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THE STRESS IN STATE FINANCES

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

General government spending was one of the major drivers of economic growth in the first half of this fiscal year. And with state governments accounting for a majority of total general government spending, it is critical to analyse the trends in their finances. The unaudited fiscal data of 21 states, which account for around 90 per cent of India's GDP in 2017-18, for the first eight months (April-November) of the current financial year, reveals some sombre trends.

First, at the aggregate level, revenue receipts of these states have grown by a mere 4.6 per cent, sliding down from 15.3 per cent over the same period last year. Under the broad rubric of revenue receipts, the analysis shows that the states' share in Central tax devolution has slowed the most, contracting by 2.3 per cent during this period, after having grown by 12.1 per cent over the same period last year. This fall likely reflects an adjustment made for the higher-than-mandated devolution carried out in during the last fiscal year. This was a consequence of the optimistic forecast of the Centre's gross tax collections in its revised estimates for that year, relative to the subsequently available provisional actuals.

Moreover, the Centre's gross tax revenues are expected to fall short of the budgeted target by a considerable Rs 3- 3.5 trillion this fiscal year. Based on the shortfalls in the Centre's tax collections last year, and the estimated gap this year, the aggregate tax devolution to all states may be as much as Rs 1.7 – 2.2 trillion lower in the current fiscal year than what was budgeted. This is a key revenue risk staring at the state governments this year.

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In addition, the states' own non-tax revenues have contracted by 1.5 per cent during the first eight months of this fiscal year, after an expansion of 15.3 per cent over the same period last year. Further, growth of states' own tax revenues, the largest source of their revenue receipts, eased to a tepid 2.2 per cent during this period, down from a healthy 16 per cent over the same period last year, dampened, in part by the modest rise in collections of the State Goods and Services Tax (SGST).

However, grants from the Centre to these states grew by 26.9 per cent during these eight months, up from 18.7 per cent last year, driven likely by a 72.7 per cent expansion in the GST compensation paid to all states. This amounted to Rs 647 billion in April-November 2019, up from Rs 374 billion in these months last year. Subsequently, another tranche of Rs 359 billion was released to states in December 2019, comparable in size to the release in the first eight months of last year. The primary factor boosting the GST compensation seems to be the low growth in states' GST revenues relative to the mandated 14 per cent annual growth for the five-year transition period.

Some **state governments have voiced concerns** over the delays in receipt of the compensation amount in recent months, which has complicated their fiscal position and cash flow management. The timing of receipt of the compensation is the second major revenue risk facing state governments. If compensation for one or more months of the current fiscal year gets delayed to the next fiscal year, we may well find some traditionally revenue surplus states staring at a revenue deficit as well as a sharp rise in their fiscal deficit this year. But it seems states will have to start gearing up for life without the GST compensation.

The brunt of subdued revenue expansion is clearly faced by capital expenditure, whose growth shrank to 1.4 per cent in the first eight months of this fiscal year, down from a healthy 19.8 per cent over the same period last year. The data indicates a multi-fold increase in the aggregate revenue deficit of these states to Rs 829 billion (April-November 2019), up from Rs 155 billion over the same period last year. Their fiscal deficit has also widened to Rs 2,643 billion over this period (53 per cent of the budgeted amount), up from Rs 2,199 billion last year (48.7 per cent of the budgeted amount).

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It is thus not a surprise that market borrowings or State Development Loans (SDLs) have risen substantially this year. According to ICRA's estimates, net SDL issuance of all states and eligible union territories (UTs) rose by 15.5 per cent to Rs 2,806 billion in the first three quarters of this fiscal year, up from Rs 2,429 billion last year. This trend has been exacerbated by larger redemptions this year. Accordingly, the combined gross SDL issuance have expanded by a significant 34.9 per cent to Rs 3,874 billion this fiscal year (April-December), up from Rs 2,872 billion last year.

The calendar for state government market borrowings for the fourth quarter indicates tentative gross SDL issuances of Rs 2,086 billion in the quarter, implying a moderate 9.1 per cent growth. But, this conceals a large dip in redemptions. According to our estimates, there will be a dip in redemptions during the fourth quarter, implying that net SDL issuances will expand by a staggering 55.7 per cent to Rs 1,766 billion in Q4FY20, up from Rs 1,134 billion last year, underlining the stress in state government finances this year.

If market borrowings in the fourth quarter are in line with the amounts indicated, total gross borrowing this fiscal year would rise by 24.6 per cent to nearly Rs 6 trillion, up from Rs 4.8 trillion last year. Moreover, net borrowings by states would rise by an even sharper 28.3 per cent to Rs 4.6 trillion this year, becoming nearly as large as the Central government's net market borrowings of Rs 4.7 trillion that have been announced so far for this year.

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