● STATES' FINANCES

WHILE RBI BROUGHT OUT ITS REPORT ON STATES' FINANCES IN RECORD TIME, IT DIDN'T NET OUT THE RECEIPTS IN THE CASE OF LOTTERIES AND PUBLIC ENTERPRISES, AMONG OTHER MISSES

Not very optimistic on the fiscal front

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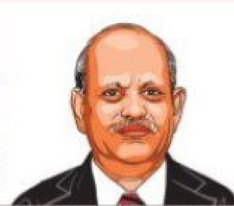
Views are personal



THE RESERVE BANK of India (RBI) must be complimented for bringing out the study on states' finances for 2018-19 in a record time. Until this year, the study published in July-August, actually provided the data and analysis of the previous year. In contrast, this year's study provides details of both 2017-18 and 2018-19 and this should help to assess the overall fiscal situation in the country. Of course, I must mention two caveats. First, experience shows that both revised estimates and budget estimates of fiscal variables undergo substantial changes and, therefore, we need to look at the estimated for 2017-18 and 2018-19 with caution. Second, while the overall deficit and debt trends can be inferred from RBI's analysis, they could be misleading when it comes to the estimates of revenues and expenditures and their inter-state comparisons. This is because, RBI does not net out the expenditures in the case of items like lotteries and departmentally-run enterprises. A number of state-run lotteries, but taking gross revenues without netting for prize money, overstates both revenues and expenditures. Similarly, some states still run road transport and electricity distribution companies departmentally and it is necessary to net out the expenditures from the gross revenues. There are also many transfers to and from various funds in the states which needs to be netted out. There is also the question of comparability on interest payment for the states which have opted for UDAY and which have not. While these adjustments will require time, RBI can at least net out the receipts in the case of lotteries and public enterprises.

The performances of the states have to be judged from three different perspectives. First, from macroeconomic perspective, it is important to evaluate their deficits to get an aggregate picture of the borrowing space available to the private sector and the impact of government borrowing on yields. Second, it is necessary to know the efforts of the states in raising revenues to finance public services. Finally, it is necessary to understand the size and composition of their expenditures on public services in pursuit of their developmental role.

Deficits and debt:

The disturbing fact brought out by the study is the steady increase in both the gross fiscal deficit (GFD) and revenue deficit of the states. The FRBM Acts of the states fix the GFD target at 3% of GSDP for each state which aggregates to 2.6% of GDP. (GSDP is measured in factor cost and GDP in market prices). The average GFD relative to GDP during 2005-11 was 2.1%, during 2011-16, it was 2.4% and this increased to 3.5% in 2016-17. Although the revised estimate (RE) for 2017-18 and budget estimate for 2018-19 show lower figures at 3.1% and 2.6%, respectively, the actuals are likely to undergo upward revisions as the states fully factor in the liabilities on account pay revisions, farm loan waivers and interest obligations on account of UDAY and additional expenditures on schemes that may be introduced during the election year. The outstanding liabilities of the states in end-March 2017 stand at 23.8% of GDP, and are estimated to increase to 24.3% of GDP by end-March 2019. This will make achieving the target of 20% by 2022-23, the target set by the FRBM Review Committee much more difficult.

In terms of individual states, the GFD situation in Punjab in 2016-17 is alarming, at 12.3%, mainly as the outgoing government borrowed heavily through corporations with state guarantee which had to be eventually taken over by the state government. The revised estimate shows that it has been brought down to 4.5% in 2017-18 and is budgeted at 3% in 2018-19. The GFDs of Telangana (5.3%), Haryana (4.8%), Uttar Pradesh (4.5%), Kerala, Madhya Pradesh and Tamil Nadu (4.3%), too, were well above the targets set in their respective FRBM Acts. Although these states have shown lower estimates for 2017-18 and 2018-19, it is doubtful whether they will be able to bring it down in the election year.

> **Karnataka's loan waiver proposal is expected to cost an additional ₹40,000 crore. Kerala will need substantial spending for addressing flood damage**

Revenue trends

An important finding of the study is the remarkable stagnancy in states' own revenues. During the last five years, the states' own tax revenues relative to GDP have been stagnant at 6.2%. With the introduction of GST, the states have been promised a compensation for loss of revenue calculated at 14% increase over the base every year and that should help them improve the buoyancy. One reason for the stagnancy in own revenues is the decline in the revenue from stamps and registration as well as motor vehicles and goods and passengers' tax, mainly due to the impact of demonetisation. The revenue from GST is yet to stabilise and it is difficult to get a clear picture. In contrast to own revenues, Central transfers have shown an impressive increase from 5.4% of GDP in 2014-15, a year prior to the implementation of Fourteenth Finance Commission's recommendations to an estimated 7.2% in 2017-18 (RE) and is estimated at 7.4% in 2018-19.

From the developmental perspective, the states' spending on social and economic services is important. The study brings out that allocations to both revenue and capital expenditures relative to GDP are likely to be higher in the current year. The revenue expenditure as a ratio of GDP shows an increase from 13.7% in 2016-17 to at 15% in both 2017-18 (RE) and 2018-19 (BE). Similarly, capital outlay is budgeted to increase from 2.6% in 2016-17 to 3% in the next two years. The development (social and economic services) expenditure too is budgeted to increase from 12% in 2016-17 and is estimated to be at 12.5% in 2017-18. The major items of increase seem to be in urban development, housing, water supply and sanitation and welfare of SCs, STs and OBCs.

On the face of it, higher expenditures, a marginal revenue surplus of 0.2% and a lower fiscal deficit of 2.6% budgeted for 2018-19 look optimistic. As mentioned earlier, it is difficult to see how the temptation to erode fiscal discipline will be curbed in the election year. In fact, the proposal for loan waiver in Karnataka's new budget is expected to cost an additional ₹40,000 crore. Kerala has seen an unprecedented devastation and will require substantial spending for rebuilding the basic infrastructure. Andhra Pradesh has an ambitious plan of building its new capital. A number of states will not resist the temptation to revise the pay scales of their employees in an election year. There will be demands to implement farm loan waivers in more states. The year is also likely to see the full interest burden of taking over of the liabilities of discoms under UDAY. In addition, the states may be tempted to introduce additional welfare schemes as the election approaches. The situation does not look very optimistic on the fiscal front.