STATE FINANCES - GS II MAINS

Q. Examine the issues faced by the state government in assessing its finances and bring out the measures to be taken to enhance its financial resources. (15 marks, 250 words)

News: *Decoding state budgets: Can growth projections keep pace with reality?*

What's in the news?

- The ongoing election season has drawn sharp attention to India's fiscal health.
- While the Government of India's fiscal metrics are keenly dissected and well understood, the fiscal situation of state governments tends to be less scrutinised.
- However, the rise in market borrowings of state governments and key policy changes in recent years have rekindled an interest among market participants on the fiscal health of states.

Concerns Regarding State Finances:

1. Reliance on Own Revenues:

- About half of the total revenues of states come from their own tax revenues (SOTR), making any deviation from projected growth rates impactful.
- The growth of key components of own taxes, such as sales tax and state GST, has been below expectations, impacting revenue projections.

2. Devolution from the Centre:

- Transfers from the Centre account for 40-45% of state revenues, with tax devolution projected to increase but showing variability.
- States have seen fluctuations in actual grants received compared to estimates, particularly in Centrally Sponsored Schemes (CSS).

3. Debt Issuance:

- Actual debt issuance has exceeded projections, possibly due to factors like holding larger cash reserves during the Model Code of Conduct period.
- Gross borrowing is expected to rise significantly, potentially impacting fiscal health.

4. Capital Spending:

- Capital spending is anticipated to start slowly due to elections and may remain subdued during the monsoon months, leading to back-ended spending.

5. Technical Inefficiencies in Tax Collection:

- High technical inefficiencies exist in collecting state taxes, affecting revenue generation and leading to tax evasion.

6. Lack of Uniformity in Tax Structures:

- Lack of uniformity in GST slabs and motor vehicle tax structures across states creates complexity and challenges in revenue collection.

7. Vertical Fiscal Imbalance:

- Vertical fiscal imbalance exists between the Union and state governments, with states having major expenditure responsibilities but limited tax powers.

8. Concerns Regarding Cess and Surcharge:

- Revenue collected from cess and surcharge is exclusively at the disposal of the Union government, posing challenges for state finances.

Measures Needed for Improving State Finances:

1. Balance Between Tax and Non-Tax Revenues:

- States should aim to increase their own tax and non-tax revenue ratios sustainably while aligning financial resources with state priorities.

2. Prioritizing Private Investments in Less Developed States:

- Less developed states should receive focused attention to attract private investments and aid their growth potential.

3. Implementing Recommendations of Finance Commissions:

- States should adopt recommendations from finance commissions for restructuring government finances, taxation reforms, subsidy rationalization, and fiscal transfers.

4. Rationalizing Revenue Deficits:

- States should avoid borrowing for revenue expenditures and focus on increasing revenue streams to cover essential expenditures.

5. Harnessing Royalty Rates on Minerals:

- States should advocate for regular revisions of royalty rates on minerals to maximize revenue from this source.

Improving state finances requires comprehensive strategies including enhanced revenue mobilization, prudent fiscal management, and efficient resource utilization. By prioritizing economic growth, reducing unnecessary expenditures, and implementing recommended reforms, states can strengthen their financial positions and better serve their citizens.