State Finances in India: Managing Fiscal Risks and Sustaining Recovery

No. 413
27-June-2024

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Abstract

In India, there have been significant post-pandemic fiscal corrections at both the Union and State levels. Our analysis shows that excessive fiscal corrections by some States coupled with the emergence of revenue deficits resulted in a situation of underutilisation of fiscal space and lower capital expenditure than its potential at the State level. However, many fiscal risks remain. Some of the major risks include increasing off-budget operations by the States. The study notes that future bailout of DISCOMs may significantly reduce fiscal space for development spending at the State level. The study concludes that State-specific fiscal risks need appropriate policy considerations for sustainable fiscal recovery.

[*] A summary version of this paper was published as an 'Issue Note' titled "The RBI Study of State Finances 2023-24: Fiscal Balance Improves but Fiscal Risks Remain' on the Forum for State Studies on March 20, 2024. The "Issue Note" is available at the following link: (https://forumforstatestudies.in/issue-notes/the-rbi-study-of-state-finances-2023-24-fiscal-balance-improves-but-fiscal-risks-remain/).

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Introduction

Globally, the COVID-19 pandemic has resulted in contraction in subnational revenues and an increase in their deficits.[1] In India also, the decline in revenues coupled with rising expenditure commitments increased the debt and deficits of States. In the fiscal year 2022, at the global level, the rise in general government deficit and debt that occurred during the COVID-19 pandemic started receding. However, the Fiscal Monitor published by the International Monetary Fund (2024) in April 2024 noted that *"(A)fter a brisk reduction in fiscal deficits and public debt levels in 2021–22, fiscal aggregates turned in 2023, halting progress toward policy normalization."* In India, though there have been post-pandemic fiscal corrections at both the Union and State levels, many fiscal risks remain. Fiscal risks emanating due to the rising geo-political tension in various parts of the world also cannot be ignored[2]. There are increasing off-budget fiscal risks as well.

Research on the impact of geo-political risks on fiscal sustainability shows that such risks lead to an increase in fiscal instability (Afonso, Alves and Monteiro, 2024). Jha *et al*. (2009) mentioned that "policy responses to macroeconomic uncertainties during the 2010s in Asia resulted in a fiscal burden, contributing to heightened public debt. This was exacerbated by the pronounced dependence of Asian economies on the dynamics of oil price shocks during this period. The resultant debt stress was originated from increased public spending, diminished revenues, and consequently, a higher primary deficit"[3].

It is reasonable to assume that the revenue risks arising due to the global macroeconomic uncertainties at the State level in India are asymmetric. States that are more integrated globally with higher economic interdependence with the rest of the world may face more economic challenges. It won't be easy for them to insulate the local economy from such shocks. This has the potential to weaken their fiscal balance more than other States that are relatively less integrated with the global economy. Since only a few States are also the major growth centres of the Indian economy, going forward, their macroeconomic stability, fiscal balance and ability to deliver key services will be major determinants of India's overall economic growth. Some key State-level macroeconomic data may be useful to highlight this issue. If we consider individual State's share in GDP, the top 7 major States in terms of per capita real income are Haryana (₹172657), Gujarat (₹170384), Karnataka (₹164471), Telangana (₹158202), Tamil Nadu (₹154557), Kerala (₹148810) and Maharashtra (₹138490) and they together contribute more than 50% of India's GDP.[4] The shares of these States in India's GDP are 3.7%, 8.3%, 8.4%, 4.8%, 8.8%, 4.0%, and 13.2% respectively. The combined share of exports from these States in India's

[1] International Finance Corporation (2021): The Impact of the COVID-19 Crisis on Subnational Governments in Emerging Markets: The Outlook One Year On, https://www.ifc.org/content/dam/ifc/doc/mgrt/ifc-covid19-municipalities2021-final-web-7-28-21.pdf. Most subnational governments experienced a decline in revenues due to recession and crisis response measures, such as lockdowns and emergency tax relief (International Finance Corporation, 2021).

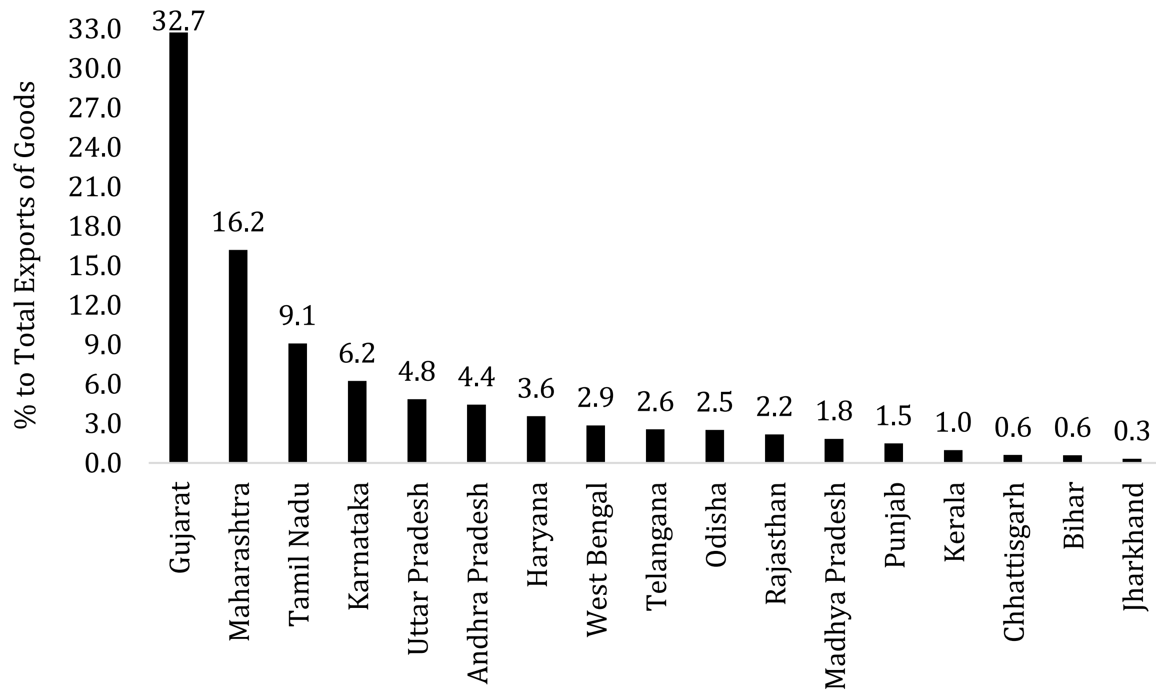
[2] For a detailed discussion on how geo-political risks impact fiscal stability see (Afonso, Alves and Monteiro, 2024).

[3] As quoted in (Afonso, Alves and Monteiro, 2024).

[4] Based on 2021-22 GSDP data of States obtained from the Handbook of Statistics on Indian States 2022-23, Reserve Bank of India.

total export of goods is 71.3%[5]. The States in descending order of export share is presented in Figure 1. Global demand fluctuation can adversely impact the economic growth of these States more compared to the States that are less dependent on exports.

Figure 1: State-wise Shares in Exports of Goods in Total Exports of Goods: 2022-23

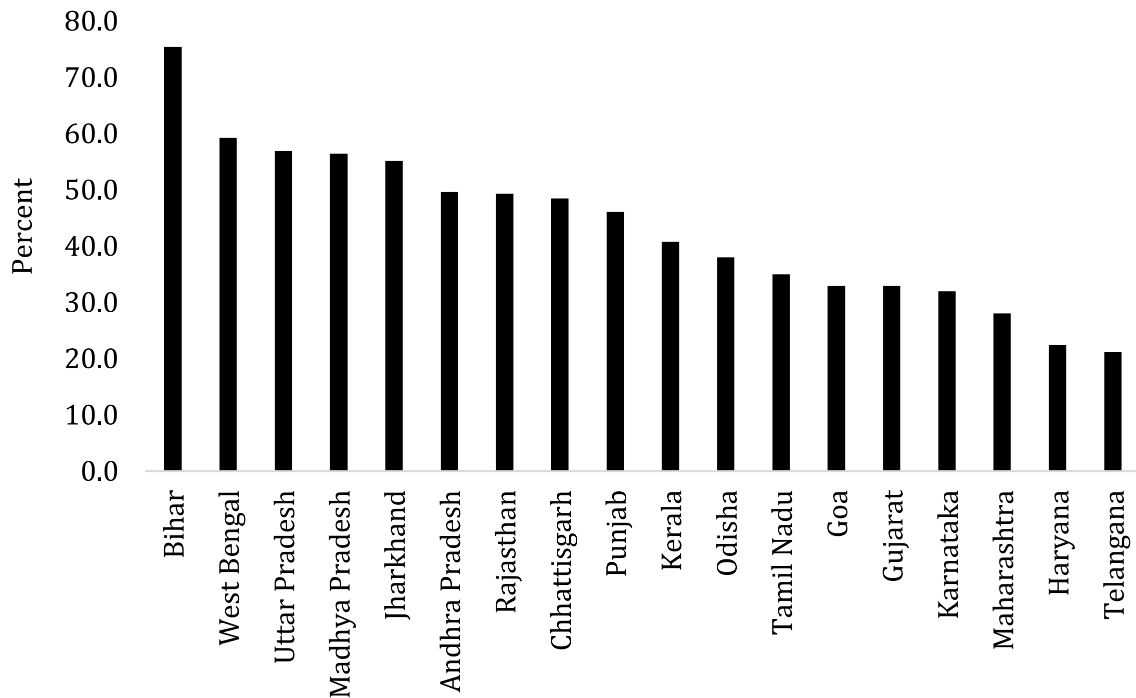


Source: National Import-Export Record for Yearly Analysis of Trade (NIRYAT), Government of India.

The second set of issues relates to the States' dependence on Union transfers. The dependence of States on Union transfers (measured as transfers to revenue receipts ratio) is 46.6% (data corresponds to the fiscal year 2021-22). For the income-poor States dependence on transfer is even higher. For the year 2021-22, the share of central transfers in total revenue of Bihar, Jharkhand, Uttar Pradesh, Chhattisgarh and Odisha were 75.4%, 55.2%, 56.9%, 48.5%, and 38% respectively (Figure 2). Though Union taxes have shown buoyant growth post-pandemic, the stability of growth of Union tax revenues would also be an important determinant of the fiscal stability of individual States, particularly for those States that are heavily dependent on Union transfers. Thus, fiscal management in the context of rising macroeconomic uncertainty needs to insulate prosperous States from the fiscal risks emanating due to their greater global economic integration and reduce fiscal risks impacting poorer States due to the revenue risks that may arise if Union revenues fluctuate/decline.

[5] It is important to note that the ranking of these 7 States in terms of their shares of export in total India's export is different than the ranking in terms of the shares of GSDP in India's GDP.

Figure 2: State-wise Shares of Central Transfers in Total Revenue Receipts: 2021-22



Source: State Finances: A Study of Budgets 2023-24, RBI.

The borrowing limit of States was enhanced during the pandemic. This enhancement in borrowing limit had two objectives: a) to provide necessary resources to the States in the face of pandemic-induced revenue contraction; and b) as a countercyclical expansionary fiscal measure to enable the States to make additional spending for post-pandemic economic recovery. The COVID-19-induced fiscal shock resulted in a significant increase in debt ratios of States.

It needs to be emphasised that in the Indian context, macro-fiscal stability issues are dependent on the fiscal balance at the Union and State levels. The share of States' fiscal deficit in the combined fiscal deficit of the Union and States is estimated to be 35.16% as per FY 2023-24 (BE). A very high level of fiscal deficit in some States (see Table 3) driven by revenue deficit is also acting as a major constraint in undertaking capital investment through budget at the State level.

Given the size of States' fiscal operation, an up-to-date understanding of their finances is also critical to draw evidence-based inferences on the fiscal situation of the country. In India, States together mobilise more than one-third of total revenue, spend 60% of combined government expenditure, and their share in general government borrowing is around 40%. The off-budget operation of States is significant. The risks arising from off-budget operations need to be considered while assessing the fiscal risk. Since comprehensive data on off-budget fiscal risks is not available, in this paper, we examine the fiscal risks arising due to the power sector operation and financing of DISCOMs (Power Distribution Companies) at the State level.

The Reserve Bank of India (RBI) study on State Finance published on 11 December contains fiscal data for the years 2021-22 (actuals), 2022-23 (revised estimates) and 2023-24 (Budget Estimates). This yearly publication of the RBI provides important insights on the emerging issues in State finances in India. Major highlights of the RBI study are presented below:

- *States' consolidated gross fiscal deficit to gross state domestic product (GFD-GSDP) ratio declined from 4.1 per cent in 2020-21 to 2.8 per cent in 2021-22, led by a moderation in revenue expenditure, coupled with an increase in revenue collection.*
- *Some States have budgeted for fiscal deficits exceeding 4 per cent of GSDP in 2023-24 as against the all-India average of 3.1 per cent. They also have debt levels exceeding 35 per cent of GSDP as against the all-India average of 27.6 per cent.*
- *The strong growth in SGST has been instrumental in reducing the vertical fiscal imbalance between the Centre and the States in recent years.*
- *The support received from the Centre in the form of 50-year interest-free capex loans has helped in reducing States' interest burden.*

In this article, we analyse emerging fiscal issues and fiscal risks at the State level based on the data available from the RBI *Study on State Finances 2023-24*. Apart from the Introduction, this paper has the following sections. Section I analyses States' own resources and Union transfers to States in India. Section II discusses the patterns of expenditure and State-level deficits. State-level debt and contingent liabilities are discussed in Section III. The power sector DISCOM finances are discussed in Section IV. Section V concludes.

I. Own Resources and Union Transfers

As evident from Table 1, between 2019-20 and 2023-24 (BE), the own-tax revenue to GSDP ratio of States is expected to increase from 6.4% to 7.0% - an increase of 0.6 percentage points from its pre-pandemic level. However, non-GST revenues including taxes on petrol and diesel remained stagnant at around 4% of GSDP during this period. Both tax devolution and grants remained at around 6% of GSDP, except in the first year of the pandemic when the transfer of grants increased by 0.6 percentage points from its pre-pandemic level (2019-20). The share of grants declined from 20% of total revenues of the States in 2019-20 to 17% in 2023-24 (BE). Transfer of grants as a percentage of GSDP is expected to decline to 2.5% in 2023-24 (BE).

The increase in the tax-to-GSDP ratio at the State level in India is similar to the tax revenue recovery at the Union government level. This is also similar to the revenue recovery at the global level after the pandemic. The Revenue statistics published by the OECD show that "the OECD average tax-to-GDP ratio rose by 0.6 percentage points in 2021, to 34.1%, the second-strongest year-on-year increase since 1990. The report also shows that tax-to-GDP ratios increased in 24 of the 36 OECD countries"[6] after the pandemic.

[6] https://www.oecd.org/tax/tax-revenues-rebounded-as-economies-recovered-from-the-covid-19-pandemic-according-to-new-oecd-data.htm

Table 1: Revenue Receipts relative to GSDP for All State Combined

Year	Own Tax Revenue	Own Tax Revenue without SGST	Own Non-Tax Revenue	Tax Devolution	Grants-in-Aid	Revenue Receipts
2019-20	6.4 (45.8)	3.8 (27.7)	1.4 (9.8)	3.4 (24.4)	2.8 (20.0)	13.9 (100.0)
2020-21	6.1 (45.3)	3.8 (28.0)	0.9 (6.8)	3.1 (23.0)	3.4 (24.9)	13.5 (100.0)
2021-22	6.2 (45.6)	3.7 (27.0)	1.0 (7.6)	3.9 (28.4)	2.5 (18.2)	13.7 (100.0)
2022-23 RE	6.7 (46.3)	3.8 (26.5)	1.0 (7.2)	3.6 (25.3)	3.0 (21.2)	14.4 (100.0)
2023-24 BE	7.0 (49.5)	4.0 (28.1)	1.2 (8.3)	3.5 (24.7)	2.5 (17.7)	14.1 (100.0)

Note: Figures in parentheses are percentage shares of total revenue receipts.
Source: Same as Figure 2.

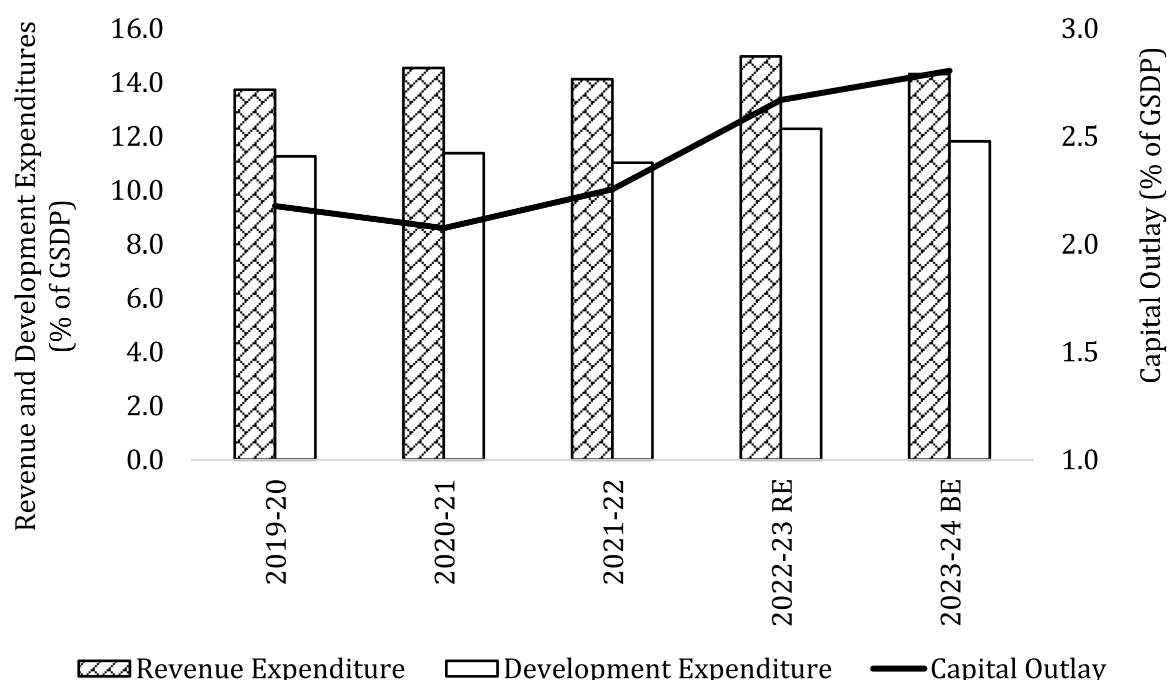
II. Patterns of Expenditures and State-Level Deficits

On the expenditure side, it is evident from Figure 3 that States' aggregate revenue expenditure as a percentage of GSDP increased from 13.7% in 2019-20 to 14.5% in 2020-21. It is budgeted to decline to 14.3% in 2023-24 (BE). In contrast, the aggregate capital outlay to GSDP ratio has shown a gradual rise from 2.1% in 2020-21 to 2.8% in 2023-24 (BE). This increase in capital expenditure can also be attributed to the 50-year interest-free loans to the States given by the Union government on a year-on-year basis since the onset of the COVID-19 pandemic. However, the revenue deficit at the State level has also risen in the recent past. In the context of a rising revenue deficit at the State level, an increase in capital expenditure driven by interest-free loans from the Union is incentive-incompatible. It has the potential to substitute capital expenditure financing by States from their own resources.

II.a State-Level Deficits

The all-State fiscal deficit increased from its pre-pandemic level of 2.7% in 2019-20 to 4.2% in 2020-21 (see Table 2). It declined to 2.8% in 2021-22. This ratio is estimated to increase to 3.5% in 2022-23 (RE) and budgeted to be 3.2% in 2023-24 (BE). Aggregate revenue account balance at the State level generated a surplus in 2019-20. However, the revenue surplus situation turned into a revenue deficit in the year 2020-21 and is continuing. Among the major States, the level of revenue deficit in six States (Haryana, Kerala, Punjab, Rajasthan, Tamil Nadu and West Bengal) recorded a level much higher than the all-State average (See Table 3) during this period.

Figure 3: Trends in Expenditures relative to GSDP for All States Combined



Source: Same as Figure 2.

Table 2: Trends in Revenue and Fiscal Deficits for All States Combined since the Pandemic relative to GSDP

Year	Revenue Deficit	Fiscal Deficit
2019-20	-0.2	2.7
2020-21	1.1	4.2
2021-22	0.5	2.8
2022-23 RE	0.6	3.5
2023-24 BE	0.2	3.2

Source: Same as Figure 2.

Table 3: Revenue and Fiscal Deficits Relative to GDP across Centre, States and Combined

State	Revenue Deficit (% of GDP)			Fiscal Deficit (% of GDP)		
	2021-22	2022-23 RE	2023-24 BE	2021-22	2022-23 RE	2023-24 BE
Andhra Pradesh	0.8	2.2	1.5	2.2	3.6	3.8
Arunachal Pradesh	-15.3	-14.5	-7.1	3.1	7.5	5.9
Assam	0.2	3.0	-0.5	4.4	8.1	3.7
Bihar	0.1	3.8	-0.5	3.9	9.2	3.0
Chhattisgarh	-1.1	-0.6	-0.7	1.5	3.2	3.0
Goa	-0.1	-0.6	-0.7	3.2	5.1	4.7
Gujarat	-0.3	-0.3	-0.4	1.2	1.5	1.7

Haryana	2.3	1.8	1.5	3.7	3.3	3.0
Himachal Pradesh	-0.6	3.2	2.2	3.0	6.4	4.6
Jharkhand	-1.9	-2.4	-3.1	0.7	2.2	2.7
Karnataka	0.7	0.3	0.5	3.3	2.7	2.5
Kerala	3.2	1.9	2.1	4.9	3.5	3.4
Madhya Pradesh	-0.4	-0.1	0.0	3.3	3.6	3.8
Maharashtra	0.5	0.6	0.4	2.1	2.7	2.5
Manipur	-4.0	-15.0	-14.9	4.9	6.4	5.7
Meghalaya	-1.7	-3.5	-4.7	5.6	4.4	3.3
Mizoram	-2.2	-1.3	-1.1	1.3	7.0	3.2
Nagaland	-5.1	-3.3	-1.7	0.8	6.4	2.7
Odisha	-6.5	-2.3	-3.1	-3.1	2.8	3.0
Punjab	3.0	3.5	3.3	4.5	4.9	4.7
Rajasthan	2.1	2.3	1.6	4.0	4.3	4.0
Sikkim	-1.1	-2.0	-0.1	2.4	4.4	4.3
Tamil Nadu	2.2	1.3	1.4	3.9	3.2	3.4
Telangana	0.8	-0.2	-0.3	4.1	3.8	4.0
Tripura	-2.4	-0.6	0.0	-0.1	4.0	5.3
Uttar Pradesh	-1.7	-2.4	-2.5	2.0	3.6	3.2
Uttarakhand	-1.5	-0.8	-1.3	1.4	2.7	2.7
West Bengal	2.3	2.6	1.8	3.7	4.0	3.8
All States	**0.5**	**0.6**	**0.2**	**2.8**	**3.5**	**3.2**
Centre	**4.4**	**4.1**	**2.9**	**6.7**	**6.4**	**5.9**

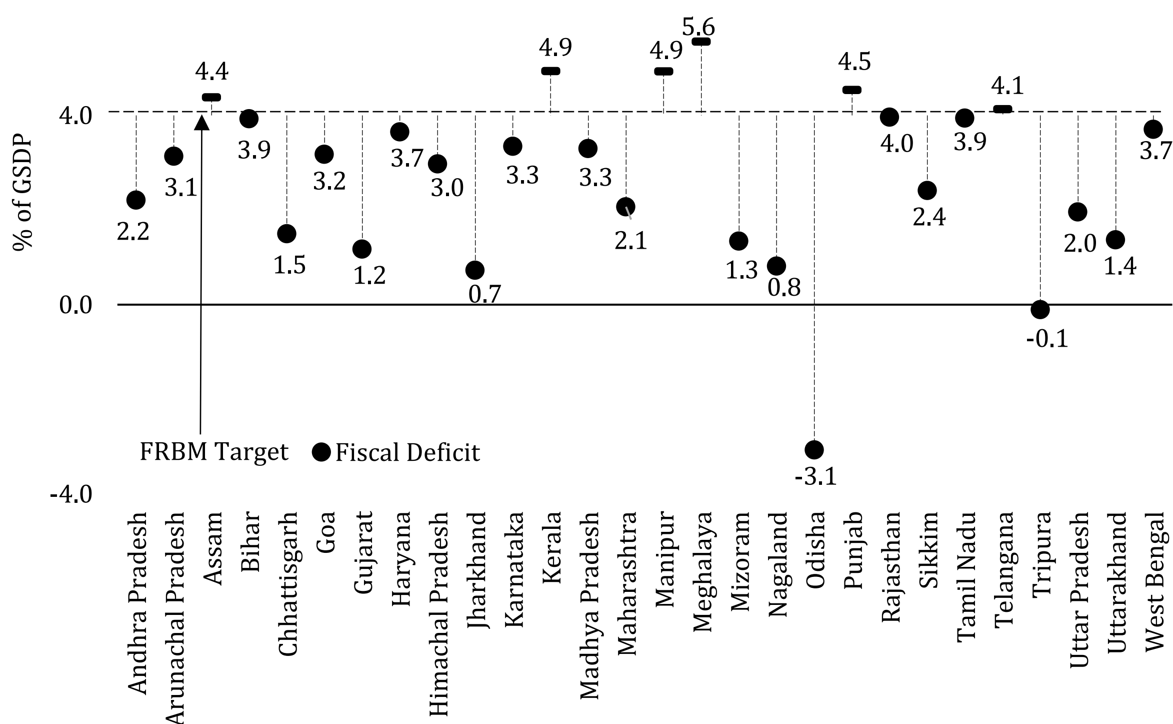
Note: As per the Handbook of Statistics on Indian Economy 2022-23, RBI, Centre and States combined revenue deficit as % of GDP was 5.5% in 2021-22 (RE) and budgeted to decline to 3.9% in 2022-23 (BE). Centre and States combined fiscal deficit as % of GDP was 10.3% in 2021-22 (RE) and estimated to decline to 8.9% in 2022-23 (BE).

Sources: 1) State Finances: A Study of Budgets 2023-24, RBI; and
2) Handbook of Statistics on Indian Economy 2022-23, RBI.

II.b Underutilisation of Fiscal Space

The 15th Finance Commission (FC-XV) recommended a revised fiscal roadmap from 2021-22 onwards considering the spillover effect of the pandemic. Consequently, the Union government, as per the recommendations made by the FC-XV, allowed the State governments to borrow an additional 1% of their GSDP by relaxing the fiscal deficit target under the Fiscal Responsibility and Budget Management (FRBM) Act from 3.0% to 4.0% in 2021-22 and 3.5% in the subsequent year. Besides, an additional borrowing of 0.5% of GSDP was also allowed to the States for a four-year period from 2021-22 to 2024-25. This additional borrowing was made conditional and linked to the power sector reforms at the State level.

Figure 4: Fiscal Deficit – GSDP Ratio against FRBM Target: 2021-22 Actuals



Source: Same as Figure 2.

It is evident from Figure 4, a large number of States underutilised their borrowing limits in 2021-22. States that borrowed over and above their borrowing limits were Assam, Kerala, Manipur, Meghalaya, Punjab and Telangana. Other than these six States, fiscal correction in the remaining States was more than the mandated borrowing limits for those years. Excessive fiscal corrections coupled with the emergence of revenue deficits resulted in a situation of underutilisation of fiscal space and lower capital expenditure than its potential at the State level.

However, there are significant fiscal challenges that need correction in the short to medium time frame. The most critical one is containing the revenue deficit of States. The reduction in fiscal deficit has not been accompanied by a corresponding reduction in revenue deficit. Indeed, the mere presence of a revenue deficit cannot be considered as a sign of fiscal profligacy. It is also true that pressure on revenue expenditure was high during COVID-19. However, increasing revenue deficit driving the fiscal imbalance has long-run fiscal implications and there is a need to correct this imbalance in the revenue account. This correction is necessary to create fiscal space for capital expenditure to create an enabling framework for State-level growth.

On the question of revenue deficit, a long-run view is also necessary. If we examine, the last 20 years' data, revenue deficit had almost disappeared from State Budgets before COVID. States, in aggregate, were generating revenue surpluses almost all the years during this period. However, the re-emergence of revenue deficit in recent years should take the focus back on the management of revenue deficit by creating an incentive-compatible framework. The following measures can be considered:

(1) Going forward, interest-free loans to the States by the Union Government, if continued, may be linked to a reduction in revenue deficit. This will help eliminate the possibility of substitution of States' own capital spending and prevent the diversion of borrowed resources to finance revenue expenditure. A defined time path for revenue deficit reduction with a credible fiscal adjustment plan would help restore fiscal balance and improve the quality of expenditure.

(2) A forward-looking performance incentive grant could also be considered for the reduction of revenue deficit. In this context, different approaches provided by the previous Finance Commissions can be considered to decide the framework of the incentive structure.

III. Debt and Contingent Liabilities

The pre-COVID all-State debt to GSDP ratio for the year 2019-20 was 27.3%. This increased to 31.7% in 2020-21 and declined to 29.8% in 2021-22. This increase in debt to GSDP ratio needs to be analysed by taking into consideration the pre-COVID macroeconomic context, the movement of pre-COVID debt to GSDP ratio and key policy changes that impacted the fiscal balance sheet of States, particularly the debt ratio. It is important to note that the debt to GDP ratio has shown remarkable stability at the State level since the introduction of the FRBM framework in 2005-06. However, the debt ratio started increasing due to certain policy changes like the bailout of the power sector in 2015-16 and increasing revenue risks and rising revenue expenditure at the State level. Long-run debt sustainability at the State level requires a careful analysis. In this section, we briefly discuss the movement of key variables that are critical for the debt sustainability analysis.

As per Domar (1944), debt is sustainable if the nominal rate of growth is higher than the nominal rate of interest. However, it is not a straightforward relationship. For debt to be sustainable, three alternative situations are possible and these are given below: $(1)\ g = i; (2)\ g > i; and\ (3)\ g < i.$, where g denotes economic growth and i denotes interest rate.

Also, economic theories do not provide any specific level of public debt that is sustainable or unsustainable. The debt becomes unsustainable when the rate of interest surpasses the rate of economic growth. Also, even if the debt sustainability condition is maintained, debt could become unsustainable if there is an increase in the primary deficit. Even when there is a primary surplus, debt could become unsustainable if the quantum of primary surplus falls short of covering the excess of the nominal interest rate over the growth rate. These suggest that for all practical purposes, a stable debt-GDP ratio needs a decreasing primary deficit. As evident from Table 4, the primary deficit relative to GSDP for all States combined has increased over time from 1.10% in 2015-16 to 2.11 in 2021-22. During this period, the effective interest rate exceeded the rate of growth of nominal GSDP for the years 2019-20 and 2020-21 and violated the debt sustainability condition. This occurred due to the COVID-induced contraction in economic growth. Going forward,

a reduction in the primary deficit without violating the debt sustainability condition will be critical for a sustained reduction in the State debt-to-GDP ratio.

Table 4: Key Indicators of Debt Sustainability

Year	Nominal GSDP Growth Rate	Effective Interest Rate	Primary Deficit-to-GSDP Ratio	Growth Rate - Effective Interest Rate
(1)	(2)	(3)	(4)	(5) = (2) – (3)
2015-16	10.5	7.81	1.10	2.65
2016-17	11.1	7.71	1.50	3.41
2017-18	10.4	7.60	1.85	2.75
2018-19	13.1	7.44	0.70	5.67
2019-20	6.3	7.34	0.75	-1.08
2020-21	-2.6	7.23	0.85	-9.86
2021-22	19.7	6.94	2.11	12.72
2022-23 RE	14.8	6.87	0.96	7.94
2023-24 BE	9.2	6.93	1.66	2.30

Sources: Same as Table 3.

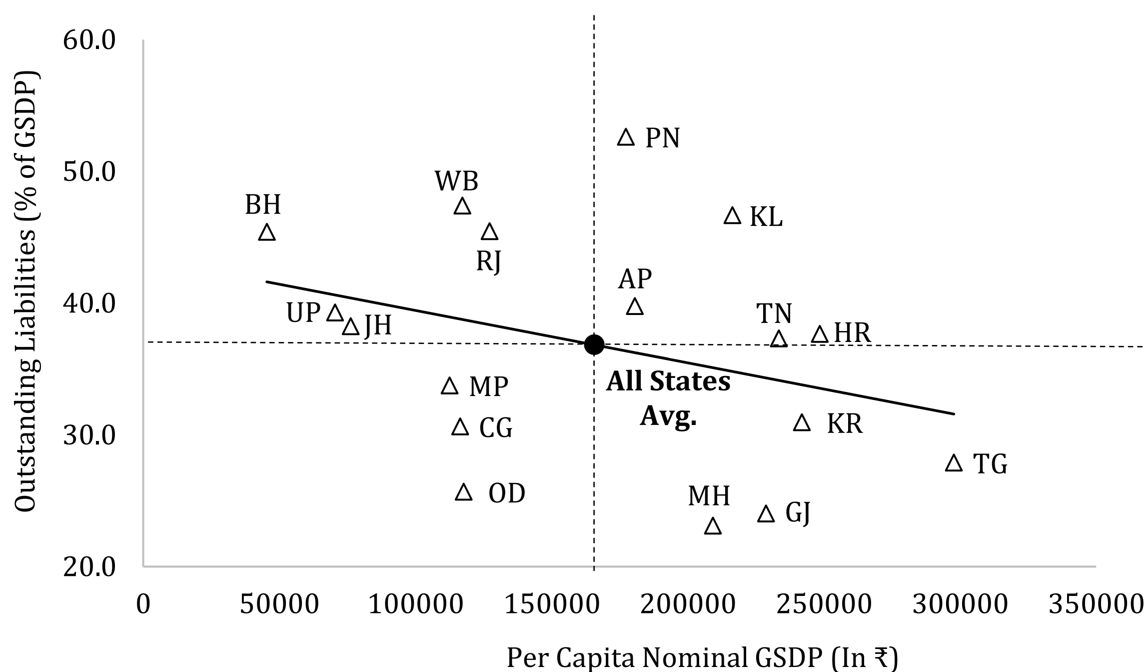
The fiscal risks arising due to the guarantees issued by the State government need careful analysis. Guarantees issued by the State governments usually constitute their contingent liabilities. If the guarantees are invoked, that could lead to a sudden increase in cash outflows and thereby increase deficit and debt. In this regard, the recent RBI *Report of the Working Group on State Government Guarantees* (2023) argued that upfront cash payment does not usually occur in the case of guarantees issued and this is one of the prime reasons behind the increase in guarantee at the State level. However, literature shows that ambiguity regarding the timing and quantum of potential cash outflows against the issued guarantees makes fiscal management intricate for the subnational governments and bears enormous implications on the stock-flow adjustments of debt and deficit (Campos *et al.*, 2006). An increase in guarantees extended by the State governments during the period 2019-20 to 2021-22 is evident from Table 5. Besides, as evident from Figure 5, outstanding liabilities and per capita GSDP are inversely related and both vary considerably across States.

Table 5: Trends in Outstanding Liabilities and Outstanding Guarantees for all-States combined

Year	Outstanding Liabilities (% of GSDP)	Outstanding Guarantees (% of GSDP)
2019-20	27.3	3.1
2020-21	31.7	4.0
2021-22	29.8	4.0

Source: Same as Figure 2.

Figure 5: Varied Outstanding Liabilities and Per Capita GSDP across States: 2021-22



Source: Same as Figure 2.

A number of studies found that contingent liabilities impact the debt spike more than fiscal deficit (Campos *et al.*, 2006) and off-budget operations have become a reliant path to circumvent the fiscal rules (von Hagen and Wolff, 2006). Contingent liabilities in advanced and developing economies have not only driven debt spikes but also have been considered as major deterrents for fiscal transparency (Jaramillo *et al.*, 2017). International evidence also suggests that fiscal rules have induced governments to use off-budget operations as a form of creative accounting (Milesi-Ferretti, 2003). Since fiscal risks due to off-budget operations show an increase at the State level in India, it is important to improve fiscal transparency regarding off-budget operations. Strengthening institutional mechanisms to monitor off-budget borrowing at all levels of government would reduce fiscal risk and impart greater stability to the budgetary operation.

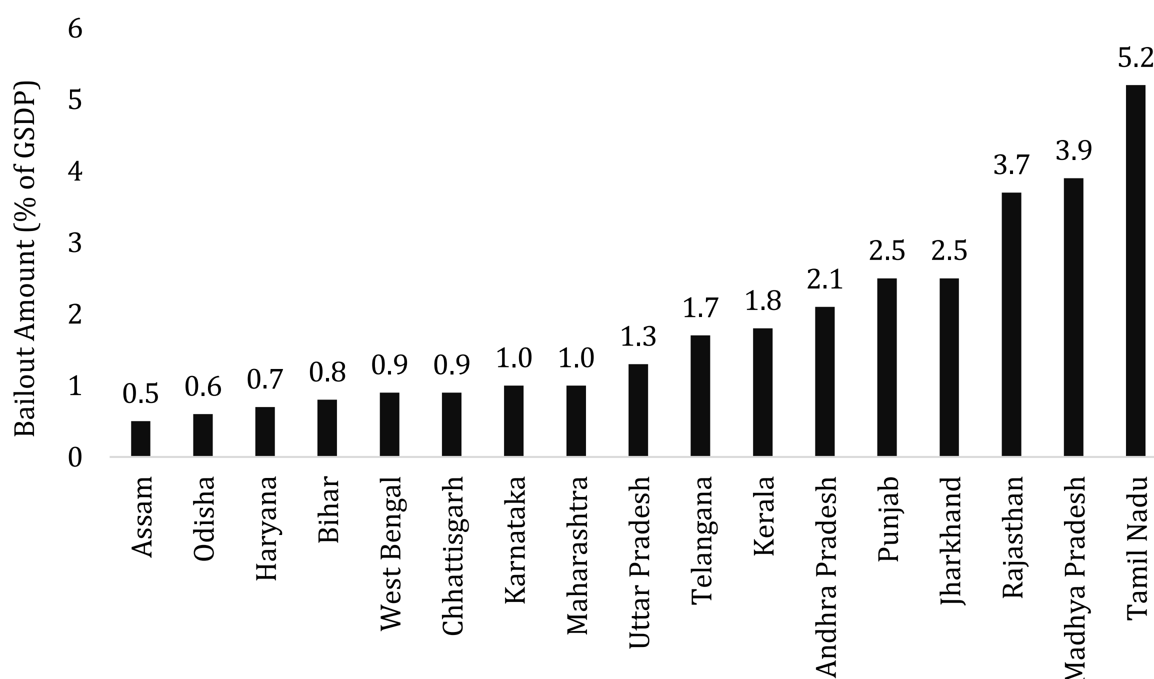
IV. Power Sector DISCOM Finances and Fiscal Risks

Finally, the risk emanating from the financing of DISCOM remains a major source of fiscal risks for the State governments. The power sector reforms at the State level through bailout episodes and corresponding governmental interventions over the years are presented in Table 6. We briefly discuss the most recent initiative in this regard called the UDAY scheme. UDAY required State governments to take over the debt of power distribution companies in their books of accounts. Though this one-time intervention made both debt and deficit measures more comprehensive, this has raised many challenges including the comparability of deficit across States and long-run fiscal implications of power sector debt on State finances (Chakraborty *et al.*, 2018).

Chakraborty *et al*. (2018) further noted that since this restructuring of power sector debt increased the stock of outstanding debt, this can increase the revenue deficit and a corresponding reduction in capital expenditure through the State Budget, if a State has to remain within the fiscal deficit target specified under the Fiscal Responsibility Act.

The RBI Study on State Finances 2023-24 observed that "*Power distribution has strained State finances due to persistent operational inefficiencies and significant under-recoveries. Receipts from the power sector constitute less than a tenth of the corresponding revenue expenditure incurred by the States.*" The implementation of the UDAY scheme by a total of 16 States led to a sharp rise in fiscal deficit, outstanding debt and interest payments in 2015-16 and 2016-17 (Misra *et al*., 2020). The major issues in the context of DISCOM finances highlighted are low tariff rates, high procurement costs of power, cross-subsidisation, and the dominance of State authorities which limits decision-making autonomy. A recent study by Josey *et al*. (2024) observed that "The aggregate annual losses of State-owned DISCOMs are comparable to 35% of the aggregate revenue- deficit of State budgets in 2021–22". The study further noted that "There is wide variation in the extent of losses across States but the fact remains that if State governments were to take over annual losses, the impact on State finances would be significant." In this regard, it could be seen from Figure 6 that bailout amount of DISCOMs in 2020-21 was considerable and varied widely across major States. It is important to note that the Aggregate Technical & Commercial (AT&C) losses of DISCOMs across a majority of the States have declined from 2015-16 to 2021-22. The AT&C losses have increased in Maharashtra, Telangana and Andhra Pradesh (see Figure 7).

Figure 6: Bailout of DISCOMs in Major States: 2020-21



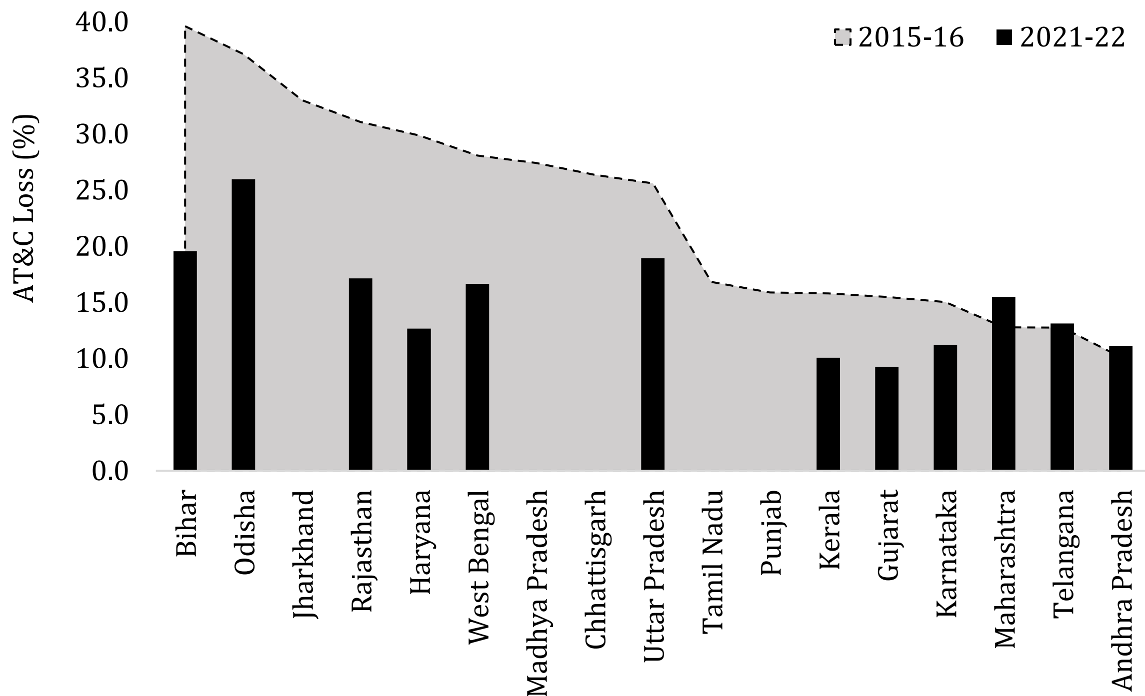
Source: State Finances: A Risk Analysis, RBI, Jun 16, 2022.

Table 6: Power Sector Reforms at the State Level: Central Interventions and Bailout

Year	Bailout Episodes and Interventions
2003	The State governments cleared the outstanding dues of respective State Electricity Boards to Central Power Sector Undertakings through the issuance of Power Bonds.
2012	The State governments had to undertake a Financial Restructuring Plan to enable DISCOMs to meet their short-term debt obligations.
2015	The Ujjwal DISCOM Assurance Yojana (UDAY) was launched by the Government of India (GoI) for operational and financial turnaround of State owned Power Distribution Companies (DISCOMs), under which the participating states took over 50% of the outstanding debt of DISCOMs as on 30-09-2015 by 31st March, 2016.
May, 2020	The GoI has intervened to improve the financial and operational efficiencies of DISCOMs by launching Liquidity Infusion Scheme (LIS).
July, 2021	The GoI launched Revamped Distribution Sector Scheme (RDSS) intending to improve the quality and reliability of power supply to consumers through a financially sustainable and operationally efficient distribution Sector. The scheme has an outlay of ₹3,03,758 crore and estimated Government Budgetary Support from Central Government of ₹97,631 crore.
2021-22	The GoI incentivised the States by allowing additional borrowing of 0.5% of GSDP to States linked to power sector reforms, and additional prudential norms for lending by Power Finance Corporation (PFC) Limited and REC Limited based on performance of utilities.
August, 2023	State would issue non-SLR (Statutory Liquidity Ratio) including SDL (State Development Loans) bonds, which will have a maturity period of 10-15 years with a moratorium on repayment of principal up to 5 years, as required by the State.

Sources: 1) UJWAL Discom Assurance Yojana (UDAY), Press Information Bureau (PIB), Ministry of Power, Government of India dated 03 March 2016;
2) Reforms in Power Sector, PIB, Ministry of Power, Government of India dated 31 March 2022;
3) Several interventions undertaken by Power Ministry to improve financial and operational efficiencies of DISCOMs, PIB, Ministry of Power, Government of India dated 26 July 2022;
4) National Level AT&C Losses in Power Network down from 22.3% in 2020-21 to 16.4% in 2021-22, PIB, Ministry of Power, Government of India dated 11 August 2023; and
5) State Finances: A Risk Analysis, RBI, Jun 16, 2022.

Figure 7: AT&C Losses of DISCOMs across States



Source: India Climate & Energy Dashboard, NITI Aayog.

Note: Data for five States (Chhattisgarh, Jharkhand, Madhya Pradesh, Punjab and Tamil Nadu) for 2021-22 are not available.

IV. Conclusions

To conclude, the fiscal situation has improved at the State level after the pandemic. Our analysis shows that States together have managed to contain their fiscal deficits at a level which is lower than what was proposed by the Fifteenth Finance Commission for the year 2023-24. This fiscal consolidation is significant in many ways. First, within the limited fiscal headroom, States in aggregate managed to be fiscally prudent despite a significant contraction in revenues even during the peak of COVID. Second, emergency provision for health spending and livelihood during the COVID-19 pandemic was not easy and this required Union-State fiscal coordination. Third, within the limited fiscal space, States were able to reprioritise expenditure and quickly contain the fiscal deficit. Fourth, the combined picture of the State budget 2023-24 shows that the reduction in fiscal deficit is a combination of expenditure side adjustments, better GST collection and higher tax devolution due to buoyant central revenues. Fifth, non-GST revenues are also showing signs of recovery after the pandemic in most States. However, multiple fiscal risks remain and some of these risks are also increasing due to the off-budget operations of the States. The major fiscal risk in this regard is rising power DISCOM losses. If the State governments have to bail out power distribution companies in the short to medium term again, this would result in a significant reduction in fiscal space for State level development spending. However, the debt and deficit profile and consequent fiscal risk vary across States. These State specific fiscal vulnerabilities including power sector losses need appropriate policy considerations to enable sustainable fiscal recovery.

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