GS-II: States at Centre

Context

In recent times, economic discussion in India has focused largely on the stress on central government finances. But state government finances are also facing headwinds.

State of states’ finance:

- States increasingly account for a larger share in general government spending.
- An RBI report on state finances notes that over the past two years, the overall size of state budgets has reduced. This may have “inadvertently deepened” the economic slowdown.
- States have pegged their revenues to grow at a slower pace largely due to lower tax devolution and grants.
- Revenue expenditure tends to be sticky in nature — rising due to higher interest and pension payments.
- States have offset slower revenue growth by curtailing capital spending, which will lower overall public sector capex.
- RBI report also notes that state debt to GDP has surged to 25% of GDP in 2019-20. Bringing it down to 20% as per FRBM review committee will be challenging.

Challenges facing state finances

- The strains on state finances stem from several sources.
- States are increasingly undertaking capital expenditure through state public sector enterprises.
- States extend support to these enterprises through guarantees on their borrowings, “weak cost recovery mechanisms”, as in the case of the power and transport sectors, pose a fiscal risk.
- Under UDAY agreements, states have to take over incremental losses of power discoms.
- Sharp cuts in corporate taxes and sluggish GST collections will also impact tax devolution to states.
- There are concerns over the fiscal costs of Ayushman Bharat.
- Centre has also asked the 15th Finance Commission to look into the possibility of providing funds for defence and internal security. These are likely to come at the expense of states.