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SUPPORTING STATES THROUGH INNOVATIVE FINANCING METHODS: ESTIMATED UNCOVERED LOSS AT ~RS 3.1 LAKH CRORES

The pandemic has created a massive disruption in state finances. The states are likely to witness a decline of Rs 3 lakh crores in Own Tax Revenue. A very basic assumption of loss of an entire month's revenue in components like State VAT, excise, stamps and registration will bring down the revenue for Q1 FY21 at around Rs 53,000 crore. Combining this estimate with the loss in SGST estimate in Q1 shows that major states are going to loss around Rs 1.2 lakh crore in the first quarter itself, translating into an annual Rs 3 lakh crore loss. We estimate an additional Rs 1.5 lakh crore revenue loss from Centre. Taking into account, the additional expenditure of States of Rs 1.7 lakh crores, the total loss thus comes to around Rs 6.2 lakh crores for the major states.

Against this background, the Centre has decided to accede to the request of the States and increase borrowing limits of States giving extra resources of Rs 4.28 lakh crore. Our research suggests that only 8 states are in position to fulfill all the conditions of Government and can avail 2% of GSDP as extra borrowing. Hence out of Rs 4.28 lakh crore we believe that only Rs 3.13 lakh crore (73% of total available) might be actually borrowed by the State Governments in FY21, keeping a uncovered gap of Rs 3.1 lakh crores for states at this point of time.

How this gap of at least Rs 3.1 lakh crores can be bridged? In fact, Central Government has recently released GST Compensation for FY20 at Rs 1.65 lakh crores. To release the GST compensation for FY20, balance of cess amount collected during FY18 and FY19 was also utilized. So, the Centre does not have the cushion of past years' funds, to even compensate for the shortfall in revenue owing to GST.

One way to bride the gap is a direct transfer of the combined full amount of Rs 54,000 crores from State Disaster Response Fund (SDRMF) and National Disaster Response Fund (NDRF). An endeavor should be next made to transfer at least 50% of the remaining Rs 2.5 lakh crores through further hike in WMA limits and supporting additional borrowing of states through Open Market Operations by RBI and relaxing some of the conditional ties associated with borrowing. We must appreciate that the states are the most vulnerable as they have limited source of own tax revenue. The fund transfer to states will support also health, immediate payment to contractors for infrastructure work to reduce the stretched working capital cycle which will also have employment and demand boosting properties.

On a separate note, we also estimated the correlation coefficient between jump in per capita debt (PD) and per capita income (PCI) loss for each of the states by all the three methods, i.e. Pearson's, Spearman's Rank Correlation and Kendall's tau. All the estimated results are significant and linearly correlated: R 0.86, r 0.93 & Tau 0.72. Interestingly, there is no direct causality between both (PD and PCI) the variables, clearly indicating the presence of an independent factor that is pushing up both of these in unison. Our results show, out of 20 states there are 11 states like Telangana, Haryana, Andhra Pradesh and Maharashtra etc, PCI loss is more than the national average level. The jump in PD is at least 0.7 times that of the Centre for states like Maharashtra, Kerala, Haryana, Karnataka, Tamil Nadu and Karnataka. For the record, budgeted nominal GDP is likely to be now even lower than FY19 itself !

We are thus in unprecedented times and we emphasize an immediate fiscal support for states in some form or the other!

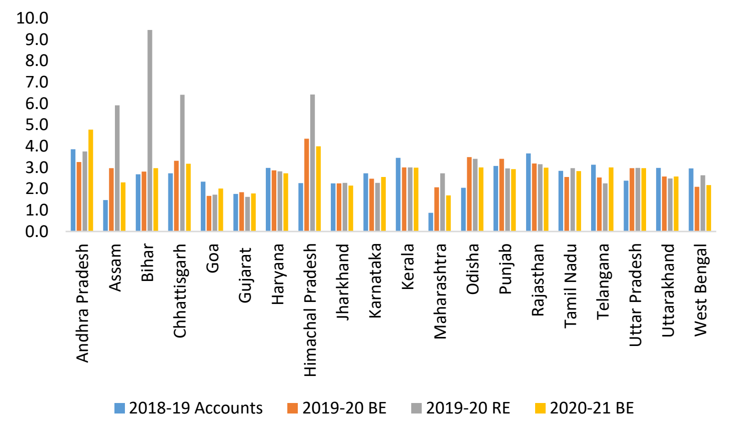
STATE BUDGETS : FUTURE "PERFECT TENSE"

- The state budget documents are generally ambitious in the sense that do not have any worst-case scenario projection. If we look at the 2019-20 Budget estimates of 20 states the average fiscal deficit as % of GSDP was 2.79% and the standard deviation was 0.64. However, the revised estimates revealed the average increased to 3.56% in FY20 RE and the standard deviation increased to 1.97, as some states far exceeded their budget estimates. Only 7 states registered a lower than estimated budget deficit. FY20 RE actuals is now to be significantly revised downwards as lockdown began in March itself and FY21 numbers will also witness gargantuan downward revisions. As per the FY21 BE, out of 20 states only 4 were earlier expected to have their fiscal deficit above 3%, as compared to 8 in FY20 BE. However, it seems likely that all states will now register a fiscal deficit much higher than 3% of GSDP as they grapple with lower GSDP growth and reduced taxes.

TAX REVENUE SITUATION OF STATES EXTREMELY GRIM

- The overall GST collection for the month of April was Rs 32,294 crore which was 28% of the revenue collected during the same month last year and the GST collection for May was Rs 62,009 crore which was 62% of the revenue collected during the same month last year. For June the GST Collection was Rs 90917 crore, which was 91% of the revenue collected during the same month last year. **GST collection for the first quarter of the year is 59% of the revenue collected during the same quarter last year.**
- If we look at the components of month wise GST Collections for Q1 FY21, the SGST for Q1 FY21 was 54% of SGST for Q1 FY20, although on a month to month basis their collection improved rapidly as lockdown measures were eased. The overall IGST Collection (excluding Imports) has also come down to Rs 48,612 crore which is 59% the revenue collected during the same quarter last year. From this 45% has been allocated to states vis-à-vis 54% allocated last year for Q1. **The overall SGST and allocated IGST Revenue for states stands at Rs 64703 crore, which is 47% less than the revenue in Q1 FY20.**

Fiscal deficit as % of GSDP



Source: SBI Research

GST Collection

Component	Apr'20 (Rs cr)	Y-o-Y Growth	May'20 (Rs Cr)	Y-o-Y Growth	Jun'20 (Rs Cr)	Y-o-Y Growth	Q1 FY21 (Rs Cr)	Y-o-Y Growth
CGST	5067	-76%	10330	-42%	18980	3%	34377	-40%
SGST	5951	-79%	12911	-47%	23970	-5%	42833	-46%
IGST	7956	-75%	16062	-36%	24594	-5%	48612	-41%
Cess	632	-92%	5579	-22%	7058	-7%	13270	-42%
IGST Settlement to States/ UTs	1833	-89%	8920	-38%	11117	-18%	21870	-50%
Collection on Imports	12074	-48%	16640	-33%	15709	-29%	44423	-37%
State Revenue (SGST+IGST Settlement)	7784	-83%	21832	-44%	35087	-10%	64703	-47%
Total GST	32294	-72%	62009	-38%	90917	-9%	185220	-41%

Source: SBI Research

TRENDS IN OWN TAX REVENUE FOR SELECT STATES SHOW A SHORTFALL OF RS 3 LAKH CRORE

- **In FY91, the % share of states' own tax revenue in total tax revenue was 68%**. The % share of states' own tax revenue in overall tax revenue collections has remained in the range of 60%-72% from FY91 till FY20. However, from FY16, there is a sharp increase in the share of central government taxes in states' tax revenue. The data for FY20 shows that 62% of tax revenue of all the states combined was expected to come from own tax revenue. In this the share of SGST, State Sales Tax/VAT (on petrol and diesel), state excise and stamps & registration fee was the highest at 43.5%, 19.1%, 12.5% and 10%. The lockdown has pushed down the revenue in all these segments.
- For Q1 FY20, the combined total of SGST and the allocated portion of IGST was 35% of the overall GST Collections, and this was around 20% of the last year's SGST RE for the 20 major states. For Q1 FY21, the combined total of SGST and the allocated portion of IGST is Rs 58,322 crore or 31% of the overall GST Collections, and this is around 9% of SGST BE FY21 for these 20 states. If we assume that states would have garnered 20%, of SGST BE FY21 also, had things been normal, then the revenue total would have been Rs 1,23,951 crore. **Thus, there is a shortfall of Rs 65,629 crore in these two GST Components.**
- A very basic assumption of loss of an entire month's revenue in other components like state vat, excise, stamps and registration will bring down the revenue in these components for Q1 FY21 at around Rs 53,000 crore. **Combining this estimate with the SGST estimate shows that only these 20 states are going to loss around Rs 1.2 lakh crore in the first quarter itself. Overall the losses could go upto Rs 3 lakh crores, purely from loss in Own Tax revenue.**

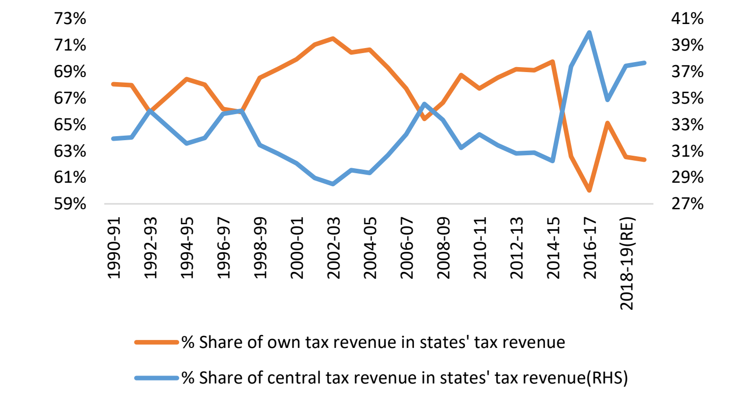
CENTRE SUPPORT CRUCIAL , BUT INNOVATIVE APPROACH REQUIRED

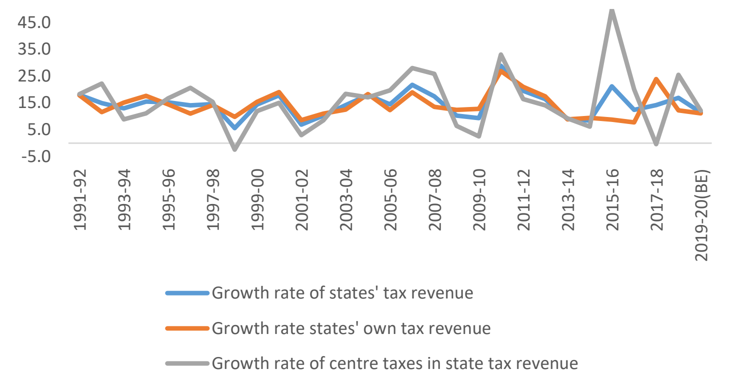
- Central Government has recently released GST Compensation of Rs 13,806 crore to States for Mar'20, thus releasing the entire compensation upto FY20 to States. The total amount of compensation released for FY20 is Rs 1,65,302 crore whereas the amount of cess collected during FY20 was Rs 95,444 crore. To release the compensation for FY20, balance of cess amount collected during FY18 and FY19 was also utilized.
- So, the Centre does not have the cushion of past years' funds, to compensate for the shortfall in revenue owing to GST. Data for the above mentioned 20 states shows that they had budgeted around Rs 1.20 lakh crore as cess. In this some states had not even budgeted for the cess. Given the COVID situation, the magnitude of cess demanded will go up. The collection amount of cess for last year shows that Centre cannot rely of just GST compensation cess to support the states. This year also, the cess collection for Q1 FY21 is Rs 13269.77 crore, showing a de-growth of 42% from Q1 FY20.

THE HEADY COCKTAIL OF JUMP IN PER CAPITA INCOME LOSS AND PER CAPITA DEBT INCREASE FOR STATES

- We estimate that the states to have significant loss in per capita income and jump in per capita debt given the current unprecedented situation. **We estimated the correlation coefficient between jump in per capita debt (PD) and per capita income (PCI) loss, by all the three methods, i.e. Pearson's, Spearman's Rank Correlation and Kendall's tau. All the estimated results are significant and linearly correlated: R 0.86, r 0.93 & Tau 0.72**. Interestingly, there is no direct causality between both (PD and PCI) the variables, clearly indicating the presence of an independent factor that is pushing up both of these in unison. Our results show, out of 20 states there are 11-states like Telangana, Haryana, Andhra Pradesh and Maharashtra etc, (out of 20),PCI loss is more than the national average level. The jump in PD is at least 0.7 times that of the Centre for states like Maharashtra, Kerala, Haryana, Karnataka, Tamil Nadu and Karnataka.

Trends in components of revenue





Source: SBI Research

Arithmetic of State Finances: Own Tax collection(20 states)

Sr No	Particulars	Amount(Rs crore)
1	Q1 FY20 GST Collection	314094
2	Q1 FY20 SGST+Allocated portion of IGST to States(excluding IGST on imports)	110037
3	% Share of Q1 FY20 SGST+Allocated portion of IGST in Q1 FY20 GST Collection	35%
4	SGST Collection(FY20 RE)	537272
5	% Share of Q1 FY20 SGST+Allocated portion of IGST in FY20 RE of States	20%
6	Q1 FY21 GST Collection	185220
7	Q1 FY21 SGST+Allocated portion of IGST to States(excluding IGST on imports)	58322
8	% Share of Q1 FY21 SGST+Allocated portion of IGST in Q1 FY21 GST Collection	31%
9	SGST Collection(FY21 BE)	619755
10	% Share of Q1 FY21 SGST+Allocated portion of IGST in FY21 BE of States	9%
11	Q1 FY21 SGST+Allocated portion of IGST @ 20% share in FY21 BE of states	123951
12	Shortfall in States' Revenue in GST Component	65629
13	Shortfall in States' Revenue in VAT, Excise and Stamp and Duty	53073
14	Total shortfall for Q1	118702
15	Total shortfall for FY21	296756

Source: SBI Research, SGST Revenues of 20 states have been arrived at from the published budget documents

Is Percapita Income Loss leads increase in Percapita Debt?**

Rs	Increase in Percapita Debt	Percapita Income Loss
Kerala	77	158
Punjab	60	120
Himachal	55	112
Haryana	79	186
Uttarakhand	70	114
Andhra Pradesh	53	168
Telangana	73	240
Tamil Nadu	74	162
Karnataka	73	138
West Bengal	47	70
Gujarat	69	159
Rajasthan	40	85
Maharashtra	73	137
Jharkhand	31	45
Chhattisgarh	36	43
Odisha	37	52
Assam	42	35
UP	19	49
Bihar	15	31
All India	100	100

Source: SBI Research **Normalized to 100 scale for Centre

HOW CAN REVENUE SHORTFALL IN STATES BE FINANCED?

- India has declared Covid-19 as a "notified disaster", which would enable it to provide assistance and spend more funds to fight the pandemic, through the National Disaster Response Fund (NDRF) and State Disaster Response Fund (SDRF). NDRF is defined in Section 46 of the Disaster Management Act, 2005 (DM Act) as a fund managed by the Central Government for meeting the expenses for emergency response, relief and rehabilitation due to any threatening disaster situation or disaster. NDRF is constituted to supplement the funds of the State Disaster Response Funds (SDRF) of the states to facilitate immediate relief in case of calamities of a severe nature. **Till 27 May 2020, release from SDRMF was Rs 11,170 crore, out of the budgeted Rs 28,983 crore for FY21. From NDRF Rs 1624.23 crore has been released, out of Rs 25,000 crores.**
- **Increase in Borrowing Limit of States:** In view of the unprecedented situation due to COVID-19, Centre has decided to accede to the request of the States and increase borrowing limits of States from 3% to 5%, for 2020-21 only. This gives States extra resources of Rs 4.28 lakh crore. Our research suggests that out of 20 states only 8 states are in position to fulfill all the conditions of Government and can avail 2% of GSDP as extra borrowing. Hence out of Rs 4.28 lakh crore we believe that only Rs 3.13 lakh crore (73% of total available) might be actually borrowed by the State Governments in FY21.
- Till 18 Aug'20, all states together have borrowed Rs 2.5 lakh crore (Rs 1.6 lakh crore till 20 Aug'19), which is around 30% of the limit authorized and 70% of the authorised borrowing remains unutilized. This sharp rise in borrowings reflects the shock to the revenues of the state governments given the decline of Rs 3 lakh crore estimated for FY21) in the consumption of several non-essential goods and services that is expected to have taken place during the lockdown period. However, looking at historical data it can be said that even though Centre's borrowing is front loaded, the States' borrowing is mostly towards the end of the year.
- With the RBI's liquidity measures, the yields on state development loans (SDLs) have fallen close to 140 basis points since 07 Apr to 18 Aug'20. In April, states were paying as high as 7.7% (Weighted Avg) for SDL, now the same has dropped to 6.3% (weighted average)
- Unless financing is not provided, states will have to drastically cut their capital expenditure. We expect States to at least strip its estimated Budgeted Capital Expenditure for FY21 from Rs 7.5 lakh crores for 20 major states by at least 40 per cent.
- So, there is a need for an unconditional immediate direct transfer of the combined full amount of Rs 54,000 crores from SDRMF and NDRF. An endeavor should be made to transfer at least 50% of the remaining Rs 2.5 lakh crores and through further hike in WMA limits, and supporting additional borrowing of states through Open Market Operations by RBI and relaxing some of the conditional ties associated with borrowing. We must appreciate that the states are the most vulnerable as they have limited source of own tax revenue. States must be supported towards testing and contact tracing, instead of passive responses like re-imposing lockdowns. The fund transfer to states will support also health & other infrastructure work, which will also have employment and demand boosting properties.

Market Borrowings (Rs lakh crore)

Centre	FY16	FY17	FY18	FY19	FY20 (RE)	FY21 (BE)	FY21 (RE)
Gross Borrowing	5.9	5.8	5.9	5.7	7.1	7.8	12.0
Repayments	1.4	1.7	1.4	1.5	2.4	2.4	1.0
Net Borrowing	4.4	4.1	4.5	4.2	4.7	5.4	11.0
State							
Gross Borrowing	2.9	3.8	4.2	4.8	6.3	7.9	9.6
Repayments	0.3	0.4	0.8	1.3	1.5	1.5	1.5
Net Borrowing	2.6	3.4	3.4	3.5	4.9	6.4	8.1

Source: SBI Research (Repayment as on 17.08.2020. State government additional borrowing has been taken as 0.75% of GDP, which has been conditionally hiked to 5% of GDP)

Fiscal Deficit Estimate (Rs lakh crore)

A	States FD (BE)	7.5
B	Revenue Loss for States from Centre	1.5
C	Revenue Loss of States' Own Revenue (SGST+ Allocated IGST + State Vat+ Excise+ Stamps & Registration)	3.0
B+C=D	**Total Revenue slippage**	**4.5**
E	**Extra Spending by States owing to Corona**	**1.7**
D+E=F	**Total Revenue & Expenditure Slippage**	**6.2**
G	Additional Effective Borrowing by States	3.1
H	**Uncovered Loss**	**~ 3.1**

Source: SBI Research

Weighted Average Yield of SDLs (%)

Source: SBI Research

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