RBI Report on State Finances 2024-25

For Prelims: **Reserve Bank of India**, **Tax buoyancy**, **Gross Domestic Product**, **Pradhan Mantri Ujjwala Yojana**, **Production Linked Incentives**, **Centrally-Sponsored Schemes**, **State Goods and Services Tax**

For Mains: Impact of Subsidies on Fiscal Health of States, Fiscal Discipline for Sustainable Growth, State budgets.

Source: IE

Why in News?

The **Reserve Bank of India's (RBI)** report, ***State Finances – A Study of Budgets of 2024-25,*** highlighted the progress made by state governments in fiscal consolidation, alongside significant challenges such as high debt levels and rising subsidies.

What are the Key Highlights of the Report?

- **States Performance Post-Pandemic:**
  - **Improved Tax Revenue:** The average **tax buoyancy** (responsiveness of tax revenue to changes in the economic growth rate) increased to 1.4 (during 2021-25) from 0.86 (during 2013 to 2020), reflecting **improved efficiency in tax collection.**
    - Higher tax revenues have enabled states to allocate **greater funds for asset creation,** including highways and bridges.
  - **Capital Expenditure:** States have consistently improved the quality of expenditure, with capital expenditure rising from 2.4% of **Gross Domestic Product (GDP)** in 2021-22 to 2.8% in 2023-24, and it is budgeted at 3.1% of GDP in 2024-25.
    - This indicates a sustained focus on improving the quality of expenditure with growth-enhancing investments.
  - **Fiscal Discipline:** States' gross **fiscal deficit** is budgeted at 3.2% of GDP for 2024-25, a marginal increase from 2023-24 (2.9%).
    - States' revenue expenditure is projected to increase to **Rs 47.5 trillion in FY25,** which accounts for **14.6% of GDP** as against Rs 39.9 trillion or 13.5% of GDP FY24.
  - **Dependence on Borrowing:** States' dependence on market borrowings has surged, accounting for 79% of the **gross fiscal deficit (GFD)** in FY25.
    - Gross market borrowings of states and Union Territories increased by 32.8% to Rs 10.07 trillion in FY 2023-24.
  - **Elevated Debt Levels: States' debt-to-GDP ratio** (relative measure of debt compared to economic output) **decreased from 31.0% of GDP in March 2021 to 28.5% in March 2024,** but remained higher than the pre-pandemic level of 25.3% in March 2019.
    - State debt levels exceed the **Fiscal Responsibility and Budget Management committee's recommended debt-to-GDP ratio of 60% by 2023** (with **40% for the Central Government and 20% for State Governments**).

        - States like **Arunachal Pradesh, Himachal Pradesh, Sikkim, and Tripura** have forecast high fiscal deficits, while larger economies like **Gujarat and Maharashtra have lower deficits** as a share of GDP.
        - **Electricity distribution companies (DISCOMs)** continue to **strain State finances,** with accumulated losses reaching Rs 6.5 lakh crore by 2022-23 (2.4% of India's GDP).
- **Concerns Regarding States Budgets:**
    - **Rising Subsidy Burden:** Several states have announced **"farm loan waivers, free/subsidised services** (like electricity to agriculture and households, transport, gas cylinder and cash transfers to farmers, youth and women)".
        - These measures risk **crowding out funds meant for critical social and economic infrastructure.**
        - Subsidy schemes like **income transfers for women** (around Rs 2 lakh crore, ~0.6% of GDP) strain state finances.
    - **Revenue Generation:** Revenue from **non-tax sources** and central grants has contracted in FY25.
        - The pace of growth in **State Goods and Services Tax (SGST),** the primary driver of state tax revenues, has slowed.
    - **Lack of Fiscal Transparency:** Inadequate reporting of **off-budget liabilities** obscures the true fiscal position.

What are the Recommendations by RBI on State Finances?

- **Debt Consolidation:** Establish clear, transparent, and **time-bound glide paths** for debt reduction. Ensure uniform reporting of liabilities to **improve fiscal accountability.**
    - The report calls for "next generation" fiscal rules that offer states flexibility to handle shocks while ensuring medium-term fiscal sustainability.
- **Expenditure Efficiency:** Focus on outcome-based and **climate-sensitive budgeting.**
    - Rationalise **centrally-sponsored schemes (CSS)** effectively to free up resources for state-specific needs and reduce fiscal stress.
- **Subsidy Rationalization:** Contain and optimize subsidies to prevent them from **overshadowing more productive expenditures.**
- **Efficient Market Borrowings:** Reduce **over-reliance on market borrowings** to manage fiscal deficits and minimize financial vulnerabilities.
- **Revenue Generation:** Strengthen collection mechanisms for SGST, **stamp duty,** and other key revenue sources. Increase non-tax revenues and grants to reduce dependency on market borrowings.

Note: A subsidy is a **government benefit provided to individuals, or institutions,** either **directly (cash payments) or indirectly (tax breaks),** aimed at easing burdens and promoting social or economic goals.

What is the Need for Balancing Subsidies and Fiscal Discipline?

- **Importance of Subsidies:**
    - **Human Development:** Welfare programs like subsidies, healthcare, and income transfers support vulnerable populations.
        - For example, **Pradhan Mantri Ujjwala Yojana (PMUY)** provides subsidized **LPG connections** to poor households, reducing health risks from traditional cooking.
            - The **Public Distribution System (PDS)** offers subsidized food grains to low-income families, ensuring food security.
    - **Economic Equality:** Subsidies help **reduce income inequality by redistributing wealth,** which can contribute to more inclusive growth.
        - Subsidies help mitigate the **negative impacts of market forces** on the poor, providing a **safety net during times of economic distress.**
- **Importance of Fiscal Discipline:**

    - **Sustainable Public Finances:** Excessive welfare spending without proper funding can lead to **high deficits and rising public debt,** jeopardizing long-term financial stability.
        - Maintaining fiscal discipline ensures sustainable government spending, prevents excessive deficits.
    - **Investor Confidence:** Maintaining fiscal discipline is key to ensuring that **markets and foreign investors continue to view the country as a reliable economic partner.**
        - The government's focus on fiscal consolidation through schemes like **Goods and Services Tax (GST)** and **Fiscal Responsibility and Budget Management (FRBM) Act, 2013** ensures stable fiscal management.
    - **Economic Growth:** Focusing too much on welfare spending at the cost of productive investments can **hinder economic growth,** reducing the resources available for sustainable development.
- **Balancing Subsidies and Fiscal Discipline:**
    - **Targeted Welfare Programs:** Targeted welfare spending, like **Pradhan Mantri Kisan Samman Nidhi (PM-KISAN)** for farmers and **Direct Benefit Transfer Scheme** for efficient subsidy delivery, ensures resources reach those in need, maximizing impact and minimizing wastage.
        - Streamlining welfare programs through **Digital India** and **Aadhaar-linked benefits** improves subsidy efficiency, reduces leakages, and frees up resources for infrastructure, health, and education investments.
    - **Revenue Growth**: Strengthening the tax base through GST enhances revenue collection. Developing initiatives like **Production Linked Incentives (PLI),** which **can provide long-term income rather than additional subsidies,** creates **fiscal space for both welfare and investment.**
    - **Economic Stability:** Maintaining fiscal discipline helps in controlling **inflation, reducing public debt**, and ensuring economic stability.

Conclusion

Balancing subsidies with fiscal discipline is crucial for sustaining India's growth trajectory. Efficient allocation of resources, along with strategic **reforms in welfare spending and revenue generation,** can pave the way for a **stable and prosperous economy.**

Drishti Mains Question:

Discuss the challenges faced by Indian states in balancing welfare spending and fiscal discipline, and suggest measures to address them.

UPSC Civil Services Examination Previous Year Question

Prelims

Q1. Which one of the following is likely to be the most inflationary in its effect? (2021)

(a) Repayment of public debt
(b) Borrowing from the public to finance a budget deficit
(c) Borrowing from the banks to finance a budget deficit
(d) Creation of new money to finance a budget deficit

Ans: (d)

Q2. Consider the following statements: (2018)

1. The Fiscal Responsibility and Budget Management (FRBM) Review Committee Report has recommended a debt to GDP ratio of 60% for the general (combined) government by 2023, comprising 40% for the Central Government and 20% for the State Governments.
2. The Central Government has domestic liabilities of 21% of GDP as compared to that of 49% of GDP of the State Governments.

3. As per the Constitution of India, it is mandatory for a State to take the Central Government's consent for raising any loan if the former owes any outstanding liabilities to the latter.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (c)

Q3. Which of the following is/are included in the capital budget of the Government of India? (2016)

1. Expenditure on acquisition of assets like roads, buildings, machinery, etc.
2. Loans received from foreign governments
3. Loans and advances granted to the States and Union Territories

Select the correct answer using the code given below:

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (d)

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