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State Finances: A Study of Budgets of 2011-12

The Reserve Bank of India (RBI) today released "State Finances: A Study of Budgets of 2011-12", a publication that provides data, analysis and assessment of finances of State governments.

The State government budgets for 2011-12 proposed to carry forward the fiscal correction process by focusing more on expenditure control against the backdrop of roll back of fiscal stimulus measures and tapering off of the impact of the Sixth Pay Commission award. All States, barring one, amended their Fiscal Responsibility and Budget Management (FRBM) Acts/Rules, in line with the Thirteenth Finance Commission (ThFC) recommendation, with the aim of eliminating revenue deficits and bringing about graduated reductions in fiscal deficit and debt levels latest by 2014-15.

Role of the Reserve Bank in State Finances

The theme chapter on the "Role of the Reserve Bank in State Finances" traces the responsibilities of the Reserve Bank which have, over the years, increased beyond its mandated roles of serving as a banker and debt manager of the State governments. As a banker to the States, the Reserve Bank extends banking services to all the States. It also modulates ways and means (WMA) limits and overdraft (OD) regulations to meet the short-term resource requirements of the States without impinging upon fiscal discipline and monetary stability. As a debt manager, the Reserve Bank created the enabling conditions for the States to transit from an administered system to a full-fledged auction system for market borrowings. Apart from these traditional roles, the Reserve Bank has also been playing an advisory role and has been instrumental in initiating rule-based medium-term fiscal consolidation of the States, besides advising them on policy issues emerging from time to time to ensure fiscal sustainability. The dissemination of information and analysis of State finances by the Reserve Bank every year have become an important reference for not only undertaking policy decisions but also facilitating research in this area.

Issues in State finances

The Study also highlights several issues of significance and concern for the State Governments. Although all the States except Goa have amended their FRBM Acts/Rules, most of them do not include provisions for additional disclosures for enabling transparent assessment of State finances. The recommended restructuring of the public expenditure system would enable better management of outlays for effective outcomes. Successful restructuring of the public expenditure management system would, however, call for appropriate assimilation of the new system across the government machineries at all levels including the Planning Commission, the Central and the State governments. The rationalisation of the operation of Centrally Sponsored Schemes is expected to address the issues of lack of flexibility in these schemes, counterpart funding shortage from States and low utility of large number of schemes with thinly spread resources at the field level. The financial losses of State power utilities continue to be a drag on State finances which necessitate not only renegotiating debt liabilities of distribution utilities but also undertaking necessary reforms to enable independent functioning of State Electricity Regulatory Commissions and to address issues relating to periodic tariff revisions. As part of fiscal transparency initiatives, the State governments need to ensure that their finances capture both explicit and implicit liabilities associated with certain off-budget activities, including project financing undertaken through SPVs/public-private partnership mode. There is also need for greater focus on structural issues confronting State finances, particularly for those States that could not undertake rule-based fiscal corrections prior to the crisis years of 2008-09 and 2009-10.

Major findings of the Study

Fiscal consolidation budgeted to continue in 2011-12, with a turnaround in the consolidated revenue account

- The consolidated revenue account is budgeted to switch from deficit to surplus during 2011-12 after a gap of two years, driven primarily by a compression in revenue expenditure.
- The improvement in the revenue account is expected to not only provide the necessary resources for increased capital outlay but also enable a reduction in the GFD-GDP ratio by 0.5 percentage point in 2011-12(BE) over 2010-11(RE). The envisaged fiscal deficit-GDP ratio for 2011-12 is, however, higher than the ThFC's annual path, mainly on account of higher capital outlay.

Improvement in key fiscal indicators to be broad-based across States

- Most States have budgeted to eliminate their revenue deficit in 2011-12 as envisioned by the ThFC, with 23 out of the 28 States expected to record revenue surpluses. The GFD-GSDP ratio is budgeted to decline in 18 States during 2011-12, even though capital outlay (CO)-GSDP ratio is placed higher in 17 States during the same period.
- The budgeted improvement in the revenue account is led by a reduction in revenue expenditure-GSDP ratio in 16 States.

Decline in key expenditure ratios raises concern regarding the quality of fiscal adjustment

- State-wise position with regard to quality of expenditure shows that during 2011-12, out of the 28 States, 15 States have budgeted for a decline in development expenditure-GSDP ratio and 16 States have budgeted for a decline in social-sector expenditure-GSDP ratio over the previous year. Committed expenditure-GSDP ratio is budgeted to increase in 15 States during the same period. This raises concerns about the quality of fiscal adjustment being undertaken at the State level.

Decline in States' overall debt-GDP ratio to continue in 2011-12

- The consolidated debt-GDP ratio of the States declined during 2010-11 to 23.5 per cent from 25.5 per cent in 2009-10, with a reduction in debt-GSDP ratio across all the States (except two in the special category). With further budgeted reduction during 2011-12, debt-GDP ratio at 22.5 per cent is expected to be much below the ThFC recommended limit of 26.1 per cent for the year. This trend is poised to continue in the medium term with the amended FRBMs of the States setting out a graduated path of reduction in debt-GSDP ratios for the respective States.
- The compositional shift of outstanding liabilities towards market loans continued during 2010-11 and is budgeted to increase further during 2011-12. The declining trend in the share of NSSF (the high cost component of debt) could be further reinforced in the light of reduction in the mandatory allocation of small savings collections for the States from 80 per cent to 50 per cent from the fiscal year 2012-13.
- Aided by the reduction in debt-GSDP ratios, interest payments (IP) to revenue receipts (RR) ratios of 14 of non-special category States are expected to be lower in 2011-12(BE) than their levels in 2010-11(RE).

This publication has been prepared in the Fiscal Analysis Division (FAD) of the Department of Economic and Policy Research**.** The current issue along with past issues are available on the RBI website (www.rbi.org.in). All the articles/studies on State Finances from 1950-51 to 2010-11 are available in a Compendium CD, which was released in July 2011. Comments on this publication may be sent to Director, Fiscal Analysis Division, Department of Economic and Policy Research, Reserve Bank of India, Shahid Bhagat Singh Road, Mumbai-400001. Comments can also be sent via e-mail.

Alpana Killawala
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