I Overview

Introduction

I.1 At the consolidated level, state finances budgeted for some improvement during 2014-15, although information available for 17 states warrants a careful assessment of these initial expectations[1]. Budget estimates for 2014-15 had hinged around a marked acceleration in revenue receipts (RR) to bring about an expansion in the surplus on the revenue account after erosion to near-balance in the preceding year. Even so, six out of the total of 29 states (including bifurcated Andhra Pradesh) budgeted for revenue deficits and ten projected gross fiscal deficits higher than 3 per cent of gross state domestic product (GSDP). This dilutes the recommendation of the Thirteenth Finance Commission (FC-XIII) - that states should eliminate their revenue deficits and attain a GFD/GSDP ratio of 3 per cent by 2014-15, the end of its award period. It is against this backdrop that this year's report adopts fiscal consolidation as its theme in order to evaluate the true magnitude and quality of the rule-based sub-national fiscal consolidation that has been undertaken through Fiscal Responsibility and Budget Management (FRBM) legislations. As Chapter II shows, fiscal consolidation is not inimical to growth.

I.2 Key to states recommitting more strongly to fiscal consolidation is a reinvigoration of their own revenues, as in 2012-13 when states' own tax collections - particularly sales tax/value added tax (VAT) - offset the deceleration in central transfers and the increase in revenue expenditure in that year. This is validated by the results of empirical analysis on pre- and post-crisis fiscal consolidation episodes presented in Chapter II of this report. Taxing burgeoning e-commerce, which is addressed in Chapter IV, could bolster states' own revenues, provided there is greater clarity around rules and procedures governing inter-state trade. With the introduction of the consumption-based destination-centric goods and services tax (GST), however, attention will need to be paid to the development of a uniform model for taxing e-commerce to reduce complexity and improve compliance. States' revenue efforts would be complemented by the award of the Fourteenth Finance Commission (FC-XIV) which seeks to expand autonomy of states within the ambit of fiscal federalism by stepping up statutory transfers through untied tax devolution, reduction of discretionary plan grants and improvements in the design of transfers.

I.3 Alongside, efforts need to be redoubled to sustain the pick-up in capital outlays that occurred in 2013-14(RE) so as to ensure high quality fiscal consolidation. However, financing growth in capital outlays through grants from the centre in the face of virtually stagnating own revenues and tax devolutions as in 2013-14 would not be a viable proposition going forward. Setting the consolidated debt-GDP ratio of states on a declining trajectory is crucial to improving their finances. The latter assumes significance as outstanding liabilities of state governments, which increased by double digits during 2012-14, are budgeted to increase further in 2014-15 on account of bonds issued

[1] Based on revised estimates available for 17 major states.

under the Financial Restructuring Plan (FRP) for state power distribution companies (discoms) being taken over by some states.

I.4 Halting the deterioration in the GFD-GSDP ratio that took place in 2013-14 is also critical in the context of fiscal consolidation. States have, in general, performed poorly in terms of fiscal marksmanship as analysis presented in Chapter IV shows, reflecting over-estimation of expenditures relative to receipts. States need to improve the reliability of their forecasts of key fiscal parameters like tax and expenditure, and macroeconomic aggregates.

I.5 The organising framework of the report is as follows. Chapter II deals with the theme chosen for this year's report, *i.e.*, fiscal consolidation. Chapter III provides an analysis of the fiscal position at the consolidated level and the underlying state-level dynamics, including debt positions and contingent liabilities. Chapter IV addresses some facets of the finances of states that are likely to assume topical relevance going forward. As in the past, data on various budgetary components and fiscal indicators of 29 state governments are presented in appendices and statements.