RBI on State Finances

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The fiscal positions of state governments have improved significantly since 2004- 05. However, in the last couple of years signs of fiscal stress have re-emerged on the back of poor performance of state public sector enterprises (SPSEs). The GFD-GDP ratio in 2015-16 (RE) breached the 3% ceiling of fiscal prudence for the first time since 2004-05 and was at 3.6% for all states. Information on 25 states indicates that the improvement in fiscal metrics budgeted by states for 2016-17 may not materialize.

The recent initiative by several state governments of assuming additional debt liabilities as part of financial and operational restructuring of state power distribution companies (through issuance of UDAY bonds) has led to deterioration in fiscal health. This has been reflected in the worsening of key fiscal indicators. It is expected that states will take necessary steps to renew their efforts towards fiscal consolidation and reduce their liabilities

The 14th Finance Commission (FC-XIV) has suggested an increase in the states' share in the divisible pool of taxes to 42% (earlier 32%) from 2015-16 onwards. This led to greater predictability and certainty in the quantum of funds being transferred to the states. Further, there has been an overall increase in untied funds. As a result, the share of states in central taxes increased by 1.1% points of GDP in 2015-16 (RE) over the previous year.

The increasing use of special levies (viz., cess, surcharge and other additional/special duties) by the Central Government, however, resulted in a reduction in the divisible pool of taxes as these levies are not shared with state governments, although they did boost the Central Government's tax revenue. It is expected that most of the cesses will be subsumed in the GST, which will increase the size of the divisible pool of resources to the advantage of the states

Some developments which have a bearing on the debt/fiscal sustainability of states over the medium term are:

- The guarantee commitments of state governments in respect of SPSEs have recently emerged as a major source of potential risk to debt sustainability. Some of the states with high outstanding guarantees were: Rajasthan (Rs 94,580 cr as of March 2015 (AE)), Punjab (Rs 65850 cr), Tamil Nadu (Rs 51,590 cr), (2016 March (RE)), Telengana (Rs 18,500 cr) and Gujarat (Rs 16,000 cr) in March 17 (BE).

- The interest liabilities of states that have participated in financial restructuring of DISCOMs (through UDAY) would increase going forward.
- Additional provisions are required to be made by the state governments for extending financial support to these utilities in case they continue to incur losses in future.
- The committed liabilities of states may increase in case they decide to implement the recommendations of their own Pay Commissions in 2017-18 as this will entail more market borrowing for additional funds.
- Many states which were earlier refraining from seeking additional funds through market borrowing may now borrow as per the criteria of additional borrowing indicated by the FC-XIV.
- Another dimension is the ad hoc nature of various types of loan waivers announced from time to time by state governments.

As per the information available for 25 states, the GFD-GSDP ratio is budgeted at 2.6% during 2017-18 compared with 3.4% during 2016-17 (RE) which is lower than the Central Government's budgeted gross fiscal deficit to GDP ratio at 3.2%. Even as the Central Government makes significant efforts toward fiscal consolidation, the accumulation of liabilities could result in higher debt burden of the states unless immediate steps are taken to contain them.

There are several downside risks like implementation of recommendations of states' own pay commissions, farm loan waiver in some states, and revenue uncertainty on account of the implementation of GST. On a comparable basis, the revised estimates of the GFD for 2016-17 were higher by 0.4 percentage point over the budgeted ratio – raising concerns about potential fiscal slippage.

However, on the whole the GST is expected to be positive:

- Successful implementation will result in additional revenue through simpler and easier tax administration.
- GST is expected to reduce administrative costs for collection of tax revenue.
- Uniformity in tax rates and procedures across the country will economize on compliance cost.
- It will also lead to increase in the shareable pool of resources, resulting in larger central transfer to the states which, in turn, will enable them to undertake much needed developmental expenditure.

The recently released FRBM Review Committee Report, 2017 has recommended debt-GDP ratio of 20% for state governments by 2022-23. The states will have to considerably tighten their finances to reach this benchmark, given that their outstanding liabilities to GDP ratio stood at 23.9% at end-March 2017.

How vulnerable do states look

While information for FY18 is not provided, based on FY17 (BE) estimates, the major states have been clubbed under 4 categories of Debt/GSDP ratio.

Debt/GDP	States
>30%	West Bengal, UP, Rajasthan, Punjab, Goa
25-30%	Kerala, Haryana, Bihar
20-15%	Andhra Pradesh, Gujarat, Jharkhand, Madhya Pradesh
Less than 20%	Chattisgarh, Maharashtra, Odisha, Tamil Nadu, Telengana, Karnataka

How have the deficit ratios turned out in FY16 (Revised)?

RBI data shows further that of the 18-Non-special category states, only 7 had maintained a surplus: Chattisgarh, Gujarat, Jharkhand, Karnataka, MP, Odisha and UP. The others had gone into a deficit on revenue account.

For fiscal deficit, 9 had reined it below 3%: AP, Chattisgarh, Gujarat, Karnataka, Kerala, Maharashtra, Tamil Nadu, Telangana and West Bengal.

Hence only 3 states had met both the targets of revenue surplus and fiscal deficit of <=3%.

For FY17 (BE) on account of UDAY, the fiscal deficit has gone past 3% in case of Goa, Haryana, MP, Odisha, Rajasthan, Telengana and UP.

The performance of state budgets in FY18 will hence be quite significant as it would subsume the impact of various policy effects ranging from UDAY debt to losses of SPSEs, GST, Pay Commissions, Finance Commissions and overall growth of the national and state economies.

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