I Overview

The State governments formulated their budgets for 2009-10 against the background of the knock-on effect of the global financial crisis on the Indian economy. Taking cognizance of uncertain growth prospects, many State governments announced fiscal stimulus packages to sustain the growth momentum. In this context the fiscal correction and consolidation witnessed in State finances in the recent past provided the fiscal space for the stimulus. Consequently, the overall Gross Fiscal Deficit (GFD)-GDP ratio is estimated to increase to 3.2 per cent in 2009-10 (Budget Estimates) from 2.6 per cent in 2008-09 (Revised Estimates) and 1.5 per cent in 2007-08 (Accounts). As the recovery process sets in, the States need to return to the path of fiscal consolidation.

1. Introduction

1.1 The period up to 2007-08 witnessed a considerable improvement in the consolidated fiscal position of State governments. States were given incentives by the Twelfth Finance Commission (TwFC) to implement their own Fiscal Responsibility Legislation (FRL) in the form of conditional debt restructuring and interest rate relief. However, the economic slowdown following the knock-on effect of the global financial crisis and the accompanying moderation in the pace of revenue growth adversely affected the finances of the States in 2008-09.

1.2 This study on 'State Finances: A Study of Budgets of 2009-10'[1] has been prepared based on the data available in the budget documents of 28 States governments, and other sources. The State governments presented their budgets for 2009-10[2] in an environment marked by an uncertain growth scenario. It is evident that the tax revenue buoyancy achieved till 2007-08 could not be realised during 2008-09 (RE). States may also be under pressure to increase expenditure to boost demand in the economy. In addition, the impact of the implementation of the Sixth Central Pay Commission (CPC)/State Own Pay Commissions (SPCs) by many State governments had implications for their revenue expenditure during 2008-09 (RE) and 2009-10 (BE). In short, the pace of fiscal correction and consolidation witnessed during the recent past is likely to suffer a setback.

1.3 States, while presenting their budgets for 2009-10, seem to have taken into account the likely impact of a slowdown in their tax collections and Central transfers. In order to deal with the slowdown, a few State governments announced dedicated fiscal stimulus packages in order to boost demand, while many other States announced sector specific tax reductions. However, the focus of the additional expenditure in 2009-10 appears

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[2] An analysis of the consolidated fiscal position of State governments based on State budgets of twenty-seven (of which two were Vote on Account) States for 2009-10 has been published in the Reserve Bank of India Annual Report, 2008-09. This Study provides further details on the consolidated fiscal position of twenty-eight State governments as also a State-wise analysis covering budgetary data as well as additional information obtained from the State governments and the Government of India. Information with respect to NCT Delhi and Puducherry is provided additionally as memo item.

to be through revenue expenditure as reflected in higher revenue expenditure as a ratio to gross state domestic product (GSDP) in many States, rather than capital expenditure. In fact, a majority of the State governments have budgeted a lower capital outlay as percentage to GSDP for 2009-10.

1.4 Recognising the need for reviving economic growth, the Government of India permitted the State governments to borrow an additional 0.5 per cent of their GSDP by relaxing the fiscal deficit target under FRBM from 3.0 per cent to 3.5 per cent in 2008-09 and further to 4 per cent of their GSDP in 2009-10. In the Union Budget 2009-10, it was announced that a goods and services tax (GST) would be introduced by April 1, 2010 after due consultations with all stakeholders. The implementation of GST is however, likely to be postponed to a future date. In order to facilitate the process of a further convergence of central excise duty rates to a mean rate (currently 8 per cent), various policy measures with regard to tax rates were proposed by reviewing the list of items. The Reserve Bank in its role as banker, debt manager and monetary authority has also been taking various initiatives to improve the financial condition of the State governments. A non-competitive bidding facility has been introduced to State Development Loans (SDLs) since the auction held on August 25, 2009.

2. Preview

1.5 A noticeable improvement in the finances of the State governments was discernible as revised estimates of 2007-08 translated into accounts. This was reflected in an increase in revenue surplus, reduction in GFD and primary deficit turning into surplus. However, the significant improvement in key deficit indicators of State governments witnessed till 2007-08 appears to have abated with the overall macroeconomic slowdown in 2008-09 and 2009-10.

1.6 The consolidated revenue surplus as percentage to GDP increased from 0.6 per cent in 2006-07 to 0.9 per cent in 2007-08. Although the States were able to achieve revenue surplus in 2008-09 (RE) as well, there was a significant decline of 0.7 percentage points in the revenue surplus-GDP ratio [from 0.9 per cent in 2007-08 to 0.2 per cent in 2008-09 (RE)]. The consolidated revenue balance of the States, after remaining in surplus for three consecutive years, is however, budgeted to turn into deficit (0.5 per cent of GDP) in 2009-10 (BE). Reflecting the deterioration in the revenue account of State governments, GFD as percentage to GDP is estimated to be higher at 3.2 per cent in 2009-10 as compared with 2.6 per cent in 2008-09 (RE) and 1.5 per cent in 2007-08 (Accounts). The increase in GFD in 2009-10 (BE) would be mainly due to deterioration in the revenue account coupled with an increase in net lending. The consolidated capital outlay as a percentage to GDP, however, is budgeted to decline in 2009-10 by 0.2 percentage points to 2.6 per cent as compared with 2008-09 (RE). The primary surplus generated by State governments in 2007-08 turned into primary deficit (0.7 per cent of GDP) in 2008-09 (RE) which would further increase to 1.3 per cent in 2009-10.

1.7 During 2009-10, deterioration in the consolidated fiscal position is observed across majority of the States. Out of the 28 States, 14 States have budgeted a revenue deficit in 2009-10 as compared to 4 States both in 2008-09 (RE) and 2007-08 (Accounts). Revenue account positions with respect to 10 States are budgeted to turn into deficit in 2009-10 (BE) from a surplus position in 2008-09 (RE). Further, another nine States have budgeted a lower revenue surplus as compared with 2008-09 (RE). In total, the revenue account is expected to be adversely impacted in the case of 23 States during 2009-10. Similarly, the number of States with the GFD-GSDP ratio of less than 3.0 per cent decreased from 18 in 2007-08 (Accounts) to 9 in 2008-09 (RE) and further to 6 in 2009-10 (BE). In short, out of 28 States, 22 States would not be able to achieve a GFD-GSDP ratio of 3 per cent in 2009-10 as indicated in their FRLs.

1.8 Given the targets with respect to key deficit indicators prescribed by the TwFC, it is observed that at the consolidated level, the States were able to achieve most of the targets well in advance rather than in the terminal year *i.e.*, 2009-10. At the consolidated level, State governments wiped out revenue deficit in 2006-07 and were able to contain GFD-GDP below 3 per cent in 2005-06. However, progress came to a halt when the impact of the overall macroeconomic slowdown and the implementation of the Sixth CPC/SPCs began to reflect in State finances in 2008-09. In 2009-10 (BE), the consolidated State finances are likely to deteriorate further. An analysis of State budgets shows that with the re-emergence of revenue deficit after three years and the expansion in GFD to more than 3.0 per cent of GDP, the States would apparently not be able to meet the TwFC targets in the terminal year of 2009-10.

1.9 The outstanding liabilities of State governments, as a percentage to GDP, showed a persistent decline from the peak level of 32.8 per cent in 2003-04 to 26.2 per cent in 2008-09 (RE). However, due to increasing financing needs, the debt-GDP ratio is budgeted to be marginally higher at 26.5 per cent in 2009-10. Likewise, the ratio of interest payments to revenue receipts of the State governments, which declined sharply from 26.0 per cent in 2003-04 to 14.4 per cent in 2008-09 (RE), is estimated to be marginally higher at 14.5 per cent in 2009-10 (BE).

1.10 Given the recent setback to State finances, there are a number of issues that States have to look into. For instance, the States need to resume the reform process towards fiscal consolidation in the coming years. At the same time the States have to ensure adequate growth enhancing expenditure so as to counter the downturn in the economy. The States need to successfully manage the transition with regard to the implementation of the Sixth CPC/SPCs. In addition, there are certain structural issues that continue to remain important for State finances such as the quality of expenditure and surplus cash balances of State governments. With experience gathered through their FRLs, the States need to plan the next round of reforms and resume the process of fiscal correction and consolidation at the earliest.

1.11 The Chapter-wise scheme of the Study is as follows: Chapter I provides an overview of the Study. Chapter II highlights major policy initiatives of State governments, the Government of India and of the Reserve Bank of India. Chapter III provides an assessment of the consolidated budgetary position of the State governments. Chapter IV brings out the State-wise assessment of their fiscal performance. Chapter V 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.,* an analysis of the trend and pattern of expenditure of the States, covering the period 1980-81 to 2009-10. The major emerging issues relating to State finances are presented in Chapter VII. Annex 1 sets out the State-wise major policy initiatives announced in the State budgets. The consolidated data on various fiscal indicators of the twenty-eight State governments are set out in Appendix Tables 1-23, while State-wise data are provided in Statements 1-57. The detailed State-wise budgetary data are provided in Appendices I-IV (Appendix I - Revenue Receipts, Appendix II - Revenue Expenditure, Appendix III – Capital Receipts, Appendix IV - Capital Expenditure).