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TAMIL NADU STATE FINANCES: ISSUES AND OPTIONS

Pinaki Chakraborty

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Gandhi Mandapam Road
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Tamil Nadu State Finances: Issues and Options

Pinaki Chakraborty

Abstract

This paper analyses emerging fiscal issues for the State of Tamil Nadu. Various fiscal shocks during the covid and their impact on the fiscal balance of the State has been quantified. The paper suggests specific policy issues related to own resource mobilisation, public expenditure management and management of public debt for post-covid fiscal recovery.

Keywords: *Finance*
JEL Codes: *Q54, H63, C23, D72*

Preface

Madras School of Economics (MSE) established the Centre for Public Finance (CPF), which started functioning from April 1, 2021. This Centre is financed by the Government of Tamil Nadu. Its activities are guided by an Advisory Council (headed by me). The Centre focuses on both theoretical and empirical issues of public finance covering the following areas: deficit financing and public debt, monetary and fiscal interactions, tax policy and reforms, public expenditure management, public investment appraisal and cost benefit analysis, public enterprises reform, intergovernmental transfers, local finances and environmental issues.

Apart from general research activities, the Centre is committed (i) to review the Tamil Nadu Economy and State Finances every year, (ii) to conduct an Annual Conference on topics related to public finance and policy and (iii) to conduct Training Programs on public finance. It will also undertake specific studies on public finance funded by Government of Tamil Nadu and other National and International agencies.

During the academic year 2021-22, the Centre organized "Virtual Meeting on Improving the Presentation of Tamil Nadu Budget Document" on April 29, 2021 and conducted the 5-day Training Programs on Public Finance for (270) 15 batches of Groups A and Group B officials of Government of Tamil Nadu through online mode (from August 31 ,2021 to December 31, 2021). It has also initiated about 10 research studies.

The study "Tamil Nadu State Finances: Issues and Options" by Pinaki chakraborty is the Eighth working paper of the Centre for Public Finance. This working paper analyses emerging fiscal issues for Tamil Nadu and also quantifies the impact of various, fiscal shocks during the covid period on fiscal balance. It suggests specific policy measures relating to revenue mobilisation, public expenditures and public debt.

C.Rangarajan
Chairman

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Pinaki Chakraborty

INTRODUCTION

Tamil Nadu is the second-largest contributor among States[1] to the GDP. The share of State's GSDP in national GDP, as per the 2020-21 data, was 9.04 per cent. Tamil Nadu's GSDP (at constant prices) registered a trend growth rate of 6.61 per cent during the period 2011-12 to 2021-22. From the peak of 8.6 per cent during the year 2017-18, Tamil Nadu's growth rate in real-term slipped to 1.4 per cent in 2020-21 due to the Covid pandemic. The GDP contraction during the same year was -6.6 per cent in real terms. The economic growth of Tamil Nadu increased to 7.8 per cent in 2021-22 implying that the State witnessed significant post-covid economic recovery. The economy of Tamil Nadu has two distinguishing features:

a. The State has always been one of the more industrialized States in the country, reflected in the contribution of industry in the State's GSDP, at around 31 percent in 2004-19. In addition, the State accounted for the most number of factories in India (15.73 percent), according to the Annual Survey of Industries 2018-19.
b. According to the 2011 Census, Tamil Nadu is the third most urbanized State (after Goa and Mizoram)[2], with around 48.4 percent of the population living in urban areas[3].

Tamil Nadu was affected severely by both the first and the second wave of Covid. Prolonged lockdown and other Covid containment measures affected the State economy and increased public financial management (PFM) challenges for the State. The Covid-induced fiscal

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[1] Comparison with States excluding UTs, Delhi and Puducherry
[2] Delhi not included in the comparison
[3] In terms of population living below the poverty line, as per the Tendulkar methodology, the State has performed well, with a decline in poverty rate from 17.1 percent in 2009-10 to 11.28 percent in 2011-12. While rural poverty has declined from 21.2 percent to 15.8 percent, urban poverty has halved from 12.8 percent to 6.5 percent in this period. The average MPCE in rural and urban areas at Rs. 1571 and Rs. 2534 in 2011-12 respectively, were much higher than the all-India averages of Rs. 1287 and Rs. 2477 respectively.

shock resulted in a significant increase in deficit and debt at the State level. Given the PFM challenges, the short to medium-term fiscal policy objectives need to focus on improving own resource mobilisation (both own tax and non-tax), aligning expenditure to key SDG goals, increasing capital expenditure for higher public investment, promoting private investment, and return to a sustainability path of debt and deficit. This paper highlights the key issues related to State finance of Tamil Nadu based on the fiscal data for the period from 2011-12 to 2022-23 (BE) with a focus on post covid fiscal recovery.

The paper proceeds as follows. The next two sections compare the pre and post-covid growth performance of Tamil Nadu, provide an overview of State Finances of Tamil Nadu and analyse fiscal shock arising due to the Covid. The subsequent section discusses debt and deficit at the State level and issues related to FRBM. The downside off-budget fiscal risks are also discussed in this section. The final section concludes with a focus on short- and medium-term fiscal reform at the State level.

COMPARING PRE AND POST-COVID GROWTH

If we consider long time-series data, the GSDP of Tamil Nadu grew consistently at a higher rate than the all-State GSDP during 2012-13 to 2020-21, except for the years 2014-15, and 2016-17 (See Figure 1). The growth rate of the GSDP was positive in the first year of covid (1.4 per cent). A comparative picture of the impact of Covid on the economic growth of major States in India is presented in Figure 2. If we compare the State-specific GSDP growth rate during COVID-19, the highest economic contraction was observed in Kerala (-9.2 percent) and the lowest in Assam (-0.4 percent). However, Bihar, Goa, Tamil Nadu, and West Bengal economies grew during the pandemic at 2.2 percent, 1.6 percent,1.4 percent and 1.1 percent respectively.

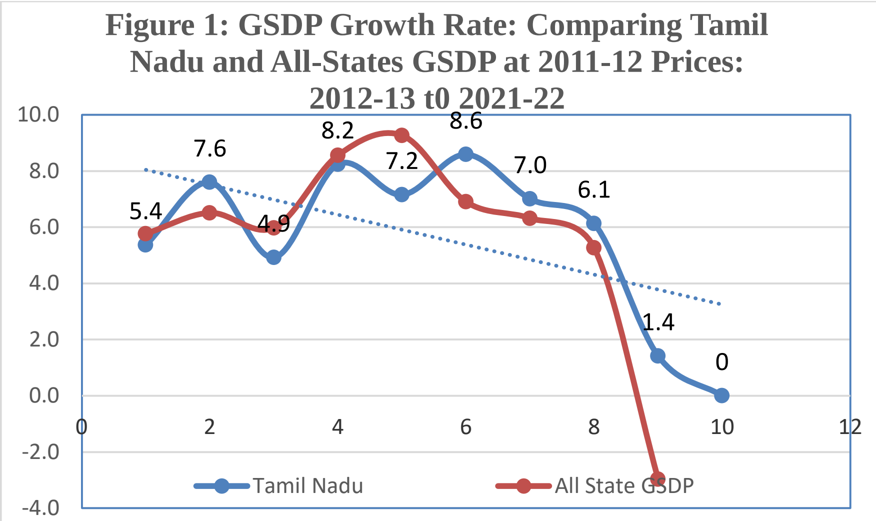
Figure 1: GSDP Growth Rate: Comparing Tamil Nadu and All-States GSDP at 2011-12 Prices: 2012-13 t0 2021-22
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
0
2
4
6
8
10
12
5.4
7.6
4.9
8.2
7.2
8.6
7.0
6.1
1.4
0
Tamil Nadu
All State GSDP

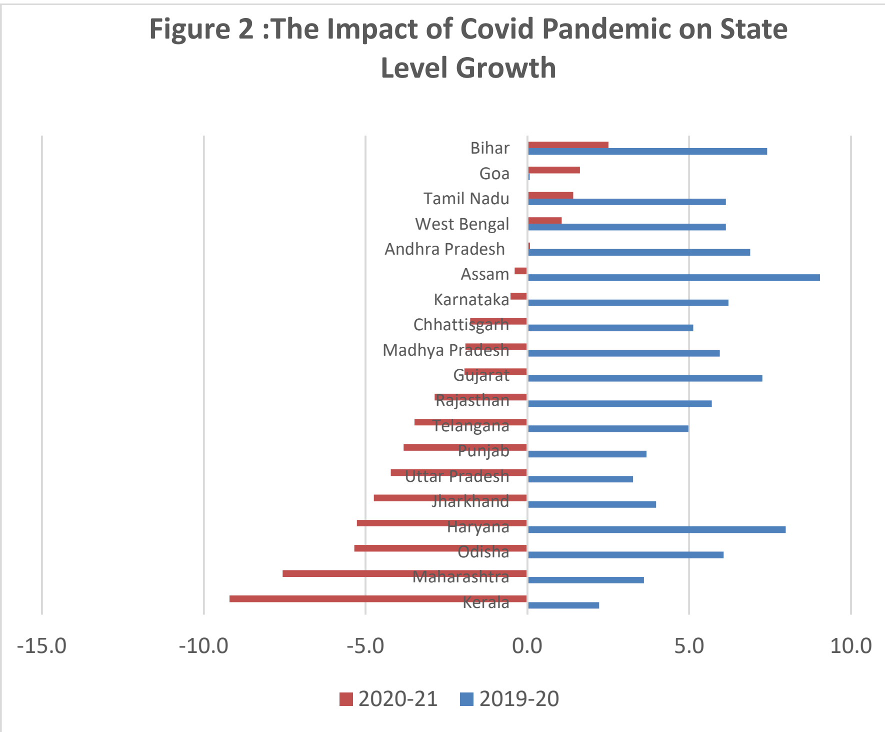
Figure 2 :The Impact of Covid Pandemic on State Level Growth
Bihar
Goa
Tamil Nadu
West Bengal
Andhra Pradesh
Assam
Karnataka
Chhattisgarh
Madhya Pradesh
Gujarat
Rajasthan
Telangana
Punjab
Uttar Pradesh
Jharkhand
Haryana
Odisha
Maharashtra
Kerala
-15.0
-10.0
-5.0
0.0
5.0
10.0
2020-21
2019-20

A disaggregated analysis of the growth of Tamil Nadu is presented in Table 1. The growth is divided into two sub-periods: Pre-Covid (2012-13 to 2019-20) and Post-Covid (2020-21 and 2021-22). The economy of Tamil Nadu has a large service sector presence, which registered a 6.5 percent trend growth rate during 2011-12 to 2019-20. In real terms, agriculture grew at a higher rate in 2020-21, compared to the average growth of 5.3 per cent observed during 2011-12 to 2019-20. During the year 2020-21, 'Mining and Quarrying' sector contracted by -17.79 per cent. However, this sector recovered and registered a growth rate of 18.08 per cent in 2021-22. The primary sector growth was 4.84 per cent due to a positive agricultural growth rate. The Secondary and Tertiary Sector growth was 0.36 and 1.11 per cent respectively in 2020-21. Within service sectors, the contact-intensive sectors contracted during Covid. Services like transport registered a sharp contraction. The air transport services contraction was more than 50 per cent during the year.

Table 1: Pre and Post Covid Growth Rates of Tamil Nadu

(Per cent per annum)

Item	2011-12 to 2019-20	2020-21	2021-22
Agriculture, forestry and fishing	5.30	5.69	5.77
Mining and quarrying	8.86	-17.79	18.08
Primary	5.43	4.84	6.12
Manufacturing	8.89	0.45	8.02
Electricity, gas, water supply and other utility services	3.61	-2.34	0.15
Construction	4.62	0.37	7.75
Secondary	7.29	0.36	7.76
Trade, repair, hotels and restaurants	6.33	-3.47	9.43
Trade and repair services	6.38	-0.43	7.53
Hotels and restaurants	6.01	-24.99	27.23
Transport, storage, communication and services related to broadcasting	2.62	-2.31	7.99
Railways	5.92	-7.42	4.49
Road transport	1.32	-0.96	5.49
Water transport	4.24	-6.96	9.65
Air transport	12.06	-50.53	139.83
Services incidental to transport	-1.61	-7.00	11.45
Storage	11.01	-8.63	5.17
Communication and services related to broadcasting	5.90	2.09	7.61
Financial services	6.96	10.83	8.11
Real estate, ownership of dwelling and professional services	7.66	0.62	5.59
Public administration	3.89	-2.95	7.15
Other services	9.01	5.28	8.36
Tertiary	6.53	1.11	7.59
TOTAL GSVA at basic prices	6.67	1.25	7.48
Taxes on Products	7.84	1.36	8.44
Subsidies on products	-2.91	-7.33	-8.37
Gross State Domestic Product	7.05	1.42	7.85
Per Capita GSDP (Rs.)	6.43	0.95	7.45

Source: National Accounts Division, CSO

Note: Gross State Value Added by economic activity at constant (2011-12) prices as on 15.3.2022

AN OVERVIEW OF STATE FINANCES OF TAMIL NADU

Since Covid was a major disruption, and Tamil Nadu was one of the States with a very high incidence of Covid, the fiscal management during the Covid was not easy. The State government introduced several measures to contain the spread of the pandemic. There was a significant contraction in revenue during the initial months of the Covid pandemic. The *High-Level Committee on Medium-Term Policy Response Related to Covid-19* (2020) chaired by Dr. C. Rangarajan (hereafter HLC-Covid 19), appointed by the Government of Tamil Nadu noted that during the first quarter of the fiscal year 2020-21, the revenues declined sharply. According to the HLC-Covid19 (2020), "the SGST collection for the month of April was 16 per cent, for the month of May was 70 per cent and for the month of June was 89 per cent of the corresponding months of the previous year. The collection of 'other commercial taxes' for the month of April was 47 per cent of the corresponding month of the previous year." However, the revenue growth recovered in subsequent months with the gradual opening up of the economy.

The overview of State finances presented in Table 2 gives us an understanding of the evolving fiscal situation of the State. As evident from the table, despite a severe contraction in revenue during the initial months of the covid pandemic, the government of Tamil Nadu could generate 5.58 per cent of GSDP as taxes during the fiscal year 2020-21. The own non-tax revenue and central transfers for the year were 0.55 and 3.02 per cent of GSDP respectively. The revenue expenditure to GSDP ratio increased to more than 12 per cent during the year. The capital expenditure increased to 1.74 per cent of GSDP. This resulted in an increase in aggregate expenditure to around 15 per cent of GSDP. The fiscal deficit of the State increased to 4.94 per cent of GSDP in 2020-21- an increase of 1.66 percentage points compared to the deficit level of the previous year (See Table 2). The increase in fiscal deficit was driven by a significant increase in revenue deficit. The debt ratio of the State during 2020-21 was 27.27 per cent of GSDP. The post-pandemic public debt to

GSDP ratio of Tamil Nadu has not stabilised and is increasing. As per 2022-23 (BE), the outstanding liabilities to GSDP ratio of the State is 28.48 per cent of GSDP.

Table 2: An Overview of State Finances (per cent of GSDP)

	2011-12	2014-15	2017-18	2019-20	2020-21	2021-22 (RE)	2022-23 (BE)
Total Revenue Receipt	11.34	11.41	9.98	9.71	9.15	9.35	9.31
Own Revenue Receipt	8.68	8.11	7.13	6.70	6.13	6.13	6.37
Own Tax Revenue	7.92	7.33	6.40	5.98	5.58	5.59	5.75
Own Non-Tax Revenue	0.76	0.78	0.73	0.72	0.55	0.54	0.63
Central Transfers	2.66	3.30	2.85	3.01	3.02	3.22	2.94
Share in Central Taxes	1.69	1.57	1.85	1.47	1.31	1.54	1.34
Grants-in-aid	0.97	1.73	1.00	1.55	1.71	1.68	1.60
Revenue Expenditure	11.16	12.01	11.46	11.71	12.42	11.89	11.44
Compensation and Assignment to LBs	1.00	0.93	0.78	0.87	0.83	0.83	0.76
Capital Expenditure	2.17	1.66	1.38	1.43	1.74	1.74	1.73
Total Expenditure	13.33	13.67	12.84	13.14	14.16	13.63	13.17
Revenue Deficit	0.18	-0.60	-1.47	-2.00	-3.28	-2.54	-2.12
Fiscal Deficit	-2.30	-4.08	-2.72	-3.35	-4.94	-4.17	-3.89
Primary Deficit	-1.12	-2.73	-0.94	-1.57	-3.02	-2.26	-2.01
Outstanding Liabilities	16.92	17.88	22.29	23.58	27.27	28.01	28.48

Source: Finance Accounts of the State of Tamil Nadu (CAG-Various Issues) and the Union Budget 2022-23.

However, the weakening of the fiscal strength of the State finances of Tamil Nadu cannot be attributed to the Covid-pandemic alone. If we examine the growth performance for a longer period, revenue receipts of Tamil Nadu registered a trend growth rate of 15.89 percent during 2004-12, aided by trend growth rates of 15.91 percent and 16.25 percent in own tax revenues and central transfers, respectively. The revenue growth remained subdued in the 2011-20 period. The revenue receipts growth during 2011-12 to 2019-20 was 9.74 per cent and the own tax revenue growth during the same period was 7.09 per cent. The own tax to GSDP ratio declined from 7.92 per cent in 2011-12 to 5.98 per cent in 2019-20. The own non-tax revenue to GSDP ratio remained stagnant at around 0.70 per cent of GSDP during this period. As a percentage of GSDP, own non-tax revenue declined from 1.01 percent in 2004-05 to 0.76 percent in 2011-12 and it declined further to 0.72 per cent in 2019-20[4]. State Finance Audit Report of the Comptroller and Auditor General of India (2020) observed that for the year ended March 2020 there has been a significant decrease in non-tax revenue and the buoyancy of the State's own revenue was also lower than in the preceding four years.

The SGST revenue which contributes around 42 per cent of State's own tax revenue has not yet stabilised. A comparative picture of the all-State own tax revenue and SGST revenue growth are presented in Table 3 and Table 4 respectively. The SGST revenue contracted by 1.3 per cent in Tamil Nadu in the year 2020-21. The all-State average for the same was -7.89 per cent. The 2021-22 (RE) and 2022-23 (BE) expect Tamil Nadu's SGST revenue growth to be 13.39 and 15.21 per cent respectively. They also expect Tamil Nadu's own tax revenue growth to be 14.79 and 17.91 per cent respectively.

[4] Interest receipts from PSUs, departmental undertakings and cooperative societies are the steady contributor to this revenue stream.

Table 3: The Own Tax Revenue Growth of Indian States: Pre and Post Pandemic

(Per cent per annum)

	2019-20	2020-21	2021-22 RE	2022-23 BE
Andhra Pradesh	-0.74	-0.33	28.26	23.61
Bihar	2.82	-0.59	16.61	18.08
Chhattisgarh	3.22	3.49	20.14	5.45
Gujarat	-1.37	-11.06	49.86	13.85
Haryana	0.57	-2.13	55.06	13.44
Jharkhand	13.69	0.65	22.65	19.96
Karnataka	5.71	-5.19	14.88	13.80
Kerala	-0.63	-5.29	23.51	25.87
Madhya Pradesh	9.71	-2.44	18.07	13.32
Maharashtra	0.81	-13.07	38.34	12.89
Odisha	6.59	6.08	20.97	10.93
Punjab	-5.00	0.19	26.65	19.77
Rajasthan	3.25	1.75	37.36	18.71
Tamil Nadu	1.83	-1.22	14.79	17.19
Telangana	4.52	-1.40	39.40	16.47
Uttar Pradesh	2.25	-2.39	33.74	37.61
West Bengal	-0.10	-0.63	22.59	7.36
All State	2.12	-3.79	29.41	17.48

Source: Budget Documents of Various States

Table 4: The Growth Rate of SGST of Indian States (Per cent per annum)

	2019-20	2020-21	2021-22 RE	2022-23 BE
Andhra Pradesh	-1.86	-6.70	23.07	24.97
Bihar	3.35	1.58	28.48	19.88
Chhattisgarh	-3.76	0.38	31.01	6.56
Gujarat	-2.24	-13.63	68.25	16.40
Haryana	1.40	-3.38	77.45	1.44
Jharkhand	2.64	-5.79	7.18	22.94
Karnataka	0.46	-10.53	21.84	15.83
Kerala	-2.70	-2.05	21.58	51.20
Madhya Pradesh	10.48	-15.60	25.16	15.74
Maharashtra	0.30	-15.32	54.12	11.22
Orissa	10.56	-1.21	30.93	14.06
Punjab	-3.93	-7.31	37.07	26.85
Rajasthan	-4.29	-5.46	54.88	22.88
Tamil Nadu	-0.41	-1.13	13.39	15.21
Telangana	-1.36	-5.64	39.70	16.78
Uttar Pradesh	2.44	-9.26	51.13	36.26
West Bengal	0.89	-4.74	26.55	9.70
All States	0.70	-7.89	38.35	18.26

Source: Budget Documents of Various States

State excise revenues remain a main contributor to State's own tax revenue, with the highest trend growth among all contributors at around 21 percent in 2004-12. Revenue from excise relative to GSDP increased from 1.16 percent in 2004-05 to 1.56 percent in 2011-12. Among the reasons attributed to this performance is an increase in the sale of IMFL and improved collections, along with "huge receipts under 'vend fee on foreign liquor and spirits', duty on beer and malt liquor" in 2011-12, as per the AG's reports on the State's revenues. In recent years excise duty to GSDP ratio declined sharply. As noted by the HLC-Covid 19 (2020), the sharp fall in excise duty collection requires further analysis. The prices, as well as taxes on alcoholic products, are determined by the Government, which distorts the market mechanism. HLC-Covid 19(2020) report mentioned that the Government of Tamil Nadu on 29.03.2013 had abolished the Vend fee and the rate of licensee renewal fee had been reduced from Rs.500 Crore p.a. to Rs.1 lakh p.a. The structural change related to vend fees was the outcome of the definition of "Income" in the IT Act effected in 2014. The Budget Speech 2022-23 highlighted that "(T)he pandemic and unprecedented floods have severely affected the State"s Own Tax Revenues. As a result, the Commercial Taxes, State Excise and Motor Vehicles Tax are projected to fall short of the Budgetary Estimates in the Revised Estimates. In the aggregate, the State's Own Tax Revenue is expected to be Rs.1,21,857.55 crore in the Revised Estimates as against Rs.1,26,644.15 crore in Budget Estimates".

The decline in own revenue was partly compensated by an increase in central transfers through grants. The share of central taxes however declined due to the contraction of the central revenues. It is important to note that Tamil Nadu's share in all State devolution was 5.305 per cent as per the Twelfth Finance Commission award. The share of tax devolution declined consistently thereafter and became 4.023 per cent as per the Fourteenth Finance Commission award. The share of tax devolution increased to 4.079 per cent as per the award of the Fifteenth Finance Commission. Due to the decline in the share of Tamil Nadu in the divisible pool of taxes, the tax devolution as a percentage of GSDP declined from 1.69 per cent of GSDP in 2011-12 to 1.34 per cent of GSDP in 2022-23 (BE). This was partly offset by the increase in grants. Unlike the revenue side, the revenue expenditure to GSDP ratio hovered around 11.5 per cent of GSDP. The fiscal deficit started increasing in recent years, which resulted in a sharp increase in the debt to GSDP ratio. Capital expenditure to GSDP ratio declined to meet the target of fiscal responsibility legislation. Interest Payment, Pension and Salary constituted more than 5 per cent of GSDP in the year 2019-20 (See Table 5). The high share of committed expenditures is a major challenge in fiscal management. According to the AG Report (2020), the ***committed expenditure*** is on an increasing trend and stood at 66.57 per cent of the total revenue receipts of the State during 2019-20, as against 62.12 per cent during 2018-19, thereby leaving lesser funds towards other social and economic activities. A progressive reduction in the committed liabilities will help in freeing up resources for capital and other development spending.

Table 5: Profile of Expenditure (per cent of GSDP)

	2011-12	2014-15	2017-18	2019-20	2020-21	2021-22 (RE)	2022-23 (BE)
Total Expenditure	13.33	13.67	12.84	13.14	14.16	13.63	13.17
General Services	3.89	3.98	4.18	4.41	4.20	4.00	4.46
Social Services	5.07	5.09	4.40	4.44	5.29	5.07	4.40
Economic Services	3.38	3.67	3.47	3.41	3.84	3.73	3.55
Developmental Expenditure	8.45	8.76	7.87	7.86	9.13	8.80	7.95
Education Art and Culture (2202 to 2205)+4202	2.08	2.32	2.00	2.16	2.03	1.78	1.76
Medical and Public Health(2210+4210)	0.49	0.52	0.56	0.52	0.71	0.72	0.59
Interest Payment	1.18	1.36	1.78	1.78	1.92	1.90	1.88
Pension	1.68	1.62	1.53	1.68	1.43	1.21	1.59
Salary	2.11	1.45	1.63	2.36	NA	NA	NA

Source: Finance Accounts of the State of Tamil Nadu (CAG-Various Issues) and the Union Budget 2022-23.

On public financial management couple of issues highlighted by AG report 2020 is worth highlighting here:

a. ***Subsidies*** consumed 11.54 per cent of State's revenue receipts. The expenditure on subsidies increased by 6.46 per cent from Rs. 18,922 crore during 2018-19 to Rs. 20,144 crore in 2019-20.
b. ***Implicit subsidies*** in the form of marriage assistance, maternity assistance, free supply of laptop, uniform, etc., was on a decreasing trend from 2015-16 to 2018-19.
c. Government ***invested*** Rs. 39,866 crore (up to March 2020) in the share capital of statutory corporations, joint stock companies and co-operatives. The average rate of return, increased marginally from 0.37 per cent in 2018-19 to 0.40 per cent during the current year. The ***return on investment*** was meagre compared to Government's average rate of borrowing of 8.07 per cent during the year.

d. One of the issues highlighted in the AG Report 2020 is the use of supplementary demand for grants to expand the budgetary expenditure. At the same time, there were persistent savings in certain departmental expenditures on a consistent basis.

DEBT, DEFICIT AND FISCAL RESPONSIBILITY

In terms of State finances, Tamil Nadu managed to meet the targets of the Tamil Nadu FRBM Act 2003, ahead of schedule, registering revenue surpluses from 2005-06 to 2008-09. It was among the few States that maintained a revenue surplus in 2008-09, notwithstanding some payment of arrears related to the Pay Commission. The revenue surplus position provided the fiscal space to the State for increasing capital expenditure from 1.98 percent of GSDP in 2005-06 to 2.97 percent of GSDP in 2008-09, while remaining within the FRBM fiscal deficit limit of 3 percent of GSDP.

However, the subsequent slowdown in revenue growth, enhanced expenditure on food subsidies, and revision of pay scales as per the Pay Commission's recommendations contributed to the State moving into a revenue deficit in 2009-10 and 2010-11; albeit small in magnitude relative to GSDP (0.5-0.7 percent range). With capital expenditure averaging around 2.4 percent of GSDP in 2009-11, the fiscal deficit-GSDP ratio increased from 2.14 percent in 2008-09 to its highest level at 2.94 percent in 2010-11. However, fiscal improvement was witnessed in 2011-12, with significant growth in revenues relative to expenditure enabling Tamil Nadu to return to a revenue surplus situation in 2011-12 (0.18 percent of GSDP). Therefore, despite a significant increase in capital expenditure to 2.17 percent of GSDP in 2011-12, fiscal deficit-GSDP ratio witnessed a small decline to 2.3 percent. This situation has changed with the increase in revenue deficit (See Table 2) after 2011-12. The fiscal space for capital expenditure has declined since 2011-12. During the five-year period 2015-20, the ratio of outstanding debt of the State to GSDP remained between 18.96 and 23.58, which was consistently below the norm of 25.20 per cent of GSDP prescribed by the TNFR Act, 2003 amended from time to time.[5] The Covid induced fiscal shock has further increased the debt to GSDP ratio of the State.

In this context, the recommendations of the Fifteenth Finance Commission (FC-XV) about FRBM also become critically important. FC-XV Report (2020) envisions a next-generation fiscal architecture and a system of inter-governmental fiscal transfers to enable India to utilize the opportunity presented by the crisis, to be ready, agile and to thrive in what lies ahead (FC XV: para 1.73). FC-XV argued that the upward increase on Union and State debt positions is unavoidable at a time when growth destruction must be mitigated and income support extended (FC-XV: Para 1.37). However, in the medium term, fiscal policies must be embedded in caution rather than exuberance, in restraint rather than profligacy (Para 1.38). What would emerge, will depend on the actual quantum of fiscal shock due to COVID and the fiscal need required for COVID response and recovery. The FC-XV has taken a view that though necessary flexibility needs to be provided, there is a need to return to sustainable fiscal management for macro stability and growth when we take a medium-term view.

Although, the debt-ratio of the Tamil Nadu government remained below the target debt ratio recommended by the FC-XV (See Table 6), the aggregate debt position of the States worsened in recent years. The FC-XV Report also highlighted that many States have resorted to financing public expenditure through EBRs or off-budget borrowings. However, States do not generally report these figures, the Commission was unable to factor these in their calculations while recommending the fiscal consolidation path. According to Shanmugam and Shanmugam (2022) "(A)lthough the current level of debt-GSDP (i.e., above 25

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[5] State Finance Audit Report of the Comptroller and Auditor General of India for the year ended March 2020.

percent) is within the limit set by the Fifteenth Finance Commission considering the pandemic, it is not the sustainable debt level for Tamil Nadu".

Table 6: Indicative Debt-Deficit Path for the State Governments (percent of GSDP)

Indicators	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Revenue Deficit*	-0.1	-0.5	-0.8	-1.2	-1.7	-2.5
Fiscal Deficit	4.5	4.0	3.5	3.0	3.0	3.0
Total Liabilities**	33.1	32.6	33.3	33.1	32.8	32.5

Source: 15th FC Report; Notes: * (-) surplus/ (+) deficit; ** State-wise debt path is in the annexure.

The recent RBI Study on State Finances (2022) observed that the power sector accounts for much of the financial burden of State governments in India, both in terms of subsidies and contingent liabilities. Illustratively, many State governments provide subsidies, artificially depressing the cost of electricity for the farm sector and a section of the household sector. State governments also infuse capital into power distribution companies (DISCOMs) through equity and debt to enable them to undertake productive investments. The performance of the DISCOMs has remained weak, with their losses surpassing the pre-UDAY level of 0.4 per cent of GDP in 2018-19. In addition, their long-term debt started increasing since 2017-18.

In Tamil Nadu, majority of the guarantee had been extended to the power sector, with TANGEDCO being the largest recipient. the State Government undertook various measures to improve the financial health of power utilities including equity infusion (conversion of dues on electricity duty and ways and means into equity share capital), provision of loans and extension of guarantees. Given the high degree of continued financial assistance to the power entities in the State, it becomes essential to analyse the financial health of these entities to determine the implications for the future finances of the State. Tamil Nadu was among the last States to initiate unbundling of its State Electricity Board – TNEB. Under the Tamil Nadu Electricity (Reorganization and Reforms) Transfer Scheme 2010, TNEB has been unbundled into TNEB Limited (holding company), Tamil Nadu Generation and Distribution Corporation Limited (TANGEDCO) and Tamil Nadu Transmission Corporation Limited (TANTRANSCO). As per the AG Report (2020) "The total outstanding guarantees of the State Government were Rs.47,318.87 crore as on 31 March 2020. This constituted 27.24 *per cent* of the total revenue receipts of 2018-19 (Rs.1,73,741.16 crore) and 2.56 *per cent* of the GSDP (Rs.18,45,853 crore at current prices). No guarantee was invoked during the year. Further, as against the estimated receivable Guarantee Fees of Rs. 1,498.83 crore, Guarantee Fees received by the Government was Rs. 278.61 crore. Thus, there was a short collection of Guarantee Fees to the tune of Rs.1,220.22 crore".

The Commission also recommended an incentive-based extras borrowing for States. Considering the impact of the pandemic on the power sector and on State finances, the Commission considered various options that would provide States with a liquidity cushion to implement structural improvements in the finances of DISCOMs and simultaneously introduce governance improvements. Accordingly, FC-XV recommended an extra annual borrowing space for the States, of the magnitude of 0.50 per cent of their GSDP for each of the first four years of the award covering the period (2021-22 to 2024-25), based on certain performance criteria in the power sector. (The Ministry of Power will be the nodal department for monitoring the progress of the indicators and will submit its annual assessment and recommendation to the Ministry of Finance. The final decision to grant an extra 0.50 per cent of GSDP as additional borrowing to the State will be taken by the Ministry of Finance, based upon the recommendation of the Ministry of Power.) On the assumption not all States would prefer to avail the entire additional borrowing space available to them, they may revert to the normal borrowing pattern and borrow below the 3 per cent from 2021-22 onwards the commission provides the possible range of all-State FD-GSDP ratio during its award period (Table 7).

Table 7: Range of All-State FD under the Recommended Space for Borrowing (percent of GSDP)

	2021-22	2022-23	2023-24	2024-25	2025-26
Upper Limit (if all States use the full borrowing space available)	4.5	4.0	3.5	3.5	3.0
Lower Limit (States, on an average, reach current FRBM limit)	3.0	3.0	3.0	3.0	3.0

Source: FC-XV Report

However, the path of fiscal responsibility recommended by the Commission for the States has become less relevant due to several factors including a higher nominal GDP growth rate in the 2020-21 and 2021-22 (compared to what was assumed by the Commission). In case of Tamil Nadu, this is evident from the movement of debt to GSDP ratio and the elevated levels of debt and deficit. There is a need to recalibrate the FRBM path for the States, particularly the debt path in light of the recent macroeconomic development including higher nominal growth compared to what was assumed by the Fifteenth Finance Commission. The debt path recommended by the Commission appears more liberal when compared with the actual movement of debt to GSDP ratio at the State level.

POLICY ISSUES

Based on the above analysis, for post-covid fiscal recovery and for improved fiscal outcome following issues become important. These issues are classified into three broad categories: (a) own resource mobilisation, (b) public expenditure management and (c) management of public debt.

a. Own Revenue Mobilisation

a.1 Motor Vehicle Tax: The Budget Speech mentioned that "The collections from the Taxes on Motor Vehicles are estimated at Rs.7,149.25 crore in Budget Estimates 2022-23 against Rs.5,635.03 crore in Revised Estimates 2021-22. Since motor vehicles tax is primarily levied on registration of vehicles, the tax collections in the coming years is expected to be in accordance with improved economic growth prospects. A growth rate of 25.0 per cent is expected for the year 2023-24 and 15.0 per cent for the year 2024-25." The motor vehicle tax in Tamil Nadu is an Ad-valorem tax. The tax rate in Tamil Nadu is higher than in Maharashtra and Gujarat but lower than in Andhra Pradesh. Since it is already an ad-valorem tax, the State may consider increasing rates of tax on luxury vehicles from 15 to 17 per cent costing more than 25 lakhs.

a.2 Stamp Duty and registration: Post-Covid, the Stamp Duty and Registration (SDR) fee has seen robust growth. However, the SDR in Tamil Nadu is one of the highest in the country. The rationalisation of rate structure may contribute to better revenue yield. A detailed study in this regard could be considered to understand the revenue impact of such rationalisation keeping in view the future growth of urbanisation and the real estate sector in Tamil Nadu.

a.3 Return on Investment: As highlighted by successive AG Reports, the return on invested capital is less than one per cent when the average cost of borrowing is more than 7 per cent. Given this, there is a need to chart out a strategic disinvestment policy to reduce the budgetary outgo to the loss-making public sector units within a defined time frame.

a.4 Revision of Royalty: On the royalty revenue, the HLC-Covid19 (2020) recommended the following and requires follow up: "The

Constitution assigns the power to harness major minerals to the Central government and royalty payments are payable to the States. It is also stated that the royalty on mines and minerals cannot be changed more than once in three years. The last time the revision was made in 01.09.2014 and therefore, the revision is overdue. The State government should represent to the Government of India to notify the revision at the earliest. In 2019-20, the State government received the royalty payments of Rs. 791.79 crore and this year it is budgeted to receive Rs. 820 Crore. The revision could substantially increase the State's revenues." The State government need to exploit the minor minerals. According to the HLC-Covid19 (2020), "the last revision of the fees was made on 28.12.2017. The State government should prepare the revised structure of mineral concession fees/seigniorage fees and notify the same in January 2021 to raise additional revenue."

b. **Public Expenditure Management**

b.1 *Credible Medium Term Expenditure Framework:* It is well known that the weakest link in the PFM framework is the link between MTEF and bottom-up costing of programs and budgets prepared by line departments. In the past, attempts were made by some States to undertake a bottom-up MTFP. For a credible MTEF, a bottom-up plan is critical and it can be initiated in a State like Tamil Nadu in key spending departments. This will improve the quality of estimates and the credibility of the budget.

b.2 *Robust GSDP Estimates:* Since in the case of States, MTFP is for three years, the quality of GSDP estimates becomes extremely important. Some of the critical reforms necessary to improve the quality of GSDP data could be the following: a. Reducing the frequency of sample surveys from 5 to 3 years, b. conducting an Economic census every 5 years, c. direct recruitment of State officers from ISS, d. Identify important statistical products for regular updates - expenditure side, input-output, price series, and e. State DES needs a guiding framework - which includes both regulatory authority and methodological framework.

b.3 *Protecting Fiscal Space for Capital Expenditure:* States have a ceiling on capital expenditure due to the hard budget constraint imposed by FRBM. The FC-XV has recommended a gradual decline in the level of deficit (See Table 6 and Table 7) for the States. Given the fluctuations in revenues, a reduction in borrowing space has implications for State-level capital spending. Efforts need to be made to reduce this volatility in capital spending for broad-based and sustained recovery at the State level. The Rs. One trillion interest-free loans for fifty years to the States announced in the 2022-23 Union Budget becomes particularly important for this reason.

b.4 *Evaluation of the Abolition of Plan Non-Plan Distinction:* The major change in the PFM system was the elimination of plan and non-plan distinction. This is the fifth year, post the abolition of plan non-plan distinction. We need to examine how this has changed fiscal management in the State of Tamil Nadu. There is a need to examine what has happened to development spending in the absence of a plan? What are the issues when we talk about operation and maintenance, which was part of non-plan, and the introduction of new schemes post the abolition of plan and non-plan distinction? How this can be linked to improving MTEF at the State level? Also, there are exceptions to this. A few States continue to practice plan and non-plan budgeting. A large number of States including Tamil Nadu have abolished their Planning Board and replaced them with State Development Councils. Many State Development Councils focus on SDGs and localising SDGs at the State level. Given that Covid resulted in a significant reduction in primary expenditure for development (as evident from Table 2), it will be important to analyse investment in achieving SDGs in the new institutional framework of development.

Debt Sustainability

c.1 *Debt Reduction*: For the years 2021-22 and 2022-23, the debt to GSDP ratio of Tamil Nadu remained below the limits prescribed by the Fifteenth Finance Commission for those years. However, State's interest liability remained at around 1.9 per cent of GSDP and debt servicing cost has increased over time. Given that the State has recovered from the Covid shock and is growing, it would be prudent to rework a path of reduction of debt and the incidence of debt burden on the State budget. This is particularly important, as the aggregate debt position of the State of Tamil Nadu has worsened in recent years.

c.2 *Off Budget Borrowing and Comprehensive Measure of Pubic Debt*: The FC-XV Report also highlighted that many States have resorted to financing public expenditure through EBRs or off-budget borrowings. However, States do not generally report these figures, the Commission was unable to factor these into their calculations while recommending the fiscal consolidation path. A comprehensive measure of public sector debt and its reduction within a defined timeframe can improve the finances of the State.

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