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RBI releases 'State Finances: A Study of Budgets of 2006-07'

The Reserve Bank of India (RBI) today released 'State Finances: A Study of Budgets of 2006-07' – a publication that provides data, analysis and assessment of finances of State Governments. The publication provides data at both, consolidated and disaggregated levels based on the State budgets for 2006-07. Statistical tables appended to the publication provide information on several fiscal parameters as well as State-wise budgetary data covering both revenue and capital accounts.

The data analysed in the publication highlight that there has been a marked improvement in the fiscal position of the State Governments in recent years in terms of key deficit indicators. In 2005-06, gross fiscal deficit (GFD) and revenue deficit (RD), as ratios to gross domestic product (GDP), have declined to 3.2 per cent and 0.5 per cent, respectively. Such a correction has been primarily through revenue enhancement with revenue receipts, as ratio to GDP, rising by 1.0 per cent over the previous year and States' own tax receipts rising by 0.3 per cent. Further, the revised estimates (RE) of 2005-06 point out that the fiscal performance of the State Governments has improved compared to the budget estimates, particularly in the revenue account, reversing the usual trend of decline in fiscal performance in the revised estimates.

The State Governments have committed in their budgets to carry forward the process of fiscal correction and consolidation further in their budget for 2006-07. The consolidated fiscal position of State Governments in 2006-07 indicates that the States have budgeted to achieve near balance in the revenue account during 2006-07. As a consequence of decline in the RD by 0.4 percentage points in 2006-07 (budget estimates (BE)) over 2005-06 (RE), the GFD is budgeted to decline by the same extent to 2.8 per cent of GDP. Fiscal correction in the revenue account during 2006-07 has been budgeted to be achieved primarily through revenue enhancement. The higher grants coupled with the incentives provided by the Twelfth Finance Commission (TFC) towards restructuring of State finances have aided the States in their endeavour for fiscal correction and consolidation. Notwithstanding the marked improvement in consolidated fiscal position of the State Governments during 2006-07, there are wide variations across the States.

The emerging issues on State finances, such as, fiscal correction and consolidation, fiscal rules and accounting arrangement, surplus cash balances, liquidity and investment management by States, fiscal empowerment, power subsidies have also been discussed in the publication.

The publication notes that the States have the challenging task of continuing and sustaining fiscal correction, which would eventually translate into durable fiscal consolidation. The publication also suggests that the fiscally weak States, may consider initiating measures to catch up with the fiscally sound States. While lauding the enactment of fiscal responsibility legislation (FRLs) by majority of States that has ushered in a rule based fiscal policy framework at the State level, the Study suggests

that the fiscal correction path under the FRLs would need to be realistic and should not adversely impact capital outlay and spending on social sectors. In fact, the Study suggests that bulk of the responsibilities pertaining to expenditure on social sectors is placed in the domain of State Governments and improvement in quality and delivery of social sectors may help in raising cost recovery in respect of these services.

The Study notes that there has been sharp build-up of surplus cash balances of the State Governments in recent period as reflected in their investment in 14-Day Intermediate Treasury Bills due to several factors, which has posed challenges to the cash and financial management of the State Governments.

The State Governments may emphasise fiscal empowerment to augment revenues, *i.e.*, by expanding the scope and size of revenue flows into budget. This would provide them the necessary flexibility to shift the pattern of expenditure to redirect it for social sector and capital expenditure. In this context, apart from tax reforms, levying of appropriate user charges, rationalisation of subsidies (including power sector subsidies) and restructuring of State level public sector undertakings assume significance. Furthermore, the State Governments' strategy of augmenting tax mobilisation through improvement in tax administration and recovery of tax arrears needs to be continued with greater vigour.

The publication has been prepared in the Division of State and Local Finances (DSLFF) of the Department of Economic Analysis and Policy. Starting with 2001-02, this publication is available at RBI website (www.rbi.org.in). Comments on this publication may be sent to Director, Division of State and Local Finances, Department of Economic Analysis and Policy, Reserve Bank of India, Shahid Bhagat Singh Road, Mumbai 400 001. Comments can also be sent via email.

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