# STATE OF STATE FINANCES

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Debt at a historic high due to impact of COVID-19 and economic slowdown

Growing cesses and surcharges reduce tax devolution to states

Share of untied funds in central transfers to reduce during 2021-26

GST compensation guarantee to end in 2022, high impact on some states

The economic slowdown seen in 2019-20 impacted states' revenue receipts, requiring them to borrow more or cut their expenditure. COVID-19 aggravated this pattern the following year. As the impact was anticipated in 2020-21, the Centre allowed states to borrow more than their usual limits to prevent a drastic cut in expenditure. As a result, their debt level increased sharply. Amidst this, states have to brace for impact post 2022 when the compensation guarantee of a 14% annual growth in GST revenue ends. Both the Centre and states also need to plan how to mitigate the expected loss in revenue if petroleum products are brought under GST. Meanwhile, the poor financial situation of state power distribution companies continues to demand additional allocation and guarantees from states. There is also a need to increase the allocation towards health and reform the finances of local bodies, as recommended by the 15th Finance Commission. To achieve these, the Commission increased the share of grants in its transfers to states. For 2021-26, it has maintained the share of states in the divisible pool of central taxes at 41%. However, the divisible pool itself has reduced in size due to cesses and surcharges, particularly in 2020-21. Raising revenue from cess and surcharge, instead of tax, has reduced devolution to states as a proportion of the Centre's gross tax revenue.

In this context, this report analyses the finances of all states and the union territories of Jammu and Kashmir (only for 2021-22) and Delhi, based on their budget documents. The following abbreviations have been used for states in the charts throughout the report.

| State | Abbreviation | State | Abbreviation | State | Abbreviation |
|---|---|---|---|---|---|
| Andhra Pradesh | AP | Jharkhand | JH | Odisha | OD |
| Arunachal Pradesh | AR | Jammu and Kashmir | JK | Punjab | PB |
| Assam | AS | Karnataka | KA | Rajasthan | RJ |
| Bihar | BR | Kerala | KL | Sikkim | SK |
| Chhattisgarh | CG | Meghalaya | MG | Tamil Nadu | TN |
| Delhi | DL | Maharashtra | MH | Tripura | TR |
| Goa | GA | Madhya Pradesh | MP | Telangana | TS |
| Gujarat | GJ | Manipur | MN | Uttarakhand | UK |
| Himachal Pradesh | HP | Mizoram | MZ | Uttar Pradesh | UP |
| Haryana | HR | Nagaland | NL | West Bengal | WB |

## Contents

## DEVELOPING THEMES IN STATE FINANCES

### COVID-19 aggravated the adverse impact of the ongoing economic slowdown on state finances

States' revenue receipts declined by 0.6% in 2020-21. A similar decline was seen in 2019-20 due to the economic slowdown. To prevent any drastic cut in expenditure, states were allowed to borrow more in 2020-21. While their total expenditure grew by around 5% in both these years, capital outlay declined by 5% in 2019-20. In 2020-21, it increased by 1.4%, but remained 4% lower than 2018-19.

### General government debt estimated to reach a historic high in 2020-21

The 15th Finance Commission estimates the total government debt (the Centre and states) to increase from 70% of GDP in 2018-19 to 90% of GDP by 2020-21. The Commission has estimated this to come down to 85.7% of GDP by 2025-26, based on the fiscal deficit path recommended by it. States' outstanding public debt is estimated to increase from 19.1% of GDP in 2018-19 to 25% by 2020-21.

### Centre's preference to raise money through cess and surcharge reduces tax devolution to states

The Centre's cess and surcharge revenue, which is not shared with states, is estimated to increase by 77% to Rs 4.5 lakh crore in 2020-21; two-thirds of it to come from petrol and diesel. Due to cesses and surcharges, states' share in the Centre's gross tax revenue is around 29% in 2020-21. This is lower than the 41% share in central taxes recommended by the 15th Finance Commission.

### Share of untied funds in central transfers to states to reduce during 2021-26

As per the 15th Finance Commission estimates, untied funds (tax devolution + revenue deficit grants) in central transfers are estimated to be 29.5% of the Centre's gross revenue receipts during 2021-26. This is notably less than the same during 2015-20 (32.4%). Due to the declining share of states in the Centre's gross tax revenue, the share of tax devolution is estimated to decline in the central transfers.

### Levying GST on petrol and diesel may lead to a loss of revenue for both the centre and states

GST laws permit a maximum rate of 40%; the current central and state tax rates on petrol and diesel are much higher. Thus, levying GST on petrol and diesel may lead to a loss of revenue for both the Centre and states. If GST is set at a high rate to avoid a loss in revenue, states will gain at the expense of the Centre. Under GST, the Centre will have to share 41% of its revenue with states, unlike the present scenario where states receive only 2-3% of the excise duty revenue from petrol and diesel.

### States with high reliance on GST compensation may face a shortfall in revenue after 2022

Due to the compensation guarantee, all states achieved at least a 14% annual growth in GST revenue. States relied on compensation to achieve 23% of the guaranteed revenue in 2019-20 and 36% in 2020-21. Once the guarantee ends in 2022, states dependent on compensation may get sharply impacted. Such states will have to increase their own revenue to keep attaining the level of guaranteed revenue.

### Health spending remains below National Health Policy targets, including on primary healthcare

The National Health Policy (2017) recommends states to spend at least 8% of the budget on health. In 2021-22, states have allocated only 6% of their budget towards health. The 15th Finance Commission recommended states to achieve the 8% target by 2022. It also recommended an increase in the share of primary health expenditure in the total health expenditure, from the current 53% to 67% by 2022.

### Turnaround of discoms to remain a priority for containing risks to state finances

In most states, state-owned power distribution companies (discoms) remain a source of strain on state finances as they continue to make losses and their liabilities are on the rise. For instance, in 2020-21, 16 states provided guarantees for borrowing of Rs 1.36 lakh crore by discoms, i.e., 0.67% of 2019-20 GDP. Such guarantees pose a potential risk to state finances in the event of any default by discoms.

## COVID-19 aggravated the adverse impact of the ongoing economic slowdown on state finances

In 2020-21, due to the economic impact of COVID-19 and multiple lockdowns, India's nominal GDP (i.e., at current prices) was 3% lower than that in 2019-20. This consequently impacted the tax and non-tax receipts of the Centre and states. States' revenue receipts, which consists of their own tax and non-tax receipts, and transfers from the Centre, declined by 0.6% in 2020-21. A similar decline was seen in 2019-20 due to the economic slowdown. To mitigate the fall in revenue, states may borrow more to bridge the gap, to maintain the expenditure as planned in the budget. However, borrowing (i.e., fiscal deficit) done by states needs to be approved by the Centre and is usually capped at 3% of the state GDP (GSDP). Thus, if states cannot borrow more, they have to cut their expenditure.

In 2020-21, the Centre allowed states to increase their fiscal deficit from 3% of GSDP to 4% of GSDP. Another 1% of GSDP was available for states implementing four specified reforms. States' fiscal deficit increased from 2.9% of GDP in 2019-20 to 4.1% of GDP in 2020-21 (by Rs 2.25 lakh crore). Of this, Rs 1.1 lakh crore was due to GST compensation loans (provided to states in lieu of the compensation grants). Most of this incremental borrowing was used to finance revenue expenditure, similar to 2019-20. Total expenditure grew by around 5% in both these years, but capital outlay of states saw a 5% decline in 2019-20. It then increased by 1.4% in 2020-21, but remained 4% lower than 2018-19.

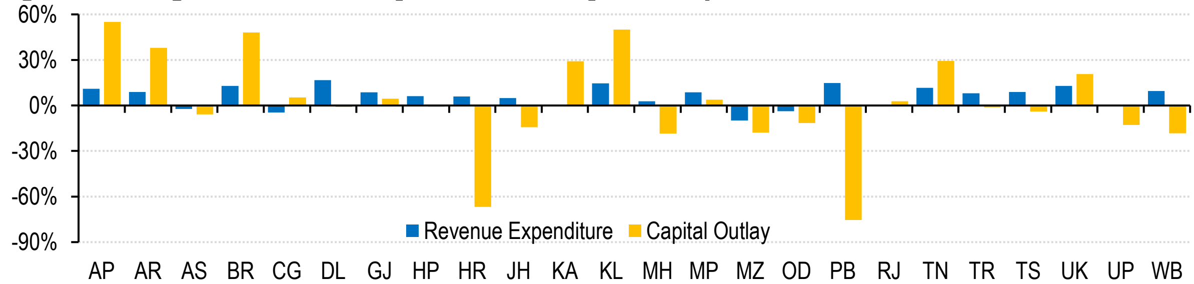
**Table 1: State finances in 2018-21 (Rs lakh crore)**

| | 2018-19 | 2019-20 | 2020-21 |
|---|---|---|---|
| Revenue receipts | 25.47 | 25.38 | 25.22 |
| *change (%)* | - | *-0.4%* | *-0.6%* |
| Revenue expenditure | 25.75 | 27.3 | 28.88 |
| *change (%)* | - | *6%* | *5.8%* |
| Capital outlay | 4.32 | 4.08 | 4.14 |
| *change (%)* | - | *-5.4%* | *1.4%* |
| Fiscal deficit | 4.65 | 5.85 | 8.1 |
| *change (%)* | - | *26%* | *38.4%* |
| *% of GDP* | *2.5%* | *2.9%* | *4.1%* |

Note: 2020-21 data from states' provisional accounts except Goa and Delhi. Receipts exclude UP's non-tax revenue from Sinking Fund (Rs 12,693 crore in 2018-19, Rs 71,180 crore in 2019-20).
Sources: CAG; State Budget Documents; PRS.

Figure 1 shows the change in states' expenditure in 2020-21 from 2019-20. Revenue expenditure increased in most states but capital outlay differed across states. Capital outlay increased significantly in states such as Andhra Pradesh, Bihar, and Kerala, while it declined in states such as Haryana, Jharkhand, Maharashtra, Punjab, and Uttar Pradesh. Note that states' capital outlay is estimated to finance 25% of the National Infrastructure Pipeline of Rs 111 lakh crore during 2019-25 (i.e., Rs 4.6 lakh crore/ year). The current level of capital outlay by states may not be adequate to meet this target.

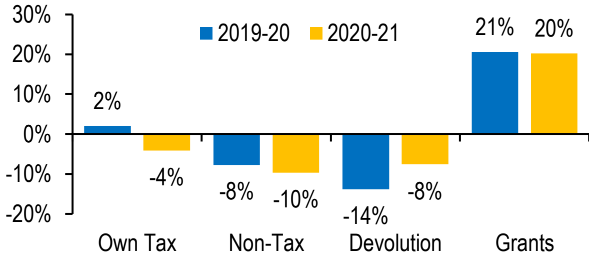
**Figure 1: Change in the revenue expenditure and capital outlay of states from 2019-20 to 2020-21**




Note: Goa, Meghalaya, Manipur, Nagaland, and Sikkim not shown here as their capital outlay grew by more than 85%. Haryana and Punjab see a sharp decrease in 2020-21 due to a much higher capital outlay in 2019-20 (for investment in electricity boards/ discoms under UDAY).
Sources: CAG; State Budget Documents; PRS.

Figure 2 shows the change in revenue receipts of states source-wise during 2019-21. Grants from the Centre was the only source that saw an increase in both 2019-20 and 2020-21 (largely due to Finance Commission grants). Note that devolution to states declined by 8% in 2020-21 despite a 1% increase in the gross tax revenue of the Centre. This is because a large part of the increase was due to a growth in the Centre's cess and surcharge revenue, which is not shared with states (see Page 5).

**Figure 2: Change in revenue receipts during 2019-21**



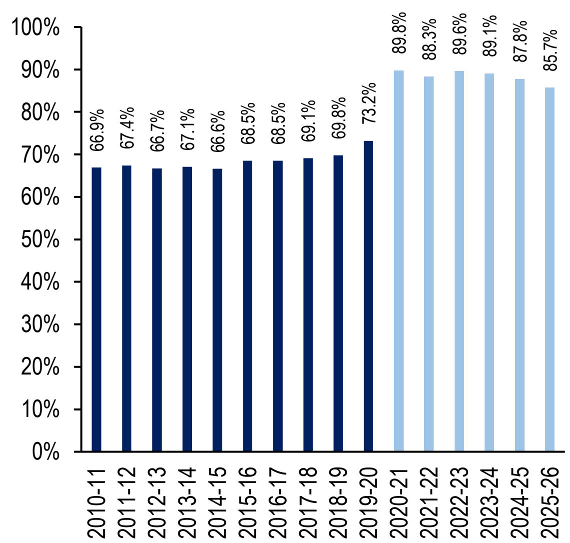

Note: Non-tax revenue receipts exclude UP's receipts from Sinking Fund of Rs 12,693 crore in 2018-19 and Rs 71,180 crore in 2019-20.
Sources: CAG; State Budget Documents; PRS.

## General government debt estimated to reach a historic high in 2020-21

Historically, India's government debt level has been higher than many comparable economies.[1] Hence, reduction in debt level has been one of the key aims for the management of public finances in India.[2] In 2017, the FRBM Review Committee (Chair: Mr. N. K. Singh) had observed that while there is an incentive for capital scarce countries like India to borrow and invest to boost economic growth, large levels of accumulated debt can also be associated with lower growth.[1] It observed that higher public debt might distort economic activity to service the debt through distortionary taxes or through cuts in developmental spending, which can dampen investment and growth.[1]

The FRBM Act of the Centre was amended in 2018 to set a ceiling on general government debt[*] at 60% of GDP by 2024-25 (with 40% limit on the Centre's debt).[3] However, general government debt has been on the rise since 2015-16 and stood at 70% of GDP in 2018-19.[2] In 2019-20 and 2020-21, the reliance on debt to fund their budget increased significantly for both the Centre and states, owing to the impact of economic slowdown followed by the onset of COVID-19 pandemic. The governments faced twin challenges – a shortfall in revenue and an increased need for public expenditure on welfare and economic revival measures. Consequently, the general government debt is estimated to register a sharp rise to 90% of GDP at the end of 2020-21 (Figure 3).[2] The previous peak since 1991 for India's general government debt was about 84% in 2003-04.[4]

**Figure 3: General government debt as per estimates by 15th FC (as % of GDP)**




Note: Figures for the 2020-26 period are estimates by the Finance Commission based on the recommended fiscal deficit levels.
Source: Report of the 15th Finance Commission for 2021-26; PRS.

**Table 2: Indicative Debt Path projected by 15th FC (as % of GDP)**

| Particular | 2020-21 | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 |
|---|---|---|---|---|---|---|
| **Revenue Deficit** | | | | | | |
| Centre | 5.9 | 4.9 | 4.5 | 3.9 | 3.3 | 2.8 |
| States | -0.1 | -0.4 | -0.8 | -1.1 | -1.6 | -2.4 |
| **Combined** | **5.8** | **4.5** | **3.7** | **2.8** | **1.7** | **0.4** |
| **Fiscal Deficit** | | | | | | |
| Centre | 7.4 | 6 | 5.5 | 5 | 4.5 | 4 |
| States | 4.2 | 3.3 | 3.3 | 2.8 | 2.8 | 2.8 |
| **Combined** | **11.6** | **9.3** | **8.8** | **7.8** | **7.3** | **6.8** |
| **Total Liabilities** | | | | | | |
| Centre | 62.9 | 61 | 61 | 60.1 | 58.6 | 56.6 |
| States | 31.1 | 30.7 | 31.3 | 31.1 | 30.9 | 30.5 |
| Netting* | 4.2 | 3.4 | 2.7 | 2.1 | 1.7 | 1.4 |
| **Combined** | **89.8** | **88.3** | **89.6** | **89.1** | **87.8** | **85.7** |

Note: The items netted include loans from the Centre to states, the stock of NSSF securities and treasury bills held by the states.
Source: Report of the 15th Finance Commission for 2021-26; PRS.

The 15th Finance Commission estimates the general government debt to come down to 85.7% of GDP by the end of 2025-26 based on the fiscal deficit path recommended by it (Table 2).[2] The Commission has recommended that the Centre bring down fiscal deficit to 4% of GDP by 2025-26.[2] For states, it recommended the fiscal deficit limit (as % of GSDP) of: (i) 4% in 2021-22, (ii) 3.5% in 2022-23, and (iii) 3% during 2023-26.[2] However, while the Centre accepted the recommended fiscal path for states, it intends to bring its own fiscal deficit down to 4.5% of GDP by 2025-26 from 6.8% of GDP in 2021-22.[5,6] Further, extra annual borrowing worth 0.5% of GSDP will be allowed to states for four years (2021-25) upon undertaking power sector reforms.[5] These factors may lead to a higher debt level as compared to the projection by the Finance Commission.

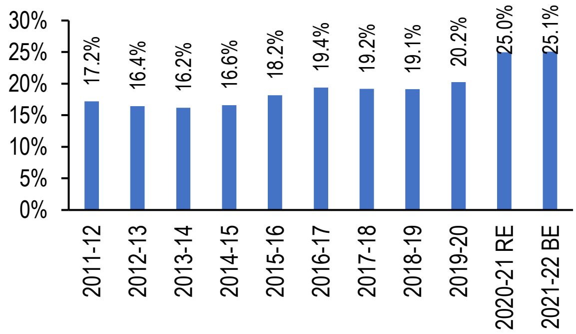
[*] General government debt represents the indebtedness of the Centre and states taken together. Debt of a government comprises: (i) **public debt** – debt contracted against consolidated fund; includes borrowings from domestic market and financial institutions, also includes loans from the Centre in case of states and external debt in case of the Centre; and (ii) **other liabilities** – liabilities incurred on public accounts such as provident funds. General government debt is arrived at after netting certain inter-governmental transactions such as loans from the Centre to states and stock of small savings securities and treasury bills held by state governments. It also includes extra budgetary resources of the central government. Extra budgetary resources are financial liabilities raised by government agencies for funding the schemes of the central government, for which the burden of repayment of the entire principal and interest amount is on the central government.

## States' outstanding public debt increases from 19.1% of GDP in 2018-19 to 25.1% in 2021-22

Outstanding public debt of a state comprises liabilities contracted against the consolidated fund of the state and represents the accumulation of borrowing to fund the budget deficit. It includes borrowings from markets and financial institutions, and loans from the central government. At the end of 2021-22, aggregate public debt of states is estimated to be 25.1% of GDP, a significant rise from 17.2% of GDP in 2011-12 (Figure 4). This will require states to set aside a comparatively higher percentage of their budget towards interest payments and debt repayment in future, constraining other developmental expenditure. Note that public debt does not include other liabilities of states such as liabilities on public account, which have ranged between 6.7%-7.7% of GDP during 2011-21.

Between 2011-12 and 2014-15, outstanding public debt of states had reduced from 17.2% of GDP in 2011-12 to 16.6% of GDP in 2014-15. Takeover of debt of state-owned power distribution companies under the UDAY scheme was one of the principal reasons for rise in the public debt level in 2015-16 and 2016-17.[2] Due to economic slowdown in 2019-20 and advent of COVID-19 pandemic and associated lockdown in 2020-21, there was an increased dependence on borrowings to fund the expenditure. In 2020-21 and 2021-22, states have been permitted to incur fiscal deficit up to 5% and 4% of their GSDP, respectively (the pre-pandemic limit was 3%).

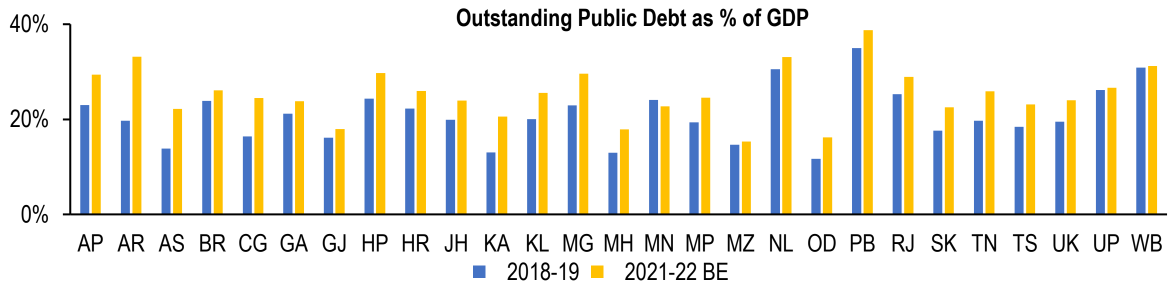
**Figure 4: States' Public Debt estimated to rise to 25.1% of GDP by 2021-22**




Note: GST compensation loans given by the Centre to states (which states are not required to repay) have been excluded from public debt.
Sources: State Finances: A Study of Budgets 2020-21, RBI; State Budget Documents; Union Budget; PRS.

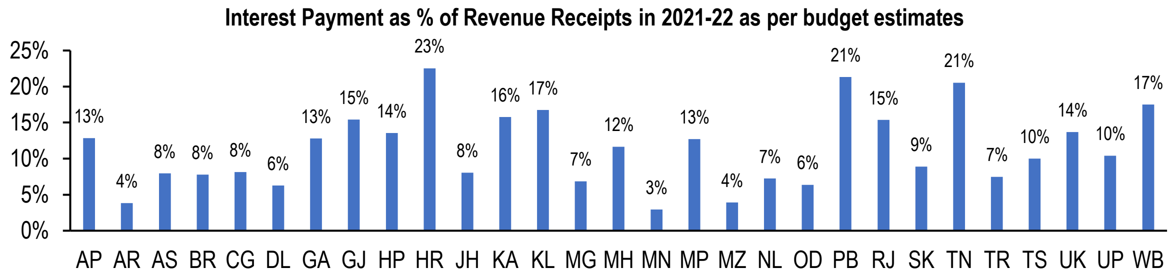
Among larger states, Assam, Chhattisgarh, Karnataka, and Andhra Pradesh are estimated to register a comparatively higher increase in their outstanding public debt since 2018-19 (Figure 5). RBI (2019) had observed that the debt level of a state is considered sustainable if interest payment is less than 10% of its revenue receipts.[7] In 2021-22, states on aggregate are estimated to spend 12.8% of their revenue receipts on interest payment. In 2021-22, 16 states have estimated their interest payment to be higher than the recommended level of 10% (Figure 6).

**Figure 5: Punjab estimated to have the highest outstanding public debt as % of GDP as of 2021-22**




Note: GST compensation loans given by the Centre to states (which states are not required to repay) have been excluded from public debt.
Sources: State Finances: A Study of Budgets 2020-21, RBI; State Budget Documents; PRS.

**Figure 6: Haryana estimated to spend the highest proportion of revenue on interest payments in 2021-22**



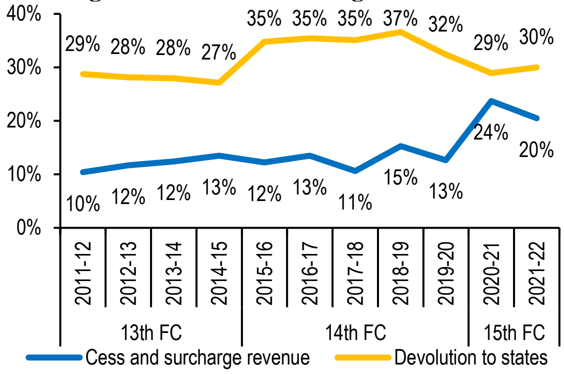

Sources: State Budget Documents; PRS.

### Centre's preference to raise money through cess and surcharge reduces tax devolution to states

The Finance Commission (FC) recommends the share of the Centre and states in the divisible pool, which is made up of net proceeds of taxes required to be divided between them as per the Constitution (i.e., union taxes). Article 270 of the Constitution specifies the taxes which form the divisible pool. It does not include any cess or surcharge levied by the Centre to raise funds for its own purpose. Thus, the cess and surcharge revenue directly goes to the Centre and is not shared with states as devolution.

Figure 7 shows that the share of the Centre's Gross Tax Revenue (GTR) that is generated through cesses and surcharges has increased sharply over the last two years. While the cess and surcharge revenue remained around 10-15% of GTR during 2011-20, its share is estimated to significantly increase to 24% in 2020-21. This is due to an increase in the cess and surcharge rates on petrol and diesel in May 2020. As a result, the Centre's cess and surcharge revenue is estimated to increase from Rs 2.55 lakh crore in 2019-20 to Rs 4.5 lakh crore in 2020-21, which is an increase of 77%. Consequently, devolution to states has decreased from nearly 35% of GTR during 2015-20 to around 30% of GTR in the last two years.

**Figure 7: Share of devolution and cess and surcharge revenue in Centre's gross tax revenue**




Note: In 2019-20, devolution was cut by around Rs 60,000 crore (~3% of GTR) to balance for the extra transfer made in 2018-19.
Sources: Union Budget Documents; 15th FC Report; PRS.

**Cess and surcharge on petrol and diesel:** In 2020-21, the Centre expects to earn two-thirds of its cess and surcharge revenue from petrol and diesel (nearly Rs 3 lakh crore), through the following levies: (i) surcharge, (ii) road and infrastructure cess (to finance infrastructure projects), and (iii) agriculture infrastructure and development cess (to generate funds for agricultural infrastructure). This revenue is estimated to increase by 85% in 2020-21, despite an 11% decline in consumption of petrol and diesel. This revenue is not shared with states. In addition, the Centre charges a basic excise duty on petrol and diesel; this revenue is shared with states.

The increase seen in cess and surcharge revenue from petrol and diesel was realised by changing their rates twice in 2020-21: (i) in May 2020, the cess and surcharge rates were increased by Rs 10 per litre on petrol and Rs 13 per litre on diesel, resulting in an increase in the overall excise duty rate, and (ii) in February 2021, their rates were increased by Rs 1.5 per litre on petrol and Rs 3 per litre on diesel by substituting an equivalent amount of the basic excise duty (whose revenue would have otherwise been shared with states). Such substitution is done to keep the overall excise duty rate the same, but results in a loss of revenue to states, as the entire cess and surcharge revenue directly goes to the Centre. Note that a similar substitution of Rs 2 per litre was done through the Finance Act, 2018.[8]

Due to such changes over the past few years, 95% of the excise duty revenue from petrol and 92% in case of diesel comes through cesses and surcharge now and is not shared with states (Table 3). In April 2017, this was at 56% for petrol and 35% for diesel. Thus, the share of excise duty revenue that goes to the divisible pool has reduced significantly.

**Table 3: Excise duty on petrol and diesel (Rs/ litre)**

| Excise duty | Petrol | | Diesel | |
|---|---|---|---|---|
| | Apr-2017 | Nov-2021 | Apr-2017 | Nov-2021 |
| Tax | 9.48 | 1.4 | 11.33 | 1.8 |
| Cess and surcharge | 12 | 26.5 | 6 | 20 |
| **Total** | **21.48** | **27.9** | **17.33** | **21.8** |

Sources: Petroleum Planning and Analysis Cell, MoPNG; PRS.

The 15th FC has recommended a 41% share for states in the divisible pool of union taxes. In case of petrol and diesel, the divisible pool is a small part of the excise duty revenue earned from them, so only 2-3% of this revenue is shared with states. In the Centre's total excise duty revenue from all sources (estimated at Rs 3.61 lakh crore in 2020-21), states' share is 5% (Rs 19,578 crore). Similarly, due to increase in the share of cess and surcharge revenue in the Centre's GTR, the divisible pool has become smaller. Thus, though states have a 41% share in divisible pool, their share in GTR is around 29% in 2020-21 (similar to 2011-12 when states had a 32% share in divisible pool). Note that levying a cess allows the Centre to direct expenditure towards specific purposes (such as road infrastructure); spending may be done by states. However, it restricts the autonomy of states to decide where or how to spend, as otherwise they would have received their share of funds in an untied form by devolution.

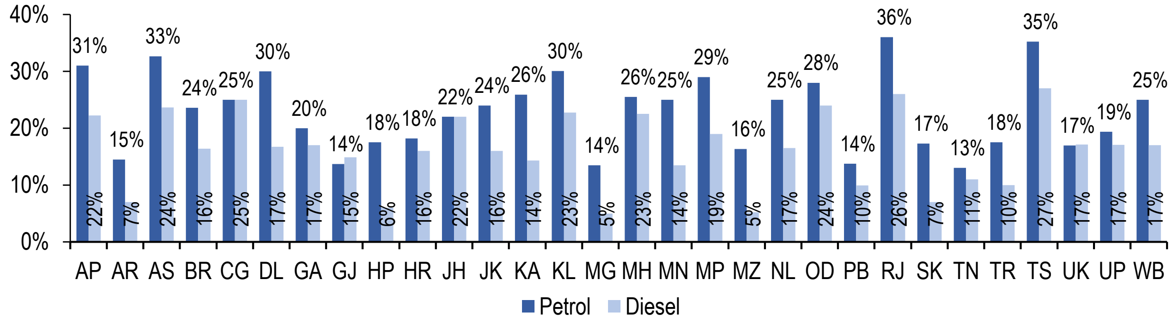
### Levying GST on petrol and diesel may lead to a loss of revenue for both the Centre and states

At present, petrol and diesel are not within the GST structure. Instead, they are subjected to excise duty levied by the Centre, and sales tax/ value added tax (VAT) levied by states. Petroleum products are used as input for production or supply of many goods and services. Excluding them from GST means suppliers cannot claim back the taxes they paid on the petroleum products used as input. Thus, these taxes add to the cost of goods and services they supply and lead to cascading of taxes (i.e., levy of further tax on these taxes). The Constitution mandates the GST Council to recommend the date when GST will subsume the existing taxes on petroleum products. While this could resolve the issue of cascading of taxes, it may have an adverse impact on the revenue of both the Centre and states.

GST laws permit a maximum tax rate of 40%, i.e., 20% GST by the Centre (CGST) and 20% GST by states (SGST). In comparison, at the present price structure, the union excise duty of Rs 27.9 per litre on petrol translates to a tax of 52% on the base price, with the state sales tax/ VAT rate equivalent to a 47% tax on the base price (for Delhi).† In case of diesel, these figures are 40% and 26%, respectively. Thus, to make the transition revenue neutral, the GST rate would need to be much higher than 40%.

Note that unlike excise duty, sales tax/ VAT is an ad valorem tax (Figure 8), i.e., it may not have a fixed value and is charged as a percentage of the value of other components, including excise duty. This implies that states earn revenue by levying sales tax/ VAT on the union excise duty as well (i.e., tax on tax). Once petrol and diesel come under GST, this revenue by levy of tax on tax will not come to states. Due to such levy of tax on tax, Delhi's effective tax rate, calculated on the base price, (e.g., 47% in case of petrol as shown above) turns out to be higher than its actual VAT rate (30%). In comparison, if a 40% GST is levied on petrol, Delhi would earn revenue from its GST rate of 20%.

**Figure 8: Sales tax/ VAT rates levied by states on petrol and diesel (as on November 12, 2021)**




Note: The rates shown for Maharashtra are averages of the rates levied in the Mumbai-Thane region and in the rest of the state.
Sources: Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas; PRS.

Further, in most states, the total sales tax/ VAT rates are higher than the rates shown in Figure 8 due to the additional charges levied by them such as cess (see Table 12 in annexure). For instance, Tamil Nadu levies a tax of Rs 11.52 per litre on petrol and Rs 9.62 per litre on diesel, in addition to the tax rates of 13% and 11%, respectively. Once petrol and diesel come under GST, there will be a uniform rate across the country. States will not have the flexibility to change rates or levy additional taxes on them without the approval of the GST Council. Thus, states will lose autonomy on a significant part of their revenue (petroleum products presently generate around 17% of states' own tax revenue).

The Centre may also face a significant revenue loss if petrol and diesel come under GST. States may further see its impact as they have a share in the Centre's tax revenue. However, in case of petrol and diesel, states' share in the excise duty revenue is only 2-3% (Page 5). This is because the Centre earns most of its excise duty revenue using cess and surcharge (95% in case of petrol and 92% in case of diesel). Thus, devolution to states will not see much impact of any loss in the Centre's revenue from petrol and diesel. For instance, if 40% GST is levied on petrol, the current rate structure of 52% excise duty and 47% VAT (as calculated above) on the base price will be replaced by CGST and SGST of 20% each. States will get 41% of this 20% CGST as their share in the Centre's revenue (amounts to 8.2% of the base price). This would be much higher than their present share (2% share in 52% excise duty, i.e., 1.1% of the base price). This increased share in the revenue from petrol would

† Base price (i.e., price paid by dealers + dealer commission) has been derived from the Indian Oil prices in Delhi as on November 16, 2021.

partly offset the revenue loss of states in transitioning from 47% VAT to 20% SGST. In case of the Centre, the revenue loss would be much higher, from 50% (95% share in 52% excise duty) to 12% (59% share in 20% CGST) of the base price. Thus, levying GST may cause revenue loss for both the Centre and states, but will increase the overall share of states in the revenue from petrol and diesel.

The tables below show the revenue earned by the Centre and states from petrol and diesel (after states receive their share in the Centre's tax, i.e., post devolution). The tables compare the revenue currently earned by the Centre and states with their expected GST revenue under two different scenarios. Table 4 shows the scenario if 40% GST is levied on petrol and diesel. Table 5 shows the scenario if GST is set at a rate that keeps the overall revenue constant, i.e., there is no overall revenue loss. However, in this scenario, states will see a gain in revenue at the expense of the Centre. Such a revenue neutral rate would need to be considerably higher than the maximum permissible GST rate of 40%.

**Revenue sharing between the Centre and states (at current structure vs under GST):** Note that the calculations below are based on the retail prices of petrol and diesel in Delhi, as of November 16, 2021. They aim to show the aggregate impact on states and do not consider the difference across states in tax rates and prices. Thus, they will change with changes in the price or tax components over time or across states. Further, as the devolution share of each state is different, the impact on revenue would vary across states.

**Table 4: Tax levied by the Centre and states on petrol and diesel at 40% GST vis-à-vis the current tax rates (Rs per litre)**

| Component | Petrol | | | Diesel | | |
|---|---|---|---|---|---|---|
| | Present | At 40% GST | Change | Present | At 40% GST | Change |
| Tax levied by the Centre (on sale across India) | 27.9 | 10.4 | -17.5 | 21.8 | 10.4 | -11.4 |
| Tax component (A) | 1.4 | 10.4 | 9 | 1.8 | 10.4 | 8.6 |
| Cess and surcharge component (B) | 26.5 | 0 | -26.5 | 20 | 0 | -20 |
| Centre's revenue (C = B + 59% of A) | 27.3 | 6.1 | -21.2 | 21.1 | 6.2 | -14.9 |
| Devolution share of states (D = 41% of A)* | 0.6 | 4.3 | 3.7 | 0.7 | 4.3 | 3.6 |
| Tax levied by state (on intra-state sale) (E) | 24 | 10.4 | -13.6 | 12.7 | 10.4 | -2.3 |
| States' aggregate revenue (S = D + E) | 24.6 | 14.7 | -9.9 | 13.4 | 14.7 | 1.3 |
| **Total tax (C + S)** | **51.9** | **20.8** | **-31.1** | **34.5** | **20.9** | **-13.6** |

Note: *The Centre will earn its revenue from the sale across India, which will be devolved to states based on their respective share in the divisible pool.
Sources: Indian Oil Corporation Limited; Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas; PRS.

**Table 5: Tax levied by the Centre and states at revenue neutral rates under GST vis-à-vis the current tax rates (Rs per litre)**

| Component | Petrol | | | Diesel | | |
|---|---|---|---|---|---|---|
| | Present | At 100% GST | Change | Present | At 66% GST | Change |
| Tax levied by the Centre (on sale across India) | 27.9 | 25.9 | -2 | 21.8 | 17.2 | -4.6 |
| Tax component (A) | 1.4 | 25.9 | 24.5 | 1.8 | 17.2 | 15.4 |
| Cess and surcharge component (B) | 26.5 | 0 | -26.5 | 20 | 0 | -20 |
| Centre's revenue (C = B + 59% of A) | 27.3 | 15.3 | -12 | 21.1 | 10.2 | -10.9 |
| Devolution share of states (D = 41% of A)* | 0.6 | 10.6 | 10.1 | 0.7 | 7.1 | 6.4 |
| Tax levied by state (on intra-state sale) (E) | 24 | 25.9 | 1.9 | 12.7 | 17.2 | 4.5 |
| States' aggregate revenue (S = D + E) | 24.6 | 36.6 | 12 | 13.4 | 24.3 | 10.9 |
| **Total tax (C + S)** | **51.9** | **51.9** | **0** | **34.5** | **34.5** | **0** |

Note: *The Centre will earn its revenue from the sale across India, which will be devolved to states based on their respective share in the divisible pool.
Minor differences in calculations may be due to rounding off.
Sources: Indian Oil Corporation Limited; Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas; PRS.

The above calculations assume that both the Centre and states levy GST at equal rates, with no other charges such as cess (which are levied even under GST). For instance, the Centre uses compensation cess to compensate states for revenue loss due to GST. Similarly, to bring petrol and diesel under GST, if the GST Council decides to compensate the Centre or states or both for revenue loss, it may approve a cess. This may change the revenue sharing pattern between the Centre and states.

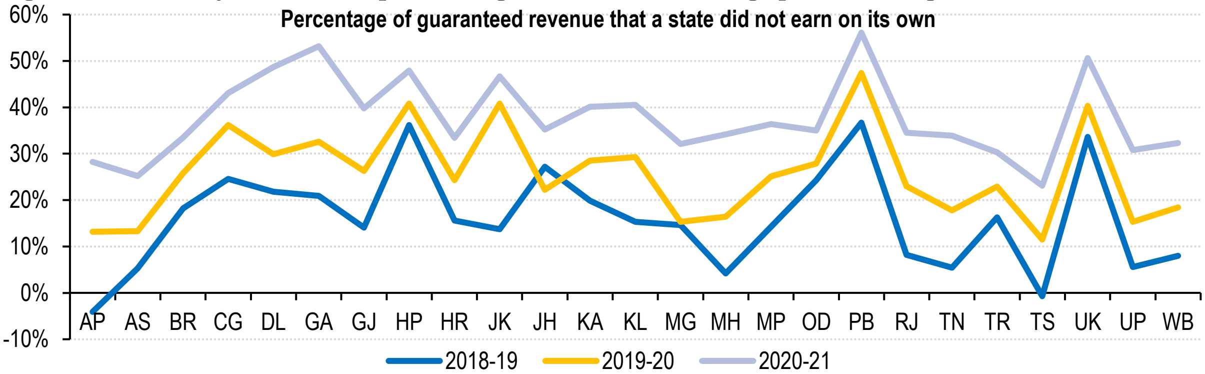
**Loss of revenue due to input tax credit:** If petroleum products come under GST, input tax credit will be allowed on their supply. Input tax credit is given to suppliers for the taxes paid by them on inputs they used in the course of their business (and not for self-consumption). At present, suppliers cannot claim the benefits of input tax credit for petroleum products. However, if they come under GST, taxpayers can claim input tax credit, which might increase the loss of revenue to the exchequer.

### States with high reliance on GST compensation may face a shortfall in revenue after 2022

GST changed the principle of indirect taxation for many goods and services from origin-based to destination-based. This means that the ability to tax goods and services and raise revenue shifted from the origin state (where goods or services are produced) to the destination state (where they are consumed). This change posed a risk of revenue uncertainty for some states. This concern was addressed by guaranteeing states a 14% compounded annual growth in their GST revenue for a period of five years (i.e., till June 2022). Any shortfall in a state's GST revenue from this level is covered by the Centre by providing compensation grants to the state. For example, if a state's base revenue is Rs 100 in a year, it is entitled to a guaranteed revenue of Rs 114 next year. If the state is unable to earn Rs 114 through its own GST revenue, the Centre provides it compensation to meet the revenue gap.

During 2018-21, most states have relied on compensation grants to achieve the guaranteed revenue, i.e., a 14% annual growth in their GST revenue. Figure 9 shows the proportion of guaranteed revenue that states could not achieve on their own and used compensation to meet the revenue gap. In 2018-19, states were able to achieve 88% of the target on their own and relied on compensation for only 12%. The revenue gap has increased since then and states have relied on compensation for 23% of their guaranteed revenue in 2019-20 and 36% in 2020-21. States such as Himachal Pradesh, Punjab, and Uttarakhand have a significantly higher reliance on compensation as compared to the other states. Note that Figure 9 excludes states which did not require any compensation for a 14% growth in their GST revenue, i.e., Arunachal Pradesh, Manipur, Mizoram, Nagaland, and Sikkim (except 2020-21).

**Figure 9: States rely on GST compensation grants to achieve a large part of their guaranteed revenue**




Sources: GST Council; PRS.

Due to the compensation guarantee, all states achieved at least a 14% annual growth in their GST revenue. However, once the guarantee ends in 2022, states dependent on GST compensation may get sharply impacted. For example, a significant part of Punjab's guaranteed revenue was met using compensation (37% in 2018-19, 47% in 2019-20, and 56% in 2020-21). After 2022, it will have to increase its own revenue significantly to attain the level of guaranteed revenue achieved so far.

The 15th Finance Commission noted that the assurance of 14% growth rate for five years, by treating all the states on par in terms of GST revenue growth, has created a significant complication in federal finances. It observed that the trend growth rate of VAT in various states in the pre-GST regime was widely different. In aggregate, the trend growth rate of VAT/ sales tax was 12.7% during the period 2011-17. However, it ranged from 7.2% in Bihar to 13.8% in Rajasthan, among the large states.

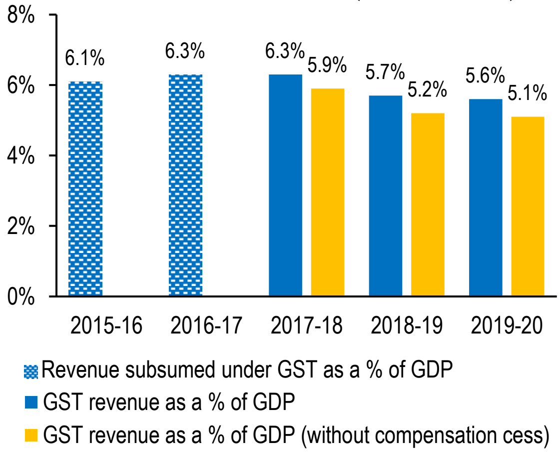
Further, since 2019-20, the growth in nominal GDP, and thus, GST revenue, has been much lower than 14%. As states are guaranteed a 14% growth, their compensation requirement saw a significant increase. Meanwhile, the cess collection used by the Centre to provide compensation grants declined, particularly in 2020-21. The Centre estimated that less than Rs 70,000 crore cess collection would be available to meet the compensation requirement of Rs 3 lakh crore for 2020-21 (Apr 2020-Jan 2021). This led to a shortfall of nearly Rs 2.3 lakh crore, of which Rs 1.1 lakh crore was given as loans to states (instead of grants) in 2020-21. The remaining grants and the loans (including interest) will be paid after 2022 from future cess collection. A similar mechanism has been adopted for 2021-22 (Feb 2021-Jan 2022) to meet the gap between compensation requirement and cess collection. States have been given loans of Rs 1.59 lakh crore, with the remaining amount payable after 2022, if any.

### Impact of GST on revenue and the issues observed with its design and implementation

Introduced on July 1, 2017, GST subsumed various indirect taxes levied earlier by the central and state governments on most goods and services. These include the union and state excise duties, sales tax/ VAT, and service tax. The 15th FC observed that GST was envisaged to bring in considerable efficiency gains in the economy with its 'one nation-one-market-one-tax' paradigm.[9] It was expected to lead to simplification of the tax structure, elimination of barriers to domestic production and trade, and gains in tax compliance.[9] However, various issues need to be addressed to achieve the objectives.

Figure 10 shows a comparison of the revenue of the general government (the Centre and all states combined) from taxes subsumed under GST with the GST revenue (as a percentage of GDP). In 2016-17, the revenue of the general government from taxes subsumed under GST was equivalent to 6.3% of GDP. In comparison, in 2019-20, the GST revenue of the general government is significantly lower at 5.6% of GDP. Excluding the compensation cess (a new cess levied since 2017-18), it comes further down to 5.1% of GDP. The 15th FC observed that revenue realisation from GST has been much below expectations.[9] This is also evident in the shortfall seen in the Centre's GST revenue vis-à-vis the budget estimates for the years 2018-19 and 2019-20.[10]

**Figure 10: Comparison of GST revenue with tax revenue subsumed under GST (as % of GDP)**




Sources: 15th Finance Commission report for 2021-26; PRS.

For 2018-19, the Centre had estimated a GST revenue of Rs 7.44 lakh crore, whereas its actual revenue was 22% lower at Rs 5.82 lakh crore. In 2019-20, the Centre's GST revenue was close to Rs 6 lakh crore, which is 10% lower than the budget estimate of Rs 6.63 lakh crore. In response to the CAG (November 2020), the Ministry of Finance attributed GST rate rationalisations as one of the main reasons for shortfall in GST revenue.[11] The shortfall seen in 2020-21 was higher at 21%, as the Centre's GST revenue decreased to Rs 5.49 lakh crore. Note that this shortfall was also due to the impact of COVID-19, which was seen later in the year after the 2020-21 budget estimate was made.

The 15th FC noted that improving the efficiency of GST will strengthen overall finances of the Centre and states.[9] This impact will be greater on state finances as more than 70% of GST revenue accrues to states, post devolution. The 15th FC highlighted various issues related to the implementation of GST.[12] These include: (i) large shortfall in collections as compared to the original forecast, (ii) high volatility in collections, (iii) accumulation of a large amount of unsettled GST credit, (iv) glitches in invoice and input tax matching, and (v) delay in refunds. Some of these issues are discussed below.

**Tax rate structure:** GST rates vary considerably across goods and services. Apart from the standard rate of 18%, there are three slabs of 5%, 12%, and 28% (with a cess also levied on some items in the 28% slab).[9] Some items are exempted and outside the GST system (such as petroleum products) and a few essentials are taxed at zero rate (Table 6). In addition, precious metals and stones such as gold and silver and other such items are taxed at special rates of 0.25% or 3%. The 15th FC noted that the revenue neutrality of GST has been compromised due to multiple rate cuts since its introduction.[9]

**Table 6: GST rate structure**

| Rate slab | Number of items | Examples |
|---|---|---|
| 0% | 183 | Food items, agricultural produce |
| 5% | 308 | Packaged food, drugs, medicine |
| 12% | 178 | Beverages, frozen meat, tractor |
| 18% | 517 | Capital goods, soap, toothpaste, refrigerator |
| 28% | 28 | ACs, projectors, cars, cement |

Sources: 15th Finance Commission report for 2021-26; PRS.

A tax change is said to be revenue neutral if the modified tax is able to realise revenue comparable to the original tax regime, relative to the tax base. The 15th FC recommended that to increase revenue, the rate neutrality of GST needs to be restored by streamlining the rate structure.[9] It observed that, as per RBI estimates (2019), the effective weighted average GST rate declined from 14.4% at the time of inception to 11.6%, after multiple rate adjustments. To restore the revenue neutral rate, the 15th FC recommended: (i) merging the rates of 12% and 18%, (ii) operating with a three-rate structure of a merit rate, a standard rate, and a demerit rate (of around 28%-30%), and (iii) minimising exemptions.[9]

**Inverted duty structure:** The 15th FC noted that in a GST regime with multiple rates, the balance of the rate structure of intermediates and final goods and services has important implications.[9] However, in many cases, this rate structure is inverted, i.e., the tax rate on intermediates is higher than that on the final output. This may result in a higher outflow of input tax credit and a lower inflow of tax payments. The Commission observed that such inverted duty structures are leading to large refunds and less than expected net tax collections for the central and state governments.[9] It observed that in 2018-19, about 78.5% of the tax liability on outward supplies was paid by suppliers through their input tax credit, which could be due to the inverted duty structure for many items. It recommended that the inverted duty structure needs to be resolved by streamlining the multiple rate structure.[9]

For rationalisation of rates, the GST Council constituted a Group of Ministers in September 2021 to simplify the rate structure, reduce disputes related to classification of goods and services, and enhance revenue.[13] It will: (i) review supply of goods and services exempt from GST to expand tax base and ensure seamless availability of input tax credits, (ii) recommend suitable rates to eliminate inverted duty structure as far as possible, (iii) recommend changes in tax slab rates as may be needed to garner required resources, and (iv) review the rate slab structure, including special rates, and recommend rationalisation measures required for a simpler rate structure.

**Compliance system:** Under the GST system, taxpayers are required to submit returns on a monthly/ quarterly and annual basis based on their turnover. The returns may require details of all the sales of a taxpayer (such as the GSTR-1 return) or only the summary of the sales and input tax credit payable for the purpose of payment of tax (such as the GSTR-3B return). The 15th FC observed that the compliance in filing of the more comprehensive GSTR-1 has always been less than the filing of the self-assessed and summary GSTR-3B.[9] It noted that delays and non-compliance in filing of returns, especially the comprehensive GSTR-1, makes it difficult to monitor tax evasion regularly.

During July 2017-December 2020, 3,852 cases were detected in which fake invoices were filed to get the benefit of input tax credit.[14] Note that taxpayers eligible for input tax credit can use them to pay or lower their tax liability. In these 3,852 cases, fake invoices were used to avail input tax credit of Rs 35,620 crore. The 15th FC noted that sample-checks of outlier input tax credits cannot fully capture frauds in a systematic manner.[9] It recommended the direct and indirect tax authorities to overcome technical impediments and operationalise the entire tax information system efficiently (e.g., through integration of the corporate tax and GST datasets to verify the GST payments made by a company). The 15th FC noted that this would improve efficiency of the GST structure, ensure better compliance, check evasion, and enable early settlement of input tax credits and other adjustment claims.[9]

**Invoice matching:** The CAG (2019) observed that due to a complex return mechanism and technical glitches, the invoice matching system, that matches the GST returns filed by suppliers and recipients, was rolled back.[15] The invoice matching system was designed to verify that input tax credits claimed by a taxpayer have been paid by his suppliers. In absence of such system, input tax credit is claimed by taxpayers on self-assessment basis, without cross-verification. The CAG observed that the system is prone to irregular claims of input tax credit that may go undetected, resulting in frauds.[15] This has led to the continuation of a physical interface between assesses and tax officials. It recommended that the compliance should be simplified by introducing invoice matching and simplified returns.

In its latest audit, CAG (2021) noted that due to continuing extensions in roll out of simplified return forms and delay in decision making, the envisaged invoice matching system is not yet in place.[11] As a result, a non-intrusive e-tax system still remains unimplemented. It noted that the GST return system is still a work in progress after more than three years.[11] In absence of a stable and simplified return mechanism, one of GST's main objectives, i.e., simple tax compliance system, is yet to be achieved.[11] The CAG recommended that a definite time frame may be fixed for roll out of simplified return forms as frequent deferments delay stabilisation of the return filing system and lead to uncertainty in the GST ecosystem.[11] In September 2021, the GST Council constituted a Group of Ministers for reforms, including checks and balances, in the GST system to minimise tax evasion and ease compliance.[16]

## Share of untied funds in central transfers to reduce during 2021-26

By constitutional design, higher and more buoyant revenue-raising powers have been assigned to the Centre whereas higher responsibilities for incurring expenditure have been assigned to the states.[17] Hence, a structural gap exists between states' own resources and their expenditure liabilities. To address this gap, the Finance Commission (FC), a constitutional body, makes recommendations to share the resources of the Centre with the states. The recommendations of the 15th FC for the five years between 2021-22 and 2025-26 were accepted by the central government in February 2021.[18] The recommendations of the 15th FC will govern a major portion of transfers to states (about 70%).

The 15th FC has estimated that total central transfers to states will be around 49.1% of Gross Revenue Receipts (GRR) of the Centre for the 2021-26 period (excluding GST compensation), at the same level as during the 14th FC period (2015-20).[17] Note that the erstwhile state of Jammu and Kashmir was bifurcated into two Union Territories in 2019, and hence is not covered under the 15th FC recommendations. The total central transfers to states can be classified as: (i) states' share in central taxes as per the recommendations of the FC, (ii) grants recommended by the FC, and (iii) other grants by the Centre such as those for centrally sponsored schemes. The Commission has recommended 41% share for states in the divisible pool of central taxes for 2021-26.[17] However, due to the declining size of the divisible pool as a share of gross tax revenue of the Centre (see Page 5), the share of tax devolution is estimated to decline in the overall scheme of central transfers (Table 7).

**Table 7: Projected transfers to states as % of gross revenue receipts of the Centre**

| Particular | FC-XIV 2015-20 | FC-XV 2021-26 |
|---|---|---|
| **Tax Devolution** | **30.59** | **27.55** |
| **FC Grants to States** | **4.68** | **6.74** |
| Of which | | |
| Revenue Deficit Grants | 1.81 | 1.92 |
| Disaster Management Grants | 0.45 | 0.80 |
| Grants to Local Governments | 2.43 | 2.85 |
| **Devolution + FC Grants** | **35.27** | **34.29** |
| **Non-FC Grants** | **12.81** | **12.82** |
| **GST Compensation** | **2.08** | **4.02** |
| **Aggregate transfers (including GST compensation)** | **50.16** | **51.13** |
| **Aggregate transfers (excluding GST compensation)** | **49.10** | **49.08** |

Note: Gross Revenue Receipts comprises both tax and non-tax revenue. Gross Tax Revenue is projected to contribute 88% of the Gross Revenue Receipts of the Centre during 2021-26.
Source: Chapter 11, Volume I, Report of 15th FC; PRS.

The increased quantum of grants recommended by the 15th FC will keep the overall transfers during the 2021-26 period at a similar level as during 2015-20. The 14th FC had observed that tax devolution should be the primary route of transfer of resources to States and had termed this principle to be conducive to sound fiscal federalism.[17] The central taxes devolved to states are untied funds, and states can spend them according to their discretion. In contrast, the funds received in the form of grants (except grants such as revenue deficit grants and GST compensation) usually are purpose-specific and have certain conditions attached to them. For instance, during the 14th FC period, actual amounts disbursed to rural and urban local bodies were 10% and 15% less than the recommended FC grants.[17] This was due to the inability of local bodies to meet conditionalities attached to performance grants imposed by the Commission as well as the Centre.[17]

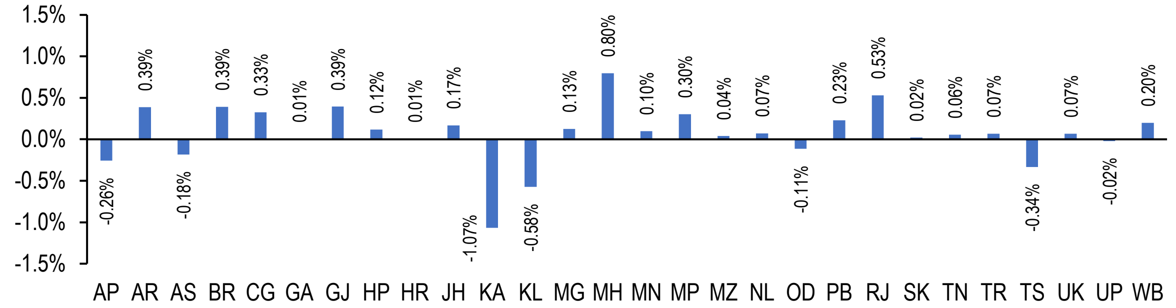
The 15th FC observed that on one hand, higher tax devolution vis-à-vis grants enables higher revenues to states when central taxes are buoyant.[17] Further, in case of a decline in revenues (as during the COVID period), the burden-sharing by both the Centre and states has some advantages. On the other hand, it noted that grants are fixed absolute numbers, and thereby they give better predictability to the states.[17] Overall, untied funds (tax devolution + revenue deficit grants) recommended by FC are estimated to be 29.5% of the GRR of the Centre during the 2021-26 period. This is notably less than the same during the 2015-20 period (32.4% of GRR). Even after including GST compensation grants, untied funds are estimated to be less by about 1% of GRR (33.49% of GRR for 2021-26, as compared to 34.38% of GRR for 2015-20). Note that the GST compensation grants received after June 2022 will be to pay off back-to-back loans given by the central government in lieu of GST compensation grants for 2020-21 and 2021-22.

### Share of southern states in the divisible pool declines; NEH states and poorer states gain

The 15th FC revised the criteria for determining the share of individual states in the divisible pool.[17] The devolution formula sought to provide for: (i) **equity** – poorer states need more funds, (ii) **need** – higher the population, area, and forest cover, higher the need for funds, and (iii) **performance** – greater the performance on augmenting own tax and containing population, greater the reward.[17] The net effect of these recommendations has changed the share of each state in the divisible pool as compared to the 14th FC period (2015-20).[17] This implies that for the next five years, while some states will see an increase in the flow of funds from the Centre in the form of tax devolution, other states will see a cut.

The reduction in the share in the divisible pool has been higher in the case of southern states (except Tamil Nadu). This could be due to higher per capita income as well as lower population share (leading to a lower score on both equity and need parameters). Share of certain poorer states such as Bihar, Madhya Pradesh, and Rajasthan, and the north-eastern and hill states (except Assam) has also increased. However, Uttar Pradesh, the state with the largest share in divisible pool and the state with the second-lowest per capita income, has seen a marginal decline in its share.

**Figure 11: Change in percentage share in the divisible pool from 14th FC period to 15th FC period**

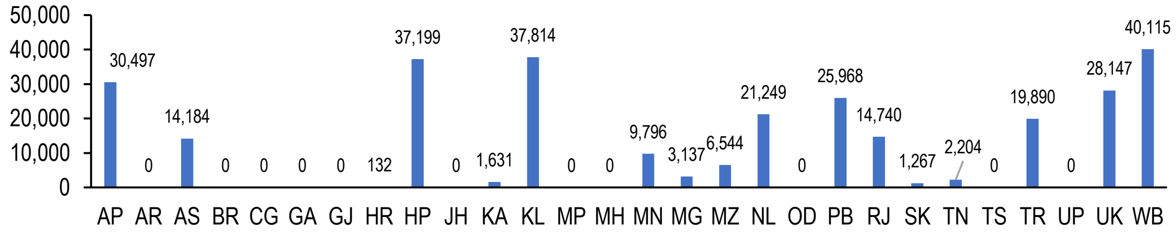



Note: A negative difference of 1% point implies that the state will receive one rupee less in every hundred rupees in the divisible pool during the 15th Finance Commission period as compared to the 14th Finance Commission period.
Source: Chapter 6, Volume I, Report of the 15th Finance Commission for 2021-26; PRS.

### *Grants offset the decline in tax devolution in case of states with high revenue deficit*

The 15th FC has recommended revenue deficit grants worth Rs 2.94 lakh crore for the 2021-26 period (about 7% of the projected devolution).[17] These grants have been provided to 17 states to address the mismatch between their expenditure and aggregate of their own revenue and tax devolution. The Terms of Reference of the 15th FC required it to examine if revenue deficit grants should be provided at all.[17] The Commission also noted that certain states suggested discontinuation of these grants as these may be a disincentive for tax effort and prudence in expenditure.[17] However, it observed that any abrupt departure from revenue deficit grants may not be fiscally sustainable as there are issues related to legacy as well as there is the issue of an adjustment path.[17] Substantial revenue deficit grants in case of states such as Kerala and Andhra Pradesh are likely to offset the loss on account of the revised devolution formula. In comparison, Telangana and Karnataka (except in 2021-22) will not receive any revenue deficit grant as they remain revenue surplus states. Most of the north-eastern and hill states will also receive revenue deficit grants. States such as Bihar, Uttar Pradesh, Madhya Pradesh, and Odisha will not receive any revenue deficit grants as they observe revenue surplus.

**Figure 12: Revenue deficit grants during the 2021-26 period (in Rs crore)**



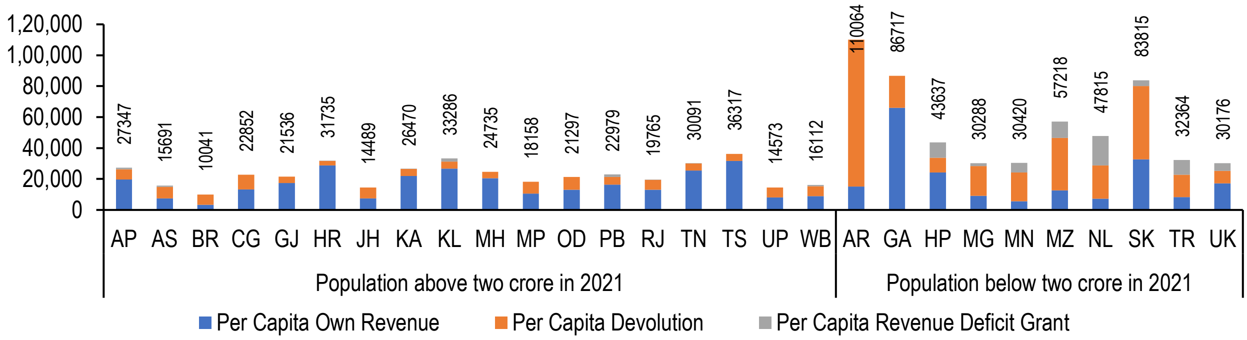

Source: Chapter 10 of Volume-I, Report of the 15th Finance Commission for 2021-26; PRS.

## Revenue and expenditure capacity of states post Finance Commission transfers

The 15th FC observed that given the large differences in the resource base available and the status of development across states, equalisation is an essential objective while distributing resources among states.[17] The 11th FC had observed that fiscal transfers should reduce, if not remove, disparities across states so that all states may provide basic public services to their people at reasonably comparable levels.[19] As stated earlier, the 15th FC used the principles of need, equity, and performance to meet this objective. However, the 15th FC observed that equalisation transfers in India have been far from proportional to population.[17] In the following paragraphs, based on the projections by 15th FC, we discuss the disparity in revenue receipts and revenue expenditure by states during 2021-26.

Among the larger states, Bihar, Jharkhand, and Assam are projected to have the lowest per capita own revenue receipts during the 2021-26 period (Figure 13). Their average per capita own revenue is estimated to be 23%, 52%, and 52% of the average per capita own revenue of states on aggregate. After accounting for tax devolution and revenue deficit grants (about 60% of total estimated central transfer), this ratio improves to 48%, 70%, and 75%, respectively. However, their per capita revenue is estimated to be less than half of that of Telangana which is estimated to have the highest per capita revenue among the large states. Uttar Pradesh (40% of Telangana), West Bengal (44%), Madhya Pradesh (50%), and Rajasthan (54%) also have relatively low per capita revenue receipts.

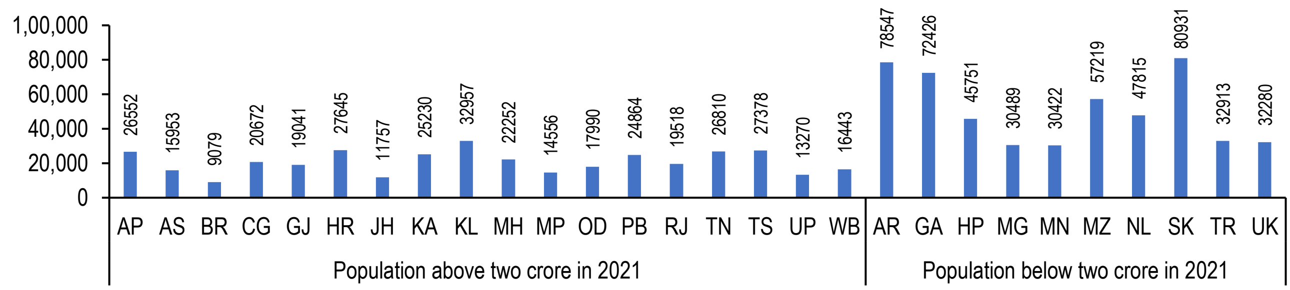
**Figure 13: Estimated average per capita revenue post-FC transfers during 2021-26 period (in rupees)**




Note: Own revenue does not include GST compensation grants.
Sources: Chapter 4 of Volume-II, Report of the 15th Finance Commission for 2021-26; Report of National Commission on Population Projections (2011-2036); PRS.

Any further mismatch between expenditure and revenue will have to be funded through debt. However, borrowings in a year are subject to a similar limit for all states (as % of their GSDP). This implies that a state with a lower per capita GSDP will be permitted to borrow a comparatively lower amount. Further, as a sound financial management practice, states are expected to channel any borrowing towards capital expenditure, i.e., either towards the creation of assets or reduction in liabilities.[17] Poorer states also have higher infrastructure spending needs; hence, they try to limit revenue expenditure in order to also channel any revenue surplus towards capital expenditure. As a result of these factors, there is a wide disparity in the per capita revenue expenditure by states (Figure 14). For instance, the average per capita revenue expenditure by Bihar during 2021-26 is projected to be only 36% of that of Telangana.

**Figure 14: Estimated average per capita revenue expenditure during 2021-26 period (in rupees)**

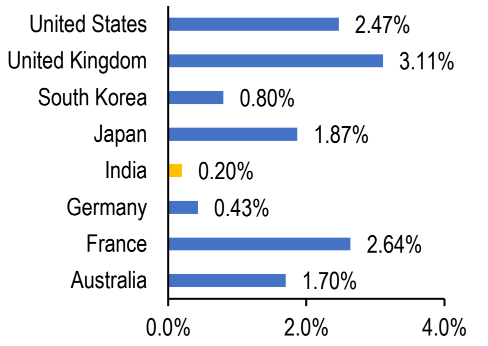



Sources: Chapter 4 of Volume-II, Report of the 15th Finance Commission for 2021-26; Report of National Commission on Population Projections (2011-2036); PRS.

### Property tax collection needs to grow in tandem with GSDP to receive ULB grants

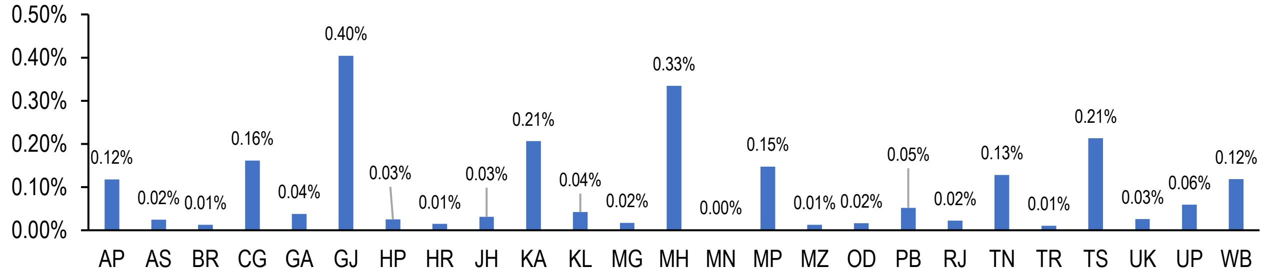
The 15th Finance Commission has recommended grants worth Rs 1.21 lakh crore over five years for urban local bodies.[17] To receive grants from the year 2022-23 onwards, states will need to show consistent improvement in property tax collection.[17] To meet the eligibility criteria, the property tax in the previous year should grow in tandem with the average growth rate of the state's own GSDP in the most recent five years.[17] In India, property tax is collected by the local governments. Property tax is calculated by the local governments in proportion to the assessed value of the property. The 15th FC observed that property tax collection forms the bedrock of local government revenue across the world.[17] However, the property tax collection level in India is significantly lower (0.2% of GDP) as compared to some of the developed countries (Figure 15).[20] The 15th FC highlighted the following as some factors leading to low property tax revenue: (i) undervaluation of property, (ii) incomplete property tax records, (iii) policy inadequacy, and (iv) inefficient administration. In 2017-18 (the latest year to which comparable data is available), Maharashtra, Gujarat, and Telangana were some of the states with a comparatively higher level of property tax collection by their urban local bodies (Figure 16). Property tax collection of urban local bodies as % of GSDP was less than 0.05% of respective GSDP in case of 14 out of 25 states (for which data is available, see Figure 16).

**Figure 15: Property Tax as % of GDP in 2016**




Source: World Bank; PRS.

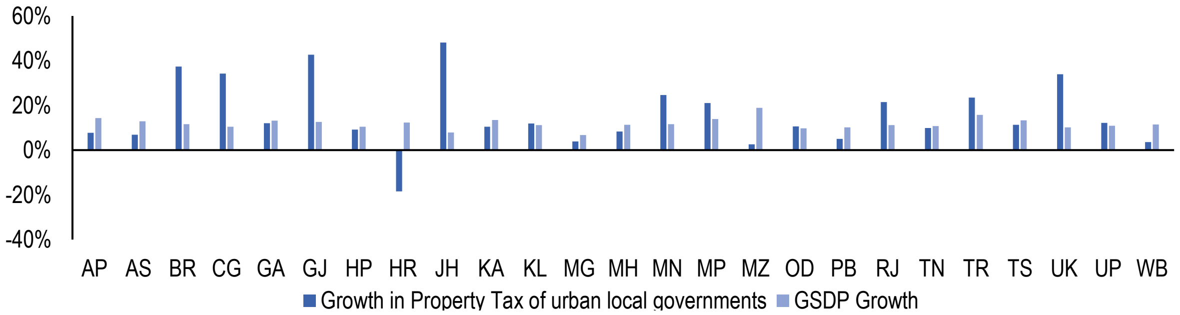
**Figure 16: Property tax collection by urban local bodies as a percentage of GSDP (2017-18)**




Note: Data not available for Arunachal Pradesh, Nagaland, and Sikkim.
Source: State of Municipal Finances in India, ICRIER, A Study commissioned by 15th Finance Commission; PRS.

States such as Bihar, Jharkhand, and Uttarakhand have observed a significantly high growth rate in the property tax between 2012-13 and 2017-18, although over a low base. Notably, property tax collection of urban local bodies of Gujarat and Chhattisgarh grew at an annualised rate of 43% and 34% during the same period. For 12 out of 25 states for which data is available, property tax collection grew at a slower rate than the nominal GSDP during 2012-18. These include states such as Andhra Pradesh, West Bengal, Haryana, Maharashtra, and Punjab. These states may need to augment efforts towards increasing property tax collection to meet the eligibility criteria for ULB grants.

**Figure 17: Growth in property tax collection by urban local bodies vis-a-vis growth in GSDP (2012-18)**




Note: Growth computed as the compounded annual growth rate between 2012-13 and 2017-18.
Source: State of Municipal Finances in India, ICRIER, A Study commissioned by 15th Finance Commission; PRS.

### Health spending remains below National Health Policy targets, including on primary healthcare

Over the years, the health sector has been repeatedly identified as one of the most critical areas in the need of reform and public investment. The 15th Finance Commission (FC) noted that the pace of progress has, however, been tardy, as reflected in India's health indices and poor quality of public healthcare facilities. As a result, irrespective of the ability to pay, people increasingly seek private healthcare even for minor illnesses such as cold, fever, and diarrhea. The Commission observed that primary level care has the potential to take care of 90% of healthcare demands. It noted that investment in primary healthcare, including prevention, provides better health and developmental outcomes at a much lower cost as it helps reduce the need for costlier and complex healthcare.

The National Health Policy (2017) recommends allocation of a major share of resources (at least 67% of the total health expenditure) to primary care, followed by secondary and tertiary care.[21] The 15th FC has recommended that the share of primary health expenditure in the total health expenditure should be increased from the current level of 53% to 67% by 2022.

Table 8 shows the requirement of funds put forward by the Union Ministry of Health and Family Welfare for expenditure by states on primary healthcare. As per the Ministry's submission to the FC (for the period 2021-26), the major components of primary healthcare that require funds are: (i) addressing the shortfall in health workforce (35% of the total requirement of funds), (ii) ensuring access to medicines to reduce the out-of-pocket expenditure (26%), and (iii) bridging the infrastructure gap in public health facilities (23%).

**Table 8: Requirement of funds (states' share) for primary healthcare (as per the Union Health Ministry)**

| Component | Amount (Rs crore) | Share in total |
|---|---|---|
| Addressing the shortfall in health workforce | 1,77,742 | 35% |
| Ensuring access to medicines to reduce the out-of-pocket expenditure | 1,34,959 | 26% |
| Bridging the infrastructure gap in public health facilities | 1,18,781 | 23% |
| Other components | 82,290 | 16% |
| **Total** | **5,13,772** | **100%** |

Sources: 15th Finance Commission report for 2021-26; PRS.

The 15th FC observed that local governments play a critical role in public health. However, due to weak local governance, especially at the sub-district level, the government capacity to deliver is poor, making proficient service delivery in the health sector difficult. Strengthening the local governments in terms of resources, health infrastructure, and capacity building can enable them to play a catalytic role in healthcare delivery. It recommended that the Kerala model, in which local governments and public health institutions play a vital role in effective delivery of healthcare, needs to be emulated in other states. Involving Panchayati Raj Institutions as the supervising agencies would strengthen the overall primary healthcare system. To facilitate this, the 15th FC has provided Rs 70,051 crore as unconditional grants to local governments for primary level and other healthcare facilities.

Overall, the spending on health is still significantly lower than the targets set by the National Health Policy (2017) for: (i) states and (ii) the Centre and states combined. The Policy required states to increase their health expenditure to at least 8% of budget by 2020. In 2021-22, states have allocated only 6% of their budget towards health (see Figure 34 on Page 26). The 15th FC has recommended states to achieve the 8% spending target by 2022. The Policy also recommends an overall target of 2.5% of GDP for government health expenditure by 2025. In 2018-19, the Centre and states together spent around 1% of GDP on health, of which 70% was done by states. The 15th FC recommended that the Centre should also increase its allocation for health. Adequate funds should be provided to the Ministry of Health and Family Welfare as per its projected requirement (Table 8).

Further, the 15th FC observed that there is a lack of accountability in the service delivery model within the health sector. Service delivery has traditionally focused on infrastructure and inputs, instead of outputs, outcomes, and accountability. This has led to under-performance in government health facilities and consequent emergence of a large private sector. The 15th FC recommended a shift in the focus of the inter-governmental fiscal transfers (e.g., grants for centrally sponsored schemes) from inputs to outputs/ outcomes. It recommended the central government to provide flexibility to states to adapt and innovate, so that they become empowered to choose their own pathways to achieve results.

## Turnaround of discoms to remain a priority for containing risks to state finances

In most states, state-owned power distribution companies (discoms) have remained a source of strain on state finances, despite the initiatives in the past including UDAY.[2] State governments provide support to their discoms in the form of grants, loans from the budget, and guarantee on their market borrowings. State-owned discoms have continued to make losses and their liabilities are on the rise. Between 2017-18 and 2019-20, their liabilities increased from 5.26% of GDP to 5.40% of GDP. This increase was driven by a rise in dues for power purchase from 0.91% of GDP in 2017-18 to 1.17% of GDP in 2019-20. Overall outstanding debt saw a decline, primarily on account of some states converting their loans to discoms into grants and equity.[22] Outstanding debt from other sources (banks, financial institutions, bonds etc.) had increased to 2.03% of GDP in 2019-20 from 1.87% of GDP in 2017-18. The combined net worth of state-owned discoms continues to be negative.[22]

In 2020-21, state-owned discoms of 16 states are estimated to borrow Rs 1.36 lakh crore for clearing dues of generators and transmission companies (see Table 13 in annexure).[23] Thus, discoms will see a further rise in their debt servicing burden. Respective state governments have provided a guarantee for this borrowing of Rs 1.36 lakh crore, i.e., about 0.67% of 2019-20 GDP. Such a guarantee poses a potential risk to state finances in the event of default by discoms. At the end of 2019-20, the aggregate outstanding guarantee of state governments was estimated to be about 3% of GDP.[24]

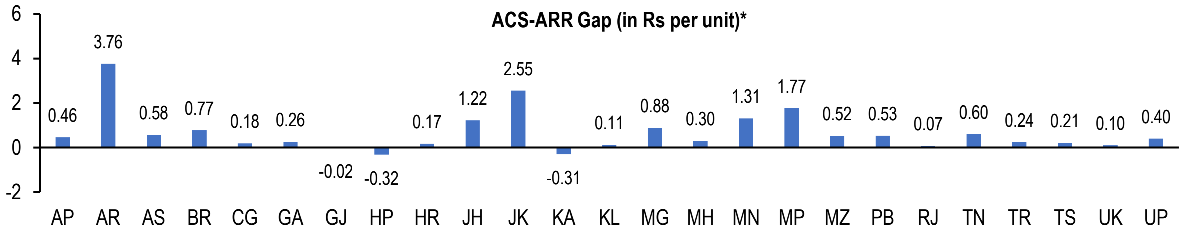
**Table 9: Liabilities of state-owned discoms stood at 5.4% of GDP at the end of March 2020**

| Particular | Amount (Rs lakh crore) | | | As % of GDP | | |
|---|---|---|---|---|---|---|
| | 2017-18 | 2018-19 | 2019-20 | 2017-18 | 2018-19 | 2019-20 |
| i. Outstanding Debt | 4.49 | 4.75 | 4.87 | 2.63% | 2.52% | 2.39% |
| *of which State Govt Loans* | *1.30* | *0.99* | *0.74* | *0.76%* | *0.52%* | *0.37%* |
| *Other Borrowings* | *3.19* | *3.76* | *4.13* | *1.87%* | *1.99%* | *2.03%* |
| ii. Payables for Purchase of Power | 1.55 | 2.09 | 2.38 | 0.91% | 1.10% | 1.17% |
| iii. Other Current and Non-Current Liabilities | 2.95 | 3.29 | 3.74 | 1.72% | 1.74% | 1.84% |
| **Total (i + ii + iii)** | **8.99** | **10.13** | **10.99** | **5.26%** | **5.36%** | **5.40%** |

Note: Certain states have integrated utilities performing generation as well as distribution functions. Payables for purchase of power in their case also includes payables for fuel.
Source: Report on the performance of power utilities 2019-20, Power Finance Corporation; PRS.

This year, two important measures aimed at turnaround of the power sector have been formulated which may have significant implications for state finances. First, the central government has announced the Revamped Distribution Sector Scheme.[25] This scheme will provide financial assistance to state-owned discoms and power departments for strengthening the power supply infrastructure (including installation of prepaid smart meters). An outlay of Rs 3.03 lakh crore over five years (2021-26) is estimated under this scheme. Of this, the central government will provide grants worth Rs 97,631 crore. The central government will provide a grant worth 15% of the prepaid smart meter cost, and a grant worth 60% of the distribution infrastructure works in case of general category states. Given the poor financial situation of state-owned discoms, they might need further financial support from state governments in implementing this scheme. Second, the state governments have been permitted additional annual borrowing space of 0.5% of GSDP for four years between 2021-22 and 2024-25 upon performance improvements in the power sector.[26] Both these measures aim to incentivise states to eliminate the revenue gap and reduce technical and commercial losses of discoms.[25,26] A portion of the borrowing permitted to states in 2020-21 was also made conditional to similar improvements, most of the states did not fulfil these conditions (see next page).

**Figure 18: Most states observe under-recovery of cost of supply of power to consumers**




Note: *ACS=Average Cost of Supply; ARR=Average Revenue Realised.
Source: UDAY Portal as accessed on November 7, 2021; PRS.

## Reform-linked additional borrowing space for 2020-21 saw mixed uptake from states

In view of the COVID-19 pandemic, in May 2020, the central government permitted states to increase their fiscal deficit limit from 3% of GSDP to 5% of GSDP in 2020-21.[27] Of this 2% increase, an increase of 1% of GSDP was to be permitted upon completion of reforms in four areas (0.25% of GSDP for each reform): (i) one nation one ration card, (ii) ease of doing business, (iii) urban local body, and (iv) power distribution (for more details on reforms, see Table 14 in annexure). States were required to receive clearance from the concerned central line ministry regarding the completion of the reform by February 15, 2021, for being eligible for the additional borrowing.[28] As per the Union Ministry of Finance, states gained permission for reform-linked borrowing worth 0.42% of their aggregate GSDP in 2020-21 (Rs 89,944 crore).[29,30,31,32] Note that a lower utilisation may be due to reasons such as a state deeming additional borrowing non-essential, avoidance of additional borrowing to manage debt levels, or inability to complete reforms in due time.

For availing additional borrowing space, 20 states completed ease of doing business reforms whereas urban local bodies reforms were completed by six states (Table 10). No state completed all three components of the power distribution-related reforms. Andhra Pradesh and Madhya Pradesh completed more reforms as compared to others becoming eligible for borrowing worth 0.9% of their respective GSDP. Six states including Jharkhand, Maharashtra, Mizoram, Nagaland, Sikkim, and West Bengal did not avail reform-linked borrowing space at all.

**Table 10: Status of reforms completed by states to avail additional borrowing in 2020-21**

| State | Ease of Doing Business (0.25% of GSDP) | One Nation One Ration Card (0.25% of GSDP) | Urban Local Bodies (0.25% of GSDP) | Power Distribution (0.25% of GSDP) | | | Borrowing Permitted (as % of GSDP) |
|---|---|---|---|---|---|---|---|
| | | | | Direct Benefit Transfer to farmers (0.15% of GSDP) | Reduction in Revenue Gap (0.05% of GSDP) | Reduction in Technical & Commercial Losses (0.05% of GSDP) | |
| AP | ✓ | ✓ | ✓ | ✓ | × | × | 0.90% |
| AR | ✓ | × | × | × | × | × | 0.25% |
| AS | ✓ | × | × | × | × | × | 0.25% |
| BR | × | × | × | × | ✓ | × | 0.05% |
| CG | ✓ | × | × | × | × | × | 0.25% |
| GA | ✓ | ✓ | ✓ | × | × | ✓ | 0.80% |
| GJ | ✓ | ✓ | × | × | × | × | 0.50% |
| HP | ✓ | × | × | × | × | × | 0.25% |
| HR | ✓ | ✓ | × | × | × | × | 0.50% |
| JH | × | × | × | × | × | × | 0.00% |
| KA | ✓ | ✓ | × | × | × | ✓ | 0.55% |
| KL | ✓ | ✓ | × | × | × | × | 0.50% |
| MG | ✓ | × | × | × | × | × | 0.25% |
| MH | × | × | × | × | × | × | 0.00% |
| MN | × | × | ✓ | × | × | × | 0.25% |
| MP | ✓ | ✓ | ✓ | ✓ | × | × | 0.90% |
| MZ | × | × | × | × | × | × | 0.00% |
| NL | × | × | × | × | × | × | 0.00% |
| OD | ✓ | × | × | × | × | × | 0.25% |
| PB | ✓ | ✓ | × | × | × | × | 0.50% |
| RJ | ✓ | ✓ | ✓ | × | ✓ | × | 0.80% |
| SK | × | × | × | × | × | × | 0.00% |
| TN | ✓ | ✓ | × | × | × | × | 0.50% |
| TR | ✓ | ✓ | × | × | × | × | 0.50% |
| TS | ✓ | ✓ | ✓ | × | × | × | 0.75% |
| UK | ✓ | × | × | × | ✓ | ✓ | 0.35% |
| UP | ✓ | ✓ | × | × | × | × | 0.50% |
| WB | × | × | × | × | × | × | 0.00% |
| **Completed** | **20** | **13** | **6** | **2** | **3** | **3** | **0.42%** |

Sources: Press releases of the Union Ministry of Finance; Press Information Bureau; PRS.

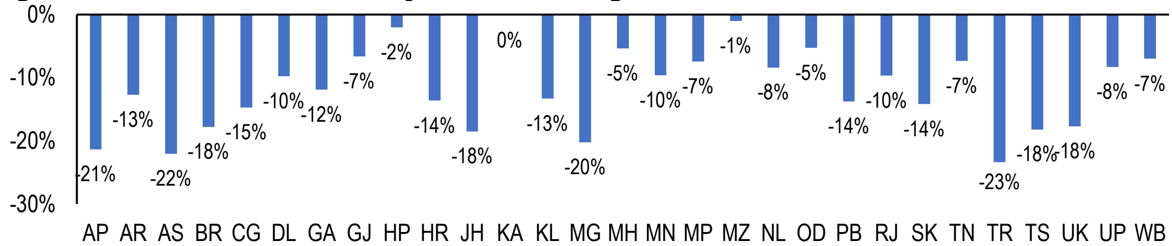
### Budget marksmanship: Optimistic revenue estimates and cuts in capital outlay

The state budget provides three sets of numbers: (i) budget estimates: an estimate for the upcoming financial year, (ii) revised estimates: revision in the budget estimates for the ongoing financial year, and (iii) actuals: the final audited amount for the previous year. The state legislature approves the budget for the coming year based on the budget estimates. The revised estimates may provide a more realistic picture of the government's finances in the ongoing year as they are made with reference to the actual transactions already recorded that year. Actuals may fall short of or exceed budget estimates, and this comparison helps understand the credibility of a proposed budget.

**States raised 10% less revenue than budgeted during 2015-20**

During the 2015-20 period, states raised 10% less revenue than their budget estimates. States such as Tripura (23%), Assam (22%), and Andhra Pradesh (21%) saw a relatively higher shortfall in revenue during this period (Figure 19). States can borrow more to make up for this shortfall, so that they can spend as budgeted. However, as borrowing is limited by FRBM laws, many states cut their expenditure to meet the borrowing limits.

**Figure 19: Shortfall in revenue receipts of states during 2015-20**

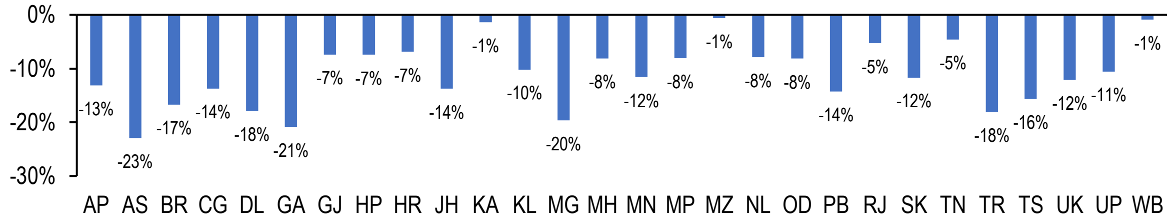



Sources: State Budget Documents; PRS.

**States spent 9% less than what they budgeted; 17% underspending in capital outlay**

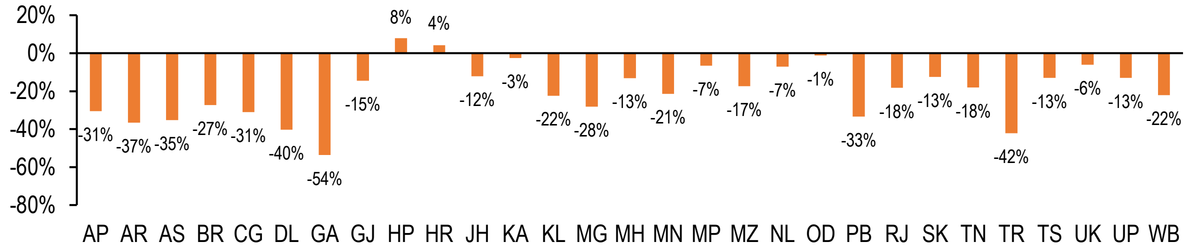
During the period 2015-20, on average, states underspent their budget by 9%. States such as Assam (23%), Goa (21%), and Meghalaya (20%) saw higher underspending during this period (Figure 20). States such as Karnataka and West Bengal saw the least variance in the budget and actual spending figures. Average underspending during this period in case of revenue expenditure is 8%. As a large part of the revenue expenditure cannot be cut (see Figure 27 on Page 23), there is a disproportionately higher underspending in case of capital outlay, at 17%. States such as Goa (54%) and Tripura (42%) saw a higher cut in capital outlay as compared to the budget estimates during this period (Figure 21).

**Figure 20: Underspending by states during 2015-20**




Note: Expenditure denotes the sum of revenue expenditure and capital outlay.
Sources: State Budget Documents; PRS.

**Figure 21: Underspending in capital outlay during 2015-20**




Sources: State Budget Documents; PRS.

## State Budgets in 2021-22

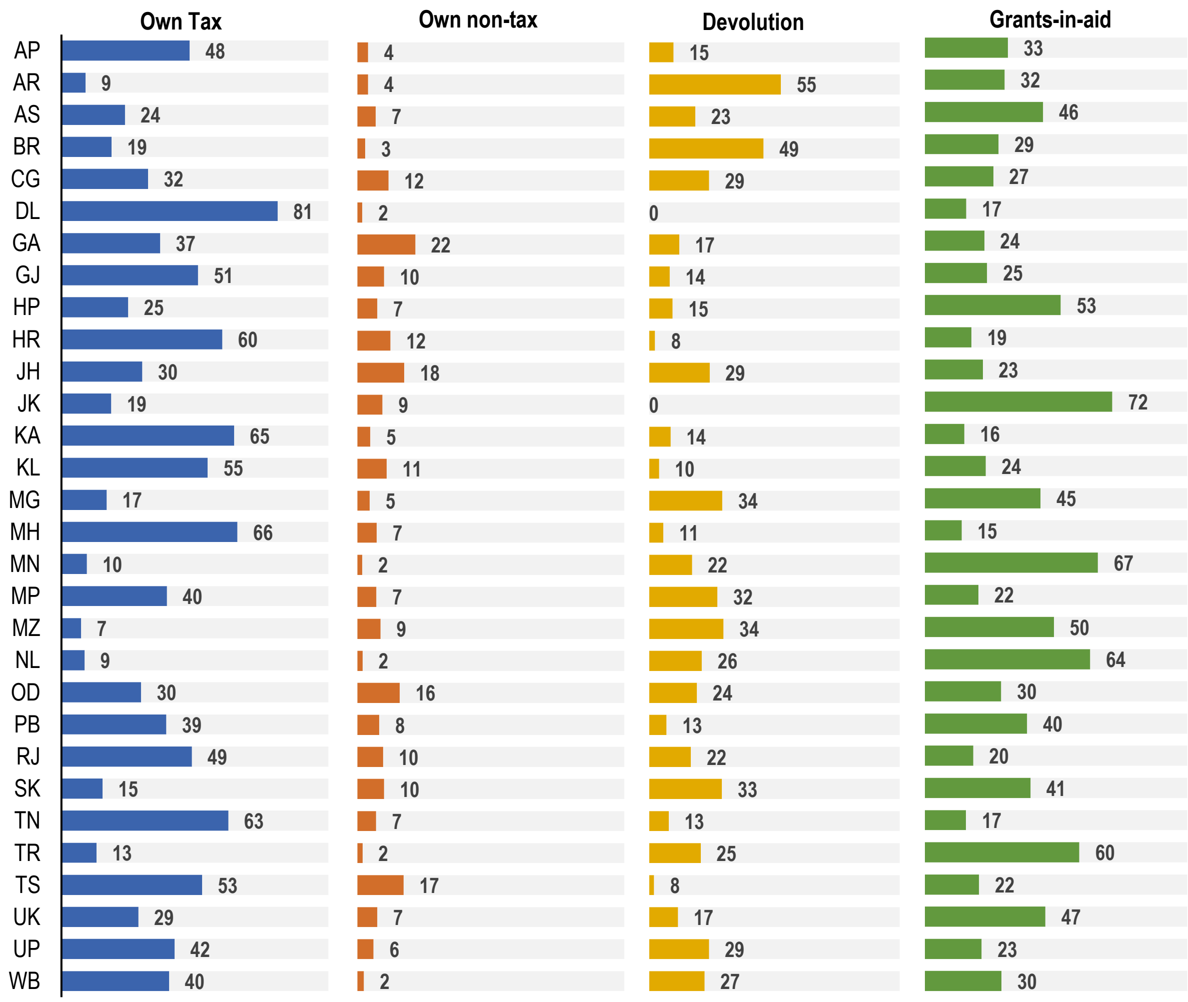
This section provides a snapshot of how states are estimated to earn and spend in 2021-22.

### Own tax revenue is the largest source of revenue for most states

Revenue receipts of states comprise revenue from own sources, and transfers from the Centre. Own revenue consists of tax revenue (45% of revenue receipts in 2021-22) and non-tax revenue (8% ), whereas central transfers consist of states' share in central taxes (20%) and grants-in-aid from the Centre (27%). Share in central taxes is based on the recommendations by the Finance Commission. As Delhi and Jammu and Kashmir are union territories, they do not have any share in central taxes.

The contribution of own revenue is estimated to be significantly higher (more than 70% of total revenue receipts) in states such as Telangana, Maharashtra, Haryana, Tamil Nadu, and Delhi (Figure 22). Whereas, states such as Bihar, Jammu and Kashmir, Himachal Pradesh and the north-eastern states depend on the Centre for most of their revenue. Share of own non-tax revenue is estimated to be in the range of 6-16% of total revenue in most states. Goa at 22% is an exception (electricity distribution in the state is through a government department unlike most states). As can be seen in Figure 22, states such as Himachal Pradesh, Jammu and Kashmir, and the north-eastern states are comparatively more dependent on grants-in-aid from the Centre. Unlike devolution, which is constitutionally provided as per the Finance Commission's criteria, a major portion of grants is decided by the Centre. Grants are often tied to specific expenditure priorities and thus, offer states little flexibility and choice. Higher dependence on central grants limits the ability of states to spend as per their local economic and social priorities.

**Figure 22: Components of revenue receipts (2021-22 BE, figures in %)**




Sources: State Budget Documents; PRS.

Disinvestment and Asset Monetisation

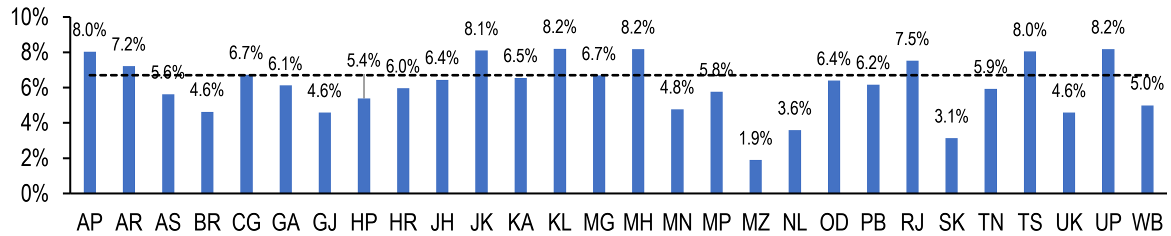
Unlike the central government, states typically do not make estimates of any receipts through disinvestment or monetisation of assets. However, faced with revenue shortfall in light of the COVID-19 pandemic, a few states are now trying to generate additional funds through disinvestment or asset monetisation. In recent years (before the pandemic), only a couple of states had received or estimated a sizeable amount of receipts through disinvestment. In 2018-19, West Bengal received Rs 692 crore from the sale of its equity in Haldia Petro Chemicals Limited. Haryana estimated capital receipts of Rs 1,040 crore in 2018-19, Rs 1,778 crore in 2019-20, and Rs 3,750 crore in 2020-21 (budget estimate). However, it was able to generate Rs 49 crore, Rs 54 crore, and Rs 63 crore, respectively, in these years. For 2021-22, along with Haryana (Rs 5,000 crore), Madhya Pradesh has estimated Rs 1,447 crore as capital receipts, of which Rs 1,434 crore will be generated from disinvestment of equity holding of the state government. Other than disinvestment, some capital receipts are also expected through other avenues such as sale or lease of land (e.g., Rs 36 crore by Karnataka in 2021-22).

The central government is also trying to incentivise states to engage in disinvestment or asset monetisation through the scheme 'Special Assistance to States for Capital Expenditure for 2021-22'. Under the scheme, states will be provided interest-free loans of up to Rs 15,000 crore in 2021-22, that need to be repaid after 50 years.[33] Of this, Rs 5,000 crore of loans are earmarked for states which carry out disinvestment of State Public Sector Enterprises or monetisation/ recycling of infrastructure assets. States will be provided these loans on a first-come first-serve basis for doing capital expenditure. The amount of loan given to a state will range from 33%-100% of the amount realised by it through monetisation of assets, listing, and disinvestment. Through monetisation, the government aims to unlock the value of assets, eliminate their holding cost, and enable utilisation of scarce public funds for new projects.

## States' own tax revenue estimated at 6.7% of their GSDP in 2021-22

As discussed earlier, own tax revenue is estimated to be the largest source of revenue (45% of total revenue receipts) for states in 2021-22. Own tax-GSDP ratio is a measure of a state's potential to generate taxes from its economy on its own. A higher ratio indicates a better ability to harvest taxes from the economic activities in the state. States' own tax revenue in 2021-22 is estimated to be 6.7% of their GSDP. For most states, own tax to GSDP ratio is estimated to range between 5%-8%, except for north-eastern states, where it is between 3%-5%.

**Figure 23: Own tax as a percentage of GSDP (2021-22 BE)**

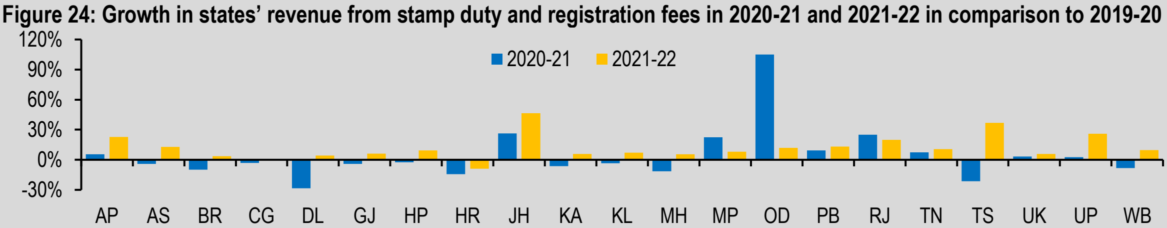



Sources: State Budget Documents; PRS.

Cut in Stamp Duty Rates by States

Stamp duty and registration fee applicable on transfer or sale of a property is a major source of states' revenue, which contributes about 11% to their own tax revenue. The revenue from this source depends on the tax rates and the valuation of the property on which these rates are applied. The valuation of a property, in turn, depends on the land rates approved by states from time to time. In light of the economic contraction due to the COVID-19 pandemic, some states announced a cut in their stamp duty rates, registration fees, or land rates to provide relief to buyers and boost economic activity. For instance, Kerala reduced the stamp duty rate from 8% to 4% and registration fee from 2% to 1% for properties located in industrial parks to attract investment in industries. Karnataka and Rajasthan reduced their stamp duty rates for apartments below the specified values to promote affordable housing. Other states which announced a cut in their rates during this period include Maharashtra and West Bengal. Figure 24 shows the annual growth in the revenue from stamp duty and registration fees of 21 major states in the years 2020-21 and 2021-22, in comparison to the year 2019-20. On average, the revenue of these states decreased by 3% in 2020-21. In comparison, the annual growth in 2021-22, over the year 2019-20, is estimated to be higher at 12% (based on the 2021-22 budget estimates).

**Figure 24: Growth in states' revenue from stamp duty and registration fees in 2020-21 and 2021-22 in comparison to 2019-20**



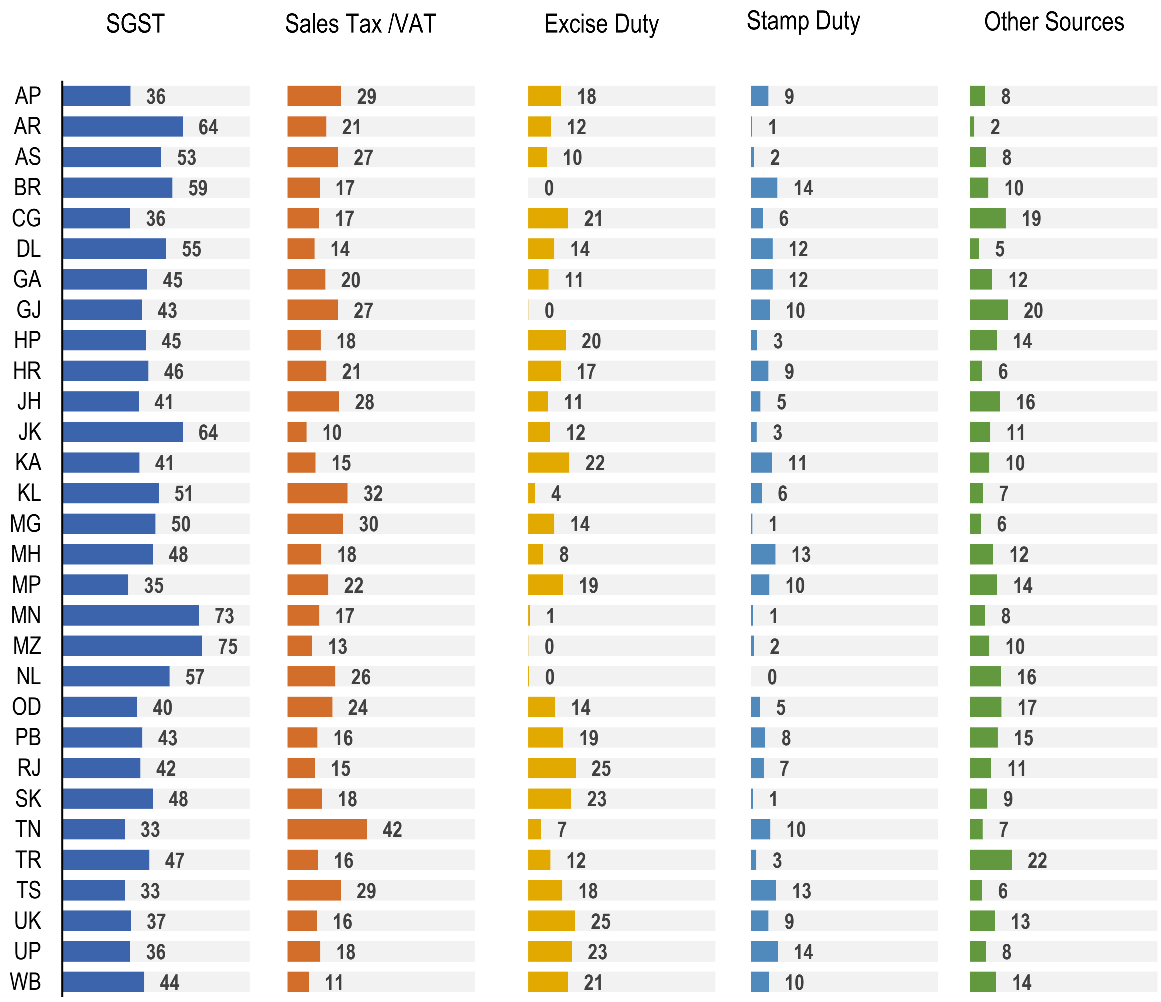

Note: The figure excludes the north-eastern states (except Assam) and Goa.
Sources: CAG; State Budget Documents; PRS.

A study of the Union Ministry of Housing and Urban Affairs (2020) observed that lowering of taxes by states could spur demand and lead to an increase in property transactions. [34] In such a scenario, states may not face a revenue loss (or even gain revenue) despite cutting their tax rates. The study noted that one of the key reasons for high housing prices is the high stamp duty and registration charges levied by state governments at the time of a transaction. In comparison, other countries (such as UK, Japan, and Germany) charge lower stamp duty rates. High stamp duty incentivises underreporting of transactions and tax evasion, which may result in a loss of revenue to states. The 15th FC (2021-26) observed that many states have revised stamp duty rates downwards to 5% or below and digitised their land and property records. However, states' revenue remains below potential due to undervaluation of properties.

## State GST is the largest source of own tax revenue for states

In 2021-22, SGST is estimated to be the largest source of own tax revenue for states (42% of aggregate own tax revenue). With the introduction of GST, many indirect taxes levied by states have been replaced. While these taxes were earlier under the control of each state, GST rates are now decided by the GST Council. This implies that states have limited flexibility in making decisions regarding tax rates on goods and services. Consequently, states have limited autonomy on a large part of their own tax revenue as the receipts from SGST depend on tax rates decided by the GST Council. After SGST, Sales tax/VAT (22% of own tax revenue), and the state's excise duty (15%) are estimated to be the largest sources of own tax revenue for the states. Sales tax/VAT and excise duty mainly come from these taxes on petroleum products and alcohol (these two products are not part of the GST system). In 2021-22, other notable sources of own tax revenue are estimated to be: (i) stamp duty and registration fees (about 10% of own tax revenue), (ii) taxes on vehicles (5%), (iii) taxes and duties on electricity (3%), and (iv) land revenue (1%).

**Figure 25: Share of key taxes in own tax revenue (2021-22 BE, figures in %)**




Source: State Budget Documents; PRS.

### States in violation of the Constitution in setting up State Finance Commissions

Article 243-I of the Constitution requires the state governments to appoint State Finance Commission (SFCs) from 1994 after every five years. State government transfers to local governments are to be governed by the mandate of their current SFC. Accordingly, states should have constituted their Sixth State Finance Commission by now. The 15th Finance Commission observed that most state governments did not constitute SFCs in time and did not give due importance to the recommendations of the SFCs (Table 11). The Commission made it mandatory for all states to constitute SFC and act upon its recommendations by March 2024 to receive any local body grants thereafter.

**Table 11: Status of the constitution of State Finance Commission (as of October 2020)**

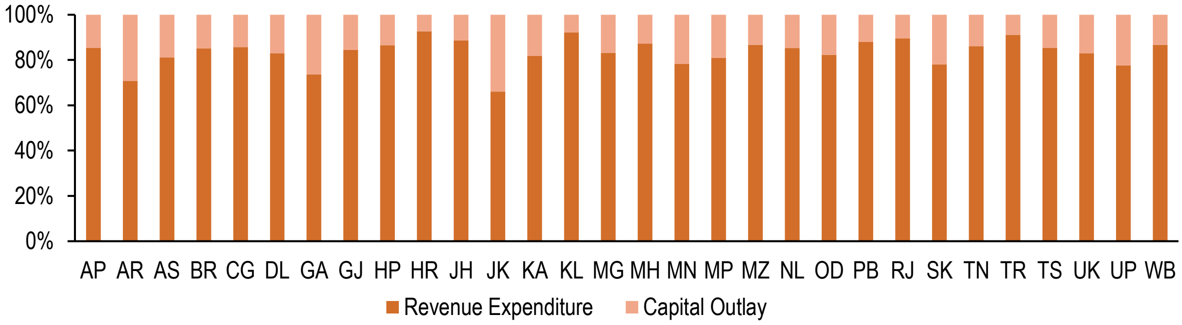
| State | Last SFC Constituted |
|---|---|
| Assam, Bihar, Punjab, Rajasthan | VI |
| Haryana, Himachal Pradesh, Kerala, Madhya Pradesh, Maharashtra, Odisha, Sikkim, Tamil Nadu, Tripura, Uttarakhand*, and Uttar Pradesh | V |
| Andhra Pradesh, Karnataka, and West Bengal | IV |
| Chhattisgarh*, Goa, Gujarat, Jharkhand*, and Manipur | III |
| Arunachal Pradesh, Mizoram | II |
| Erstwhile Jammu and Kashmir, Telangana# | I |

Note: * Chhattisgarh, Jharkhand, and Uttarakhand were formed in 2000, hence, they should have constituted fifth SFC. #Telangana was formed out of Andhra Pradesh in June 2014; it constituted its first SFC in December 2017.
Source: Report of the 15th Finance Commission for 2021-26; PRS.

## Revenue expenditure to form the bulk of total expenditure of all states

The expenditure of a government can be classified into two components: (i) revenue expenditure, and (ii) capital expenditure. Revenue expenditure is recurring in nature and includes expenditure on salaries, pensions, interest payment, and subsidies. Capital expenditure goes towards creating assets or reducing liabilities. Capital expenditure includes capital outlay which leads to the creation of assets such as schools, hospitals, and roads and bridges. Capital expenditure also includes repayment of loans (which lowers the state's liability burden), and loans and advances given by a government. In 2021-22, states on aggregate are estimated to incur 85% of their expenditure as revenue expenditure and 15% as capital outlay (debt components excluded from the expenditure for analysis).

**Figure 26: Composition of expenditure of states (2021-22 BE)**

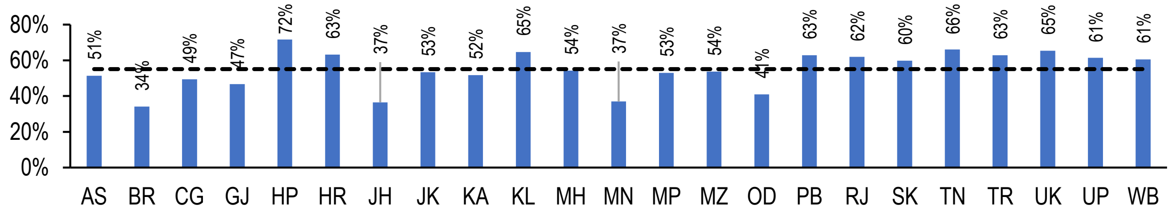



Note: Expenditure excludes debt repayment, and loans and advances given by the states.
Sources: State Budget Documents; PRS.

## States estimated to spend 55% of their revenue receipts on committed expenditure items

Committed expenditure of a state typically includes expenditure on payment of salaries, pensions, and interest payments. A larger proportion of state budget allocated for committed expenditure crowds out other developmental expenditure. In 2021-22, states on aggregate have budgeted to spend 55% of their revenue receipts on committed expenditure (salaries, pensions, and interest payments) (Figure 27). 30% of the revenue receipts are estimated to be incurred on salaries and wages, followed by 13% on interest payments and another 12% on pension. Spending by states such as Bihar and Jharkhand on committed expenditure is lower than the average. This is mainly due to a lower portion of their revenue receipts being spent on salaries and wages.

**Figure 27: Committed expenditure as a percentage of revenue receipts (2021-22 BE)**

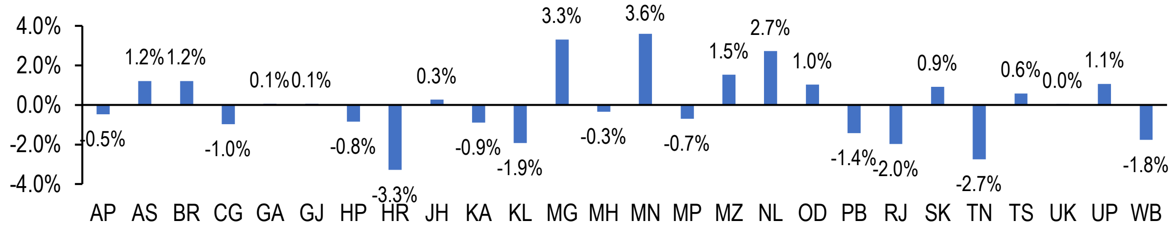



Note: Salary estimates not available for states not in the chart.
Sources: State Budget Documents; PRS.

## Twelve states have estimated a revenue deficit in 2021-22 at the budget stage

Revenue deficit is the excess of revenue expenditure over revenue receipts. A revenue deficit means that states need to borrow to meet expenses which do not create any assets. A revenue surplus can be used to incur capital outlay or pay off outstanding debt. While a high revenue surplus in the short term may allow for greater spending on asset creation, such a surplus for a longer-term may indicate inadequate revenue expenditure by the state. The 13th Finance Commission (FC) recommended that a long term and permanent target for states should be to maintain a zero-revenue deficit. The 15th FC has provided grants to 17 states in 2021-22 for eliminating revenue deficit. Even after accounting for this grant, 12 states are estimated to observe a revenue deficit in 2021-22. States with notably high revenue deficit in 2021-22 include Haryana (3.3% of GSDP), Tamil Nadu (2.7%), and Rajasthan (2%). Revenue deficit of states on aggregate is estimated to be 0.5% of GSDP in 2021-22.

**Figure 28: Revenue balance as a percentage of GSDP (2021-22 BE)**

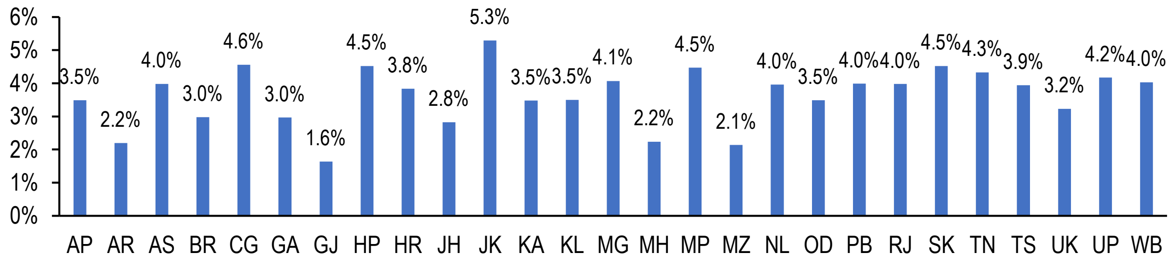



Note: Delhi and Tripura not shown in above chart as their GSDP estimates for 2021-22 are not available. Arunachal Pradesh and Jammu and Kashmir also not shown in above chart, they have estimated a revenue surplus of 21.8% of GSDP and 14.1% of GSDP in 2021-22, respectively (owing to high grants-in-aid from Centre).
Sources: State Budget Documents; PRS.

## Fiscal deficit of states estimated to be 3.5% of GSDP in 2021-22

Fiscal deficit is the excess of government expenditure over its receipts. A high fiscal deficit of a government implies a higher borrowing requirement in a financial year. The borrowed funds may be spent by the state for various purposes, such as capital outlay and administrative expenditure. For 2021-22, the fiscal deficit limit permitted for states is 4% of GSDP. States will be allowed additional borrowing worth 0.5% of GSDP upon completing power sector reforms. Fiscal deficit of states on aggregate is estimated to be 3.5% of their GSDP in 2021-22. 18 states have estimated their fiscal deficit to be below the 4% level. States with relatively high fiscal deficit in 2021-22 include Jammu and Kashmir, Chhattisgarh, Madhya Pradesh, and Himachal Pradesh.

**Figure 29: Fiscal deficit as a percentage of GSDP (2021-22 BE)**




Note: Delhi and Tripura not shown in above chart as their GSDP estimate for 2021-22 is not available. Manipur not shown in above chart, it is estimated to observe a fiscal deficit of 9.2% of GSDP in 2021-22.
Sources: State Budget Documents; PRS.

As per Article 293(3) of the Constitution, state governments require the permission of the central government to raise any loan if there is still any outstanding loan or guarantee that the central government has given to the state. The permission granted by the central government is based on the projected GSDP figures. As the actual GSDP figures could be different, states may end up borrowing above the budgeted fiscal deficit to GSDP ratio.

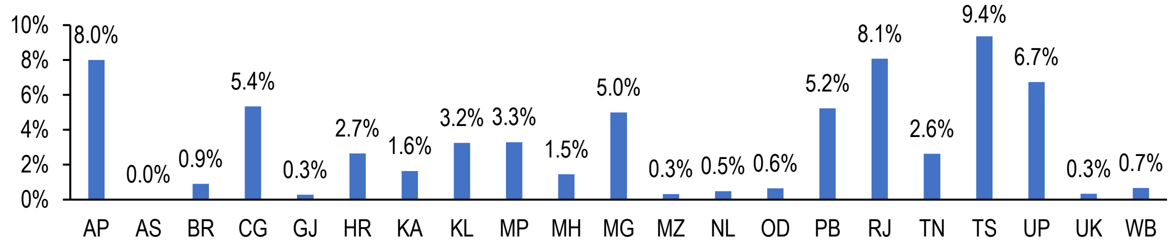
**Fiscal Reforms recommended by the 15th Finance Commission**

- **Overhaul of FRBM Framework**: In view of contemporary challenges, the FRBM framework needs a major restructuring. A high-powered inter-governmental group should be formed to review the FRBM Acts recommend a new FRBM framework for both the Centre and states, and oversee its implementation.
- **Reporting of liabilities**: States should amend their fiscal responsibility legislation to ensure consistency with the Centre's legislation, in particular, with the definition of debt. A complete reporting mechanism of explicit and implicit guarantee is not yet in place. Standards should be developed for reporting and disclosure of broader public debt and contingent liabilities, and their risks.
- **Independent Fiscal Council**: An independent Fiscal Council should be established with powers to assess records from the Centre as well as states. The Council should only have an advisory role. Some key functions of the proposed council could be: (i) providing multi-year macroeconomic and fiscal forecasts, (ii) assessing the consistency of fiscal targets in states, (iii) carrying out independent assessment of long-term sustainability, and (iv) advising on the conditions for escape clause under FRBM laws.
- **A legal framework for public financial management**: A legal framework should be adopted for public financial management providing for fiscal responsibility principles, accounting and reporting, and accountability of government agencies and undertakings.

## Outstanding guarantee given by states at about 3.3% of their GSDP as of 2019-20

Outstanding liabilities of states do not include a few other liabilities that are contingent in nature, which states may have to honour in certain cases. State governments guarantee the borrowings of State Public Sector Enterprises (SPSEs) from financial institutions. This may be because these enterprises have a poor credit profile, and a government guarantee will make it easier for them to obtain a loan. RBI has noted that these contingent liabilities are a risk to state governments owing to the large outstanding debt and losses of SPSEs. The guarantee given by the states was 3.3% of their aggregate GSDP at the end of 2019-20 (as per the latest data available for 22 states). States such as Telangana, Rajasthan, Andhra Pradesh, Uttar Pradesh, and Punjab had a comparatively higher outstanding guarantee. Note that 16 states are estimated to give guarantee for borrowing of Rs 1.36 lakh crore by their discoms in 2020-21 (see Table 13 in annexure). This will lead to a further rise in their guarantee level.

**Figure 30: Outstanding government guarantee as a percentage of GSDP at the end of 2019-20**




Sources: CAG, RBI, State Budget Documents; PRS.

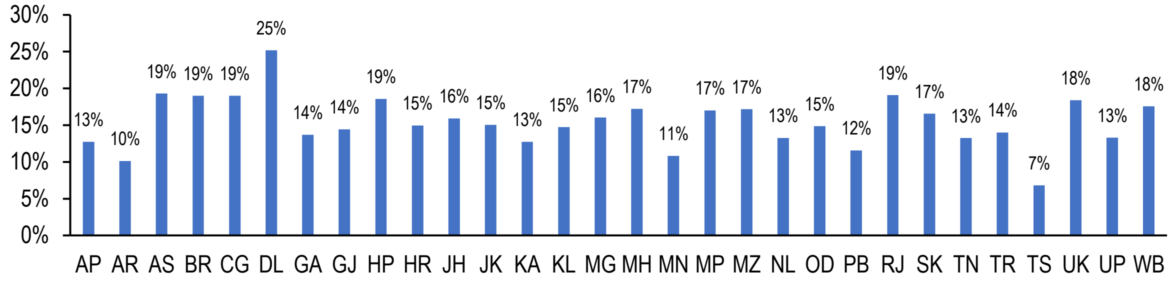
## Sector-wise outlay in 2021-22

We show below the allocation by states on key sectors in 2021-22. The share of expenditure on a particular sector denotes the share of that sector in the state's budget. Expenditure on a sector is the sum of the revenue expenditure made and the capital outlay done in that sector. Note that spending on a sector may be affected by funding from the Centre in the form of grants for centrally sponsored schemes and other central grants. The sectoral spending in Delhi may be different from other states as Police is with the Centre and the state has negligible rural or agricultural area.

### Education

In 2021-22, states on aggregate have allocated 15.2% of their budget towards education sector. This includes expenditure on schemes (such as the Samagra Shiksha Abhiyan and the Midday Meal scheme), construction and maintenance of school buildings, and payment of salaries and pensions of teaching and other staff.

**Figure 31: Most states have allocated the highest proportion of their budget towards education in 2021-22**

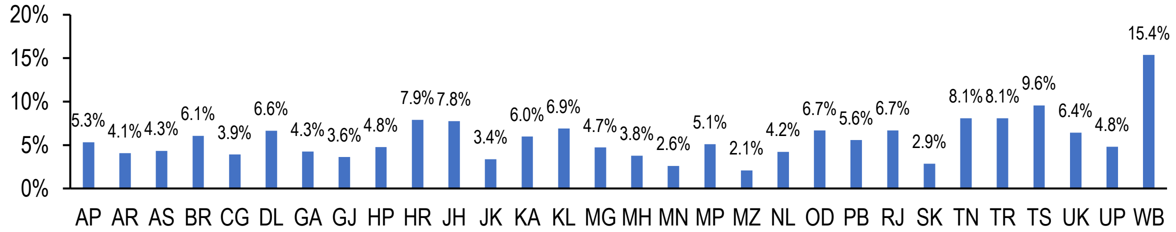



Sources: State Budget Documents; PRS.

### Social welfare and nutrition

In 2021-22, states on aggregate have allocated 6.3% of their budget towards social welfare and nutrition. This includes spending on social security pensions, nutrition, and disaster relief measures.

**Figure 32: West Bengal to spend the highest on social welfare and nutrition in 2021-22**

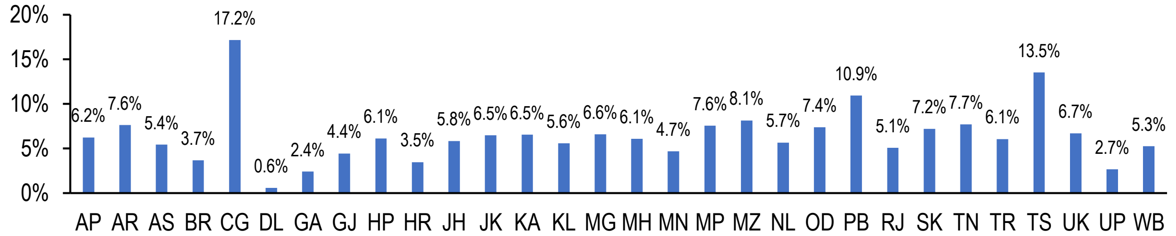



Sources: State Budget Documents; PRS.

### Agriculture and allied activities

Expenditure under this head includes expenditure on subsidies, agricultural marketing, crop husbandry, horticulture, waiver of agricultural loans (in some states), and implementing schemes, including Prime Minister Fasal Bima Yojana and Rashtriya Krishi Vikas Yojana. In 2021-22, states on aggregate have allocated 6.2% of their budget towards agriculture.

**Figure 33: Chhattisgarh to spend the highest on agriculture and allied activities in 2021-22**

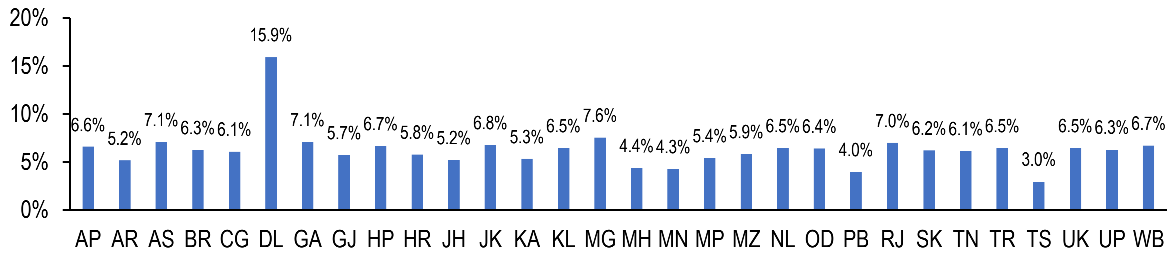



Sources: State Budget Documents; PRS.

## Health and family welfare

In 2021-22, states on an average have allocated 6% of their budget towards health and family welfare. This includes expenditure on schemes such as the National Health Mission, Ayushman Bharat, and construction and maintenance of hospitals. Note that the National Health Policy, 2017 had recommended that by 2020, states should allocate at least 8% of their budget towards health. The 15th Finance Commission re-iterated this target and recommended states to meet this target by 2022.

**Figure 34: Allocation towards health in 2021-22 below the recommended level in most states**

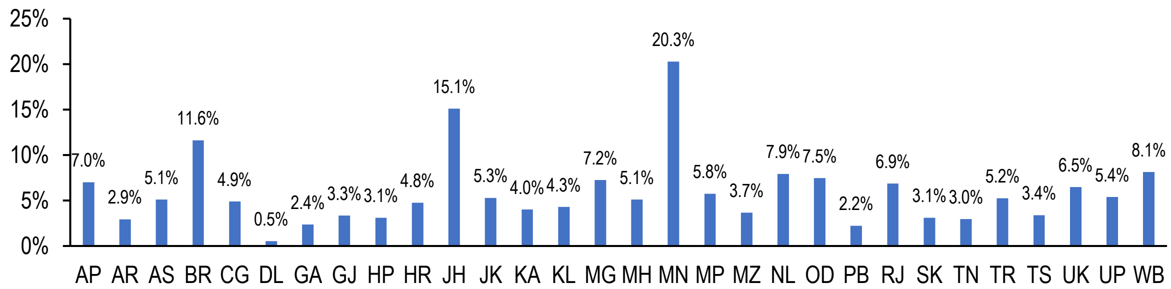



Sources: State Budget Documents; PRS.

## Rural development

Expenditure on this sector includes implementation of various rural development schemes, such as the National Rural Employment Guarantee Scheme, and the Swachh Bharat Mission. In 2021-22, states on an average have allocated 5.7% of their budget towards rural development.

**Figure 35: Manipur to spend the highest on rural development in 2021-22**

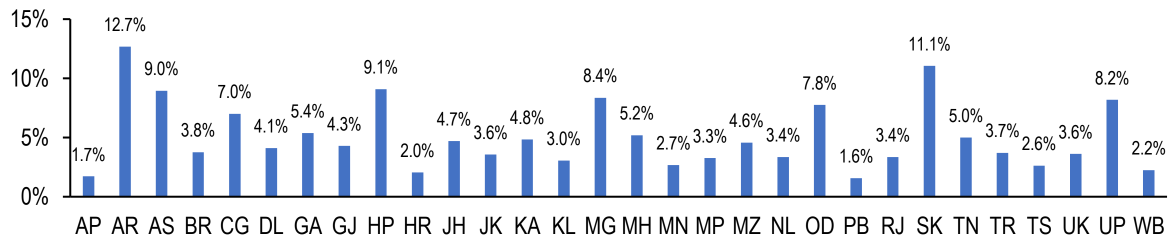



Sources: State Budget Documents; PRS.

## Roads and bridges

In 2021-22, states on aggregate have allocated 4.7% of their budget towards roads and bridges. This includes spending on construction and maintenance of state highways.

**Figure 36: Arunachal Pradesh to spend the highest on roads and bridges in 2021-22**

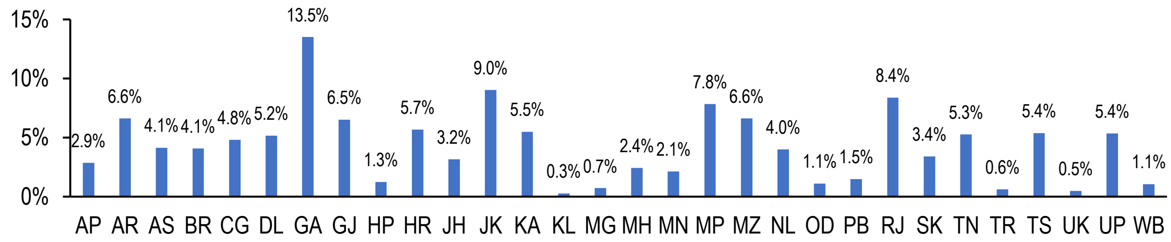



Sources: State Budget Documents; PRS.

## Energy

Expenditure under this head includes subsidy to consumers, allocation for power projects, and assistance to discoms under UDAY scheme in certain states. In 2021-22, states on aggregate have allocated 4.4% of their budget towards the energy sector.

**Figure 37: States to spend 4.4% of their budget on energy sector in 2021-22**

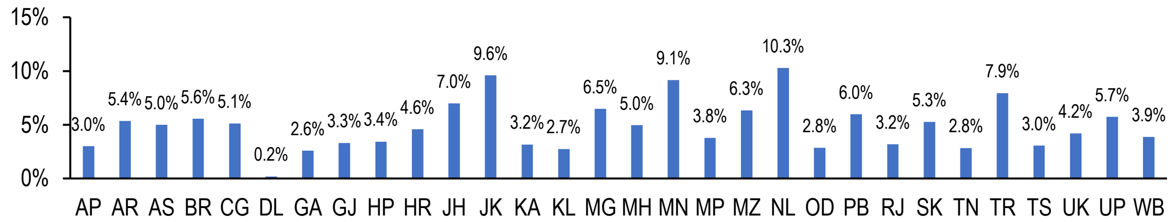



Note: States such as Goa and Jammu and Kashmir have higher spending on energy through the budget as power distribution is undertaken by the government department unlike state-owned or private discoms in most other states.
Sources: State Budget Documents; PRS.

## Police

In 2021-22, states on aggregate have allocated 4.3% of the budget towards police.

**Figure 38: Nagaland to spend the highest on police in 2021-22**

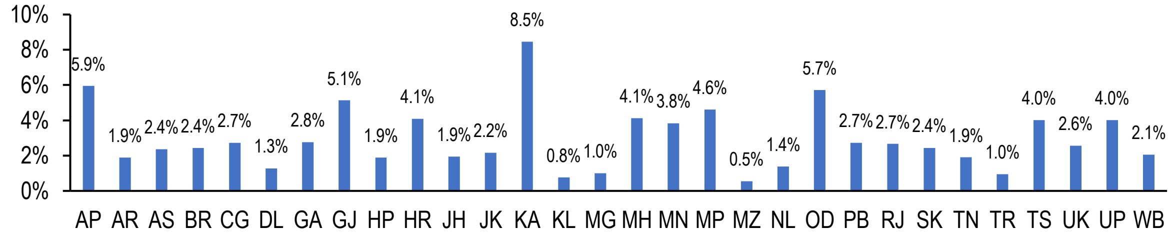



Sources: State Budget Documents; PRS.

## Irrigation and flood control

In 2021-22, states are estimated to spend 3.6% of their budget on irrigation and flood control.

**Figure 39: Karnataka to spend the highest on irrigation and flood control in 2021-22**

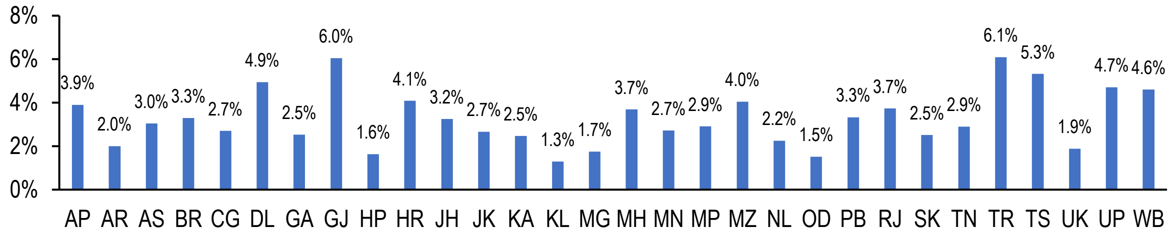



Sources: State Budget Documents; PRS.

## Urban development

In 2021-22, states on aggregate have allocated 3.6% of their budget towards urban development.

**Figure 40: Tripura to spend the highest on urban development in 2021-22**

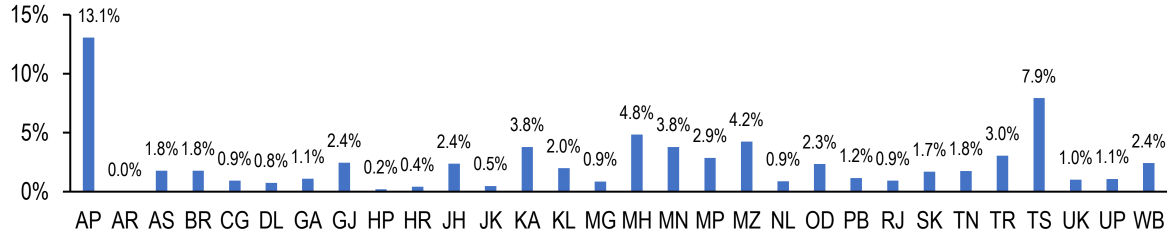



Sources: State Budget Documents; PRS.

## Welfare of SC, ST, OBC, and minorities

In 2021-22, states on aggregate have allocated 3% of the budget towards the welfare of SC, ST, OBC, and minorities.

**Figure 41: Andhra Pradesh to spend the highest on welfare of SC, ST, OBC & minorities in 2021-22**

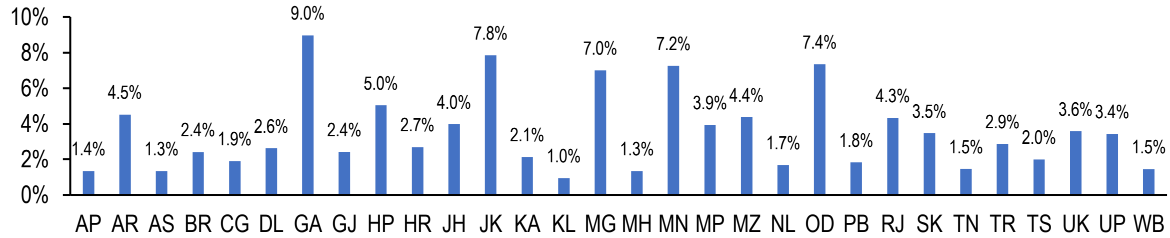



Sources: State Budget Documents; PRS.

## Water supply and sanitation

In 2021-22, states on aggregate have allocated 2.8% of the budget for water supply and sanitation.

**Figure 42: Goa to spend the highest on water supply and sanitation in 2021-22**

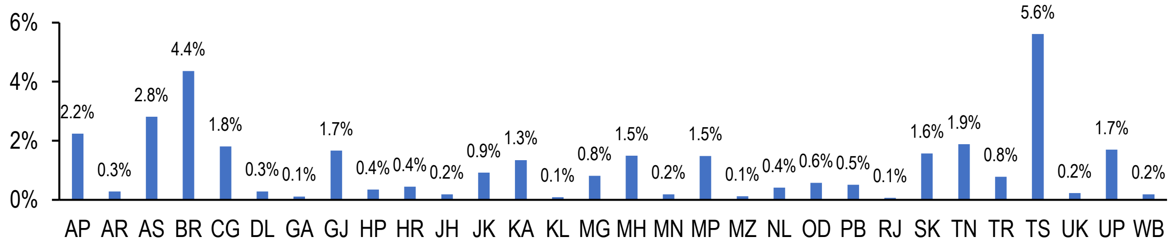



Sources: State Budget Documents; PRS.

## Housing

In 2021-22, states on aggregate have allocated 1.5% of their budget towards the housing sector.

**Figure 43: Telangana to spend the highest on housing in 2021-22**




Sources: State Budget Documents; PRS.

## Annexure

**Table 12: Sales taxes/ VAT rates levied on petrol and diesel across states (as on November 12, 2021)**

| States | Petrol | Diesel |
|---|---|---|
| Andhra Pradesh | 31% VAT + Rs.4/litre VAT+Rs.1/litre Road Development Cess and Vat thereon | 22.25% VAT + Rs.4/litre VAT+Rs.1/litre Road Development Cess and Vat thereon |
| Arunachal Pradesh | 14.50% | 7.00% |
| Assam | 32.66% or Rs.22.63 per litre whichever is higher , Rebate of Rs.5 per Litre & Additional rebate of Rs. 5.3 per litre | 23.66% or Rs.17.45 per litre whichever is higher , Rebate of Rs.5 per Litre & Additional rebate of Rs. 5.1 per litre |
| Bihar | 23.58% or Rs 16.65/Litre whichever is higher (30% Surcharge on VAT as irrecoverable tax) | 16.37% or Rs 12.33/Litre whichever is higher (30% Surcharge on VAT as irrecoverable tax) |
| Chhattisgarh | 25% VAT + Rs.2/litre VAT | 25% VAT + Rs.1/litre VAT |
| Delhi | 30% VAT | Rs.250/KL air ambience charges + 16.75% VAT |
| Goa | 20% VAT + 0.5% Green cess | 17% VAT + 0.5% Green cess |
| Gujarat | 13.7% VAT+ 4% Cess on Town Rate & VAT | 14.9% VAT + 4 % Cess on Town Rate & VAT |
| Haryana | 18.20% or Rs.14.50/litre whichever is higher as VAT+5% additional tax on VAT | 16.00% VAT or Rs.11.86/litre whichever is higher as VAT+5% additional tax on VAT |
| Himachal Pradesh | 17.5% or Rs 13.50/Litre- whichever is higher | 6% or Rs 4.40/Litre- whichever is higher |
| Jammu and Kashmir | 24% MST+ Rs.2/Litre employment cess, Rebate of Rs.4.50/Litre | 16% MST+ Rs.1.00/Litre employment cess, Rebate of Rs.6.50/Litre |
| Jharkhand | 22% on the sale price or Rs. 17.00 per litre, whichever is higher + Cess of Rs 1.00 per litre | 22% on the sale price or Rs. 12.50 per litre, whichever is higher + Cess of Rs 1.00 per litre |
| Karnataka | 25.92% sales tax | 14.34% sales tax |
| Kerala | 30.08% sales tax+ Rs.1/litre additional sales tax + 1% cess | 22.76% sales tax+ Rs.1/litre additional sales tax + 1% cess |
| Madhya Pradesh | 29 % VAT + Rs.2.5/litre VAT+1%Cess | 19% VAT+ Rs.1.5/litre VAT+1% Cess |
| Maharashtra – Mumbai, Thane, Navi Mumbai, Amravati, and Aurangabad | 26% VAT+ Rs.10.12/Litre additional tax | 24% VAT+ Rs.3.00/Litre additional tax |
| Maharashtra (rest of the state) | 25% VAT+ Rs.10.12/Litre additional tax | 21% VAT+ Rs.3.00/Litre additional tax |
| Manipur | 25% VAT | 13.5% VAT |
| Meghalaya | 13.5% or Rs 11.00/Litre- whichever is higher (Rs.0.10/Litre pollution surcharge) | 5% or Rs4.00/Litre- whichever is higher (Rs.0.10/Litre pollution surcharge) |
| Mizoram | 16.36% VAT | 5.23% VAT |
| Nagaland | 25% VAT or Rs. 16.04/litre whichever is higher +5% surcharge + Rs.2.00/Litre as road maintenance cess, Rebate Rs. 5.5 per litre | 16.50% VAT or Rs. 10.51/litre whichever is higher +5% surcharge + Rs.2.00/Litre as road maintenance cess, Rebate Rs. 5.1 per litre |
| Odisha | 28% VAT | 24% VAT |
| Punjab | Rs.2050/KL (cess)+ Rs.0.10 per Litre (Urban Transport Fund) + 0.25 per Litre (Special Infrastructure Development Fee)+13.77% VAT plus 10% additional tax or Rs.12.50/Litre whichever is higher | Rs.1050/KL (cess) + Rs.0.10 per Litre (Urban Transport Fund) + 0.25 per Litre (Special Infrastructure Development Fee) + 9.92% VAT plus 10% additional tax and or Rs.8.24/Litre whichever is higher |
| Rajasthan | 36% VAT+Rs 1500/KL road development cess | 26% VAT+ Rs.1750/KL road development cess |
| Sikkim | 17.30% VAT+ Rs.3000/KL cess | 7% VAT + Rs.2500/KL cess |
| Tamil Nadu | 13% + Rs.11.52 per litre | 11% + Rs.9.62 per litre |
| Telangana | 35.20% VAT | 27% VAT |
| Tripura | 17.50% VAT+ 3% Tripura Road Development Cess | 10.00% VAT+ 3% Tripura Road Development Cess |
| Uttar Pradesh | 19.36% or Rs 14.85/Litre whichever is higher | 17.08% or Rs 10.41/Litre whichever is higher |
| Uttarakhand | 16.97% or Rs 13.14 per litre whichever is greater | 17.15% or Rs 10.41 per litre whichever is greater |

| States | Petrol | Diesel |
|---|---|---|
| West Bengal | 25% or Rs.13.12/litre whichever is higher as sales tax+ Rs.1000/KL cess – Rs 1000/KL sales tax rebate (20% Additional tax on VAT as irrecoverable tax) | 17% or Rs.7.70/litre whichever is higher as sales tax + Rs 1000/KL cess – Rs 1000/KL sales tax rebate (20% Additional tax on VAT as irrecoverable tax) |

Sources: Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas; PRS.

**Table 13: Loan sanctioned to discoms under the Liquidity Infusion Scheme for the Power Sector (as of June 2021)**

| S. No. | State/UT | Loan sanctioned (in Rs crore) | As % of 2021-22 GSDP |
|---|---|---|---|
| 1 | Andhra Pradesh | 8,370 | 0.79% |
| 2 | Bihar | 3,503 | 0.46% |
| 3 | Himachal Pradesh | 276 | 0.16% |
| 4 | Jammu and Kashmir | 11,024 | 5.48% |
| 5 | Karnataka | 7,247 | 0.43% |
| 6 | Maharashtra | 14,310 | 0.48% |
| 7 | Manipur | 111 | 0.26% |
| 8 | Meghalaya | 1,345 | 3.49% |
| 9 | Puducherry | 150 | - |
| 10 | Punjab | 4,000 | 0.66% |
| 11 | Rajasthan | 6,574 | 0.55% |
| 12 | Tamil Nadu | 30,230 | 1.42% |
| 13 | Telangana | 12,652 | 1.10% |
| 14 | Uttar Pradesh | 33,923 | 1.56% |
| 15 | Uttarakhand | 800 | 0.29% |
| 16 | West Bengal | 1,021 | 0.07% |
| | **Total** | **1,35,536** | **-** |

Source: Unstarred Question No 2544, Rajya Sabha, Ministry of Power, August 10, 2021; PRS.

**Table 14: Details of reforms to be completed for availing additional borrowing space in 2020-21**

| Reform Area | Details |
|---|---|
| **Ease of Doing Business** | ▪ Completion of the first assessment of 'District Level Business Reform Action Plan'<br>▪ Elimination of the requirements of renewal of registration certificates/approvals/licenses obtained by businesses under various Acts<br>▪ Implementation of computerised central random inspection system under the Acts wherein allocation of inspectors is done centrally, the same inspector is not assigned to the same unit in subsequent years, prior inspection notice is provided to the business owner, and report is uploaded within 48 hours of the inspection. |
| **One Nation One Ration Card** | ▪ Aadhaar Seeding of all the ration cards and beneficiaries in the State<br>▪ Automation of all the Fair Price Shops in the State |
| **Urban Local Bodies** | ▪ Notification of floor rates of property tax in urban local bodies which are in consonance with the prevailing circle rates (guideline rates for property transactions)<br>▪ Notification of floor rates of user charges in respect of the provision of water supply, drainage, and sewerage which reflect current costs/past inflation<br>▪ Implementation of a system of periodic increases in floor rates of property tax/user charges in line with price increases |
| **Power Distribution** | ▪ Implementation of direct benefit transfer of power subsidy to farmers in at least one district<br>▪ Reduction in ACS-ARR Gap as per the target set by the central Ministry of Power; ACS-ARR gap indicates the gap between the average cost of supply (ACS) of power and average revenue realised (ARR) from the sale of power at per-unit level<br>▪ Reduction in Aggregate Technical and Commercial Loss (AT&C Loss) as per the target set by the central Ministry of Power; AT&C loss is the ratio of power for which the discom did not receive any payment to the total electricity procured by the utility, technical losses are incurred due to heat and energy loss in the wires and other equipment, commercial losses include non-collection of revenue and pilferage of electricity<br>▪ Out of borrowing worth 0.25% of GSDP, borrowing worth 0.15% of GSDP was linked to Direct Benefit Transfer to farmers, and 0.05% of GSDP each for a reduction in ACS-ARR gap and AT&C loss |

Source: Press Releases of Union Ministry of Finance; Press Information Bureau; PRS.

## Glossary of key terms

**Receipts** indicate the money received by the government. This includes: (i) the money earned by the government, (ii) grants received (mainly from the Centre), and (iii) the money it receives in the form of borrowings or repayment of loans.

**Capital receipts** indicate the receipts which lead to a decrease in assets or an increase in liabilities of the government. It consists of: (i) the money earned by selling assets such as shares of public enterprises, and (ii) the money received in the form of borrowings or repayment of loans.

**Revenue receipts** are receipts which do not have a direct impact on the assets and liabilities of the government. This consists of the money earned by the government through tax and non-tax sources (such as dividend income and grants from the central government).

**Capital expenditure** is used to create assets or to reduce liabilities. It consists of: (i) the money spent by the government on creating assets such as roads and hospitals, and (ii) the money given by the government for repayment of its borrowings or as loans to state public enterprises or local bodies.

**Revenue expenditure** is the expenditure by the government which does not impact its assets or liabilities. For example, this includes salaries, interest payments, pension, administrative expenses, and subsidies.

**Devolution of union taxes** means the money received by states from the central government as the state's share in union taxes such as corporation tax, income tax, central GST, customs, and union excise. It is devolved to the state as per the criteria recommended by the Finance Commission.

**Grants-in-aid** are transferred by the central government to states and are tied in nature, i.e., they are linked to specific schemes and expenditure avenues, such as Swachh Bharat Mission, and National Health Mission.

**Fiscal deficit** is the gap between the government's expenditure requirements and its receipts. This equals the money the government needs to borrow during the year. A surplus arises if receipts are more than expenditure.

**Revenue deficit** is the gap between the revenue components of receipts and expenditure, i.e., revenue disbursements and revenue receipts. This indicates the money the government needs to borrow to spend on non-capital components (which do not lead to creation of assets).

**Primary deficit** equals fiscal deficit minus interest payments. This indicates the gap between the government's expenditure requirements and its receipts, not taking into the account the expenditure incurred on interest payments on loans taken during the previous years.

**Outstanding debt** is the stock of money borrowed by governments over the years which the government currently owes. The figure for a financial year indicates the government's outstanding debt at the end of the year.

**Consolidated Fund of the State** is the Fund or account into which all of the state government's receipts are credited, and which it uses for financing its expenditure.

**Charged expenditure** includes expenditure which is not required to be voted on by the Assembly and is charged directly from the Consolidated Fund of the State. Such expenditure can still be discussed in the Assembly. Examples include interest payments, and salaries and allowances of the Governor and judges of the High Court.

**Voted expenditure** consists of all expenditure other than charged expenditure. Such expenditure is required to be voted upon by the Assembly in the form of Demands for Grants.

**Fiscal Responsibility and Budget Management Framework** relates to laws passed by states for institutionalizing financial discipline. The framework provides targets for revenue deficit, fiscal deficit, and outstanding debt to be met for a specified timeframe by states. It also requires states to bring out statements on fiscal policy for greater transparency.

[1] The FRBM Review Committee Report, Volume I, January 2017, https://dea.gov.in/sites/default/files/Volume%201%20FRBM%20Review%20Committee%20Report.pdf.
[2] Chapter 12: Fiscal Consolidation Roadmap, Volume-I, Report of the 15th Finance Commission for 2021-26, February 2021, https://fincomindia.nic.in/writereaddata/html_en_files/fincom15/Reports/XVFC%20VOL%20I%20Main%20Report.pdf.
[3] The Fiscal Responsibility and Budget Management Act, 2003, https://www.indiacode.nic.in/bitstream/123456789/2064/1/A2003-39.pdf.
[4] General Government Debt as % of GDP, Global Debt Database, Website of International Monetary Fund as accessed on October 28, 2021, https://www.imf.org/external/datamapper/GG_DEBT_GDP@GDD/IND.
[5] Explanatory Memorandum to the Report of the 15th Finance Commission for 2021-26, February 1, 2021, https://fincomindia.nic.in/writereaddata/html_en_files/fincom15/Reports/ATR%20Summary%20Annex%20III%20English.pdf.
[6] Para 141 and 142, Speech of Nirmala Sitharaman, Minister of Finance on Union Budget 2021-22, February 1, 2021, https://www.indiabudget.gov.in/doc/Budget_Speech.pdf.
[7] State Finances: A Study of Budgets of 2019-20, Reserve Bank of India, September 30, 2019, https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/STATEFINANCE201920E15C4A9A916D4F4B8BF01608933FF0BB.PDF.
[8] The Finance Act, 2018, Ministry of Finance, March 28, 2018, http://egazette.nic.in/writereaddata/2018/184302.pdf.
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