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STATES ARE SPENDING. THE ECONOMY IS WAITING

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

After an increase in deficits due to the Covid19 pandemic, state governments have veered towards the path of fiscal consolation. In both 2021-22 and 2022-23, the aggregate fiscal deficit of state governments was actually under 3 per cent of Gross Domestic Product (GDP), despite the Union government providing them greater space to borrow, capping their deficits at 4.5 per cent and 4 per cent respectively.

State governments, put together, spend more than the central government. In fact, they account for over three-fifths of total general government expenditure. In the past few years, states have been focusing more on the revenue expenditure (money spent on paying salaries, pension, interest, subsidies, etc.). However, in 2023-24, there has been a shift in their spending priority with more allocated towards capital expenditure. The capital outlay of states (excluding Arunachal Pradesh, Goa, Manipur and Meghalaya) jumped 45.7 per cent, while their revenue expenditure grew by a modest 9.3 per cent during April-November 2023.

The quality of their expenditure — ratio of capital outlay to total expenditure — which effectively implies the proportion of funds channeled towards productive assets stands at 14.1 per cent, an eight year high, during this period. This is growth enhancing. A one per cent increase in the capital outlay effectively leads to a 0.82-0.84 per cent increase in the states' GDP.

States' capital expenditure (capex) is being fuelled by an interplay of two forces. First, the advance release of the monthly tax devolution and timely disbursements of funds for the special scheme on capital assistance. The Union government has been proactive in releasing the advance instalments of tax devolution in the past few years.

In 2023-24, the customary advance installments which were usually released in end of fiscal year (until 2021-22) were released in June and December. In addition, the Union government has approved capital expenditure worth Rs 973.74 billion and released Rs 590.3 billion under the scheme of special assistance to states for capital investment till November 2023 out of the budgeted Rs 1.3 trillion in 2023-24.

Second, the states' own revenues have been fairly buoyant. The states own tax revenues (SOTR) and own non-tax revenues (SONTR) have grown at a good pace of 11.5 per cent and 19.5 per cent respectively during the first eight months of the year.

Tax revenues are generally a function of economic activity. It has to be noted that nominal GDP growth has been muted and likely to be 8.9 per cent as per National Statistical Office's First Advance Estimates. With own tax revenues growing at a faster pace than nominal GDP growth, it suggests efficiency of tax administration and increased formalisation of the economy leading to improvement in tax capacity. Also, revenue from mining industries forms a significant chunk of collections under SONTR. The mining activity (in real terms) has grown at a strong pace due to reforms such as e-auction of mining leases, etc. However, the benefits are limited to mineral rich states.

Despite this healthy growth in states own revenues, their overall revenue receipts have grown at an average pace of 5.5 per cent during this period owing to a shortfall in grants from the Union government. These fell 29.2 per cent during this period.

The tepid growth in overall revenue receipts has meant that the states have had to resort more to market borrowings for funding their expenditure this year. In fact, as per the latest data available, the states' gross market borrowings were at a record of Rs 5.8 trillion during the first nine months of the year. Higher borrowings are, however, largely utilised for capex.

Based on the current trends and the NSO's expectation of a pick up in net taxes in the second half of the year, states may find it a bit difficult to achieve their aggregate fiscal deficit target of 3.1 per cent of GDP. A marginal slippage of 20-30 basis points can't be ruled out.

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