

STATE GOVERNMENT FINANCES

Trailing Central transfers widened state governments' fiscal deficits in April-Oct FY2022 relative to pre-Covid levels

DECEMBER 2021





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Exhibit: Performance of key fiscal indicators during 7M FY2020 and FY2022

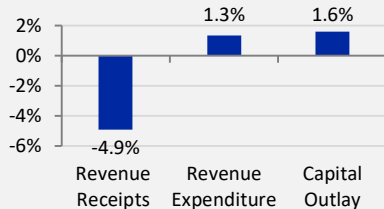
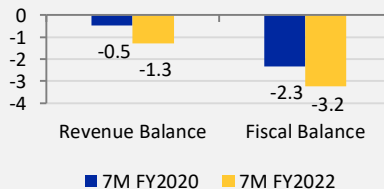


Exhibit: Fiscal balances during 7M FY2020 and FY2022 (Rs. Trillion)



The revenue receipts of 22 state governments whose provisional fiscal data is available, contracted by 4.9% to Rs. 12.3 trillion in 7M FY2022 from Rs. 13.0 trillion in 7M FY2020, following a Rs. 0.9 trillion decline in Central transfers. Their revenue expenditure rose by a muted 1.3% in 7M FY2022 compared to the pre-Covid period, resulting in a widening of the combined revenue deficit to Rs. 1.3 trillion from Rs. 0.5 trillion in the pre-Covid period of 7M FY2020. With a mild rise of 1.6% in capital spending, the states' fiscal deficit stood at Rs. 3.2 trillion in 7M FY2022, exceeding the pre-Covid level of Rs. 2.3 trillion.

- Revenue receipts in 7M FY2022 were 4.9% lower than the pre-Covid levels, led by Central transfers:** The combined Central transfers of the 22 state governments contracted by a sharp 17.6% to Rs. 4.5 trillion in 7M FY2022 from Rs. 5.4 trillion in 7M FY2020, led by both lower devolution of taxes as well as transfer of grants from the Government of India (GoI) to the states. The latter reflects the disbursement of goods and services tax (GST) compensation as grants and back-to-back loans in FY2022 compared to the release of the entire amount as grants in FY2020. However, the combined own tax and non-tax revenues of the 22 state governments increased by 4.2% to Rs. 7.9 trillion in 7M FY2022 from the pre-pandemic level of Rs. 7.5 trillion.
- Step-up in devolution and release of GST compensation cess in November 2021, to have boosted the states' revenue collections:** After releasing the entire Rs. 1.6 trillion back-to-back GST compensation loan to the states till October 2021, the GoI released Rs. 170 billion GST compensation grants to the states in November 2021 from the cess collections. Moreover, following a healthy growth in the GoI's tax revenues, it doubled the devolution to the states to Rs. 951 billion in November 2021 from Rs. 475 billion each in the previous four months. Despite this, tax devolution in April-November FY2022 remained 4.5% lower than the pre-Covid level.
- Mild growth in expenditure amid contraction in Central transfers led to weaker fiscal balances in 7M FY2022 from pre-Covid levels:** The combined revenue and capital expenditure of the 22 state governments rose by a mild 1.3% and 1.6%, respectively, in 7M FY2022 from the pre pandemic level of 7M FY2020, with the absolute rise in total expenditure being limited at Rs. 0.2 trillion. The extent of the widening in the combined revenue deficit of the 22 states (by Rs. 0.8 trillion to Rs. 1.3 trillion in 7M FY2022) and in their fiscal deficit (by Rs. 0.9 trillion to Rs. 3.2 trillion) is broadly in line with the decline in Central transfers during this period.

States' revenue receipts in 7M FY2022 were 4.9% lower than pre-Covid levels

Exhibit: Revenue receipts in 7M during FY2020-22

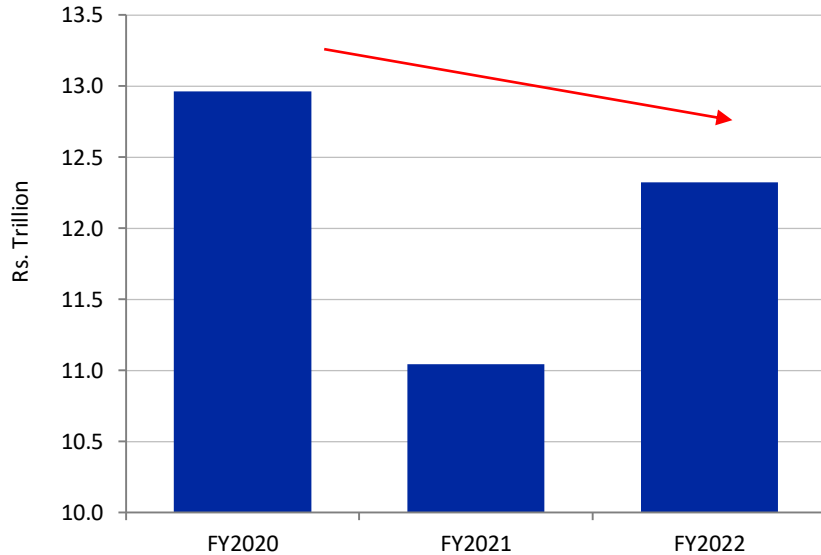
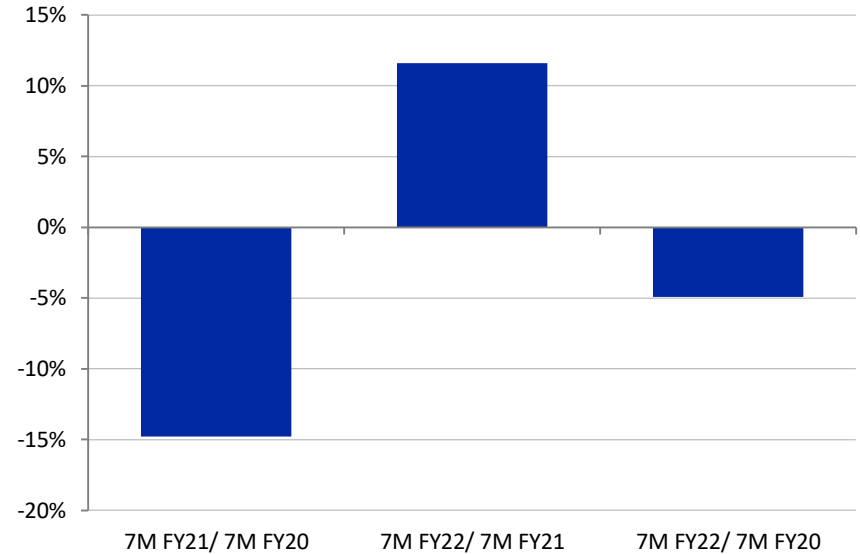


Exhibit: Growth performance of revenue receipts in 7M during FY2021-22



- During April-October FY2022, the combined revenue receipts of the 22 states* stood at Rs. 12.3 trillion, 11.6% higher than the year-ago level, while remaining 4.9% lower than the pre-Covid level collections of Rs. 13.0 trillion in 7M FY2020.

Note: * Unaudited provisional actuals for 7M FY2022 is available for 22 Indian states, except Arunachal Pradesh, Assam, Goa, Manipur, Telangana and West Bengal from the Comptroller and Auditor General (CAG).

Source: CAG; ICRA Research

This was led by trailing Central transfers, whereas own revenues recovered above pre-Covid levels during 7M FY2022

Exhibit: Trends of sub-components of revenue receipts in 7M during FY2020-22

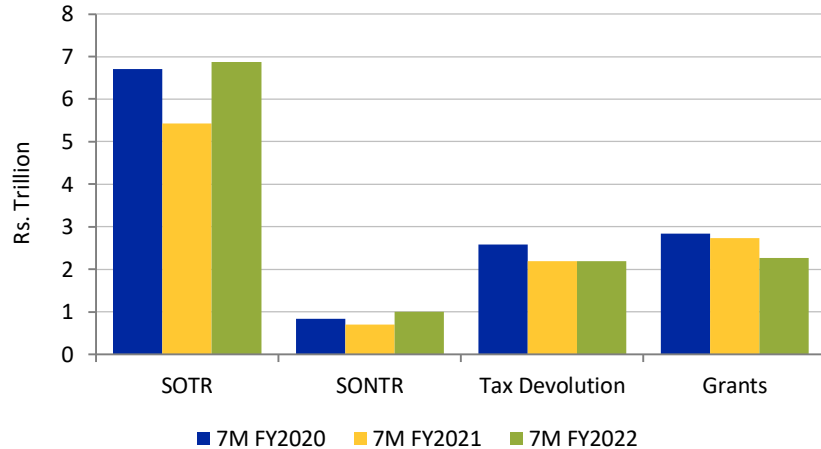
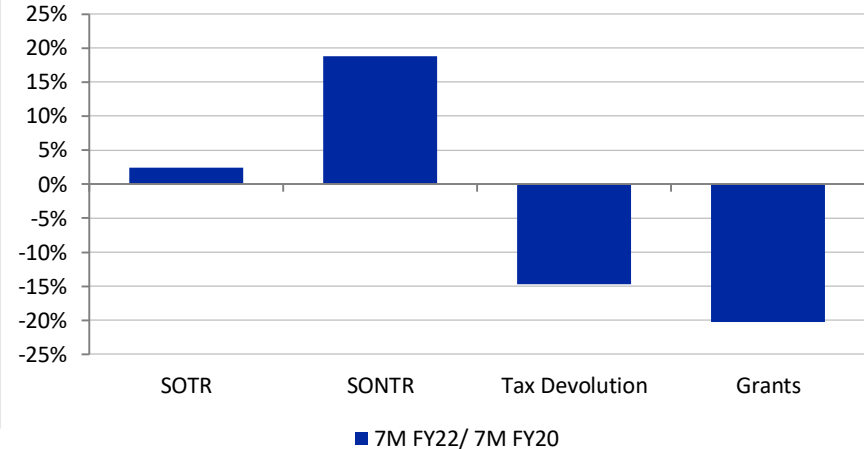


Exhibit: Growth performance of sub-components of revenue receipts in 7M during FY2020 and FY2022



- State own tax revenues (SOTR), comprising nearly half of the total revenues, rose by 2.4% to Rs. 6.9 trillion in 7M FY2022 from the pre-Covid levels of Rs. 6.7 trillion.
- Moreover, state's own non-tax revenues (SONTR), a relatively low contributor to state revenues, expanded by ~19% in 7M FY2022 from the pre-Covid levels.
- In contrast, grants from the Centre contracted by a considerable 20.3% to Rs. 2.3 trillion in 7M FY2022 from Rs. 2.8 trillion 7M FY2020, partly led by lower release of GST compensation through the grants route.
- Moreover, the Gol had devolved Rs. 2.2 trillion to states in 7M FY2022, ~15% lower than the Rs. 2.6 trillion released during 7M FY2020.

40% of decline in grants relative to the pre-Covid level is on account of GST compensation, following the shift to partial funding through back-to-back loans

Exhibit: Grants to 22 states during 7M FY2020-22

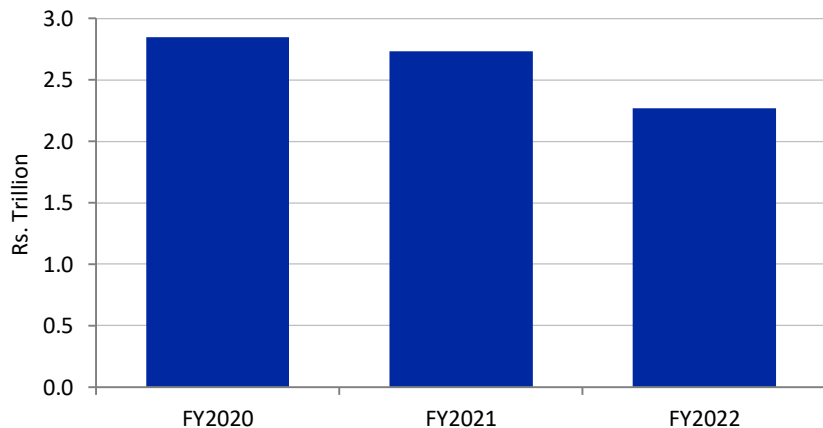
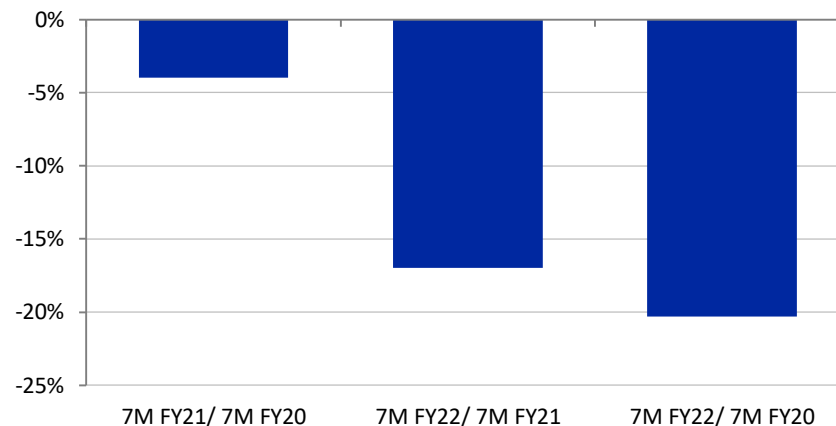


Exhibit: Growth performance of grants to 22 states during 7M FY2021-22



- Grants from the Centre to the states include scheme-related grants, Finance Commission recommended grants and other transfers including GST compensation.
- The 20.3% contraction in grants in 7M FY2022 relative to pre-Covid levels is partly on account of lower GST compensation grants. Till FY2020, the entire GST compensation was financed by the cess collections, which was recorded by the states under grants from the Centre. However, since FY2021, a portion of the GST compensation is being financed through the back-to-back loans from the Gol.
- As per publicly available information, the Gol had transferred Rs. 433 billion GST compensation grants to states during 7M FY2022, lower than the Rs. 640 billion transferred during 7M FY2020. This forms around 40% of the decline in total grants during the same period.
- The entire back-to-back GST compensation loan of Rs. 1.6 trillion was transferred to the states in April-October 2021; this should ideally not have been recorded under grants by any of the states.

GST compensation cess collections likely to meet the level budgeted for FY2022

Exhibit: GST cess collections

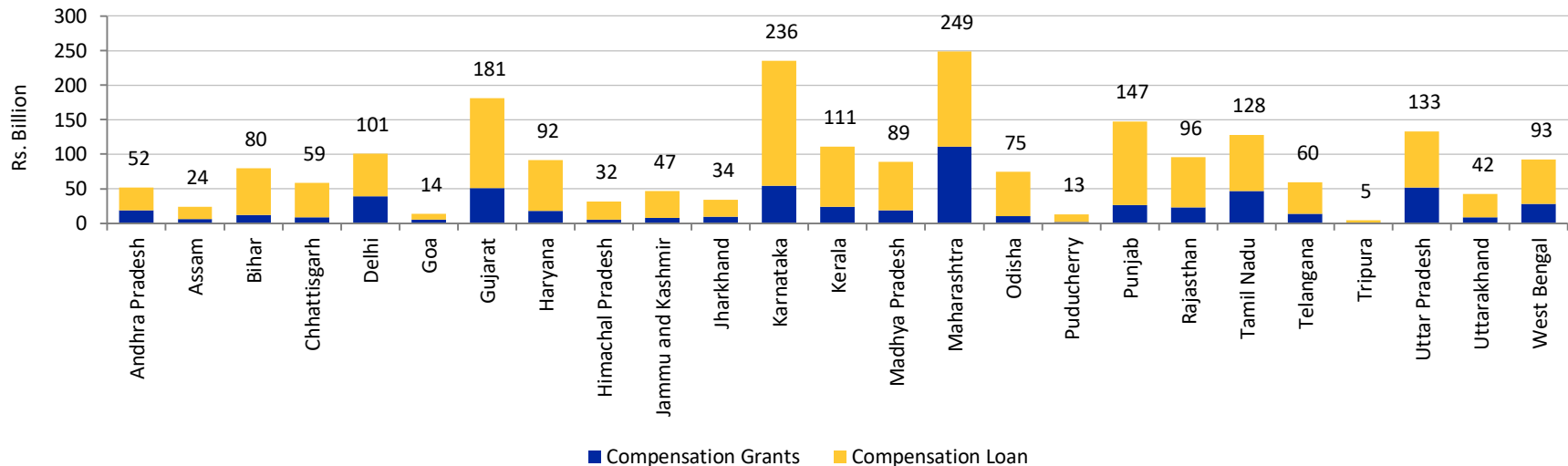
Amount in Rs. Billion	FY2022 BE (A)	8M FY2022 (B)	% of BE (B/A)
GST Compensation Cess	1,000	689	68.9%
GST Compensation grants transferred to states		603	

Source: Union Budget; PIB releases; Rajya Sabha; ICRA Research

- In the Union Budget FY2022, the Gol had included Rs. 1.0 trillion for GST compensation cess collections in FY2022. As per the PIB releases, Rs. 689 billion or ~69% of the budgeted amount had been collected during 8M FY2022.
- Although the supply-side challenges related to semiconductor availability could continue to constrain the performance of GST compensation cess in the remainder of this fiscal, we do not expect the FY2022 BE of Rs. 1.0 trillion to be missed, with 69% of the target achieved in the first eight months.
- During Apr-Oct 2021, the Gol had released Rs. 433 billion to the state governments as grants from the GST cess collections. Subsequently, in November 2021, the Gol transferred a further Rs. 170 billion to the states/UTs as GST compensation grants from the cess collections.

Nearly 80% of the estimated GST compensation requirement for FY2022 has been released till November 2021

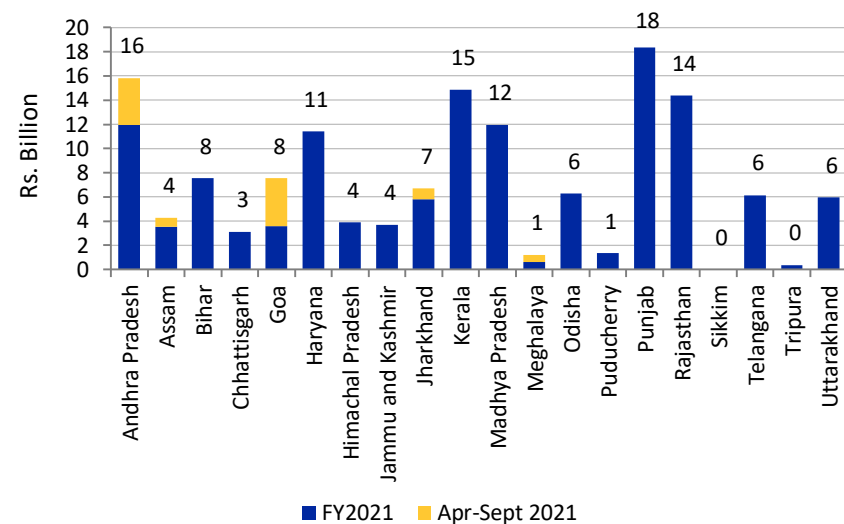
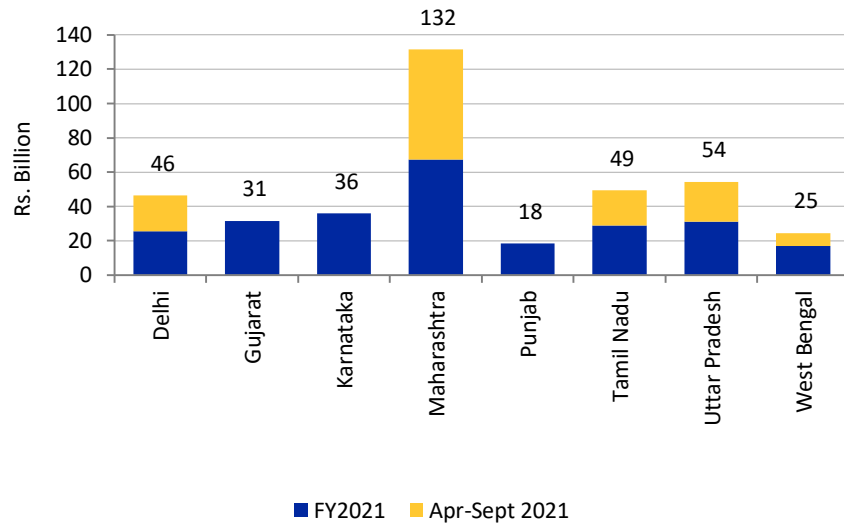
Exhibit: State-wise GST compensation transfers during FY2022 (till November 2021)



- ICRA estimates the total GST compensation requirement for all states for FY2022 at Rs. 2.7 trillion.
- So far, the Gol has released Rs. 603 billion to the state governments from the GST compensation cess collections (till November 2021) and Rs. 1.59 trillion as GST compensation back-to-back loan, aggregating to Rs. 2.2 trillion, equivalent to nearly 80% of the estimated requirement for this fiscal.
- Nearly half of the Rs. 2.2 trillion has been transferred to six states, namely, Maharashtra (Rs. 249 billion), Karnataka (Rs. 236 billion), Gujarat (Rs. 181 billion), Punjab (Rs. 147 billion), Uttar Pradesh (UP; Rs. 133 billion) and Tamil Nadu (TN; Rs. 128 billion).

Pending GST compensation for FY2021 and H1 FY2022 is pegged by the Gol at Rs. 372 billion and Rs. 147 billion, respectively

Exhibit: Status of state-wise GST compensation pending for FY2021 and FY2022* as on November 24, 2021



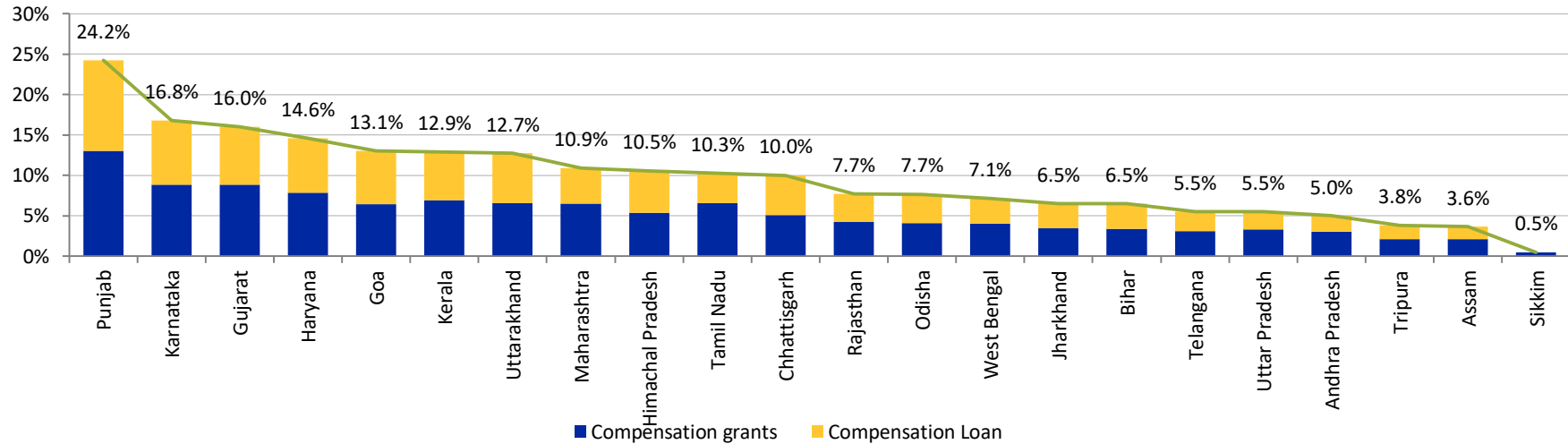
- Against the GST compensation requirement of Rs. 2.8 trillion in FY2021, the Gol had transferred Rs. 2.5 trillion (Rs. 1.4 trillion cess plus Rs. 1.1 trillion back-to-back loan) leading to a pending amount of Rs. 372 billion, which is spread across 27 states/UTs, while being dominated by Maharashtra, Karnataka, Gujarat, UP and TN.
- The Gol has placed the pending GST compensation for H1 FY2022 at Rs. 147 billion; while this is spread across 10 states/UT, the pending amount is concentrated amongst Maharashtra, UP, Delhi and TN.
- The resources available from the budgeted cess collections (Rs. 1.0 trillion) and GST back-to-back loan (Rs. 1.59 trillion) is around Rs. 109 billion lower than our estimate of the GST compensation requirement of Rs. 2.7 trillion for FY2022, suggesting that it may be carried forward to next year.

Note: * As per Rajya Sabha starred question, the GST compensation pending to states for FY2022 is due for the period Apr-Sept 2021, status as on November 24, 2021. Amounts mentioned in labels correspond to the sum for FY2021 and H1 FY2022.

Source: Rajya Sabha; ICRA Research

Looming cessation of GST compensation to states after June 2022, to structurally alter the fiscal profile of those states with higher dependence on such flows

Exhibit: State-wise GST compensation grants and back-to-back loan* as a proportion of revenue receipts in FY2021



- GST compensation is currently intended to be provided to the states only till June 30, 2022. If the GST compensation is not continued beyond June 2022, it will pose a structural challenge to the states, which have a relatively higher dependence on the GST compensation.
- We expect that the pending GST compensation for FY2021 and FY2022 to be released by the GoI to the states in FY2023, in addition to the compensation for Feb-March FY2022 and Q1 FY2023; the latter is the final quarter for which compensation is meant to be released as per the original transition plan.
- **Such transfers may aggregate to around Rs. 1.2-1.5 trillion, which would boost the cash flows of the states in FY2023, providing them a somewhat softer landing after the compensation period ends.**

Despite rise in tax devolution in Nov 2021, aggregate amount for 8M FY2022 remains 4.5% lower than the pre-Covid level

Exhibit: Monthly tax devolution in FY2021 and projected monthly tax devolution in FY2022

Amount in Rs. Billion	April	May	June	July	August	September	October	November	December	January	Feb	March	Total
FY2021	460	460	420	420	420	420	372	372	372	372	353	1,508	5,950
FY2022 (Scenario 1)	392	392	392	475	475	475	475	951	475	475	475	1,804	7,256
FY2022 (Scenario 2)	392	392	392	475	475	475	475	951	951	475	475	1,328	7,256

Source: Controller General of Accounts (CGA); Union Budget; ICRA Research

- Gross tax revenues (GTR) expanded by 55.8% to Rs. 13.6 trillion during 7M FY2022 and reached 61.5% of the FY2022 BE. Based on the healthy growth in Gol's GTR, ICRA expects tax devolution to all states to increase to Rs. 7.3 trillion in FY2022.
- Based on the projected tax devolution for FY2022, we had earlier highlighted that the retention of the monthly amount of tax devolution at Rs. 475 billion in October-February FY2022, would have back-ended the release of Rs. 2.3 trillion to March 2022.
- The Gol transferred twice as much tax devolution to the states in November 2021 (Rs. 951 billion), compared to the Rs. 475 billion released in the previous four months. The YoY growth of the tax devolution improved to 20.4% during 8M FY2022 from a muted 3.5% during 7M FY2022. However, tax devolution during 8M FY2022 remained 4.5% lower than the pre-Covid level of 8M FY2020.
- If the monthly amount reverts to Rs. 475 billion in December 2021-February 2022, it would entail a release of Rs. 1.8 trillion in March 2022, based on our estimate, which is 19.6% higher than the level in March 2021.
- If the Gol releases Rs. 951 billion in December 2021 as well, before reverting back to Rs. 475 billion each in the next two months, the amount remaining to be released in March 2022 would be Rs. 1.3 trillion, 11.9% lower than March 2021. **Stepping up the release amount in December 2021 would allow capital expenditure to be expedited, which will be growth supportive in our view.**

Revenue expenditure in 7M FY2022 was 1.3% higher than the pre-Covid level

Exhibit: Revenue expenditure during 7M FY2020-22

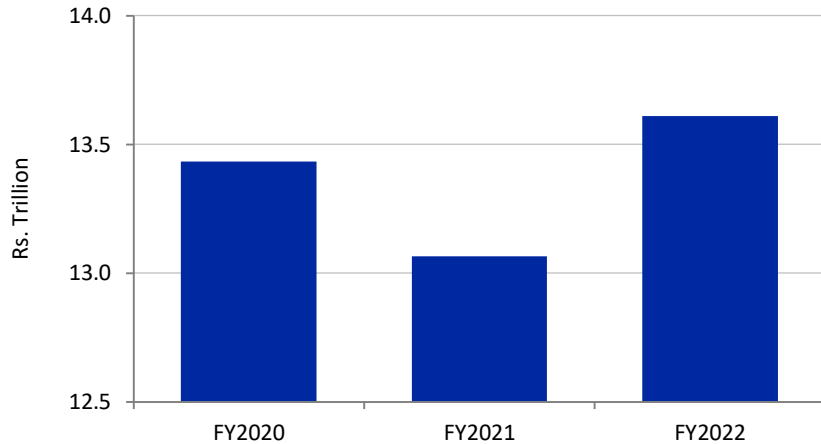
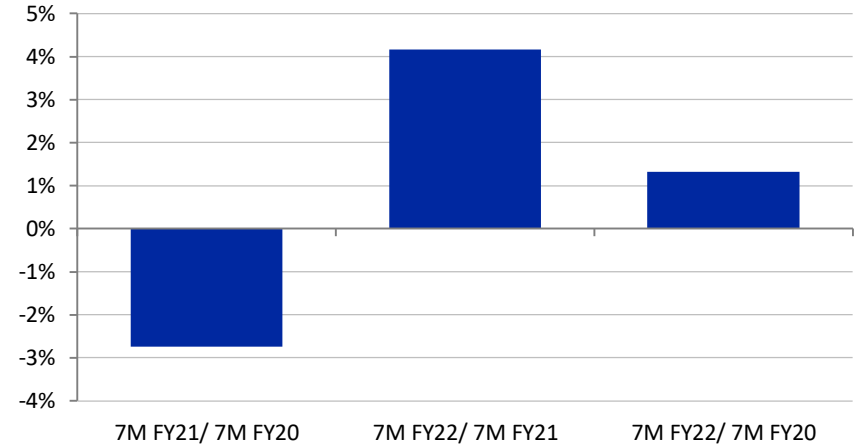


Exhibit: Growth performance of revenue expenditure in 7M during FY2021-22



- Revenue expenditure had contracted by a mild 2.7% in 7M FY2021 (Rs. 13.1 trillion), possibly reflecting the freeze in salaries and pensions announced by some state governments and stringent lockdown in Q1 FY2021
- The revenue spending of the 22 states rose by 1.3% to Rs. 13.6 trillion in 7M FY2022, relative to the pre-Covid level of Rs. 13.4 trillion in 7M FY2020. Higher social sector spending in Q1 FY2022, amid the second wave of Covid-19, is likely to have been partly offset by lower expenditure towards centrally-sponsored schemes. This could be another reason for the decline in grants from the Centre in 7M FY2022 relative to the pre-Covid level.

Capital spending in 7M FY2022 exceeded pre-Covid levels by subdued 1.6%

Exhibit: Capital outlay during 7M FY2020-22

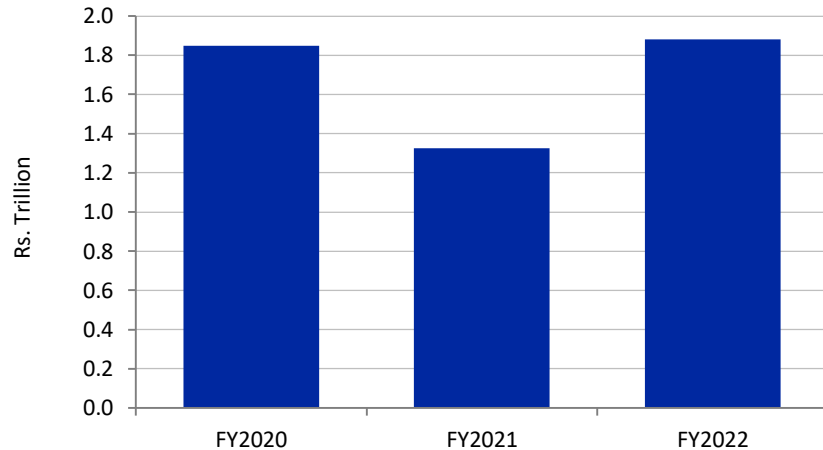
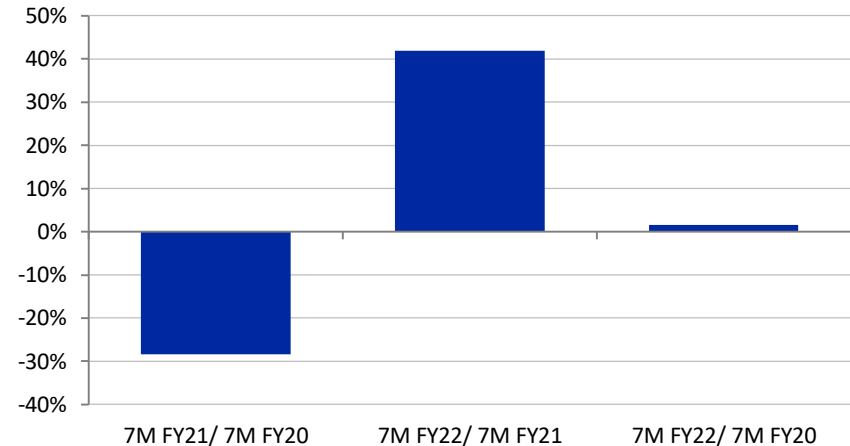


Exhibit: Growth performance of capital outlay in 7M during FY2021-22



- On account of the adverse impact of the nationwide lockdown on revenue collections as well as the ongoing restrictions in Q1 FY2021, capital spending by the 22 state governments had contracted by a sharp 28.4% to Rs. 1.3 trillion in 7M FY2021 from Rs. 1.8 trillion in 7M FY2020.
- However, given the relatively healthy revenue position as well as permission to continue construction activities with some restrictions, the capital spending by the 22 state governments expanded by ~42% to Rs. 1.9 trillion in 7M FY2022 on a YoY basis and exceeded the pre-pandemic level by 1.6%.

Fiscal balances remained weaker than the pre-Covid level during 7M FY2022

Exhibit: Revenue balance during 7M FY2020-22

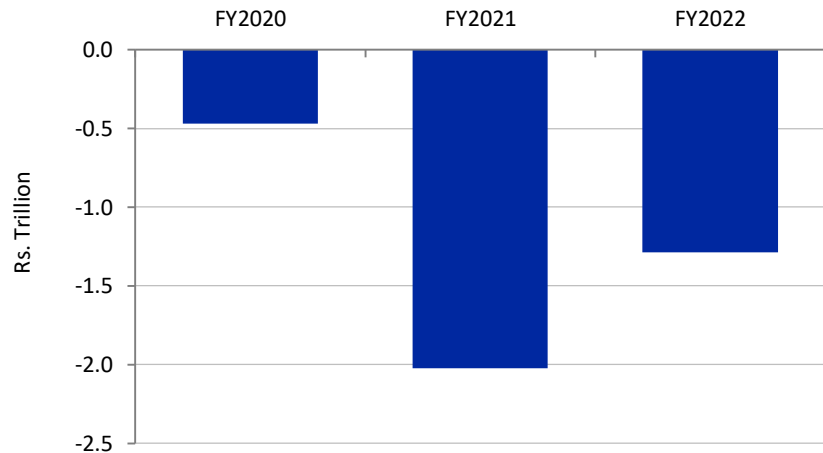
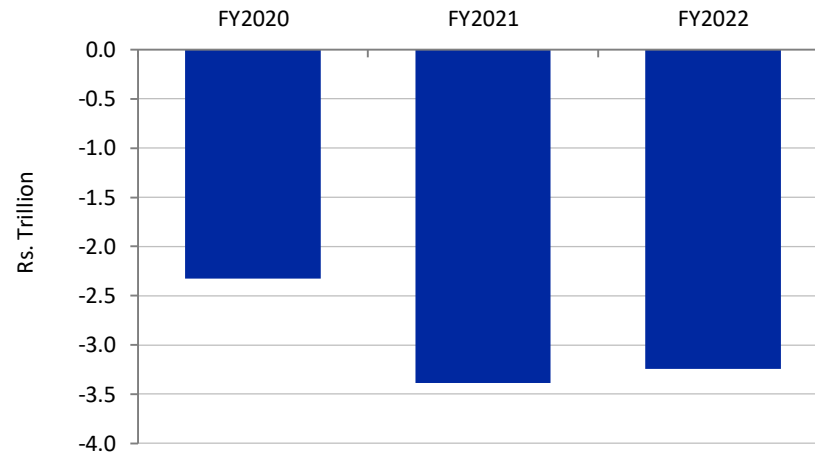


Exhibit: Fiscal balance during 7M FY2020-22



- With a relatively sharper pick-up in revenue receipts compared to revenue expenditure, the revenue deficit of the 22 states narrowed appreciably to Rs. 1.3 trillion in 7M FY2022 from Rs. 2.0 trillion in 7M FY2021. On account of the sharp YoY pick-up in capital spending, the fiscal deficit of the 22 states narrowed only mildly to Rs. 3.2 trillion in 7M FY2022 from Rs. 3.4 trillion in 7M FY2021.
- Nevertheless, the decline in Central transfers by Rs. 0.9 trillion appears to be the dominant factor leading to the widening of the revenue deficit and fiscal deficit to Rs. 1.3 trillion and Rs. 3.2 trillion, respectively, in 7M FY2022, relative to the pre-Covid levels of Rs. 0.5 trillion and Rs. 2.3 trillion, respectively.



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