

## Gist of EPW November Week 3, 2020

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## The State of State Finances

### **Context:**

The article discusses conditions of state finance amidst the pandemic and the need for more resources for states to deal with various fiscal and social responsibilities.

### **Abysmal conditions of state finances:**

- State finances are in a dismal state and this is evident from the steady rise in the debt of the states after a long interval.
- A recent report by the **Reserve Bank of India** has shown that the debt of the states has increased significantly from 22% of the GDP in 2014-15 to 26.6% of GDP in the budget estimates of 2020-21.
- This rapid hike in the debt of the states represents a turnaround of the previous trends when there was a reduction in the state debt by 10 percentage points of the GDP from the highest level of 31.8% in 2003-04.
- Besides, the pace of growth of state debt is four times greater than that of the Central government's debt, which increased by 1.2% of the GDP and stood at 50.6% in the budget estimates of 2020-21 as compared to 49.4% of the GDP in 2017-18.

### **Causes of dismal conditions of state finances:**

- This rapid increase in state debt in comparison to the debt of the central government indicates that there are other reasons for it apart from the slowdown in the economy.
- One of the important reasons behind the dismal condition of state finances is the reduction of resource flows from the central government to the states.
- However, the share of the states in the union divisible pool of taxes was remarkably increased by the Fourteenth **Finance Commission** from 32% to 42%.
- The centre has contravened the mandate of the Commission by mobilizing additional resources via non-shareable cesses and surcharges which has led to a noticeable reduction in the share of states in union taxes from 42% (as mandated by the Fourteenth Finance Commission) to merely 32%.
- In addition to this, the cut in corporate tax rates and Goods and Service Tax (GST rates) have also led to a negative impact on resource flows from the centre to states.
- Furthermore, the rise in state debt is also attributed to the rising expenditure of the states, which has increased by more than one percentage point of the GDP over the period of five years to reach the highest level of 18% of the GDP in the revised estimates of 2019-20.
- There are many reasons for this:
  - Besides the inflation and the enforcement of the pay commission award by the states, various acts of commission and omission by the centre have also encumbered the states.
  - As a part of the financial restructuring, states had to take responsibility for the debts of the power distribution companies under the **Ujwal Discom Assurance Yojana (UDAY)**.
  - Furthermore, states have also declared loan waivers due to rising distress of the farmers in the country. This has also added to the escalating state expenditures.
  - On the contrary, the tax revenues of states and total revenue of states have gone up by only 0.2 and 0.5 per cent of the GDP respectively.

- The main reason for the falling tax receipts of the states is the glitches in the GST rollout, which has negatively hit tax collections.

**Impacts on spending patterns:**

- The hike in the state debt along with the reduction in their fiscal share has negatively affected the spending pattern of the states.
- Development expenditure of the states which stood at the highest percentage of 67.6% of the total expenditure of the state government in 2016-17 has reduced to 63.4% in 2020-21.
- The data represents that despite the reduction in fiscal leeway, the states have managed to maintain their social development spending, which is largely allocated for health, education, and water supply and sanitation, which has increased by a few marginal points to approximately 57% of the total expenditure.
- On the contrary, the share of economic services, which is largely allocated for rural development, agriculture, transport and energy, has fallen to 42%. This will undoubtedly act as a hindrance to medium-term growth.

**Future trends in state finances:**

- Under such circumstances, states have to withstand the impact of the pandemic. The pandemic has already led to an increase in the **fiscal deficit**.
- Before the pandemic, the average fiscal deficit of the states for the year 2020-21 was 2.4% of the gross state domestic product (GSDP). The number almost doubled to 4.6% as evident from budgets which were presented after the breakout of the pandemic.
- As evident from current trends, if the recovery does not happen at expected rates, then it would be difficult for the states to mobilize the required resources. This is even after the conditional increase in the states' borrowing limits from 3% to 5% of the GSDP.
- In the 2nd quarter of GST, a partial recovery made by states has lessened the scissor effect which RBI used to depict the situation where expenditure surges and revenue collapses.
- However, high spending on healthcare and income support to people who have been hit hardest amidst the pandemic will tend to reduce investment by states. This will impact growth and the vicious cycle will continue.

**The way forward:**

- To overcome this, states will have to reprioritise their spending. The focus areas should be high multiplier capital projects which have low gestation periods. Along with it, investment should be made in building healthcare infrastructure and providing social security.
- In deficit states, there is a need to introduce universal health coverage.
- There is also a need to re-design fiscal policy. The fiscal spending has to be anti-cyclical, rather than procyclical, so that it can act as a stabilising tool.
- This can only happen when there will be substantial resource transfer to states. The hope for substantial resource transfer depends on the second report of the **Fifteenth Finance Commission**, so that they can meet their rapidly growing responsibilities.

## In Search of Responsible Politics

**Context:**

The article discusses the state of politics in India by taking the case of the recently concluded Bihar election.

**Ideal and real politics:**

- The recently completed Bihar assembly elections have once again highlighted the gap between real politics and ideal politics.
- The "real" aspect of politics could be explained in terms of narrow political interests that are accomplished by using measures that do not involve any standard or prescribed norms.
- The negative aspect of "real" politics includes making use of unproductive rhetoric, without considering the needs of the people, strategic planning accompanied by caste arithmetic to avoid difficult issues, and

a quest to become powerful not only by cutting opposition parties down by size but also to own electoral allies.

- This real substance of politics becomes ideal for some parties who seem to be using such an aspect again and again by completely disregarding the noble dimension of politics.
- By continuously using such type of politics, the actual politics, that is, communal and narrow gets converted into an ideal one.
- The real aspect of politics, however, does not create any significant impact on the voters.
- The primary concern of some political parties is to capture political power for realizing sectional interests, even through a simple majority.
- For the so-called national parties, gaining at least a simple majority even without putting substantive content in the election becomes a political ideal worth cherishing.
- In contrast to this, the normative aspect of politics focuses on the creation of a democratic ethos among not only the voters but also among the political leaders.

***Importance of voting:***

- Voting must be declared as one of the most responsible acts that should be unavoidably used in developing the ethos of democracy.
- There is no need to lay stress on the fact that the future of democracy is dependent on the creation of such ethos, the ethos that is described with regards to the extent to which the democratic values are incorporated among the citizens.
- Such ethos protects these democratic values by taking a moral initiative without waiting for the lead from political leaders.
- Citizens as responsible voters should lead a campaign among themselves for the candidates who can genuinely promise to strengthen such ethos.

***Responsibilities of political parties and voters:***

- Idealist politics is based on distributive justice and values of equality and dignity.
- Hence, it is the moral responsibility of both voters and political parties to imbibe such ideals in their political decision making.
- Political parties have higher responsibilities to integrate these ideals into their agenda for election campaigns. Not only this, they also have the responsibility to create democratic ethos every day by involving voters in this endeavour.
- As citizens, voters are also responsible for persuading political leaders to include these ideals into their politics of electoral mobilization.
- It is the fundamental responsibility of the citizens to use the deliberative opportunity to create and stay with the democratic ethos. Also, they need to put moral pressure on politicians to participate in the creation of this democratic ethos and own responsibility for the same.
- Deliberation is a two-way process. It not only happens between citizens and leaders, but also citizens deliberate among themselves.
- This deliberation helps in the evolution of the truth of an electoral verdict.
- Democratic deliberations on electoral choices enhance democratic ethos.

***The case of Bihar assembly election:***

- The recently held Bihar election campaigns represented the issue centric deliberation between the leaders of political parties and the voters.
- This was evident by the number of voters present in the election meetings addressed specifically by the leaders of political parties.
- This deliberation was the result of common intuition that motivated the voters to observe the truth that they found out in the promises of the leaders from various political parties.
- The candidates of opposition parties raised these value-based agenda. For example, they promised to generate jobs for local people to make out-migration unnecessary.

- Migrating to other places for work brings some benefits. However, migrants have to face humiliation at the host locations. By promising health and market facilities to the people and the farmer respectively, leaders of a few political parties seek to establish the principle of social justice.

**Conclusion:**

- In the recently held assembly election of Bihar, electoral campaigns by some political parties were exclusively based on caste and communal issues. They didn't even refer to the difficult issues faced by the people of Bihar. Such political parties cannot be expected to create a democratic ethos.
  - If a larger cause is being promoted then it would motivate people to raise voice against those who have only diatribes and caste prejudice on their side.
  - In the Bihar election, the issue of caste in advancing political interest worked and a few political parties reaped electoral benefits.
  - However, it went against democratic politics which is based on issues and not on emotions.
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