Ecowrap

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FINDING WAYS TO SUPPORT STATES TIDE OVER RS 3 LAKH REVENUE SHORTFALL FROM GST

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The Government has given option to State Governments to borrow as much as Rs 2.35 lakh crore in the form of borrowings, over and above Rs 4.28 lakh crores allowed to states under Atmanirbhar package, However, Article 293 (3) of the Indian Constitution imposes certain restrictions on the borrowings by the State Governments. The Article stipulates that a State may not, without the consent of the Government of India, raise any borrowings if it has any loan outstanding, which is repayable to the Government of India. Furthermore, under the Constitution, State Governments, unlike the Centre, cannot borrow externally. The Centre plays the role of an intermediary in the transfer of external borrowings to States. **We propose 3 options of how states meet the shortfall.**

OPTION 1

The first option is RBI monetizes state debt. Contextually, RBI is a banker to all state Governments (including J&K now after August 2019). However, such an arrangement is purely contractual and cannot be used as an alibi for state debt monetization. As of now before the beginning of the each fiscal year, the feasible levels of the market borrowing for Centre and States together is advised to the Government by RBI. However, RBI does not invest in State Government loans either in primary issues or in the secondary market. Thus monetization of state debt is not exactly possible in the current circumstances and it is better if the Centre monetizes the debt and gives to states and the RBI will be also comfortable by dealing with the Centre rather than deal with close to 30 sub national entities.

OPTION 2

The next option in borrowing could be a review and enlargement of WMA advances. However this can purely be short term measure as WMA is to be liquidated within 90 days specified period and is not a multi year measure. Following the recommendations of the Advisory Committee on WMA scheme for state governments, the WMA limit was set at Rs 32,225 crore for all states/ UTs together until the next review in 2020-21. Currently, a new Committee (Chairman: Shri Sudhir Shrivastava) is reviewing these limits. Pending its recommendations, it was decided on April 1, 2020 to increase the WMA limit to Rs 51,560 crore/ 60% over and above the level as on March 31, 2020. This interim measure will remain valid till September 30, 2020. We strongly recommend that the Committee comes up with revised recommendations on such WMA limits soon that could even consider extension of the 90 day period to below 1 year and an interest free agreement. The stress on state government finances is evident in FY21 as 13 states resorted to WMA and 10 states availed OD in current fiscal year.

OPTION 3

The third option is recourse to NSSF. The Central Government has set up the NSSF, which is akin to a Special Purpose Vehicle (SPV) providing an autonomous source of finance for the Governments. It mobilises small savings through post offices and banks and used to lend against non-tradable securities issued by the States till it was discontinued in FY2017 as the special securities carried a rate of interest of 9.5%, that was considered too high by states. We recommend that in the current extraordinary circumstances, the states be again allowed to tap NSSF at a concessional rate of interest so that their reliance on open market borrowings is reduced. This will require discussions at the highest level including the Finance Commission.

COMPENSATION CESS: A THORNY ISSUE

- GST collection for the first quarter of the year is 59% of the revenue collected during the same quarter last year. If we look at the components of month wise GST Collections for Q1 FY21, the SGST for Q1 FY21 was 54% of SGST for Q1 FY20, although on a month to month basis their collection improved rapidly as lockdown measures were eased. The overall IGST Collection (excluding Imports) has also come down to Rs 48,612 crore which is 59% the revenue collected during the same quarter last year. From this 45% has been allocated to states vis-à-vis 54% allocated last year for Q1. The overall SGST and allocated IGST Revenue for states stands at Rs 64703 crore, which is 47% less than the revenue in Q1 FY20.
- As per Revenue Secretary, During April - July 2020, total GST compensation to be paid is Rs 1.5 lakh crore, this is so because there was hardly any GST collection in April and May. Annual GST compensation requirement is estimated to be around Rs 3 lakh crore, and cess collection is expected to be around Rs 65,000 crore, leading to an annual compensation gap of Rs 2.35 lakh crore.
- As per our ecowrap "SUPPORTING STATES THROUGH INNOVATIVE FINANCING METHODS: ESTIMATED UNCOVERED LOSS AT ~RS 3.1 LAKH CRORES" we had estimated a shortfall of Rs 65,629 crore in Q1 FY21 in the GST Components of SGST and allocated IGST (excluding imports) for 20 major states. Going by the numbers that the Government has given, our estimates now seem conservative, as for the entire year, we were expecting a revenue shortfall of Rs 1.6 lakh crore for these 20 states. However, if we also add the budgeted cess by these states at Rs 1.2 lakh crore then the loss due to GST comes in at around Rs 3 lakh crore. Among the 20 states for which we had the data, some states had not even budgeted for the cess, as they were confident of achieving their revenue targets. **With the sudden advent of COVID-19, these states will also demand compensation, thus pushing up the numbers to Rs 3 lakh crore and beyond. There is also no clarity, whether this GST shortfall number has the aspect of devolution from CGST as well.**

GST Collection

Component	Apr'20 (Rs cr)	Y-o-Y Growth	May'20 (Rs Cr)	Y-o-Y Growth	Jun'20 (Rs Cr)	Y-o-Y Growth	Q1 FY21 (Rs Cr)	Y-o-Y Growth
CGST	5067	-76%	10330	-42%	18980	3%	34377	-40%
SGST	5951	-79%	12911	-47%	23970	-5%	42833	-46%
IGST	7956	-75%	16062	-36%	24594	-5%	48612	-41%
Cess	632	-92%	5579	-22%	7058	-7%	13270	-42%
IGST Settlement to States/ UTs	1833	-89%	8920	-38%	11117	-18%	21870	-50%
Collection on Imports	12074	-48%	16640	-33%	15709	-29%	44423	-37%
State Revenue (SGST+IGST Settlement)	7784	-83%	21832	-44%	35087	-10%	64703	-47%
Total GST	32294	-72%	62009	-38%	90917	-9%	185220	-41%

Source: SBI Research

Arithmetic of GST Compensation(Rs Lakh crore)

Item	SBI Estimate*	Govt Estimate
Compensation Cess	1.2 (Budget)	1.5
Loss of Own tax revenue due to SGST and Allocated IGST	1.6	1.5
Route for Financing		
Item	**Route 1**	**Route 2**
Compensation Cess given by Centre	0.65	0.65
Borrowing from RBI (over and above 2% of GSDP/ Rs 4.28 lakh crores already mandated for States as part of Atmanirbhar Package)	0.97	2.35
Total	1.62	3.0
Remaining shortfall due to GST**	1.38	0

Source: SBI Research, *Data for 20 states and does not include IGST on imports. The cess is calculated from the published state budget documents** states going for route one have been given additional borrowing limits

- Revenue Secretary said that a special window can be provided to the states, in consultation with the Reserve Bank of India (RBI), at a reasonable interest rate for borrowing of Rs 97,000 crore. The amount can be repaid after five years (of GST implementation) ending 2022 from cess collection. The modalities are still not clear. However, certain details have emerged. First option has two legs: 1) Centre facilitating states through RBI, in getting loans - for that portion arising out of GST implementation. 2) The gap arising in compensation due to the extraordinary situation and Act of God in the form of COVID-19 can be filled with the government giving a further relaxation of 0.5% in states' borrowing limit under FRBM Act as second leg of Option 1. States can choose to borrow more, beyond the expected compensation itself, since that is the injury caused by COVID-19. If a state goes for Option 1, it will borrow less, but its compensation entitlement will be protected.
- There may be some states which may prefer to get the hard-wired compensation rather than going to the market to borrow more, which is the second option. The second option before the states is to borrow the entire Rs 2.35 lakh crore shortfall under the special window.

WHAT ARE THE OPTIONS FOR STATES: BORROWING FROM RBI, DEBT MONETIZATION AND RECOURSE TO NSSF

- Government has given option to State Governments to borrow as much as Rs 2.35 lakh crore in the form of borrowings, over and above Rs 4.28 lakh crores allowed to states under Atmanirbhar package, However, Article 293 (3) of the Indian Constitution imposes certain restrictions on the borrowings by the State Governments. The Article stipulates that a State may not, without the consent of the Government of India, raise any borrowings if it has any loan outstanding, which is repayable to the Government of India. **Furthermore, under the Constitution, State Governments, unlike the Centre, cannot borrow externally. The Centre plays the role of an intermediary in the transfer of external borrowings to States.**
- Under these unprecedented circumstances, Centre could be made arrangement with the RBI to facilitate such borrowing. How this arrangement could be? **One obvious answer is whether monetization of state debt is possible?**
- Contextually, RBI is a banker to all state Governments (including J&K now after August 2019). However, such an arrangement is purely contractual. As of now before the beginning of the each fiscal year, the feasible levels of the market borrowing for Centre and States together is advised to the Government by RBI. The State-wise allocation of borrowings in respect of a particular fiscal year is conveyed to RBI for the conduct of borrowing programme according to the MoU signed between RBI and respective State Governments.
- **RBI does not invest in State Government loans either in primary issues or in the secondary market. Thus monetization of state debt is not exactly possible in the current circumstances and it is better if the Centre monetizes the debt and gives to states and the RBI will be also comfortable by dealing the Centre rather than deal with close to 30 sub national entities.**
- **The next option in borrowing could be an review of WMA advances.** The approach in this case will be to increase limits under WMA so that states tide over the mismatch between revenuers and expenditure. However this can purely be short term measure as WMA is to be liquidated within 90 days specified period and is not a multi year measure. Following the recommendations of the Advisory Committee on WMA scheme for state governments, the WMA limit was set at Rs 32,225 crore for all states/ UTs together until the next review in 2020-21. Currently, a new Committee (Chairman: Shri Sudhir Shrivastava) is reviewing these limits. Pending its recommendations, it was decided on April 1, 2020 to increase the WMA limit to Rs 51,560 crores / 60% over and above the level as on March 31, 2020. This interim measure will remain valid till September 30, 2020. **We strongly recommend that the Committee comes up with revised recommendations on such WMA limits soon.** 13 states resorted to WMA and 10 states availed OD in current fiscal year.
- **The third option is recourse to NSSF.** The Central Government has set up the NSSF, which is akin to a Special Purpose Vehicle (SPV) providing an autonomous source of finance for the Governments. It mobilises small savings through post offices and banks and used to lend against non-tradable securities issued by the States till it was discontinued in FY2017. The loans used to have a maturity of 25 years with an initial moratorium of five years in the repayment of principal. One-twentieth of the amount is repaid every year beginning from the sixth year. The special securities carried a rate of interest of 9.5%, that was considered too high by states and thereby since FY17, redemptions of state government securities owed to the NSSF were not rolled over. This is also one of reasons why Centre has started to use NSSF funds / off balance sheet in a big way in the last couple of years. We recommend that in the current extraordinary circumstances, the states be again allowed to tap NSSF at a concession rate of interest so that their reliance on open market borrowings is reduced. This will require discussions at the highest level including the Finance Commission on issues like as National Small Savings Fund (Custody and Investment) Rules, 2001 states that the investment in the securities of a particular State Government shall be based on the net collections in that State.

…..HOW MUCH STATES COULD BORROW?

- As discussed above, in view of the unprecedented situation due to COVID-19, Centre had already decided to accede to the request of the States and increase borrowing limits of States from 3% to 5%, for 2020-21 only. This gives States extra resources of Rs 4.28 lakh crore. Till 25 Aug'20, all states together had borrowed Rs 2.69 lakh crore (Rs 1.74 lakh crore till 27 Aug'19), which is around 30% of the limit authorized and 70% of the authorized borrowing remains unutilized. Further, to meet the tax shortfall, Government has suggested states to borrow up to Rs 2.35 lakh crore from the market. So total borrowing could be as much as Rs 6.63 lakh crores.
- The only good thing is that such additional borrowing will not require amendment in individual state FRBM act for adjustment in fiscal deficit. This because the Act also permits "*exceeding annual fiscal deficit target due to ground or grounds of national security, act of war, national calamity, collapse of agriculture severely affecting farm output and incomes, structural reforms in the economy with unanticipated fiscal implications, decline in real output growth of a quarter by at least three per cent points below its average of the previous four quarters*".

States' Additional Borrowing for FY21

Earlier Announcement	Yesterday' Announcement		Total Additional States Borrowings	
	Route 1	Route 2	Route 1	Route 2
2% of GSDP or Rs 4.28 lakh crore (Memo: As per our estimates States can borrow max Rs 3.13 lakh crore)	Rs 0.97 lakh crore + 0.5% of FRBM borrowing limit	2.35 lakh crore	Rs 5.25 lakh crore + 0.5% of FRBM borrowing limit	Rs 6.63 lakh crore

Source: SBI Research

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