RBI’s Annual Report on State Finances

Why in News

Recently, the **Reserve Bank of India (RBI)** released its annual report on state finances.

Key Points

- **Covid-19 Impact:** The double whammy (also termed as **scissor effect**) of the **Covid-19 pandemic** — **a collapse in revenue** and **rise in health-related and other costs** — is likely to have a significant impact on state government finances.
- **Fiscal Deficit:** As most states presented their budgets before the onset of the pandemic, their budget estimates of deficits are **unlikely to capture the true picture of the ongoing fiscal year (2020-21)**.
  - The average value of **gross fiscal deficit to GSDP** (Gross State Domestic Product) for the states which presented their budget before the outbreak of the pandemic is 2.4%, while the average for the remaining states that made post-outbreak budget presentations is 4.6%.
  - This indicates that the **gross fiscal deficit of states is going to double for the 2020-21 period**.
  - **Fiscal Deficit** is the difference between the total income of the government and its total expenditure.

- **Capital Spending:** Capital spending by the states is going to be **lower than budgeted levels** this year. Also, States may treat **capital expenditure as a residual element**.
  - Lower spending is a result of states **not being able to start a lot of projects** due to the lockdown in the first quarter and monsoon in the second quarter.
  - Capital expenditure undertaken by states is generally treated as a residual and is **prone to adjustment, conditional upon revenue generation**.
  - Capital expenditure is the **money spent on the acquisition of assets like land, buildings, machinery, equipment**, as well as **investment in shares**.
    - It accounts for more than 60% of general government (centre + states) capital expenditure.
- **Tax Buoyancy:** The implied tax buoyancy for 2020-21 is higher than budgeted on the basis of 2019-20 revised estimates.
  - Tax buoyancy is the **ratio of change in taxes and GSDP** (Gross State Domestic Product). **Higher tax buoyancy implies that tax collection would rise at a faster pace for the same rise in incomes.**
- **GST Revenue:** States Goods and Service Tax (SGST), the component of the **GST**, which accrues directly to the states, would suffer the biggest hit.
  - SGST collections fell by 47.2% during the April-June 2020-21 quarter.
  - State receipts will also suffer because of a fall in the divisible pool of the Centre's tax revenue.
- **Overall Impact:**
  - **States' indebtedness is set to rise,** and if it is not accompanied by an acceleration in growth, fiscal sustainability will become the casualty, overwhelming the modest gains of the prudence in recent years.
  - Due to a surge in contingent liabilities (guarantees), **state governments may have to put investment projects on hold**.
  - To give a **boost to aggregate demand**, state governments are **reducing various kinds of expenditure**. These include deferment and deduction of salaries and allowances and rationalisation of travel and establishment expenses.

Source: IE