenue Receipt						
1. Own Tax Rev. (including CST)	**264(228 x 1.156)**	**305**	**353**	**408**	**472**	**1802**
2.Own Non-Tax rev.(excludes power receipts)	**17.0(14x1.2)**	**21**	**25**	**30**	**36**	**129**
Total (A)	**281**	**326**	**378**	**438**	**508**	**1931**
B. Non Plan Rev. Exp.						
1.General Services						
1.1 Interest Payments (1.10)	**87**	**101**	**116**	**131**	**146**	**581**
1.2 Pension (10%)	**51**	**56**	**61**	**67**	**74**	**309**
1.3 Election	**1**	**1**	**2**	**3**	**3**	**10**
1.4 Other General Services (5.5%)	**72**	**76**	**80**	**85**	**90**	**403**
Sub-Total	**211**	**234**	**259**	**286**	**313**	**1303**
2. Social Services (15%)	**206(179 x 1.15)**	**237**	**273**	**314**	**361**	**1391**
3. Economic Services (11%)	**41(37 x 1.11)**	**46**	**51**	**57**	**63**	**258**
4. Compensations & Assignments to local bodies and panchayats	**3**	**3**	**4**	**4**	**5**	**19**
5. Committed Liabilities			**45**	**50**	**55**	**150**
6. Total Non Plan Rev. Exp.	**461**	**520**	**632**	**711**	**797**	**3121**
7. Tax devolution	**103**	**121**	**141**	**165**	**192**	**722**
8. Non Plan Rev.(NPR) Deficit(before tax devolution)	**-180**	**-194**	**-254**	**-273**	**-289**	**-1190 @**

@:Period 2000-05NonPlan Rev.Deficit: Rs.3121-1931= Rs.1190 crore before Central tax devolution and Rs.468 Crores after Devolution of Rs.722 crores

In the above table, unbridged Non Plan Rev. Deficit, after Central Tax Devolution of

Rs.722 crores works out as Rs.468crores. In Chap.IV, we obtained slightly lower unabridged Non-Plan Rev. Deficit of Rs.410 Crores as against Rs.468 crores above (after Central tax devolution of Rs.722 Crores) , as Own Tax Rev.growth of 15.6% p.a. as assumed above was earlier projected at a slightly higher 16.8% p.a.. as applicable to G3 Cluster Group in which Goa figures as High Income Group , with nearly 8% Tax effort in the past

Pondicherry also slightly edges into High Income Group , with similar good tax effort of 8% in the past. However once Pondicherry is considered under Special Category Status,then annual Tax Rev. Projection for 2000-05 is likely to be considered at slightly lower rate of 15.6 %. Consequently Non-Plan Rev.Deficit increases in view of the compounding effect of the differential rate over 5 years (16.8% vs, 15.6%). Under both circumstances central tax devolution would remain same at Rs.722 Crores. However if Pondicherry is considered as Special Category State then this Gap of Rs468 crores will be funded under Article 275(1) now mainly recommended only for Special Category State by the Finance Commission

If annual Power Subsidy of Rs.25 to 30 Crores is also considered(since Pondicherry is dependent on outside power sources), then additional Non Plan Revenue Deficit to be covered on power account would be about Rs.150 crores for 2000-05 period,possibly Under upgradation and special problems provision for Special Category State

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On its part Pondicherry State to induce even the above 15.6% growth in tax revenues and 20% in non-tax revenue would have to reposition its revenue profile to the changed circumstances and then:

i. **Start to tap the remaining 14 of the 19 taxes as mentioned in list II of VII Schedule. Further within the five major taxes increasingly focus on other than sales tax. Also explore service sector as revenue source.**
ii. **As pointed out by EFC non-tax revenue particularly from economic services should be user charge based gradually by 2004 –05. More importantly significantly reduce subsidy on economic services and go in for privatization even for public services, wherever feasible. Private Finance Initiative in Infrastructure projects (BOT,DBFO,BLT) need to be tapped innovatively**

With acceptance of special category state status, Pondicherry during 2000-05 could expect:

1. **Central Taxes and Duties through devolution of Rs.722 crore (0.1924%) and also expenditure and services tax portion (0.196%).**
2. **Non Plan Revenues Deficit of at least Rs.468 crores as Grants-in-Aid**
3. **Central Plan Assistance based on 90 % grants and 10% loan, which is likely to be annually Rs. 200-250 crores approx. Also be eligible for accommodation in non-plan grant for meeting committed liabilities of maintenance of operational plan schemes (It approx. works out as 30% of plan rev. exp. as per EFC report).**
4. **Write off of the Rs. 86 crore of interest as on 31.3.2000 and consolidation of loans for repayment on easy terms.**
5. **Grants-in-Aid for Municipalities of about Rs. 12 crore (high level of urbanization as compared to Goa) and Rs. 8 crore to Panchayats.**
6. **Up gradation grants and special problems assistance in the range of Rs.60-80 crore awarded to most of the special category states.**
7. **Relief fund expected in the range of above Rs. 10 crores.**

The following recommendatory observations in EFC report's summary, which are of interest are:

1. **"The requirements of the states for Plan Revenue Expenditure should be assessed (by Central Govt. and Union Planning Commission) with reference to their deficiencies in the basic minimum needs and not be given on the basis of the Gadgil formula. A fresh look needs to be given to the formula itself.' (Point 14.17)**
   Since parameters of population (60%) and per capita distance/deviation method (25%) are not favourable to Pondicherry, any move on above lines to provide plan revenue expenditure with reference to deficiency in the basic minimum need augurs well for Pondicherry.

2. **"As services are emerging as a fast growing sector of the economy and constituting over 50% GDP, they should be increasingly brought under the tax net for improving the buoyancy of indirect taxes." (Expenditure and service Tax Point 3.41). This is relevant to Pondicherry.**

3. **"The revenue gaps of the Special Category State should be met out of the finance commission grant. The responsibility for the development of infrastructure of vital importance to the region requiring large investment should be that of the Center."**

Therefore Special Category Status of Pondicherry entails both grants to bridge non-plan revenue deficit through grants-in-aid from finance commission and also central assistance for large infrastructure investments. Further central assistance will be in the form of 90% grants and 10% loans. Consequently public debt of Rs. 698 crores of Pondicherry as on 31.3.2000, will step up by Rs. 40 crore (10% of Rs. 350-400 crores of annual plan assistance) only per year and with annual loan repayment of Rs. 45 –50 crore, its level will more or less stabilize around Rs. 700-750 crore during 2000-05. This would augur well for Pondicherry to control debt at sustainable level.