I Overview

The consolidated fiscal position of the States/Union Territories is budgeted to improve in 2011-12 with a return to surplus in the revenue account, reduction in fiscal deficit-GDP ratio and declining trend in debt-GDP ratio. This trend is poised to continue with majority of the States amending their Fiscal Responsibility and Budget Management Acts which map out graduated reductions in fiscal deficit and debt relative to their GSDPs over the medium term. An analysis of the Reserve Bank's contribution to finances of States over the years shows that, apart from being a banker and debt manager of the States, the Bank has progressively played a greater role since the 1990s as reflected in the formulation of model responsibility legislation for the States and advices given on fiscal sustainability issues from time to time. As the States return to rule-based fiscal consolidation, they need to deal with structural rigidities in their finances, focus on qualitative aspects of the correction process, undertake effective expenditure management and address issues relating to State Power Utilities including their impact on State finances.

1. Introduction

1.1 In 2011-12, the States announced their budgets aimed at resumption of fiscal correction process. The focus was more on expenditure control against the backdrop of the rollback of fiscal stimulus measures and the tapering off of the impact of the Sixth Pay Commission Award. All States, with the exception of Goa have amended their Fiscal Responsibility and Budget Management (FRBM) Acts/ Rules. Under the amended Acts, the State governments are aiming to eliminate revenue deficits and to bring about gradual reductions in fiscal deficit and debt levels latest by 2014-15, as was recommended by the Thirteenth Finance Commission (ThFC). While this augurs well for medium-term fiscal sustainability of the States, the eventual fiscal outcome would be shaped not only by the macroeconomic conditions but also by the joint commitment of the Centre and the States to implement fiscal reforms in the pipeline. This report on "State Finances: A Study of Budgets of 2011-12"[1] has been prepared based on the data available in the budget documents of 28 State governments, two Union Territories with legislature, *viz*., NCT Delhi and Puducherry.

2. Preview

1.2 The year 2011-12 is expected to bring an improvement in fiscal position of the State governments, as evident from budgeted target of either a turnaround in their revenue accounts from deficit to surplus or lower revenue deficits. The consolidated budgetary position of the States shows a revenue surplus (0.2 per cent of GDP) in 2011-12 (BE) after a gap of two years (revenue deficits of 0.5 per cent and 0.3 per cent of GDP in 2009-10 and 2010-11, respectively). Consequently, the aggregate fiscal deficit is budgeted lower at 2.2 per cent of GDP in 2011-12 (2.7 per cent and 2.9 per cent of GDP in 2010-11 and 2009-10, respectively), though it remains

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higher than the Thirteenth Finance Commission's annual path. This is mainly on account of higher capital outlay budgeted for 2011-12 while anchoring the fiscal deficit-GDP ratio below 3 per cent.

1.3 The declining trend in outstanding debt-GDP ratio, which was visible from end-March 2004 when it had peaked (32.8 per cent), has continued through end-March 2011 (RE) (23.5 per cent), and is budgeted at 22.5 per cent for end-March 2012(BE). The debt-GDP ratios are lower than the benchmarks for these years and the medium term target of 24.3 per cent for 2014-15 recommended by the ThFC. This trend is poised to continue with amended FRBMs of the States setting out a graduated path of reduction in debt-GSDP ratios for the respective States. The continued emphasis on market borrowings for financing gross fiscal deficit of State governments is reflected in the shift in composition of the States' outstanding liabilities. There was, however, lower recourse to market borrowings during 2010-11 after the crisis years of 2008-09 and 2009-10, as the States reverted to fiscal consolidation path and their cash balances improved.

1.4 The Reserve Bank has been playing an important role as banker and debt manager of the States. Over the years, as a banker, while remaining sensitive to growing requirements of the State governments for short-term accommodation amidst fiscal decentralisation, the Reserve Bank also ensured short-term fiscal discipline by States, consistent with its objective of maintaining monetary stability. As a debt manager, the Reserve Bank's management of market borrowings of the States has sequentially evolved from the traditional practice of underwriting to administered system of pre-determined notified amounts/coupons before eventually migrating to a full-fledged auction system. In the wake of fiscal stress of the States from the late 1990s, the Reserve Bank's focus expanded beyond its traditional functions as it provided inputs facilitating the introduction and implementation of rule-based medium-term fiscal consolidation at the State level. The Reserve Bank also advised State governments in framing policies related to fiscal sustainability issues which emerged from time to time.

1.5 As the States embark upon the second phase of a rule-based fiscal consolidation path, care needs to be taken to address the structural rigidities in State finances, improve disclosures for remaining alert on qualitative aspects of fiscal correction, move towards the proposed restructured public expenditure system for better management of outlays for effective outcomes, rationalise centrally sponsored schemes for improving their effectiveness and address issues relating to financial losses of the State Power Utilities.

1.6 The Chapter-wise scheme of the report is as follows. While this Chapter has provided an overview of the report, the major issues relating to the finances of the States in the current context are presented in Chapter II. Chapter III highlights the major policy initiatives undertaken by the State governments, Government of India and the Reserve Bank of India. Chapter IV provides an assessment of the consolidated budgetary position of the State governments. Fiscal performance across States is covered in Chapter V. Chapter VI provides an analysis and assessment of the debt position of the States, including market borrowings and contingent liabilities. Chapter VII focusses on the special theme, *i.e.*, role of the Reserve Bank in State finances. The consolidated data on various fiscal indicators of 28 State governments are covered in Appendix Tables 1-21, while State-wise data are provided in Statements 1-47. 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).