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Fiscal Scenario in India

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Abstract

Fiscal Responsibility and Budget Management Act have been framed by the Government to make the Government accountable for ensuring prudence in fiscal management and fiscal stability by progressive elimination of revenue deficit, sustainable debt management consistent with fiscal stability, greater transparency in fiscal operations and conduct of fiscal policy in a medium term frame work. The 14th Finance Commission has recommended a revised fiscal reform path to consolidate the finances of the Governments from the financial year 2015-16 onwards. The recommendations of the Commission are on the following lines: 1. The Fiscal Deficit of all States will be anchored to an annual limit of 3 per cent of GSDP. The States will be eligible for flexibility of 0.25 per cent over and above this for any given year for which the borrowing limits are to be fixed if their debt-GSDP ratio is less than or equal to 25 per cent in the preceding year. 2. States will be further eligible for an additional borrowing limit of 0.25 per cent of GSDP in a given year for which borrowing limits are to be fixed if the interest payments are less than or equal to 10 per cent of the revenue receipts in the preceding year. 3. The two options under these flexibility provision can be availed of by a State either separately, if any of the above criteria is fulfilled, or simultaneously if both the above stated criteria are fulfilled. Thus, a State can have a maximum fiscal deficit-GSDP limit of 3.5 per cent in any given year. 4. The flexibility in availing the additional limit under either of the two options or both will be available to a State only if there is no revenue deficit in the year in which borrowing limits are to be fixed and the immediately preceding year. Fiscal position and fiscal management is discussed in this research paper for major states of India. The consolidated fiscal position of states deteriorated during 2015-16 and 2016-17 to cross the Fiscal Responsibility and Budget Management (FRBM) threshold due to the Ujwal Discom Assurance Yojana (UDAY) scheme. While state finances were budgeted to improve in 2017-18, revised estimates suggest a deterioration of 35 basis points in gross fiscal deficit to gross domestic product (GFD-GDP) ratio, essentially on the revenue account. Outstanding liabilities of states continued their double digit growth with a rising share of market borrowings in 2017-18. For 2018-19, states have budgeted for a revenue surplus and GFD-GDP ratio of 2.6 per cent. Revenue mobilization remains the key towards attaining the budgeted targets.

Keywords: FRBM Act, Fiscal Deficit, Revenue deficit, Sustainable Debt Management
JEL Classification: H2,H23,H25,H51,H53,O1,O23

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1. Introduction

India is a multi-tier federal country with 29 States, 7 Union Territories and about 2.5 lakh local bodies all of which having constitutional status as institutions of self-government. Fiscal Responsibility and Budget Management Act have been framed by the Government to make the Government accountable for ensuring prudence in fiscal management and fiscal stability by progressive elimination of revenue deficit, sustainable debt management consistent with fiscal stability, greater transparency in fiscal operations and conduct of fiscal policy in a medium term frame work. The 14th Finance Commission has recommended a revised fiscal reform path to consolidate the finances of the Governments from the financial year 2015-16 onwards. The recommendations of the Commission are on the following lines: 1. The Fiscal Deficit of all States will be anchored to an annual limit of 3 per cent of GSDP. The States will be eligible for flexibility of 0.25 per cent over and above this for any given year for which the borrowing limits are to be fixed if their debt-GSDP ratio is less than or equal to 25 per cent in the preceding year. 2. States will be further eligible for an additional borrowing limit of 0.25 per cent of GSDP in a given year for which borrowing limits are to be fixed if the interest payments are less than or equal to 10 per cent of the revenue receipts in the preceding year. 3. The two options under these flexibility provision can be availed of by a State either separately, if any of the above criteria is fulfilled, or simultaneously if both the above stated criteria are fulfilled. Thus, a State can have a maximum fiscal deficit-GSDP limit of 3.5 per cent in any given year. 4. The flexibility in availing the additional limit under either of the two options or both will be available to a State only if there is no revenue deficit in the year in which borrowing limits are to be fixed and the immediately preceding year. Fiscal position and fiscal management is discussed in this research paper for major states of India with Various Deficit Indicators in Section 2. Government Reforms and Policy in the connection of FRBM Act is also described in Section 3. The summary and Conclusion is given in the Section 4.

2. Major Fiscal Indicators

In federal finance, Central and State Governments have to maintain fiscal discipline, which will help them in financial stability and economic stability as well as political stability. In this present paper, following major indicators discussed in length to understand state efforts towards financial stability and economic stability they are:

- Revenue Deficit as a percent of GSDP
- Fiscal Deficit as a percent of GSDP
- Primary Deficit as a percent of GSDP

Let’s see above mentioned parameters one by one:

Revenue Deficit as a percent of GSDP: Revenue Deficit means Revenue Expenditure minus Revenue Receipt. As per FRBM Act, state has to generate Revenue Surplus i.e Revenue Deficit must be Zero. In Table, Andhra Pradesh, Haryana, Kerala, Maharashtra, Punjab, Rajasthan, Tamil Nadu and West Bengal, these are the states those are facing the problem of Revenue Deficit and not achieved the target of FRBM act fully.

Table 1 Various Fiscal Indicators

State	RD/GSDP (In%)				GFD/GSDP (In%)				PD/GSDP (In%)			
	2015-16	2016-17	2017-18(RE)	2018-19 (BE)	2015-16	2016-17	2017-18(RE)	2018-19 (BE)	2015-16	2016-17	2017-18(RE)	2018-19 (BE)

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1. Andhra Pradesh	1.2	2.5	0.5	-0.6	3.6	4.4	3.4	2.6	2.0	2.7	1.6	1.0
2. Bihar	-3.3	-2.5	-0.3	-3.9	3.2	3.8	7.2	2.0	1.3	1.9	5.2	1.0
3. Chhattisgarh	-0.9	-1.9	-1.0	-1.2	2.1	1.4	3.0	2.8	1.3	0.5	2.0	1.7
4. Goa	-0.2	-1.1	-0.4	-0.2	2.7	1.5	4.6	4.8	0.8	-0.3	2.9	3.2
5. Gujarat	-0.2	-0.5	-0.5	-0.4	2.2	1.4	1.7	1.7	0.7	-0.1	0.2	0.4
6. Haryana	2.4	2.9	1.4	1.2	6.5	4.8	2.8	2.9	4.8	2.9	0.9	0.8
7. Jharkhand	-1.8	-0.8	-2.8	-2.1	5.0	4.0	2.5	2.5	3.5	2.3	0.9	0.6
8. Karnataka	-0.2	-0.1	0.0	0.0	1.9	2.5	2.8	2.9	0.8	1.5	1.7	1.7
9. Kerala	1.7	2.5	1.9	1.7	3.2	4.3	3.4	3.2	1.2	2.3	1.4	1.2
10. Madhya Pradesh	-1.1	-0.6	-0.1	0.0	2.7	4.3	3.4	3.3	1.1	2.9	1.7	1.7
11. Maharashtra	0.3	0.4	0.6	0.5	1.4	1.7	1.8	1.8	0.1	0.4	0.5	0.6
12. Odisha	-3.1	-2.5	-2.1	-2.2	2.1	2.5	3.5	3.4	1.1	1.4	2.3	2.2
13. Punjab	2.2	1.7	3.1	2.5	4.4	12.3	4.5	3.9	1.9	9.6	1.2	0.7
14. Rajasthan	0.9	2.4	2.4	1.9	9.2	6.1	3.5	3.0	7.5	3.8	1.1	0.7
15. Tamil Nadu	1.0	1.0	1.3	1.1	2.8	4.3	2.8	2.8	1.3	2.7	1.0	1.0
16. Telangana	0.0	-0.2	-0.2	-0.7	3.3	5.5	3.2	3.5	1.9	4.1	1.7	2.1
17. Uttar Pradesh	-1.3	-1.6	-1.4	-1.8	5.2	4.5	3.1	3.5	3.3	2.4	0.8	0.8
18. West Bengal	1.0	1.5	0.9	0.0	2.3	2.4	2.4	1.7	-0.2	0.0	0.2	-0.2

Note:

1. RD = Revenue Deficit; GFD= Gross Fiscal Deficit; PD = Primary Deficit RE= Revenue Estimate;
2. BE = Budget Estimate; GSDP = Gross State Domestic Product
3. (-) means surplus

Source: State Finance, RBI, Various Issues

Fiscal Deficit as a percent of GSDP: Fiscal deficit is the difference between the government's expenditures and its revenues (excluding the money it's borrowed). All 18 states are having Fiscal Deficit; if we consider the target of FRBM Act, it should be less than 3 % of GSDP, Bihar, Goa, Madhya Pradesh, Orissa, Pujab, Telangana, Uttar Pradesh these are the states who have more than 3 % of Fiscal Deficit of GSDP. There must be requirement of fiscal reforms to correct these.
Primary Deficit as a percent of GSDP: Primary Deficit is a differences between Fiscal Deficit and Interest Payment. Most of the states have primary deficit only Gujarat, West Bengal and Goa have surplus in 2016-17,2018-19 (BE).

3. Reforms on Public Finance:

To sum up, states' fiscal position deteriorated during 2015-16 and 2016-17 due to the states taking over of Discom debt under UDAY schemes. Consequently, their consolidated fiscal deficit rose above the FRBM threshold level. As per the revised estimates, GFD-GDP ratio continued to remain above the FRBM threshold during 2017-18 due to shortfall in revenue receipts and higher revenue expenditure from implementation of pay commission recommendations on salaries and pensions. States have budgeted for a revenue surplus in 2018-19 and a lower fiscal deficit. Going forward, fiscal risk may emanate for many states going for election during the year, continuing announcements and rollouts of farm loan waivers as well as the implementation of the pay commission awards by some states. Revenue mobilization remains

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the key towards attaining the budgeted targets. As the GST stabilizes, it should boost states' revenue capacity and support the resumption of fiscal consolidation. The cushion provided by compensation cess by the Centre for any interim shortfall may help smooth state finances from the revenue front. Nevertheless, better fiscal marksmanship and efficiency of expenditures appear essential to providing robustness to state finances if revenue receipts end up again in shortfall relative to budgeted levels. (See, State Finances, Various Issues)

In recent years, signs of pressures on the fiscal position of states have re-emerged. While states budgeted a gross fiscal deficit to gross domestic product (GFD-GDP) ratio of 2.7 per cent in 2017-18, revised estimates reveal GFD-GDP ratio of 3.1 per cent. The deterioration was located in the revenue balance. In contrast, the capital account has helped to contain the GFD. While states taken together have projected a revenue surplus and a lower consolidated GFD of 2.6 per cent of GDP in 2018-19, 11 states have budgeted for fiscal deficits above the threshold of 3 per cent of GDP. With states continuing announcements and rollout of farm loan waivers, the budgeted GFD could be at risk, and the additional borrowing requirement could produce a concomitant impact on the already elevated borrowing yields. Risks are also likely to emanate from possible higher pre-election expenditure in more than 10 states and implementation of the balance pay commission awards, particularly to the extent that they are not fully provided for under the budgeted expenditure. Capital expenditure may have to bear the brunt of the fiscal correction, as it has done over the past two years. With a combined GFD to GDP ratio at about 6.4 per cent vis-àvis the FRBM Committee's medium-term target of 5.0 per cent, private investment risks getting crowded out of the finite pool of financial resources. Moreover, funding these persisting large public sector deficits through enhanced borrowings runs the risk of feeding an unsustainable spiral of higher debt repayments pre-empting productive expenditures and inducing even higher debt levels. A comparison across G20 countries shows that India's general government debt at about 68 per cent of GDP was higher than the EME average in 2016 (IMF, 2017) (See, State Finances, Various Issues)

The fourteenth Finance Commission has enhanced the fiscal flexibility available to states to pursue their own development models by enlarging the unconditional transfers to states by 10 per cent of the divisible pool. As brought out in Reports of preceding years, a binding constraint emanates from the resource crunch due to the creeping encroachment of cesses and surcharges into the divisible pool of gross tax revenue. These revenues have gone up from 9.3 per cent of gross tax revenues in 2014- 15 to around 14.2 per cent in 2018-19 (BE). Accordingly, states' share in centre's gross tax revenue (including cess/surcharges) fell to 34.6 per cent in 2017-18 (RE) from 35.4 per cent in 2016-17. Going forward, these issues on fiscal federalism need to be evaluated in a post-GST framework. In a growing economy like India, which has recently undertaken structural tax reforms like the GST, inherent buoyancy could lead to more revenues for all levels of government from a medium term perspective. It is also crucial that states are able to judiciously allocate freed untied resources to desired sectors for long-term growth with minimal leakages. Revenue mobilization remains one key ingredient to attaining fiscal targets. In 2018-19, states' revenue capacity may be augmented with the stabilization of GST and the consequent expansion of tax base and efficacy. The cushion provided by compensation cess from the centre for any interim shortfall should smooth state finances. With the implementation of the e-way bill for inter-state movement of goods from April 2018, states could also strive for generating more revenues by locking in efficiency in tax administration. Looking ahead, states could benefit from improving their budgetary forecasting techniques and fiscal marksmanship. Getting their bonds rated on the basis of prudent fiscal performance and reliance on credible medium-term forecasts could provide incentives for such changes as better ratings will bring the deserving states the benefit of lower borrowing yields. If financial markets differentiate risks more discerningly across states through yield differentials, improvement of fiscal discipline by states could in fact become an imperative. (See, State Finances, Various Issues)

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4. Summary and Conclusion

In this present paper, we explained State Fiscal Scenario with respect to FRBM Act. Fiscal Responsibility and Budget Management Act have been framed by the Government to make the Government accountable for ensuring prudence in fiscal management and fiscal stability by progressive elimination of revenue deficit, sustainable debt management consistent with fiscal stability, greater transparency in fiscal operations and conduct of fiscal policy in a medium term frame work. Basically three main deficit indicators were discussed as try to see state performance in these regards. Andhra Pradesh, Haryana, Kerala, Maharashtra, Punjab, Rajasthan, Tamil Nadu and West Bengal, these are the states those are facing the problem of Revenue Deficit and not achieved the target of FRBM act fully. Bihar, Goa, Madhya Pradesh, Orissa, Pujab, Telangana, Uttar Pradesh these are the states who have more than 3 % of Fiscal Deficit of GSDP. Most of the states have primary deficit only Gujarat, West Bengal and Goa have surplus in 2016-17,2018-19 (BE). States have budgeted for a revenue surplus in 2018-19 and a lower fiscal deficit. Going forward, fiscal risk may emanate for many states going for election during the year, continuing announcements and implementation of the pay commission awards by some states. Revenue mobilization remains the key towards attaining the budgeted targets. As the GST stabilizes, it should boost states' revenue capacity and support the resumption of fiscal consolidation. The cushion provided by compensation cess by the Centre for any interim shortfall may help smooth state finances from the revenue front. Nevertheless, better fiscal marksmanship and efficiency of expenditures appear essential to providing robustness to state finances if revenue receipts end up again in shortfall relative to budgeted levels. The fourteenth Finance Commission has enhanced the fiscal flexibility available to states to pursue their own development models by enlarging the unconditional transfers to states by 10 per cent of the divisible pool. As brought out in Reports of preceding years, a binding constraint emanates from the resource crunch due to the creeping encroachment of cesses and surcharges into the divisible pool of gross tax revenue.

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