

1. Introduction

1.1 The global crisis affected output and employment across the world. To support aggregate demand, the major advanced and emerging market economies resorted to expansionary fiscal and monetary policies. While expansionary fiscal policy played an important role in the process of global economic recovery, fiscal sustainability has since assumed significance. In India, with the unprecedented global developments in the second half of 2008-09, the Central as well as State governments adopted an expansionary fiscal stance to counter the effects of the global crisis on the Indian economy. Although only a few State governments announced expenditure-led fiscal stimulus packages, these policy measures had a discernible impact on the consolidated revenue receipts and aggregate expenditures of State governments in 2008-09 and 2009-10. Consequently, there was a marked deterioration in the major fiscal indicators of the States.

1.2 With the Indian economy showing faster recovery from the second half of 2009-10, reverting to the path of fiscal consolidation has become an immediate priority of both the Central and State governments. Recognising the need for fiscal consolidation, the Thirteenth Finance Commission (FC) has set out a roadmap for fiscal correction and consolidation in the medium term, both for the Centre and State governments. In the Union Budget 2010-11, the Central Government announced the process of fiscal consolidation in terms of rolling targets for 2010-11 to 2012-13. The budgets of the State governments for 2010-11 reflect their commitment to resuming the process of fiscal consolidation. Importantly, with the enactment of

the FRBM Acts in West Bengal and Sikkim, all the States are expected to follow a rule-based fiscal policy, *albeit* under the amended FRBM Acts as suggested by the Thirteenth FC.

1.3 This study on 'State Finances: A Study of Budgets of 2010-11'¹ is based on the data available in the budget documents of 28 State governments and two Union Territories with legislature, viz., NCT Delhi and Puducherry. The State governments presented their budgets for 2010-11 against the backdrop of a strengthening recovery and the resultant improvement in growth prospects for the Indian economy. Reflecting these positive developments, growth in own tax revenues of States is budgeted to be higher in 2010-11 than in 2009-10 (RE). In addition, the States also expect a larger devolution from the Centre in the form of share in Central taxes during 2010-11. Having undertaken massive expansion in aggregate expenditures in the previous two years in the wake of the overall macroeconomic slowdown and implementation of recommendations of the Sixth Central/State(s) Pay Commission (CPC/SPCs), the States have budgeted only a modest rise in their aggregate expenditures during 2010-11. All these factors augur well for the resumption of the fiscal consolidation process at the level of the States in 2010-11.

2. Preview

1.4 In 2010-11 (BE), State finances, in general, are estimated to show an improvement over 2009-10 (RE). The majority of the States have budgeted either a surplus or a lower deficit in their revenue accounts in 2010-11 (BE). As a result, the consolidated revenue deficit is estimated to be

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lower at 0.3 per cent of GDP in 2010-11 (BE) compared with 0.7 per cent in 2009-10 (RE). Of 28 States, 17 States have budgeted revenue surplus in 2010-11 as against 14 States in 2009-10 (RE). With an improvement in the consolidated revenue account of States, the GFD-GDP ratio is estimated to decline to 2.5 per cent in 2010-11 (BE) from 3.3 per cent in 2009-10 (RE). An improvement in State finances in 2010-11 (BE) is expected to be broad-based and reflected in lower GFD-GSDP ratios in the case of 22 States.

1.5 The aggregate outstanding liabilities of the State governments as a percentage of GDP showed a persistent decline from the peak of 32.8 per cent in 2003-04 to 26.6 per cent in 2007-08. Notwithstanding the deterioration in key deficit indicators during 2008-09 and 2009-10, the debt-GDP ratio continued to decline and was placed at 23.1 per cent in 2010-11 (BE) as GDP grew faster than the debt. The declining trend in interest payments as a percentage of revenue receipts (IP-RR ratio) persisted mainly due to considerable relief to the States in terms of debt write-off and saving in interest payments on outstanding central loans under the debt consolidation and relief facility recommended by the Twelfth FC. The IP-RR ratio is expected to decline further in 2010-11 (BE).

1.6 Given that the States deviated from the fiscal consolidation path in the past two years, it is essential for them to initiate steps towards fiscal correction in the coming years. In this context, the Thirteenth FC has suggested a roadmap for medium-term fiscal correction to be undertaken by the State governments. The positive growth outlook of the Indian economy in 2010-11 augurs well for States to achieve their budgeted tax collections. In addition, larger devolution of resources from the Centre to the States under the recommendations of the Thirteenth FC would facilitate their fiscal consolidation efforts. From the medium-term perspective, the proposed implementation of the goods and services tax (GST) is considered

important in terms of its implications for State finances. Even though a consensus on some critical issues is yet to be reached before the implementation of GST, it requires considerable efforts by the States in building their administrative capacity and IT infrastructure to ensure better compliance from a likely expansion in the tax base under the GST. The successful implementation of GST is crucial for States to benefit from such tax reforms, which would pave the way for fiscal correction and consolidation. In addition, certain structural issues continue to remain important for State finances, such as the quality of expenditure and the management of surplus in cash balances of the State governments.

1.7 The chapter-wise scheme of the Study is as follows: While this chapter has set out an overview of the study, the major issues relating to State finances that emerge in the current Indian context are presented in Chapter II. Chapter III highlights the major policy initiatives undertaken by the State governments, the Government of India and the Reserve Bank of India. Chapter IV provides an assessment of the consolidated budgetary position of the State governments, while fiscal performance across States is covered in Chapter V. Chapter VI provides an analysis and assessment of the outstanding liabilities, including market borrowings and contingent liabilities of the State governments. Chapter VI elaborates on the special theme, *i.e.*, Finance Commissions of India: An Assessment. Annex 1 provides State-wise details of major policy initiatives announced in their budgets for 2010-11. The consolidated data on various fiscal indicators of 28 State governments are covered in Appendix Tables 1-23, while State-wise data are provided in Statements 1-52. The detailed State-wise budgetary data are provided in Appendix I-IV (Appendix I – Revenue Receipts, Appendix II – Revenue Expenditure, Appendix III – Capital Receipts, Appendix IV – Capital Expenditure).