ICRA

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Slow spending of state governments cushions fiscal risk arising from low tax devolution and State GST

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OVERVIEW

The combined revenue expenditure of the 22 state governments[1] expanded by 10.6% during 9M FY2020, outpacing the 6.1% growth displayed by their revenue receipts. At the end of 9M FY2020, the combined revenue deficit of these states stood at Rs. 832 billion, nearly six times as large as the revenue deficit of Rs. 140 billion reported during 9M FY2019. The reduced fiscal space constrained capital spending by these states, which contracted by 0.9% during 9M FY2020 relative to the same period in FY2019. Reflecting these trends, the fiscal deficit of the 22 states widened by a substantial ~30% to Rs. 3,178 billion during 9M FY2020 from Rs. 2,446 billion during 9M FY2019. In line with this, the aggregate gross state development loans (SDLs) issued by these states increased by ~30% to Rs. 3,554 billion during 9M FY2020 from Rs. 2,737 billion during 9M FY2019.

In ICRA's view, the actual revenue receipts of the 22 states would be lower than the level budgeted by them for FY2020, mainly led by a shortfall of Rs. 1,258 billion in central tax devolution (CTD). While the state goods and services tax (SGST) collections are also likely to be lower than the budgeted amount by an estimated Rs. 1,232 billion, the downside in the same would be protected partly by higher grants of Rs. 400 billion-Rs.420 billion for compensation of losses related to GST, based on our estimate. Moreover, some of the other key components of revenue receipts, including the sales tax on petroleum and petroleum products (POL) products and state own non-tax revenues (SONTR) may trail the budgeted level, given the weak growth exhibited by them during 9M FY2020.

The aggregate revenue expenditure of the 22 states would need to increase by a considerable Rs. 10,439 billion in Q4 FY2020 to meet the budgeted level of Rs. 27,482 billion, given that they have spent Rs. 17,043 billion during 9M FY2020. Accordingly, in our view, there is significant headroom for compression of revenue spending in Q4 FY2020. Additionally, the 22 states had spent Rs. 2,201 billion or only 46.3% of their aggregate budgeted capital outlay during the first three quarters of FY2020. The likelihood of spending Rs. 2,558 billion or the balance ~54% of the budgeted capital outlay in Q4 FY2020 by these states appears to be low. Given the slow pace of expenditure revealed by the unaudited data for 9M FY2020, we anticipate that state government expenditure in FY2020 could be considerably lower than the budgeted level.

Overall, while revenue receipts in FY2020 are likely to be considerably lower than what the state governments had budgeted, the slow pace of expenditure in 9M FY2020, suggests that there is considerable headroom for compression in spending in Q4 FY2020, which may help to prevent a sharp fiscal slippage by the state governments.

[1] *These states are Andhra Pradesh (AP), Chhattisgarh, Gujarat, Haryana, Himachal Pradesh (HP), Jharkhand, Karnataka, Kerala, Nagaland, Maharashtra, Madhya Pradesh (MP), Mizoram, Odisha, Punjab, Rajasthan, Sikkim, Tamil Nadu (TN), Tripura, Telangana, Uttar Pradesh (UP), Uttarakhand and West Bengal (WB). The combined revenue receipts and revenue expenditure of these states comprised a sizeable ~88% and ~90% of the revenue receipts and revenue expenditure, respectively, of all the states in the Budget Estimates for FY2020 (source: Reserve Bank of India; RBI).*

Unaudited provisional fiscal data for 9M FY2020 is available for 22 Indian states, from the Comptroller and Auditor General (CAG). This note compares the growth of key fiscal aggregates of this sub-set of 22 state governments in 9M FY2020 relative to the trends in 9M FY2019, as well as with the pace of expansion of such aggregates that was projected in the Budget Estimates for FY2020[2].

Revenue Receipts: In aggregate, the revenue receipts of the 22 state governments rose to Rs. 16,211 billion in 9M FY2020 from Rs. 15,274 billion in 9M FY2019 (refer Exhibit 1). The pace of YoY growth of the same eased to a modest 6.1% during 9M FY2020 from the healthy 14.8% in 9M FY2019 (refer Exhibit 2), and considerably lagged the 20.3% expansion indicated in the Budget Estimates for FY2020 relative to the FY2019 Prov. At the end of 9M FY2020, the revenue receipts of these states stood at 60.0% of the Rs. 27,037 billion that was budgeted for FY2020. This is markedly lower than the trend seen in the previous year, with 68.0% of the full year revenue receipts as per FY2019 Prov. (Rs. 22,468 billion) having been raised by the end of 9M FY2019.

Exhibit 1: Key fiscal aggregates of the 22 states in 9M FY2019 and 9M FY2020

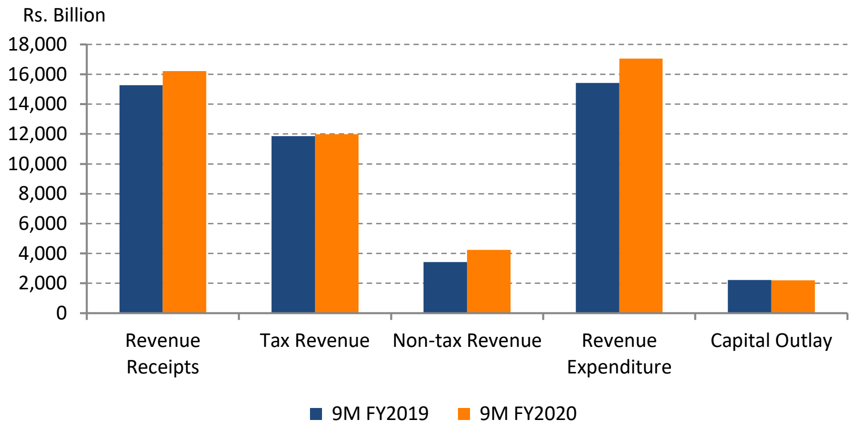
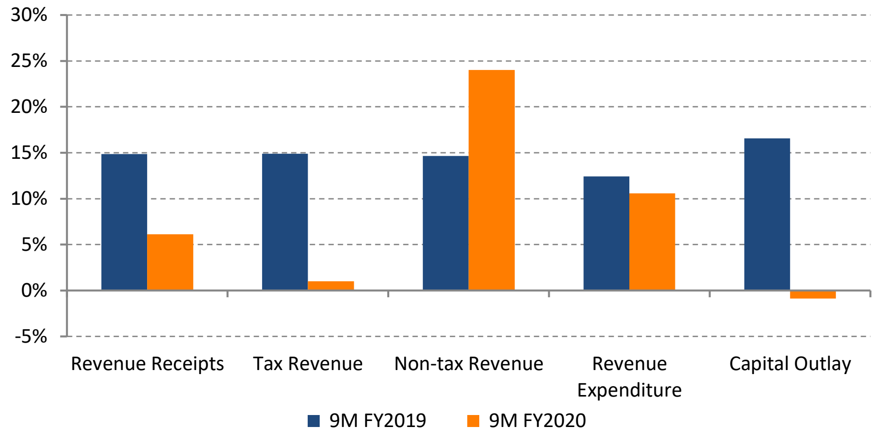


Exhibit 2: Growth of key fiscal aggregates of the 22 states in 9M FY2019 and 9M FY2020



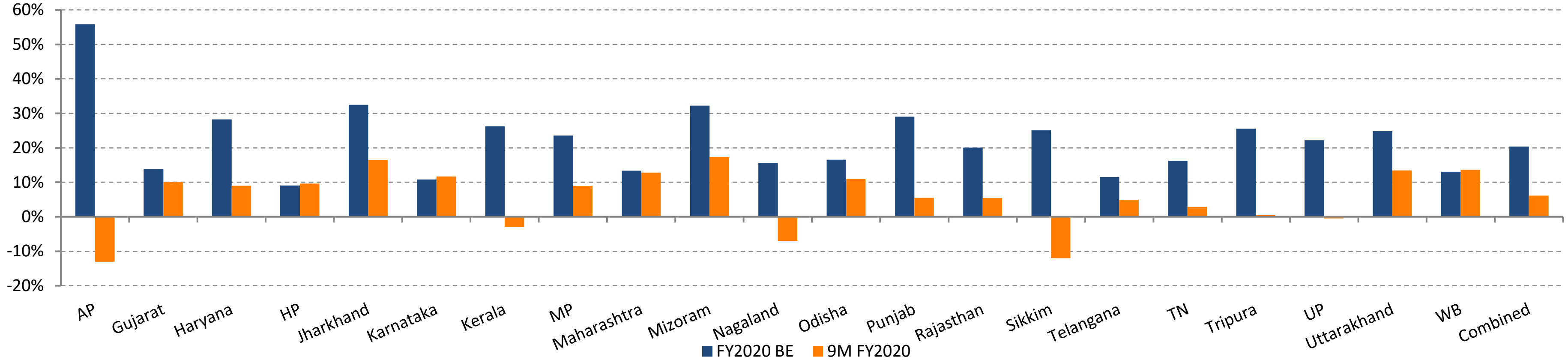
Source: State Government budgets; CAG; ICRA research

Accordingly, we expect that the eventual revenue receipts of the 22 state governments in FY2020 could be considerably lower than the level estimated by them, led by CTD, SGST, sales tax on POL, and SONTR. In a similar trend, the provisional data for FY2019 had revealed that the revenue receipts of the 22 states were a sharp Rs. 1,932 billion lower than the level forecast in the Revised Estimates, driven chiefly by grants from the Centre (Rs. 1,171 billion) and state own tax

[2] *In this note, the YoY growth of the Budget Estimates for FY2020 is calculated relative to the FY2019 Prov.*

revenue (SOTR; Rs. 685 billion). This is similar in magnitude to the shortfall of Rs. 1,672 billion in the Government of India's (GoI's) net revenue receipts in FY2019 actuals (Rs. 13,172 billion) relative to its Revised Estimates (Rs. 14,844 billion).

Exhibit 3: YoY growth in revenue receipts of the 22 states in FY2020 Budget Estimates (over FY2019 Prov.) and 9M FY2020



Source: State Government budgets; CAG; ICRA research

The disaggregated performance of the states in 9M FY2020 reveals a mixed trend. Worryingly, the unaudited data for five out of the 22 states indicates a YoY contraction in revenue receipts during 9M FY2020 (refer Exhibit 3), namely, AP (-13.1%), Sikkim (-12.0%), Nagaland (-7.0%), Kerala (-3.0%) and UP (-0.5%). Moreover, the unaudited data reveals a muted growth in the revenue receipts of Tripura (0.5%), TN (2.9%) and Telangana (4.9%) during 9M FY2020. Out of the remaining states, the revenue receipts of seven states expanded in the range of 5%-10% (Rajasthan, Punjab, MP, HP, Haryana, Gujarat and Chhattisgarh) while those of Odisha, WB, Uttarakhand, Mizoram, Maharashtra, Karnataka and Jharkhand expanded by a healthier 11%-18% in 9M FY2020.

The combined tax revenues[3] of the 22 states were budgeted to account for more than three-fourth of their total revenue receipts in FY2020, and expand by a healthy 15.5% relative to FY2019 Prov. However, the tax revenues have risen by a muted 1.0% during 9M FY2020 to Rs. 11,979 billion, sharply lower than the healthy 14.9% expansion during 9M FY2019. The share of aggregate CTD in the total tax revenues of the 22 states was budgeted at around 35% in FY2020 with

[3] Tax revenues of a state government can be classified as (a) CTD and (b) SOTR, which includes, (a) sales tax/value added tax (VAT) on POL and alcohol, (b) excise duty on alcoholic liquor for human consumption, (c) stamps and registrations duties, (d) electricity duties, (e) motor vehicles tax, (f) other taxes including taxes on professions, trades callings and employment and (g) SGST on all taxable goods and services consumed within the state other than the aforementioned items.

the balance 65% contributed by the SOTR. The subdued 1.0% expansion in the tax revenues reflects the 2.2% contraction in CTD and a modest 2.6% rise in SOTR of the 22 states during 9M FY2020.

The subdued performance of the tax revenues of the state governments was partly offset by a robust improvement in the growth of their non-tax revenues to 24.0% during 9M FY2020 from 14.6% in 9M FY2019. Despite the high growth of non-tax revenues reported during 9M FY2020, it was still lower than the 35.8% growth budgeted by the state governments for FY2020 relative to the FY2019 Prov.

CTD[4]: The Budget Estimates of the GoI's gross tax revenues and CTD forms the basis for the funds devolved each month during April-January of every fiscal year by the GoI as CTD to the states. Subsequently, based on the Revised Estimates of the gross tax revenues included by it in the Union Budget (which is now typically presented on February 1 of the fiscal), the GoI adjusts the CTD that is released to the states for the months of February and March, to align it with the Revised Estimates figure for both its gross tax revenues and CTD. If the actual gross tax collections of the GoI turn out to be different from the Revised Estimates, the adjustment for the same is carried out in the subsequent fiscal year.

For instance, in FY2019, the GoI had transferred Rs. 7,615 billion as CTD to all the state governments based on its FY2019 Revised Estimates of its gross tax collections of Rs. 22,482 billion. However, the Actuals for FY2019 pegged the GoI's gross tax revenues at Rs. 20,805 billion, a considerable Rs. 1,677 billion lower than the FY2019 Revised Estimates. Accordingly, the devolution of taxes to the states in FY2019 was higher than required by Rs. 587 billion (~35% of Rs. 1,677 billion), in line with ICRA's estimate, which is being adjusted in the CTD for FY2020.

As per the provisional data released by the Controller General of Accounts (CGA), the CTD to all states had already contracted by 2.2% to Rs. 4,761 billion in April-December FY2020 from Rs. 4,869 billion in April-December FY2019. The aggregate inter-se share of these 22 states in the CTD for all 29 states, is 82.2% for the Fourteenth FC's award period. Assuming that these states have received 82.2% of the total tax devolution to the states in both 9M FY2019 and 9M FY2020 (refer Exhibit 4), ICRA estimates that the CTD to the 22 states contracted by 2.2% to Rs. 3,912 billion from Rs. 4,000 billion during 9M FY2019.

Moreover, in the Union Budget FY2021 presented on February 1, 2020, the GoI has revised its gross tax revenues sharply downwards to Rs. 21,634 billion in the Revised Estimates for FY2020 from the Rs. 24,612 billion that was included in the Budget Estimates for FY2020. Reflecting this downward revision in gross tax revenues as well as the adjustment for the excess CTD that had been transferred in FY2019, the CTD to all states has been reduced substantially by Rs. 1,531 billion to Rs. 6,560 billion in the FY2020 Revised Estimates from the budgeted level of Rs. 8,091 billion. The Revised Estimates of the CTD for FY2020 is 13.8% lower than the Rs. 7,615 billion devolved in FY2019, indicating a contraction in CTD for the first time in 10 years.

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[4] Based on the recommendations of the successive Finance Commission's (FC's), the GoI transfers a portion of its shareable tax collections, comprising direct taxes (corporate tax and income tax) and indirect taxes (customs duty, excise duty, service tax, CGST and Integrated GST or IGST), as CTD to the state governments. The share of each state government in the CTD is based on the inter-se share of a state as recommended by the FC. The Fourteenth FC recommended that the GoI should transfer 42% of its sharable taxes as CTD to the state governments during its five-year award period of FY2016 to FY2020. Since various surcharges and cesses are not shareable with the states, the portion of the GoI's gross tax collections that was actually devolved to the states stood at 34%-35%.

Exhibit 4: Estimated CTD and SOTR of the 22 states in pre-actuals for 9M FY2020

(Amount in Rs. Billion)	Source	Pre-actuals for 9M FY2019	Pre-actuals for 9M FY2020
Total Tax Revenue of 22 States (A)	CAG	11,861	11,979
Total Central Tax Devolution to 29 States (B)	CGA	4,869	4,761
Total Central Tax Devolution to 22 States (B*82.2%=C)	Estimated by ICRA	4,000	3,912
Estimated SOTR (A-C= D)	Estimated by ICRA	7,861	8,067

Note: Difference, if any, is due to rounding off
Source: CAG; CGA; Union Budgets, ICRA research

Given that Rs. 4,761 billion have been transferred as CTD to all the states during 9M FY2020, a balance of Rs. 1,799 billion would be released during Q4 FY2020, which is sharply lower than the CTD of Rs. 2,746 billion received by the states in Q4 FY2019. ***In ICRA's view, a sharp contraction in CTD in Q4 FY2020 poses a liquidity risk to the states and has emerged as one of the key risks to the achievement of the budgeted level of revenue receipts of the state governments.***

SOTR: Based on the estimated CTD for our sub-set of 22 states, ICRA calculates that the balance (total tax revenues less CTD), i.e. the SOTR, rose to Rs. 8,067 billion during 9M FY2020 from Rs. 7,861 billion in 9M FY2019. On a YoY basis, the SOTR growth slowed sharply to 2.6% during 9M FY2020 from 16.3% during 9M FY2019. Additionally, the estimated SOTR of the 22 states during 9M FY2020 stood at 62.6% of the FY2020 Budget Estimates (Rs. 12,886 billion), considerably lower than the trend during 9M FY2019 (72.3% of FY2019 Prov.).

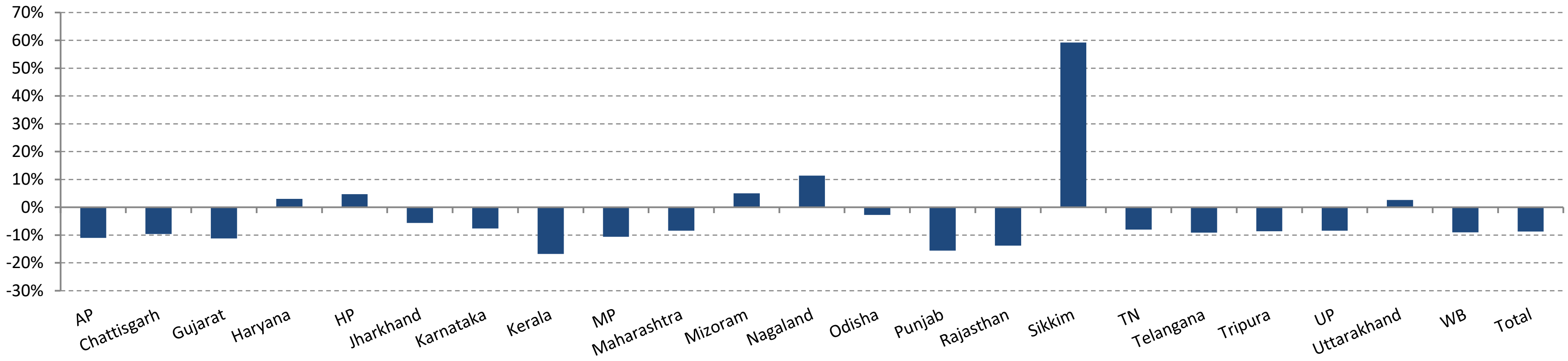
SGST: The SGST collections, which form more than 40% of the SOTR of the 22 states, were expected to expand by 18.9% to Rs. 5,492 billion in FY2020 Budget Estimates relative to FY2019 Prov. However, the actual SGST collections of these states declined by 8.7% to Rs. 3,155 billion during 9M FY2020 (Source: GST Portal) from Rs. 3,456 billion during 9M FY2019 (Source: Lok Sabha).

At the same time, the YoY growth in the headline pan-India GST collections stood at 4.3% during 9M FY2020 (source: various Press Information Bureau press releases). The Central GST (CGST) and the SGST collections rose by a healthy 13.7% and 12.7%, respectively, during this period. However, on account of a 7.5% contraction in Integrated GST (IGST) on imports during 9M FY2020, the total IGST collections recorded a YoY decline of 2.1%. The IGST collections undergo regular settlement to CGST and SGST each month[5]. Moreover, given the large accumulated unsettled balances of IGST, a provisional settlement to CGST and SGST had been undertaken in July 2018, which has contributed to a YoY decline in the inflows to the states in 9M FY2020. Post the regular and provisional settlement of

[5] *The IGST, which is levied and collected by the Central government on inter-state transactions of goods and services, as well as imports into India, is apportioned between the Centre and that state where the goods are supplied, or the services are delivered. This is referred to as the regular settlement of IGST. The IGST apportioned to the Centre is at the rate specified for that good or service in the CGST Act and the balance IGST is apportioned to the state. However, over the course of time, large unsettled balances of IGST had built up, which were not getting apportioned between the Centre and the relevant state. To address this issue, the IGST (Amendment) Bill, 2018 was passed by the Parliament in August 2018, which provided that any unsettled amount of IGST shall be divided equally between the Centre and all the states on ad-hoc basis (with the pattern of the split between the states to be decided by the GST Council). This is referred to as the Provisional settlement of IGST.*

IGST to CGST and SGST, the aggregate estimated[6] SGST collections of all the states (inclusive of the settlement of IGST) contracted by 4.4% in the same period. Only six states, namely, Sikkim (59.2%), Nagaland (11.3%), HP (4.7%), Uttarakhand (2.6%), Haryana (3.0%) and Mizoram (5.0%) reported a YoY growth in SGST collections (inclusive of the settlement of IGST) during 9M FY2020 (refer Exhibit 5). Overall, the actual SGST collections of the 22 states during 9M FY2020 were equivalent to a limited 57.5% of the budgeted amount, whereas these states had received a substantial 74.8% of their FY2019 SGST collections of Rs. 4,620 billion (Source: Lok Sabha), during 9M FY2019.

Exhibit 5: Growth in SGST collections in 9M FY2020



Source: GST Portal; Lok Sabha; ICRA research

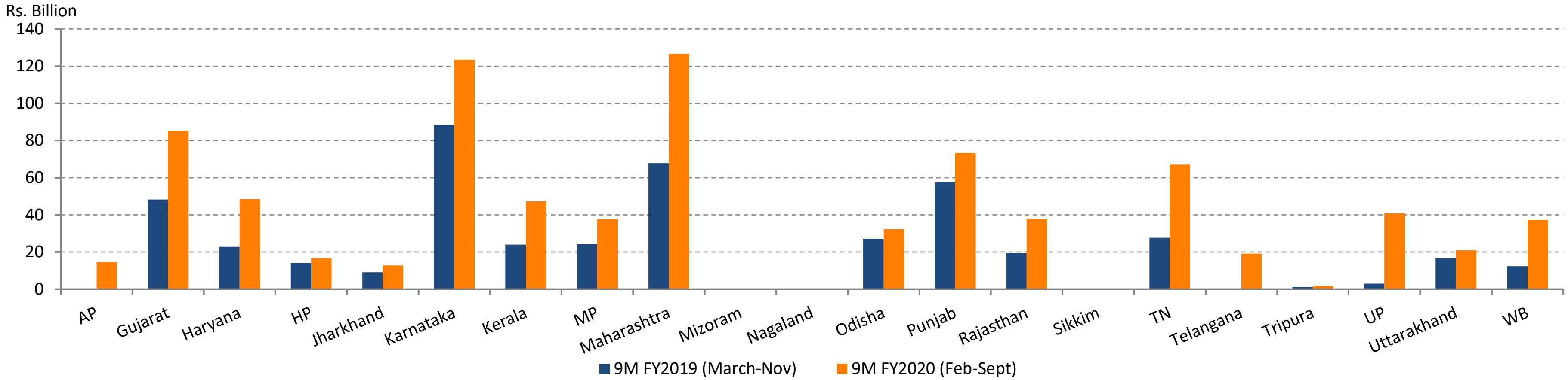
While the pace of the growth of both the headline GST collections and the SGST collections improved in January-February 2020 relative to the trend seen during 9M FY2020, the spread of the Coronavirus is likely to have an adverse impact on imports and therefore on IGST collections, in March 2020. ICRA estimates the SGST collections of all states (after settlement of IGST) to be around Rs. 1,300 billion in Q4 FY2020, of which 85% or Rs. 1,105 billion (in line with the trend recorded in 9M FY2020) would accrue to the states in our sub-set. This implies that the 22 states would collect SGST of Rs. 4,260 billion in FY2020, a substantial Rs. 1,232 billion lower than the amount of Rs. 5,492 billion that they had budgeted. While the downside in the SGST collections[7] would be protected to some extent by grants for compensation of losses related to GST, the timing of release of such grants remains a key concern for the state's cash-flows.

[6] The IGST amount settled into CGST and SGST for July 2018 and July 2019 is not available in the public domain and has been estimated by ICRA.

[7] The GST compensation is the difference between the protected revenues of a state (arrived at by growing the revenues subsumed into GST in FY2016, at an annual rate of 14%) and actual SGST collections.

Sales tax/VAT on petroleum and petroleum products: Such inflows form the second largest component of the SOTR after SGST. The provisional data published by the Petroleum Planning and Analysis Cell (PPAC), indicates a 3.5% contraction in the sales tax/VAT collections on POL products of the 22 states in H1 FY2020 compared to a 9.5% growth in 9M FY2019. This could partly be led by reduction in VAT rates on such products effected by several of the states in the sample in H2 FY2019. Following the trend in global crude oil prices, the domestic retail prices of fuels remained largely range bound in April-December 2019. During October-December 2019, the retail prices of various fuels witnessed a modest increase from the average level that prevailed during H1 FY2020. For instance, the retail prices (average of prices in Delhi, Mumbai, Chennai and Kolkata) of diesel and petrol averaged Rs. 69/litre and Rs. 77/litre, respectively, which were higher by Rs. 1/litre and Rs. 2/litre, respectively, from the average price of these fuels in H1 FY2020. However, the pace of growth of consumption of diesel eased to 0.4% in Q3 FY2020 from 1.1% in H1 FY2020, while that of petrol slowed to 7.1% from 9.1% in the same period. ***The trend in prices of diesel and petrol and growth in consumption during Q3 FY2020 suggests that growth of sales tax/VAT collections on POL products of state governments would have remained muted in that period, weighing upon their overall SOTR growth.***

Exhibit 6: GST compensation received in 9M FY2019 and 9M FY2020 on a cash flow basis



Source: Lok Sabha; ICRA research

During January 1, 2020-February 28,2020, the average retail price of diesel and petrol stood at Rs. 69/litre and Rs. 76/litre, respectively, marginally lower from level on December 31, 2019. Additionally the data on consumption of these fuels in January 2020 reveal that diesel contracted by 1.9% while that of petrol eased to 3.5% from the trend prevailing during 9M FY2020. ***In our view, the actual sales tax collections of the 22 states, the bulk of which would comprise sales-tax on POL products, are likely to record a muted growth in Q4 FY2020, dampening the SOTR collections of these states in the ongoing fiscal.***

Non-Tax Revenues: A substantial 70% of the non-tax revenues of the states is derived from grants from the Centre[8]. The pace of growth of the same to the 22 states increased substantially to 35.3% during 9M FY2020 from 14.0% during 9M FY2019, while significantly lagging the budgeted growth of 45.4% for FY2020 relative to FY2019 Prov. The grants received by these states from the Centre stood at Rs. 3,174 billion during 9M FY2020, equivalent to 62.7% of the FY2020 Budget Estimates of Rs. 5,066 billion, which is lower than the trend seen during 9M FY2019 (67.3% of FY2019 Prov.).

During 9M FY2019, the GoI had released GST compensation of Rs. 481 billion for a period of nine months (March 2018-November 2018) to these 22 states (Rs. 557 billion to all states). The total GST compensation[9] released by the GoI to the 22 states during 9M FY2020 on a cash flow basis stood at Rs. 869 billion (Source: Lok Sabha; ~87% of the total grants of Rs. 999 billion released to all states/UTs during these three quarters), which covered a period of eight months (February 2019 to September 2019). More than 50% of the Rs. 869 billion GST compensation was disbursed to Maharashtra, Karnataka, TN, Punjab and Gujrat (refer Exhibit 6). ***The average monthly GST compensation provided to the 22 states nearly doubled to Rs. 109 billion in the current fiscal from Rs. 53 billion in the previous fiscal, in line with the aforementioned weak performance of SGST inclusive of IGST, driven by states such as AP, Gujarat, Haryana, Karnataka, Kerala, MP, Maharashtra, Punjab, Rajasthan, TN, Telangana, UP and WB.***

Exhibit 7: GST compensation transferred to states in FY2019 and FY2020

Rs. Billion	FY2019	9M FY2019	FY2020 BE	9M FY2020	FY2020 (till February 2020)
GST compensation to all states/UTs	695	557	746	999	1,199
GST compensation to 22 states	597	481	630	869	NA

Source: Lok Sabha; PIB, ICRA research

In FY2019, the GoI had released GST compensation of Rs. 695 billion for 11 months (March 2018-January 2019) to all the state governments, out of which the share of the 22 states in our sub-set was Rs. 597 billion. In February 2020, the GoI has disbursed Rs. 200 billion as GST compensation to all the states for the period of October-November 2019 (in addition to the Rs. 1.0 trillion released to all the states for February 2019-September 2019, during 9M FY2020). However, it is not clear if the amount of Rs. 200 billion is adequate to cover the entire GST compensation required by the state governments for October-November 2019, given the sharp step-down from the amount of GST compensation of Rs. 353 billion released to the states for August-September 2019. Prior to the release of this Rs. 200 billion in February 2020, media reports had suggested that the GoI would be disbursing only one more tranche of the GST compensation to the states in FY2020. ***If no further tranche of GST compensation is released (except the balance portion for October-November 2019, if any) by the GoI till March 2020, it would mean that the states will have received GST compensation for 10 months in FY2020 in contrast to 11 months in the previous fiscal, which may tighten their liquidity situation in Q4 FY2020.***

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[8] *Grants from the Centre to the states include scheme related grants (state plan schemes/Central plan schemes/ centrally sponsored plan schemes), FC recommended grants (grants to local bodies, revenue deficit grants and grants for state disaster response funds) and other transfers including GST compensation.*

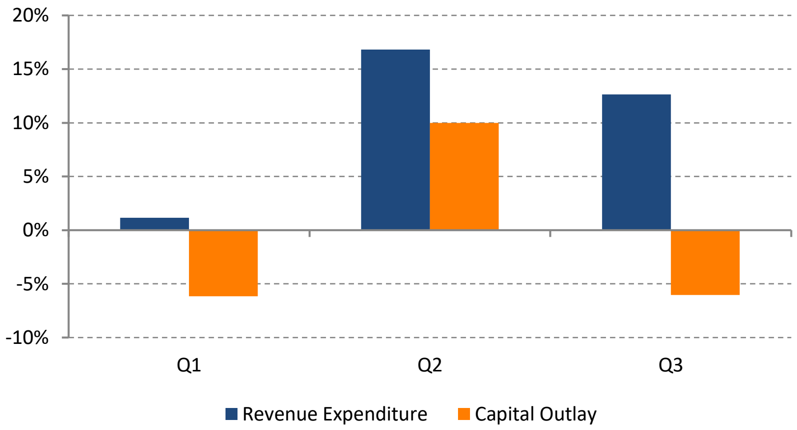
[9] *The GoI provides compensation for losses, if any, on the revenues subsumed into the GST, to the states at a nominal growth rate of 14% (using FY2016 revenues as the base), for the initial period of five years after the introduction of the GST in July 2017. The GoI has been providing the GST compensation to the state governments, typically on a bi-monthly basis, since September 2017.*

Nevertheless, the 22 states in our sub-set are likely to have received roughly Rs. 1 trillion as GST compensation in FY2020 (till February 2020; they had already received Rs. 869 billion in 9M FY2020), sharply higher than the Rs. 481 billion they received in 9M FY2019 as well as the Rs. 630 billion that they had budgeted for FY2020, which would partly offset the risk arising from lower-than-budgeted SGST collections.

SONTR comprised around 30% of the aggregate non-tax revenues of the 22 state governments in FY2020 BE. The growth in this component typically tends to be volatile. In contrast to the 17.6% YoY expansion in SONTR budgeted by these states in FY2020, the combined SONTR contracted by 0.8% during 9M FY2020 (+16.1% during 9M FY2019), the reasons for which are unclear. Moreover, SONTR stood at 48.5% of the FY2020 Budget Estimates (Rs. 2,182 billion) during 9M FY2020 (Rs. 1,059 billion), lower than the trend during 9M FY2019 (57.6% of FY2019 Prov.), which suggests a high likelihood that such revenues will fall short of the level budgeted for FY2020. However, in absolute terms, the shortfall is likely to be relatively modest as compared to the anticipated gaps for CTD and SGST.

Overall, in ICRA's view, the actual revenue receipts of the 22 states would be lower than the level budgeted for FY2020, mainly led by a shortfall of Rs. 1,258 billion in CTD. While the SGST collections are also likely to be lower than the budgeted amount by an estimated Rs. 1,232 billion, the downside in the same would be protected partly by higher grants of around Rs. 400 billion-Rs.420 billion for compensation of losses related to GST. Moreover, some of the other key components of revenue receipts, including the sales tax on POL products and SONTR may trail the budgeted level, given the weak growth exhibited by them during 9M FY2020.

Exhibit 8: Growth of revenue expenditure and capital outlay in Q1, Q2 and Q3 of FY2020 of 22 states



Source: State Government budgets; CAG; ICRA research

Exhibit 9: Expenditure Headroom left for January-March FY2020 for 22 states

Amount in Rs. Billion	Jan-March FY2019	FY2020 BE	Apr-Dec FY2020	Headroom for Jan-Mar FY2020	
	A	B	C	D=B-C	Growth (D/A)
Total Expenditure	**8,920**	**32,241**	**19,244**	**12,997**	**45.7%**
Revenue Expenditure	7,278	27,482	17,043	10,439	43.4%
Capital Outlay	1,642	4,759	2,201	2,558	55.8%

Revenue Expenditure and Capital Outlay: In aggregate, the revenue expenditure of the 22 state governments rose to Rs. 17,043 billion in 9M FY2020 (62.0% of the FY2020 Budget Estimates of Rs. 27,482 billion) from Rs. 15,415 billion in 9M FY2019 (67.9% of FY2019 Prov). The pace of growth of the revenue expenditure of these states eased somewhat to 10.6% during 9M FY2020 from 12.4% during 9M FY2019, and was nearly half of the 21.1% expansion indicated in the Budget Estimates for FY2020 relative to FY2019 Prov.

Amid considerable volatility in the growth trends in the first three quarters of FY2020 (refer Exhibit 8), the capital outlay of the 22 states contracted by 0.9% during 9M FY2020, in contrast to the healthy 16.6% expansion in 9M FY2019 and the 23.2% YoY growth that was indicated in the Budget Estimates for FY2020. The capital outlay of these states stood at Rs. 2,201 billion in 9M FY2020, which was equivalent to 46.3% of FY2020 Budget Estimates of Rs. 4,759 billion; in the previous fiscal, 57.5% of the capital outlay of Rs. 3,863 billion as per the FY2019 Prov., had been spent in 9M FY2019.

ICRA estimates that the revenue expenditure of the states would need to expand by a sharp 43.4% to Rs. 10,439 billion during Q4 FY2020 from Rs. 7,278 billion in Q4 FY2019, to meet the budgeted level of Rs. 27,482 billion (refer Exhibit 9). Moreover, the capital expenditure of the states would need to expand by a substantial 55.8% to Rs. 2,558 billion during Q4 FY2020 from Rs. 1,642 billion in Q4 FY2019, to meet the budgeted target of Rs. 4,759 billion. Given the slow pace of expenditure revealed by the unaudited data for 9M FY2020, we anticipate that state government expenditure in FY2020 could be considerably lower than the budgeted level.

Fiscal Balances: With the growth of revenue expenditure substantially outpacing that of revenue receipts, the revenue deficit of the 22 state governments has widened sharply to Rs. 832 billion in 9M FY2020 (Rs. 445 billion in FY2020 BE) from Rs. 140 billion in 9M FY2019 (Rs. 225 billion in FY2019 Prov). Notwithstanding the mild contraction in capital outlay, the fiscal deficit of the 22 state governments increased to Rs. 3,178 billion during 9M FY2020 (63.6% of FY2020 BE) from Rs. 2,446 billion in 9M FY2019 (72.5% of FY2019 Prov.).

Reflecting the sharp rise in the aggregate fiscal deficit, the gross SDLs raised by these 22 state governments expanded by a considerable ~30% to Rs. 3,554 billion during 9M FY2020 from Rs. 2,737 billion during 9M FY2019. The YoY increase in SDL issuances in 9M FY2020 was fairly broad-based; as many as 15 out of the 22 states in our sub-set issued higher gross SDLs in 9M FY2020 relative to 9M FY2019.

While revenue receipts in FY2020 are likely to be considerably lower than what the state governments had budgeted, the slow pace of expenditure in 9M FY2020 suggests that there is considerable headroom for compression in spending in Q4 FY2020 to deal with this constraint. This may help to prevent a sharp fiscal slippage by the state governments relative to the level that they had budgeted for FY2020.

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ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.