Economic Research

Tamil Nadu State Finances

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Tamil Nadu State Budget 2021-22: Need for a sustainable fiscal consolidation path

August 2021

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Overview of the fiscal health of Tamil Nadu

Tamil Nadu implemented the Fiscal Responsibility and Budget Management (FRBM) Act in 2003, and until FY20 the state had been adhering to the fiscal deficit target of 3% of the GSDP set in the Act (FRBM), except in FY17. The takeover of TANGEDCO's debt under the UDAY programme increased the fiscal deficit beyond 3% in 2016-17. Although there was compliance with the fiscal deficit target, fiscal indicators in the state have shown a steady deterioration since FY13 as it moved from a revenue surplus to revenue deficit situation. This was mainly due to substantial decline in its own tax revenues. The surge in the share of revenue deficit in fiscal deficit from 8.69% in FY14 to 66.43% in FY21 sums up the situation.

With the steadily increasing trend in fiscal deficit driven mainly by revenue deficit, there was a sharp increase in the total debt outstanding as well. Tamil Nadu's Debt to GSDP ratio increased from 17.2% in 2012–13 to 22.6% in 2018–19 and then to nearly 25% of the GSDP in FY21.

Before presenting the revised budget for FY22, on 9 August, the finance minister had released the "White Paper on the Tamil Nadu Government's Finances" highlighting the state's past and present fiscal situation. The white paper has laid bare the legacy of dismal record of fiscal mismanagement in the State during the last decade, including the steadily rising deficits, poor performance of power utilities and the taking over of the contingent liability of power utilities by the State government and consequent debt overhang from the previous government. The white paper has sounded a serious note of caution that the state's overall debt is unsustainably high.

The finance minister of Tamil Nadu, while presenting the Revised Budget Estimates (RBE) for FY22, stressed on the need for sustained efforts over the next two to three years to move towards fiscal consolidation and debt sustainability. Accordingly, in its Medium-Term Fiscal Plan (MTFP), the budget outlined the fiscal road map to maintaining the outstanding Debt to GSDP within 28.7% in FY22, 29.3% in FY23 and 29.1% in FY24, as prescribed by Fifteenth Finance Commission (See charts on the next page).

Chart 1: Between 2006-13, Tami Nadu had a net Revenue Surplus in 5 out of 7 years

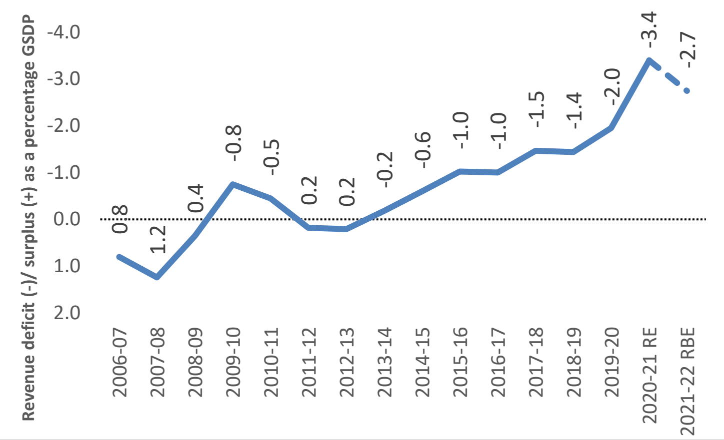


Chart 2: Falling share in central taxes (Composition of Revenue Receipts as % to total)

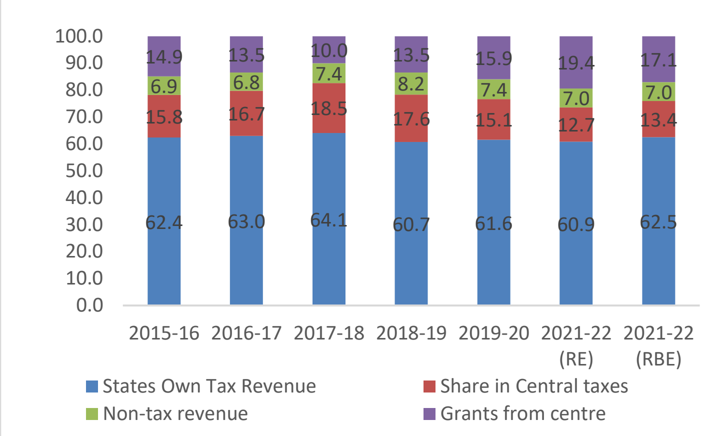


Chart 3: Substantial portion of the fiscal deficit goes towards funding the revenue deficit

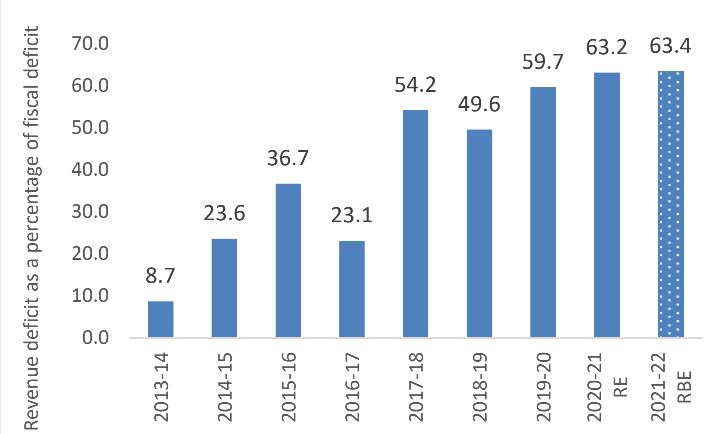


Chart 4: Rising trend of revenue-deficit-driven fiscal deficits funded mainly by borrowing

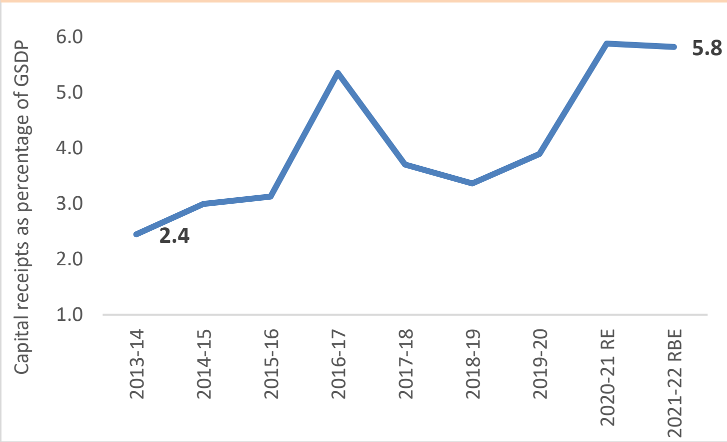


Chart 5: Until 2019-20, the fiscal deficit remained below the threshold limit of 3%

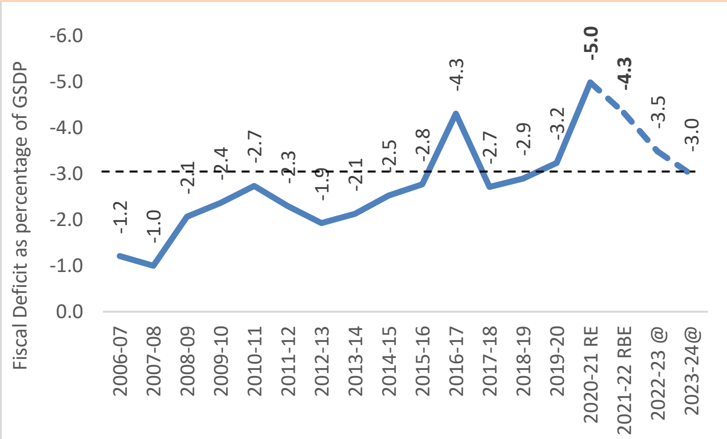
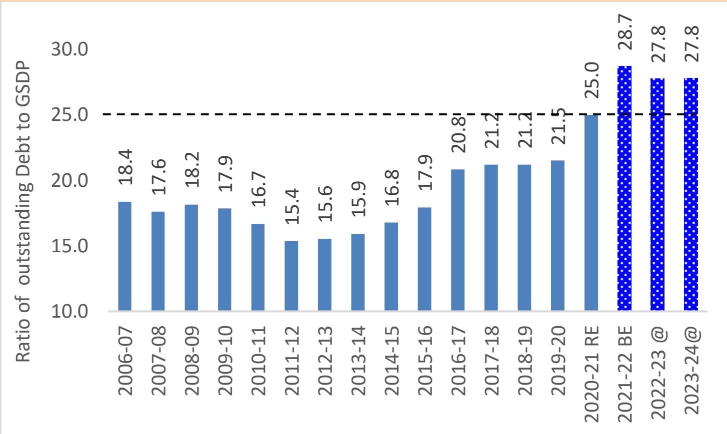


Chart 6: Debt to GSDP ratio remained within the limit prescribed by the Finance Commisions



RE: Revised Estimates, BE: Budget Estimates, RBE: Revised Budget Estimates. @ Projections
Source: Tamil Nadu Revised Budget Documents 2021-22, White Paper on the Tamil Nadu Government's Finances, and BWR Research.

Impact of the pandemic on FY21 budget estimates

> In FY17, the takeover of the debt of Tamil Nadu Generation and Distribution Corporation Limited (TANGEDCO) under the Ujwal DISCOM Assurance Yojana (UDAY) programme (to the tune of Rs 22,815 crore), which had been specifically authorised by the Government of India, resulted in the fiscal deficit crossing 3%. The state government has to sanction a grant of Rs 4,563 crore to TANGEDCO for a period of 5 years from 2017-18 to 2021-22 under the UDAY Scheme.

The impact of the pandemic and subsequent restrictions on economic activities since March 2020 on the state's fiscal health was devastating, as in the case of other states, and the state missed its FY21 budget targets by a substantial measure. The shortfall in the total revenue receipts in the revised estimate from the budget estimate was Rs 38,674 crore in FY21, which is lower by 17.6%. This is due to a 20% shortfall in the State's Own Tax Revenue (SOTR), which constitutes more than 60% of the total revenue receipts. In addition, central transfers to the state in FY21 were also substantially lower than the budget estimate and also lower than those recorded in previous years. Resources from the centre as a percentage of the GSDP have witnessed a declining trend mainly due to the declining share of Tamil Nadu in the divisible pool of the sharable taxes of the centre. On the other hand, spending was 44% more than budgeted in FY21 on medical and public health needs, while the state curtailed its revenue expenditure on general services. As per the revised estimates of FY21, both revenue and capital expenditure increased by 2.4% and 3.8%, respectively, from that budgeted. As the revenue deficit widened substantially in FY21, fiscal deficit too has exceeded the limit set by the FRBM Act. With lower revenue and higher expenditure, the fiscal deficit increased by 2.2 percentage points from that budgeted, to 4.99% of the GSDP in FY21. The debt to GSDP ratio too widened by 3.2 percentage points than budgeted, to 25% (see Table 1 and 2).

Revised budget estimates for FY22

> Due to the second wave of the Covid-19 pandemic and lockdowns, the grants-in-aid to the state, central tax shares, state's tax revenue and non-tax revenue are estimated to decrease substantially, resulting in lower revenue receipts.

The second wave of the Covid-19 pandemic, which started in March 2021, has again disrupted economic activities across the country. Tamil Nadu, like most other states, had to impose restrictions on economic activities to contain the pandemic spread, and this has substantially reversed the progress witnessed in economic recovery. While presenting the revised budget estimates for FY22, on 13 August, the state Finance Minister Dr Palanivel Thiaga Rajan, emphasised the sheer magnitude of the impact of the second wave of Covid-19 on the health and economy, and its consequences on the government's fiscal situation.

Considering the loss of output during the second wave, the revised SOTR for FY22 is estimated lower, at Rs 1,26,644 crore, than Rs 1,35,642 estimated in the interim budget. Accordingly, the revenue receipts for FY22 have been scaled down by Rs 16,496 crore to Rs 2,02,496 crore. Compared to FY21 (RE) the SOTR in FY22 is estimated to be higher by Rs 16,675 crore, which would require 15.2% year-on-year growth. The estimated tax to GSDP ratio at 5.9% for FY22 is 0.3 percentage points higher than that in the previous year. Overall, the revenue receipts are estimated to increase only by 0.2 percentage point to 9.48% of the GSDP in FY22 over the previous year. This estimate looks achievable, particularly because while presenting the budget, the state had considered the impact of the second wave of the pandemic on revenue collections so far and accordingly, had revised the budget estimates for FY22.

Additional burden of expenditure continues

For FY22, revenue expenditure was raised by Rs 780 crore to Rs 2,61,189 crore, from interim budget estimates, considering funds allocated to provide grants-in-aid and subsidies for various welfare schemes, and operation and maintenance related expenditure. Compared to FY21 (RE), the revenue expenditure is estimated to be higher by 5.9%, but as a percentage of the GSDP, it is estimated to be lower by 0.5 percentage points in FY22. On the other hand, although the capital expenditure was reduced by Rs 990 crore in the revised budget estimates from the interim budget estimates, it is estimated to be 12% higher than FY21 (RE).

Table 1: Tamil Nadu Budget at a glance (Rs crore)

	2019-20	2020-21 BE	2020-21 RE	2021-22 RBE
Revenue Receipts				
State's Own Tax Revenue	107,462	135,642	109,969	126,644
State's Own Non-tax Revenue	12,888	15,648	12,683	14,139
Total State's Own Revenue	**120,350**	**151,290**	**122,652**	**140,783**
Tax Devolution	26,392	27,148	23,039	27,148
Grants	27,783	40,553	35,009	34,564
Central Transfers	54,176	67,702	58,049	61,713
Total Revenue Receipts	**174,526**	**218,992**	**180,701**	**202,496**
Expenditures				
Revenue Expenditures, of which	210,435	260,409	246,695	261,189
Interest Payments	31,980	36,311	36,554	41,603
Capital Expenditures	47,520	68,697	60,222	67,846
Total Expenditures	**257,955**	**300,390**	**306,917**	**329,035**
Revenue Deficit	-35,909	-41,417	-65,994	-58,693
Fiscal Deficit	-60,179	-84,202	-96,890	-92,529
Debt Outstanding	**423,743**	**456,040**	**517,977**	**577,987**

RE: Revised Estimates, BE: Budget Estimates, RBE: Revised Budget Estimates.
Source: Tamil Nadu Revised Budget Documents 2021-22, BWR Research.

Table 2: Fiscal Position of Tamil Nadu (as Per Cent of GSDP)

	2019-20	2020-21 BE	2020-21 RE	2021-22 RBE
Revenue Receipts				
State's Own Tax Revenue	5.79	6.48	5.66	5.93
State's Own Non-tax Revenue	0.69	0.75	0.65	0.66
Total State's Own Revenue	**6.49**	**7.23**	**6.31**	**6.59**
Tax Devolution	1.42	1.30	1.19	1.27
Grants	1.50	1.94	1.80	1.62
Central Transfers	**2.92**	**3.24**	**2.99**	**2.89**
Total-Revenue Receipts	**9.41**	**10.47**	**9.30**	**9.48**
Expenditures				
Revenue Expenditures, of which	11.34	12.45	12.69	12.23
Interest Payments	1.72	1.74	1.88	1.95
Capital Expenditures	2.56	3.28	3.10	3.18
Total Expenditures	**13.91**	**14.36**	**15.79**	**15.40**
Revenue Deficit	-1.94	-1.98	-3.40	-2.75
Fiscal Deficit	-3.24	-4.03	-4.99	-4.33
Outstanding Debt	***21.4***	***21.8***	***25.0***	***27.1***

RE: Revised Estimates, BE: Budget Estimates, RBE: Revised Budget Estimates.
Source: Tamil Nadu Revised Budget Documents 2021-22, BWR Research.

Challenging task of managing the deteriorating fiscal conditions for the new government

The steady deterioration in finances, combined with a slowdown in economic growth, is a serious cause for concern; Covid-19 has further exacerbated the situation. Even before the Covid-19 pandemic struck, the revenue deficit as a percentage of the GSDP widened to 1.95%, and further increased to 3.4% in FY21. This is more than the entire volume of the normally permissible fiscal deficit. The rising subsidies, which accounted for 27.5% of the total revenue expenditure in FY21, are also a major burden on the finances. These commitments include those related to State Public Undertakings, mainly the power and transport sectors. The white paper called for some urgent course correction measures for the improved targeting and reorientation of subsidies to areas that enhance the public good and have positive externalities. Given the pandemic situation, the budget continued with higher expenditure under subsidies for the next two years, based on the commitment towards on-going schemes.

The budget laid a fiscal path to reduce the revenue deficit in a phased manner and thereby, to enhance the allocation for the creation of productive assets. In the forthcoming years, the state has planned to bring down the fiscal deficit within the norms prescribed by the FFC, by 3.49% of the GSDP in FY23 and 2.99% of the GSDP in FY24. Containing the fiscal deficit would help arrest the increase in the debt to GSDP ratio, while the compression of capital expenditures could have adverse effects on medium- and long-term economic growth prospects in the state. The pandemic has already impacted the growth process, and the GSDP contracted by 2% in FY21. In the budget speech, the finance minister promised to spend more on growth-oriented expenditure in FY23 and FY24 to achieve 11.5% and 12% growth, respectively. While the state did not impose any new tax to fund its deficits, it is instead confident to fulfil the required power sector reforms and use the additional fiscal space of 0.5% of the GSDP provided by the FFC for the FY22 to FY25 period.

Adhering to the fiscal targets, particularly in the present pandemic times, is going to be a major challenge for the newly elected Dravida Munnetra Kazhagam (DMK) government. The new government has announced several welfare and development measures promised in its Election Manifesto. This requires additional expenditures, which is possible only by improving the state's own tax collections. Central transfers have declined as the share of the State in tax devolution has shown steady decline in successive finance commission recommendations (from 5.305% in the Twelfth FC to 4.079% during the FFC). Thus, an improvement in the State finances, in the wake of rising expenditures would require countering decline in the State's own revenues, as well as transfers from the Centre. The state needs to revert to its pre-2014 revenue deficit to fiscal deficit ratio by improving its tax to GSDP ratio, so that it invests the borrowings fully into capital expenditure.

Historically, Tamil Nadu has been one of the most progressive states in India, contributing substantially to the national GDP with good social indicators. In the latest data on Sustainable Development Goals (SDG), the composite index for 2020-21 released by Niti Aayog, the state has improved its ranking from the third to the second, while topping in the SDG goal 1 of no poverty. The commitment of the new government to attain inclusive growth by making it a role model state is laudable. The state has already constituted an economic advisory panel with eminent economists to provide economic and social guidance. The finance minister has also assured to undertake deeper reforms to correct the debt overhang, immediately after overcoming the impact of the Covid-19 pandemic. Critical reforms are in the power sector as the subsidy to the farmers and other consumer groups needs to be phased out to restore sustainability to state finances. We expect the state to achieve its budget targets set for the current fiscal, so that it would help the state to lay the strongest foundation for the full budget for the next fiscal.

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