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Large carry forward of unutilised FY2021 borrowings by some states softens their fiscal constraints for FY2022

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Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Neetika Shridhar
+91 124 4545 305
neetika.shridhar@icraindia.com

Jaspreet Kaur
+91 124 4545 853
jaspreet.kaur@icraindia.com



SUMMARY



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States with unutilised borrowings higher than 0.5% of FY2022 GSDP:
Arunachal Pradesh, Chhattisgarh, Goa, Gujarat, Haryana, Himachal Pradesh, Karnataka, Kerala, Maharashtra, Odisha, Punjab, Tripura, Uttar Pradesh, Uttarakhand and West Bengal

States with unutilised borrowings lower than 0.5% of FY2022 GSDP:
Bihar, Jharkhand, Madhya Pradesh, Tamil Nadu and Telangana

States with no unutilised borrowing:
Andhra Pradesh, Assam, Rajasthan, Manipur, Meghalaya, Mizoram, Nagaland and Sikkim

ICRA estimates that 20 state governments have substantial aggregate unutilised borrowings of Rs. 2.6 trillion for FY2021, that have been carried forward to FY2022. For the current fiscal, out of the normal net borrowing ceiling (NBC) of 4.0% of gross state domestic product (GSDP) set by the Government of India (GoI) for the 28 state governments (Rs. 8.5 trillion), 3.5% of the GSDP may be considered unconditional, whereas the balance 0.5% of the GSDP (Rs. 1.1 trillion) is effectively conditional on its usage towards incremental capital expenditure in FY2022. The size of the unutilised borrowing of FY2021 as a proportion of the FY2022 GSDP exceeds 0.5% of GSDP for 15 states, reducing their likely dependence on the conditional borrowing of 0.5% of GSDP. This will help those states that need to incur a larger revenue deficit in FY2022 but are unable to step up their capital spending by the required magnitude of 0.5% of GSDP.

Unutilised borrowings of FY2021 estimated at Rs. 2.6 trillion: ICRA estimates the permission for market borrowings of the 28 state governments and their loans from the GoI ("financing envelope") at Rs. 10.6 trillion for FY2021. The Provisional accounts published by the Comptroller and Audit General of India (CAG) indicate a combined fiscal deficit of Rs. 8.1 trillion of the state governments for FY2021. Based on the individual financing envelopes and the fiscal deficits for FY2021, ICRA estimates that 20 states have unutilised borrowing space that is carried forward to FY2022, aggregating to Rs. 2.6 trillion. Based on our calculations, the remaining eight states do not have any carried forward borrowing space from FY2021 to FY2022.

Carry forward reduces dependence on conditional borrowing of 0.5% of GSDP tied to incremental capex in FY2022: The GoI had permitted the state governments to carry forward their unutilised market borrowings for FY2021 to FY2022, which the latter can utilise for funding a portion of their fiscal deficits for the current year. The size of the unutilised borrowing of FY2021, as a proportion of the FY2022 GSDP (estimated by the states), exceeds 0.5% of the GSDP for 15 states, reducing their likely dependence on the conditional borrowing of 0.5% of GSDP. This will help those states that need to incur a larger revenue deficit in FY2022 but are unable to step up their capital spending by the required magnitude of 0.5% of the GSDP. We expect some states to utilise their carry forward borrowings instead of the conditional borrowings of 0.5% of the GSDP, not in addition to the latter.

Downward revision in FY2021 GSDP may pare the size of assessed carry forward: The size of the permitted borrowings for FY2021, as well as the carried forward portion, is effectively linked to the GSDP that had been estimated for FY2021, based on a formula that could not account for the economic shrinkage caused by the pandemic. If the FY2021 GSDP is revised downwards by the GoI, it would compress the size of the carried forward borrowings of the state governments below the Rs. 2.6 trillion estimated by ICRA. This could negatively impact those states in FY2022, that had fully utilised their permitted borrowings in FY2021.

ICRA estimates the unconditional borrowing permission of the state governments for FY2021 at Rs. 8.5 trillion

The Gol sanctioned an aggregate reform-linked borrowing of Rs. 1.0 trillion to 23 state governments in FY2021

UNUTILISED BORROWINGS OF FY2021 ESTIMATED AT RS. 2.6 TRILLION

The Gol had pegged the normal net borrowing limit for the state governments for FY2021 at 3.0% of the GSDP at end-March 2020.¹ Subsequently, the Gol had permitted the state governments to raise additional unconditional borrowings, equivalent to 1.0% of the GSDP, over and above the base borrowing limit of 3.0% of GSDP for that fiscal. This was done to enable the state governments to meet their higher-than-budgeted fiscal deficits in FY2021 following the expected adverse impact of the Covid-19 pandemic on their finances.

Market borrowing of states estimated at Rs. 8.5 trillion for FY2021: Publicly available information (Office Memorandum of the DoE, MoF dated March 2020) reveals that the Gol had pegged the NBC of the 28 state governments at Rs. 3.2 trillion at end-March 2020 for H1 FY2021. This was equivalent to 50% of the net borrowing limit for full FY2021 and was based on the normal limit of 3.0% of GSDP. Accordingly, for FY2021, ICRA has imputed the initial net borrowing limit of the 28 states at Rs. 6.4 trillion (3.0% of GSDP), and the Gol's March 2020 estimate of FY2021 GSDP at Rs. 213.7 trillion. Based on the latter, we estimate that the additional unconditional borrowing of 1% of GSDP was equivalent to Rs. 2.1 trillion. **The total unconditional borrowing (i.e. 4.0% of the Gol's March 2020 estimate of FY2021 GSDP) of the state governments for FY2021 is, therefore, estimated at Rs. 8.5 trillion (refer Exhibit 1).**

Exhibit 1: Estimation of financing envelope for FY2021

Amount in Rs. Trillion	Total Market borrowings (A)	Reform-linked Borrowings (B)	GST compensation Loan (C)	Capital expenditure Loan (D)	Total Financing Envelope (E=A+B+C+D)
Source	ICRA Estimate	PIB Release	FY2022 Union Budget	PIB Release	ICRA Estimate
Total for 28 state governments	8.5	1.0	1.0	0.1	10.6

Source: Department of Expenditure (DoE), Ministry of Finance (MoF); Comptroller and Auditor General of India (CAG); Press Information Bureau (PIB) releases; ICRA Research

Reform-linked borrowings of Rs. 1.0 trillion sanctioned to 23 state governments in FY2021: In May 2020, the Gol had permitted the states to borrow another 1% of GSDP in FY2021, conditional on the latter executing reforms in four prescribed areas (0.25% of GSDP per reform). As on March 31, 2021, the Gol had sanctioned an aggregate reform-linked borrowing of Rs. 1.0 trillion to 23 state governments (except Jharkhand, Maharashtra, Mizoram, Nagaland and West Bengal). In FY2021 that had completed at least one of the prescribed reforms by the stipulated time line of February 15, 2021. Karnataka was eligible for the highest borrowing of Rs. 99 billion followed by Uttar Pradesh and Tamil Nadu at Rs. 97 billion and Rs. 96 billion, respectively.

¹ As per Article 293(3) of the Constitution of India, a state government is required to take permission from the Gol for raising fresh debt if the state government is indebted to the Gol.

ICRA estimates the financing envelope available to the states in FY2021 at Rs. 10.6 trillion

20 states have unutilised borrowing space that is carried forward to FY2022, aggregating to Rs. 2.6 trillion

GST compensation loan and capex related interest free loan of Rs. 1.1 trillion provided to 28 state governments in FY2021: The Gol had proposed to meet the GST compensation requirement of the state governments in FY2021, through a combination of the GST compensation cess collections and market borrowings. In H2 FY2021, the Gol borrowed Rs. 1.1 trillion and on-lent to the state governments and UTs as a back-to-back loan to meet a portion of the shortfall in the GST compensation requirement. For the 28 state governments, the GST compensation loan amounts to around Rs. 1.0 trillion.

Further, the Gol released a 50-year interest-free aggregate loan of Rs. 118 billion to all the state governments² for spending on ongoing and/or new capital projects in FY2021. Out of this, a loan of Rs. 103 billion was disbursed to the 28 states in FY2021 based on their 15th FC recommended inter-se shares for FY2021. These loans would have been utilised to finance the FY2021 fiscal deficits, with no carry forward to FY2022.

We estimate that market borrowings (Rs. 8.5 trillion), reform-linked borrowings (Rs. 1.0 trillion), GST compensation loan and interest-free loans for capex (Rs. 1.1 trillion), would aggregate to Rs. 10.6 trillion for the 28 state governments. This is the “financing envelope” that was available to these state governments for funding their fiscal deficit for FY2021.

Aggregate fiscal deficit of 28 state governments estimated at Rs. 8.1 trillion for FY2021: The provisional data on key fiscal indicators of state governments available on the CAG’s website for FY2021³, indicates an aggregate revenue deficit of Rs. 3.9 trillion (1.9% of GSDP⁴; refer Exhibit 2), sharply higher than the initially budgeted revenue deficit of Rs. 0.3 trillion (0.2% of GSDP) for FY2021. The provisional combined fiscal deficit is estimated at Rs. 8.1 trillion (4.0% of GSDP) for FY2021, significantly larger than the budgeted Rs. 6.1 trillion (3.0% of GSDP).

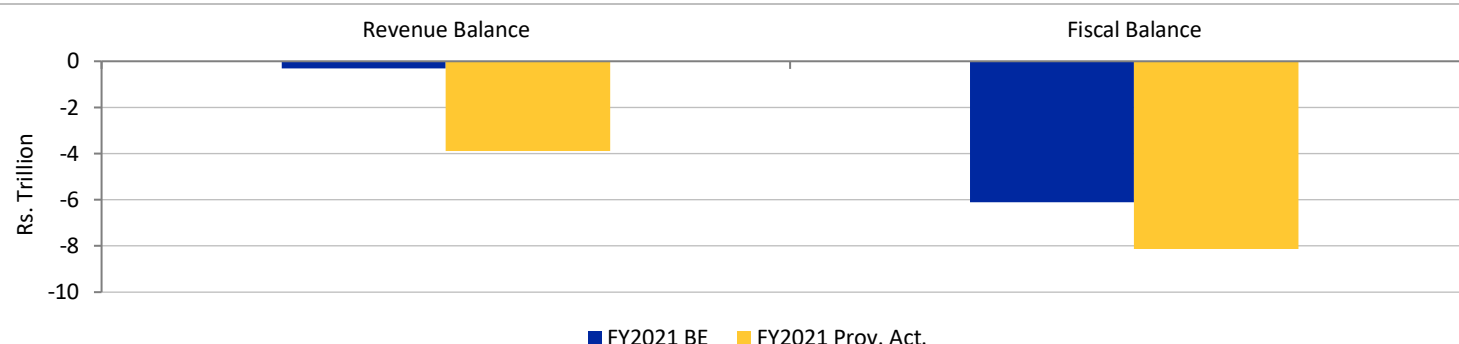
The Gol had permitted the state governments to carry forward the unutilised portion the base net borrowing limit, the additional unconditional borrowing limit and the sanctioned reform-linked borrowing for FY2021 to FY2022. **Based on the individual financing envelopes and the fiscal deficits for FY2021, ICRA estimates that out of the 28 states, 20 have unutilised borrowing space that is carried forward to FY2022, aggregating to Rs. 2.6 trillion. Based on our calculations, the remaining eight states do not have any carried forward borrowing space from FY2021 to FY2022.**

² A press release by the Ministry of Finance dated January 6, 2021 mentions that under the Gol’s scheme for special assistance to states for capital expenditure, Rs. 103 billion have been allocated to 28 states. The financing envelope estimated in this note includes the state-wise allocation of Rs. 103 billion mentioned in the aforementioned press release. As per a subsequent press release dated April 2021, the actual amount released by the Gol to the states for the capex related loan is a higher Rs. 118 billion. However, the state wise break-up of the same is not available.

³ FY2021 provisional data is available for all states except for Assam, Goa and Manipur, accordingly, for these states their revenue and fiscal balances as per the revised estimates for FY2021 have been used.

⁴ The GSDP of 25 states for FY2021 is based on the estimate included by them in their FY2022 state budgets. In the absence of data being published in the state budgets, ICRA has projected FY2021 GSDP to contract on a YoY basis by 3.0% for Sikkim, Tripura and Himachal Pradesh, in line with the nominal GDP contraction of 3.0% for FY2021 based on the NSO estimates.

Exhibit 2: Aggregate revenue and fiscal deficit of 28 state governments in FY2021 BE and provisional actuals



Source: State budgets; CAG; ICRA Research

CARRY FORWARD REDUCES DEPENDENCE ON BORROWING OF 0.5% OF GSDP TIED TO INCREMENTAL CAPEX IN FY2022

The FY2022 BE of the 28 Indian state governments had projected an aggregate fiscal deficit of Rs. 7.6 trillion for the current fiscal. This is equivalent to 3.4% of the GSDP for FY2022, included by them in their FY2022 Budgets.⁵ The GoI has accepted the normal NBC of 4.0% of the GSDP (Rs. 8.5 trillion; Source: Monthly Summary Report for March 2021, DoE, MoF) recommended by the Fifteenth Finance Commission (15th FC) for the state governments for FY2022. However, out of this, 3.5% of GSDP may be considered unconditional. The permission for the balance 0.5% of GSDP (Rs. 1.1 trillion) has been earmarked by the GoI towards incremental capital expenditure by the state governments in FY2022, making it effectively conditional in nature.

The aggregate budgeted fiscal deficit of the 28 state governments of 3.4% of GSDP, is only marginally lower than the unconditional NBC of 3.5% of GSDP for FY2022. However, most of the state governments had presented their FY2022 Budgets prior to the emergence of the second wave of Covid-19. The associated restrictions could result in a combination of lower-than-projected revenues and the GSDP, as well as higher-than-forecast expenditure, leading to the eventual fiscal deficit exceeding the budgeted 3.4% of GSDP, similar to the slippage seen in FY2021.

ICRA's estimate of the aggregate unutilised borrowings of Rs. 2.6 trillion for FY2021 of 20 state governments, is more than twice as large as the incremental capex of Rs. 1.1 trillion estimated by the GoI for FY2022 across all the 28 states. This substantial carry forward would augment the borrowing limit of the states for FY2022, helping them to absorb the shock related to the second or any subsequent waves of Covid-19.

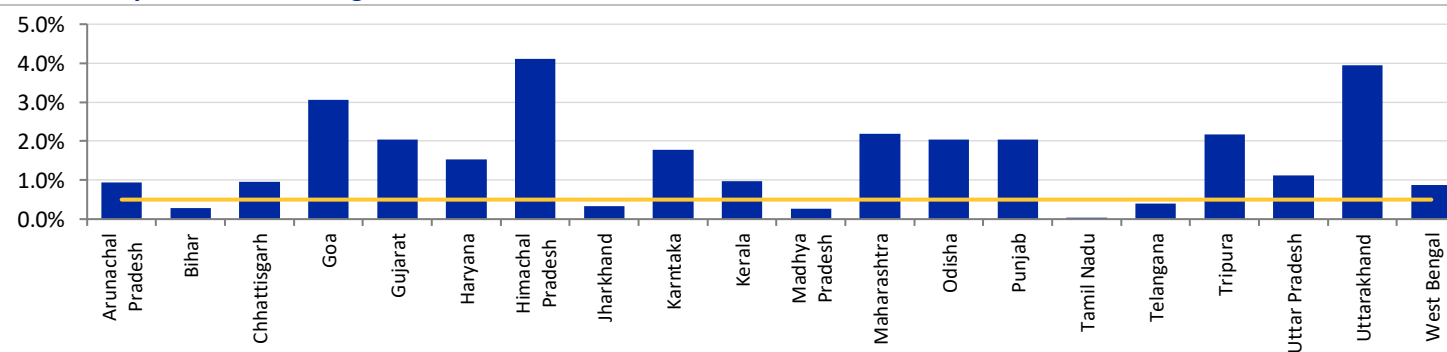
Post the second wave of Covid-19, the states' combined fiscal deficit may exceed the budgeted 3.4% of GSDP, similar to the slippage seen in FY2021

⁵ The GSDP of 26 states for FY2022 is based on the estimate included by them in their FY2022 state budgets. In the absence of data being published in the state budgets, ICRA has projected FY2022 GSDP to expand on a YoY basis by 15.0% for Sikkim and Tripura.

15 states have carried forward borrowing space in excess of 0.5% of the GSDP

However, the size of the unutilised borrowing of FY2021 as a percentage of the FY2022 GSDP (estimated by the states in their Budgets) is highly varied across the states. It exceeds 0.5% of the GSDP for 15 states, namely Arunachal Pradesh (0.9%), Chhattisgarh (1.0%), Goa (3.1%), Gujarat (2.0%), Haryana (1.5%), Himachal Pradesh (4.1%)⁶, Kerala (1.0%), Karnataka (1.8%), Punjab (2.0%), Maharashtra (2.2%), Odisha (4.05%), Tripura (2.25%), Uttar Pradesh (1.1%), Uttarakhand (3.9%) and West Bengal (0.9%), reducing their likely dependence on the conditional borrowing of 0.5% of the GSDP (refer Exhibit 3). This will help those states that need to incur a larger revenue deficit in FY2022 but are unable to step up their capital spending by the required magnitude of 0.5% of GSDP. We expect some states may choose to utilise their carry forward borrowings instead of the conditional borrowings of 0.5% of GSDP, not in addition to the latter.

Exhibit 3: Carry-forward borrowing from FY2021 as % of FY2022 GSDP



Source: DoE, MoF; CAG; PIB releases; State budgets; ICRA Research

The unutilised borrowing of FY2021 of Bihar (0.1%), Jharkhand (0.3%), Madhya Pradesh (0.3%), Telangana (0.4%) and Tamil Nadu's (0.04%) is less than 0.5% of GSDP for FY2022, which gives them limited leeway to absorb a shock in FY2022. However, we estimate that the remaining states, i.e. Andhra Pradesh, Assam, Rajasthan, Manipur, Meghalaya, Mizoram, Nagaland and Sikkim had utilised their entire permitted borrowing for FY2021, in that fiscal itself, and therefore have no carry forward from FY2021 to FY2022 (refer Exhibit 4).

⁶ The sharply higher carried forward borrowing as a percentage of FY2022 GSDP of Himachal Pradesh and Uttarakhand is on account of revenue surpluses indicated by these states in their FY2021 Provisional accounts (Rs. 16 billion and Rs. 11 billion, respectively) relative to the revenue deficit included in their FY2021 BE (Rs. 7 billion and Rs. 0.5 billion, respectively).

Exhibit 4: Estimation of unutilised borrowing space for FY2021

Amount in Rs. Billion	Total Market borrowings (A)	Reform-linked Borrowings (B)	GST compensation Loan (C)	Capital expenditure Loan (D)	Total Financing Envelope (E=A+B+C+D)	FY2021 Fiscal Deficit (F)	Space Available* [G=A+B-(F-C-D)]
Source	ICRA Estimate	PIB Release	FY2022 Union Budget	PIB Release	ICRA Estimate	CAG	ICRA Estimate
Andhra Pradesh	404	91	23	3	522	537	-
Arunachal Pradesh	11	1	-	2	15	12	2
Assam	150	19	10	5	183	221	-
Bihar	258	3	39	8	309	298	11
Chhattisgarh	143	18	31	3	195	158	37
Goa	36	7	8	0	52	24	27
Gujarat	696	87	92	3	878	495	384
Haryana	343	43	44	1	431	295	136
Himachal Pradesh	70	13	17	5	105	39	66
Jharkhand	141	-	17	3	161	149	12
Karnataka	721	99	124	3	948	646	302
Kerala	362	45	58	2	466	382	85
Madhya Pradesh	380	85	45	7	517	486	31
Maharashtra	1,232	-	120	5	1,356	702	655
Manipur	12	2	-	2	16	37	-
Meghalaya	15	2	1	2	21	26	-
Mizoram	11	-	-	2	13	28	-
Nagaland	13	-	-	2	15	21	-
Odisha	229	43	38	4	314	80	234
Punjab	243	31	84	2	358	234	124
Rajasthan	437	87	46	5	575	579	-
Sikkim	12	1	-	2	15	23	-
Tamil Nadu	770	96	62	4	932	923	9
Telangana	401	75	24	2	502	456	46
Tripura	24	6	2	2	34	20	14
Uttar Pradesh	776	97	60	15	948	704	245
Uttarakhand	112	24	23	5	164	54	110
West Bengal	543	-	44	6	594	497	97
Total	8,510	969	1,005	102	10,587	8,102	2,625

Note: Unlike market borrowings and reform-linked borrowings, loans from the Centre (GST compensation loan and capital expenditure loan) are not eligible to be carried forward to FY2022. The loans from the Centre have been subtracted from the fiscal deficit of the states for FY2021. The balance fiscal deficit for FY2021 has been adjusted from the market borrowings available in that fiscal to arrive at the fiscal space for FY2022.

Source: DoE, MoF; CAG; PIB releases; ICRA Research

The GoI's GSDP estimate for FY2021 made in March 2020, was much higher than the NSO's current estimate of FY2021 GDP

DOWNWARD REVISION IN FY2021 GSDP MAY PARE SIZE OF ASSESSED CARRY FORWARD

We have imputed the nominal GSDP used by the GoI (in March 2020) for calculating the FY2021 market borrowings to the 28 state governments at Rs. 213.7 trillion. This is 7.7% higher on a YoY basis, than the GSDP of Rs. 198.5 trillion for FY2020 (as per National Statistical Organisation or NSO) and is likely to have followed the formula for estimating the GSDP recommended by the 15th FC (refer Box 1). Following the pandemic, India's nominal GDP for FY2021 recorded a 3.0% contraction to Rs. 197.5 trillion based on the NSO's estimates.

Box 1: Calculation of base GSDP for estimating the net borrowing ceilings of state governments

As per the 15th FC, for the purpose of assigning state-specific borrowing limits as a percentage of the GSDP for a given fiscal year (t), the GSDP should be estimated on the basis of the annual average growth rate of the actual GSDP observed during the previous three years or the average growth rate of GSDP observed during the previous three years, for which actual GSDP data is available. This growth should be applied on the GSDP of the year t - 2. Specifically, the GSDP for the year (t-1) and the given fiscal year (t) should be estimated by applying the annual average growth rate of the GSDP in t - 2, t - 3 and t - 4 years on the base GSDP (at current prices) of t - 2. The 14th FC had recommended that the state-wise estimates of the GSDP published by the NSO should be used for this purpose.

The size of the permitted borrowings for FY2021, as well as the carried forward portion, is effectively linked to the GSDP that had been estimated for FY2021, based on a formula that could not account for the economic shrinkage caused by the pandemic. If the FY2021 GSDP is revised downwards by the GoI, it would compress the size of the carried forward borrowings of the state governments below the Rs. 2.6 trillion estimated by ICRA. This could negatively impact those states in FY2022, that had fully utilised their permitted borrowings in FY2021.

Based on the NBC of 4% of the GSDP for FY2022 or Rs. 8.5 trillion, we have imputed the March 2021 estimate of the GoI of the GSDP for the 28 state governments at Rs. 211.7 trillion. This is equivalent to a contraction of 0.9% over the GoI's March 2020 estimate of the FY2021 GSDP. This is slightly lower than ICRA's forecast of the total nominal GDP for the ongoing year, which factors in the impact of the second Covid-19 wave. Accordingly, in our view, the GSDP estimated appeared to be assumed by the GoI for calculating the NBC for FY2022, appears appropriate.



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Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: Jayantac@icraindia.com
Tel: +91 80 4332 6401 / +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: Communications@icraindia.com
Tel: +91 124 4545 860

Registered Office

B-710, Statesman House 148,
Barakhamba Road
New Delhi-110001
Tel: +91 11 23357940-45

Corporate Office

Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon - 122 002
Tel: +91-124-4545300

Ahmedabad

1809-1811, Shapath V,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

Bengaluru 1

'The Millenia', Tower B Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

4th Floor, 'Shoban'
6-3-927/A&B. Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

No. 7-1-58, 301, 3rd Floor, 'Concourse',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 1194

Email: Info@icraindia.com

Helpdesk: 9354738909

Website: www.icra.in/ www.lcraresearch.in