State Budgets - Need for Government Spending

What is the issue?

- Several state governments have presented their budgets for the financial year 2021-22.
- States have spent less in this year, and may focus on fiscal consolidation in the year to come, weakening the hopes of a public-spending-led recovery.

What is the projection on government spending?

- There was much a collapse in states' revenues in the last fiscal given the pandemic times.
- Transfers from the Centre thus become a key aspect in the last financial year.
- This was coupled with a "reluctance" among some states to borrow more to spend.
- So at the aggregate level, spending by these states in 2020-21 will end up being lower than what they had budgeted for before the onset of the pandemic.
- The revised estimates peg their total expenditure to decline by around 6% in 2020-21 from their budget estimates.
- These are based on 11 states that account for a little over 60% of India's GDP.
- These trends may hold for the other states as well.
- In that case, the "additional" spending by the central government, over and above its budget estimate, is likely to be offset by the decline in spending by states.
- In effect, the total general government spending may end up being around or even lower than what was budgeted for before the onset of the pandemic.

How is the revenue status?

- This year, states which typically run revenue surpluses will run revenue deficits.
- The revenue collapse meant that states that usually borrow to finance capital expenditure have had to borrow for recurring expenditure as well.
- As a result, capital spending by states, which was budgeted to be around 50% more than that of the Centre in 2020-21, has been cut sharply.

- The states had to cut back even on some of its revenue expenditure.
- Notably, most of these states have cut back on allocations for pensions.
- Some have even slashed allocations for salaries this year.

What is the gap among the states?

- Some of the states did have the leeway to boost spending by borrowing more.
- The Centre had raised the ceiling on their market borrowings from 3 to 5% of GSDP.
- Of this 2 percentage point increase in the borrowing limit, part was unconditional while the remaining was subject to fulfilling Centre-mandated reforms.
- Several states did qualify to undertake the conditional borrowings.
- But, it is only the low-income states with already stretched finances that seem to have availed the additional borrowing space.
    - [These include Bihar, Rajasthan and Madhya Pradesh; their budgeted fiscal deficit for 2020-21 was pegged at 3% or above before the pandemic.]
- They were thus able to either maintain or exceed their budgeted expenditure levels.
- In comparison, the high-income states of Gujarat, Maharashtra and Karnataka, that were better placed to borrow more and spend, have not done so.
- The economic hit from the pandemic is thus uneven.
- The growth projections accompanying these budgets suggest that some states expect to do better than others.
- But, considering the extent of the crisis, there has to be far greater spending than what is visible in these budgets.

What is the scope for fiscal consolidation?

- As is the case with the Centre, states have, remarkably, budgeted for aggressive fiscal consolidation next year.
- The average fiscal deficit across these states is expected to fall by more than 1 percentage point of GSDP.
- This is more than twice the decline recommended by the 15th finance commission.
- This aggressive consolidation is expected to be achieved not by expenditure compression, as is the case with the Centre, but by significant revenue enhancement.
- However, some revenue assumptions are quite ambitious.
- E.g. some states have pegged their GST and VAT collections to grow far in excess of 30% in 2021-22

What is the right way forward?

- Subdued general government spending during these crisis years heightens the risks to economic recovery.
- There is a possibility of the economy exiting from this period with lower medium-term growth prospects.
- Given this, there is a strong case for greater government spending during these years.
- The states, put together, account for a larger share of general government spending than the Centre.
- Their spending stance is thus pivotal to the hopes of a government spending-led economic recovery.

Source: The Indian Express

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