I Overview

1.1 In 2017-18, the combined finances of states were budgeted to improve mainly on the back of a rise in tax revenue - due to their own tax efforts as well as through devolution from the centre. This would have resulted in an undershoot of the gross fiscal deficit (GFD) threshold of 3 per cent of gross domestic product (GDP) by 0.3 percentage points. Actual outcomes reflected in the revised estimates place the consolidated GFD at 3.1 per cent of GDP on account of overshooting of revenue expenditure and shortfall of revenue receipts. In the event, the GFD-GDP ratio crossed the threshold for the third consecutive year.

1.2 For 2018-19, the states have budgeted for a consolidated GFD of 2.6 per cent of GDP. This consolidation is aimed to be facilitated by the expansion in revenues as the goods and services tax (GST) stabilises and gains traction. Alongside, it is expected that efforts to reverse the worsening of the revenue expenditure to capital expenditure ratio, targeting of expenditures and enhancing their efficiency will strengthen the ability of states to orient public expenditures towards growth-enhancing investments in education, health, job creation and inclusiveness so that the demographic dividend in India is fully capitalised upon.

1.3 Chapter II undertakes an in-depth analysis of the fiscal position of states in their budgets for 2017-18 and analyses the consolidation budgeted for 2018-19. An examination of the rising profile of market borrowings and the associated redemption pressures is also presented in this chapter. These issues warrant close attention going forward. First, the share of the states in the general government deficit has been rising since 2015-16 with important macroeconomic implications – the general government sector pre-empted 68 per cent of the available pool of financial resources in the form of gross domestic households' financial savings of about 9 per cent of GDP in 2016-17. The consequent crowding out of the private sector has wider ramifications. In particular, external debt sustainability has emerged as a corporate sector risk in view of the recent appreciation of the US dollar and US dollar funding gaps. Second, states' borrowing costs have been rising steadily, with their bond issuances attracting premium on the centre's bond yields. This is translating into debt repayment costs occupying a growing proportion of committed expenditure of states as Chapter III points out.

1.4 While the last year's report had dealt with issues from the revenue side, particularly the GST, Chapter III of this Report also examines the states' expenditure, especially under the committed head and those arising out of additional state-specific schemes like farm loan waivers that will likely generate fiscal pressures going forward. This Chapter throws light on early signs of such fiscal stress evident in high state development loan (SDL) issuances, low secondary market liquidity of SDLs and the behaviour across states of SDL yield spreads over yields on Central Government Securities.

1.5 Chapter IV sets out in conclusion some policy perspectives and balance of risks for debt sustainability, cooperative fiscal federalism and financial markets. Given the funding constraints on states' budgets and rising borrowing costs, improving efficiency of public expenditures holds the key to achieving the Fiscal Responsibility and Budget Management (FRBM) targets. While the GST and the e-way bill implementation could augment the tax base and lock in efficiency in tax administration, re-prioritising expenditures seems essential to avoid further fiscal slippage.

1.6 Data on fiscal indicators for 29 states for 2017-18 and 2018-19, including various budgetary components, are presented in appendices and statements in the Report.