RBI’s Report on State Finances

What is the issue?

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- RBI’s recent report on “State Finances” has pointed out the rising fiscal deficits for state governments.
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- Sadly, the situation is unlikely to improve in the near term though revenue receipts are projected to go up in 2018-19.
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What does the RBI report state?

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Gross Fiscal Deficit

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- Populist schemes, escalating pay revisions, and farm loan waivers have limited the state governments’ ability to contain expenditures.
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- Due to heavy borrowings and consequent unsustainable interest burdens, indebtedness of states is rising and it is crowding out capital expenditure.
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- Inefficient tax collection (a pan Indian phenomenon), and the inability of States to rein in fiscal deficit has risen to epic proportions.
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- 2017-18 is the 3rd consecutive year during which States were unable to contain their Gross Fiscal Deficit (GFD) within 3.0% limit.
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- Notably, the 3% limit is a legal mandate that most states have pledged to under their “Fiscal Responsibility and Budget Management” target.
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GST Impact

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- The 0.33% shrinkage in State's "own tax revenues" (OTR) in 2017-18 vis-à-vis the Budget estimate is due to accounting issues related to GST.
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- Most States have reported State GST revenue, but reporting of Integrated GST, Central GST, and GST compensation cess has not been consistent.
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- While an accurate assessment of 2017-18 OTR will be available only in 2018-19, the shortfall was partially offset by greater devolution from the centre.
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Salary Expenditures

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- The aggregate work force of State governments exceeds that of the Union government and the salary expenditure is a big burden for them.
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- 13th Finance Commission (FC) had recommended that the ratio of "salary expenditure to overall revenue expenditure" should not exceed 35%.
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- But most states don't adhere to it and some have fared as high as 55% after the pay commission revisions were implemented.
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Borrowing Costs

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- Despite interest payments increasing by almost 16% over 2016-17 in 2017-18 (RE), the ratio of interest payments to GDP was stable at 1.7%.
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- However, the weighted average yield on state government debt, increased from 7.48% in 2016-17 inched up to 7.60% in 2017-18.
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- Notably, state government's bonds attract a premium over the Central government's bonds, thereby making borrowing costly.

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Food Subsidy

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- The Centre footed around 85% of the food subsidy bill during 2015-18, but States play a vital role in food security by distributing subsidised food grains.
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- **Subsidies -** During 2015-16 to 2017-18, many state governments subsidised food grains further from the central issue price up to 0.4%.
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- Significantly, three States (Tamil Nadu, Karnataka and Kerala) distribute them for free to all “Antyodaya Anna Yojana” and priority household cardholders.
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- Unsurprisingly, 2017-18 State subsidy bill on food grains was maximum for Tamil Nadu (Rs. 2,000 crore), followed by Karnataka (Rs. 1,000 crore).
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- **DBT -** Direct benefit transfers (DBT) of food subsidies through cash transfers reduce the need for large physical movement of food grains.
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- Further, it is also desirable as it would provide greater autonomy for beneficiaries to choose their consumption basket.
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- But the switch to DBT requires the fulfilment of certain pre-conditions, which including complete digitisation and de-duplication of the beneficiary database.
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- Also, Aadhaar seeding of bank accounts and ensuring adequate availability of food grains in the open market are other complications.
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Redemption Pressures

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- Most States (barring Delhi, Madhya Pradesh, Kerala, and Arunachal Pradesh) are currently excluded from the National Small Savings (NSS)

Fund facility.
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- This has increased redemption pressure (account closures without access to new cheap funds from NSS) on state governments.
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- Notably, market borrowings of states more than doubled in the past 5 years Rs. 30,630 crore in 2012-13 to Rs. 78,900 crore in 2017-18.
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- Further, states are expected to face maximum redemption pressure in 2026-27, when over Rs. 3,50,000 crore State development loans (SDL) are due.
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Capital Expenditure Impact

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- The inability of State governments to rein in their revenue expenditures has resulted in a crowding out of capital expenditures.
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- Capital expenditures continued to be abysmally low despite marginally improving to 2.8% of GDP in 2017-18 (RE) from 2.6% in 2016-17.
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- Unbudgeted pre-election expenditure in some states and implementation of remaining pay commission awards is only likely to weaken the fiscal further.
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- Currently, there is minimal difference between the yields of debt issued by States with stronger and weaker fiscal profiles.
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- The RBI has recommended States to secure fiscal ratings, so as to make states eligible of capitalising on loans according to their stature.
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Source: Business Line

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