IAS PARLIAMENT
Information is Empowering
A Shankar IAS Academy Initiative

RBI's Report on State Finances

What is the issue?

\n\n

\n
- RBI's recent report on "State Finances" has pointed out the rising fiscal deficits for state governments.
\n
- Sadly, the situation is unlikely to improve in the near term though revenue receipts are projected to go up in 2018-19.
\n

\n\n

What does the RBI report state?

\n\n

Gross Fiscal Deficit

\n\n

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

\n

\n\n

GST Impact

\n\n

\n

- 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.
\n
- Most States have reported State GST revenue, but reporting of Integrated GST, Central GST, and GST compensation cess has not been consistent.
\n
- 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.
\n

\n\n

Salary Expenditures

\n\n

\n

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

\n\n

Borrowing Costs

\n\n

\n

- 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%.
\n
- However, the weighted average yield on state government debt, increased from 7.48% in 2016-17 inched up to 7.60% in 2017-18.

\n

- Notably, state government’s bonds attract a premium over the Central government’s bonds, thereby making borrowing costly.

\n

\n\n

Food Subsidy

\n\n

\n

- 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.

\n

- **Subsidies -** During 2015-16 to 2017-18, many state governments subsidised food grains further from the central issue price up to 0.4%.

\n

- Significantly, three States (Tamil Nadu, Karnataka and Kerala) distribute them for free to all “Antyodaya Anna Yojana” and priority household cardholders.

\n

- 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).

\n

- **DBT -** Direct benefit transfers (DBT) of food subsidies through cash transfers reduce the need for large physical movement of food grains.

\n

- Further, it is also desirable as it would provide greater autonomy for beneficiaries to choose their consumption basket.

\n

- But the switch to DBT requires the fulfilment of certain pre-conditions, which including complete digitisation and de-duplication of the beneficiary database.

\n

- Also, Aadhaar seeding of bank accounts and ensuring adequate availability of food grains in the open market are other complications.

\n

\n\n

Redemption Pressures

\n\n

\n

- Most States (barring Delhi, Madhya Pradesh, Kerala, and Arunachal Pradesh) are currently excluded from the National Small Savings (NSS) Fund facility.
  \n
- This has increased redemption pressure (account closures without access to new cheap funds from NSS) on state governments.
  \n
- 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.
  \n
- 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.
  \n

\n\n

Capital Expenditure Impact

\n\n

\n

- The inability of State governments to rein in their revenue expenditures has resulted in a crowding out of capital expenditures.
  \n
- 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.
  \n
- Unbudgeted pre-election expenditure in some states and implementation of remaining pay commission awards is only likely to weaken the fiscal further.
  \n
- Currently, there is minimal difference between the yields of debt issued by States with stronger and weaker fiscal profiles.
  \n
- The RBI has recommended States to secure fiscal ratings, so as to make states eligible of capitalising on loans according to their stature.
  \n

\n\n

\n\n

Source: Business Line

\n\n

\n

IAS PARLIAMENT

Information is Empowering

A Shankar IAS Academy Initiative