Evaluation Report of Compliance to Provisions of the Sikkim FRBM Act: Fiscal Year 2020-21

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Chapter 1: Objectives and Scope of Evaluation

Introductory

1.1 The evaluation report is an independent review process of the state's finances and compliance of the state government to the Fiscal Responsibility and Budget Management Act (FRBM Act) of Sikkim. The review is an ongoing process stipulated by the fiscal responsibility legislation of the state. The report is placed in the state legislature as per the requirements of the FRBM Act and contributes to the legislative scrutiny of public finances. It is expected that the report will aid in the wider dissemination of information and consultation process.

1.2 The report is for the fiscal year 2020-21 and provides key conclusions and lessons learned from fiscal management. In addition to highlighting the state's compliance with the targets of the fiscal responsibility act, the report presents a broad trend of fiscal management. Budgetary projections for revenue and expenditure have been analysed, taking into consideration the actual outcomes, to assess the government's ability to implement the budgetary plans. The report assesses the revenue plan and outcomes, as well as the spending plans of departments under social, economic, and general services, by incorporating the revenue efforts of the state government and resource transfers from the union government. It draws upon earlier review reports and available literature on the state finances of Sikkim.

1.3 The State Government entrusted the responsibility of reviewing the compliance of the Act for the fiscal year 2020-21 to the National Institute of Public Finance and Policy (NIPFP), New Delhi, a Centre for research in public economics. Founded in 1976, the institute undertakes research, policy advocacy and capacity building in areas related to public economics. NIPFP assists the Central, State and Local governments in formulating and reforming public policies by providing an analytical base. The institute was set up as an autonomous society, at the joint initiative of the Ministry of Finance, Planning Commission, several state governments and distinguished academicians.

1.4 The Covid-19 pandemic brought in severe distortions to the public finances of both the Union government and states in terms decline in revenue receipts, increased expenditure, and changes in spending patterns, partially in 2019 and to a greater extent in 2020-21. The review reports has taken into consideration the fiscal stress faced by the state in 2020-21. The assessment of fiscal management and compliance with the FRBM Act in 2020-21focusses on analyzing the inherent strength of the state government to return to the fiscal consolidation process.

1.5 Against this backdrop, this evaluation report examines the state's finances in recent years and provides a summary of the key conclusions and lessons learned from fiscal management for the fiscal year 2020-21. The report highlights following key features of state finances and issues relating to compliance with fiscal responsibility legislation.

a. The assessment of macroeconomic outlook, which includes growth performance, broad growth perspective, and contribution of various sectors to the state income, The FRBM Act calls upon the state to prepare a macroeconomic outlook along with its Medium-Term Fiscal Plan (MTFP).
b. The evaluation of state finances took into consideration the revenue effort, central transfers, and spending pattern in the budget, as well as fiscal outcomes such as deficit and debt stock. The fiscal management during recent years and particularly in 2020-21 provides a context and background to understand how the state government responded to the requirements of the fiscal responsibility act, taking into account the availability of resources and commitments.
c. Compliance of the State Government to the provisions of FRBM Act in the fiscal years 2020-21 is the major focus of this assessment. The fiscal targets include to deficit, debt, and other fiscal variables as specified in the Act.
d. Evaluation of credibility of state budget in terms of its budget projections and outturns both on revenue and spending side was carried out for the year 2020-21.
e. While assessing the compliance of the state to the FRBM Act provisions, the report reviews the state's adherence to fiscal management principles and transparency requirements enunciated in the Act.

The Review of Compliance to FRBM Act: The Context and Background

1.6 Thirteenth Finance Commission (FC-XIII), in their report, acknowledged that the provision of an independent review of implementation of the respective FRBMAs by many states contributed to the fiscal consolidation process[1]. According to the Commission, these reviews played a crucial role in enhancing the credibility and transparency of actions taken by

[1] Report of the Thirteenth Finance Commission, para 9.65, pp.137.

state governments in implementing fiscal responsibility legislation. The recommendations of FC-XIII prompted many states to amend their fiscal responsibility legislations and incorporate an independent review mechanism to improve transparency in fiscal management.

1.7 FC-XIII recommended to institutionalize the process of independent review of compliance of FRBM Act at both Union and state level. According to the Commission, the independent review mechanism should evolve into a fiscal council with legislative backing over time[2]. Fourteenth Finance Commission (FC-XIV) and other expert bodies also favored creating fiscal council at the Union level3. Fifteenth Finance Commission (FC-XV) as part of their reform recommendations relating to fiscal architecture and building fiscal institutions strongly favored fiscal council at both Union and state levels.

1.8 FC-XV recommended to establish an independent Fiscal Council with powers to access records as required from the Union as well as the States, and act in an advisory role[4]. The recommendation has been made based on international experiences showing that independent fiscal councils improve the accuracy of fiscal projections and help countries adhere to fiscal rules better[5]. Fiscal councils can be established in the form of permanent executive or legislative agencies and can be entrusted with responsibilities such as unbiased scrutiny of fiscal policies, plans, and performance. The establishment of a fiscal council is advocated with key functions including advising on fiscal policies and plans, auditing fiscal plans and performance[6].

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[2] Report of the Thirteenth Finance Commission, para 13.56, pp.395.

[3] The 13th and 14th Finance Commissions advocated for establishing independent fiscal agencies to review the government's adherence to fiscal rules, and to provide independent assessments of budget proposals. The N.K. Singh committee, (2017) on the review of fiscal rules suggested the creation of an independent fiscal council that would provide forecasts and advise the government on whether conditions exist for deviation from the mandated fiscal rules. In 2018, the D.K. Srivastava committee on Fiscal Statistics suggested the establishment of a fiscal council that could co-ordinate with all levels of government to provide harmonized fiscal statistics and provide an annual assessment of overall public sector borrowing requirements.

[4] Report of the Fifteenth Finance Commission, para 9.66, pp.137.

[5] Roel M. W. J. Beetsma ; Xavier Debrun ; Xiangming Fang ; Young Kim ; Victor Duarte Lledo ; Samba Mbaye ; Xiaoxiao Zhang (2018), Independent Fiscal Councils: Recent Trends and Performance, Working Paper No. 18/68, International Monetary Fund.

[6] Hemming, R., & Joyce, P. (2013). The role of fiscal councils in promoting fiscal responsibility. in Cangiano, M., Curristine, T. and Lazare M. (eds.), Public financial management and its emerging architecture, 205-24, Washington, DC: International Monetary Fund.

1.9 However, in the case of India, the establishment of a fiscal council has not taken root in the economic management of the country. The Union Government has entrusted the responsibility of independent evaluation of the FRBM Act to the Comptroller and Auditor General of India (CAG). Several states have amended their FRBM Acts to include periodic independent reviews, which appear to be a more feasible approach to enhance accountability and transparency.

1.10 Scrutiny of fiscal policy by an independent agency enhances transparency and trust on government policies[7]. Following are the reasons that support independent review of compliance with the FRBM Act:

a. Assessing fiscal policy objectives, programs to implement the policies, outcomes and deviations from plans helps taking corrective measures.
b. Established legislative control gets boost from the review reports on policy formulation to achievement of results need to come under established legislative control and the information becomes available to the public. All the stakeholders get a nuanced view of the quality of fiscal policies, plans and performance.
c. Assessment of disclosure of fiscal information as stipulated in the Acts helps the cause of transparency.
d. Issues relating to comprehensiveness of the state budget, accessibility of budget documents comprising all the key fiscal information, level of coordination with central government as reflected in flow of funds in central schemes[8] can also be assessed in the review process.
e. The review report can be used to assess the budget credibility and examine the ability of the government to implement the planned activities. The budget credibility at sub-national level in India face challenges like generating less than budgeted revenue due to deviations in own revenue and central transfers and consequent adjustments in spending plan[9].

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[7] IMF Code of Good Practices on Fiscal Transparency.

[8] PEFA: Framework for Assessing Public Financial Management, (2016), PEFA Secretariat, Washington DC.

[9] Jena Pratap Ranjan and Abhishek Singh," Sub-national Budget Credibility: Institutional Perspective and Reform Agenda in India", Working Paper No. 338, July-2021, National Institute of Public Finance and Policy.

Review of State FRBM Act

1.11 Sikkim implemented the FRBM Act in 2010 with the aim of establishing a rule-based fiscal management system to ensure fiscal stability and sustainability, while ensuring efficient provision of public services. The introduction of the FRBM Act facilitated the formulation of the Medium-Term Fiscal Plan (MTFP) providing a medium-term perspective to the macro-fiscal management. The state FRBM Act sets quantitative targets for deficit measures and debt levels, which have been changed over the years based on recommendations from successive Central Finance Commissions and state fiscal requirements. The Act emphasizes prudent fiscal policies, transparency in fiscal management, predictability in funding arrangements, medium-term revenue and expenditure management, and improved efficiency in asset and liability management.

1.12 The fiscal targets prescribed in the Act included eliminating revenue deficit and reducing fiscal deficit to 3.5 percent of GSDP by 2011-12 and reduce to 3 percent thereafter. The Act stipulated to stabilize debt burden and limit the annual incremental guarantees following Sikkim Ceiling on Government Guarantees Act, 2000. The State Government made necessary changes in the FRBM Act by bringing amendments following the recommendations of Central Finance Commissions. The fiscal adjustment path for Sikkim recommended by the FC-XIII with targeted fiscal deficit to ensure sustainable level of debt ended in 2014-15. The FRBM Act of the State took into account the recommendations made by the FC-XIV starting from the fiscal year 2015-16. The Commission recommended certain changes in the fiscal consolidation process to provide flexibility in the fiscal management of the State. The state government also brought amendment to the Act to reflect the recommendations of the FC-XV regarding gradual decline of fiscal deficit and adopting an indicative debt-GSDP ratio. The overall fiscal management in terms of budget decisions and implementation has remained within the boundary set in the fiscal rules and the recommendations made by the Central Finance Commissions.

1.13 Post enactment of the FRBM Act, the state of Sikkim was successful in reducing fiscal deficit and generate revenue surplus. The incentives provided by the union government, higher central transfers and acceleration of GDP growth contributed to fiscal consolidation process at the states level. While states in India managed to navigate through the financial crisis of 2008-09 and consequent decline in national growth rate and reduced central transfers, the Covid-19

Pandemic induced fiscal stress has brought about large disruptions. The revival of growth process in the country will be instrumental in coming back to fiscal consolidating path.

1.14 In addition to the stated objective of achieving fiscal targets, other important feature of state FRBM Act includes a set of guiding fiscal management principles to act as a catalyst for institutional change for better public financial management process. The MTFP prepared along with the budget gives fiscal targets in a medium term elaborating on fiscal management strategy of the government for the ensuing budget year and two outward years.

1.15 The FRBM Act emphasizes on fiscal discipline, which is crucial in the public financial management to take sound decisions on resource allocation and achieve operational efficiency. These aspects are crucial features in the fiscal management to address the emerging socio-economic issues and development requirement. The ability to develop and implement clear fiscal strategy leads to achieving fiscal goals. As the state has a limited base to generate resources internally and the provision of public services in a difficult hilly terrain is costly, the Government needs to calibrate its fiscal policy and spending pattern with a restraint provided by the fiscal rules.

1.16 As provided under section 7(7) of the Sikkim Fiscal Responsibility and Budget Management Act (FRBM), 2010, the government assigns the task of conducting periodic reviews for compliance with the Act to an independent external agency. The specific objective of the review is to examine the state government's adherence to fiscal targets in terms of deficit and debt stock relative to the State GSDP, which are benchmarks for a rule-based fiscal management system to achieve fiscal stability and sustainability. The review also assesses compliance with other budget management requirements outlined in the Act, such as transparency and adherence to desirable fiscal management principles.

Data and Information for the Evaluation Report

1.17 The evaluation report was based on various sources of data, including budgetary data published by the state government, reports from the Comptroller and Auditor General (CAG), and other socio-economic data. Fiscal data from state budgets of the relevant years, finance account, and appropriation account were the main sources of information for the study. The Department of Finance provided data and information on state finances and offered an overall perspective on state fiscal management, including trends in revenue receipts, debt management, resource allocations to different sectors, and achievement of FRBM fiscal targets.

Organization of the Report

1.18 The report is organized as follows. Section 2 of this report provides an overall assessment of macroeconomic outlook and sector composition of GSDP. Section 3 contains analysis on state finances in recent years. Compliance of the State Government to the fiscal targets and fiscal management principles under the Sikkim FRBM Act are covered in Section 4. Issues relating to revenue mobilization and expenditure pattern for the year 2020-21 as compared to the budget provisions are analyzed in this chapter. Section 5 contains summary and concluding remarks.

Chapter 2: Overview of the State Economy

The Impact of Covid-19 Pandemic

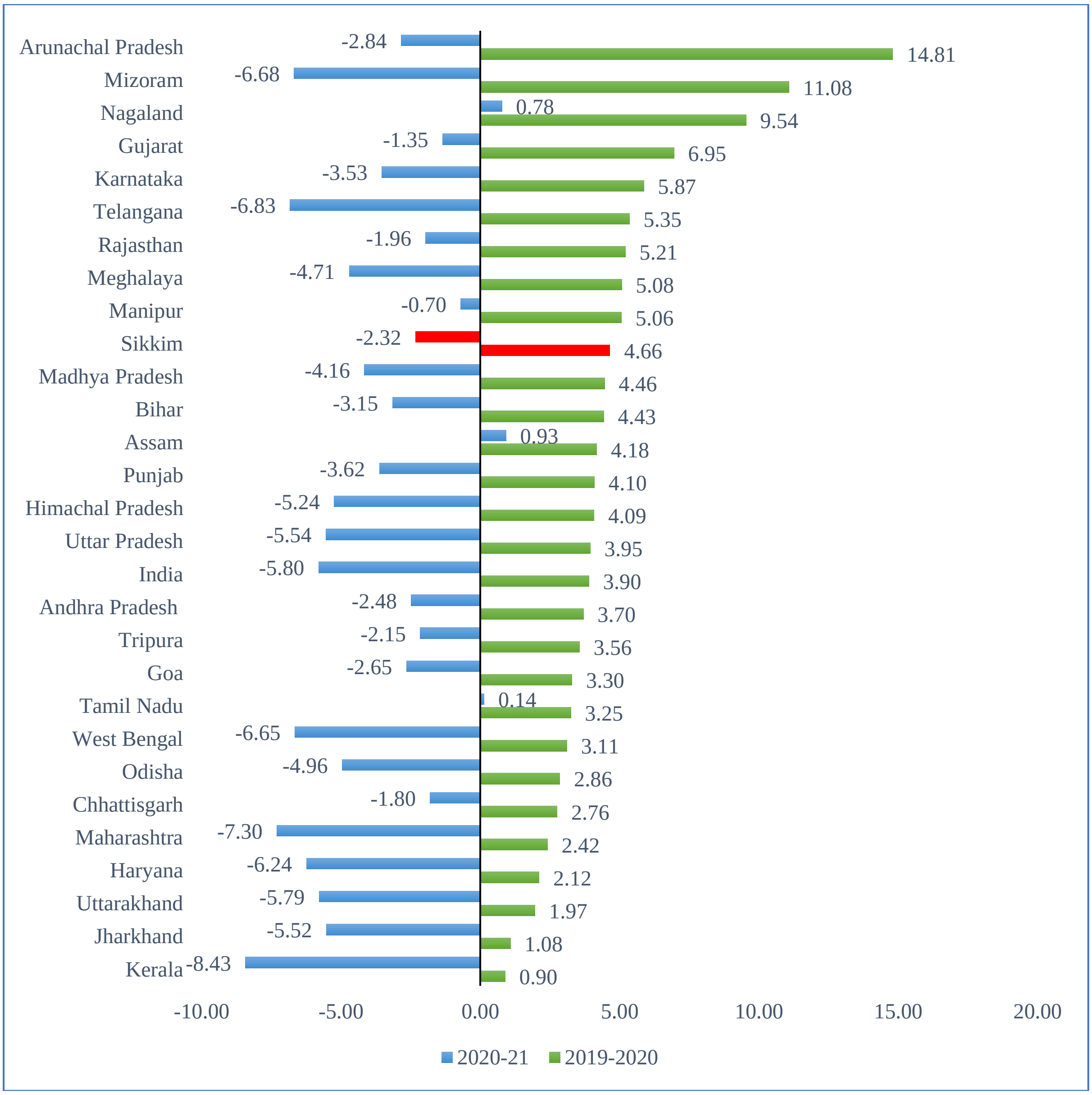
2.1 The national economy was already moderating in a challenging global environment and declining manufacturing and construction industries and slowing down of the demand in 2019-20 for which the growth rate of GDP softened to 3.7 percent. As a result of lockdown and limits on economic activity to stop the virus' transmission, the covid-19 pandemic in 2020-21 posed serious economic challenge to the global economy and India as well. This has led to a recessionary trend. The country suffered a severe economic downturn in 2020-21 and the GDP contracted by 5.80 percent. The GDP growth recovered to 8.7 percent growth in 2021-22 after the opening up of the economy and the revival of economic activities.

2.2 While the impact of pandemic on GDP growth as well as the corresponding loss of income and livelihood across the nation was acknowledged, its effects on state economies and public finances started becoming apparent after statewide growth data made available in the Handbook of Statistics on Indian States, RBI, 2022, enabling a comparative examination. The handbook highlighted the significant changes in the growth process that occurred throughout the pandemic period. The contraction in state GSDP in 2020-21 became clear after the data provided by the Central Statistical Organization (CSO).

2.3 The disruptive impact of the pandemic on growth rates of state GSDP has been varied[10]. The data given by CSO for Indian states shows a skewed picture ranging from contraction of 9.20 percent Kerala in 2020-21 to low of -0.70 percent for Manipur (Figure 2.1). States like Nagaland, Assam, and Tamil Nadu managed to show small positive growth rates in pandemic affected year. Among major states Maharashtra, West Bengal, Telangana, Haryana, Kerala, and Uttar Pradesh showed high decline. Decline in output in pandemic year does not show significant link with size of the economy or per capita income level.

[10] Economic & Political Weekly, December 3, 2022 Vol LVII No 49, pp 7

Figure 2.1
GSDP growth rates (at constant prices) in all states in 2019-20&2020-21



Source: Central Statistical Office, GoI

2.4 The average growth rate of Sikkim from 2013-14 to 2017-18 was 9.17 percent (14.78% growth rate was achieved in 2017-18) at constant prices. But due to Covid-19 and the slowdown in economy in 2018-19 and 2019-20, the economy of Sikkim grew at the average growth rate of 2.57 percent in the last 3 years (2018-19 to 2020-21). The growth rate turned negative in 2020-21, to (-) 2.32 percent. As indicated above, the GSDP decline across the states were varied during the pandemic year and difficult to relate the performance to any perceptible economic parameter defining the state economies.

2.5 The growth rate of GSDP is an important factor in the context of revenue generation effort of the State Government. The state economy's overall growth rate and the contribution of different sectors helps in determining potential budgetary revenue outcomes. The GSDP reflects the state's revenue base, even though the macroeconomic outlook at the national level is a key element in fiscal policy at both the Union and state levels. The tax buoyancy, which is utilized to examine the internal revenue effort of the state government, is derived by assuming the GSDP as proxy for tax base. However, the growth rate of the GSDP, notably in 2020-21, hardly provides a foundation for examining the state government's revenue efforts when it is faced with higher spending obligations due to the pandemic.

2.6 Contribution of various sectors to the state economy assumes significance in budget management process due to their impact on revenue generation efforts. Assessment of state is part of the independent evaluation of compliance to FRBM Act by the state. The Act stipulates that the state government should provide a macro-economic framework statement along with the FRBM related documents. The objective of this statement is to provide analysis of growth and sectoral composition of GSDP.

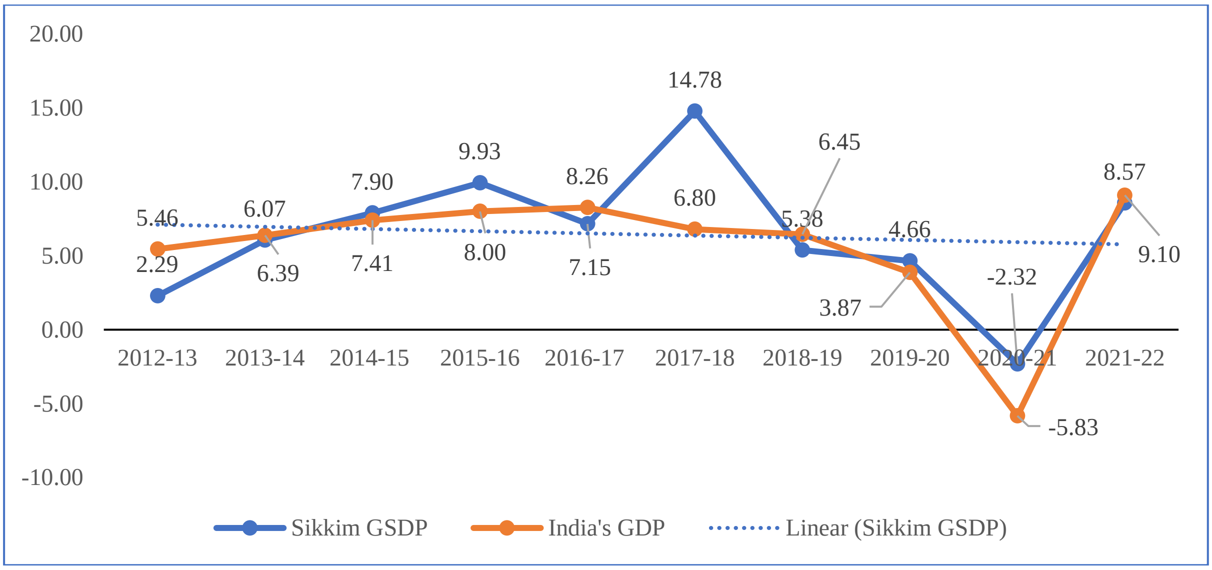
The Trend of GSDP Growth in Sikkim

2.7 Unbiased macroeconomic and fiscal projections forms the foundation for the fiscal strategy of the state government. The medium term fiscal plan (MTFP) presented along with the budget elaborates on state government's fiscal strategy adopted in the budget and the macroeconomic trends. The trend of economic growth and contribution of various sectors to the state economy assumes significance in formulating fiscal strategy for the year, primarily for assessing the possible revenue implication. The prospects of state economy is crucial to express the fiscal outcomes as percentage to GSDP. The Central Government fixes borrowing limit of the State as proportion to GSDP. This is based on assumptions regarding the growth rate usually made by the Central Finance Commission.

2.8 The GSDP at constant prices in Sikkim continued to grow steadily from 2.29 percent in 2012-13 to 9.93 percent in 2015-16. After a sharp decline in 2016-17 (7.15 percent), the GSDP growth rate reached a peak of 14.78 percent in 2017-18 (Figure 2.2). Once again, the GSDP suffered a setback in 2018-19, as its growth declined to 5.38 percent. The declining trend continued in 2019-20 (4.66%) and in 2020-21, it registered a negative growth rate of 2.32 percent.

2.9 The GSDP growth more or less reflected the trend of the national economy except in 2012-13 and 2017-18. However, a comparison of GSDP growth at constant prices with India's GDP growth during 2012-13 to 2020-21 shows that the growth rate of the state economy remained higher than the national growth rate in all years, leaving only 2018-19. While the national economy contracted by 5.83 percent in 2020-21, the state economy declined by 2.32 percent.

Figure 2.2
The Economic Growth of Sikkim: GDP-GSDP Growth rates (at constant prices)



Source: Central Statistical Office, GoI

2.10 Improvement in GSDP growth of Sikkim in 2021-22 reflects the country's recovery process, despite continued global challenges. The fiscal management and achieving the consolidation process as per the amended FRBM Act would be positively influenced by the recovery process. The slowdown of the state economy and a decline in growth in 2020-21 is thus examined in the compliance report to evaluate the macroeconomic prospects for the coming years.

2.11 The growth rate of GSDP becomes a crucial factor in the context of budget making as it is the denominator in all targets fiscal ratios, and it is also the determining factor for borrowing limit of the State. The GSDP growth at constant prices showed an increasing trend from 2012-13 to 2017-18, but 2018-19 onwards the declining trend was noticeable. Average annual growth rate during 2012-13 to 2019-20 works out to be 7.72 percent. The growth rates assumed by Central Finance Commissions in current prices becomes reference points while making budget estimates. FC-XIV projected the GSDP growth at current prices for Sikkim for the award period 2015-16 to 2019-20 at 24.32 percent. However, the average annual growth rate of GSDP during this period was 15.03 percent. FC-XV in their report for the year 2020-21 projected annual growth rate of comparable GSDP (current prices) at 10.2 and 11.1 percent for 2019-20 and 2020-21 respectively. The state recorded a higher growth at current prices in 2019-20, at 10.70 percent. However, the growth rate at current prices for 2020-21 was 1.14 percent which was much below than the projection of the Commission (Table 2.1).

Table 2.1
Key Aggregates of State Domestic Product (Constant Prices)

Item	Growth over previous year (in %)								
	2012-13	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
Gross State Value Added	1.74	5.15	8.08	9.09	6.16	11.94	8.26	5.06	-2.03
Taxes on Products	21.44	23.31	1.33	20.65	21.37	56.22	28.04	-2.71	-4.54
Less Subsidies on Products	15.55	-4.68	-4.70	19.17	-20.19	30.99	3.89	-0.05	46.41
Gross State Domestic Product	**2.29**	**6.07**	**7.90**	**9.93**	**7.15**	**14.78**	**5.38**	**4.66**	**-2.32**
Consumption of Fixed Capital	1.96	5.05	7.22	15.36	5.10	24.61	10.81	6.16	-0.40
Net State Value Added	1.71	5.16	8.21	8.15	6.33	9.95	7.81	4.86	-2.34
Net State Domestic Product	2.34	6.21	8.00	9.16	7.46	13.33	4.50	4.40	-2.66
GSDP at Current Prices	*10.51*	*12.35*	*11.14*	*17.05*	*14.71*	*25.54*	*9.36*	*10.70*	*1.14*

Source: Central Statistical Office, GoI

2.12 The past growth performance based on higher investments in secondary sector propelled Sikkim very high in the per capita income ladder across Indian states. Per capita income of Sikkim has improved from Rs. 2,45,987 in 2015-16 to Rs. 4,72,543 in 2020-21 at current prices (Table 2.2). The per capita income of the State shows an annual average growth rate of 11.74 percent during this period (2015-16 to 2020-21). While the average growth rate was about 14 percent during 2015-16 to 2019-20, the low growth of just 0.03 percent in 2020-21 has affected growth of per capita income of the state. The average per capita income during the period from 2015-16 to 2020-21 shows that the state stood in second position among all the states. The revival of growth process in the state after the Covid-19 pandemic is expected to facilitate overall development process and help in achieving improved socio-economic indicators.

Table 2.2
Per Capita GSDP (in Rs.) of all States (at current prices)

States	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	Average
Goa	334576	378953	411740	423716	435949	431351	472070	412622
Sikkim	**245987**	**280729**	**349163**	**375773**	**412627**	**412754**	**472543**	**364225**
Haryana	164963	184982	208437	223022	230563	229065	264835	215124
Karnataka	148108	169898	185840	205245	221431	221310	265623	202494
Telangana	140840	159395	179358	209848	231326	225687	265942	201771
Gujarat	139254	156295	176961	197457	212428	212821	250100	192188
Kerala	148133	166246	183252	205437	208879	194322	228767	190719
Tamil Nadu	142028	156595	175276	194373	206165	212174	241131	189677
Uttarakhand	147936	161752	180858	186195	190543	184002	211657	180420
Maharashtra	146815	163726	172663	182865	189889	183704	215233	179271
Himachal Pradesh	135512	150290	165497	174804	185728	183333	201854	171003
Mizoram	114055	127107	155222	164708	195365	187838	188839	161876
Arunachal Pradesh	116985	124129	138836	155103	182182	190212	215897	160478
Andhra Pradesh	108002	120676	138299	154031	160341	163746	192587	148240
Punjab	118858	128780	139835	149974	154385	149193	161888	143273
Nagaland	82466	91347	102003	109198	122759	126452	142363	110941
Tripura	84267	91596	100444	113016	121456	119789	140803	110196
Rajasthan	83426	91924	98698	106604	115360	115122	135962	106728
West Bengal	75992	82291	91401	103920	110313	106510	124798	99318
Chhattisgarh	72991	83285	88793	102024	106603	104788	120704	97027
Odisha	64835	77507	87055	98005	104741	102166	128873	94740
Madhya Pradesh	62080	74324	81966	92337	101909	103654	121594	91124
Assam	60817	66330	75151	81034	90123	90482	102965	80986
Meghalaya	68836	73753	77504	82653	87653	84638	90638	80811
Manipur	55447	59345	71507	73795	78574	79797	84345	71830
Jharkhand	52754	60018	67484	75421	75016	71071	78660	68632
Uttar Pradesh	47118	52671	57944	62350	65677	61374	70792	59704
Bihar	30404	34045	36850	40715	44230	43605	49470	39903

Source: Central Statistical Office, GoI

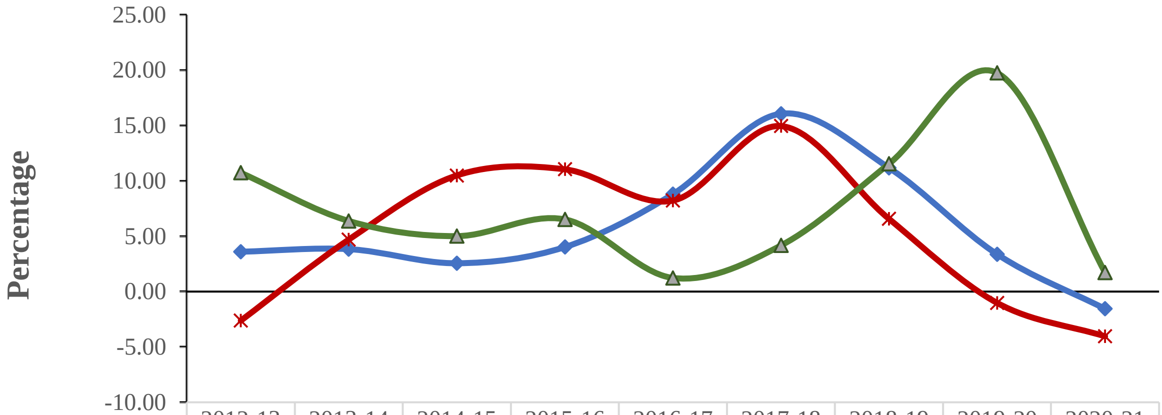
Sector-wise Contribution to State GSDP

2.13 Contribution of various sectors is crucial to assess the trend of state GSDP, particularly in the context of declining growth rate in 2019-20 and contraction experienced in 2020-21. At the national level, while agriculture sector sustained the growth rate at 3.6 percent in 2020-21, the industry sector suffered massive set back as it contracted by 7 percent and the services sector contracted by 8.4 percent due to reduction in economic and social activities. The impact of pandemic causing a recession with an unprecedented drop in GDP is better explained by sectoral trends.

2.14 All three sectors, primary (agriculture and allied), secondary (industry) and tertiary (service) sectors, show varied performance over the years from 2012-13 to 2020-21 (Figure 2.3). The declining trend, however, became more pronounced for agriculture and industry sectors in both 2019-20 and 2020-21, and service sector in 2020-21. The primary sector, which was showing an increasing trend, exhibited a sharp increase in the growth rate to 8.80 percent in 2016-17 and further improved to16.06 percent in 2017-18. The growth rate of primary services declined to 11.41 percent in 2018-19 and the declining trend continued in 2019-20 (3.38%) and it registered a negative growth rate of 1.56 percent in 2020-21. It is important to note that at the national level growth of the agriculture sector remained positive as compared to the other two sectors.

2.15 The Industry sector has remained a crucial component of the state's economy due to its preeminent share. The industry sector continued to show increasing growth rate during 2013-14 to 2017-18 and its growth rate declined in 2018-19. The peak growth rate of the industry sector was experienced in 2017-18 at 14.95 percent. Growth rate of industry sector contracted in 2019-20 (-1.02%) and 2020-21 (-4.04%) with negative growth rates. There was a declining trend in the service sector of the state from 2012-13 to 2016-17, after which it started showing a higher growth. This sector has achieved the highest growth rate of 19.75% in 2019-20. The growth rate suffered heavily in the year 2020-21, as it declined to 1.72 percent. The negative growth of primary and secondary sectors pulled down the aggregate GSDP growth of Sikkim in 2020-21.

Figure 2.3
Year-on-Year Growth of Sectors at constant prices (2011-12)



	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Primary	3.60	3.83	2.56	4.02	8.80	16.06	11.17	3.38	-1.56
Secondary	-2.63	4.70	10.49	11.04	8.22	14.95	6.56	-1.02	-4.04
Tertiary	10.73	6.38	5.01	6.52	1.23	4.16	11.54	19.75	1.72

Source: Author's Calculation

2.16 The composition of GSDP of Sikkim shows that industry sector, which includes manufacturing, Electricity, Gas, Water Supply & Others and construction has remained the largest contributor to the economy (Table 2.3). It accounted for about 60 percent of state GSDP during 2011-12 to 20-18-19. Given the small size of the economy, the investments in hydroelectricity and pharmaceuticals have strengthened the secondary sector. Due to slowdown in economic activities in 2019-20 and the Covid-19 pandemic in 2020-21, the relative share of industry sector has declined. Its share has gone down from 60.92 percent in 2018-19 to 57.61 percent in 2019-20 and further to 56.6 percent in 2020-21. The decline in growth of this sector, alluded earlier, affected its relative share.

2.17 The relative share of the service sector, which includes trade, hotel, transport, real estate, and financial services, has more or less remained stagnant for more number of year in recent past. Its share has marginally increased from 28.12 percent in 2011-12 to 28.78 percent in 2015-16. The relative share of this sector continued to fluctuate after that and in 2020-21, it increased to 31.12 percent. The increase in relative share of service sector reflects its higher growth in 2018-19 and 2019-20.

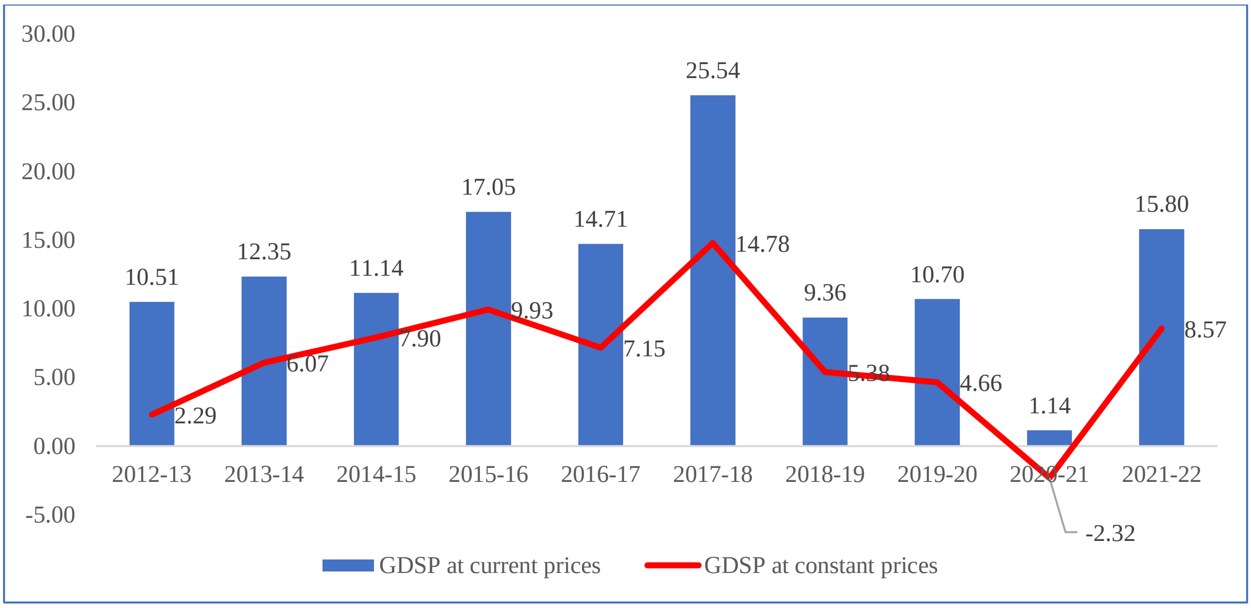
Table 2.3
Composition of GSDP (Constant Prices)

Economic Activity	Percentage Share									
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
Agriculture, Forestry and Fishing	8.07	8.17	7.99	7.59	7.17	7.29	7.38	7.81	7.72	7.79
Mining and Quarrying	0.07	0.07	0.09	0.08	0.09	0.08	0.07	0.06	0.05	0.04
Primary	**8.14**	**8.25**	**8.07**	**7.68**	**7.26**	**7.37**	**7.46**	**7.87**	**7.77**	**7.83**
Manufacturing	38.57	37.81	38.53	40.05	41.62	43.85	44.30	44.08	40.27	39.59
Electricity, Gas, Water Supply & Others	16.71	15.01	13.56	13.84	12.90	12.08	12.00	12.97	13.16	13.30
Construction	6.01	5.53	5.50	5.08	5.05	4.24	3.94	3.87	4.19	3.71
Secondary	**61.29**	**58.34**	**57.59**	**58.97**	**59.57**	**60.16**	**60.24**	**60.92**	**57.61**	**56.60**
Trade, Repair, Hotels and Restaurants	2.82	4.46	5.03	4.60	4.31	4.31	4.31	4.72	5.07	5.65
Transport, Storage, Communication	2.54	2.96	3.10	3.07	3.00	3.16	2.82	2.78	2.89	2.89
Financial Services	1.48	1.52	1.51	1.50	2.59	1.57	1.36	1.38	1.66	1.89
Real estate	5.23	5.22	5.11	4.80	4.38	4.22	3.78	3.72	3.78	3.87
Public Administration	6.63	6.99	6.92	6.83	6.27	5.87	5.20	6.43	7.51	7.70
Other Services	9.42	9.29	8.87	8.92	8.23	8.06	7.21	7.09	8.97	9.12
Tertiary	**28.12**	**30.44**	**30.53**	**29.71**	**28.78**	**27.19**	**24.68**	**26.12**	**29.89**	**31.12**
TOTAL GSVA at Basic Prices	**97.55**	**97.03**	**96.19**	**96.36**	**95.61**	**94.73**	**92.38**	**94.90**	**95.27**	**95.55**

Source: Central Statistical Office, GoI

2.18 Revival of growth process in Sikkim in 2021-22 is in sync with national growth process and is expected to enhance development process and bring in sectoral restructuring. State GSDP shows the highest growth of 25.54 percent and 14.78 percent at current and constant prices respectively in 2017-18 (Figure 2.4) and lowest growth rate during the pandemic 2020-21. During this year, the growth rate at current prices was 1.14 percent and growth rate at constant prices was (-) 2.32 percent. The state GSDP improved considerably in 2021-22. The GSDP recovered to a growth rate of 8.57 percent at constant prices and 15.80 percent at current prices. Decomposition of growth process at constant prices in 2021-22 shows that aggregate growth was based on 8.93 percent growth in primary sector, 8.13 percent in secondary sector, and 9.29 percent in service sector Improvement in growth of industry and service sectors augurs well for revenue generation in the state. Crucial activities like manufacturing, construction, trade and hotel, and transport have shown improvement in growth in 2021-22 as compared to the pandemic affected year.

Figure 2.4
GSDP Growth at Current and Constant Prices



Source: CSO, GOI

2.19 Growth perspective is crucial from budget management point of view as the state economy is usually assumed to provide base for the revenue. Thus, movement of the economy and contribution of different sectors are tracked through an unbiased macroeconomic and fiscal projections to get a handle over revenue projections. In the case of Sikkim a large part of the GSDP is derived from manufacturing and power generation. These sources do not result in a corresponding increase in local consumption and consequently revenue. The sectors growing rapidly and contributing to growth process have not contributed to tax revenue to the same extent. The generation of hydroelectricity, though adds to the GSDP numbers, remain outside the state tax system. Similarly, the products of pharmaceutical industries transit out of the state and do not contribute to VAT or GST.

Chapter 3: Fiscal Overview of Sikkim

The Impact of the Slowdown and Covid-19 Pandemic on State Finances

3.1 The states in India have successfully managed to maintain the gross fiscal deficit within the limits specified under FRBM Act at 3 percent of GDP since 2005-06[11]. There have been some exceptions to this achievement, such as 2009-10, 2015-16 and 2016-17, where factors beyond the control of the States have resulted in gross fiscal deficit to cross the threshold set by the FRBM Act. For instance, the global financial crisis of 2008-09 had adverse impact on the national economy of India in 2009-10. The process of fiscal consolidation was derailed almost completely during 2020-21 due to pandemic, and the spillovers are still being felt three years after.

3.2 The significance of fiscal consolidation via limiting gross fiscal deficit within a specified limit can be understood by assessing the impact of other fiscal variables on public financial management process. Fiscal management influences the overall development process of an economy. To achieve fiscal consolidation, the states in India have readjusted their spending pattern, mainly in capital expenditure.

3.3 In 2019-20, to adhere to the FRL limit, the state governments had to curtail their spending budget when revenue receipts slowed down. In the process of readjustment of spending plans, both the capital outlay and spending on other priority sectors were affected. Expenditure undertaken by states influences the development of human capital and physical infrastructure. It is, however, crucial for the state governments to balance developmental aspirations and sustainability commitments. For this, augmenting resource base through raising additional resources should be encouraged at the sub-national level.

3.4 As a consequence of shortfall in revenue receipts state governments faced fiscal stress to meet their expenditure commitments in 2019-20[12]. The decline in tax devolution from Centre, along with fall in states' own revenues, particularly, State Goods and Services Tax

[11] State Finances A Study of Budgets 2020-21.
[12] Letter by Department of Expenditure (Public Finance – State Division) to the Principal Secretaries (Finance), States, 26 February, 2020.

(SGST) has resulted in the decline in revenue receipts. The consolidated GFD worsened marginally in 2019-20 as compared to previous years (Table 3.1). The revenue receipts declined from 13.9 percent of GDP in 2018-19 to 13.1 percent in 2019-20.[13] This led to worsening of revenue deficit in 2019-20.

Table 3.1
Major deficit Indictors: All States and UTs with Legislature

(Rs in Lakh Crores)

Item	2017-18	2018-19	2019-20	2020-21	2021-22 (PA)	2022-23 (BE)
Gross Fiscal Deficit	4.10	4.63	5.25	8.05	6.67	8.83
(% of GDP)	(2.4)	(2.5)	(2.6)	(4.1)	(2.8)	(3.4)
Revenue Deficit	0.19	0.18	1.21	3.71	1.01	0.84
(% of GDP)	(0.1)	(0.1)	(0.6)	(1.9)	(0.4)	(0.3)
Primary Deficit	1.17	1.44	1.73	4.18	2.53	4.12
(% of GDP)	(0.7)	(0.8)	(0.9)	(2.1)	(1.1)	(1.6)

Source: State Finances: A Study of Budgets, 2021-22 and 2022-23, RBI

3.5 To address the fiscal hardships in 2019-20, the state governments demanded the Central Government to relax the FRBM limits and increase the net borrowing ceiling (NBC) from the existing 3 percent of GSDP. The Central Government adjusted Rs. 58,843 crores in 2019-20 against states' share of central taxes on account of lower tax revenue collection in 2018-19. The lower tax collection was a primary reason for lower tax devolution. The state of Sikkim was allowed the flexibility to incur additional NBC of Rs.216 crores.

Fiscal year 2020-21: Imbalances in Public Finances due to Covid-19 Pandemic

3.6 During the pandemic, the state of public finance in the country deteriorated due to the economic contraction faced by the national economy in 2020-21. The fiscal health of the Indian states was challenged due to contraction of own revenue receipts, decline in central transfers, and rising expenditure. The aggregate revenue receipt declined from 13.9 percent of GDP in 2018-19 to 13.1 percent in 2020-21, and the aggregate expenditure increased sharply from 31.25 percent to 34.15 percent driven mainly by revenue expenditure; the capital expenditure witnessed a decline. The decline in central tax collection also resulted in decline in transfer of

[13] State Finances: A Study of Budgets, 2021-22 and 2022-23, RBI, pp 3.

GST compensation to the states. The aggregate fiscal deficit reached its highest level since 2004-05, at 4.1 percent of GDP. To manage the increased expenditure, and make up for the loss of GST compensation, the Central government allowed the states to incur higher borrowing by enhancing the limit of fiscal deficit. States' debt to GDP ratio increased sharply from 25.3 percent in 2018-19 to 31.1 percent by end-March 2021.

3.7 For undertaking infrastructure projects, the GoI has initiated "Scheme for Special Assistance to States for Capital Expenditure". The assistance is provided in the form of 50-year interest free loan. The funds allocated under this scheme will help the states to manage ongoing capital projects which are stuck due to paucity of resources. This loan is over and above the normal borrowing ceiling allowed to the states.

Central Finance Commission Recommendations relating to Fiscal Consolidation

3.8 The fiscal year 2019-20 was the last year and 2020-21 was the first year of FC-XIV and FC-XV respectively. While the broad features of transfer system did not undergo drastic changes, there was a need to redefine fiscal consolidation process and glide path to reduce the fiscal deficit after the Covid-19 pandemic. FC-XIV recommend for states to anchor the fiscal deficit at an annual limit of 3 percent of GSDP with a flexibility to avail the flexibility to increase the fiscal deficit by 0.5 percent, 0.25 percent separately, for any given year satisfying certain conditions. While the Commission did not recommend state specific debt-GSDP targets, the target of achieving a debt-GSDP ratio of 25 percent to avail addition fiscal deficit of 0.25 percent, is recognized as the limit.

3.9 FC-XV submitted first report for financial year 2020-21 and later submitted a final report for the period 2021-22 to 2025-26 separately. It recommend maintaining the vertical devolution at 41 per cent for 2020-21, which is in line with FC-XIV recommendations with a 1 per cent adjustment due to the changed status of the erstwhile state of Jammu and Kashmir. In the tax devolution formula, FC-XV introduced a new indicator called demographic performance along with other indicators like population, area, forest and ecology, income distance and tax and fiscal efforts. The Commission did not make any specific recommendations on fiscal consolidation process for the year and allowed the existing FRBM Act to continue.

3.10 The FC-XV while revising the fiscal consolidation path looking at the fiscal distress faced by the state prescribed for a fiscal deficit of 4.5 percent of GSDP in 2020-21 and tapering off to 3 percent in 2025-26 (Table 3.2). The Commission suggested that the ratio of public debt to GDP should continue to serve as the medium-term anchor for fiscal policy in India, with fiscal deficit as the operational target. Once the estimated revenue deficit adjusted with matching provision for revenue deficit grant, the whole borrowing space under fiscal deficit is available for capital spending. It is from this perspective the Commission determined the net borrowing limit (gross borrowing minus repayment) of the state governments.

Table 3.2
FC-XV: Indicative Deficit and Debt Path

(% to GSDP)	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**
Revenue Deficit*	-0.1	-0.5	-0.8	-1.2	-1.7	-2.5
Fiscal Deficit	4.5	4	3.5	3	3	3
Indicative Debt Path for Sikkim						
	27.4	27.5	28.1	28.1	28.0	27.9
*Negative values indicate surplus and positive values indicate deficit						

Source: Report XV Finance Commission

Post FRBM Act Fiscal Developments in Sikkim

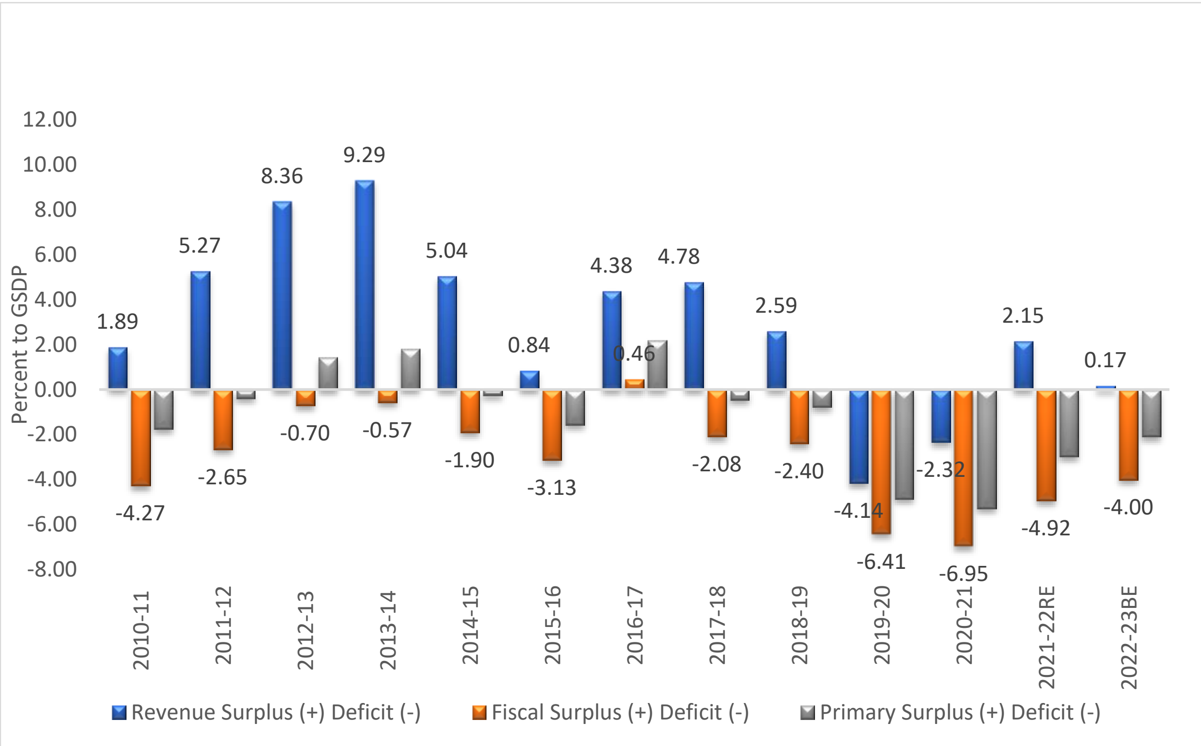
3.11 State governments adopted self-regulating Fiscal Responsibility and Budget Management (FRBM) Act to address the fiscal imbalance experienced during the late 1990s and early 2000s. Higher growth of the national economy has led to larger central transfers to states, along with improvements in own revenue receipts due to the introduction of VAT. State governments also restricted their spending plans to facilitate adherence to the fiscal consolidation process. As a reflection of the overall improvement in public finances across the states in India, state finances of Sikkim have significantly improved after the adoption of the FRBM Act in 2010.

3.12 The state's fiscal performance shows that it has been able to generate revenue surplus and keep the fiscal deficit within the target of 3 percent (fig 3.1). From a fiscal deficit of 4.27 percent of GSDP in 2010-11, the state managed to limit it below 3 percent until 2018-19. The state government availed the flexibility provided by FC-XIV to increase the fiscal deficit by 0.5 percent, meeting conditions related to interest payment and fiscal prudence in previous years.

3.13 The revenue surplus, which was at 4.74 percent of GSDP in 2014-15, declined considerably to 2.59 percent in 2018-19. During next two years, 2019-20 and 2020-21, Sikkim experienced large revenue deficit – 4.14 and -2.32 percent to GSDP respectively. The revenue surplus depends upon the central grants and own revenue, which contracted to a large extent. While in 2019-20 state government targeted a fiscal deficit of 3.5 percent factoring in the flexibility provided by FC-XIV, the actual deficit increased to 6.4 percent.

3.14 The fiscal deficit exceeded the limit of 3.5 percent of GSDP in 2019-20 and 2020-21. The slowdown in GDP in 2019-20 and the impact of the Covid-19 pandemic resulted in decline in revenue receipts, leading to a significant increase in the fiscal deficit, which breached the limits set by the FRBM Act. As, a result, the fiscal deficit increased from 2.40 percent to GSDP in 2018-19 to 6.41 percent in 2019-20 and 6.95 percent in 2020-21. To safeguard essential state spending, address the distortions caused by the pandemic, and boost capital investment for economic growth, higher borrowing was necessary.

Figure 3.1
Key Fiscal Variables

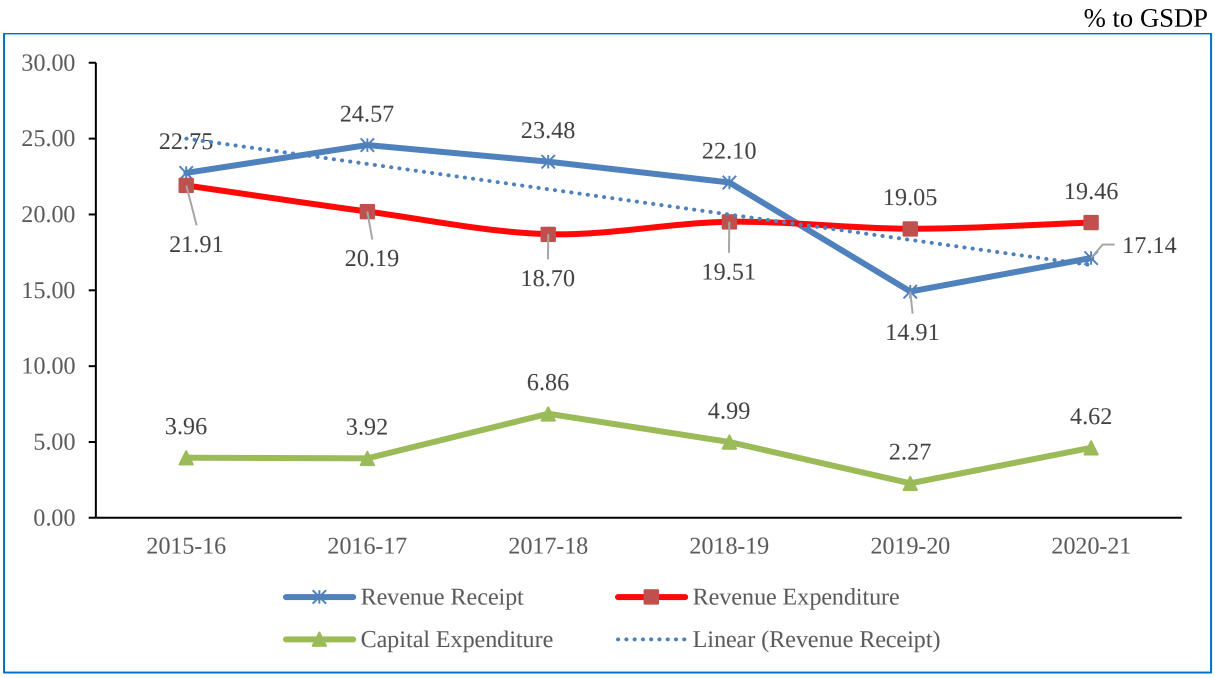


3.15 In 2020-21 the state was allowed to increase the fiscal deficit up to 5 percent as part of central government package in the wake of Covid-19 pandemic. Government of India, under the Aatma Nirbhar Abhiyan in May 2020, allowed the states to increase their borrowing limits from 3 percent to 5 percent for the fiscal year 2020-21. While 0.5 percent of the GDP of the additional borrowing is unconditional during current financial year, the states need to meet specific reforms requirements to avail another 1 percent of GDP as additional borrowing. Following the GST council meet in October, it was decided that states opting for the special window facility to meet the shortfall arising due to GST compensation, can avail additional 0.5 percent borrowing unconditional. Government of India has provided assistance under "Scheme for Special Assistance to States for Capital Expenditure". Funds under this scheme will help the States to manage ongoing capital projects, which could be stuck due to resource problem. Sikkim, like other NE states was allowed to avail Rs.200 crores under this facility. This has further increased the fiscal deficit limit.

3.16 The fiscal outturns are influenced by various factors, including the state's ability to effectively prepare and implement the budget while considering strategic fiscal policies, generate projected revenue while managing uncertainties and risks, and successfully implement programs to achieve predetermined results. Thus, it is important to explore other fiscal variables relating to revenue receipts and broad spending items to understand the outturns.

3.17 The trend of aggregate revenue as a percent of GSDP in the state has shown a fluctuating pattern. Figure 3.2 shows that the revenue receipt as percent of GSDP has increased from 22.75 percent in 2015-16 to 24.57 percent in 2016-17 and after that it started declining till 2019-20 (14.91%). But it increased significantly in 2020-21 (17.14%). The decline in aggregate revenue as percent of GSDP in 2019-20 was due to deterioration of the central transfers. The recovery in 2020-21 was mainly due to improvement in central transfers relating to those recommended by the FC-XV. During the period 2015-16 to 2020-21, the downward sloping linear trend is unmistakable for aggregate revenue. The overall growth scenario in the country was not conducive to both the union and state governments to raise higher revenue.

Figure 3.2
Revenue Receipt and Aggregate Spending Categories

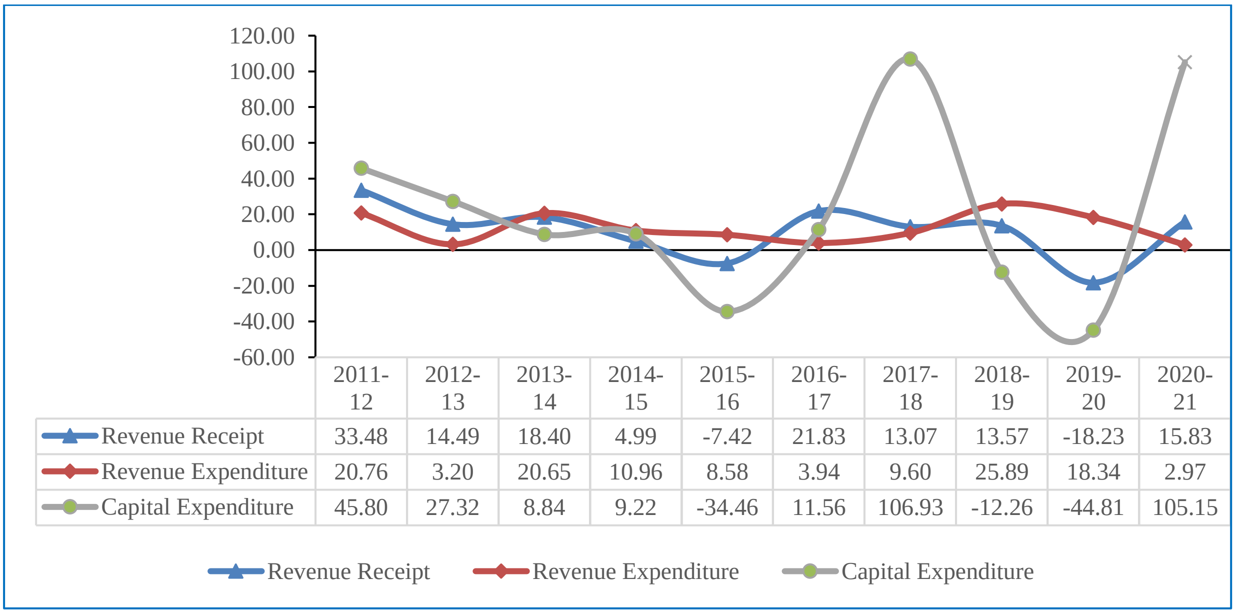


3.18 The usual spending pattern typically aligns with the size of revenue over the years. There was a declining trend in revenue expenditure from 2015-16 to 2017-18. However, it increased in 2018-19. The revenue expenditure in the pandemic year 2020-21 shows some increment over the previous year due to additional spending demand. Over the years, the trend in revenue expenditure reflects the government's efforts to exercise restraint and maintain fiscal consolidation.

3.19 Capital expenditure as percent to GSDP exhibited initial growth, which tapered off after wards. It declined from 4.4 percent in 2016-17 to 3.3 percent in 2019-20. The push given by the Union government and flexibility provided to states for additional borrowing for capital expenditure seems to have positively influenced capital expenditure as it increased in 2020-21 despite revenue shortfall.

3.20 While the total revenue receipts in nominal terms increased from Rs. 2,872 crores in 2011-12 to Rs. 5,920.36 crores in 2018-19, it experienced a decline for the first time to Rs. 4,841.27 crores in 2019-20. However, it increased to Rs. 5,607.82 crores in 2020-21. Despite this recovery, the revenue receipts of 2020-21 in nominal numbers remained less than that of the fiscal year 2018-19. In the fiscal year 2019-20 the government faced a dip in revenue receipts due to decline in own revenue receipts and central transfers. The rise in growth of revenue receipts in 2020-21 was mainly due to weak base experienced in the previous year and increase in grants component of transfers from central government relating to Finance Commission transfers. In comparison to the average annual growth rate of 14.05 percent during the period of 2011-12 and 2018-19, the revenue receipts contracted by 18.23 percent in 2019-20 but there was significant growth of 15.83 percent in 2020-21 (Figure 3.3). The aggregate revenue receipts in 2020-21 contracted by 5.28 percent when compared with the fiscal year 2018-19.

Figure 3.3
Year-on-Year Growth Rates of Major Fiscal Variables



	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue Receipt	33.48	14.49	18.40	4.99	-7.42	21.83	13.07	13.57	-18.23	15.83
Revenue Expenditure	20.76	3.20	20.65	10.96	8.58	3.94	9.60	25.89	18.34	2.97
Capital Expenditure	45.80	27.32	8.84	9.22	-34.46	11.56	106.93	-12.26	-44.81	105.15

Source: Finance Accounts and State Budget, relevant years.

3.21 The growth rate of revenue expenditure, which was showing a declining trend despite fluctuations, showed an increase in 2018-19. The growth of revenue expenditure decelerated in 2019-20 as compared to the previous year. The growth rate declined from 25.89 percent in 2018-19 to 18.34 percent in 2019-20. The growth rate further declined to 2.97 percent in 2020-21. In nominal terms, the revenue expenditure rose from Rs. 3,644.57 crores in 2015-16 to Rs. 6,368.63 crores in 2020-21. While the average annual growth rate during the period of 2011-12 to 2019-20 was 13.55 percent, it declined to 2.97 percent in 2020-21. Overall trend of revenue expenditure indicates that the government has exercised restraint.

3.22 The growth rate of capital expenditure has shown large fluctuations, with noticeable spikes in 2017-18 and 2020-21 and with negative growth rates in 2015-16, 2018-19 and 2019-

20. The capital expenditure in nominal terms has increased from Rs. 664.90 crore in 2011-12 to 1006.40 crore in 2014-15, but there was a significant dip in 2015-16 to Rs. 659.63 crore. It increased in 2017-18 with Rs. 1522.81 crore driven by a onetime central transfers. The growth rate of capital expenditure in 2017-18 was significantly higher than the previous year. The capital expenditure contracted in next two years due to resource problems and increased to Rs.1512.70 crore with a large positive growth rate in 2020-21. Higher growth of capital expenditure in 2020-21 as compared to the previous year was mainly due to central assistance aligning with the national initiative in recent years. Capital expenditure has remained a residual in the system depending on central transfers and revenue expenditure commitments.

Own Revenue Receipts of the State

3.23 Own revenue receipts of the state on an average constituted about 25 percent of total revenue receipts during 2011-12 to 2020-21 out of which own tax revenue was 14.47 percent and own non-tax revenue was 10.53 percent. The relative share of own revenue receipts as compared to central transfers has been increasing since 2011-12. It has increased from 18.73 percent in 2011-12 to 34.30 percent in 2019-20, but due to Covid-19, it has declined to 29.05 percent in 2020-21. The share of central transfer has shown a declining trend since 2011-12, from 81.27 percent in 2011-12 to 58.40 percent on 2020-21 with the lowest at 52.30 percent in 2019-20.

3.24 The own revenue and that of its components, own tax, and own non-tax receipts, as percent to GSDP show a subdued trend over the years. The trend of own tax revenue has increased from 2011-12 to 2013-14 and then sharp decline was noticed in 2014-15 after which the trend almost remained constant until 2018-19 (Figure 3.4). It declined from 5.81 percent in 2018-19 to 5.13 percent in 2019-20 and further to 4.98 percent in 2020-21. Both the components own revenue i.e., own tax and non-tax receipts as percentage of GSDP showed an almost similar pattern since 2011-12.

3.25 The own revenue growth shows large volatility in its components - own tax and non-tax revenue receipts (Figure 3.5). The growth rate in own tax revenue shows huge fluctuations with maximum growth rate at 48.17 percent in 2012-13 and minimum growth rate at -0.38 percent in 2020-21. The negative growth rate in 2020-21 is owing to the lockdown imposed to tackle Covid-19. In nominal terms the own tax revenue of the state was Rs. 293.91 crores in

2011-12, which increased to Rs. 970.40 crores in 2019-20 and declined to Rs. 966.70 crores in 2020-21. The non-tax revenue also shows a fluctuating growth pattern with large negative growth rates particularly in 2014-15 (-10.45%) and 2020-21 (-4.49%).

Figure 3.4
Own Revenue as Percent to GSDP

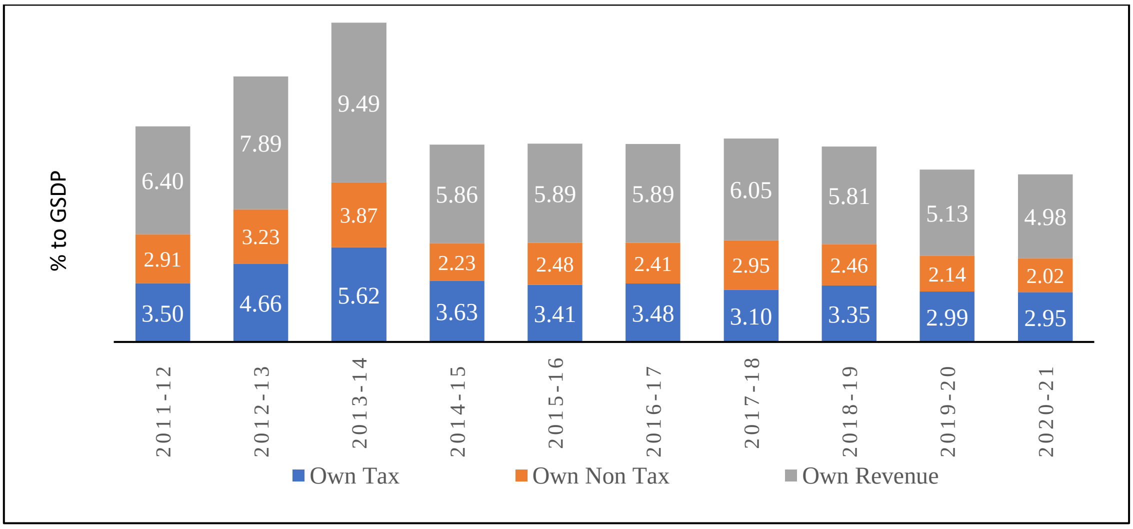
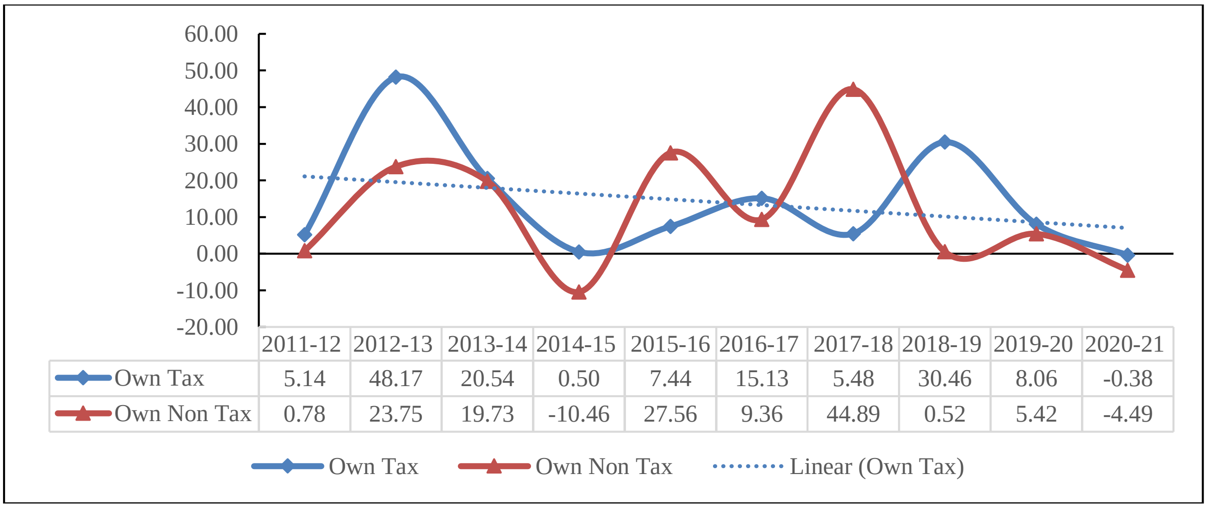


Figure 3.5
Y-O-Y Growth Rate of Own Revenue



	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Own Tax	5.14	48.17	20.54	0.50	7.44	15.13	5.48	30.46	8.06	-0.38
Own Non Tax	0.78	23.75	19.73	-10.46	27.56	9.36	44.89	0.52	5.42	-4.49

3.26 Sales Tax including VAT and SGST constitute major portion of the state taxes. Average relative share of sales tax & VAT during 2011-12 to 2016-17 was 52.63 percent, which increased after adoption of GST in 2017-18 and the total share of these taxes constituted about 68.10 percent in 2020-21 (Table 3.3). The GST compensation provided by the union government was accounted for under grants-in-aid. State excise is another important source of own tax revenue for Sikkim; however, its share has declined steadily from 32.75 percent in 2011-12 to 21.75 percent in 2020-21. Relative share of motor vehicle tax and stamp duty remains low over the years.

Table 3.3
Composition of Own Tax Revenue

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
State GST							24.90	45.18	46.88	47.90
Sales Tax	42.25	52.17	54.55	53.48	57.47	55.91	36.27	20.96	20.37	20.20
State Excise	32.75	25.53	22.98	24.90	25.07	23.94	21.86	20.39	21.35	21.75
Motor Vehicle Tax	5.64	3.76	3.53	3.68	3.94	3.82	4.27	3.69	4.23	3.00
Stamp Duty	2.81	1.23	1.23	1.28	1.50	1.93	1.97	1.66	1.37	1.36
Other Taxes	16.54	17.32	17.70	16.65	12.02	14.41	10.73	8.12	5.81	5.80

Tax Buoyancy

3.27 Since 2017-18, the annual buoyancy[14] coefficients for own tax revenue remained significantly below 1, except in 2018-19 (Table 3.4). Higher buoyancy in 2018-19 was due to significant spurt in receipts of SGST. The buoyancy in 2020-21 remained low reflecting problems in revenue generation due to moderation of growth rate. Covid-19 pandemic brought distortions in revenue receipts due to contraction in state economy for which the buoyancy coefficient was negative. The taxes like SGST and state excise show positive buoyancy while` sales tax, motor vehicle tax and SDRF have shown negative buoyancy in 2020-21. A longer-term tax buoyancy for the period 2011-12 to 2020-21 estimated through regression analysis reveals that the growth of taxes has fallen behind the growth of the GSDP. The buoyancy coefficient for total own-tax receipts for the period 2011-12 to 2020-21 was 0.945.

3.28

[14] Buoyancy coefficients of state taxes provide indicators to assess the performance of taxes as compared to growth of state income. Tax buoyancy measures responsiveness of revenue mobilization efforts in response to growth of the GSDP. A tax is said to be buoyant if the tax revenue increases more than proportionately in response to a rise in GSDP.

Table 3.4
Buoyancy Coefficient of State Taxes

	2017-18	2018-19	2019-20	2020-21	2011 to 2020-21
Own Tax Receipts	0.21	3.25	0.75	-0.33	0.945
SGST	0.00	14.60	1.13	1.57	
Sales Tax	-1.24	-2.63	0.47	-1.06	
State Excise	-0.14	2.32	1.23	1.32	0.666
Motor Vehicle Tax	0.70	1.36	2.25	-25.82	0.764
Stamp Duty	0.31	1.08	-1.03	-1.11	0.820
Other Taxes	-0.84	-0.14	-2.12	-0.47	-0.130

Non-tax revenue

3.29 The growth rate of own non-tax revenue has shown considerable fluctuation, with negative growth rate during 2014-15 at (-) 10.46 percent, and during 2020-21 at (-) 4.49 percent. The highest growth rate of non-tax revenue was achieved during 2017-18, at 44.89 percent. The average relative share of economic services of own non-tax revenue which includes forestry and wildlife, major and minor irrigation, and other economic services accounted for about 55.6 percent from 2015-16 (51.8%) to 2020-21 (63.0%) (Table 3.5). The share of this component is the highest in the composition of non-tax revenue. In nominal terms, income from the non-tax revenue increased from Rs. 244.00 crore in 2011-12 to Rs. 693.40 crore in 2019-20 and then experienced declined in 2020-21 to Rs. 662.29 crores. State non-tax revenue contains income from forestry and wildlife, interest receipts, dividends and user fees from services provided by the State Government. Income from forestry and wildlife constituted the largest source of revenue in terms of non-tax revenue of the state.

Table 3.5
Composition of Non-Tax Revenue

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Own Non-Tax Revenues	100.0	100.0	100.0	100.0	100.0	100.0
Interest Receipts	17.6	17.4	17.5	19.1	20.7	19.2
Dividends and Profits	3.1	0.4	0.4	0.7	0.5	0.4
General Services	25.3	24.5	20.5	23.9	26.3	13.2
Social Services	2.3	2.6	2.0	2.6	2.4	4.2
Economic Services	51.8	55.2	59.5	53.8	50.0	63.0

Source: Finance Account Data, Sikkim

Central Transfers

3.30 FC-XV kept the recommendations for Tax devolution similar to those made by FC-XIV. However, FC-XV changed the criteria and weightage while determining the inter-se share of states in the divisible pool by including demographic performance, reducing the income distance weight, and including tax effort as a criterion. The inter se share of Sikkim in the divisible pool has experienced a minor increase from 0.367 percent under FC-XIV to 0.388 in the recommendation of FC-XV for the year 2020-21. The State did not receive revenue deficit grant under the award of both the Commissions.

3.31 The central transfers to the state of Sikkim show the linear downward trend since 2011-12 (Figure 3.6). The annual average transfers from the center during FC-XIV was 15.77 percent of GSDP from 2015-16 to 2019-20. Central transfers experienced considerable decline in 2019-20 due to subdued economic growth in the country. It declined from 16.11 percent in 2018-19 to 9.79 percent of GSDP in 2019-20. Aggregate central transfers has, however, has improved in 2020-21 to 12.16% (Figure 3.6). The major driving force behind increase in central transfers in 2020-21 as compared to the previous year was the grants component recommended by the FC-XV. The improvement in central transfers in 2020-21 as compared to the previous year, however, could not match to the fiscal year 2018-19.

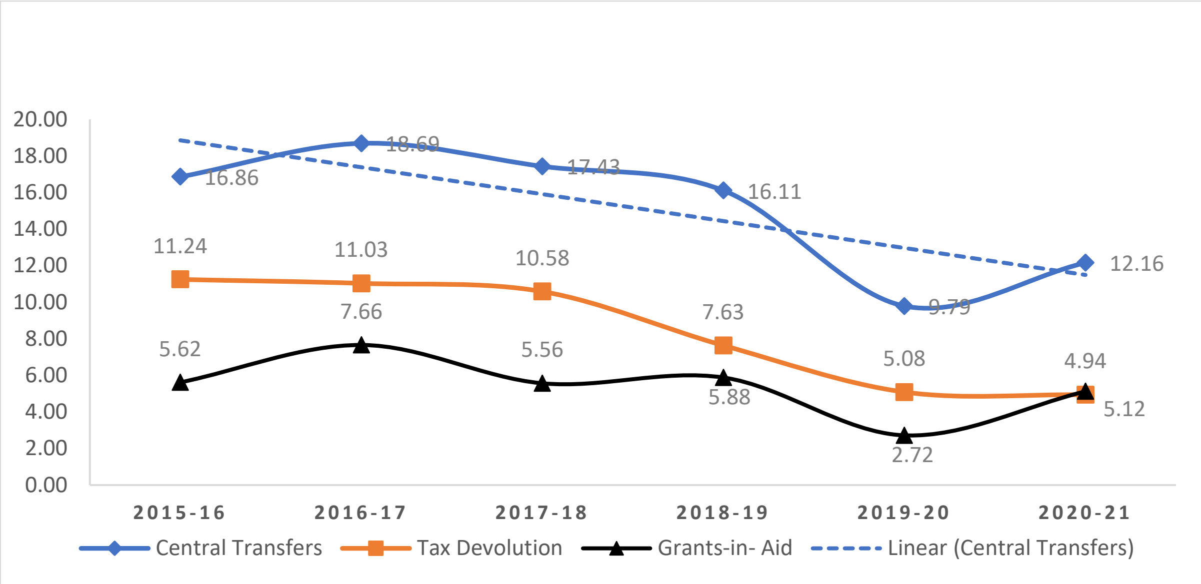
3.32 Higher annual growth rate of central transfers in 2020-21 at 25 percent has to be seen against an extremely weak base in 2019-20 when the growth rate declined by 27 percent. The growth rate of central transfers in 2020-21 compared to the fiscal year 2018-19 shows a decline of about 9 percent. The impact of pandemic slowed down national growth rate considerably due to which tax devolution to the State could not improve significantly.

3.33 In the central transfers, the relative share of tax devolution increased considerably in 2015-16 to about 49.42 percent as compared to 20 percent received in the previous year. The recommendations of FC-XIV to raise the share of states in the divisible pool enhanced flow of tax devolution to all the states. This was accompanied by reduction in grants component which included discontinuation of many Finance Commission Grants and closure of plan grants to states. Thus, overall share of central transfers went down and the state did not gain much due to change in the architecture of central transfers.

3.34 From the figure 3.6, it is clear that tax devolution as percentage to GSDP has suffered decline consistently since 2015-16. Tax devolution as percentage to GSDP declined from 11.24 percent in 2015-16 to 5.08 percent in 2019-20. It has further declined to 4.94 percent in pandemic affected fiscal year 2020-21.

Figure 3.6

Trend of Central Transfers (% to GSDP)



3.35 Recommendation on tax devolution is formulaic and flow of resources under this head to states depends on collection of central revenue. Thus, there are some elements of uncertainty in actual flow of resources. As the tax devolution accounts for about half of the central transfers, any deviation from the expected flow of resources affects budget management. From table 3.6, it is apparent that there have been large deviations from the recommended tax devolution to the state. The deviation from recommended tax devolution has increased since 2015-16.

Table 3.6

Recommended and Actual tax Devolution

Rs. Crore

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Recommended Tax Devolution	2129	2457	2839	3285	3804	3318
Actual Tax Devolution	1870	2069	2350	2045	1650	1615
Difference	-259	-388	-204	-495	-1508	-1016

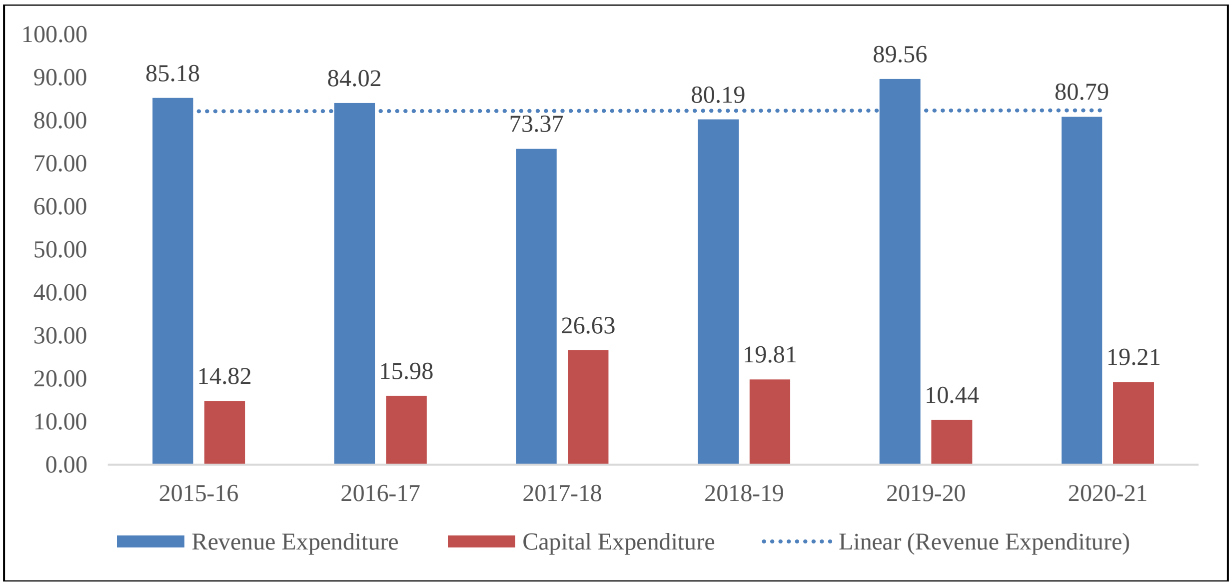
The Expenditure Trends

Broad Composition of Government Expenditure

3.36 In an earlier section, while analyzing broad fiscal trends in Sikkim, it has already been pointed out that revenue expenditure as percentage to GSDP, which declined in 2019-20 due to revenue shortfall, increased in 2020-21 to cater to pandemic related spending pressure (Figures 3.2, para 3.18 & 3.195). The state government managed to increase capital expenditure as percentage to GSDP in 2020-21 as compared to a decline in 2019-20. Capital expenditure assistance provided by the union government helped in safeguarding capital investment despite revenue concerns.

3.37 Composition of government expenditure in terms of revenue and capital expenditure since 2015-16 given in figure 3.7 shows that the state government managed to restrain the growth of revenue expenditure despite the pressure from committed spending. The relative share of revenue expenditure in the state was 85.18 percent of total expenditure in 2015-16, while the capital expenditure stood at 14.82 percent. A declining trend in the relative share of revenue expenditure was witnessed as it came down from 85.18 percent in 2015-16 to 80.19 in 2018-19. The relative share of revenue expenditure got a boost in 2019-20 as it increased to 89.56 percent. Its share, however, slipped down to 80.79 percent in 2020-21. The decline in relative share was due to the boost given to capital expenditure aligned with national priorities.

Figure 3.7
Relative Share of Revenue and Capital Expenditure (%)



Sector Outlays and Priorities: Revenue and Capital Expenditure

3.38 In revenue expenditure, state government spent on an average 61.46 percent on social and economic services during 2015-16 to 2020-21, 37.17 percent on general services and about 1.36 percent on compensation to local bodies.

- In general services, interest payment and pension payment are two major items of spending. Relative share of interest payment and pension continued to increase over the years from 2015-16 to 2020-21 (Table 3.7).
- The composition of the social services indicates that spending on education, health, water supply and sanitation, welfare, and nutrition have been the prime areas of focus. The relative share of education at 20.62 percent and 18.75 percent in 2019-20 and 2020-21 respectively remained the largest spending item. The expenditure on health has been steadily increasing from 4.85 percent in 2015-16 to 6.83 percent in 2020-21. The relative expenditure on social welfare and nutrition has increased in 2019-20 as compared to the previous years but decreased in 2020-21.
- In economic services, the relative share of agriculture in revenue expenditure was an average of 7.71 percent from 2015-16 to 2020-21 and shows a fluctuating trend over the year. The share of energy decreased from 5.95 percent in 2015-16 to 4.91 percent in 2020-21.
- The expenditures on wages and salary, pension payments, and interest payment taken together constitute a major portion of revenue expenditure. These spending items, by their nature are committed expenditure, and cannot be avoided or postponed during the year. The committed expenditure averaged 62.47 percent of total revenue expenditure over 2015-16 to 2020-21. The average committed expenditure as percentage to the revenue expenditure over the years 2011-12 to 2014-15 was lower at 56.89 percent. The share of aggregate committed expenditure has shown an increasing trend from 2015-16 to 2019-20 but experienced a significant fall 2020-21 (Table 3.8). The relative share of items of committed spending shows that salary and wages have increased in 2019-20 compared to the previous year but decreased in 2020-21. The share of interest payment pension in revenue expenditure has shown a rising trend over the years.

Table 3.7
Relative Share of Major Items: Revenue Expenditure

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	Average
Interest Payment	7.19	8.56	8.72	8.29	8.24	8.61	8.27
Pension	11.04	11.79	12.17	14.11	14.72	14.26	13.01
Education	20.71	19.75	20.32	18.41	20.62	18.75	19.76
Health	4.85	5.05	5.33	5.72	5.83	6.83	5.60
Water Supply, Sanitation, Housing & Urban	2.96	4.44	5.60	8.25	4.18	5.02	5.08
Social Welfare & Nutrition	3.06	2.69	2.94	3.95	2.84	4.61	3.35
Agriculture & Allied Activities	8.48	7.09	7.23	8.18	7.91	7.34	7.71
Rural Development	2.37	3.61	2.47	0.69	0.72	0.59	1.74
Energy	5.95	5.63	5.06	3.93	4.61	4.91	5.01
Compensation to LBs	1.06	1.47	1.53	1.27	1.36	1.47	1.36

Table 3.8
Share of Committed Spending in Revenue Expenditure (%)

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Interest Payment	7.19	8.56	8.72	8.29	8.24	8.61
Pension	11.04	11.79	12.17	14.11	14.72	14.26
Salaries and wages	37.25	37.58	35.62	43.38	51.98	41.31
Committed Expenditure	**55.48**	**57.93**	**56.51**	**65.77**	**74.94**	**64.18**

3.39 Despite slowdown in the national economy resulting in reduced central flow of resources in 2019-20 and contraction of economy in 2020-21, the state government managed to hold on to capital expenditure growth. While the state government accorded priority to the productive economic services in capital expenditure, spending on infrastructure building in social services also has been emphasized. On an average during the period 2015-16 to 2020-21, about 55.63 percent of capital outlay has gone to economic services and 32.55 percent has been spent on social services (Table 3.9). The capital outlay on general services which includes public works and police infrastructure got about 9.71percent during this period. While share of the economic services increased from 44.21 percent in 2019-20 to 60.46 percent in 2020-21, there was some decline in the relative share of social services (Table 3.9).

3.40 The composition of capital expenditure given in table 3.9 shows that the sectors like transport, energy and the general economic services are the priority sectors for capital investment in the state. In the case of social services, water supply, sanitation an urban development, welfare services, health and education are the important sectors where government has invested to create infrastructure. However, the share of water supply, sanitation and urban development declined to 10.63 percent in 2020-21 from 23.62 percent in 2019-20 and the share of health and education in 2020-21 has increased as compared to previous years. It is important to note here that the net lending (disbursement of loans and advances minus recoveries of loans and advances) is negative of 0.08 percent of total capital outlay in the year 2020-21.

Table 3.9
Composition of Capital Expenditure

Heads	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
General Services	**9.70**	**9.67**	**9.83**	**5.44**	**17.47**	**6.16**
Police	0.75	0.94	0.45	0.11	0.00	0.12
Public works	8.95	8.73	9.11	5.11	17.47	5.94
Social Services	**30.44**	**33.05**	**35.10**	**27.20**	**36.04**	**33.46**
Education	2.82	6.24	6.41	5.24	5.63	9.98
Public Health	10.03	9.91	14.71	6.79	5.30	11.86
Water Supply Sanitation Housing & Urban Dev	15.38	15.61	12.96	13.85	23.62	10.63
Welfare of SC/ST/OBC	0.56	0.90	0.89	0.77	0.71	0.41
Social Welfare and Nutrition	1.64	0.36	0.13	0.56	0.78	0.58
Economic Services	**55.97**	**55.15**	**54.01**	**64.00**	**44.21**	**60.46**
Agriculture and Allied Services	0.99	1.15	0.92	1.01	0.68	0.80
Rural Development	0.03	1.31	0.83	0.40	0.06	0.61
Irrigation and Flood Control	0.18	0.11	0.13	3.88	0.11	2.73
Energy	5.68	7.86	5.01	4.76	2.77	10.70
Industry and Minerals	0.09	0.26	0.14	0.05	1.01	0.03
Transport	31.87	34.87	41.08	47.04	32.59	35.36
Science and Environment	0.00	0.01	0.00	0.00	0.00	0.00
General Economic Services	13.39	5.46	4.26	4.09	4.04	6.45
Other Economic Services	3.74	4.12	1.65	2.77	2.95	3.77
Net Lending	**3.89**	**2.12**	**1.05**	**3.35**	**2.27**	**-0.08**

Composition of Aggregate Expenditure

3.41 State government expenditure can be categorized into three broad heads, expenditure on government programs, which includes both revenue and capital outlay, debt repayment and loans and advances. The interest payment on outstanding liabilities is part of revenue expenditure. Usually, loans and advances are included in capital expenditure. For the purpose of this study, we have kept it as separate category to keep revenue and capital spending on various sector together. The total expenditure net of debt repayment which includes total of revenue and capital expenditure without public debt and loans and advances shows an increasing trend from 2011-12 to 2014-15. There is a decline in 2015-16 which continued till 2019-10. However, a sharp increase was noticed in 2020-21 with 99.00 percent of aggregate expenditure (Table 3.10). The share of repayment of public debt of the state shows an increasing trend during 2011-12 to 2019-20, which declined significantly 2020-21. Loans and advances by the state government has declined in the recent years, allowing larger direct capital investment.

Table 3.10
Composition of Aggregate Expenditure (%)

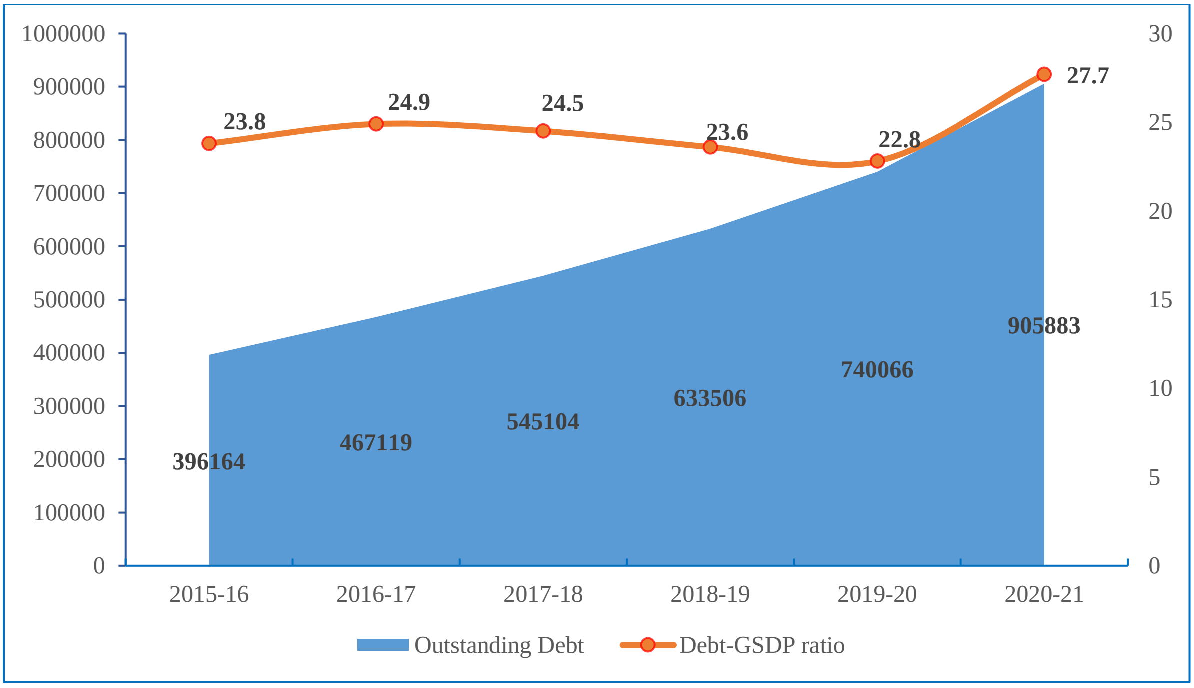
Heads	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Total Expenditure net of debt repayment	96.89	97.78	97.55	97.45	95.04	94.48	94.02	93.91	94.13	99.00
Public Debt	1.55	2.08	2.20	1.96	4.36	5.16	5.70	5.42	5.64	1.00
Loans and Advances	1.56	0.15	0.25	0.60	0.60	0.36	0.28	0.67	0.23	0.00

Debt Stock and its Management

3.42 The debt to GDP ratio of the states increased sharply in 2020-21 to meet spending requirements in the pandemic affected year. The state governments were given flexibility by the Union government to increase the fiscal deficit beyond the FRBM Act requirements. This was done to compensate decline in revenue receipts and flow of central funds in a pandemic year and second, to encourage capital investment to give boost to economic recovery. The aggregate debt-GSDP ratio for states increased from 26.7 percent of GDP in 2019-20 to 31.1 percent in 2020-21 (RBI State Finances, 2022).

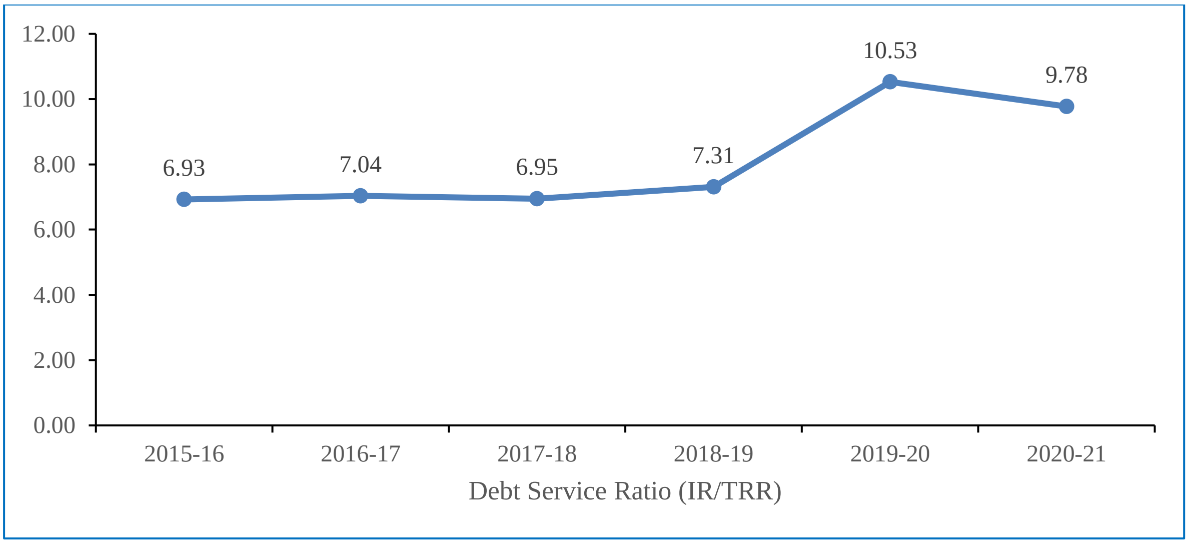
3.43 The Debt-GSDP ratio of Sikkim remained within the limit of 25 percent of GSDP during 2015-16 to 2019-20[15]. In the pandemic affected fiscal year of 2020-21, the ratio increased beyond this limit to 27.7 percent of GSDP (Fig 3.8). The impact of debt burden in term of interest payment as percent to revenue receipt increased moderately from 6.93 percent in 2015-16 to 7.31 percent in 2018-19. However, there was sharp rise in 2019-20 to 10.53 percent (Fig 3.9). The debt service ratio has declined in 2020-21 to 9.78 percent. Despite the decline in 2020-21, it has remained at an elevated level as compared to the previous years.

Fig 3.8
Debt Stock (Rs. Lakh) and Debt GSDP Ratio (%)



[15] The FC-XIV in their fiscal roadmap for the States recommended anchoring the fiscal deficit at 3 percent of the GSDP. The States can avail the flexibility to increase this limit by 0.5 percentage points, 0.25 percent separately depending upon conditions prescribed. One of the major conditions was to limit the debt-GSDP ratio to 25 percent in the previous year. Thus, for all effective purposes the benchmark of debt-GSDP ratio was 25 percent.

Table 3.9
Debt Service Ratio – Interest Payment/Revenue Receipts (%)



3.44 Government of India stepped up the borrowing limits of states from 3 percent to 5 percent in terms of increased fiscal deficit limit in 2020-21, to provide flexibility to ease the unusual fiscal pressures. FC-XV in their report assessed that states being revenue-stressed might avail of the additional borrowing facility offered to them and worked out indicative debt-GSDP path for the states. Indicative debt-GSDP ratio for Sikkim was estimated at 27.4 percent for the year 2020-21. In this estimation, however, the debt-GSDP ratio for the state does not come down in next five years. The state government amended the FRBM Act in 2021-22 by including annual debt-GSDP ratio following the indicative debt-GSDP path given by the FC-XV.

3.45 The composition of public debt given in Table 3.11 reveals that the relative share of internal debt which includes market loans, special securities and NSSF, and loans from financial institutions increased from 72.08 percent in 2015-16 to 77.17 percent in 2018-19. The share of internal debt has decreased to 71.68 percent in 2019-20 and this increased marginally to 72.83 percent in 2020-21.The internal debt has increased in nominal terms from Rs. 2,855.65 crores in 2015-16 to Rs.6, 598.09 crores in 2020-21.

Table 3.11
Outstanding Liabilities

(Rs. In Lakh)

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public Debt	**296958**	**350613**	**421697**	**498629**	**540572**	**689143**
Internal Debt	285565	339568	411412	488877	530500	659809
Central Govt. Loans	11393	11045	10285	9752	10072	29334
Other Liabilities	**99206**	**116506**	**123407**	**134877**	**199494**	**216815**
Small savings Provident Fund	74783	83115	91172	100565	116286	131829
Reserve Fund	8422	9379	5806	6331	47058	48751
Deposits	16001	24012	26429	27981	36150	36234
Total Liabilities	**396164**	**467119**	**545104**	**633506**	**740066**	**905958**
Debt-GSDP Ratio (%)	23.8	24.9	24.5	23.6	22.8	27.7
Public Debt	74.96	75.06	77.36	78.71	73.04	76.07
Internal Debt	72.08	72.69	75.47	77.17	71.68	72.83
Loans from Central Government	2.88	2.36	1.89	1.54	1.36	3.24
Other Liabilities	25.04	24.94	22.64	21.29	26.96	23.93
Small savings Provident Fund	18.88	17.79	16.73	15.87	15.71	14.55
Reserve Fund	2.13	2.01	1.07	1.00	6.36	5.38
Deposits	4.04	5.14	4.85	4.42	4.88	4.00

Source: Finance Accounts, various issues.

3.46 The share of central government loans to the state, which was on a declining trend for many years, increased in 2020-21. It declined from 2.88 percent in 2015-16 to 1.34 percent in 2019-20 and increased to 3.24 percent in 2020-21. In nominal terms, loans from the Central Government have decreased from Rs.113.93 crore in 2015-16 to Rs.100.72 crore in 2019-20 and increased to Rs. 293.34 lakh in 2020-21. The Union government assistance for capital expenditure in terms of central loan has played a role in this increment for the year 2020-21. The relative share of other liabilities from the public accounts like small savings and provident fund, reserve fund and deposits has declined from 25.04 percent in 2015-16 to 21.29 percent in 2020-21.

3.47 The maturity profile of the repayment liabilities pertaining to the internal debt shows that up to 2021-22, the debt stock getting matured is small at Rs. 156.31 crores, which accounts for only 1.94 percent of all the internal debt (Table 3.12). Thus, the debt repayment liabilities in the short run was not much and their impact on fiscal management would be manageable. During the next five years, i.e., from 2022-23 to 2026-27, about 26.17 percent of the existing debt will be matured and the amount for this period would be about Rs. 2110.93 crore. During the next five years (2027-28 to 2031-32) an amount of Rs. 5778.74 crore (71.63 % of the debt stock) will be matured. Thus, beyond 2022-23, the repayment liabilities will increase as large portion of loans are going to be matured by 2031-32 in the next ten years.

Table 3.12
Maturity Profile of Internal Debt

Financial Year	Total - 6003 Internal Debt (Rs. Crore)
Maturing in and prior to 2021-22	156.31
Maturing in 2022-23 to 2026-27	2110.93
Maturing in 2027-28 to 2031-32	5778.74
Maturing in 2032-33 to 2036-37	18.525
Maturing in 2037-38 to 2038-39	2.7037
Total	8067.25
Composition (%)	
Maturing in and prior to 2021-22	1.94
Maturing in 2022-23 to 2026-27	26.17
Maturing in 2027-28 to 2031-32	71.63
Maturing in 2032-33 to 2036-37	0.23
Maturing in 2037-38 to 2038-39	0.03

Source: Finance Accounts, 2021-22

Guarantees given by the State Government

3.48 Guarantees are contingent liabilities on the Consolidated Fund of the State in case of default by the borrower for whom the guarantees are extended. Statutory Corporations, Government Companies, Joint-Stock Companies, Co-operative Institutions, Local Bodies, Firms, and Individuals can raise loans to discharge their liabilities with explicit state government guarantees. The guarantees given by the state government are based on Constitutional provisions and are reported in the budget. The end of the year finance account prepared by the CAG also reports these. The Government usually puts limit on guarantees to be given by it as permitted under the Constitution. “Guarantees are contingent liabilities that come into play on the occurrence of an event covered by the guarantee. Since guarantees result in increase in contingent liability, they should be examined in the same manner as a proposal for a loan, taking into account, inter alia, and the credit-worthiness of the borrower, the amount and risks sought to be covered by a sovereign guarantee, the terms of the borrowing, the justification and public purpose to be served, probabilities that various commitments will become due and possible costs of such liabilities, etc.” (GOVERNMENT GUARANTEE POLICY, Ministry of Finance, GOI, 2010).

3.49 The issue of off-budget borrowing through the sovereign guarantee given by the states has come into prominence after the report of the FC-XV came into being and concerns raised in the context of large off budget borrowing incurred by several states. According to the directive of the union government, from 2021-22 the guarantees given by the state government for borrowing by state entities will now form part of the state borrowing limit.

3.50 Government of Sikkim constituted Guarantee Redemption Fund in the year 2005 for meeting payment obligations arising out of the guarantees issued by the Government in respect of bonds issued and borrowings by the State Undertakings or other bodies, in case the same are revoked. The Government is required to contribute an amount equal to at least one-fifth of the outstanding invoked guarantees plus an amount likely to be invoked as a result of the incremental guarantees issued during the year. However, it is open to the Government to increase contribution to the fund at its discretion. During 2020-21, the State Government transferred Rs.2.00 crore to the Guarantee Redemption Fund along with accrued interest of Rs.3.50 crore. No guarantees were invoked during the year. The fund had a corpus of Rs.63.87 crore at the end of the year out of which Rs.60.41 crore stood invested. (Finance Accounts, 2020-21).

3.51 Sikkim Ceiling on Government Guarantees Act, 2000 controls the process of giving guarantees. As per the total outstanding Government Guarantees as on the first of April of any year shall not exceed thrice the State's tax revenue receipts of the second preceding year as in the books of the Accountant General of Sikkim. The FRBM Act stipulates that total outstanding guarantees of the government should follow the Government Guarantees Act, 2000. The total outstanding guarantees in 2020-21 were Rs.3455.04, which was within the limits prescribed as per the interpretation of the guarantees Act provided by the state government for this study.

Chapter 4: Compliance of the State Government to the Provisions of FRBM Act

An Act to provide for the responsibility of the State Government to ensure fiscal stability and sustainability through maintaining balance in revenue account and planned reduction of fiscal deficit and prudent and sustainable debt management consistent with fiscal stability through limits on State Government's borrowings, including off-budget borrowing and achieving greater transparency in fiscal operation of the Government and conduct of fiscal policy in a medium term fiscal framework and for matters connected therewith or incidental thereto. **(The Sikkim Fiscal Responsibility and Budget Management Act, 2010).**

4.1 State governments in India adopted fiscal rules in the form of FRBM Act to address persistent fiscal imbalance existing during late nineties and early 2000s. Rule based fiscal management was expected to counter the tendency of fiscal bias by restraining the government to take budgetary decisions within predetermined limits of deficits and debt..

4.2 After adopting the FRBM Act the state of Sikkim was successful in reducing fiscal deficit within a range and stabilize the debt ratio at prescribed level. The FRBM Act was adopted with specific targets to achieve fiscal deficit to GDP ratio at 3 percent by 2013-14 and balance the current account. The Act aimed at reaching a sustainable fiscal stance which was supposed to be carried on beyond the target year. The need for maintaining long-run fiscal sustainability and preventing rise in future indebtedness remained overarching objective of fiscal rules. The FRBM act stipulated to providing information on policy decisions through a fiscal policy statement and forecasting fiscal variables for three years.

4.3 The national growth rate's moderating trend in 2019-20 and the Covid-19 pandemic's distorting effects in 2020-21 demonstrated that effectiveness of fiscal rules depend on country's growth performance. The initial success of fiscal rules at both the Union government and states level was due to significant improvement in the fiscal situation in the country following a buoyant economy and resultant improvement in revenue receipts in the areas of direct and indirect taxes. The fiscal rules were breached when national economy slowed down considerably in 2008-09 because of the international financial crisis. The Government had to adopt expansionary fiscal stance through fiscal stimulus packages comprising both tax cuts and expenditure hikes to rejuvenate the economy. While state governments in general and Sikkim in particular showed consistency in adhering to fiscal legislation targets over the years, the exceptional fiscal stress faced in 2020-21 adversely affected the FRBM Act targets.

4.4 The fiscal targets of FRBM Act have undergone several rounds of amendment. In 2012, the Union government redesigned their fiscal targets under the FRBM Act with a longer time horizon. Since then, despite the Act's several amendments, the deadline for achieving the goal has remained elusive. The FRBM Act targets were further delayed until 2025-26, as a result of the Covid-19 outbreak causing problems in the public finances.

4.5 State governments amended their FRBM Acts following the recommendations of central Finance Commissions and responding to specific requirements as allowed by the Union government. While the FRBM Act adopted by Sikkim in 2010 contained the gradual reduction of deficit and debt conforming to FC-XII fiscal consolidation path, the government brought amendments to include the recommendations of FC-XIV regarding the flexibility in fiscal deficit and associated prudency conditions. FRBM Act was amended in 2020 to reflect the additional borrowing allowed by the union government.

4.6 The assessment of compliance of the state government to the FRBM Act provisions for the year 2020-21 is important to evaluate state’s capacity, commitment and fiscal management practices in the Covid-19 affected year. The review report assesses mandatory fiscal targets, accountability clauses, transparency measures and guiding principles for fiscal management. The inherent strength in state’s economy, prudency in fiscal management, and commitment to fiscal rule will be crucial factors to come back to fiscal consolidation path.

Major Features of State FRBM Act

Medium Term Fiscal Plan

4.7 The Medium-Term Fiscal Policy (MTFP) forms the core of the FRBM Act related documents. This statement gives two-year outward projection of fiscal outcomes like revenue deficit, fiscal deficit, and outstanding liabilities as percentage to the GSDP in addition to the revised estimates of current year and budget estimates of the ensuing year. The statement is supposed to include assumptions relating to the trend of fiscal variables leading to the projection of major fiscal outcomes. The MTFP gives assessment regarding the balance between revenue receipts and revenue expenditure and use of capital receipts for generating productive assets. Thus, the MTFP contains a fiscal plan of the state government for the ensuing budget year and two outward years. The Act stipulates that the MTFP should contain the following statements;

- *Fiscal Management Objectives*: The main objectives of the FRBM Act of the state are prudent fiscal management, generation of adequate revenue, and efficient spending to facilitate economic development. The Act requires the state to implement the necessary steps to reduce the revenue deficit, then accumulate a sufficient revenue surplus, maintain a manageable fiscal deficit, and use that surplus to pay for capital expenditures. Thus, the objectives include carrying out an evaluation of the performance of the prescribed fiscal indicators in the previous year vis-à-vis the targets set out earlier, and the likely performance in the current year as per revised estimates.
- *The Macro-economic Statement*: MTFP to include a statement on recent economic trends and future prospects for growth and development affecting fiscal position of the Government.
- *The Fiscal Policy Strategy Statement*: The MTFP should contain the strategic priorities of the Government in the fiscal matters for the ensuing financial year. It should provide policies of the government for the ensuing financial year relating to taxation, expenditure, borrowings and other liabilities, subsidies, lending and investments, guarantees and activities of Public Sector Undertakings which have potential budgetary implications. It is also stipulated provide an evaluation as to how the current policies of the Government are in conformity with the fiscal management principles set out in the Act.

Fiscal Management Principles

4.8 The purpose of integrating fiscal management principles in the FRBM Act is to influence policymaking to attain policy aims and facilitate adherence to established fiscal strategy. The fundamentals of fiscal management emphasize the importance of institutional and public financial management (PFM) system strengthening. The Act includes the following fiscal management principles.

(a) to maintain State Government debt at prudent and sustainable level;

(b) to manage guarantees and other contingent liabilities prudently, with particular reference to quality and level of such liabilities;

(c) to ensure that borrowings are used for productive purposes and Fiscal Management Principles accumulation of capital assets, and are not applied to finance current expenditure;

(d) to ensure that the policy decisions of the Government have due regard to the financial implications on the future generations;

(e) to maintain the integrity of the tax system by minimizing special incentives, concessions and exemptions;

(f) to pursue tax policies with due regard to economic efficiency and compliance costs;

(g) to pursue non-tax policies with due regard to cost recovery and equity;

(h) to pursue expenditure policies that would provide impetus to economic growth, poverty, reduction and improvement in human welfare;

(i) to build up a revenue surplus for use in capital formation and productive expenditure;

(j) to ensure maintenance of the physical assets of the Government;

(k) to maintain transparency by disclosing sufficient information to allow public to scrutinize the state of the public finances;

(l) to minimize the fiscal risk associated with management of public sector undertakings and the utilities providing public goods and services;

(m) to ensure discharge of current liabilities in a timely manner;

(n) to formulate a realistic budget with due regard to the general economic outlook and revenue prospects and minimize deviations during the course of the year.

The Fiscal Policy Strategy Statement:

4.9 The fiscal policy strategy statement contains the fiscal stance of the state government with respect to fiscal targets for the ensuing year, revenue generation efforts, expenditure plan and consequent borrowing requirements. The other important elements of fiscal policy strategy statement are as follows;

a) The strategic priorities of the government;

b) The reasons for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administered pricing and borrowings;

c) An evaluation of the current policies of the Government based on fiscal objectives and fiscal principles enunciated in the Act.

Fiscal Targets

4.10 The fiscal targets for the Government of Sikkim, as per the FRBM Act, are the following;

- Maintain revenue account balance beginning from the year 2011-12 ;
- Reduce the fiscal deficit to 3.5 percent of the estimated Gross State Domestic Product in each of the financial year starting from 2011-12 and reduce the fiscal deficit to not more than three percent of the estimated Gross State Domestic Product at the end of 31st March 2014 and adhere to it thereafter;
- Cap the total outstanding guarantees within the specified limit under the Sikkim Ceiling on Government Guarantees Act, 2000 (21 of 2000);
- Ensure that the outstanding debt-GSDP ratio follows a sustainable path emanating from the above targets of the deficit as specified by the Government beginning from the fiscal year 2011-12.

The Fiscal Responsibility and Budget Management (FRBM) Review Committee, which submitted its report in 2018, recommended a debt to GDP ratio of 60 percent for the general (combined) government by 2023, comprising 40 percent for the central government and 20 percent for the state governments. Given deterioration in public finances faced by the government in 2020-21, it was not possible to adhere to this recommendation.

During the fiscal year 2020-21, Government of India allowed the state to increase the fiscal deficit to 5 percent of GSDP with an additional 2 percent borrowing. Out of this increased borrowing facility, 1 percent was conditional on taking up reform measures specified by union government. Thus, the debt-GSDP ratio of the state was set to increase. FC-XV in their second report covering the award period 2021-22 to 2025-26 have given indicative debt path for state governments. Taking into account the increased borrowing facility, the debt as percentage of GSDP was indicated at 27.4 percent for Sikkim for the year 2020-21.

Measures for Fiscal Transparency

4.11 The FRBM Act stipulates the governments to provide data and information on fiscal variables and outcomes of fiscal transactions. These are called disclosure statements and rules to the Act specifies the format in which these information are to be given. The data and information given in FRBM Act document is expected to enhance transparency in the system and help the policy makers to take informed decisions. The disclosures include the following statements;

- Key fiscal indicators depicting fiscal management;
- The significant changes in the accounting standards, policies and practices affecting or likely to affect the computation of prescribed fiscal indicators;
- As far as practicable and consistent with protection of public interest, the contingent liabilities created by way of guarantees.

Measures to Enforce Compliance

4.12 The FRBM Act of the state provides for a half-yearly review statement by the Minister of Finance containing the trends in receipts and expenditure in relation to the budget estimates and place before the State Legislature. The review should present any deviation from the projected fiscal variables in the budget and contained in the Fiscal Policy Strategy Statement. The Minister should provide measures taken by the government to address the deviations and remain within the fiscal targets stipulated in the Act. Impact of any unforeseen events on fiscal management and ways and means taken up by the government to address such situation should be mentioned in the review statement.

4.13 The Act also enables the state government to entrust an independent agency to review periodically as required, the compliance of the provisions of this Act and such reviews shall be laid on the table of the State Legislature.

Other Legal Issues

4.14 Under this Act state government retains the power to make rules to carry out the provisions of the Act. Legal proceedings are not allowed against government officials as protection is accorded for taking actions in good faith. The provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

4.15 The FRBM Act related documents, particularly the MTFP and the fiscal policy strategy statements, are expected to give a perspective on the impact of the policies included in the budget in the medium term. The MTFP provides a platform to articulate the fiscal policy objectives and fiscal constraints in quantitative and qualitative terms and forms the basis to assess the fiscal impact of the budget provisions. Considerable scope is there to develop the MTFP to a meaningful budgeting document that become helpful not only disseminating government’s fiscal policy stance but also become helpful in decision making process.

Compliance of the State Government to the FRBM Act Targets: 2020-21

4.16 This review report takes into account these constraints while assessing the compliance of the state to the provisions of FRBM Act in 2020-21. The review report assesses fiscal targets, requirement of disclosure of data and information, and overarching fiscal policy objectives and principles that the state needs to follow. The comparison of FRBM Act provisions and the outturns shows that there were shortfalls in adhering to fiscal targets. The state government, however, met other requirements of disclosing information in specified formats. The government placed MTFP containing fiscal management details for the ensuing year, growth perspective, fiscal strategy and disclosers in specified formats along with the budget. The compliance record of the state government to the FRBM targets is given in tables 4.1, 4.2, and 4.3.

FRBM Documents following the provisions of the FRBM Act and Rules to the Act

4.17 Among all the documents indicated in table 4.1, Medium Term Fiscal Policy (MTFP) document is most crucial. It provides projected fiscal outcomes for 2 outward years beyond the budget year. The projection in the MTFP is usually carried out in a rolling manner taking into consideration the emerging economic situation. The MTFP for the year 2019-20 was prepared much before the impact of distortions due to Covid-19 was felt for which the emerging imbalance was not possible to capture. The fiscal outturns projected for the year 2020-21 exceeded the deficit and debt-GSDP outturns achieved. As compared to the projections of the preceding year, all the fiscal outcomes deteriorated significantly in 2020-21. Shortfall in revenue receipts and additional borrowing allowed to compensate shortfall in revenue receipt increased the deficit and debt outcomes in 2020-21 beyond the projections.

Table 4.1

Presentation of FRBM Documents Along With Budget

FRBM Documents	Compliance
Assessment Period	2019-20 and 2020-21
Mid-year review by the Finance Minster	The mid-year review of fiscal situation keeping the FRBM Act targets in consideration was presented by the Finance Minister in the assembly.
Medium Term Fiscal Plan	
MTFP Rolling Targets	The Medium Term Fiscal Plan, as required under sub-section (1) of section 3, of the Act shall include in Form F-2 three years rolling targets in respect of the following fiscal indicators are presented along with the budget (a) Revenue deficit as a percentage of GSDP; (b) Fiscal deficit as a percentage of GSDP; (c) Total outstanding debt as a percentage of GSDP; (d) Primary deficit / surplus as a percentage of GSDP.
Assumptions underlying	The assumptions made to project the fiscal variables reflecting the fiscal policy choices with realistic assumptions relating to the likely behaviour of fiscal variables presented.
The Macro-economic Framework Statement	The growth perspective as required under MTFP was presented contained following points: a) Overview of the State economy b) GSDP Growth c) Overview of State Government Finances and prospects
Fiscal Policy Overview in Form F-1, (See Rule 3), Medium Term Fiscal Plan	The MTFP presented along with budget contained the following fiscal management processes 5 Tax Policy 6 Expenditure Policy 7 Debt management 8 Strategic priorities for the ensuing year 9 Fiscal management practices and evaluation

Fiscal Targets and Achievements in 2020-21

4.19 FRBM Act provisions and achievements given in table 4.2 shows that the state government fell short of achieving the targets in 2020-21, when actual expenditure and receipts are taken for computation. While the Act required that there should be surplus in the revenue account, it has gone into deficit in 2020-21, which was large at 2.32 percent of GSDP. Slowdown in growth of revenue receipts, particularly in 2020-21 resulted in higher revenue deficit as spending commitments increased.

4.20 Fiscal deficit, taking actual expenditure and revenue receipts of the state government, works out to be 6.95 percent of GSDP in 2020-21, which exceeded fiscal deficit target of 5 percent target by 1.95 percentage points. The state government faced fiscal imbalance in 2020-21 due to revenue shortfall and rise in spending pressure for which fiscal deficit increased considerably.

Table 4.2

FRBM Act Provisions and Compliance

	2020-21	
	Target	**Achievement**
Revenue deficit(-) /surplus(+) % of GSDP	Surplus	-2.32
Fiscal deficit % of GSDP	-5.00	-6.95
Total debt stock % of GSDP	27.4*	27.68
Outstanding Government Guarantees as on the first of April of any year shall not exceed thrice the State's tax revenue receipts of the second preceding year	Rs.11062.78**	Rs.3455.04

Source: Budget documents for the years 2021-22 and 2022-23.

Notes: The GSDP figures used to find the ratios are taken from state budgets for the years 2020-21

* Indicative debt-GSDP target worked out by FC-XV

** State's tax revenue receipts of the second preceding year (2018-19) includes own tax revenue and share in central taxes.

4.21 For the third indicator, debt-GSDP ratio, the FC-XV did not specify any target in their interim report for 2020-21. In their final report, FC-XV worked out indicative debt path for the states taking into consideration the emergent fiscal situation, additional borrowing facility, and the fiscal adjustments to come back to the consolidation path. According to this debt path, FC-XV estimated the debt-GSDP level for Sikkim in 2020-21 to be 27.4 percent. Taking the indicative debt-GSDP given by FC-XV, the state has exceeded the target by 0.28 percentage points n 2020-21.

4.22 Outstanding Government Guarantees, the fourth indicator, according to the government guarantee Act adopted in 2000, as on the first of April of any year should not exceed thrice the State's tax revenue receipts of the second preceding year. The outstanding guarantee given by the state government to various entities in 2020-21 was Rs.3455.04 crores, which was less than three times of state taxes of 2018-19. The state taxes here include own tax of the state and the share in central taxes.

4.23 There is another view regarding the limits of outstanding guarantees, which the CAG has put in its audit report of state finances. According to this, the state taxes of the second preceding year, three times of which is taken as the limit, includes only own tax revenue of the state. Then, the outstanding guarantees of 2020-21 at Rs.3455.04 crore exceeds three times of own tax revenue of the year 2018-19, which works out to be Rs.2693.95 crore. As the guarantees given by the state remained small in recent years, the rule position should be clarified. The limit accepted by the state government, which includes both own tax and share in central tax, works out to be quite large number as compared to the size of the state budget.

Disclosure Statements in the FRBM Documents

4.24 The disclosure statements provided by the state government along with the FRBM related documents are listed in table 4.3.

Table 4.3
Disclosure of Information and Compliance – 2020-21

Disclosure Statements	Compliance
1. A statement of select indicators of fiscal situation in Form D-1	Following select fiscal indicators were presented in the MTFP following the FRBM Rules in Form D1 1. Gross Fiscal Deficit as Percentage to GSDP 2. Revenue Deficit as Percentage of GSDP 3. Revenue Deficit as Percentage of Gross Fiscal Deficit 4. Revenue deficit as Percentage of TRR 5. Debt Stock as Percentage of GSDP 6. Total Liabilities as Percentage to GSDP 7. Capital Outlay as Percentage of Gross Fiscal Deficit 8. Interest Payment as Percentage of TRR 9. Salary Expenditure as Percentage of TRR 10. Pension Exp. As Percentage of TRR 11. Non-development Expenditure as Percentage of Aggregate Disbursements 12. Non-tax Revenue as Percentage of TRR
2. Components of State Government Liabilities in Form D-2	Components of state government liabilities were presented in the MTFP following the FRBM Rules in Form D2. 1. Internal Debt 2. Loan from Centre 3. State Provident Funds 4. Reserve Funds 5. Deposits 6. Other Liabilities
3. Guarantees Given by the Government in Form D-3	Details of Guarantees given by the state government were presented in MRFP following FRBM Rules in Form D3.
4. Number of Employees in PSUs & Aided Institutions and Expenditure of State Government in Form D-4	Details of number of employees in Public Sector Undertakings & Aided Institutions and Expenditure of State Government were given in MTFP following FRBM Rules in Form D4.

Observing Fiscal Management Principles

4.25 The fiscal management principles included in the State FRBM Act are guiding in nature and the Act does not fix any targets or give any indicator to assess these principles like those for mandatory fiscal targets. The objective of including these principles has been to influence the policy making to achieve policy objectives and take appropriate public financial management decisions. The principles reflect broad objectives of economic policies governments at any level. In the context of Sikkim, the fiscal management principles assume significance due to the challenges like lack of adequate resource base, a large committed spending, and provision of public services in a difficult terrain, which becomes costly.

4.26 The list of fiscal management principles given in an earlier section following the rules associated with the Act can be grouped into following categories.

- Maintaining prudency in debt management
- Simplifying tax policies and administration
- Expenditure Policy and Institutional Measures to Improve Quality of Expenditure
    - Improving transparency
    - Formulating realistic budget

Prudency in Debt Management

4.27 The FRBM Act calls upon the state government to maintain debt at sustainable level and manage guarantees and other contingent liabilities prudently. The government should ensure that borrowings are used for productive purposes and are not applied to finance current expenditure. The objective is to ensure that the policy decisions of the Government have due regard to the financial implications on the future generations. Debt management policy of any government aims at meeting the financing needs at the lowest possible long-term borrowing costs and to keep the total debt within sustainable levels.

4.28 The borrowing limit of the State governments is determined by Ministry of Finance, Government of India annually as states need Centre's consent to borrow in case the state is indebted to the Centre over a previous loan (Article 293(3)). As RBI manages the public debt of state governments and facilitates their investment of surplus cash balances, the states do not face the test of the market based on their fiscal capacity and economic situation. The practice of determination of borrowing limit by the central government acts as an external control in rule based fiscal management. Since the recommendations of the FC-XIII, the central government fixes the borrowing limit of a state based upon the fiscal deficit target stipulated in the FRBM Act. State government can utilize their cash balances to finance their deficit, which reduces their borrowing requirements.

4.29 In the Covid-19 affected year of 2020-21, the state government faced reduction in revenue receipts and higher spending pressure for which fiscal deficit increased as compared to the previous year. This has resulted in resorting to higher borrowing allowed by the Union government. The debt stock as percentage of GSDP at 27.68 percent exceeded the indicative debt path charted out by the FC-XV at 27.4 percent in 2020-21. The state government, however, kept the guarantees within the limit set under the Guarantees Act of 2000.

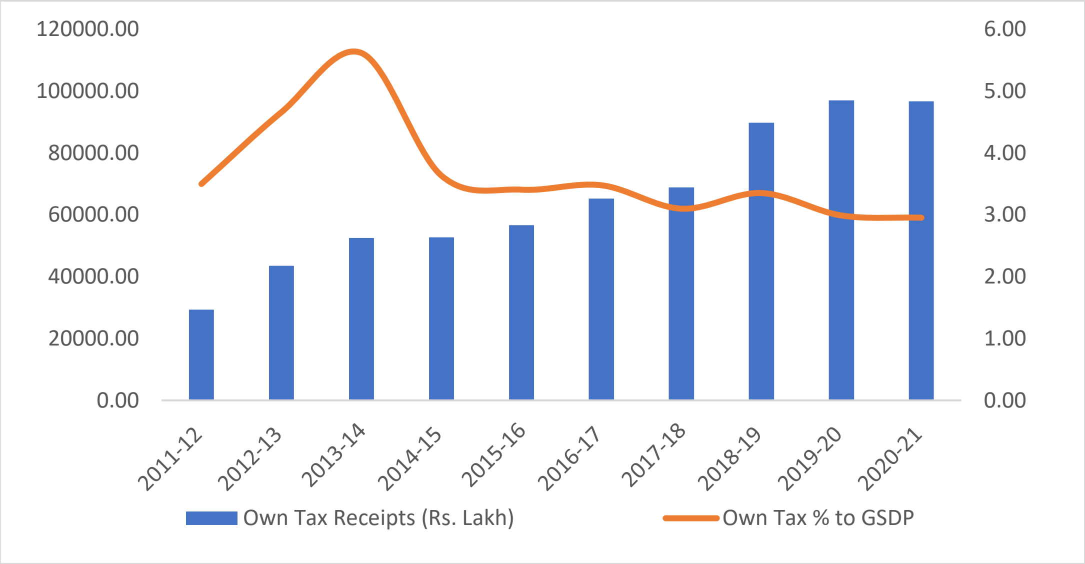
4.30 Due to higher spending in 2020-21, the revenue account ended up with a deficit of 2.32 percent as against the FRBM Act target of generating surplus. Thus utilizing all the borrowed funds for creating capital assets has not been satisfied. In the fiscal year 2020-21 financing of fiscal deficit shows that the net market borrowing of the state government has increased as compared to the previous years. While, fiscal deficit has increased significantly in 2020-21, the outstanding debt did not rise to that extent because of using public account funds financing fiscal deficit

Simplifying Tax Policy and Administration

4.31 The FRBM Act requires the State Government to maintain integrity of the tax system by minimizing discretionary policies like special incentives, concessions and exemptions. It also emphasizes on pursuing the tax policy with due regard to economic efficiency and compliance cost. Taxes collected internally by the state does not constitute a major portion of total revenue receipts. It constituted on an average about 15.80 percent of total revenue receipts during the period 2015-16 to 2020-21. As percentage to GSDP, own tax revenue has been declining since 2013-14 (Figure 4.1). Decline in growth of own tax revenue in 2020-21 was due to slow down of the national and state economies in Covid-19 affected 2020-21.

4.32 One of the important features of a good tax system is to maintain stability and predictability in the level of tax burden. There have not been many changes in tax rate of individual State taxes. While, the VAT regime, introduced in 2005 had stabilized in terms of rate and base structure in the State, the GST has emerged as an important source of revenue for the government.

Figure 4.1
Own Tax Revenue



Expenditure Policy and Institutional Measures to Improve Quality of Expenditure

Expenditure Policies

4.33 The FRBM Act calls upon the state government to focus on economic growth, poverty reduction, and improvement in human development in allocating resources. The fiscal management principles also require the government to improve institutional framework to maintain physical assets, increase transparency, minimize fiscal risks associated with public sector undertakings (PSUs), and formulate realistic budget formulation to minimize the deviations during the course of the year. The achievement of these goals needs to be assessed over a long period.

4.34 In an earlier section we have shown emerging priority sectors of the state by analyzing relative expenditure shares of different sectors. While the interest payment, pension, and administrative services have remained important spending items, education, health, agriculture, rural development, transport, electricity, and water supply and sanitation and urban housing continue to be large spending departments in Sikkim. This spending pattern reveals the focus areas of the Government, which broadly includes rural, and agriculture sector and infrastructure.

4.35 Capital expenditure witnessed sharp decline in 2019-20 due to revenue concerns. The state government managed to improve the capital expenditure as percentage to GSDP as it increased from 2.27 percent in 2019-20 to 4.62 percent in 2020-21. Special assistance provided by the Union government played a key role in addition to expenditure restructuring carried out by the state government in improving capital expenditure.

4.36 The achievement of socio-economic development in Sikkim has been significant. The State economy has experienced substantial growth in recent years and the per capita income of the state has increased from Rs.2, 45,987 in 2015-16 to Rs. 4, 12, 754 in 2020-21 at current prices. The major socio-economic indicators for the State show commendable improvement. The poverty ratio has declined to 8.19 percent as compared to all India average of 21.92 percent in 2011-12. The literacy rate at 81.40 percent in 2011-12 is significant achievement. The IMR has gone down to 5 per 1000 in 2020 as compared to the all India average of 28.

Table 4.4
Socio Economic Indicators

Socio Economics Indicators	**Sikkim**	**All India Status**	**Other States**	
Decadal Growth Rate% (census- 2011)	12.89	17.7	8.2 (Goa)	25.42 (Bihar)
Rural-Urban ratio of Population (census-2011)	74.8: 25.1	69:31:00	52 : 47 (Kerela)	89:11 (Bihar)
Sex Ratio Females/1000 Males [NFHS 05- 2019-20]	890	1020	1121 (Kerala)	926 (Haryana)
Literacy Rates (%) (census-2011)	81.42	73%	93.91% (Kerala)	61.80% (Bihar)
Male Literacy Rate (%) (census-2011)	86.55	82.14	96.10 % (Kerala)	71% (Bihar)
Female Literacy Rate (%) (census-2011)	75.61	64.46	92.10% (Kerala)	51.50% (Bihar)
IMR [SRS- 2020] (per 1000 birth)	5	28	6 (Kerala)	38 (2nd highest in U.P., C.G.)

Socio Economics Indicators	Sikkim	All India Status	Other States	
Malnourished Children (% of underweight children under < 5 years [NFHS 5]-2020-21	7.2	32.1	12.3 (Mizoram)	39.4 % (Jharkhand)
Human Development Index (HDI 2021-22)	0.702	0.633	0.72 (Kerala)	0.5 (Bihar)
Percentage of Forest Area to Geographical Area (2021)	47.1	21.71	(84.53) Mizoram	3.63 (Haryana)
Percentage of Total Population Below Poverty Line (2011-12)-[RBI handbook-2022]	8.2	21.9	5.1% (Goa)	39.9% (Chhattisgarh)
Replacement Rate of Population (2020)	1.1	2	lowest in Sikkim (1.1)	3.0 (Bihar)
State-Wise Gross Enrolment Ratio- (2021-22) Primary (1 to 5)	106.2	103.4	112.5 (Telengana)	86.9 (Madhya Pradesh)
Upper Primary(6 to 8)	77.7	94.9	106 (Telengana)	86.0 (Bihar)
Elementary(1 to 8)	92.9	100.1	110 (Telengana)	88.7 (Madhya Pradesh)
Secondary (9 to 10)	89.1	79	97.9 (Kerala)	64.9 (Bihar)
Higher Secondary (11 to 12)	64.2	57.6	85 (Kerala)	35.9(Bihar)

Transparency in Fiscal Management

4.37 Fiscal transparency measures enunciated in the FRBM Act requires the state government to minimize the secrecy and disclose data and information relating to the fiscal operations. The rules to the Act specify the data and information to be disclosed along with the budget documents. However, thee disclosure statements containing data and information do not cover all aspects of budget management.

4.38 Transparency in public finances leads to comprehensive budgeting and financial information prepared consistently, which is accessible to users. The crucial features of transparency in financial management are comprehensive budget classification, budget documents covering all aspects of financial transactions of the government, minimal revenue sources and spending responsibility outside the budget, less discretionary element in transfers of resources to the state, and timeliness on information on transfers.

4.39 The PFM system at state level as that of at Union level in India with established institutional structure like budgeting, accounting, audit and legislative control systems has its root in the constitutional provisions. The state governments do not play substantive role in determining the contours of major institutional changes. The accounting standards are prepared by the CAG and the end of the year financial report – the Finance Accounts and Appropriation Accounts are prepared also prepared by the CAG. The state audits are also the responsibility of the CAG. The legislature in the state play a crucial role in budget management starting from approving the budget to securitizing the audit observations. Budget management procedures are established for setting policy agenda and implementing the budget. While fiscal information are prepared by the government are widely accessible to the public, the timeliness of producing and disseminating these information needs to be improved.

Budget Realism and Predictability

4.40 The state FRBM Act calls upon the government to formulate a realistic budget with due regard to the general economic outlook and revenue prospects and minimize deviations during the course of the year. Lack of predictability in fund flows resulting in discrepancies between intents and achievements poses risks to both existing and future program management. A realistic budget leads to implementation of programs as planned and this aspect of budgeting system shows the ability of the government to deliver public services as enunciated in government policies. Failure to implement the budgets as planned may result in shifting spending priorities, exceeding deficit targets, and compromising on critical service delivery promises.

4.41 Sikkim is heavily dependent on central transfers that includes share in central taxes and central grants. The pattern and timing of fund flow from the central government influences the spending. Many a times the expenditures planned in the budget go awry due to non-receipts of components of these funds and late receipt of grants towards the end of the financial year. Timeliness of reliable information on the allocation from the Central Government for the coming year helps the sub-national governments to take resource allocation decision and the actual flow determines the spending pattern. The capacity of the Government to implement the policies, structural bottlenecks, and hurdles posed due to legal and environment factors are other reasons for derailment of spending plans.

4.42 Unbiased revenue projections are crucial in the budget preparation process as the spending plan and the ability of the Government to provide services is based on this. Overestimating the revenues leads to unreasonably large resource allocations that would require either an unsettling reduction during the year or an unplanned borrowing to maintain spending plan. Overtly conservatism in revenue forecasts, on the other hand, results in utilization of the surplus revenue in projects and schemes that have not gone through the detailed scrutiny of the budget.

4.43 Governments do adjust their budget during the course of the year by presenting supplementary budgets. However, if budget amendments change the budget projections for various programs considerably then the sanctity of the budget will be lost.

4.44 Comparison of actual revenue generated and expenditure incurred with the original approved budget and the extent of deviation from the projections gives the measure of budget credibility. The deviations as percent to the budget projections in 2020-21 as performance indicator are given table 4.5 to measure budget credibility.

Table 4.5
Budget Estimates and Outturns for the year 2020-21

(Rs. Lakh)

	2019-20	**2020-21**	**2020-20 (BE)**	**Difference (Actual to BE – 2019-20)**	**Difference in % to BE**
Total Revenue Receipts	484127	560782	797324.51	-236542.35	-29.67
Own Tax Revenues	97040.47	96670.36	124190.70	-27520.34	-22.16
Own Non-Tax Revenues	69340.23	66229.03	71066.25	-4837.22	-6.81
Central Transfers	317746.35	397882.77	602067.56	-204184.79	-33.91
Tax Devolution	229556.00	230227.00	304262.00	-74035.00	-24.33
Grants	88190.35	167655.77	297805.56	-130149.79	-43.70
Revenue Expenditure	618507.61	636863.71	734359.63	-97495.92	-13.28
Interest Payment	50967.79	54840.77	56204.31	-1363.54	-2.43
Pension	91058.17	90813.20	95985.02	-5171.82	-5.39
Capital Expenditure	73737.71	151270.73	167562.62	-16291.89	-9.72
Capital Outlay	72060.93	151387.85	166399.15	-15011.30	-9.02
Net Lending	1676.78	-117.12	1163.47	-1280.59	-110.07
Deviation (Rs. Crores)					
Revenue Deficit	134380.56	76081.55	-62964.88	139046.43	
Fiscal Deficit	208118.27	227352.28	104597.74	122754.54	
Primary Deficit	157150.48	172511.51	119169.19	53342.32	
Outstanding Debt	740067.00	905884.00	859204.14	46679.86	

Source: Basic data – Finance Accounts and Budget Document for the relevant years.
Note: Negative sign for revenue deficit indicates surplus.

4.45 Budget credibility analysis taking into consideration, the deviations of budget outturns from budget estimates given in table 4.5 reveals the following result.

- The impact of Covid-19 pandemic is clearly visible in budget outturns as compared to the budget projections in 2020-21. Actual revenue receipts and spending fell short of budget projection considerably. The budget credibility suffered significantly in 2020-21 as the shortfall in revenue receipts affected the spending plan.
- While own tax revenue fell short of budget estimates by 22.16 percent, central transfer was less by 33.91 percent of budget estimates. In the central transfers, both the tax devolution and grants declined significantly as compared to budget forecast. As a result aggregate revenue receipts fell short of budget estimates by 29.67 percent. Such a large deviation from budget plan had its impact on both revenue expenditure and capital expenditure.
- Revenue expenditure fell short of budget estimates by 13.28 percent despite the fact that in Covid-19 affected year there was a need for higher spending to address pandemic related spending. Large deviation in revenue receipts adversely affected the revenue expenditure plan of the government.
- Capital expenditure was less by 9.03 percent as compared to budget estimates in 2020-21. Although, the government managed to improve upon capital expenditure as compared to the previous year by availing special assistance provided by the Union government, it was less than the budget plan.
- The state government ended up with a higher revenue deficit of Rs.1390.46 crore and fiscal deficit of Rs.1227.55 crores in 2020-21 as compared to the budget projections. While the government projected to generate a surplus in the revenue account and limit the fiscal deficit within the FRBM Act target, due to the large revenue shortfall, deficit targets could not be met.
- Outstanding debt exceeded the target by Rs.466.80 crores. As the budget projections were constricted given the uncertainties relating to revenue availability, additional borrowing facilities helped the government to expand the spending program and as a result the debt burden has increased more than what was planned in the budget.

Chapter 5: Concluding Remarks

5.1 The fiscal year 2020-21 posed considerable challenges to the state government. While revenue growth was subdued, the spending pressure continued to persist. Covid-19 pandemic brought in severe distortions to public finances in terms of shortfall in revenue receipts in 2020-21as compared to the budget estimates. Tax effort of the state suffered due to decline in economic activity during lockdown period. To compensate decline in central transfer of resources, flexibility was provided for additional borrowing, which increased overall liabilities. Compliance to the FRBM Act as a restraining fiscal instrument got diluted when additional borrowing was placed beyond limits provided under this Act.

5.2 Growth of national economy and state economy played crucial role in adhering to fiscal rules. Contraction of GDP by 5.8 percent and contraction of state economy by 2.32 percent affected flow of central resources and internal revenue generation in 2020-21. The composition of Sikkim's GSDP shows that both the primary sector and industry sector contracted in 2020-21 with negative growth rates. While the services sector managed to show a positive growth rate (1.72 percent), the growth rate was much leas that of the previous year (19.75 percent)

5.3 The aggregate revenue receipts showed a healthy growth rate of 15.83 percent in 2020-21 due to improvement in central transfers as compared to the previous year. This growth in a pandemic year needs to be seen in the context of a weak base witnessed in 2019-20. In 2019-20 the aggregate revenue receipts contracted by a massive 18.23 percent. Despite the improvement in the revenue receipts in 2020-21, it contracted by 5.28 percent as compared to the fiscal year 2018-19. The revenue receipts in 2020-21 in nominal numbers remained less than that of the fiscal year 2018-19. Thus, the fiscal management in the state and adherence of FRBM Act in 2020-21 had to bear the brunt of Covid-19 related imbalance and severe decline in revenue receipts experienced in 2019-20.

5.4 The decline in central transfers in 2019-20 continued to haunt the state finances as this is the major source of revenue for the state. Central transfers relative to GSDP to the state show linear downward trend since 2011-12. While annual average transfers from the center during FC-XIV award period was 15.77 percent of GSDP, it declined to 9.79 percent of GSDP in

2019-20. The improvement in 2020-21 to 12.16 percent relative to the GSDP remained less than that of the16.29 percent achieved in 2018-19. The improvement in 2020- 21 over the previous year was mostly due to receipt of Finance Commission related transfers. Overall the central transfers in 2020-21 contacted by about 9 percent as compared to the fiscal year 2018-19.

5.5 Own revenue receipts, which accounts for a quarter of aggregate revenue receipts, continued to remain subdued in 2020-21. Growth of own revenue contracted by 2.09 percent. Both own tax revenue and own non-tax revenue experienced negative growth rate in 2020-21. As percentage of GSDP own tax revenue declined from 2.99 percent in 2019-20 to 2.95 percent in 2020-21 and own non-tax revenue declined from 2.14 percent to 2.02 percent. Own tax buoyancy of the state in 2020-21 remained significantly low reflecting Covid-19 related problems.

5.6 Despite muted revenue performance, government spending both in revenue expenditure and capital expenditure increased in 2020-21. The state had to expand revenue expenditure to address the pandemic related spending pressure. As the revenue expenditure constitutes about 82 percent of total expenditure, its trend become important in overall spending plan. The revenue expenditure increased from 19.05 percent in 2019-20 to 19.46 percent in 2020-21. Expenditure in health, social welfare and nutrition, and water supply, sanitation and urban sector demonstrated maximum growth. Capital expenditure witnessed large growth in 2020-21 as compared to the previous year. Capital expenditure as percentage to GSDP increased from 2.22 percent in 2019-20 to 4.63 percent in 2020-21. In nominal terms, it increased from Rs.737.78 crores in 2019–20 to Rs.1512.71 crores in 2020–21, which accounts for a more than 2-fold rise. The push given by the Union government and flexibility provided to states for additional borrowing for capital expenditure seems to have positively influenced capital expenditure.

5.7 The Union government provided the flexibility to increase the fiscal deficit from 3 to 5 percent of GSDP by increasing the borrowing limit as part of central government package in the wake of Covid-19 pandemic. The flexibility allowed the states to increase their borrowing, which was partly unconditional and partly conditional linked to undertaking specific reform measures. Government of India has also provided assistance under “Scheme for Special Assistance to States for Capital Expenditure”. Funds under this scheme was expected to help the states to manage ongoing capital projects, which could be stuck due to resource problem. Expansion of capital expenditure by the Government of Sikkim was facilitated by the additional borrowing during 2020-21.

5.8 The state government, while justifying the additional borrowing given the resource problem, opined in their amendment to the FRBM Act in 2020 that there was a need to balance the additional debt against the long term fiscal sustainability. The government hoped that the excess borrowing undertaken would not put pressure on future fiscal management. There is a need to improve future GSDP growth for revenue augmentation and rationalize spending pattern to reduce unproductive expenditure. The recovery of GSDP growth to 8.57 percent in 2021-22 from a negative growth of 2.32 percent witnessed in 2020-21 augurs well will for the state and is expected to improve overall revenue situation of the government.

5.9 Slow growth of revenue receipts, the need to expand expenditure in a pandemic year and expansion of capital expenditure by resorting to higher borrowing, resulted in breaching fiscal targets stipulated in FRBM Act. Against a target of generating surplus in the revenue account, there was a deficit of 2.32 percent and the fiscal deficit increased to 6.95 percent as against the target of 5 percent allowing the additional borrowing facility. The debt GSDP ratio increased to 27.68 percent in 2020-21. This level of debt-GSDP ratio exceeded the indicative debt-GSDP path worked out by FC-XV at 27.4 percent for Sikkim, which was based on the expectation that the state would avail the additional borrowing facility.

5.10 The disruption caused by the Covid-19 pandemic in the public finances of the country made it difficult to comply with the FRBM Act targets. The targets to get back to fiscal consolidation path for the Union government was extended until 2025-26. State governments faced severe revenue constraint and breached their fiscal responsibility legislation targets. FC-XV charted out fiscal consolidation roadmap for both the Union government and states starting from the fiscal year 2021-22. According to this, states were expected to get back to the fiscal consolidation path by 2023-24. According to the FC-XV, the impact of the contraction in 2020-21 would continue to be present in the borrowing limits of the states for the years 2023-24 and 2024-25 also. The recovery in growth process, according to the Commission, most likely would counterbalanced the impact of borrowing requirements.

5.11 As the recovery of growth process in Sikkim has already started in 2021-22 and the Union government continues to provide special assistance for capital investment, the state is expected to address the fiscal imbalance problem and adhere to the FRBM Act provisions. The state government has made it clear in their amendment to FRBM Act in 2020 that the state needs to improve its revenue effort and get back to long term fiscal consolidation process.