Help states beat budget constraints

States’ revenues, including central devolution, will contract; Centre must help them out or let RBI come up with a solution

GIVEN HOW STATES are staring at a liquidity crisis due to a collapse in revenues, both at the Centre and locally, they need to be given more fiscal room. To begin with, the share of revenues they receive from the Centre—the bulk of which is the GST—is falling as GST collections themselves are down to an estimated third of the usual in March; states get roughly 55% of the total collections. With direct tax collections too expected to be quite short of target given the economy is expected to contract this year, the devolutions are also likely to shrink. In a typical April, Kerala’s revenues are around ₹6,000 crore; this time, they have been about a tenth of that. While devolution is happening, it is coming in dribs and drabs, and many states could soon run out of money.

At present, the revised estimates (RE) for FY20, the tax devolution to states was ₹6.5 lakh crore; this year, they might just about get ₹4 lakh crore. Perhaps, the Centre should guarantee a minimum amount of devolution because, given the current revenue flows, states are entitled to about 40% of the divisible pool.

As economist Govinda Rao points out, the budget estimates for revenues in FY21 are 6.5% smaller than those of the Finance Commission—which translates into a loss of some ₹71,000 crore. There is a suggestion that the Centre could allocate the ₹2 lakh crore of grants-in-aid for capital assets, provided for in the central budget, for immediate needs.

Unfortunately, the lockdown prevented states from mopping up revenues from auto fuels and alcohol, but even with the hikes, the revenues are not going to be sufficient to pay the bills. So, it is expenditure that is going to be axed. Already, salaries are being cut or deferred; as Kerala’s finance minister, Thomas Isaac, has said, there is simply no option. Punjab has managed May salaries, but is not sure it can manage in June. Isaac also pointed out that most development schemes would be deferred and, given that states account for 60% of total expenditure, this would hurt aggregate demand.

If the economy is not to be altogether derailed, there is a case for allowing states to borrow more by increasing the FRBM limit from 3% to 5%. To be sure, the higher borrowing limit must pencil in a flat or only slight growth in GDP this year; but 2% additional room should be sufficient.

On a rough reckoning, for a reasonably good state—assuming revenues of 100 come down to 75, and the revenue expenditure stays the same at 110, with the capex down to zero—the fiscal deficit would go up to 3.5%. This number, of course, would be higher if the GDP contracts.

That is the easy part. The real problem is that even though they have enough surpluses, banks are not keen to buy SDLs for fear of value erosion; at a recent auction, some states were made to cough up as much as 9%. To eliminate the mark-to-market risks, some have suggested that the Reserve Bank of India (RBI) allow states to issue short-term paper, and permit banks to hold this till maturity. If this doesn’t comfort the banks, the Centre may need to borrow more and pass it on to the states.

As of now, states have bailed in a 25%-30% increase in net SDLs in FY21, which would take total issuances to ₹6.2-6.4 lakh crore in FY20. ICRA estimates gross issuances to rise by 19-23% to ₹6.6-7.8 lakh crore in FY21, from ₹6.3 lakh crore in FY20.

To help them tide over the immediate liquidity crisis, and to enable them to spend on healthcare and other essentials is almost entirely on the states; GST compensation to them can’t be delayed. Nor is this the time to quibble over deficits; states’ FRBM limit should be increased by 2%.

Given the onus of spending on healthcare and other essentials is almost entirely on the states, GST compensation to them can’t be delayed. Nor is this the time to quibble over deficits; states’ FRBM limit should be increased by 2%.

WMM— an overdraft facility. As of now, they are allowed 60% more than the March 31 level for H1FY21, or roughly ₹20,000 crore. Given that the onus of spending on healthcare and other essentials is almost entirely on the states, they are justifiably miffed that the Centre’s WMA has been upped to ₹2 lakh crore from ₹75,000 crore.

So far, states have been pruning their expenditure, primarily capex, and in some instances, salaries. Some are toying with the idea of deferring the allowances for 12-24 months. While an analysis by ICRA of 21 states shows they combined deficit to have narrowed to ₹5.1 lakh crore in FY21, from ₹5.6 lakh crore in FY20, RE looks highly unlikely now. But, given the exigencies, this is no time to quarrel over fiscal deficits. The Centre needs to unleash more stimulus packages, but it cannot delay the dues of states; according to some reports, GST compensation is late by a few months, which is unpardonable. It should either rush to support states or let RBI come up with a solution. A financial emergency, costing states their autonomy, is undesirable.