

STATE GOVERNMENT FINANCES

**States' budget estimates tended to
underestimate fiscal deficit in
FY2018-20**

JANUARY 2022





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Karnataka displayed the least average variation in actual and budgeted revenues receipts and capital expenditure during FY2018-20

AP exhibited large downward deviation in its revenue receipts and Telangana in its revenue expenditure from their respective budgeted levels during FY2018-20

Punjab's actual capital spending during FY2018-20 trailed the budgeted amount by a wide margin

In the post goods and services tax (GST) period (FY2018-20), the actual revenue receipts of most of the 12 state governments that we have analysed, significantly trailed the amount indicated in their Budget Estimates (BE) for those years. Some of the key reasons for this divergence include over-estimation of state GST (SGST) collections, and seemingly misplaced expectations of improvement in consumption and the associated taxes. We have also observed misclassification of GST compensation grants, distorting the component-wise performance in this period.

Amidst lower-than-budgeted receipts, several states curtailed their revenue spending on various schemes, while undertaking relatively milder cuts in stickier components such as salaries, pensions and interest payments. Moreover, to adhere to the fiscal deficit norms set by the Finance Commissions, the capital spending of several states in our sample tended to be sharply lower than the budgeted amount. Despite this, several of the states' fiscal deficits exceeded the respective BE in this period.

Karnataka displayed the least variation between the actual and budgeted revenue receipts and capital expenditure during FY2018-20 and Tamil Nadu's variance in revenue expenditure was the lowest among the 12 states. Additionally, the average deviation between the actual and budgeted fiscal deficit was the lowest for Kerala and highest for UP during FY2018-20.

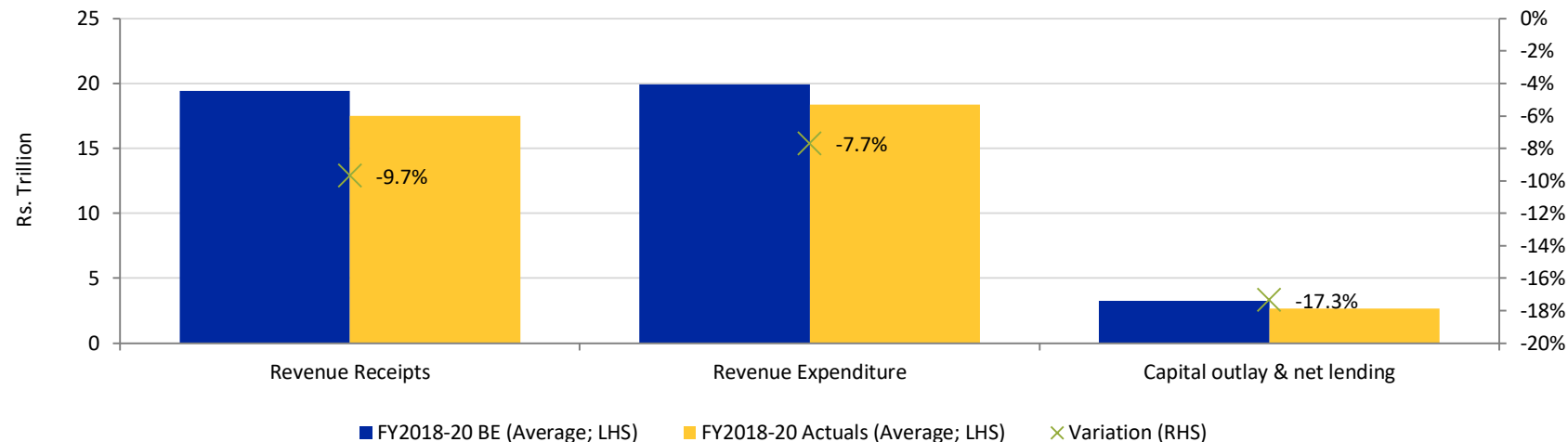
We have also observed several instances of variation between actual and indicated quarterly State Development Loans (SDLs). The variance analysis reveals scope for improving the accuracy of the budgeting exercise by the state governments to enhance the reliability/usefulness for the users of this information.

Exhibit: Rank of 12 state governments on the average variation in key fiscal indicators during FY2018-20

	AP	Gujarat	Haryana	Karnataka	Kerala	Maharashtra	Punjab	Rajasthan	TN	Telangana	UP	WB
Revenue Receipts	12	3	9	1	8	2	10	7	4	11	6	5
Revenue Expenditure	10	5	8	3	7	6	11	4	1	12	9	2
Capital Expenditure	10	5	3	1	7	4	12	11	8	2	9	6
Fiscal Deficit	9	3	6	4	1	11	8	5	7	2	12	10

Actual capital expenditure trailed the budgeted level by a wider margin than the variance in revenue receipts and expenditure during FY2018-20

Exhibit: Variation between the budgeted and actual key fiscals (average) of 12 state governments during FY2018-20



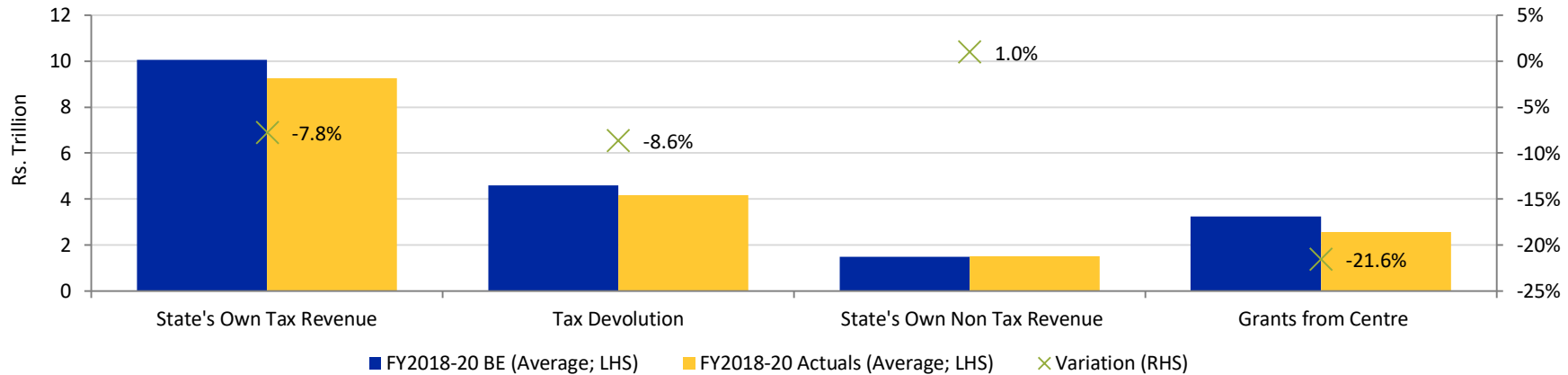
- The actual combined revenue receipts of the 12 state governments fell short of the budgeted level by 9.7% (average) during FY2018-20, while the revenue expenditure was 7.7% lower-than-budgeted in the same period.
- The cut in aggregate capital expenditure of the 12 states relative to the budget level was a deeper 17.3% during FY2018-20, suggesting higher willingness of state governments to forego capital spending compared to revenue expenditure.
- Nevertheless, in absolute terms, the cut in capital expenditure was smaller than that in revenue spending.

Note: Variance analysis in this presentation is based on the difference between the actual and budgeted key fiscal indicators during FY2018-FY2020 for a sample of 12 state governments, namely, Karnataka, Kerala, Tamil Nadu (TN), Gujarat, Maharashtra, Punjab, Haryana, Rajasthan, West Bengal (WB), Telangana, Andhra Pradesh (AP) and Uttar Pradesh (UP). The combined gross state domestic product or GSDP (at current prices) of these 12 states comprises nearly 78% of India's gross domestic product or GDP (at current prices) in FY2020.

Source: State Budgets; ICRA Research

Grants displayed wider divergence from the budgeted level compared to other components of revenue receipts during FY2018-20

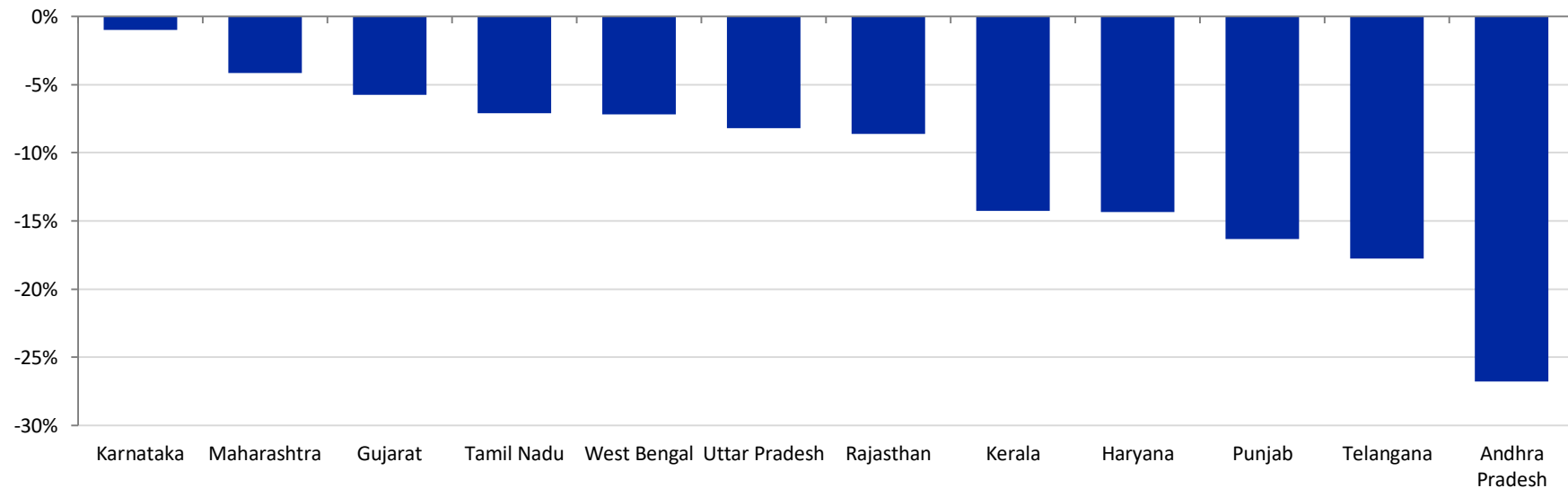
Exhibit: Variation between the budgeted and actual sub-components of revenue receipts (average) of 12 state governments during FY2018-20



- The actual combined grants from the Centre of the 12 state governments were lower than the budgeted level on average by a sharp 21.6% during FY2018-20. In FY2018-19, variance in grants contributed around 55% of the variance in revenue receipts, which eased to 16% in FY2020.
- Tax devolution was lower than the BE by 8.6% during FY2018-20. While the lower-than-budgeted devolution contributed a modest ~5% to the variance in revenue receipts during FY2018-19, this share increased to a substantial 41% in FY2020 following the adjustment of excess transfer of taxes by the GoI in FY2019 during FY2020.
- State's own tax revenues or SOTR were on an average lower by 7.8% in the actuals for FY2018-20 from the BE of those years while state's own non-tax revenues or SONTR recorded a limited variation of 1.0% during those years.
- However, the absolute variation was the largest in SOTR (by Rs. 0.8 trillion), followed by grants (by Rs. 0.7 trillion) and share in Central taxes (by Rs. 0.4 trillion).

Deviation between actual and budgeted revenue receipts during FY2018-20 was least for Karnataka and highest for AP

Exhibit: Average variation between the budgeted and actual revenue receipts of 12 state governments during FY2018-20



- Among the 12 states in our sample, Karnataka reported the least average deviation in actual revenue receipts from the budgeted level at 1.0 percentage point during FY2018-20, indicating consistently realistic projections and suggesting thoroughness in the budgeting process.
- The average deviation between actual and budgeted revenues of Maharashtra, Gujarat, TN, WB, UP and Rajasthan was between 4-9% during FY2018-20.
- The average downward deviation in AP's actual revenue receipts from the budgeted levels during FY2018-FY2020 was the highest at 26.8%, followed by Telangana at 17.8%, mainly led by lower-than-budgeted grants from the Centre during these years. Punjab, Haryana and Kerala also displayed substantial variance in revenue receipts (14-16%) during FY2018-20.

More than half the revenues of the state governments are derived from SOTR, which is dominated by SGST collections

Exhibit: Composition of revenue receipts of 12 states during FY2018-20

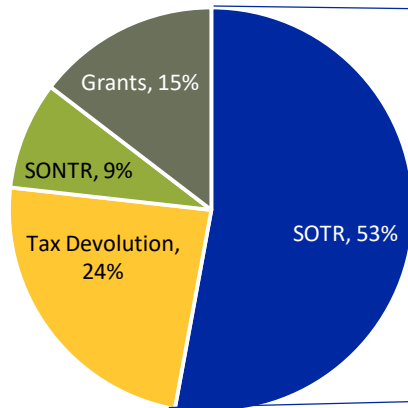
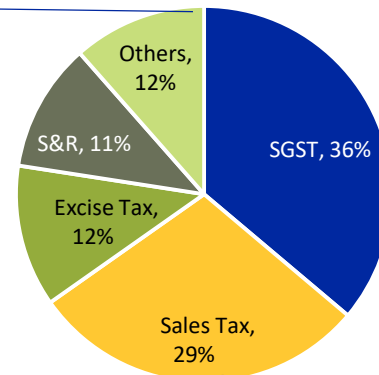


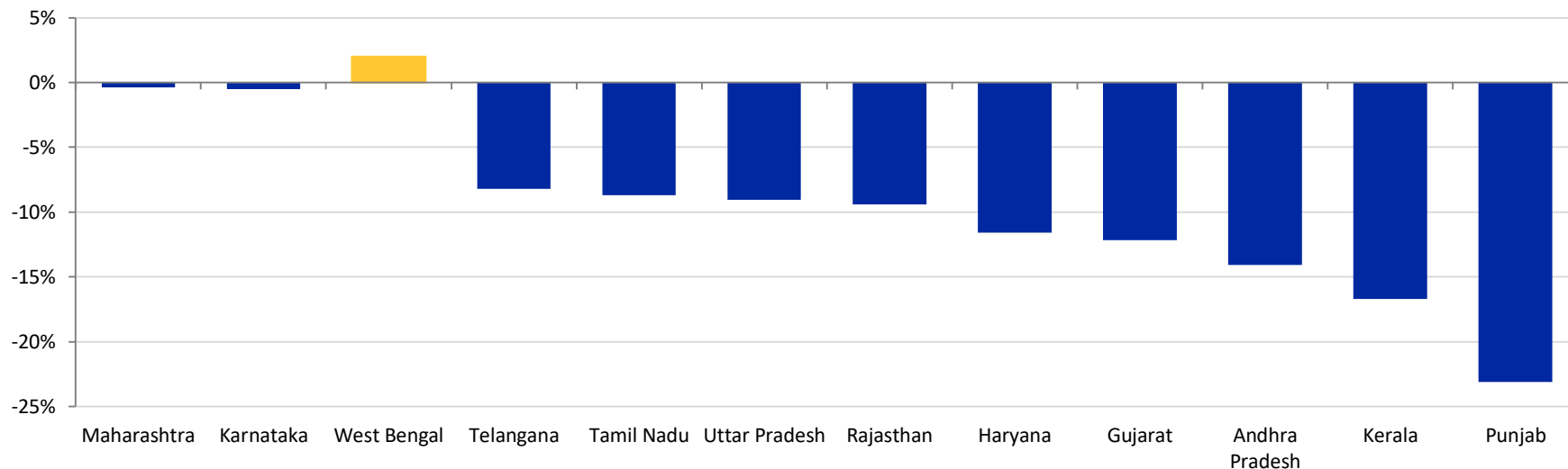
Exhibit: Composition of SOTR of 12 states during FY2018-20



- The aggregate SOTR of the 12 states comprised 53% of their revenue receipts which includes (a) sales tax/value added tax on petroleum and petroleum products and alcohol (b) excise duty on alcoholic liquor for human consumption (c) stamps and registrations (d) electricity duties (e) motor vehicles tax (f) other taxes and (g) SGST levied on all goods and services consumed within the state other than the aforementioned items.

SOTR of Maharashtra and Karnataka was similar to the budgeted level during FY2018-20 while Punjab's was sharply lower

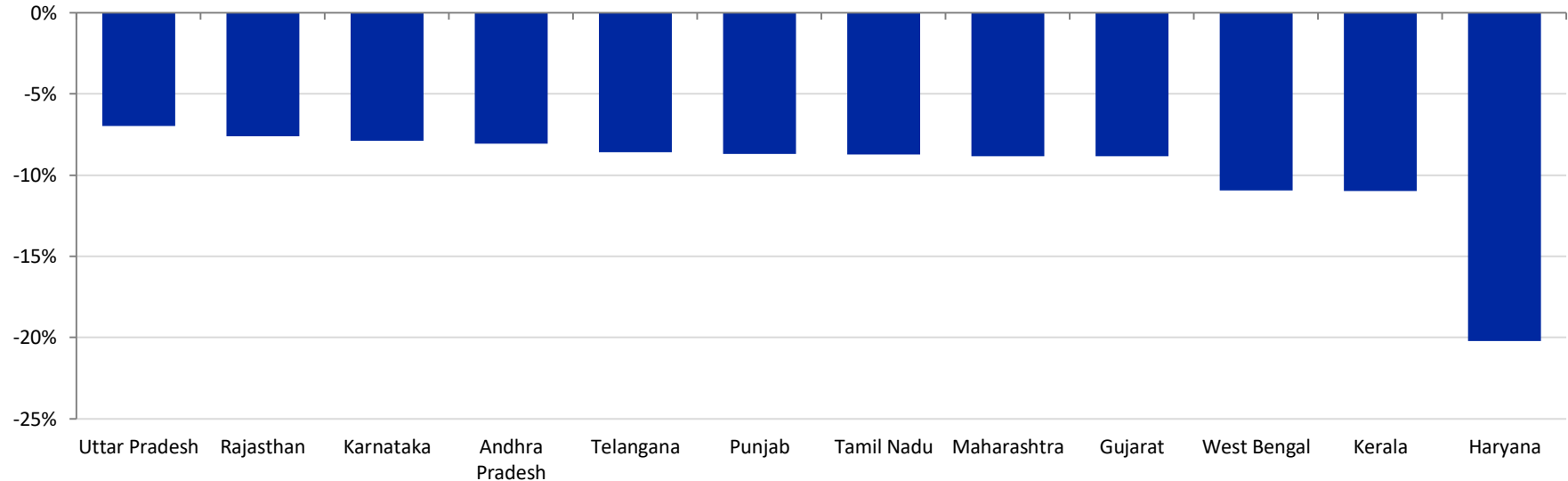
Exhibit: Average variation between the budgeted and actual SOTR of 12 state governments during FY2018-20



- The SOTR of Maharashtra and Karnataka during FY2018-20 was nearly in line with the budgeted level and WB's was mildly higher than the BE.
- The actual SOTR of Telangana, TN, UP and Rajasthan was 8-9% lower than the budgeted level, followed by a gap of 12-14% for Haryana, Gujarat and AP. This disparity was largely led by incorrect assessment of the SGST collections in the initial years following the transition to the GST regime in July 2017 and accounting misclassification of such receipts by some of the states. In the BE for FY2018, FY2019 and FY2020, Gujarat and UP included GST compensation under SGST collections, which was subsequently classified under grants in the actuals for those years.
- The SOTR of Punjab and Kerala was a sharp ~23% and ~17%, respectively, lower than the budgeted amount during FY2018-20, led by considerable overstatement of SGST collections as well as most of the other components of the SOTR.

Variation in tax devolution was fairly stable across most states, mirroring changes in Gol's estimates of shareable tax collections

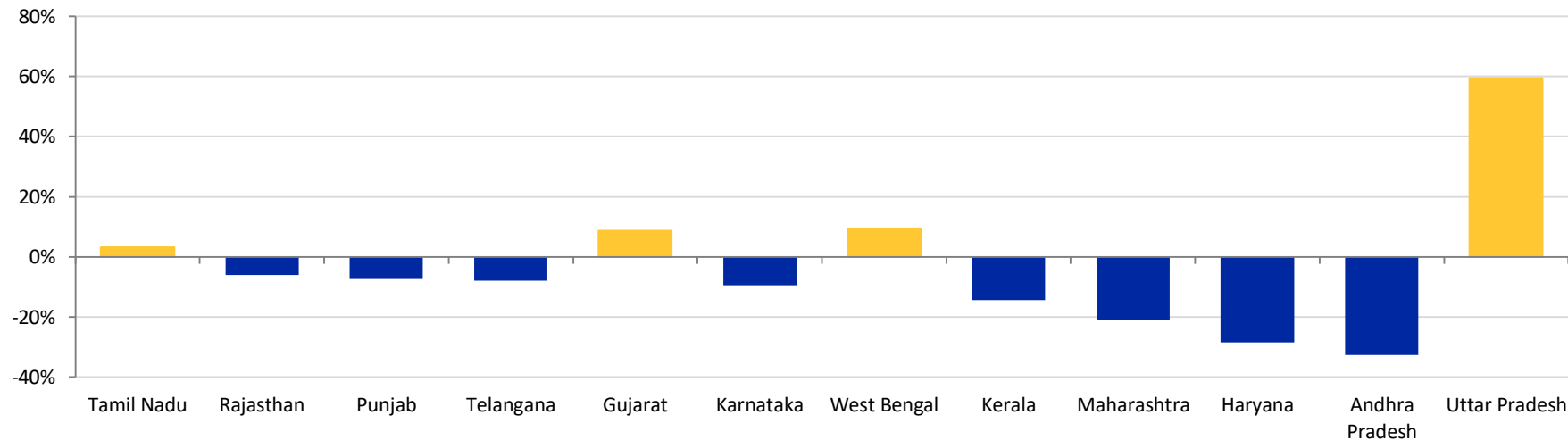
Exhibit: Average variation between the budgeted and actual tax devolution of 12 state governments during FY2018-20



- The deviation in tax devolution during FY2018-20 was largely stable in a range of 7-9% across the 12 states except for WB, Kerala and Haryana. The variation in tax devolution reported by most of the states mirrors the change in the Government of India's (Gol's) actual and budgeted shareable taxes and accordingly the tax devolution. Most of the 12 states presented their FY2018, FY2019 and FY2020 budgets after the Union Budget for these years was presented, which included the state-wise tax devolution.
- However, the actual and budgeted tax devolution of states, which present their Budgets prior to the Union Budget, generally display a sharper variation from other states, as the tax devolution included by them differs the amount mentioned in the Union Budget.

Variance between actual and budgeted SONTR displayed a mixed trend in FY2018-20

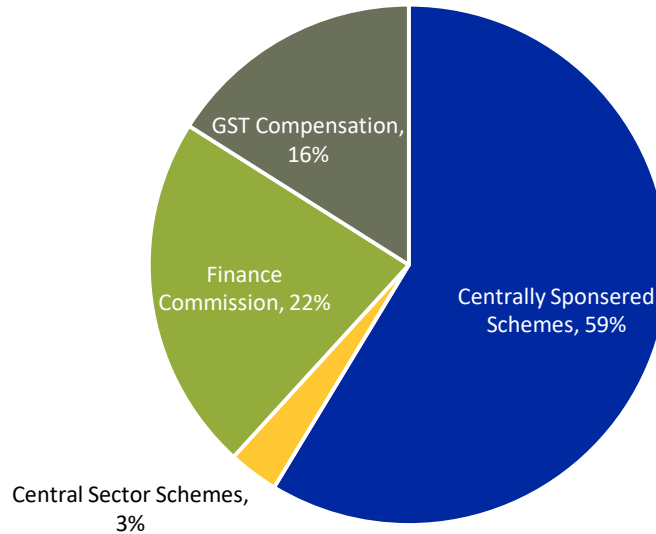
Exhibit: Average variation between the budgeted and actual SONTR of 12 state governments during FY2018-20



- The actual SONTR of TN, Gujarat and WB was higher-than-budgeted by an average 3-10% during FY2018-20, while UP's was unusually higher at ~60%. This was on account of the large one-off transfer of receipts from the UP's sinking fund of Rs. 712 billion in FY2020 against the budgeted Rs. 139 billion.
- Rajasthan, Punjab, Telangana and Karnataka displayed downward deviation of less than 10% between actual and budgeted SONTR during FY2018-FY2020, while Kerala, Maharashtra, Haryana and AP's variation ranged between a high 14-33%.
- Since SONTR is a smaller component, the small base magnified the extent of deviation between the BE and actuals, as compared to the other major sources of the states' revenues.

Grants for Centrally-sponsored schemes form the largest sub-component of grants from the Centre

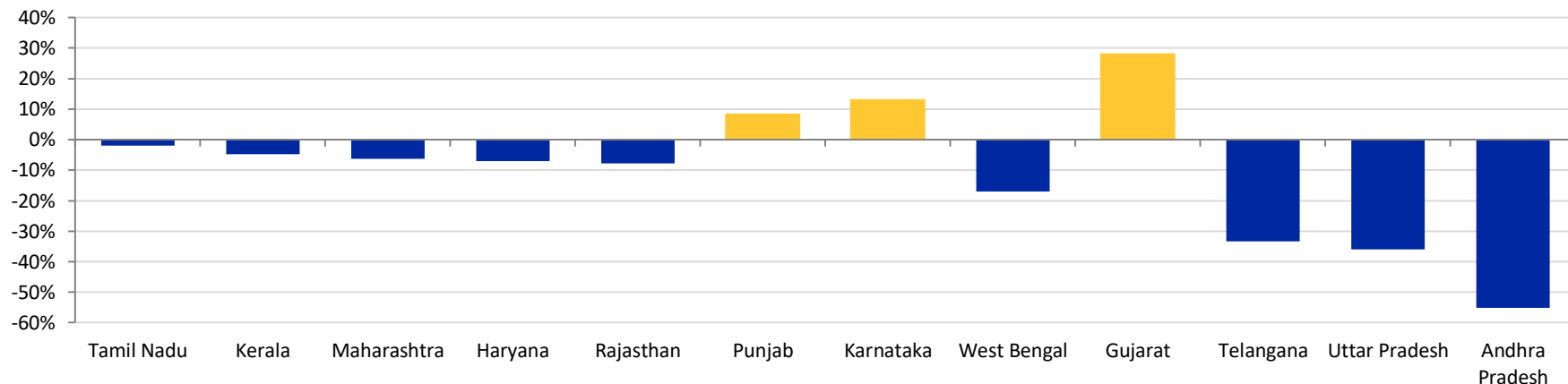
Exhibit: Composition of grants to all states during FY2018-20



- Centrally-sponsored schemes form the largest component of grants from the Centre. The funding for such schemes is borne by both the state and the Centre in the ratio of 50:50 for non-hilly states.
- Finance Commission grants are transferred based on the recommendations of the successive Finance Commissions and usually include local body grants, post-devolution revenue deficit grants and disaster relief grants.

AP, UP and Telangana displayed the sharpest deviation in grants during FY2018-20

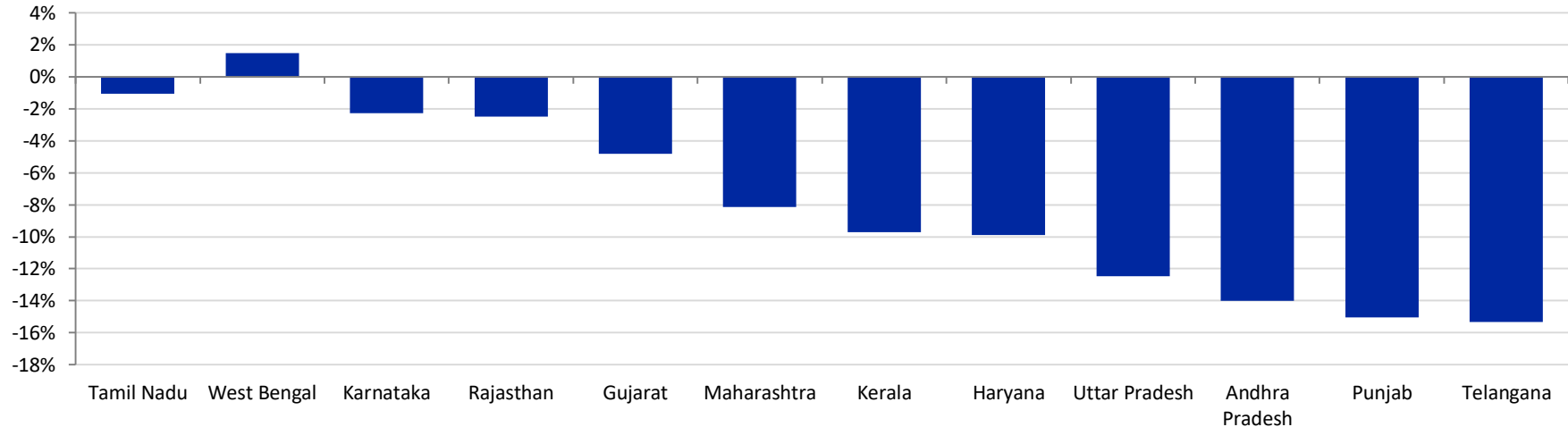
Exhibit: Average variation between the budgeted and actual grants from the Centre of 12 state governments during FY2018-20



- TN, Kerala, Maharashtra, Haryana, and Rajasthan displayed an average downward deviation of less than 10% between actual and budgeted grants during FY2018-20.
- The actual grants from the Centre received by Punjab, Karnataka and Gujarat were higher than the budgeted level, primarily on account of under-estimation of GST compensation grants. The deviation for Gujarat was more pronounced as it had misclassified the GST compensation grants under SOTR in the BE for FY2018, FY2019 and FY2020.
- Telangana and AP saw their actual grants being a substantial ~33% and ~55%, respectively, lower than the budgeted level during FY2018-20, largely due to over-estimation of bifurcation-related grants in their initial budgets, against which the GoI released nil or insignificant amounts.
- The grants of WB and UP were lower-than-budgeted on account of over-estimation of scheme-related grants. Notably, UP's grants were a substantial ~36% lower in the actuals despite the misclassification of GST compensation grants by the state (included in SOTR in the BE).

Some states undertook deep cuts in revenue expenditure in light of lower-than-budgeted revenues during FY2018-20

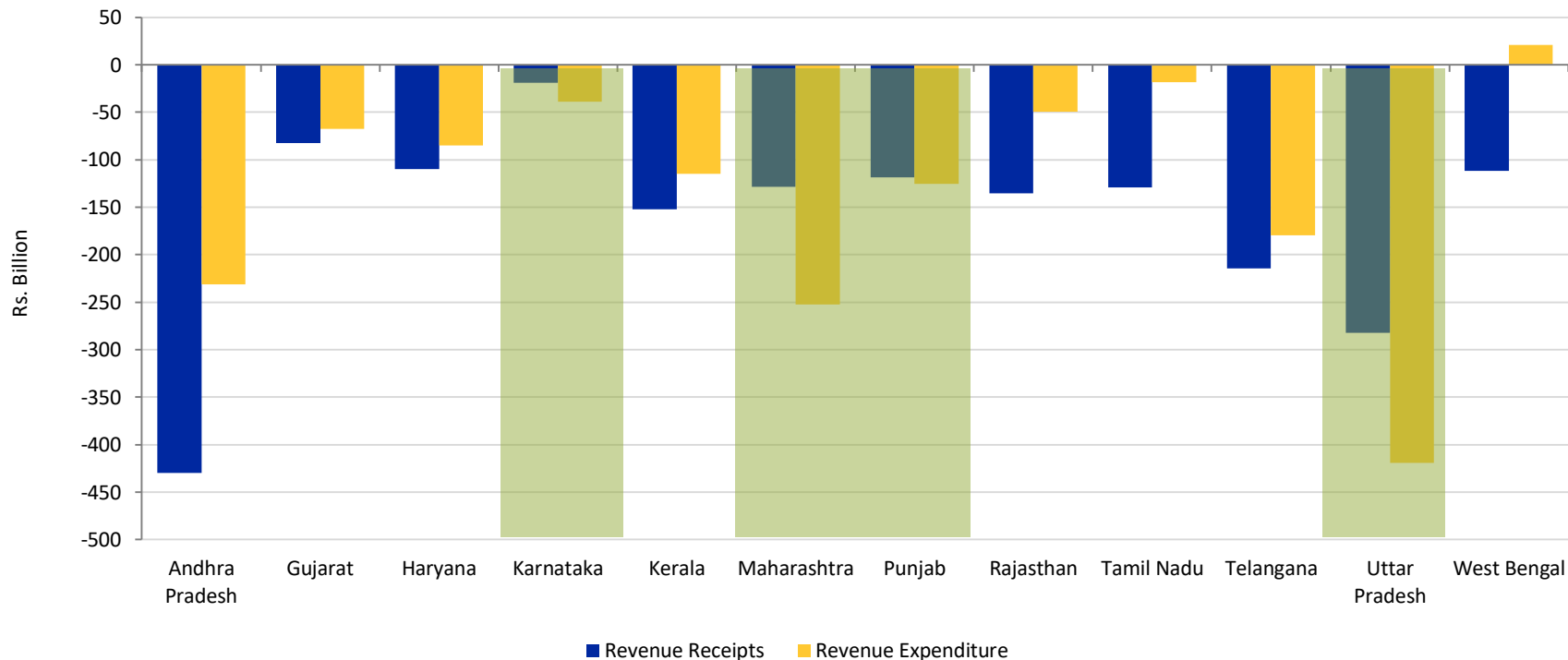
Exhibit: Average variation between the budgeted and actual revenue expenditure of 12 state governments during FY2018-20



- Amongst the 12 state governments, only WB recorded a higher revenue expenditure during FY2018-20 than the budgeted level.
- The deviation between the actual and budgeted revenue expenditure for TN, Karnataka, Rajasthan and Gujarat remained below 5% during FY2018-20.
- The deviation ranged from 8-10% for Maharashtra, Kerala and Haryana.
- With lower-than-budgeted revenue receipts, UP, AP, Punjab and Telangana curtailed their revenue spending by more than 12% during FY2018-20. Interest payments reported the lowest deviation, while expenditure excluding committed expenditure (predominantly spending on subsidies and schemes) revealed the largest deviation.

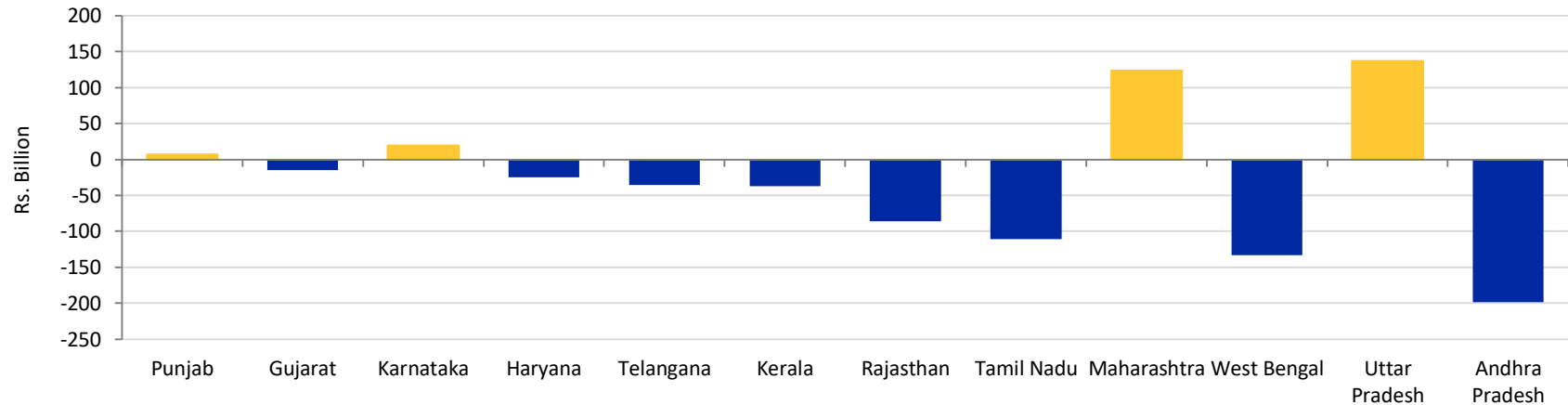
Revenue receipts displayed larger deviation relative to revenue expenditure for most of the states

Exhibit: Average variation between the budgeted and actual revenue receipts and expenditure of 12 state governments during FY2018-20



Actual revenue account balance of Rajasthan, TN, Maharashtra, WB, UP and AP differed sharply from the budgeted level in FY2018-20

Exhibit: Average variation between the budgeted and actual revenue balance of 12 state governments during FY2018-20



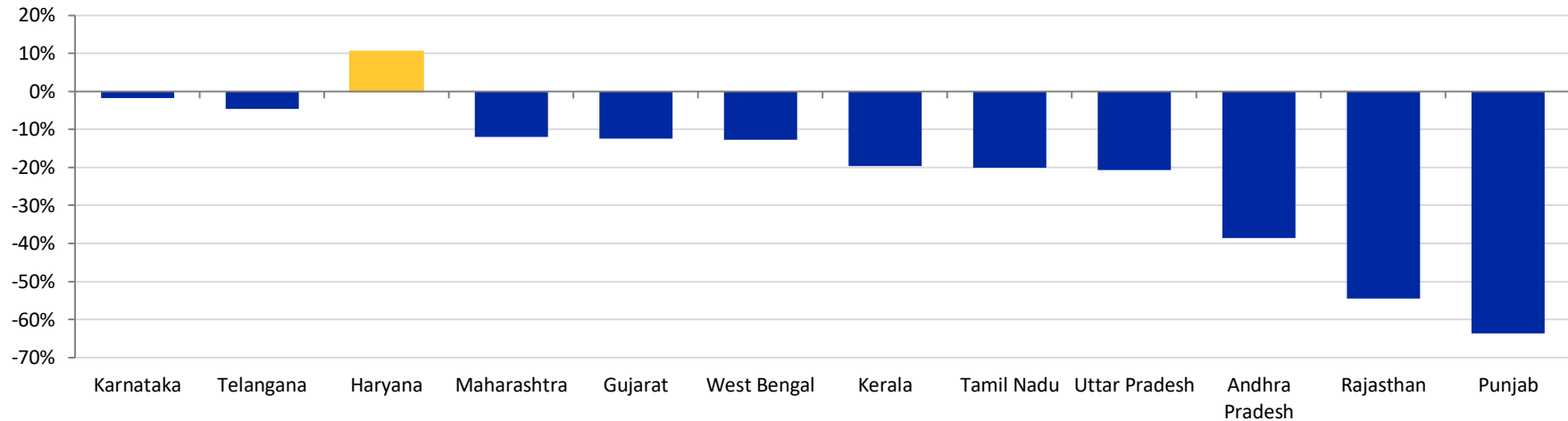
- The revenue balance of Punjab, Gujarat, Karnataka, Haryana, Telangana and Kerala varied modestly from the budgeted amount during FY2018-20.
- The actual revenue deficit of TN and Rajasthan overshot the BE by a wider extent during FY2018-20, with revenue receipts falling short of the BE by 7-9%, whereas there was a limited 1-3% variance in revenue spending.
- Mainly led by lower-than-budgeted revenue receipts during FY2018-20 and a mild increase in revenue expenditure, WB's actual revenue deficit was substantially higher than the budgeted level. Moreover, AP's revenue deficit widened considerably in the actuals from the BE, led by the sizeable downside in revenues despite sharp cuts in revenue expenditure.
- Maharashtra and UP undertook deeper cuts in revenue spending from the budgeted level during FY2018-20, than the magnitude of reduction in revenue receipts during these years, leading to a sharp upside for their revenue balance.

Note: Positive values indicate either lower revenue deficit or higher revenue surplus and vice-versa

Source: State Budgets; ICRA Research

Capital expenditure of Karnataka and Telangana was nearly in line with their BE, while Punjab, Rajasthan and AP considerably curtailed such spending

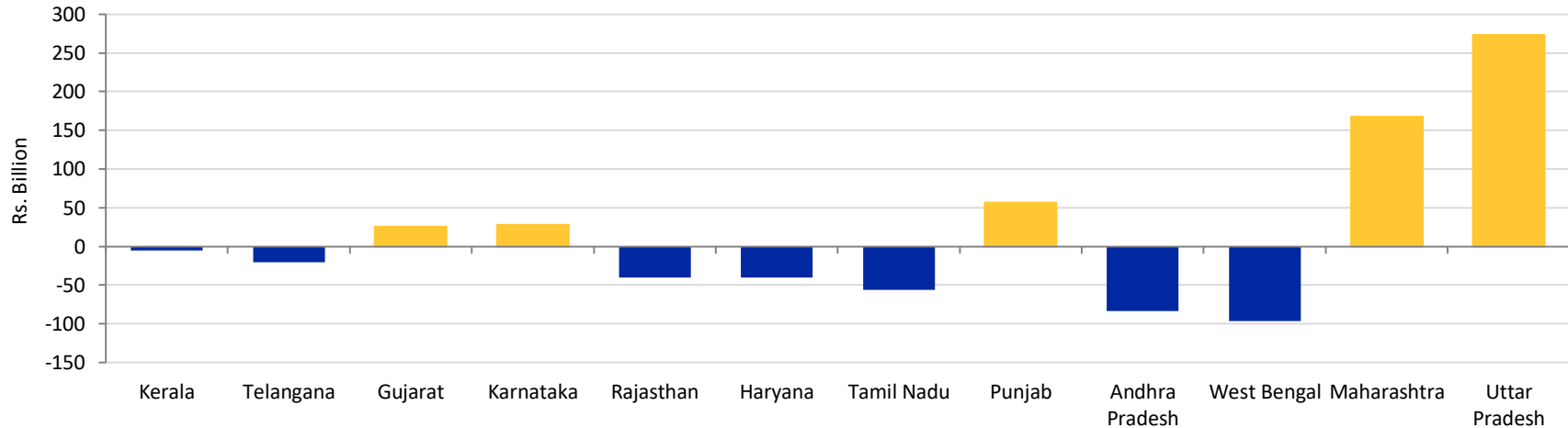
Exhibit: Average variation between the budgeted and actual capital expenditure of 12 state governments during FY2018-20



- The actual capital expenditure and net lending for Karnataka and Telangana was mildly lower than the budgeted level during FY2018-20, whereas Haryana's exceeded the same during these years
- The actual capex of Maharashtra, Gujarat, WB, Kerala, TN and UP was 12-21% lower than the budgeted level during FY2018-20. Discouragingly, Maharashtra and UP curtailed their capital spending despite the improvement in their revenue account balance during these years, pointing towards inaccurate budgeting/lack of absorptive capacity, rather than fiscal constraints.
- Rajasthan and AP cut down their capital expenditure substantially from the budgeted level during FY2018-20, following the sharp deterioration in their revenue deficit. Despite this, the fiscal deficit of these two states exceeded the target set by the 14th Finance Commission (FC) for each of these years.
- Despite a mild improvement in its revenue deficit, Punjab's capital expenditure was substantially lower than budgeted during FY2018-20, which appears to have been required to adhere to the FC set fiscal deficit limit as a percentage of GSDP.

Fiscal deficit of AP and WB sharply overshoot the BE, whereas that of Maharashtra and UP undershot by an even wider margin

Exhibit: Average variation between the budgeted and actual fiscal balance of 12 state governments during FY2018-20



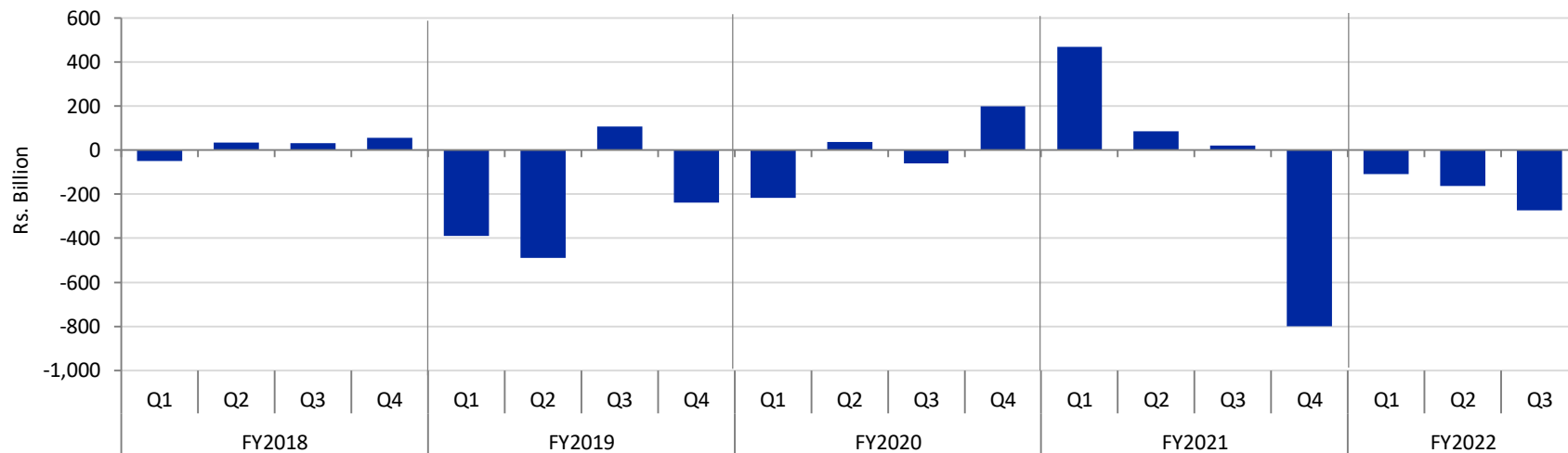
- Kerala, Telangana, Gujarat and Karnataka displayed a modest deviation between their actual and budgeted fiscal deficit during FY2018-20 (under Rs. 30 billion), while that for Rajasthan, Haryana, TN and Punjab was slightly higher at Rs. 40-57 billion.
- The actual fiscal deficit of AP and WB was a sharp Rs. 83 billion and Rs. 96 billion, respectively, wider than the budgeted amount during FY2018-20.
- In contrast, the actual fiscal deficit of Maharashtra and UP was a substantial Rs. 167 billion and Rs. 273 billion, respectively, lower than budgeted.
- On an average, seven of the 12 states in our sample reported a fiscal deficit in FY2018-20 that was higher than budgeted.

Note: Positive values indicate lower fiscal deficit and vice-versa

Source: State Budgets; ICRA Research

Deviation persists between indicated and actual quarterly SDL issuance as well

Exhibit: Deviation between combined indicated and actual SDL issuance of 12 state governments during FY2018-22



- After a mild variation in FY2018, the 12 states displayed a sharp deviation between their indicated and actual SDL issuance in FY2019-22.
- A sizeable portion of the variation between indicated and actual SDL issuance during FY2018-21 was largely led by Maharashtra, Karnataka, TN, Haryana and UP. Maharashtra, a large issuer of SDLs, liquidated its investments in Treasury-bills during FY2019 and FY2020, contributing to lower-than-indicated market borrowing.
- The divergence in the actual and indicative quarterly borrowing calendar by the state governments tempers the usefulness and reliability of the amount of borrowings indicated in the quarterly auction calendar by the states, even as the practice of issuing such calendars is now a considerable 27 quarters old.



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ICRA Analytical Contact Details



Aditi Nayar

Chief Economist

Neetika Shridhar

Assistant Vice President

Jaspreet Kaur

Analyst



aditin@icraindia.com

neetika.shridhar@icraindia.com

jaspreet.kaur@icraindia.com



0124- 4545 385

0124 – 4545 305

0124 – 4545 853





ICRA

Business Development/Media Contact Details



L. Shivakumar

Executive Vice-President

Jayanta Chatterjee

Executive Vice-President

Naznin Prodhani

Head Media & Communications



shivakumar@icraindia.com

jayantac@icraindia.com

communications@icraindia.com



022- 6114 3406

080 – 4332 6401

0124 – 4545 860





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