

ARE STATE BORROWINGS OVERSIZED WITH RESPECT TO STATE GDP?

Issue No. 32, FY22
Date: 03 Aug 2021

The Finance Commission had recommended that borrowings by states should be linked to the size of the GSDP. However, this often results in information asymmetry as GSDP numbers of states undergo revisions as like any other macro number. Given the borrowings incentivization, it also results in states projecting ambitious GSDP numbers during the budget presentations that are only revised downwards later.

As a logical corollary, states get access to higher advance borrowing based on their higher GSDP BE projections. Certain states including West Bengal, Maharashtra, Andhra Pradesh, Chhattisgarh, Uttar Pradesh, Tamil Nadu and Rajasthan have borrowed higher than 3% of their actual GSDP in either or all the years ending FY21. Even if we consider the additional borrowing conditions set by the FC for the years we find that trend is only getting broad-based.

We believe there is a need to devise a better formula for setting state borrowings and delinking it from advance GSDP estimates. In particular, states that are better behaved may be rewarded in terms of an increase in size of the permissible borrowing in the subsequent year where permissible borrowing is scaled up by the lower advance borrowings. This scale up can also come at a rate lower than market rate of interest. A similar scheme could be envisaged for states that are borrowing more, with a scale down in the permissible borrowing or the higher advance borrowings may be resorted to only at a rate that is higher than market rate of interest. Another possible solution could be linking of the state borrowing to its own tax revenue.

Such conditional limit on state borrowings finds echo in 15th Finance Commission recommendations also. It may be noted that in FY22, based on the 15th Finance Commission's recommendation, the Centre had allowed states net market borrowing of up to 4% of GSDP, additional 0.5% of GDP conditional borrowing on fulfilment of power sector reforms. Besides, the total amount of grants given to local bodies has increased. Of the Rs 2.2 lakh crore grants permitted for FY22, only Rs 1.54 lakh crore is unconditional and the remaining Rs 67,105 crore for local bodies is conditional and based on reform of urban local bodies.

Coming to the Centre's revenues, Q1 FY22 tax collection figures are now 36% of the budgeted numbers, showing a higher % than was normally observed even before the pandemic. This provides hope that devolution to states will remain robust. Rs 1.17 lakh crore has already been transferred to states as devolution by the Centre till Q1 FY22. With states already garnering 28% of budgeted GST collections in Apr-Jul'21, it is expected that the extra borrowings of Rs 1.59 lakh crore which Centre has estimated in the 43rd GST Council meeting to compensate the states for GST may be reduced.

STATE BORROWING

- ◆ Market borrowing by states for FY21 shows that Tamil Nadu has the highest share in total market borrowing by states, followed by Uttar Pradesh, Karnataka, Maharashtra, West Bengal and Rajasthan. On the other hand, North Eastern states had a small share in overall market borrowing.
- ◆ The Finance commission had recommended that the state Governments borrow from the market in terms of % of GSDP. However, this results in states often resorting to higher borrowings as initial GSDP numbers are often scaled down. This way states can project higher borrowings, only to scale it down later.
- ◆ If we look at the data for the past 3 years, one can clearly see that many states witnessed decline in actual GSDP when compared to GSDP as given in their Budget Estimates.

Share of states in total state market borrowing			
Tamil Nadu	11.0%	Assam	1.9%
Uttar Pradesh	9.5%	Chhattisgarh	1.6%
Karnataka	8.6%	Jharkhand	1.2%
Maharashtra	8.6%	Himachal Pradesh	0.8%
West Bengal	7.5%	Uttarakhand	0.8%
Rajasthan	7.2%	Goa	0.4%
Andhra Pradesh	6.4%	Odisha	0.4%
Madhya Pradesh	5.7%	Tripura	0.2%
Gujarat	5.6%	Meghalaya	0.2%
Telangana	5.5%	Nagaland	0.2%
Punjab	4.1%	Manipur	0.2%
Haryana	3.8%	Sikkim	0.2%
Kerala	3.6%	Mizoram	0.1%
Bihar	3.4%	Arunachal Pradesh	0.1%

- ◆ In 2019, 11 states of 24 had higher borrowing if we consider 3% of provisional budget estimated GDP compared to 3% of actual GSDP. If we look at the overall borrowing by 24 states, then there is not much difference in the borrowing estimate considering the BE GSDP and the actual GSDP. In fact, the amount is slightly less in case of actual GSDP.
- ◆ Certain states including West Bengal, Andhra Pradesh, Punjab, Rajasthan and Chhattisgarh had higher Budgetary estimates of GSDP compared to actual GSDP owing to which the borrowing estimate initially was much higher than when actual numbers came. Interestingly, if we look at the actual amount of borrowing of 24 states it is lower than the estimated borrowing (both when calculated as % of BE GSDP and actual GSDP).
- ◆ In FY20 as well, similar trend persisted. West Bengal, Uttar Pradesh, Punjab, Andhra Pradesh and Rajasthan among others borrowed much higher than 3% of their actual GSDP in FY20.
- ◆ Coming to FY21, comparing the unconditional borrowing @3.5% of GDP BE and RE, the advance borrowing due to higher GSDP is higher in case of many states, including Haryana, Himachal Pradesh, Chhattisgarh, Telangana, Tamil Nadu, Rajasthan, Andhra Pradesh and West Bengal among others.
- ◆ The actual amount of over borrowing in FY21 would be much higher than that shown by RE as we believe that the actual GSDP of states would be revised downwards. If we estimate the GSDP of states based on their share in total GDP, the over borrowing would amount to at least 50% higher than that is based on GSDP revised estimates. However, FY21 could be still an aberration given the onset of the pandemic.

ADDITIONAL BORROWING CRITERIA BEYOND 3% OF GSDP IN FY19 & FY20 WERE ALSO ALLOWED

- ◆ As per the criteria fixed by the Commission, additional relaxation in borrowing (beyond 3% of GSDP) was given only to those States for market borrowing, compliant to both necessary and sufficient criteria of fiscal prudence.
- ◆ The Necessary Condition (NC) was that the States should have zero revenue deficit in the year for which the borrowing limit has to be fixed and in the immediately preceding year.
- ◆ The Sufficient Conditions (SC) were
 - (i) States’ Debt-GSDP ratio should be less than or equal to 25% in the preceding year and

States	Market Borrowing of States (Rs crore)					
	FY19		FY20		FY21	
	Advance Borrowing due to higher GSDP projection	Extent of Overborrowing (based on actual GSDP)	Advance borrowing due to higher GSDP projection	Extent of Overborrowing (based on actual GSDP)	Advance borrowing due to higher GSDP projection	Extent of Overborrowing (based on RE GSDP)
Andhra Pradesh	1806	4311	4755	13236	2624	15226
Arunachal Pradesh	86	-16	229	524	52	-230
Bihar	562	-1611	1245	7086	1641	4670
Chhattisgarh	1317	3357	2056	1331	418	741
Goa	376	155	294	53	192	488
Gujarat	-1091	-8116	5890	-10585	7912	-13280
Haryana	-1702	-760	3276	1258	6120	3229
Himachal Pradesh	-92	-405	706	1699	896	925
Jharkhand	216	-3407	-3500	-2378	1706	-1734
Karnataka	-2345	-5194	-8259	-2461	75	5874
Kerala	-1400	-4209	21900	-7568	5461	-205
Madhya Pradesh	-43	-3919	-64	-4829	0	12354
Maharashtra	6158	-58115	-21144	-36058	19683	-24157
Manipur	-59	134	1300	853	-66	-17
Mizoram	156	-669	53	105	-309	-164
Nagaland	-44	-30	424	186	98	623
Odisha	-911	-9134	-4893	-8138	3026	-14843
Punjab	-496	6323	13023	10112	1323	11766
Rajasthan	334	5524	-529	9128	6139	23832
Tamil Nadu	-1577	-5781	5600	6811	5259	20018
Telangana	-879	1222	5932	8157	4415	9512
Uttar Pradesh	-3434	-1543	27291	19007	2214	7582
Uttarakhand	106	-803	-1875	-2510	61627	-2305
West Bengal	9038	10131	22220	19377	2118	12272

Source: SBI Research, RBI, State Budgets

(ii) interest payment/revenue receipts (IP/RR) should be less than or equal to 10% in the preceding year.

- ◆ States meeting one or both of the above criteria were allowed a relaxation in their fiscal deficit targets by 0.25% or 0.50% of GSDP provided they meet the Necessary Condition.
- ◆ Additionally, if a State was not able to fully utilise its sanctioned borrowing limit of 3% of GSDP in any particular year during the first four years of award period (2015- 16 to 2018-19), it had the option of availing the unutilised borrowing amount only in the following year.
- ◆ Against this background, 9 out of the 28 States satisfied the Necessary Condition (NC) and at least one of the Sufficient Conditions (SCs) and thus were eligible for additional borrowing in FY19.
- ◆ Out of these 9 States, 3 States (Karnataka, Chhattisgarh and Maharashtra) satisfied both the SC along with NC and eligible for additional borrowing up to 0.5% over and above of fiscal deficit upper limit of 3%.
- ◆ Whereas remaining 6 States (Arunachal Pradesh, Bihar, Gujarat, Jharkhand, Mizoram and Nagaland) satisfied only one SC, becoming eligible to have additional borrowing of 0.25% of GSDP in FY19.
- ◆ However, if we look at the actual borrowing data for FY19 Andhra Pradesh, Punjab, Rajasthan and West Bengal borrowed higher than 3% of GDP even though these states do not fulfill the criteria for extra borrowing as set by the FC.

- ◆ Similar trends exist for FY20 where it is found that States including Andhra Pradesh, Himachal Pradesh, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal have borrowed much more than the stipulated number.

ADDITIONAL CONDITIONAL BORROWING BY STATES ALLOWED IN FY21 AND FY22

- ◆ In FY22, based on the 15th Finance Commission’s recommendation, the Centre has allowed states a net market borrowing of up to 4% of GSDP, additional 0.5% of GDP conditional borrowing on fulfilment of power sector reforms. Given that in FY21 only 13 states have undertaken power sector reforms, if other states follow suit in FY22, the states still can borrow Rs 1.1 lakh crore from RBI.
- ◆ Besides, the total amount of grants given to local bodies has increased. Of the Rs 2.2 lakh crore grants permitted for FY22, only Rs 1.54 lakh crore is unconditional and the remaining Rs 67,105 crore for local bodies is conditional.
- ◆ The FC has clearly recommended certain pre-conditions that must be satisfied by the local bodies to receive grants. Apart from the entry level conditions, there are certain other conditions related to the usage which are prescribed. Certain amount of money has to be spent on water and sanitation.

TAX COLLECTIONS AND REVENUE

- ◆ The Centre has recently told that net tax collections for Q1FY22 stood at Rs 5.58 lakh crore. The Q1 FY22 tax collections are 36% of the budgeted tax collections. This figure used to be around 26%-29% in the previous years.
- ◆ Hence, the fiscal situation as of now looks promising even with the added expenditure that the Government has recently announced. It is only the disinvestment figures which could be undershot.
- ◆ The Centre has budgeted Rs 6.66 lakh crore as the states’ share in the tax collections. With improvement in the direct tax collections it is expected that Centre will be able to provide this amount to the states, thereby helping them manage their finances better. In the last fiscal Centre had budgeted Rs 7.84 lakh crore, while it could only provide Rs 5.5 lakh crore to them.
- ◆ Centre, however, has to release Provisional GST compensation to States/ UTs to the tune of Rs 81,179 crore for Apr’20-Mar’21 and Rs 55345 crore for Apr-May’21.

Additional borrowing criteria by 14th FC								
	NC	SC1	SC2	Additional borrowing above 3% of GSDP	NC	SC1	SC2	Additional borrowing above 3% of GSDP
States	2019				2020			
Arunachal Pradesh	yes		yes	0.25%	yes		yes	0.25%
Assam		yes	yes		yes	yes	yes	0.5%
Bihar	yes			0.25%			yes	
Chhattisgarh	yes	yes	yes	0.5%		yes	yes	
Gujarat	yes	yes		0.25%	yes	yes		0.25%
Jharkhand	yes		yes	0.25%	yes		yes	0.25%
Karnataka	yes	yes	yes	0.5%	yes	yes	yes	
Maharashtra	yes	yes	yes	0.5%		yes		
Manipur	yes				yes		yes	0.25%
Mizoram	yes		yes	0.25%			yes	
Nagaland	yes		yes	0.25%			yes	
Odisha	yes	yes	yes		yes	yes	yes	0.5%
Sikkim		yes			yes	yes	yes	0.5%
Telangana		yes			yes	yes		0.25%
Uttar Pradesh			yes		yes		yes	0.25%

Source: SBI Research

Q1 Tax collections (Rs crore)			
Head	FY 2019-20	FY 2020-21*	FY 2021-22* Q1
Corporation Tax	5,56,876	4,57,050	1,20,992
Personal Income Tax including Wealth Tax	4,81,461	4,71,402	1,20,155
Securities Transaction Tax	12,374	16,927	5,373
Head	FY 2019-20	FY 2020-21*	FY 2021-22* Q1
Net Non- GST			
Customs duty	1,09,283	1,34,825	41,831
Union Excise	2,39,452	3,89,677	1,01,564
ST(arrears)	6,029	1,644	167
Net GST			
CGST	4,94,071	4,56,348	1,17,446
IGST (residual)	9,125	7,209	25,754
Comp. Cess	95,553	85,191	24,636
Total	20,04,224	20,20,273	5,57,918

Source: Lok Sabha Questions

- ◆ This is subsequent to deliberations in the 43rd GST Council meeting, where it was decided that the Centre is borrowing Rs 1.59 lakh crore from the market through special window in current FY and passing it on to the States/ UTs as a back to back loan in appropriate tranches as was done in last year. As per this decision Rs 75,000 crore has been released to States/ UTs on 15.07.2021.
- ◆ The overall GST collections in Apr-Jul’21 is around 66% higher than Apr-Jul’20. Under this, the SGST is around 67% higher than the same period last year. This is despite the devastating second wave India witnessed.
- ◆ Hence, in the coming months GST collections are expected to improve and states would have additional resources at their disposal to meet their finances.

Disclaimer: The Ecowrap is not a priced publication of the Bank. The opinion expressed is of Research Team and not necessarily reflect those of the Bank or its subsidiaries. The contents can be reproduced with proper acknowledgement. The write-up on Economic & Financial Developments is based on information & data procured from various sources and no responsibility is accepted for the accuracy of facts and figures. The Bank or the Research Team assumes no liability if any person or entity relies on views, opinion or facts & figures finding in Ecowrap.

Contact Details:

Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in, gcea.erd@sbi.co.in
Phone:022-22742440
: kantisoumya