CAG Report on the Fiscal Health of States

Source:IE

Why in News?

The **Comptroller and Auditor General of India (CAG)** released its first decadal analysis on the **fiscal health of 28 Indian states,** showing that their **public debt** (internal borrowings plus loans from the Centre) has tripled in 10 years, reaching **Rs 59.6 lakh crore in FY 2022-23,** raising concerns about fiscal sustainability**.**

What are the Key Findings of the CAG Report on States' Fiscal Health?

- **Debt Growth in a Decade**: States' total public debt increased **3.39 times** from Rs 17.57 lakh crore in 2013-14 to Rs 59.60 lakh crore in 2022-23.
  - Debt as a share of **Gross State Domestic Product (GSDP)** (value of all finished goods and services produced within a state's geographical boundaries) rose from **16.66% to 22.96%**, showing a heavier fiscal burden.
  - States' debt stood at **22.17% of India's country's Gross Domestic Product (GDP)** in 2022-23.
- **State-wise Variations**: Punjab (40.35%), Nagaland (37.15%), and West Bengal (33.70%) had the highest debt ratios, while Odisha (8.45%), Maharashtra (14.64%), and Gujarat (16.37%) had the lowest.
- **Debt vs revenue capacity**: On average, states' debt has been about **150% of their revenue receipts**, peaking at **191% in 2020-21** during Covid-19.
- **Sources of borrowing**: Loans raised from open market through securities, treasury bills, bonds, banks, **Reserve Bank of India (RBI's) Ways and Means Advances**, and institutions like **Life Insurance Corporation of India (LIC)** and **National Bank for Agriculture and Rural Development (NABARD).**
- **Centre's Role**: Loans from the Union government increased due to **GST compensation shortfall** and special assistance for capital expenditure.
- **Golden rule violations**: The **Golden Rule of Fiscal Policy** states governments should borrow only for capital investment, not for current spending.
  - However, at least **11 states** used borrowings to cover day-to-day expenditure rather than capital investment, in Andhra Pradesh and Punjab, less than 25% of borrowings went into capital projects.

What are the Reasons for High State Debt in India?

- **Reduced Fiscal Autonomy Post-GST**: The introduction of **Goods and Services Tax (GST)** in 2017 centralized tax collection, leaving states with fewer avenues to generate revenue independently.
  - Moreover, the **decline in their share of tax revenue** due to new central cesses and surcharges further curtails their fiscal space.
- **Fiscal Imbalance**: States collect less than a third of the total revenues but are responsible for **nearly two-thirds of the public expenditure.**

    - This significant **revenue-expenditure mismatch** forces states to borrow to meet their spending needs.
- **High Reliance on Market Borrowings**: Over time, states have increasingly turned to **market borrowings**, which account for a larger portion of state debt.
    - Market borrowings come at a **higher cost** compared to other debt instruments, leading to an increased financial burden on states.
- **Contingent Liabilities**: State governments often undertake projects that involve **financial guarantees** (e.g., infrastructure projects), creating potential future financial obligations, known as **contingent liabilities**. These liabilities pose risks to fiscal health.
- **Higher Interest Rates**: States face relatively **higher borrowing costs** compared to the central government, which increases the total debt servicing burden.
- **Historical Debt Accumulation**: States with a history of **high debt levels** are forced to borrow more to service existing debt, creating a **debt trap** that's difficult to escape.

What are the Implications of Rising State Public Debt in India?

- **Threat to Fiscal Federalism**: Rising debt limits **fiscal autonomy of States** and increases **central control** over state finances, undermining the federal structure.
- **Fiscal Sustainability Risks**: High debt servicing costs limit funds for developmental spending, potentially leading to a **debt trap** where states borrow more to repay existing debt.
- **Impact on Economic Growth**: States may have reduced capacity for investment in critical sectors like infrastructure, slowing **long-term growth**.
- **Inflation and Interest Rate Risks**: Higher borrowing costs and inflationary pressure can destabilize the economy and increase fiscal stress.
- **Regional Disparities**: States with higher debt-to-GDP ratios may face increased fiscal distress, creating greater **regional inequalities** in fiscal health.
- **Impact on Social Welfare**: States may cut back on welfare programs and public services, negatively affecting vulnerable populations.

How can States Reduce Debt Burden while Maintaining Fiscal Health?

- **Enhancing Revenue Generation: Enhance tax collection efficiency by expanding the tax base, and broadening tax scopes through** economic formalization**.**
    - States can explore innovative revenue sources like mining royalties, tourism, and public asset monetization.
- **Rationalizing Expenditures:** States should **prioritize capital expenditure for long-term investments,** control discretionary spending, and rationalize inefficient welfare programs.
- **Debt Restructuring**: States should refinance high-interest debt, seek lower-cost debt sources (e.g., **National Small Savings Fund (NSSF)**, **Green Bonds** or **Infrastructure Bonds**), and set **debt ceilings** to keep **debt-to-GDP** ratios within limits, as per the **Fiscal Responsibility and Budget Management (FRBM) Act, 2003**.
- **Promoting Investment:** Focus on **Public-Private Partnerships (PPPs)** and **foreign direct investment (FDI)** in key sectors such as infrastructure, technology, and renewable energy.
    - **This can reduce the burden on state finances while leveraging private sector expertise.**
- **Create Contingency Funds:** Set up rainy day funds or contingency funds to cover unforeseen fiscal needs, helping to avoid excessive borrowing during times of economic shocks or natural disasters.
- **Enhancing Central-State Fiscal Cooperation :** Increase states' share of central revenues as per the Finance Commission, and ensure timely GST compensation to reduce short-term borrowing needs.
- **Improving Public Financial Management:** Implement performance-based budgeting with the aid of Fiscal Health Index (FHI) and link expenditure to outcomes, and use technology to streamline procurement and reduce inefficiencies.
- **Social Safety Nets**: Strengthen **social safety nets** that protect the most vulnerable without placing excessive strain on state budgets.

Drishti Mains Question:

Q. In the context of rising state debt in India, discuss the importance of strengthening public financial management.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims:

Q. 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

Mains:

Q. Public expenditure management is a challenge to the Government of India in the context of budget-making during the post-liberalization period. Clarify it. (2019)