Re-Orientation of State Fiscal Architecture

Why in news?

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The annual study of State budgets has been released by the Reserve Bank of India.

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What does RBI study implies?

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- State finances during 2018-19 shows that States have budgeted a substantial fiscal correction in terms of fiscal deficit and revenue deficit relative to GDP.
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- The fiscal deficit in budget estimates for 2018-19 reported by all States put together stood at 2.6 per cent of GDP with a revenue surplus of 0.2 per cent of GDP.
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- This is a correction from 3.1 per cent of the fiscal deficit for 2017-18 and 3.5 per cent in 2016-17.
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- GST is turning out to be a game-changer of sorts, The RBI report says States have budgeted GST revenues at 2.6 per cent of GDP as against 1.6 per cent in 2017-18.
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What are the concerns with state budget?

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- There is higher level of fiscal deficit budgeted by six of the major States, namely Goa (4.8), Kerala (3.2), Madhya Pradesh (3.3), Odisha (3.4), Punjab (3.9), Telangana (3.5), and three States in the “special category”, namely, Jammu and Kashmir (4.5), Meghalaya (3.4), and Nagaland (3.2).
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- This comes alongside the GST revenue stream on one hand and pressures on the State budget caused by agriculture debt waivers, implementation of the Seventh Pay Commission and a higher recourse to market borrowing on the other.
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- It may be noted that the fiscal deficit (revised estimates) has consistently crossed the FRBM threshold of 3 per cent for the third consecutive year now.
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- There is a decline in the developmental expenditure to GDP ratio by 0.3 percentage point.
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- To the extent that borrowing cost is higher than return on capital, the situation will eventually lead to an unsustainable pattern of expenditure and a rising debt-to-GDP ratio.
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What are the reasons behind this scenario?

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- This is largely attributed to a lower order of developmental expenditure in critical sectors like rural development, transport and communication.
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- The real conundrum is States that have a revenue surplus and, at the same time, a higher fiscal deficit, perforce driven to higher borrowing.
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- State governments have taken recourse to higher borrowings to provide for higher capital expenditure being guided by the philosophy that all capital expenditure is good and development oriented.
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How State finances can be re-oriented?

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- The Central government has a revised FRBM framework with the fiscal

deficit alone as the target variable, which will be mirrored sooner rather than later in the States.
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- With revenue deficit off the radar and fiscal deficit as the sole target variable, it will be easier to fit the norm by the simple act of reducing developmental expenditure even more.
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- States must follow the direction of expenditure to build human capital through education and health expenditure for long-term growth.
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- GST collections have helped fiscal consolidation and likely to bring more revenues as the GST system further stabilises and becomes all-pervasive.
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- Thus focussing on making State budgets more responsive, accountable and geared to the needs of the people will give a thrust to growth and development across the nation.
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Source: Business Line

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