What state budgets tell us about India's economy

The current fiscal has been a challenging year not only for the central government but even the state governments have borne the onerous task of managing their finances with dwindling revenues and expectations of higher expenditure.

A number of states have released their budget for the fiscal 2021-22 and it is important to analyse the likely areas of slippages on the revenue front for different states, whether states have actually opened their purse strings, and how have the states utilised the relaxations provided by the central government and 15th Finance Commission.

The focus area of the ensuing analysis of 15 state budgets (accounting for almost 90 percent of India's GDP) has chiefly been on the deviation of the FY21 numbers as most of the budgets where presented before the announcement of the nation-wide lockdown. Additionally, with a lower base for FY21, whether states have bumped up their budget estimates for the next year is also an important point of consideration. These 15 states are: Bihar, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh, and West Bengal.

Widening Deficit Worries

Barring Odisha, the other 14 states have recorded a revenue deficit during FY21. Seven of these 14 states (namely Karnataka, Uttar Pradesh, Bihar, Gujarat, Delhi, Jharkhand and West Bengal) have slipped from a revenue surplus, which was budgeted for in FY21, to a revenue deficit as per the revised estimates.

The revenue deficit of Maharashtra has widened by almost five times, while Rajasthan and Punjab follow closely at almost three times. Ten states have budgeted a revenue deficit for FY22. While eight of these 10 had revenue deficit even in FY20, Karnataka and Gujarat are the two exceptions in this category, having revenue surplus in FY20.

The Centre had provided relaxations to the state governments, allowing them to widen their fiscal deficit to 4 percent of its GSDP unconditionally, while an additional 1 percent was allowed if they implement certain key reforms. For FY21(RE), six states (Rajasthan, Madhya Pradesh, Punjab, Uttar Pradesh, Kerala and Bihar) have exceeded the unconditional relaxation which does indicate that they have implemented part of the reforms and also needed additional borrowings. For FY22(BE), only two states (Rajasthan and Madhya Pradesh) have budgeted for fiscal deficit more than 4 percent, which is stipulated by the 15th Finance Commission. Even in these challenging times, there are five states (Maharashtra, Karnataka, Bihar, Jharkhand and West Bengal), wherein the fiscal deficit has been budgeted below 3 percent, which does raises a question: Could expenditure have been further raised by these states?

Revenue Shortfall

The widening of deficit posits a question as to whether the state governments had to spend more amidst the pandemic troubles, or whether the nation-wide lockdown and its adverse implications on economic activities weighed on the revenues. The latter has been the prominent factor weighing on the finances.

The revised estimates of revenue receipts of the state governments have declined by almost 16 percent from the budgeted estimates. The deviation between the revised and the budget estimate for FY21 has been the sharpest for share in central taxes (28 percent) followed by state's own tax revenues (-16 percent).

The state's GST and VAT collections have recorded double digit contraction. Karnataka and Madhya Pradesh are the only two states where the revised estimates of their own tax revenues have been more than the budget estimates for FY21. Thirteen states have budgeted for a double digit growth in FY22(BE) in tax revenues over the previous year — this reflects an improvement in economic activities.

Cuts In Capital Outlay

Revenue expenditure has declined marginally by 4.5 percent in FY21(RE) from the FY21(BE) numbers, while the fall in capital outlay has been starker at around 16 percent. Lower spending does indicate that despite the relaxations on the borrowing front, revenue constraints have led to state governments having to cap expenditure, especially the discretionary nature of capital outlay, in order to manage the budget numbers.

Two things on the spending side are positive: First, spending on healthcare and family welfare has grown by 20 percent in FY21(RE) compared to FY20, and is budgeted to grow by 16 percent in FY22. Ten states have registered double-digit growth. Second, the capital outlay for FY22(BE) has been budgeted at a growth rate of almost 33 percent, which is in line with what the Union government has budgeted for — reflective of the multiplier effect of higher spending on capital projects for economic recovery. What is important, however, is whether the budgeted number translates into actual because historically states have cut back their capital spending by almost 0.5 percent of GDP on an average.

Spike In Debt Levels

Finally, and the worrisome aspect is, the outstanding debt of the state governments. Ten states have budgeted debt to be more than 25 percent of the GSDP in FY22. States such as Punjab (45 percent), Rajasthan (38 percent), Kerala (37 percent), and West Bengal (35 percent) have extremely high levels of debt to GSDP.

The 15th Finance Commission has provided a glide path for fiscal deficit to achieve 3 percent by 2025-26, but the debt levels even then will continue to be elevated at 32.5 percent. Although for some states, the debt levels are still manageable, the glide path for others will have to be closely monitored.

State governments have been at the forefront of fighting the pandemic and the associated plethora of challenges. FY2020-21 has been an unusual year, and in terms of finances it has been a complete washout.

The governments have budgeted for the next year with optimism but the challenges around the glide path of fiscal consolidation, managing debt levels, implementation of healthcare and capital projects, elevated yields for state governments amidst higher market borrowings and localised lockdowns remain inevitable.