

# How the pandemic hit state budgets in India

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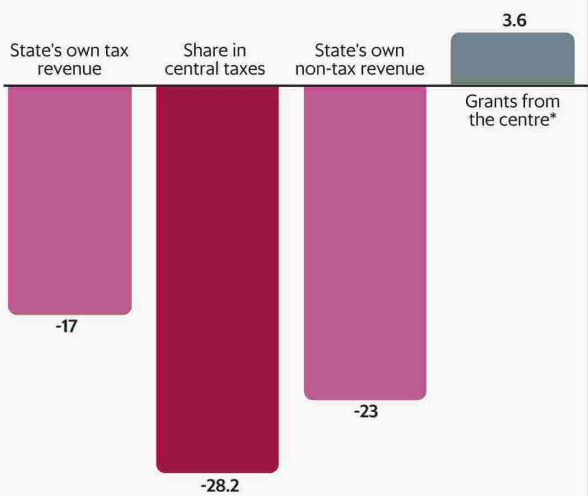
Even as governments across the world opened up their purse strings last year to deal with the fallout of the covid-19 pandemic, the Indian government practised austerity. On 1 February this year, the Union government finally shifted its stance, announcing an expansionary budget, with a focus on raising capital expenditure in the last quarter of fiscal 2021. The spending plan for fiscal 2022 represents only a modest hike over the previous fiscal year, but still involves an ambitious borrowing programme that will push fiscal deficit levels much beyond earlier thresholds.

In contrast to the expansionary stance of the Union government, state governments seem to have taken a more conservative approach to planning their budgets this year. A *Mint* analysis of the budget numbers of 19 major states shows that state government borrowing is expected to be relatively muted compared with central government borrowing. The severe strain on state finances over the past year seems to have led state governments to be much more cautious than the Centre in budgeting additional spending.

When the pandemic first struck, it was assumed that state finances would be hit hard largely because of a shortfall in their own tax revenues. However, state governments seemed to have suffered more because of a shortfall in their share of central taxes. The Centre could impose additional cesses during the pandemic to add to its kitty, but such cesses and surcharges are not shared with the states as they are not part of the divisible pool.

## Shortfall in the share of central taxes left a bigger hole in state budgets than fall in own revenues

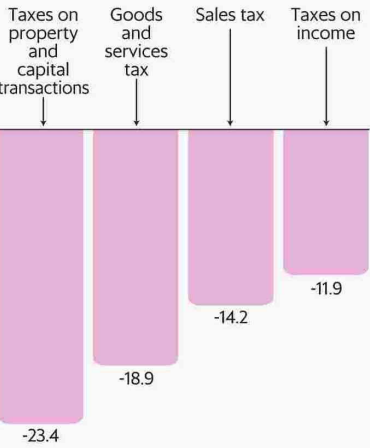
% difference between budgeted estimates and revised estimates for fiscal 2020-21



\*Grants from the Centre include funds for centrally sponsored schemes, Finance Commission grants and other transfers and grants. Analysis based on data from 21 states which have published budget figures this year.

## Components of own tax revenues

% decline in FY 21 RE (compared to BE)



Source: CMIE, State budget documents

## Loans Limited

**THE EXPERIENCE** of the past year could be limiting the appetite of state governments for greater spending. Besides, the sharp rise in central government borrowings limits the ability of states to borrow, as additional borrowing through bonds tends to push up yields. As state government bonds are priced below central government bonds (meaning yields are higher), any rise in central borrowing raises borrowing costs for states. In the past fiscal, state governments borrowed slightly less than planned and faced higher costs of borrowing, a recent report from CARE Ratings Ltd noted.

State borrowing could rise as the year progresses, said Abhishek Updadyay, economist, fixed income strategy, at ICICI Securities Primary Dealership. "States have budgeted high GST compensation figures," he said. "However, we saw last year, with GST collections falling short, the compensation could also suffer.... So, borrowing numbers could be higher."

## Increase in state borrowings much lower than the Centre's

% difference in debt receipts between budget estimates for fiscal 2021-22 and actuals for fiscal 2019-20

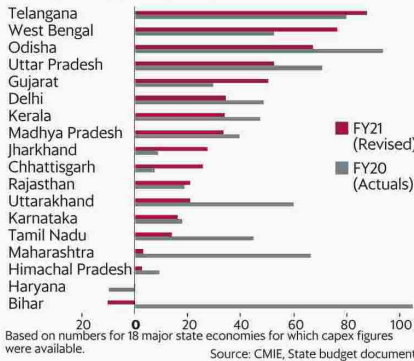


Analysis based on data from 19 major state economies which have published budget figures this year. Outliers such as Odisha and Maharashtra had borrowed far less than planned in the past fiscal year.

Source: PRS, State budget documents

## Most states have raised capex allocations

% change in budgeted capital expenditure for fiscal 2021-22 over:



Based on numbers for 18 major state economies for which capex figures were available. Source: CMIE, State budget documents

## Capex Question

**MARKETS EXPECT** higher borrowing from states in the second half, but if the Reserve Bank of India (RBI) starts normalizing monetary policy by then, this could push up bond yields and raise borrowing costs for states. RBI has indicated that it will do whatever it takes to keep yields low, at least for the first half of the fiscal year when the central government is the major borrower. However, it is not clear if that policy will continue in the second half, when state governments typically borrow more. If the economic recovery picks up pace, RBI may well shift its stance by then.

The ability of states to borrow will, in turn, determine their ability to raise capex spending, which had been hit by the pandemic last year. Most states have budgeted for relatively higher capex spends this year, but shortfall in GST collections and higher borrowing costs could lead many states to cut back on capex, as they did last year.

## Funding Growth

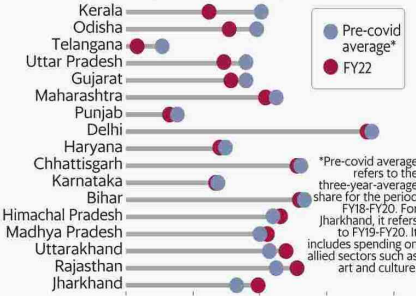
**GIVEN THAT** state governments have been the primary driver of public investments in the pre-covid era, their ability to fund capex will be key to determining India's medium-term growth trajectory. However, over the long term, the ability of states to fund essential social infrastructure projects will matter equally. As a result of the pandemic, health spending has got its due, our analysis shows. Disconcertingly, education spending is projected to fall at a time when students and teachers both need greater resources to recover from the pandemic shock. The loss in learning for disadvantaged school children could dent lifetime earnings and widen inequality, research suggests.

Most states have allocated less for education than in the pre-covid era. They include states with poor learning outcomes, such as Odisha and Uttar Pradesh. Unless there is a correction in education spending, both growth and equity will suffer in the years to come.

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## Allocation to education has declined across states

% share of education spending in total expenditure



Source: PRS, State budget documents

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