RBI’s Report on State Finances

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The **Reserve Bank of India (RBI)** has released a report titled **"State Finances: A Study of Budgets of 2019-20".**

It is an **annual publication** that provides information, analysis and an **assessment of the finances of state governments.**

Key Findings

- **Fiscal Deficit:**
  - **States’ Gross Fiscal Deficit (GFD) has remained within the Fiscal Responsibility and Budget Management Act (FRBM) threshold of 3% of Gross Domestic Product (GDP)** during 2017-18 and 2018-19.
  - For 2019-20, States have budgeted a consolidated GFD of 2.6% of GDP.
- **Concerns:**
  - **Outstanding debt** of States have risen over the last five years to **25% of GDP,** making sustainability of debt the main fiscal challenge.
  - States’ GFD was within the threshold of FRBM Act due to **sharp reduction in capital expenditure** by states.
    - Sharp reduction in capital expenditure by states has potentially adverse **implications for the pace and quality of economic development.** This is because states employ about five times more people and spend around one and a half times more than the Centre.
    - Moreover, public expenditure by states **influences the quality of physical and social capital infrastructure** of the economy.

- **Challenges:**
    - States' revenue prospects are confronted with **low tax buoyancies, shrinking revenue autonomy under the Goods and Services Tax (GST) framework** and unpredictability associated with transfers of the Integrated GST (IGST) and grants.
        - **Unrealistic revenue forecasts** in budget estimates thereby leave no option for states than expenditure compression in even the most productive and employment-generating heads.
    - States may have to take over **higher losses of power distribution companies** if they do not show a turnaround in their performance.
- **Suggestions:**
    - States need to **gradually harness the GST database** to expand the tax base.
    - They also need to **review their tariff policies relating to power** and irrigation, keeping in mind the break-even user charges.
    - States need to combine efforts towards mobilising higher revenues with strategies to maximise efficiency gains rather than mere increase in tax rates.

The Fiscal Responsibility and Budget Management (FRBM) Act

- The Act was enacted in **2003** which **set targets for the government to reduce fiscal deficits.** The targets were put off several times.
- Hence, in May 2016, the government set up a **committee under NK Singh** to review the FRBM Act.
    - The committee recommended that the government should **target a fiscal deficit of 3% of the GDP in the years up to March 31, 2020,** cut it to 2.8% in 2020-21 and to 2.5% by 2023.

Fiscal Deficit

- Fiscal Deficit is the **difference between the total income of the government (total taxes and non-debt capital receipts) and its total expenditure.**
- It is an **indication of the total borrowings needed** by the government.
    - It is to be noted that while calculating the total revenue, borrowings are not included.
- **Gross Fiscal Deficit:** It is the excess of total expenditure over revenue receipts (including external grants) and non-debt capital receipts.
- **Net Fiscal Deficit:** It is the gross fiscal deficit less net lending of the Central government.

Source: IE