

## FOREWORD

The Reserve Bank of India brings out an annual publication entitled “State Finances: A Study of Budgets”, which provides an analytical discussion on fiscal position at the state level and also serves as the primary source for disaggregated state-wise fiscal data. The Report, which was historically part of the Reserve Bank’s Monthly Bulletin since 1950-51, is being brought out as a stand-alone publication since 1999-2000 in order to enhance its visibility to the public. With a view to improving access to historical data on the fiscal position of the states, the Reserve Bank brought together all the articles/studies on state finances from 1950-51 to 2010-11 in a compendium CD, which was released in July 2011.

The analysis, orientation, coverage and format of the Report have been restructured periodically to make it more contemporary. Since 2005-06, the analytical content of the Report has been enhanced by incorporating in each issue, a special theme based on a specific issue of relevance. The special themes, which have been covered so far in past studies, include ‘Outstanding Liabilities of State Governments’, ‘Social Sector Expenditure’, ‘Fiscal Transfers to State Governments’, ‘Revenue Receipts of State Governments: Trend and Composition’, ‘Expenditure of State Governments: Trend and Composition’, ‘Finance Commissions in India: An Assessment’ and ‘Role of the Reserve Bank in State Finances’. Continuing this practice, the present report has taken up ‘Sub-national Debt Sustainability: An Assessment of the State Governments’ as its special theme.

The theme chapter undertakes an assessment of public debt sustainability at the state level in India. Starting with the conceptual definition and measurement of debt, it traces the evolution of states debt in various phases. The concerted efforts at fiscal consolidation and institutional reforms enabled states to embark on the path of fiscal correction and consolidation. Although states have faced fiscal stress, there have been no instances of systemic insolvency and defaults have not occurred. Indicator analysis of debt sustainability for states shows progress on most of indicators since the onset of fiscal consolidation. Although the necessary conditions for sustainability, viz., higher growth of GDP than debt growth and higher real output growth than real interest rate, have been fulfilled for the consolidated state governments during the phase of fiscal consolidation, the sufficient condition of generating primary surpluses has not been fulfilled in the post-fiscal consolidation phase. Empirical evidence using panel regression analysis shows that apart from the reversal of the interest rate cycle, the growth in nominal GSDP and policy measures such as the debt swap scheme and debt consolidation and relief facility contributed to the debt reduction of the states. The approach to debt relief, linked with incentives to implement reforms, has greatly helped avoid moral hazard problems. However, while the focus has been mainly on direct debt obligations, contingent liabilities pose a serious risk to states finances, especially when they become part of actual liabilities over time.

Some other salient features that emerge from this Report are as follows:

- The consolidated fiscal position of states, which had improved during 2010-11, witnessed marginal deterioration in 2011-12 (RE). Although, the revenue account continued to remain in surplus, the GFD-GDP ratio was higher in 2011-12 (RE), on account of higher capital outlay.

- For 2012-13, state governments have budgeted improvement in their overall fiscal position which would be primarily contributed by increasing surplus in the revenue account, with 23 states budgeting for revenue surplus during 2012-13. The capital outlay is budgeted to be higher during 2012-13 in the majority of the revenue surplus states, indicating that the quality of expenditure is not being compromised in achieving the deficit targets.
- A comparison of the fiscal performance of states with the Thirteenth Finance Commission's (FC-XIII) targets for deficits indicates that while the envisaged revenue balance may be achieved by most of the states, the fiscal deficit-gross state domestic product (GSDP) ratio is set to exceed the target in one non-special category state and two special category states in 2012-13.
- Notwithstanding the increase in aggregate market borrowings of the state governments, the consolidated debt-GDP ratio of the states continued to decline in 2011-12, reflecting the impact of a faster increase in nominal GDP relative to overall debt. During 2012-13, the consolidated debt-GDP ratio of the states is expected to decline further and remain below the FC-XIII recommended benchmark, indicating the continuation of the fiscal consolidation process at the state level.
- Issues that require the attention of the states include enhancing fiscal transparency through additional disclosures, efforts to raise states' own revenues by tapping available resources, improving the quality of expenditure, fiscal implications of the scheme for financial restructuring of state power distribution companies (discoms), strengthening the supply chain management and improving the cash management of the states.

The report has been prepared in the Fiscal Analysis Division (FAD) of the Department of Economic and Policy Research (DEPR) under the overall direction of Shri Deepak Mohanty, Executive Director and under the guidance and supervision of Smt. Balbir Kaur, Adviser, by a team comprising Smt Deepa S. Raj (Director); Smt Atri Mukherjee and Shri Neeraj Kumar (Asst. Advisers); and Shri Dirghau K. Raut, Shri Prabhat Kumar and Shri Anand Prakash Ekka (Research Officers). Shri P.P. Joshi, Shri A.K. Dharampal, Smt. E. Fernandes, Smt N.S. Paradkar, Smt V.S Khanolkar, Shri J.C. Gawai and Smt V.A. Sathe provided support in the compilation of data.

The Regional Offices of DEPR provided data inputs for the report. Support was also received from the Department of Government and Bank Accounts (DGBA) and the Internal Debt Management Department (IDMD) of the Reserve Bank. The report benefitted from the co-operation of the Finance Departments of the state governments, the Ministry of Finance, Government of India, the Planning Commission and the Office of the Comptroller and Auditor General (CAG) of India, New Delhi.

This report is also available on the RBI website ([www.rbi.org.in](http://www.rbi.org.in)). In order to improve the analytical or information content of the report, feedback/comments are solicited. These may be sent to The Director, Fiscal Analysis Division, Department of Economic and Policy Research, Reserve Bank of India, Shahid Bhagat Singh Road, Mumbai 400 001 or through email to [deprfad@rbi.org.in](mailto:deprfad@rbi.org.in)

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December 31, 2012