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Fiscal Health of the States

Why in news?

A comprehensive revenue deficit reduction framework is essential to improve the fiscal health of the states.

Terms

Fiscal deficit

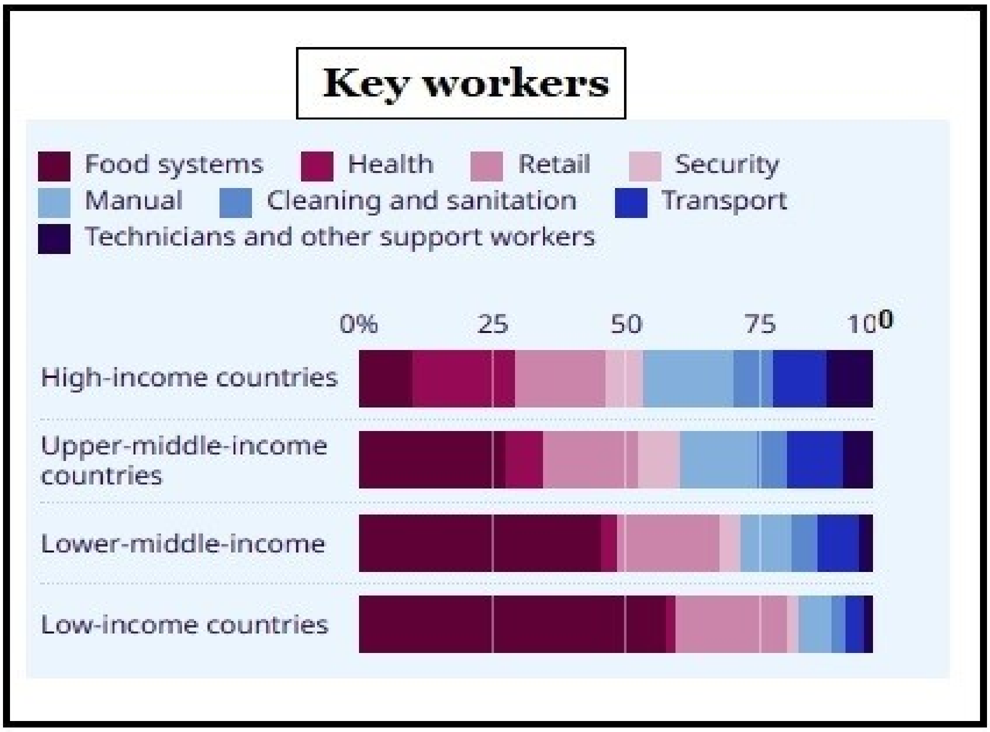
- Its the condition where the the expenditure of the government exceeds its revenue in a financial year.

Revenue deficit

- It occurs when the government's total revenue expenditure exceeds its total revenue receipts.

What is the status of the fiscal health of States?

- State mobilises *more than One-third of total revenue*, spend 60% of combined government expenditure.
- Around *40% in Government borrowing* is shared by the states of India.
- At the Union level, the fiscal deficit declined from 9.1% of GDP in 2020-21 to ***5.9%*** in 2023-24.
- All State fiscal deficit declined to ***3.24% of GDP*** in 2022-23 from 4.1% of GDP in 2020-21.
- For the major States, fiscal deficit is expected to be at 2.9% of GDP in 2023-24.



Why is this fiscal consolidation significant?

- **Fiscal prudence of the States-** The states in aggregate managed to be fiscally prudent despite a significant contraction in revenues even during peak of COVID-19 peak.
- **Union-State fiscal Coordination-** It is needed for emergency provision during the pandemic to spend for health and livelihood.
- States were able to *reprioritise expenditure* and quickly contain the Fiscal Deficit.
- **Reduction in Fiscal Deficit -** It is due to combination of expenditure-side adjustments, improved Goods and Service Tax (GST) collection and higher tax revenues.
- **Non-GST revenues –** It is also showing signs of recovery post pandemic in many states.

What are the fiscal challenges?

- **Increase in Revenue Deficit (RD) -** The reduction in fiscal deficit has not resulted in corresponding reduction in revenue deficit.
- The all state share of Revenue Deficit in Fiscal Deficit for 2023-24 is expected to be at 27%.
- **Debt to GSDP** - Most States also have large debt to GSDP ratios.
- This creates a *fiscal imbalance* which has long-run fiscal implications.

All-State Revenue Deficit - 0.78% of GSDP
All-State Fiscal Deficit - 2.9% of GSDP

What steps can be taken for revenue deficit consolidation?

- **Tackling the revenue deficit -** Re-emergence of revenue deficit in recent years can be tackled with incentive compatible framework.

- **Interest-free loans** - It can be given to the States by the Union Government to eliminate the possibility of a substitution of States' own capital spending.
- It also prevents the diversion of borrowed resources to finance revenue expenditure.
- **Fiscal adjustment plan –** A defined time path with a credible fiscal adjustment plan would help restore fiscal balance and improve quality of expenditure.
- A forward-looking performance incentive grants can be launched based on the different approaches provided by earlier Finance Commissions.
- It is necessary to achieve the targets as prescribed in Fiscal Responsibility and Budget Management Act 2003, *FRBM Act.*

To know more about Union Budget 2023-24 on Fiscal Consolidation click here.

Quick Facts

Fiscal Responsibility and Budget Management (FRBM) Act

- The Fiscal Responsibility and Budget Management (FRBM) Act was enacted in 2003.
- It led to the framing of *FRBM Rules in 2004* that sets targets for the Central government to ensure fiscal discipline.
- **Amendment** - In 2018, the Centre is mandated to take appropriate steps to limit its *fiscal deficit* to ***3% of GDP*** by March 31, 2021 although this is an operational target.
- The mandated target pertains to the *Centre's debt-GDP ratio* which is to be brought down to ***40%.***

References

1. The Hindu| Explained State Fiscal Deficit
2. Union Budget 2023| Ministry of Finance
3. Economic Survey 2023| Facts