Utilisation of additional 2% borrowing space by states would be lower

**Brickwork Ratings, Mumbai, 17 May 2020:** Of the seven announcements made by the Union Finance Minister in the fifth tranche of the Rs 20 lakh crore special economic package called the Aatmanirbhar Bharat Abhiyan, the most significant one was regarding an increase in the borrowing space for state governments to fight against the COVID-19 crisis. The central government has permitted states to increase their borrowing limits from 3% to 5% of the GSDP for 2020-21. In fact, the Fifteenth Finance Commission, in its terms of reference, was asked to consider “the conditions that the Government of India may impose on states while providing consent under Article 293 (3) of the Constitution”. The commission is yet to submit the report on this issue. However, the central government, while expanding the borrowing space of the states, has specified four reform areas that form part of its Aatmanirbhar Bharat Abhiyaan measures; these include the adoption of “One Nation One Ration card”, “Ease of doing business”, “Power Distribution Reforms” and “Urban local body revenues”.

The incremental borrowing allowed is conditional, with 0.5% automatic and an additional 1% that can be availed in four tranches of 0.25%, with each tranche linked to clearly specified, measurable and feasible reform actions, and the remaining 0.50% if milestones are achieved in at least three out of four reform areas. The reforms by themselves are important. As most states are severely hit by the pandemic and are facing severe revenue shortages, they are likely to take up reform measures that they believe are politically feasible. However, many of them may settle on borrowing less to avoid undertaking politically difficult reforms. The borrowing space that will be actually utilised from the additional 2% of the GSDP may be lower.

It is important to fiscally empower states as they face a severe shortfall in revenues due to the clampdown of economic activities and have to meet additional expenditures in saving lives and creating livelihood opportunities. In the absence of revenue from the state excise duty, stamp duties and registration fees, motor vehicles tax or sales tax on high-speed diesel and motor spirit, allowing states to borrow more is a great support. At the same time, it would have been appropriate to clear the GST compensation that the centre has promised to the states. The compensation payment has been pending since November 2019. Furthermore, the announced Rs 90,000 crore loan for Discoms from the PFC and REC on state government guarantees
announced in the earlier announcement will help clear their outstanding payables of Rs 94,000 crore to the generating companies. The devolution of taxes (Rs 46,038 crore in April) based on the budget estimate helps augment liquidity, but will be adjusted later based on actuals. The revenue deficit grants (Rs 12,390 crore), advance release of the SDRF (Rs. 11,092 crore) and additional resources of Rs. 4,113 crores from the health ministry for direct anti-Covid activities too may help the states to partially tide over the immediate requirements, but these are not additional resources. The RBI had announced a 60% increase in the WMA limits, and this will only help in timing their borrowing better. While these may help improve the liquidity of the states in the short term, their basic structural imbalance remains. Hopefully, the hard budget constraint will force the states to undertake immediate reforms to have “one nation one ration card”, “power sector reforms”, “ease of doing business” and “urban local body revenue reform”.

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