

COVID HAS NOT REALLY UNSETTLED CONSERVATIVE GOVERNMENT FINANCES: THE CASE FOR A BOND MARKET CHEER OR / AND FISCAL LEVER?

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Second wave of COVID-19 has been stabilising with declining 7Day Moving Average of daily new cases for the past few days, indicating the peak of the second wave is mostly behind us. Furthermore, daily recovered cases are now higher than daily new cases and the gap between the two is much higher than what was observed during the first wave peak. The other reason to cheer is the GST revenues which have set a new record at Rs 1.41 lakh crore in April 2021 and Rs 1.03 lakh crore in May 2021. The average SGST collection was Rs 29,137 crore for Apr-May'21 period. The average IGST collection was Rs 60,840 crore. Ideally 50% of this should be provided to states. The monthly average cess collection was Rs 9355 crore. Thus, if we combine all these figures, the average monthly revenue for states would be Rs 68,912 crore for this year. If we calculate the yearly figure on this number, then the overall revenue would be Rs 8.27 lakh crore. We collected the data for almost all states and found that the combined budgeted SGST and Cess estimates were Rs 7.67 lakh crore. Thus, if the positive trend in GST continues then providing states their due might not be a significant challenge for the Centre. Only a third wave could now force the Centre to borrow on a larger scale to compensate the states. **We have constructed 3 scenarios and it shows a marginal revenue gain of Rs 1131 crore for the states in the best case and a shortfall of Rs 79,147 crore in worst case.** Notwithstanding the cautious approach adopted by Centre, which has said that it could be borrowing Rs 1.58 lakh crore to compensate states, the recent steps taken by Centre will have definitely some impact on its finances. The extension of Pradhan Mantri Garib Kalyan Anna Yojana from July till the end of November 2021 is expected to cost Rs 91,000 crore, while vaccinating 75% of 18+ adults is expected lead to an additional burden of Rs 13851 crore. However, this number could go up if India enters into vaccine purchase agreements with foreign companies. For now we have assumed Rs 400 per dose as the vaccination cost. The Centre has again been cautious in budgeting its excise revenue at Rs 3.35 lakh crore. However, if it continues to levy the same taxes as of now based on our assumptions of petrol and diesel consumption, the excise revenue could increase by Rs 76,339 crore from the budgeted estimates. Thus overall the Government's finances do not look overstretched as GST collections have continued to maintain pace because of persistent Government efforts in plugging the loopholes and Government had already factored in some of the vaccination cost. **We expect a fiscal impact of around Rs 28,512 crore currently because of all these measures.** While we do not rule out disruption to Government finances in subsequent months as economic activity only picks up modestly, we believe the space for monetary accommodation is over and only a proactive fiscal policy can rekindle animal spirits and growth. Inflation numbers (both WPI and CPI) due to be released on Monday are likely to show a significant uptick just like US inflation numbers. **The RBI will face a multiplicity of challenges to reinvigorate growth and support a stable rupee and a potential inflation uptick that has all the prospects to turn ugly with a marauding global commodity cycle.**

STATE GST OVER THE YEARS

- ◆ The prickly issue of state revenue after the implementation of GST regime has become even more thorny after the onset of the pandemic. To understand the trajectory of revenue generation through this head, we collected state-wise data from various sources and analysed them. Our analysis does not include the data for Sikkim, Mizoram, Delhi and other Union Territories, which could lead to some difference in our estimates and the overall SGST figures and all other combined figures in this report. In FY19 state GST revenue grew by an impressive 46%. However, some base effect was at play. With the slowdown in the economy for FY20 there was de-growth of -0.4%.
- ◆ In FY21, given the COVID-19 situation and initial lockdown, states suffered revenue loss. However, in later months SGST collections picked up and the combined SGST revenue of all these states managed to remain at almost the same level as FY21, at Rs 4.88 lakh crore. However, these are revised estimates, and these can see changes when the actual figures are published next year. Interestingly, the GST press releases show that Rs 4.71 lakh crore has been the combined SGST and allocated IGST component.
- ◆ For FY22, the state GST revenues are projected to grow at 31% over the FY21 RE.

State/Year	SGST Collection(Rs crore)				
	2017-18	2018-19	2019-20	2020-21(RE)	2021-22(BE)
Andhra Pradesh	13748	21257	29857	26284	38837
Arunachal Pradesh	1155	806	802	911	1222
Assam	6329	8890	8755	14131	16251
Bihar	13319	16738	15801	20800	20621
Chhattisgarh	6481	8665	7895	7754	9338
Goa	1721	2529	2438	2373	2483
Gujarat	23348	35351	34107	33062	36612
Haryana	11571	18775	18873	20350	24300
Himachal Pradesh	2318	3450	3550	3451	4142
Jharkhand	6258	8201	8418	9064	9500
Karnataka	27387	42663	42147	37834	45947
Kerala	13708	21390	20447	19000	36922
Madhya Pradesh	13829	19751	20448	17537	23000
Maharashtra	53818	83181	82602	88000	117807
Manipur	721	787	853	1000	1500
Meghalaya	813	902	326	454	489
Nagaland	526	544	613	463	727
Odisha	9766	12639	13204	13010	15000
Punjab	8973	13510	12751	11522	16000
Rajasthan	15874	23763	21954	24000	37663
Tamil Nadu	27325	39137	38376	41249	45396
Telangana	14730	24206	23517	23600	31000
Tripura	916	1074	1027	985	1123
Uttar Pradesh	37586	48802	47232	44301	64475
Uttarakhand	2687	4960	4931	3609	4671
West Bengal	19944	28166	27308	23270	32982
Total	334849	490136	488230	488015	638007
Growth rate		46%	-0.4%	0.0%	31%

Source: RBI, SBI Research, PRS, excludes Sikkim, Mizoram, Delhi and UTs

- ◆ After the implementation of the GST regime, Goods and Services Tax (Compensation to States) Act, 2017 was enacted to levy Compensation cess for providing compensation to the States for the revenue loss arising on account of implementation of the Goods and Services tax with effect from the date from July 2017 for a period of five years or for such period as may be prescribed on the recommendations of the GST Council. The Act guarantees all states an annual growth rate of 14% in their GST revenue during the period July 2017-June 2022. If a state's GST revenue grows slower than 14%, such 'loss of revenue' will be taken care of by the Centre by providing GST compensation grants to the state.
- ◆ Looking at the budget estimates of cess for FY22, states in our sample are budgeting for a compensation cess of Rs 1.28 lakh crore. Combining the estimates of SGST and cess, it appears that states are sticking more or less to the 14% revenue growth rate projections for their estimates.
- ◆ The Centre meanwhile has budgeted the Goods and Services Tax Compensation Cess at Rs 1.00 lakh crore for FY22. Thus, already there was some conflict over the cess amount. With the second wave of COVID-19 hitting states now the issue of declining GST revenues is again a sore topic. The Centre has pegged the total compensation requirement for states this year at Rs 2.7 lakh crore. It says it will borrow around Rs 1.58 lakh crore to compensate states for the shortfall in collections besides utilizing the amount collected through cess.
- ◆ When we look at the actual GST collections this fiscal, the GST collections started on a promising note. GST Revenue collection for April 2021 set a new record at Rs 1.41 lakh crore and in May 2021 this figure is Rs 1.03 lakh crore. April- May 2021 saw a strong second wave of COVID-19 and many states imposed restrictions to curb transmission. Despite this, the GST revenue collections were stupendous. The average SGST collection was Rs 29,137 crore for Apr-May'21 period. For the IGST collection the average figure was Rs 60,840 crore. Ideally 50% of this should be provided to states. The average cess collection was Rs 9,355 crore. Thus, if we combine all these figures, the average monthly revenue for states would be Rs 68,912 crore for this year. If we calculate the yearly figure on this number, then the overall revenue would be Rs 8.27 lakh crore, which is much higher than the combined budget estimates of Rs 7.67 lakh crore of our sample states.
- ◆ Thus, if this revenue trend continues at this rate, Centre may not have to borrow much of any additional amount to compensate the states, even though the budgeted cess figures of the states is higher than the Centre's estimates. Even if there is only 42% devolution from IGST, then also if the given trend continues Centre would not have to borrow any additional amount, or at best a lower amount to compensate the states and UTs whose data we could not find.
- ◆ Alternatively, in a scenario where the average SGST falls to Rs 27000 crore, and IGST is devolved at 42%, then states can see a shortfall of Rs 24513 crore. Also, if the IGST collection also falls simultaneously and we assume it becomes Rs 50000 monthly average, then combined with 42% devolution, the shortfall in states' revenue could be Rs 79147 crore (Table 3). If the Centre uses the IGST amount then only Rs 31147 crore would have to be borrowed. Thus, all in all Centre's borrowing program is not going to take a significant hit on account of compensating states, unless a catastrophic third wave occurs which halts all activity.

Scenario 1: State tax revenue through GST(Rs crore)

	Average Collection (Apr-May)'21	Average Collection FY21	Average Collection FY20
SGST	29137	22735	25770
IGST@42%	25553	19800	20535
Cess	9355	7268	8220
Total	64045	49803	54525
Memo:			
Annual estimated from monthly average	768538	597638	654296
States' estimates BE	767407	698850	650822
Difference	1131	-101213	3474

Source: SBI Research, a positive figure shows a surplus

Scenario 2: State tax revenue through GST(Rs crore)

	Average Collection (Apr-May)'21	Average Collection FY21	Average Collection FY20
SGST	27000	22735	25770
IGST@42%	25553	19800	20535
Cess	9355	7268	8220
Total	61908	49803	54525
Memo:			
Annual estimated from monthly average	742894	597638	654296
States' estimates BE	767407	698850	650822
Difference	-24513	-101213	3474

Source: SBI Research, a positive figure shows a surplus

Scenario 3: State tax revenue through GST(Rs crore)

	Average Collection (Apr-May)'21	Average Collection FY21	Average Collection FY20
SGST	27000	22735	25770
IGST@42%	21000	19800	20535
Cess	9355	7268	8220
Total	57355	49803	54525
Memo:			
1. Annual estimated from monthly average	688260	597638	654296
2. States' estimates BE	767407	698850	650822
Difference(1-2)	-79147	-101213	3474

Source: SBI Research, a positive figure shows a surplus

IMPACT OF RECENT MEASURES OF CENTRE ON FISCAL

- ◆ Notwithstanding the cautious approach adopted by Centre over borrowing Rs 1.58 lakh crore to compensate states, which may or may not materialise, the recent steps taken by Centre will not have larger impact on its finances.
- ◆ The extension of Pradhan Mantri Garib Kalyan Anna Yojana from July till the end of November 2021 has been done. During this five-month period, more than 80 crore people will be provided 5 kg foodgrains per person per month. In its April press release, Ministry of Consumer Affairs, Food & Public Distribution had stated that Government of India will bear full expenditure of over Rs 26,000 crore on account of cost of food grains, intrastate transportation etc. as part of Central assistance to States/UTs for Additional free-of-cost foodgrains distribution to NFSA Beneficiaries under Pradhan Mantri Garib Kalyan Anna Yojana in May and June 2021. So, we estimate the cost beginning May and till November is at Rs 91,000 crore.
- ◆ As far as vaccination is concerned around 60% of India's population is 18+. This translates into around 81 crore people who are to be vaccinated under the current policy. If two dose vaccines are considered then 162 crore doses are needed. At present India has administered 25 crore doses. So, 137 crore more doses are needed. If the Centre procures 75% of these doses and administers them, then 103 crore doses are required. There is a plethora of price points at which vaccines are being sold. As per UNICEF data the range lies between \$2-\$40 per dose. For our calculation we have assumed a price point of Rs 400 per dose, which translates into a fiscal cost of Rs 48851 crore for 162 crore doses. However, Centre had already budgeted Rs 35000 crore. So, additional spending would be Rs 13851 crore.
- ◆ However, besides promising GST collection another area where Centre could make a windfall is in Excise collections and this money could be used to bolster the state finances against this contingency spending.

Centre's revenue and expenditure

Heads	Additional Expenditure/ Revenue(Rs crore)
Pradhan Mantri Garib Kalyan Anna Yojana Cost	91000
Additional Vaccination Cost	13851
Additional Gain from Excise	76339
Total impact*	28512

Source: SBI Research, + indicates positive for govt

- ◆ The 10 year CAGR for petrol and diesel consumption till the year ended FY21 is 7% and 1%. If we exclude, FY21 an outlier year, then these growth rates are 9% and 3% respectively. To be conservative we have taken 7% and 1% growth in their consumption for this fiscal and calculated the excise revenue that Centre can get from these. The PPAC data shows Centre's excise taxes on these products at Rs 32.9 and Rs 31.8 per litre. Multiplying these with the projected consumption shows total revenue of Rs 4.11 lakh core, while Centre has budgeted only Rs 3.35 lakh crore. **So there is gain of Rs 76339 crore at the current excise rate structure.**
- ◆ Thus overall the Government's finances do not look overstretched as GST collections have picked up and government had already factored in some of the vaccination cost.
- ◆ While we do not rule out disruption to Government finances in subsequent months as economic activity only picks up modestly, we believe the space for monetary accommodation is over and only a proactive fiscal policy can rekindle animal spirits and growth. Inflation numbers (both WPI and CPI) due to be released on Monday are likely to show a significant uptick as like US inflation numbers. **The RBI will face a multiplicity of challenges to reinvigorate growth and support a stable rupee and a potential inflation uptick that has all the prospects to turn ugly with a marauding global commodity cycle.**

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