



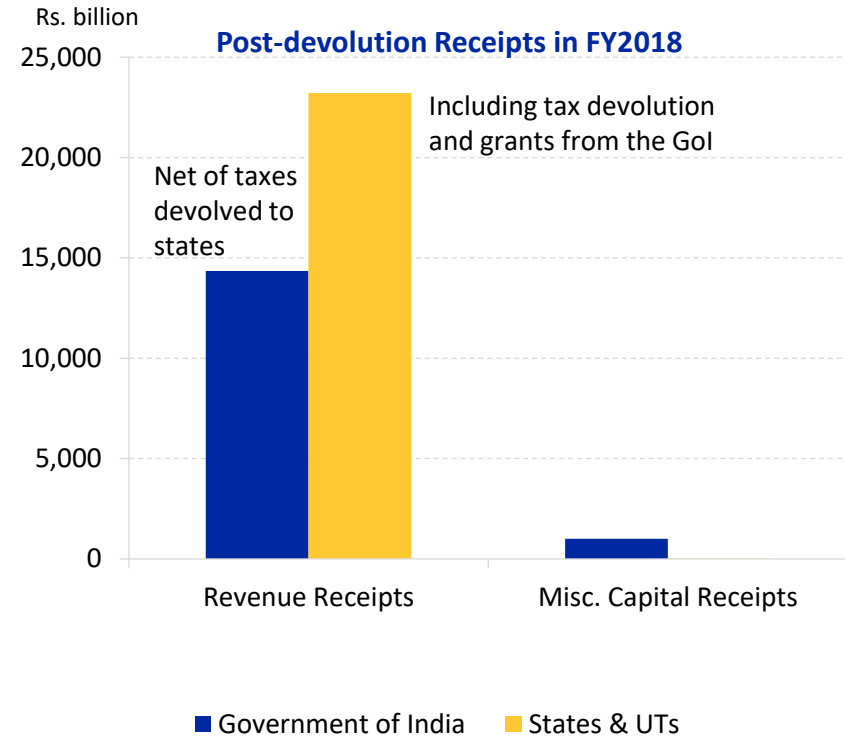
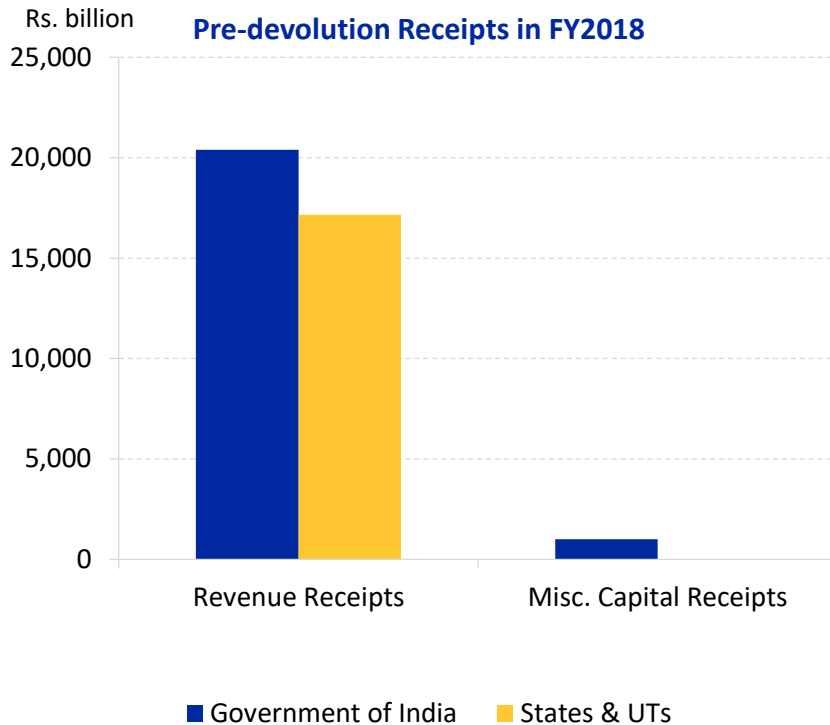
Key Takeaways for State Governments from Union Budget FY2021 and 15th FC's recommendations

February 2020

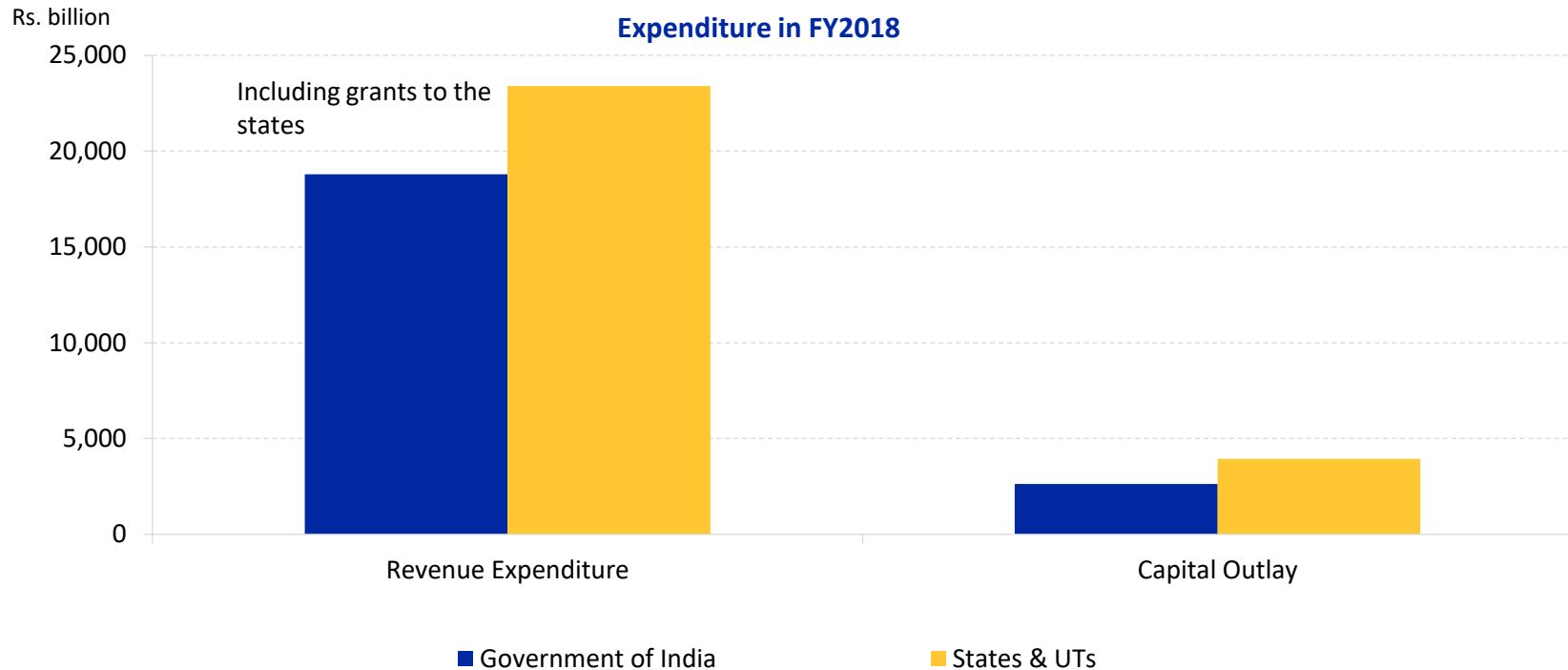


Overview of Union Budget FY2021: Takeaways for States

Vertical Imbalance between the Centre and States addressed by Central transfers

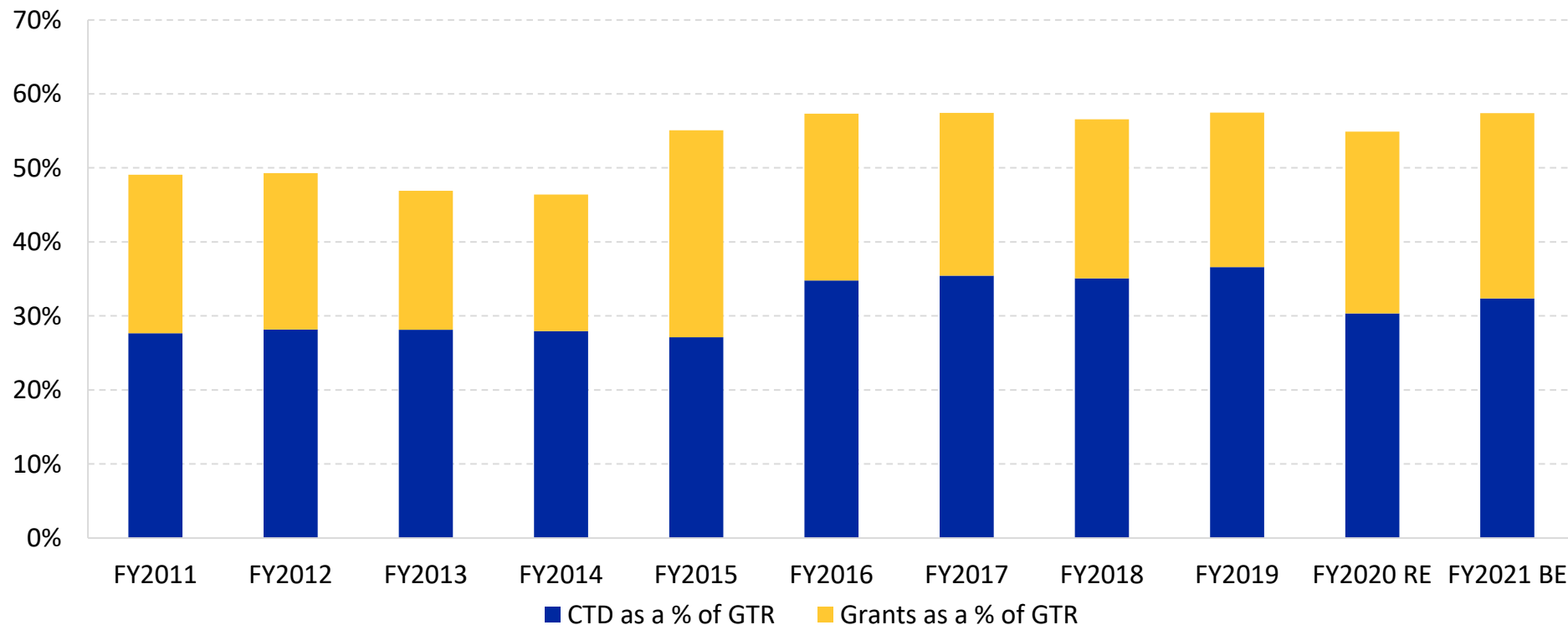


Vertical Imbalance between the Centre and States addressed by Central transfers (2)



Central transfers equivalent to more than half of the Gol's gross tax revenue (GTR)

Central tax devolution (CTD) and grants from the Centre



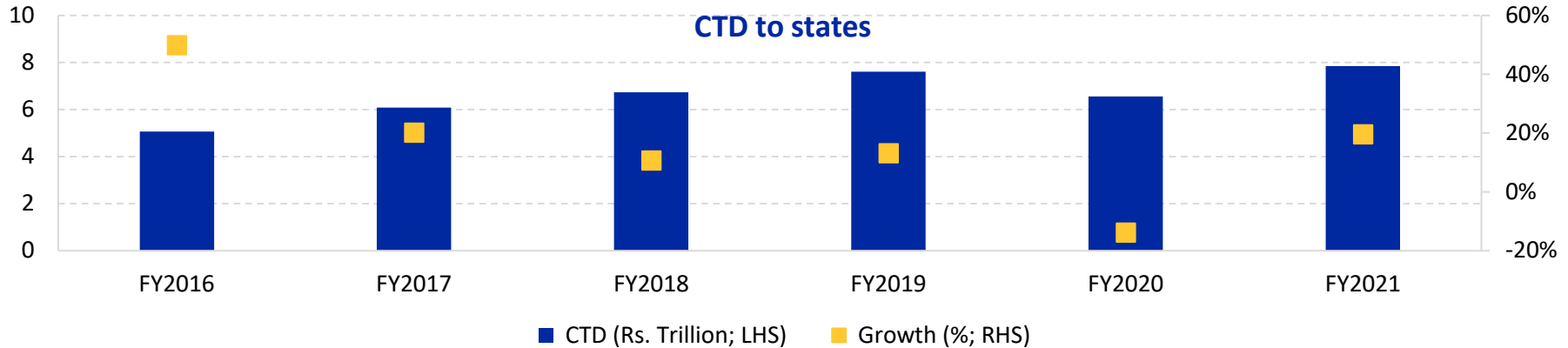
Gol's GTR for FY2020 revised down by Rs. 3.0 trillion

	FY2019 Actuals	FY2020 RBE	FY2020 (RE)		Variation	Apr-Dec FY2020	
	Rs. Billion	Rs. Billion (A)	Rs. Billion (B)	Growth (%)	Rs. Billion (C=B-A)	Rs. Billion	Growth (%)
Gross Tax Revenues^ (GTR)	20,801	24,612	21,634	4.0%	-2,978	13,830	-2.9%
Direct Taxes	11,366	13,350	11,700	2.9%	-1,650	6,872	-5.8%
Corporation Tax	6,636	7,660	6,105	-8.0%	-1,555	3,695	-13.6%
Income Tax	4,730	5,690	5,595	18.3%	-95	3,177	5.1%
Indirect Taxes	8,488	10,127	8,909	5.0%	-1,218	6,143	0.1%
Central Goods and Services Tax (CGST)GST	4,575	5,260	5,140	12.3%	-120	3,688	8.4%
IGST	290	280	0	--	-280	42	-67.2%
Customs Duty	1,178	1,559	1,250	6.1%	-309	852	-12.3%
Union Excise Duty	2,320	3,000	2,480	6.9%	-520	1,532	-2.0%
Service Tax	69	-	12	-82.6%	12	11	-81.4%
Compensation Cess for GST	951	1,093	983	3.4%	-110	705	0.3%

Note: ^ Net of Refunds, Gross of States' share in Central Taxes; # As compared to FY2019 Provisional Accounts

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

Accordingly, CTD to contract in FY2020



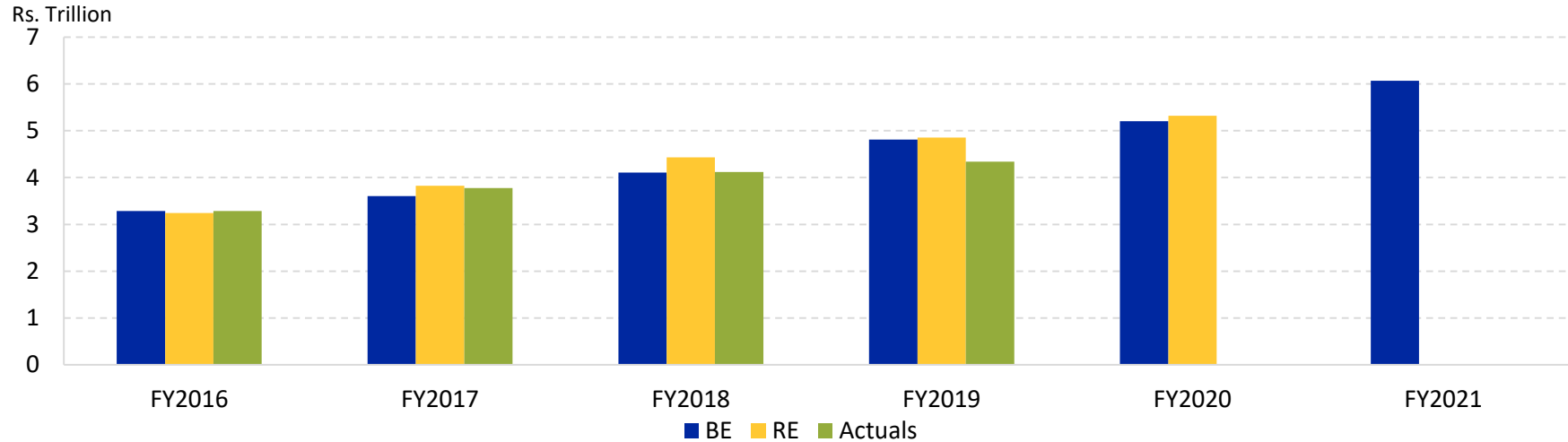
- Total CTD to all states lowered to Rs. 6,560 billion in FY2020 RE, from Rs. 8,091 billion in the BE for that year, on account of both the adjustment for FY2019 (Rs. 588.4 billion, in line with ICRA's estimate), as well as the downward revision in the Gol's tax forecast for FY2020.
- Absolute reduction in CTD in FY2020 RE relative FY2020 BE: UP (Rs. 275 billion), Bihar (Rs. 148 billion), MP (Rs. 116 billion), WB (Rs. 112 billion) and Maharashtra (Rs. 85 billion).
- CTD contracted by 2.2% during April-Dec FY2020, as compared to the 13.8% contraction expected in FY2020 RE.
- Balance central taxes to be devolved in Q4 FY2020 would decline sharply to Rs. 1,799 billion from Rs. 2,746 billion in Q4 FY2019, posing a key risk to managing state finances and cash flows in the last quarter of FY2020.

But budgeted to grow at a healthy 19.5% in FY2021

Rs. Billion	FY2020 RE	FY2021 BE	Growth in FY2021 BE
GoI's GTR	21,634	24,230	12.0%
- Corporation Tax	6,105	6,810	11.5%
- Income Tax	5,595	6,380	14.0%
- Customs Duty	1,250	1,380	10.4%
- Union Excise Duty	2,480	2,670	7.7%
- Service Tax	12	10	-15.0%
- GST	6,123	6,905	12.8%
CTD	6,560	7,842	19.5%

- CTD to all states is budgeted to grow by 19.5% to Rs. 7,842 billion in FY2021 from Rs. 6,560 billion in FY2020 RE.
- However, if FY2020 actual GTR falls short of the RE, then there could be a further downward adjustment in CTD in FY2021.
- Moreover, if the GTR of the GoI do not evolve in line with the 12% growth assumed in the budget relative to the FY2020 RE, then the expansion in CTD to Rs. 7,842 billion in FY2021 BE would come under a cloud.
- Further, eight of the 28 states have seen a reduction in their inter se share in central tax devolution as per the interim report of the 15th FC for FY2021, and would need to carefully assess their revenue situation.

Growth of grants from the Centre budgeted to ease in FY2021



- Actual grants from the Centre to the states/UTs were lower than the RE in FY2017, FY2018 and FY2019.
- The pace of growth of grants from the Centre is budgeted to ease to 14.0% in FY2021 from 22.6% in FY2020 RE.
- Growth of non-FC grants is forecast to ease to 11.8% in FY2021 BE from 20.0% in FY2020 RE.
- Growth of FC grants is projected to decline to 21.2% in FY2021 BE from 32.0% in FY2020 RE.



Key Recommendations of the 15th Finance Commission for FY2021

Change in vertical and horizontal devolution criteria.... (1)

	14 th FC weight	15 th FC weight
Population	17.5%	15.0%
Demographic Performance		12.5%
Demographic Change	10.0%	
Area	15.0%	15.0%
Forest and Ecology	7.5%	10.0%
Income Distance	50.0%	45.0%
Tax Effort		2.5%

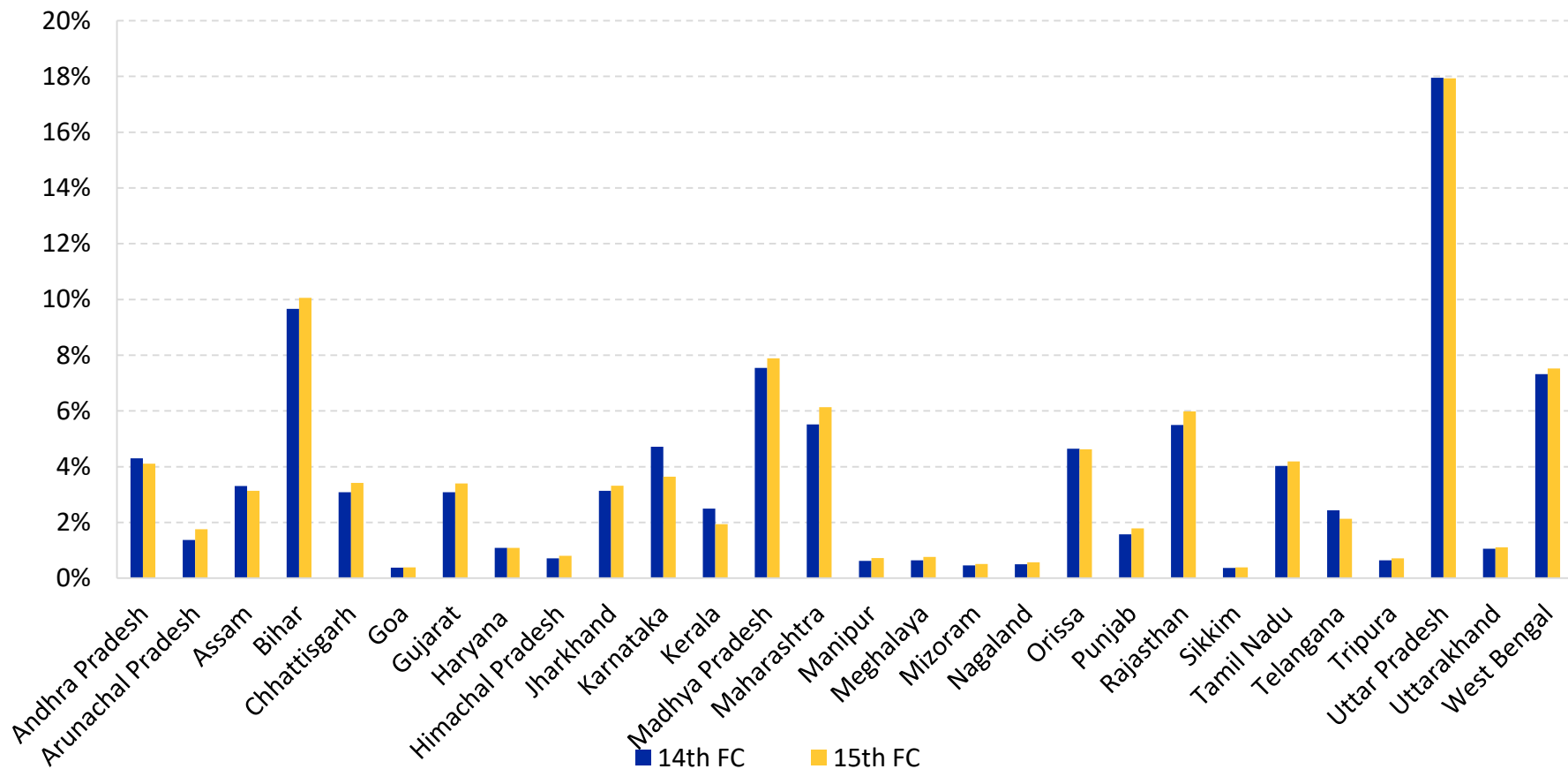
- Vertical devolution from the Union Government to the state governments reduced to 41% of the net proceeds of Union taxes in FY2021 from the extant 42%, after adjusting for 1% of the proceeds to be transferred to the Union Territories of Jammu & Kashmir (J&K) and Ladakh.

Change in vertical and horizontal devolution criteria.... (2)

Changes made by the 15th FC to the horizontal devolution criteria for FY2021:

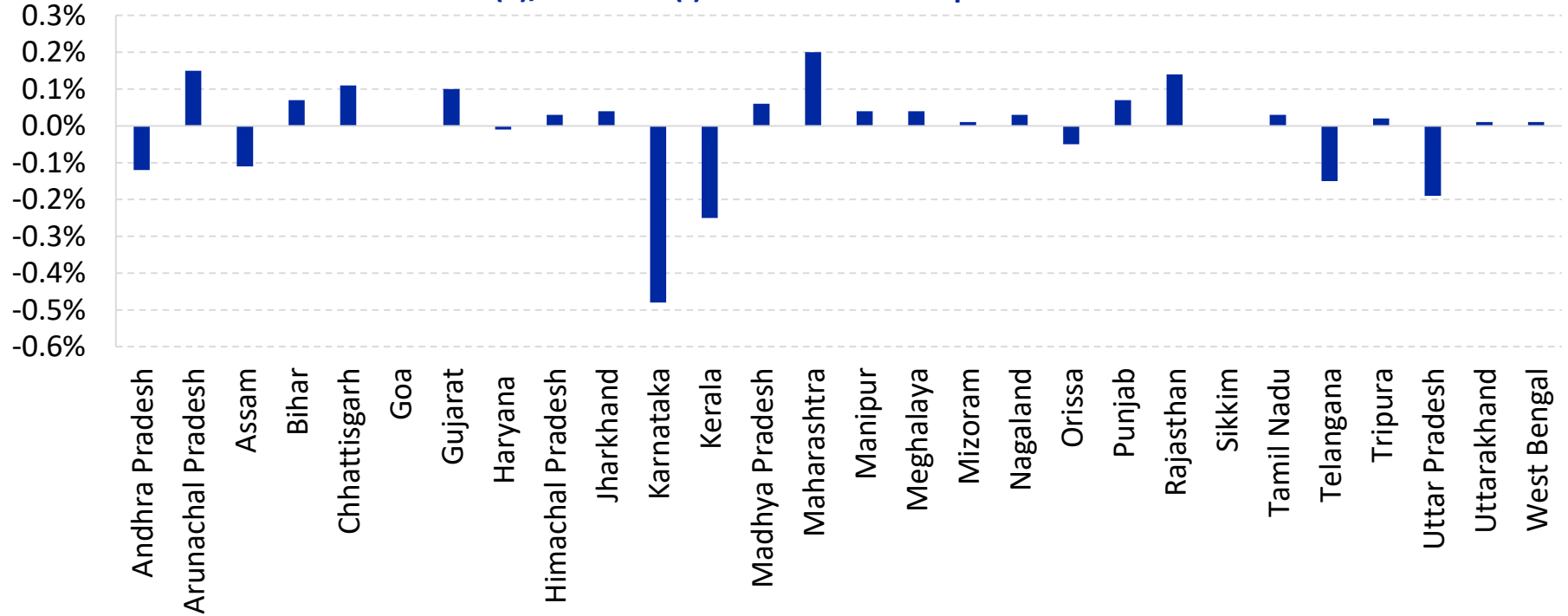
- **Population:** The 14th FC was mandated to use 1971 population, whereas the 15th FC was required to use 2011.
- **Demographic performance:** The 15th FC has measured demographic performance by using the reciprocal of the total fertility rate of a state scaled by its 1971 population, to reward states who have performed well on demographic management.
- **Demographic change:** The 14th FC's ToR mandated it to "take into account the demographic changes that have taken place subsequent to 1971". Therefore, the 14th FC assigned 10% weight to the 2011 population that would capture the demographic changes since 1971, both in terms of migration and age structure.
- **Forest and ecology:** The 15th FC slightly changed the formula for forest by taking the share of dense forest of each state in aggregate dense forest for all states from the extant forest cover.
- **Tax effort:** Unlike the 14th FC, the 15th FC decided to assign 2.5% weight to tax effort, measurable by the ratio of three-year average of per-capita own tax revenue and per-capita GSDP.

Decline in inter-se of eight state governments for FY2021

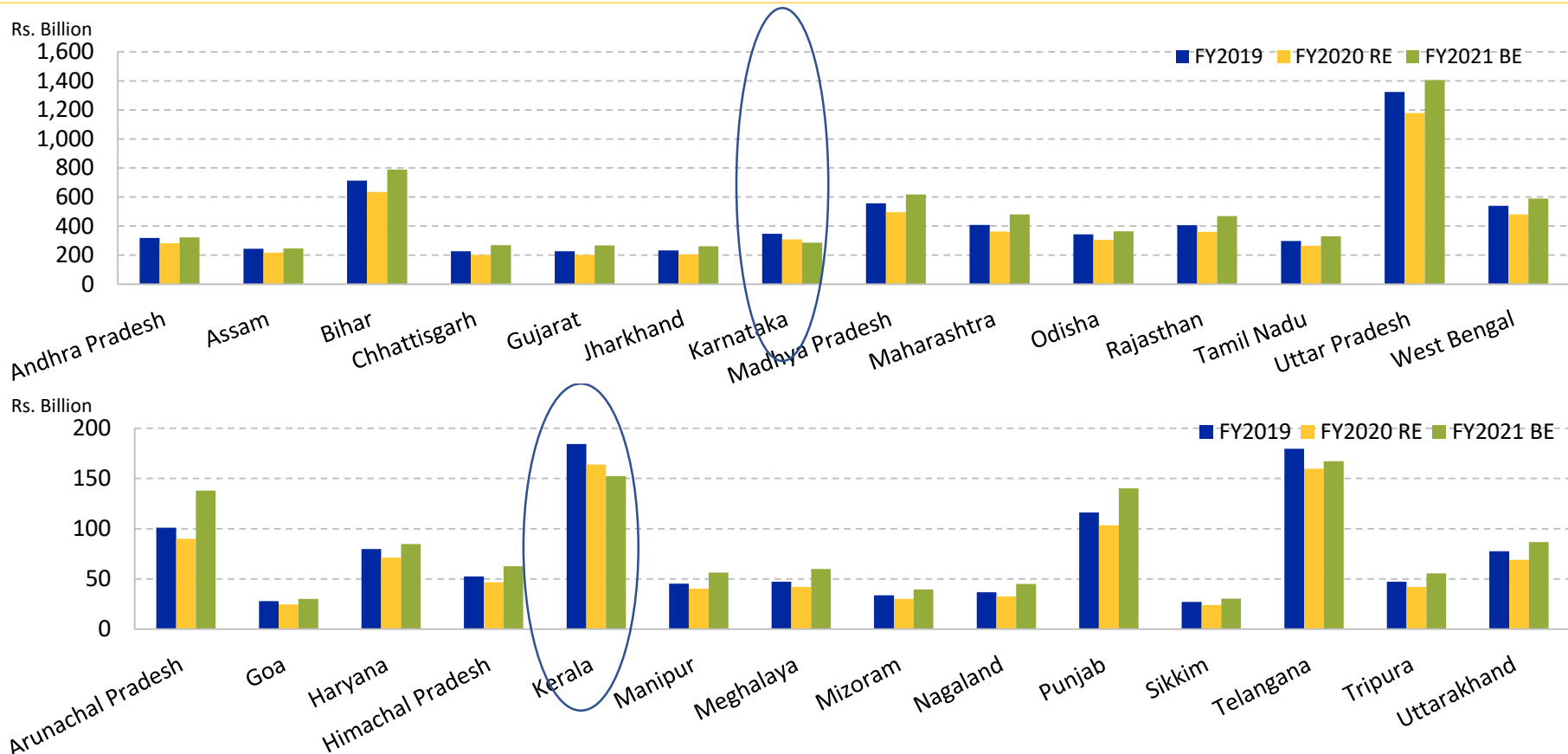


Nine out of 28 states have seen reduction in their share of divisible pool for FY2021

Increase(+)/Decrease (-) as a % of divisible pool for FY2021



Absolute decline in CTD to Karnataka and Kerala in FY2021 BE



15th FC's recommendations on grants accepted by the Gol

Rs. Billion	15th FC (FY2021)	Union Budget (FY2021 BE)
Revenue Deficit Grants	743	300
Local Bodies	900	999
SDRF	290	200
Special Grants	68	
Sectoral Grants	77	
Total Grants	2,078	1,499

- Post-Devolution Revenue Deficit Grants amounting to Rs. 743 billion to 14 states for FY2021.
- Grants for local bodies for all states amounting to Rs. 900 billion for FY2021, out of which Rs. 608 billion is for rural local bodies.
- Grants for State Disaster Response Fund of Rs. 290 billion.
- Gol has not accepted the recommendations for special and sectoral grants.

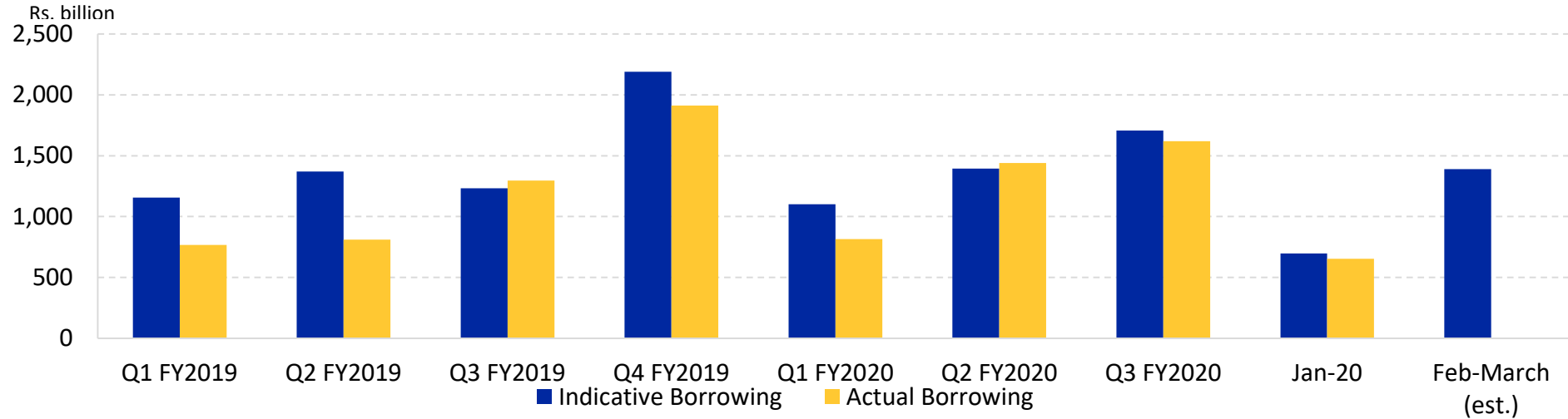
15th FC's recommendations on grants not accepted by Gol

- **Special grants:** The 15th FC has recommended special grants to three states (Karnataka; Rs. 55 billion, Mizoram; Rs. 5 billion and Telangana; Rs. 7 billion) amounting to Rs. 68 billion for FY2021, so that the absolute FC-driven transfers (devolution and revenue deficit grants) remain similar to FY2020. However, the Union Government has asked the 15th FC to reconsider this recommendation as it introduces a new principle.
- **Sectoral grants:** The 15th FC has intended to provide some sector-specific grants, namely, health, police training & housing, railways, maintenance of PMGSY roads, pre-primary education, judiciary and statistics. For these grants the 15th FC will make allocations in its final report.
 - *Out of these grants, 15th FC has recommended grants for nutrition (Rs. 77 billion) for FY2021, which the Gol has not accepted.*
- **Performance grants:** The 15th FC chose six areas for performance-based incentives, namely, implementation of agricultural reforms, development of aspirational districts and blocks, power sector reforms, reforms enhancing trade including exports, education and promotion of tourism activities. The FC advised the concerned ministries/departments to define the state-wise baseline indices using the indices to monitor incremental changes before May/June 2020. The 15th FC will recommend performance grants in its final report.



Outlook for SDLs and key risks

SDL issuances in Jan 2020 slightly lower than indicative level



ICRA had estimated the gross and net SDL issuance in FY2020 at Rs. 5.8 trillion to 6.0 trillion, and Rs. 4.4 trillion to Rs. 4.6 trillion, respectively, in line with RBI's indicative calendar for Q4 FY2020.

Key risks:

- Total CTD to all states revised downwards by Rs. 1,531 billion in FY2020 RE compared to BE, broadly as expected.
- Delays in receipt of GST compensation, cess collections falling short of requirement.

Balance in GST Compensation Fund to fall short of compensation requirement by ~Rs. 150-250 billion

Rs. Billion	Opening Balance	GST Compensation Cess Collected	GST Compensation transferred/to be transferred to states	Closing Balance
FY2018		626	415	211
FY2019	211	951	695	466
FY2020 (est.)	466	983	1,599-1,699	-150 to -250

- Based on cess collected and amount of GST compensation released by the GoI to the states during FY2018, FY2019 and FY2020 (till Dec 2019), ICRA estimates the balance available in the GST Compensation Fund to be Rs. 170 billion.
- The GoI has pegged cess collection at Rs. 980 billion in its FY2020 RE, of which Rs. 705 billion had been collected till December 2019, suggesting a further inflow of around Rs. 280 billion as cess in Q4 FY2020.
- In the current fiscal, the GoI has already released compensation to the state governments for the period from February 2019-September 2019, totalling nearly Rs. 1 trillion, by December 2019.
- ICRA assesses the GST compensation required for October 2019 to January 2020, at Rs. 600-700 billion, which the GoI would likely disburse in Q4 FY2020.
- This suggests a shortfall of ~Rs. 150-250 billion in the GST Compensation Fund at end-FY2020.

FY2021 Outlook for SDL Issuance

Rs. trillion	FY2020 (est.)	ICRA's Expectation for FY2021	
		Scenario 1 (20% YoY increase in net SDL issuance)	Scenario 2 (25% YoY increase in net SDL issuance)
Gross Borrowing	6.0	6.9	7.1
Redemption	1.4	1.4	
Net Borrowing	4.6	5.5	5.8

- ICRA estimates a 20%-25% YoY growth in the net SDL issuance in FY2021, and a decline in the SDL redemption to Rs. 1,358 billion in FY2021 from Rs. 1,388 billion in FY2020.
- Accordingly, the net and gross issuance in FY2021 is likely to be in a range of Rs. 5.5 trillion to Rs. 5.8 trillion and Rs. 6.9 trillion to 7.1 trillion, respectively.
- This implies a YoY growth of 15%-19% in the gross SDL issuance in FY2021.
- **The estimated net SDL issuance is likely to exceed the net G-sec issuance as mentioned in the Union Budget for FY2021 (Rs. 5.5 trillion).**

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