National Institute of Public Finance and Policy, New Delhi

A Compendium

State Forum 2024

26-27 September 2024

ISBN978-81-985527-3-0

STATE FORUM 2024

A COMPENDIUM

26-27 September 2024

National Institute of Public Finance and Policy, New Delhi

ISBN 978-81-985527-3-0

Email: policy.communications@nipfp.org.in

Printed by: ICHISEKAI COMMUNICATIONS PVT. LTD.

B-1, Upper Ground Floor,

Property No: 1663/3

Khasra no: 1151/3, Ward No 6,

Mehrauli,

New Delhi – 110030

Email: iseki.comm@gmail.com

CONTENT

Day -1

Day -2

2ND STATE FORUM ON INNOVATIONS IN STATE FINANCES

VENUE: VICEROY HALL, HOTEL CLARIDGES

12 APJ ABDUL KALAM ROAD, NEW DELHI – 110001

AGENDA

SEPTEMBER 26TH 2024, THURSDAY

Day 1 Theme: Emerging Issues in State Finances

04:00 – 05:00 Registration & Hi-Tea

SESSION 1 & 2 (05:00 – 7.30) State of State Finances

- ***Welcome: Dr R. Kavita Rao, Director, NIPFP***
- ***Opening Remarks***
  Mr. Hoon Sahib Soh, Practice Manager, Equitable Growth Finance & Institutions, South Asia Region, The World Bank
- ***Inaugural address***
  Shri Tuhin Kanta Pandey, Finance Secretary, Ministry of Finance, Government of India
- ***Presentation by NIPFP*** *- Overview of State Finances*
- ***Q&A***

Dinner 7.30 pm onward

DINNER AT HOTEL CLARIDGES

SEPTEMBER 27TH 2024, FRIDAY

Welcome Tea (09.00- 09.30)

Day 2 Theme: Challenges & Innovations

SESSION 3 (09.30 – 11.30) Challenges in Utilisation of Central Grants

Chair: Shri Sajjan Singh Yadav, Additional Secretary, Department of Expenditure, Ministry of Finance, Government of India

- ***Presentation by NIPFP -***
- ***Presentation by Mizoram***
  Mr. Lalhmingmawla Sailo, Addl. Secretary, and Mr. C Lungmuanpuia, Deputy Secretary, Finance Department, Government of Mizoram
- ***Presentation by Uttar Pradesh***
  Shri Deepak Kumar, Additional Chief Secretary (Finance) and Shri Samir Verma, Special Secretary, Government of Uttar Pradesh
- ***Q&A***

Tea break (11.30- 11.45)

SESSION 4 (11.45 – 01.45) Fiscal Rules, Sustainability and Growth

Chair: Dr. Manoj Govil, Expenditure Secretary, Ministry of Finance, Government of India

- ***Presentation by the World Bank***
  Shri Tanvir Malik, Economist, The World Bank
- ***Presentation by Telangana***
  Sri Sandeep Kumar Sultania, Principal Secretary, Government of Telangana
- ***Presentation by Maharashtra***
  Shri Saurabh Vijay, Principal Secretary (Expenditure), Government of Maharashtra
- ***Q&A***

Lunch time presentation (02.00 - 03.00)

Lunch time presentation by the World Bank on Data Visualisation by Ms. Emilia Skrok, Practice Manager, MTI Global Practice, and Shri Rishabh Choudhary, Economist, MTI Global Practice, The World Bank

SESSION 5 (03:00 –05:00) Innovations by States

Chair: Shri M.P. Tangirala, Additional Secretary, Department of Financial Services, Ministry of Finance, Government of India

- ***Presentation by Andhra Pradesh***
  Shri Noorul Quamer, Deputy Secretary, Finance Deptt, Government of Andhra Pradesh
- ***Presentation by Odisha***
  Sri Hrudaya Kamal Jena, Additional Secretary (Finance), Government of Odisha
- **Presentation by Karnataka**
  Shri L.K. Atheeq, Additional Chief Secretary (Finance), Government of Karnataka
  Q&A

VOTE OF THANKS

Summary of Deliberations at the State Forum, September 26-27, 2024

The second edition of the State Forum, organized during September 26-27, 2024, was an interesting interaction. The event brought together policy analysts, policy makers and executors to understand the evolving experiences of States. While seven states were invited to present, seven other states joined in the discussions. A significant step towards creating a platform for sharing knowledge about State Finances and State Innovations.

States are an important element in the fiscal landscape in India. States account for 60 percent of total expenditure in the country and close to 40 percent of total revenues. The significant divergence between own receipts and expenditures captures the dependence of States on resource transfers from the Union Government. While fiscal discipline has been institutionalized through the enactment of FRBM legislations for the Union and State Governments, the COVID pandemic posed caused significant disruption. There are two important challenges that have emerged in this period – first, there is consistent expansion on the demand for government support both in cash and kind. The Union government has extended the free food programme for five years. Competition among political parties have expanded the scope for benefits to citizens, in the form of free power, free transport(bus) and cash transfers for some segments of the economy. On the other hand, there is little evidence of convergence in the growth of different states.

This context provided the background for two issues for discussion at the Forum – "fiscal rules, sustainability and growth" raised questions about the need and scope for some variability and flexibility in the fiscal rules for states, in order to augment their capacity to support sustained and enhanced growth. Telangana and Maharashtra presented a case for finding ways to stretch the boundary so as to address the needs of the people of the state. A presentation by Tanvir Malik of the World Bank also flagged some challenges emanating from uniform fiscal rules.

Given the considerable flow of funds from the Union to State governments, the other taken up for discussion relates to the challenges in utilization of Central Grants. While NIPFP presented sectoral issues for health and education and issues relating to finance commission grants, Mizoram and Uttar Pradesh presented the perspective of the states. The need for some flexibility once again came to the fore.

The State Forum is conceptualized as a space for sharing analysis, ideas and innovations in this space. Apart from presentations on the identified topics, Andhra Pradesh was invited to speak about pension reforms, Karnataka spoke about innovations in asset monetization and Odisha spoke about innovations in public financial management.

Presented below is a summary of the presentations and deliberations During the FORUM.

DAY 1: EMERGING ISSUES IN STATE FINANCES

SESSION 1: Inaugural Address by Shri Tuhin Kanta Pandey, Finance Secretary, Ministry of Finance, Government of India

Welcome Remarks: Dr. R. Kavita Rao

The first session of the 2nd State Forum on Innovation in State Finances was opened by **Dr. R. Kavita Rao, Director, National Institute of Public Finance & Policy.** The state forum has been set up by

NIPFP to explore issues of interest for States, largely focusing on finances of States. There are seven states who have chosen to present their ideas and thoughts during the course of the 2nd state forum on 26th and 27th September, 2024.

Mr. Hoon Sahib Soh, Practice Manager, Equitable Growth Finance & Institutions, South Asia Region, The World Bank, gave the opening remarks, welcoming participants and highlighting The World Bank's appreciation of this opportunity to continue to support the National Institute of Public Finance and Policy in organizing the State Forum. The World Bank underscored its knowledge partnership with NIPFP to promote knowledge Exchange in India. Dr Soh pointed out that focus on States is important because they are on the frontiers of economic reforms in India. They are responsible for delivering major public services including about 85% of Education spending, 66% of Health spending, and over 50% of General government. Dr Soh focused on states' debt levels and fiscal sustainability in the aftermath of the pandemic. The World Bank is actively engaged in supporting India to address such challenges at both the national and subnational levels through analytical tools to help address key fiscal priorities and issues identified by the states including revenue reforms and fiscal consolidation options in Punjab Tax Administration, reforms in Assam, Rajasthan, and Punjab, medium-term fiscal framework in Chhattisgarh, Public Investment Management assessment in Tamil Nadu and Odisha, and debt management performance assessments in Uttarakhand and Himachal Pradesh. Dr Soh highlighted that the World Bank's analytical tool facilitates analysis of tax gaps, equalization of Finance commission transfers, off budgeting borrowing, drivers of growth, trade and global value chains, management of public finances, among others.

Shri Tuhin Kanta Pandey, Finance Secretary, Ministry of Finance, Government of India, was invited to deliver Inaugural address. Shri Pandey began his talk by summarizing some of the important changes in the public finance management system in the country. Drawing on his considerable experience in working with the Government of Odisha, in erstwhile Planning Commission and in Government of India, he highlighted some important reforms in the management of public resources in India. Beginning with integration of budget by the elimination of plan-non-plan distinction, the introduction of PFMS, the introduction of the nation-wide ID in the form of Aadhar, which became the basis for Jam Trinity, Shri Pandey was closely associated with these initiatives. Each of these measures was instrumental in improving the efficiency of resource use in the country. The PFMS, he mentioned, allows for effective tracking of money flows to various implementing agencies, allowing for better utilization of available resources and by improving productivity of expenditure by removal of wastage. Turning to the JAM trinity, he emphasized the significance of a number of key digital public infrastructure initiatives like Aadhar and UPI. The extensive use of UPI payment systems by even the smallest vendors in the country has positively impacted lives of people in the country. Another major initiative he drew attention to is the design and implementation of GST in India – a one of kind regime in the world, especially in a federal system. The regime represents cooperation between Centre and States – they pooled their sovereignty and implemented a regime, which allowed for the integration of the country into a common market.

Another important development Shri Pandey focused on, was the series of reforms to institutionalize fiscal responsibility through reforms during the period 2002 to 2005. Both Centre and States have been improving their deficits and their Debt to GDP ratio. COVID Pandemic did disrupt this process globally with significant increase in deficits and debt, and subsequently there is a correction being witnessed. In its efforts to maintain fiscal discipline, the central government is also focused on providing realistic estimates – even conservative estimates – to ensure that budgeted fiscal deficit and revenue deficit are adhered to. As a part of the efforts to improve transparency in the budgeting process, the Central Government has been focused on eliminating off-budget elements. However, general government debt is still at elevated level 82% of GDP, and the objective is to achieve moderation in debt levels without affecting growth.

In addition to fiscal responsibility, Shri Pandey emphasized the government's commitment to improved quality of expenditure by bringing capital expenditure on the forefront and thus making sure that it is growth enhancing expenditure. States, he pointed out, are reporting decline in outstanding liabilities and are supporting the efforts to raise capex and support job creation. The information from the last budget illustrates the importance accorded to CAPEX where Central Government has proposed capex of 3.4 percent of GDP, augmented further through investments by the various agencies, including states and public sector undertakings.

Shri Pandey suggested that States have an important role to play in supporting capital investment growth in the economy. He acknowledged that States do have limitations in raising capex since they have a mandate to spend on social sector, most of which requires revenue expenditure. He further flagged concerns regarding high level of committed expenditures as a percent of revenue receipts, which can limit the space available for other policy actions. In particular he drew attention to significant inter-state variations – committed expenditure to revenue receipts vary from over 70 percent for states like Haryana, Maharashtra, Telangana, Tamil Nadu, Kerala and Karnataka, with others like Bihar and Jharkhand at less than 50 percent.

On the revenue front, he mentioned that buoyancy of state taxes had improved – tax to GDP ratio has increased from 5.7 percent in 2003-04 to 6.9 percent in 2022-23. Today at State Forum, there is need to discuss the possibility of innovation in non-GST taxes, local taxes like property taxes and user charges to improve the revenue profile of states. Another such source to explore could be monetization of assets and disinvestment.

On the expenditure side, one persistent challenge relates to the power sector. There is need to balance concerns of viability of power utilities requiring timely increases in the tariffs and the need to provide electricity at reasonable cost to vulnerable sections of the population. Smart metering and pre-paid metering have helped in reducing AT&C losses reflecting in a reduction in under-recovery from 69 paise per kilowatt hour in 2020-21 to 22 paise in 2021-22.

Given this background, he spoke about some of the new initiatives that Government of India is exploring and states too could explore. The first component he spoke about was asset recycling through asset monetization. InVits and Reits are two categories of instruments that are now being used to aid in asset recycling. For assets with clearly defined returns, once the returns have stabilized, it is possible to issue units against them and big investors like Pension funds are happy to invest. This releases resources for investing in other assets. NHAI and Powergrid Corporation are using this route for toll roads and transmission projects through Invits. He mentioned emerging alternative hybrid annuity models where private sector could even share in some of the construction risk and the traffic risk. FCI was another example mentioned – where FCI offers land and private sector constructs the silos in return for a revenue stream.

Another approach is land monetization. Government of India worked with World Bank to develop our own version of National Land Monetisation Corporation. It is a GOI owned PSU. To facilitate this process, a series of tax changes too have been introduced. The law now allows for the creation of a mirror company of the original company with unutilised land assets. The land assets are moved into the mirror real estate company which can then monetize the assets more effectively. Shri Pandey stressed on the important of land as an asset and referred to Hong Kong's model of development to point out the potential gains from effective monetization of underutilized land.

A second dimension Shri Pandey mentioned is the possibility of raising resources by listing well managed companies or alternatively to strategically privatize them. Government of India has 81 listed entities with a combined market cap of Rs 70 trillion – where value has increased substantially over last few years. For these CPSEs, the government no longer needs to put in money for their investment – they can raise money from the market.

Another issue of importance Shri Pandey alluded to is issues of urban management. Cities are the growth engine for the economy going forward. They are generating economic activity and jobs. There is need to provide good traffic, better designed and maintained civic amenities. But Cities are resource constrained. States have a large role to play here. He highlighted the need for innovative ideas including the need to increase floor are ratios to better utilize available land. He suggested that India has to go up - there has to be vertical development of course with due concern with our climate and other issues. Particularly because agriculture and production of food grains too needs to be protected in order to feed our people – relying on imports is not an option for a large country such as ours. It is to be recognized that all of this requires planning to ensure provision for movement of traffic – alternative transit models too can be explored.

The discussion began with a question from Dr R Kavita Rao. She raised a query about the need for integrated planning for effective use of vertical development. Incremental approach to expansion of cities might not allow for development of adequate and suitable infrastructure to be developed. Shri Pandey acknowledged the issue and further flagged that vertical expansion of cities is happening – so legal and some illegal – and suggested that increase in FAR provides the space to undertake significant restructuring of urban areas including providing for affordable housing. Given that cities are expected to be the growth engines of the country, proper development of cities needs adequate focus.

Dr M Govinda Rao commented that in discussions on Union and State Finances – predominant macro-stabilisation function is with the Union government. Today there is a lot of worry about State deficits with little focus on their performance in education, health, urban development and so on. Further, there is need for a coordinating mechanism for conflict resolution and for regulating competition. These are important issues that need attention too. Shri Pandey acknowledged that these are important issues but pointed out that the lack of adequate resources too poses a problem for states to achieve progress on these fronts. Sustainability therefore is of great importance. Odisha undertook many reforms programmes, some with assistance from World Bank to pull itself out of a fiscal crisis. Further, Odisha was once considered among the poorest states in the country. The government had to judiciously invest to create growth impulses in the state – providing infrastructure for rural roads and electricity for one important focus of the government. Another issue to note is that Odisha being a mineral rich state – there are windows of opportunity that emerge. An upswing the metal cycle for instance provides an opportunity by providing buoyant mineral revenues. The issues therefore are multi-dimensional.

Mr Anurag Goyal, a Senior Adviser at NITI sought some insights in possible measures for improving efficiency of government expenditures, especially at the state level. Shri Pandey suggested that transparency and improvement in costing of new programmes – both in terms of capex and opex is necessary to ensure proper budgeting and remove the need for adhoc cuts in the face of fiscal stress. He mentioned the need to focus both on quality of service and volume of service. He mentioned that new programmes are often poorly costed, which does not allow for a rational discussion on the feasibility of the scheme. Once introduced, to make space for proper roll-out, some other schemes often face a cut, which could have unintended consequences.

Dr Soh pointed out that in addition to the above, for analyzing efficiency of expenditure, some other issues too might be relevant: for instance, one might want to look at subsidies and explore whether they are properly targeted. Another issue of relevance can be the extent of rigidity in expenditures – if high share of wage bill in total expenditure accounts for this rigidity, some civil service reforms might be explored. The issues can be context specific.

Neha from the World Bank observed that states would look to the Centre for guidance on new and evolving forms of revenue mobilization. Are there any plans for bringing in any model asset monetization policy to help states formulate their own policies? Shri Pandey mentioned that some initiative was undertaken a couple of years back, with some incentivizing, but did not find traction. Perhaps it was not yet time for this idea – divestment and privatization were still viewed skeptically. One route is for strategic or selective privatization of companies – for this, states should have such assets to sell, that is well managed commercial organisations. Many companies of state governments are meant to provide services to the people at moderate costs – these are not suitable for privatization. The other option is to go for PPP arrangements – different kinds of concession agreements can be explored. There is some success for such arrangements in the case of Ports and Airports. In other areas, we have not found much traction with states.

Dr Sukanya Bose, Associate Professor of NIPFP observed that capex has become top priority. Could social infrastructure too be considered as growth generating and how will this change the story? Second, are there likely to be long term consequences of land monetization and asset monetization on the capital markets and the macro-economy? Could these lead to bubbles in the stock market? Shri Pandey acknowledged the importance of social infrastructure and human capital formation but located this in the context of the budget constraint faced by governments in developing countries. He argued that high taxes are no longer acceptable, which might be necessary for attaining these goals. He made a reference to Nordic countries where state plays a large role and is viewed as efficient. He emphasized on the need for a suitable balance between the role of the state and the role of markets or capitalism.

The session was followed by presentations by **Sk Md Azharuddin, Economist, NIPFP, Dr. Resham Nagpal, Assistant Professor NIPFP, and Dr. Piyali Das, Assistant Professor NIPFP,** on the Overview of State Finances, specifically, on taxes, on the trends in expenditures and on the deficits and debts debt picture that's emerging from this whole discussion, respectively. These papers examine the trends over the period 2017-18 to 2024-25 divided into three sub-periods: pre-COVID (2017-18 to 2019-20); COVID period (2020-21 to 2021-22); post-COVID period (2022-23 to 2023-24 RE). States are analysed in two groups: Category-I (states other than North Eastern and Himalayan States) and Category-II (North Eastern and Himalayan (NE&H) states).

SESSION 2: State of State Finances

Chair: Shri Tuhin Kanta Pandey, Finance Secretary, Ministry of Finance, Government of India

Mr. Azharuddin presented an Overview of State Revenue Receipt in India: A Comprehensive Analysis through the Pandemic Lens. The study presented the impact of Covid-19 pandemic on Total Revenue Receipts (TRR), Own Revenue Receipts (ORR), and Central Transfers across the pre-COVID, COVID, and post-COVID phases. Following the historical trend, Category-I states exhibit a stronger reliance on own revenue sources, with ORR being a major component of their TRR, while Category-II states remain more dependent on central transfers. Both categories faced a decline in ORR during the pandemic due to the economic slowdown, COVID-related lockdowns, and disruptions from the introduction of the Goods and Services Tax (GST). For Category-I states, central transfers partially compensated for the decline in own revenues, while for Category-II states, central transfers more than offset their revenue losses during the Covid-19 period. Post-pandemic, GST played a crucial role in the recovery of own tax revenues (OTR) in both categories, where it contributed significantly to ORR growth. Own non-tax revenue (ONTR) experienced a sharp decline for both the state categories during the post pandemic period. The findings revealed a clear disparity in fiscal capacities, with Category-I states showing a stronger recovery in revenue generation, while Category-II states remained heavily reliant on central transfers. The study underscores the varying fiscal responses and revenue dynamics between the two categories during the pandemic and recovery phases.

Dr Nagpal's paper assessed the trends and composition of State's expenditure to understand the impact of COVID-pandemic. The analysis showed that the COVID-19 pandemic significantly impacted the fiscal health of Indian states, necessitating a shift in expenditure priorities. While revenue expenditure growth slowed during the pandemic, capital expenditure growth became negative. After the pandemic, both revenue and capital expenditure have begun to recover, with capital expenditure showing a more pronounced improvement. Although the Union government's 50-year interest-free loans were intended to stimulate capital expenditure, they do not appear to have been the primary driver of this increase. States seem to have undertaken capital spending on their own accord as well. At the state level, Category II states generally exhibited higher levels of both capital and revenue expenditure as a percentage of GSDP compared to Category I states. Furthermore, Category I states demonstrated a negative correlation between both capital and revenue expenditure as a percentage of GSDP and per capita GSDP. This implies that states with lower per capita GSDP, such as Bihar, Jharkhand, Uttar Pradesh, Odisha, and Chhattisgarh, put aside higher share of their GSDP for capital expenditure. In contrast, Category II states do not exhibit a clear relationship between these variables. Since the pandemic, many Category II states have shown substantial improvements in both capital and revenue expenditure. However, Category I states have remained relatively close to pre-COVID levels, with only minor improvements. The composition of expenditure has also evolved. With a greater emphasis on health and welfare initiatives, the share of social services in both revenue expenditure and capital expenditure stands higher for both categories of states.

Dr Das's presentation analyzed state finances in terms of fiscal and revenue deficits, interest payments, and debt position of Indian states from 2017-18 to 2024-25BE. Key findings reveal that during the period under review, both Fiscal and Revenue Deficits (as a share of Gross State Domestic Product (GSDP)) show uneven recovery from the peak during COVID-19 pandemic. While post-COVID reduction in Fiscal Deficit as a share of GSDP (FD/GSDP) was not consistent, it remained higher than pre-COVID levels in 2024-25BE. Category 2 states consistently showed higher FD/GSDP than Category 1 states, except during the COVID year. Revenue Deficit as a share of GSDP (RD/GSDP) for Category 1 states showed revenue surpluses for most years, contrasting with Category 2 states, which remained in deficit. Compared to 15th Finance Commission targets, states overall are unable to meet the FD/GSDP and RD/GSDP targets.

With regard to liabilities and interest payments the trend is similar to that of fiscal and revenue deficits. Liabilities (as a share of GSDP) show a sharp rise during the COVID-19 period but the post-COVID decline was gradual. Category 1 states generally had higher liability ratios than Category 2 states. Interest payments as a share of GSDP decreased following the COVID-19 surge but remained higher than pre-COVID levels in 2024-25BE for Category 2 States. Category 1 states consistently demonstrated a lower interest payment burden than Category 2 states.

Post-COVID recovery on the fiscal front has been uneven across states and categories, with several states struggling to reduce their fiscal deficits. Many states have not met the 15th Finance Commission's targets for fiscal and revenue deficits. Regional disparities exist so that Category 1 states face unique challenges related to revenue generation and fiscal capacity owing to high fiscal deficit, and Category 2 states face higher revenue deficit.

The Chair invited comments and questions from the floor. Dr Govinda Rao suggested that in discussing grants in aid, a distinction should be made between Finance commission's Devolution and grants versus the non-finance commission grants because one is discretionary and the other is not. He also suggested that it would be interesting to explore the extent to which centre’s zero-interest loan programme substituted or complemented the States’ own capex programme. Further, to understand the fiscal picture of states, it would be useful to look at not only revenue deficit and fiscal deficit, but also primary deficit.

Dr Emilia Skrok from the World Bank suggested that in analyzing revenues, since states do not have autonomy in GST regime, for own tax revenues, it would be interesting to look at GST and non-GST revenues separately. In terms of fiscal autonomy, the latter would represent purely states own revenue. Dr Azharuddin indicated that with this decomposition, for both categories of states, GST has increased, but non-GST tax revenues have declined as a percentage of GSDP.

Dr Pinaki Chakraborty of NIPFP had a few suggestions: First, it would be interesting to look at the contingent liabilities of states to explore how many guarantees have been invoked. This would be important for fiscal transparency. Second, a state wise analysis on which states are spending on capex and which are constrained by high revenue deficit would be useful to understand whether, at the state level, there is substation evident between centre’s interest free loan and state capex.

Dr Sacchidananda Mukherjee Professor, NIPFP had a few comments. First, it would be interesting to understand the reasons for increase in fiscal deficit in category 1 states in the post covid period. Second, in analyzing liabilities, GST back to back loans should be corrected for, since the liability to repay lies with the Union Government. Third, 2019-20 is a fiscally bad year. Including or excluding this year from the period of analysis can change the conclusions we arrive at.

Shri Tanvir Malik from World Bank observed that it would be interesting to explore the impact of revenue deficit grants on the performance of states, especially since fiscally stressed states pre-COVID received the largest grants. On the non-reliability of revised estimates and budget estimates, he explored the possibility of using provisional estimates provided by CAG as an alternative.

Shri Sameer from Uttar Pradesh referred to the slide on the relation between per capita GSDP and capital expenditure to GSDP which captured a negative relation. He sought to understand the reason for the observed trend – particularly for developed states spending less on capex. Dr Reshal Nagpal suggested that the driver for this could be a greater focus on fiscal prudence in the high income states and perhaps some economies of scale in capex for these states. Taking this discussion further, Shri Sameer suggested that states with higher capacity to spend on capex should be allowed to borrow more and not be constrained by uniform limits. Dr Kavita Rao suggested that while states would find the argument for variable fiscal deficit targets attractive, it would be difficult to build a consensus on any formula for variability. Dr Govinda Rao elaborated on the history of the 3 percent target for deficit and observed that if variability is allowed, an inherent contradiction emerges: poorer states would have higher needs for deficit but would have smaller capacity for to service debts. Regional disparities would get augmented.

DAY 2: CHALLENGES AND INNOVATIONS
SESSION 3: Challenges in Utilization of Central Grants
Chair: Shri Sajjan Singh Yadav, Additional Secretary, Department of Expenditure, Ministry of Finance, Government of India

The first session on Day 2 of the State Forum was chaired by **Shri Sajjan Singh Yadav, Additional Secretary, Department of Expenditure, Ministry of Finance, Government of India.** Shri Yadav highlighted the importance of sharing ideas and learning from one another and emphasize the value of collaboration among states and academia. Shri Yadav discussed the significant flow of funds from the central government to state governments, noting constitutional provisions that grant the center more revenue collection powers while states handle more expenditures. He outlined various funding mechanisms, including centrally sponsored schemes and grants from the finance commission, which total around 5 lakh crores annually and are increasing. Challenges faced by state governments include scheme design, capacity issues, and matching fund requirements. The speaker anticipates that colleagues will address these challenges in more detail during the session.

The first presentation of session 3 was delivered by NIPFP. The speakers were **Dr. Manish Gupta, Associate Professor, NIPFP, Dr. Mita Chaudhary, Professor, NIPFP, and Dr. Sukanya Bose, Associate Professor, NIPFP.**

Dr. Manish Gupta focused on Finance Commission grants. To begin with he highlighted the fact that although a large number of grants have been recommended by Finance Commissions, they account for a small proportion of total transfers recommended by Finance Commission. The share of Finance Commission grants in total central transfers to states too is low. Pre-devolution deficit grants, local body grants and grants for disaster management account for a sizeable portion of Finance Commission grants and the share of sector specific and state specific grants is small. The utilisation of grants at the state level shows that in some sectors it was as low as 50 percent. The utilisation of grants was observed to be lower for North-eastern and Himalayan states. Further, the sector specific grants recommended by Finance Commissions are very small as compared to states' revenue and total expenditure on the respective sectors. Almost all states have raised concern over the growing trend of attaching conditionalities to the grants, which adversely affected the overall utilisation of these grants. Stringent conditions attached to the release of grants were responsible for the utilisation of grants remaining low. They pointed out that in addition to the conditions set out by the Finance Commissions, the Ministry of Finance and other Union ministries and departments stipulate their own conditions. The state memoranda articulate the view that the Finance Commission should ring-fence its conditions so that no additional conditions for the release of grants can be imposed by the different Union ministries. Overall, majority of States felt that conditions, if required, should be minimum, pragmatic and implementable. This give rise to the question: are the states being paid too little money in the form of grants and being asked for too much in the form of performance? Especially drawing from the fact that despite a rise in the number, scope, and coverage of Finance Commission grants over time, their percentage in the share of total Finance Commission transfers has stayed low. The analysis suggests that given the complexities in utilization of grants, conditionalities attached, the dimensions of the grants maybe too small to introduce significant behavioural change in the states.

Following Dr Gupta's presentation, Shri Yadav put forward a few clarificatory comments. In the context of the 15th Finance Commission recommendation, Shri Yadav mentioned that in the action taken report, the government has accepted all the recommendations subject to the availability of resources. Second, on introduction of additional conditionalities, he observed that no additional conditionalities have been introduced. He further mentioned that states have been using the grants for sector specific purposes to manage their cash balances. So timely transfer of the resources to the targeted institutions is not happening. Some discipline on this front is being introduced.

Dr. Mita Chaudhary spoke on Budget Utilization under Centrally Sponsored Schemes: The Case of Health Sector. Utilization of funds under Centrally Sponsored Schemes (CSS) can be measured in two ways. The first way is to examine Actuals to Budget Estimates (B.E.): this ratio shows the amount released to state governments compared to the allocated budget. However, in many of the schemes, the state is not the implementing agency. The second measure could be constructed taking into account final expenditures by implementing agencies: here one would consider actual spending against the combined allocations from both the Centre and states. Due to limited availability of data on final expenditures, the first measure is more commonly used.

Recent data reveals that while major schemes like the National Health Mission (NHM) and Ayushman Bharat (AB-PMJAY) have nearly 100% release rates, other schemes like the Pradhan Mantri-Ayushman Bharat Health Infrastructure Mission (PM-ABHIM) and Human Resources for Health and Medical Education (HRHME) show lower performance. Despite NHM's high release rates, actual fund absorption at the state level was under 60% for 2017-18 and 2018-19.

Several factors impact fund utilization under the PM-ABHIM components: AB-HWC Component: About 60% of funding comes from health grants recommended by the 15th Finance Commission, but only 45% of these grants were utilized between 2021-22 and 2023-24 due to a complex execution structure; Block-Level Units and Laboratories: Establishing block-level public health units and integrated district laboratories faced challenges in reorganizing existing structures, which slowed fund utilization; Critical Care Hospital Blocks: Building these facilities involves complex construction procedures. Even when funds are utilized, ongoing financial commitment from states will be needed beyond the PM-ABHIM scheme's support period (up to 2025-26). States must plan for recurring costs to maintain the infrastructure, crucial for maximizing the investments made. Overall, effective planning and commitment from state governments are essential for sustaining the benefits of these investments.

Dr. Sukanya Bose spoke on Utilisation of Funds under the major Centrally Sponsored Schemes in School Education. The presentation uses information from Utilisation of Samagra Siksha Abhiyan(SMSA) and Mid-Day Meal scheme (MDM) to present an analysis of the issues in utilization of CSS for school education in 12 states. These two schemes together account for 90 percent of grant in aid for school education. One important challenge for analysis, the paper points out, is the decline in data availability in recent years. The paper advocates the case for better data dissemination: transparency resulting from consistent availability could be critical for building accountability in the system. CAG should request the state governments to consistently report data on CSS's allocation, releases and expenditure as part of Finance Accounts.

The presentation goes on to look at the utilization ratios under the SMSA and MDM schemes. For SMSA, for available information for 2023-24, the utilization ratio is 78 percent for the states for which data is available. A significant observation made is that when compared to utilization in the earlier scheme of Sarva Siksha Abhiyan, the utilization shows marked improvement. Utilization of recurring expenditure is high (average of 87%) but the same cannot be said for non-recurring expenditure (average of 24%). Even in states with high utilization ratios, the utilization of non-recurring expenditure is poor. Turning to MDM, the ratios for utilization of recurring assistance are reported to be high, on an average. This improvement in utilization should however be viewed in the context of a decline in the real allocations for these schemes.

In the MDM scheme, cooking cost and honorarium to cook cum helper which constitute about 95% of recurring assistance show very high levels of utilization. Besides the state share for MDM, states must incur their own expenditure to pay salaries to cook cum helper, which has unit costs at historical rates under MDM. It reflects the reluctance of the GoI to contribute to salary costs, though salary costs form most of the education expenditure (and social sector expenditure, in general). Generally, given the huge gaps in spending especially in the poorer states, better utilisation rates should have been accompanied by higher expenditure on CSSs, which has not happened. MME utilisation is lower than the overall UR. Programme Approval Board of MDM has asked states to raise utilization on MME. Social audits are a part of MME. In contrast to top-down reforms in financial management, social audits present important possibilities of bottom-up approach for greater transparency and accountability. Issues such as incomplete coverage of students under MDM can be handled through such mechanisms. States need to institutionalize the practice of social audits and conduct it regularly, which is not happening at present. In a fund constrained situation, the new financial management guidelines, which reduces the funds available to a state, at any given time, and makes the releases conditional on utilization may present newer challenges in implementation for states.

The second presentation of session 3 was by Mizoram. The speakers were **Mr. Lalhmingmawla Sailo, Addl. Secretary, and Mr. C Lungmuanpuia, Deputy Secretary, Finance Department, Government of Mizoram.** The presentation discussed challenges in utilization of central grants in Mizoram, which may also apply to other northeastern states. Grants from the finance commission and centrally sponsored schemes (CSS) account for significant portions of revenue. Over the past five years, finance commission grants totaled ₹20,934.42 crore, while CSS grants contributed ₹9,792.35 crore. Challenges in fund utilization include high administrative costs, complex conditionalities, geographical challenges and funding delays. The presentation highlighted that high administrative expenses under schemes like the National Rural Livelihood Mission create difficulties for smaller states. Further, conditions attached to grants delay utilization; for example, only ₹18.82 crore was utilized from a recommended ₹74.6 crore for rural local bodies. The unique geography of Mizoram complicates project implementation, such as capturing attendance in remote areas. Finally, the presentation notes that CSS projects face delays due to the structure of fund disbursement, often contingent on the utilization of other schemes.

Some suggestions were provided to improve the effectiveness of CSS in supporting development and asset creation, ensuring funds are utilized efficiently and effectively.

- Simplification of Grants: Reduce the number of sector-specific and state-specific grants, focusing on fewer grants with larger amounts and fewer conditions. This will align better with local needs and existing projects;
- Budget for Maintenance: Include dedicated budgets for the long-term maintenance of new assets created under CSS, ensuring funds are available for repairs and upgrades;
- Fiscal Federalism: Shift from CSS funding for state projects to vertical devolution of taxes, granting states more flexibility and autonomy in fund usage, simplifying the transfer process;

- Standardized Compensation: Standardize salary structures and benefits for CSS employees to promote equity across sectors;
- Independent Funding: Ensure that funding for specific schemes is not contingent on the utilization of funds from other schemes, preventing delays;
- Streamlined Fund Releases: Reduce the number of fund release installments to expedite project execution and decrease administrative burdens; and
- Timely Fund Disbursement: Emphasize the timely release of funds post-approval of action plans and ensure that states promptly provide their matching contributions, enhancing overall efficiency and implementation of schemes.

The third presentation of session 3 was by Uttar Pradesh. The speaker was **Shri Sameer, Special Secretary, Government of Uttar Pradesh.** Shri Sameer's presentation began by thanking Dr. Kavita Rao, Director of NIPFP, for a chance to participate in this State Forum. The presentation addressed the challenges in utilizing central grants, particularly in Uttar Pradesh (UP). Shri Sameer acknowledged the central government's support for aspirational states like UP. Notably, despite having a lower per capita GDP, UP is investing significantly in capital expenditure, achieving remarkable results in schemes such as the Pradhan Mantri Jan Dhan Yojana, where they have over 9.5 crore accounts.

The first issue flagged in the presentation was regarding the pace of growth of central grants. The presentation argues that grants have moderated in growth over the years, especially in comparison to growth in revenues. In terms of utilization of the CSS grants, some concerns have been flagged. First, it is observed that UP's revenue collection has improved, but central assistance often arrives late in the fiscal year, limiting their ability to utilize it effectively. For instance, over 20 percent of the central share of CSS was received in the month of March in UP in 2022-23. These could be on account of compliance requirements and the processing of the same.

Additionally, seasonal and geographical restrictions of the state can delay work completion. More flexibility in managing schemes where these concerns could help in improved utilization. The presentation provides specific insights from a few key CSS programmes like Samagra Siksha Abhiyan and PMAY(U).

To enhance the effectiveness of central grants, Shri Sameer proposed streamlining grant releases to align with operational timelines, release of funds in fewer instalments, more freedom to states for fund utilization and realistic timelines for capital expenditure disbursement.

The presentation highlighted the need for increasing the proportion of grants to match the state's aspirations and budget growth, and promoting capacity building within state departments to improve fund utilization.

Ms Supriti Dua from the World Bank pointed out that in discussions on centrally sponsored schemes, a persistent issue is the inability of some states to use the resources. Timely flow of resources could be one of the issues. Other issues could be capacity to absorb resources, which might need augmented manpower. The Centre needs to figure out a way to resolve this issue. Shri Yadav acknowledged the problem – he felt there is need to pay more attention to the design of schemes. The schemes often include many conditions, which might place limitations on rapid utilization. Further, mode hand holding and better transparency on the available funds could help in improving utilization.

SESSION 4: Fiscal Rules, Sustainability and Growth
Chair: Dr. Manoj Govil, Expenditure Secretary, Ministry of Finance, Government of India

The second session on Day 2 of the State Forum was chaired by **Dr. Manoj Govil, Expenditure Secretary, Ministry of Finance, Government of India.** The first presentation of session 4 was delivered by **Shri Tanvir Malik, Economist, The World Bank**. The presentation focused on Sub-national debt dynamics and implications for fiscal policy. The talk was divided into four parts: setting the context, examining subnational debt projections, discussing implications for fiscal management, and reviewing international examples. It was noted that state debt levels were stabilizing before the pandemic due to fiscal rules but surged afterward. There is a concerning divergence in debt levels among states from 2020 to 2023. Three forces affecting debt are primary deficits, interest payments, and nominal GDP growth. Recent trends show increasing primary deficits and slower growth, exacerbating debt issues. The existing borrowing limits, set by the finance commission, lack common medium-term debt targets across states, complicating fiscal management. Projections suggest states will not converge on lower debt levels if current trends persist.

The importance of transparency and stronger oversight is highlighted. Regarding optimal debt levels, citing research, it is shown that public debt accumulation up to 25% of GSDP can improve fiscal health, while higher levels could be detrimental.

The talk discusses the potential for differentiated borrowing limits for Indian states based on their fiscal health, advocating for a more flexible approach to borrowing that could enhance productive spending. It is highlighted that states with strong fiscal positions should be allowed to borrow more, while those with higher deficits need to identify effective programs for capital investment to increase their fiscal capacity. It is proposed to adopt a common medium-term debt target instead of a uniform annual borrowing limit. This could enable states with good fiscal health to invest more in development while necessitating stricter controls for high-debt states to manage their finances better. Past finance commissions have allowed more flexible borrowing based on fiscal performance. However, there’s a call for more significant allowances for states maintaining low debt levels without needing to demonstrate a revenue surplus. The current market does not adequately price the risks associated with state debt. There's an implicit assumption of sovereign guarantees that dampens risk differentiation among states. Shri Malik cited examples of countries like Mexico, Australia, and Brazil, which use rating systems to determine borrowing limits based on fiscal indicators such as debt levels and revenue capacity. These systems incentivize states to maintain sound fiscal practices.

In summary, the talk advocated for a more nuanced borrowing framework that aligns with states' fiscal capacities, enhancing accountability and encouraging productive investments while considering international best practices.

The second presentation of session 4 was by Telangana. The speaker was **Shri Sandeep Kumar Sultania, Principal Secretary, Finance & Planning, Government of Telangana.** The presentation focused on Telangana’s fiscal performance and the challenges faced. The talk began with an overview of Telangana. Telangana covers 1,277 square kilometers and has a population of about 3.5 crore, with significant urban and rural demographics. The literacy rate stands at 66.5%.Telangana has achieved substantial economic growth, with its Gross State Domestic Product (GSDP) increasing from ₹5.06 lakh crore to ₹15.2 lakh crore over the past decade, significantly outpacing national growth rates. The state's contribution to national GDP has also risen from 4.1% to 5.1%. The primary sector employs 47.3% of the workforce, while the secondary and tertiary sectors have also seen growth. The per capita income has tripled since the state's formation, reaching ₹3.57 lakh.

The state has made strides in infrastructure, increasing power capacity by 138%, expanding road length, and ensuring nearly universal water supply. Telangana has implemented various welfare programs, including pensions for vulnerable groups, educational scholarships, and financial support for women's empowerment and marriages.

Despite these achievements, Shri Sultania acknowledged funding challenges for continued welfare initiatives and the need for effective implementation to ensure benefits reach the intended recipients, emphasizing key issues regarding debt, expenditure, and social welfare. Telangana's debt-to-GSDP ratio is concerning, with a significant increase in loans from ₹91,000 crore in 2014-15 to ₹4.1 lakh crore now. The state is struggling to meet budget estimates, with average expenditures falling short. Revenue receipts have been volatile, affecting the state's ability to generate stable income. This has led to a growing fiscal deficit, which peaked at 4.1% but has since decreased to 2.5%. The mounting debt burden, including interest payments, is a pressing issue. Approximately 30% of state revenues go towards debt servicing, leaving limited funds for other essential services. The need for reform in welfare programs was highlighted to ensure better targeting of beneficiaries and to address deficiencies in nutrition and literacy rates. There are significant ongoing projects that require funding, such as the Kaleshwaram irrigation project, which has high maintenance costs. The government aims to prioritize infrastructure, boost employment through skill development, and improve urban areas. Initiatives include a new skill university and urban rejuvenation projects. The talk concluded with a request for assistance from the central government to restructure loans, reduce interest rates, and support the state's financial sustainability.

The third presentation of session 4 was by Maharashtra. The speaker was **Shri Saurabh Vijay, Principal Secretary (Expenditure), Government of Maharashtra.** The presentation focused on balanced growth and fiscal management in Maharashtra. The talk addressed the need for balanced growth and fiscal management in Maharashtra, highlighting the state's significant population and economic contributions. The growth of the service sector was emphasized, while noting the persistent reliance on agriculture, which employs over 50% of the workforce despite its decline. Maharashtra has a strong infrastructure and is a leader in manufacturing and foreign direct investment (FDI), with impressive GST collections. The state's development strategy focuses on infrastructure, with numerous ongoing projects, including expressways, metro systems, and coastal roads, particularly in the Mumbai Metropolitan Region (MMR). However, Shri Vijay identified challenges such as regional disparities, with some districts lagging in income and growth, and mentioned the establishment of the Maharashtra Economic Advisory Council to create a vision for becoming a trillion-dollar economy through inclusive growth. The state aims to boost the manufacturing sector and improve per capita income significantly. Social development initiatives include a human development mission, increased spending on health and nutrition, and universal health coverage. The government supports women's participation in higher education and provides targeted welfare schemes, including crop insurance for farmers. Additionally, Maharashtra is committed to sustainability, with efforts to decarbonize transport and promote renewable energy in agriculture.

Shri Vijay discusses Maharashtra's approach to balanced growth and fiscal management, emphasizing the importance of leveraging central funds and maintaining fiscal prudence. In terms of fiscal management, Shri Vijay presents Maharashtra as a conservative state in its financial approach, which aims to meet budgetary targets, particularly regarding fiscal deficits. The state is focusing on increasing its revenue from various taxes, notably GST. On the expenditure side, there are some stress points emerging - revenue expenditure is rising due to new schemes, while capital expenditure remains stable. Shri Vijay emphasized the need for rationalizing spending, particularly in committed expenditures, to ensure efficiency. On capital expenditure front, the state is planning significant investments, especially in the Mumbai Metropolitan Region (MMR), and aims to collaborate closely with the private sector to boost economic growth. Regional disparities are a persistent concern in the state and Maharashtra has established district-level strategic plans to address regional disparities and focus on sectors like energy and social welfare. Finally, the state is exploring mechanisms for sustainable development, innovative financing, and optimizing resources to enhance fiscal health while driving growth. Overall, the presentation highlighted the state's commitment to balanced development, efficient fiscal management, and strategic investment in growth initiatives.

In the discussion following the presentations, some pertinent issues were raised. Dr Pinaki Chakraborty of NIPFP commented that the presentation by Shri Malik suggests that state aggregate debt to GDP ratio to be brought down to 25% of GDP in the medium term. The 2018 Amendment to FRBM legislation caps debt of general government at 60 percent. The above would imply debt to GDP for Centre being limited to 35 percent. Would this be the recommendation and how would it work? With current Debt to GDP of 82 percent, the proposed 60 percent would require substantial compression of expenditure both by centre and states.

In targeting debt to GDP ratio, states will face very different fiscal scenarios – for states with debt to GSDP below target, there would be space for significant expansion but for states with high debt, say 46 percent, the required change would be sharp compression of expenditure. It may be important to caliberate both debt and deficit levels to provide a roadmap for transition.

On the presentation by states, it appears that the challenge both states highlight related to the inclusion of schemes involving transfers to individuals. In the absence of a framework for planning, is it possible that medium term planning has given way to short term gains.

Dr Govinda Rao pointed out that analysis should also factor in the Debt to GDP ratio for the centre to get a comprehensive picture for the medium term. He further mentioned that the 3 percent of deficit for centre and states was constructed against a background of 10 percent of GDP being the financial savings of households. With financial savings of households being substantially lower, this issue too might need to be re-examined. Further, for states, it is important to factor in the off-budget liabilities, especially power sector liabilities.

Dr Sudipto Mundle observed that given the implicit guarantee for state debt by government of India, it is difficult to articulate a scenario where interest rate differentials will incentivize fiscal discipline.

Dr S. Mukherjee referred to the paper presented in the last State Forum to suggest that pay commission payouts and not UDAY debt might account for the observed surge in the debt levels in 2016-18. He proposed the possibility of dynamic deficit target determination.

Mr Malik acknowledged the various comments received. He recognized that there is need to look at general government debt perhaps in an optimal debt context. He also raised a question for state governments regarding the choice of investment through parastatals instead of working through the budgetary process.

One question for the speaker from Maharashtra was posed on the efficiency of using parastatals for undertaking investment. How to differentiate between a good on budget borrowing and a bad off budget borrowing? How does the state decide on which parastatals should be allowed to borrow and which should not be allowed. Further, how does the state monitor the performance of the parastatals in terms of choice of projects. Clearly in some cases, the debt servicing could revert to the state government. Shri Vijay mentioned that these institutions have been around for long and have a series of checks and balances. Officers of the government are on the boards for review. Further the government encourages the institutions to identify sources of revenue flows such as toll collection for MSRDC. Further, whenever these institutions reach out for guarantees tin the context of specific projects, the finance department encourages them to examine the likely sources of revenue that can be generated in the lifecycle of the project. These are taken into account while decisions are made. Using the parastatals however has helped Maharashtra to grow infrastructure at a rapid pace. Shri Sultania added that from his experience, no big projects can be done from the state budget alone. He argued that if borrowing is undertaken to create a productive asset which will yield increase in GSDP and revenue, then such a borrowing is "good". Responding to Shri Malik's question, Shri Sultania mentioned that SDL loans imply a much lower rate of interest when compared to bank or other sources of borrowing. For Telangana, he mentioned that the state has over-resorted to loans, especially since there is no assured source of revenue expected.
Responding to a question on the possibility of centre incentivizing states for over-coming a fiscally stressed situation, Mr Malik discussed examples from Brazil and Mexico. The solutions however tend to be context specific.

Dr. Manoj Govil concluded session 4 by discussing the necessity of limits on state government borrowing, emphasizing that all states, as well as the central government, access the same debt market. Without borrowing limits, some states might increase their fiscal deficits significantly, which could raise interest rates for all. Viable projects can justify borrowing, but it's important to consider the implications of state guarantees for loans taken by parastatals. It was noted that lenders often perceive guaranteed loans as low-risk, leading to higher interest rates. There are concerns about weak guaranteeing norms and political decisions that can bypass proper financial assessments, transferring risk back to the government. States with high debt levels often rely on these guarantees, sometimes using parastatals to circumvent borrowing limits. Dr. Govil called for caution in handling guaranteed loans, particularly when state responsibilities are delegated to parastatals.

Session 4 was followed by a Lunch time presentation by the World Bank on Data Visualisation & its application to Indian States, by Ms. Emilia Skrok, Practice Manager, MTI Global Practice, and Shri Rishabh Choudhary, Economist, MTI Global Practice, The World Bank.

Ms Skrok, Practice Manager, MTI Global Practice, The World Bank, discussed the importance of analyzing public expenditures to enhance fiscal sustainability, economic growth, and accountability, emphasizing the need for effective public finance management, focusing on the allocation of resources, revenue collection, and spending efficiency. Key topics include the macro fiscal framework, revenue and expenditure analysis, and thematic areas such as green transitions and fiscal rules. The aim is to prioritize spending in crucial sectors like infrastructure, education, and health while ensuring that fiscal policies support development goals. Ms Skrok highlighted various analytical tools and methodologies used in Public Finance Reviews (PFRs) across different countries, showcasing examples from the

Pacific Islands, Poland, Turkey, and Bulgaria. These analyses assess revenue performance, public spending efficiency, and pension pressures. Ms Skrok concluded by introducing the Public Finance Review tool, suggesting its potential to provide valuable insights for improving public finance management.

Shri Rishabh Choudhary, Economist, MTI Global Practice, The World Bank, outlined the new tool designed to facilitate systematic Public Finance Reviews (PFRs) for Indian states, focusing initially on Uttarakhand. The tool aims to provide quick analytical insights into fiscal policies, including expenditure on welfare schemes, education, and health, and to evaluate revenue collection against expenditures. The tool allows for benchmarking Uttarakhand against similar states based on criteria like per capita income and population. It identifies peer categories, such as Himalayan states and neighboring states, for comparative analysis. Users can visualize spending patterns and efficiency in sectors like education and health. This includes scatter plots to assess the relationship between spending and outcomes, helping to identify potential areas for improving efficiency without increasing overall spending. The tool assesses the state's revenue profile, including dependency on central government transfers, and evaluates whether revenue collections are adequate for meeting expenditures. The tool provides insights into the state's resilience to economic shocks and climate vulnerabilities, analyzing fiscal balance, liabilities, and growth contributions from different sectors. After data analysis, the tool will offer policy advice on prioritizing expenditures, improving efficiency, and mobilizing domestic revenues to enhance the state's fiscal profile. Shri Chaudhary concluded the presentation with an introduction to phase two of the tool's development, which aims to incorporate additional analytical inputs and refine its capabilities for more comprehensive public finance management.

Prof Lekha Chakraborty raised a question regarding cyclically adjusted balance and suggested that while output gap would be a more relevant notion but the policy implications of using an output gap are unclear. The assumption that deficit will get corrected through cyclically may not be appropriate. Dr Skrok responded that while the policy implications may not be straight forward, examining the output gap can provide some insights in the emerging trends. She also flagged the possibility of analyzing components of expenditure to examine which are pro-cyclical and which are not. Shri Rishab added that in addition to cyclical factors, there can be cascading factors as well which need to be taken into account – climate change related factors for instance.

Emilia and Rishab responded to a question to indicate that this framework can be made available for a wider range of users.

SESSION 5: Innovations by States
Chair: Shri M.P. Tangirala, Additional Secretary, Department of Financial Services, Ministry of Finance, Government of India.

The last session of the State Forum was chaired by **Shri M.P. Tangirala, Additional Secretary, Department of Financial Services, Ministry of Finance, Government of India.** The first presentation in session 5 was delivered by Andhra Pradesh. The speaker was **Shri Noorul Quamer, Deputy Secretary, Finance Department, Government of Andhra Pradesh.** The presentation provided a comprehensive overview of the recent pension reforms in India, particularly focusing on the transition from the Old Pension Scheme (OPS) to the National Pension System (NPS) in Andhra Pradesh. It began by explaining the historical context of civil service pensions, which have existed since 1881. The OPS, a defined benefit scheme, guarantees a fixed percentage of the last drawn salary upon retirement. This system was designed to attract employees to civil service roles, positioning the state as a model employer. Two primary types of pension schemes were outlined: defined benefit pensions, like OPS, where the employer guarantees a certain payout, and defined contribution pensions, such as the NPS, where payouts depend on investment performance. The OPS was increasingly seen as financially unsustainable, particularly as its costs rose from 2% of revenue receipts in 1980 to 12% in 2001. This fiscal pressure led to the implementation of the NPS in 2004, aimed at creating a more sustainable pension framework. The presentation highlighted three key principles for successful pension reform:

- transition from unfunded to funded pensions: Ensuring that pension liabilities are backed by investments made from the start of an employee's career;
- Integration with general social security systems: Aligning civil service pensions with broader social security measures available to the public; and
- Shift from direct benefits to contributions: Moving towards a system where contributions are made into funds that generate returns, rather than guaranteeing specific payout amounts.

Shri Quamer acknowledged the ongoing debates about potential measures such as increasing the retirement age or extending service periods, which are contentious topics in many countries. A historical perspective shows the evolution of pensions in India, from the first Royal Commission on civil establishment in 1881 to the introduction of the NPS, shaped by recommendations from various committees, including the OSS Project in 1999.

The presentation compared OPS and NPS across several parameters, emphasizing that OPS tends to be more generous in terms of benefits. For instance, OPS provides 50% of the last drawn salary, which increases with inflation adjustments, whereas NPS benefits are tied to market performance, leading to greater variability. The NPS is characterized by lower management costs and a more sustainable fiscal impact on government budgets, costing only about 0.1% of GDP compared to OPS's 1.7%.

He identified several vulnerabilities within the NPS framework,

- Market Dependence: Pension amounts can fluctuate based on market conditions, posing risks during economic downturns;
- Lack of Safety Nets: In cases of premature death, beneficiaries may receive minimal payouts from the corpus;
- Health Emergencies: Sudden health crises can disproportionately affect retirees' financial stability;
- Family Pension Limitations: The ability to provide for dependents can vary based on individual choices.

The implications of NPS for civil servants are significant, as research indicates that its financial outcomes may be less favorable than the OPS, particularly for those who retire after long careers. To address these challenges, the government of Andhra Pradesh has initiated the development of a Unified Pension Scheme (UPS). This scheme aims to balance employee security with state fiscal responsibility by guaranteeing a minimum pension equivalent to 50% of the last drawn salary. It is designed to incorporate family pensions and life insurance provisions, addressing the vulnerabilities highlighted earlier.

Shri Quamer discussed the cost implications of various pension schemes, noting that the UPS is projected to be financially viable, with costs that are competitive with OPS while providing essential security features. Key factors in managing these costs include adjustments to minimum pension thresholds, pension calculation methods, and potential caps on benefit escalations. In conclusion, the speech underscores the importance of strategic planning and flexibility in pension reforms. The proposed Unified Pension Scheme is a step toward ensuring that civil servants receive fair and sustainable retirement benefits while also maintaining fiscal health for the state.

The second presentation of session 5 was delivered by **Sri Hrudaya Kamal Jena, Additional Secretary (Finance), Government of Odisha**.

The presentation outlined a series of innovative practices in public financial management recently adopted by the state of Odisha. It began with a broad overview of the state's economic landscape, highlighting that for the fiscal year 2023-24, Odisha's economy is projected to reach ₹8.32 lakh crore, with an impressive growth rate of around 8% sustained over the past seven years, excluding the disruption caused by the COVID-19 pandemic. The budget for 2024-25 is structured at ₹2.66 lakh crore, which accounts for approximately 29% of the state's GDP. Key fiscal targets include a fiscal deficit of 3.5% and a revenue surplus of 3%, with a capital outlay of 6.3% amounting to around ₹58,000 crore. A significant focus is placed on revenue generation, particularly from the mining sector, which has seen remarkable growth. Mining revenue surged from ₹11,000 crore in 2019-20 to around ₹50,000 crore in 2021-22. This spike can be attributed to strategic changes in the mining policy, particularly the introduction of auctioning for mining rights under the amended Mines and Minerals (Development and Regulation) Act of 2015. The presentation notes that Odisha benefited from its early adoption of these auction policies, leading to substantial financial returns. Challenges in the mining sector were also highlighted, particularly the volatility in revenue streams influenced by fluctuating market prices and recent policy shifts by the central government. These fluctuations have repercussions not only on mining revenue but also on other tax revenues, such as GST and stamp duty, further complicating fiscal planning. To address these uncertainties, Odisha has established a Budget Stabilization Fund designed to smoothen capital expenditures during periods of revenue downturns, thus ensuring continued investment in essential public services and infrastructure.

In terms of strategic budgeting, Odisha has become a pioneer in India by collaborating with the International Monetary Fund (IMF) to enhance its budget formulation processes. The state now employs a three-year budgeting horizon, allowing departments to set expenditure ceilings that promote accountability and prioritization. This strategic approach ensures that departments align their budgets with long-term fiscal goals while providing a framework for realistic resource allocation.

Cash management has also been innovated, focusing on minimizing unnecessary cash balances and ensuring efficient fund utilization. Odisha has implemented measures to reduce negative carry associated with holding excess cash. This includes establishing a Cash Management Unit that coordinates with other financial units to optimize cash flows and borrowing strategies.

Finally, the presentation discussed fiscal risk management as a critical component of Odisha's financial strategy. The state has developed a comprehensive framework to identify, categorize, and mitigate fiscal risks, which includes macroeconomic risks and those related to public debt, public-private partnerships (PPPs), and government guarantees. A fiscal risk register is maintained, and an annual fiscal risk report is presented to the state assembly, fostering transparency and proactive risk management.
Overall, the innovations in public financial management in Odisha reflect a commitment to optimizing resource use, enhancing revenue stability, and ensuring sustainable economic growth. By implementing these strategic initiatives, Odisha aims to create a more resilient financial framework capable of adapting to both local and global economic challenges.

The third and last presentation of session 5 was delivered by the state of Karnataka. The speaker was **Shri L K Atheeq, Additional Chief Secretary (Finance), Government of Karnataka.** He discussed the innovative fiscal management strategies employed by the Government of Karnataka, focusing on the state's ambitious social inclusion agenda, termed the "five guarantees." This program aims to uplift economically disadvantaged families by providing substantial financial support, with a total annual budget of approximately ₹52,000 crores (around $7 billion). Key components of the initiative include:

- Direct Cash Transfers: Women heads of households receive ₹2,000 per month, benefiting about 12 million families and costing ₹28,000 crores annually;
- Free Electricity: Approximately 14 million homes enjoy free electricity, significantly alleviating financial burdens for low-income families;
- Food Security: In addition to the National Food Security Act (NFSA) provision of 5 kg of rice per person, the state provides an additional 5 kg and cash equivalents, costing around ₹6,000 to ₹6,500 crores per month;
- Public Transport: Women can travel for free on all public buses, with about 30 million free trips taken in the past 14 months, costing ₹5,000 crores annually; and
- Unemployment Benefits: The Yuva Nidhi scheme offers financial assistance to graduates for up to two years while they seek employment, ensuring a safety net for young professionals.

Collectively, these programs account for about 16% of Karnataka's total budget of ₹3 lakh 71 thousand crores, leading to significant budgeting rigidities. To maintain fiscal sustainability while continuing to invest in infrastructure, the government is exploring two primary strategies: Public-Private Partnerships (PPPs) and innovative financial instruments.

Shri Atheeq highlighted the success of the Bangalore International Airport project, which was established with minimal public investment. The government contributed ₹50 crores and provided 4,000 acres of land at a concessional rate. This PPP has not only facilitated the construction of the airport but has also spurred economic growth in North Bangalore, attracting additional investments and creating a vibrant economic ecosystem. The presentation also introduced the newly launched "KWIN City," which utilizes 2,000 acres of land originally designated for an Information Technology Investment Region (ITIR). The vision for KWIN City includes attracting private investment in four key sectors: Knowledge, Health, Innovation, and Research. This urban development aims to accommodate approximately 500,000 residents and foster innovation, education, and healthcare services, leveraging Bangalore's existing reputation as a tech and research hub. He also discussed plans to establish an Infrastructure Investment Trust (INVIT) for the Karnataka Power Transmission Corporation Limited (KPTCL), which has assets worth ₹177,000 crores. By placing a portion of these assets into the INVIT, the government hopes to attract investments from retail and institutional investors, thereby lowering KPTCL's capital costs. Additionally, an intercorporate deposit scheme has also been proposed, allowing cash-rich public sector undertakings (PSUs) to invest their surplus funds into other government corporations requiring financing. This would create a favorable borrowing environment, where these corporations could secure loans at rates lower than the current market costs, thereby facilitating necessary investments without straining the budget.

Shri Atheeq also addressed the substantial agricultural power subsidy issue, proposing a shift to solarization for irrigation pump sets. Currently, Karnataka spends around ₹13,000 to ₹14,000 crores annually on power subsidies for approximately 38 lakh agricultural pump sets. The plan is to implement solar power stations for these feeders, significantly reducing the tariff from about ₹5.69 per unit to potentially as low as ₹2.36, thus alleviating financial pressure on the state's budget.

In conclusion, the presentation encapsulated Karnataka's multifaceted approach to balancing social welfare with fiscal responsibility, utilizing innovative public-private collaborations and financial mechanisms to sustain economic growth and enhancing infrastructure.

The State Forum was closed with a vote of thanks by **Dr. R. Kavita Rao, Director, NIPFP.** She thanked all the speakers, chairpersons, and participants, especially the 14 states, who were a part of the Forum. She also thanked the World Bank for their support in the State Forum, particularly, Dr Farah Zahir, Dr Ran Li and Dr Hoon Saheb Soh, who helped make this event feasible. She also put on record her appreciation for the effort put in NIPFP faculty and staff for making the event a success.

State Forum 2024

OVERVIEW OF STATE FINANCE

1

State’s expenditure and the impact of COVID pandemic

Resham Nagpal

National Institute of Public Finance and Policy, New Delhi

1.0 Introduction

In recent years, the COVID pandemic severely impacted the fiscal health of both Union and State governments in India. Revenues fell while spending and debt increased due to the need for higher investment in health and social sectors. The situation was aggravated as the economy was already declining before the pandemic with real GDP growth rate down to 3.9 percent in 2019-20 from 8.3 percent in 2016-17.

While both expenditure and receipts were affected by the pandemic, capital expenditure suffered the most drastic reduction. As the economy recovers from the shock and state finances stabilize, there is a growing emphasis on enhancing capital expenditure. The Union government's introduction of 50-year interest-free loans to states from 2020-21 budget onwards is a nudge in this direction.

This paper examines trends in state expenditure and evaluates the impact of the pandemic and subsequent government policies. The analysis covers the period 2017-18 to 2024-25 BE. **Section 2** analyzes trends in capital and revenue expenditure for all states, distinguishing between North-Eastern and Himalayan states (NEHS) and others **Section 3** presents the analysis at the state level with a focus on assessing the pandemic's impact. **Section 4** examines changes in the composition of expenditure due to the pandemic. **Section 5** analyzes trends in committed expenditures of states. Section 6 summarizes the salient trends emerging from this study.

2.0 Trends in Expenditure

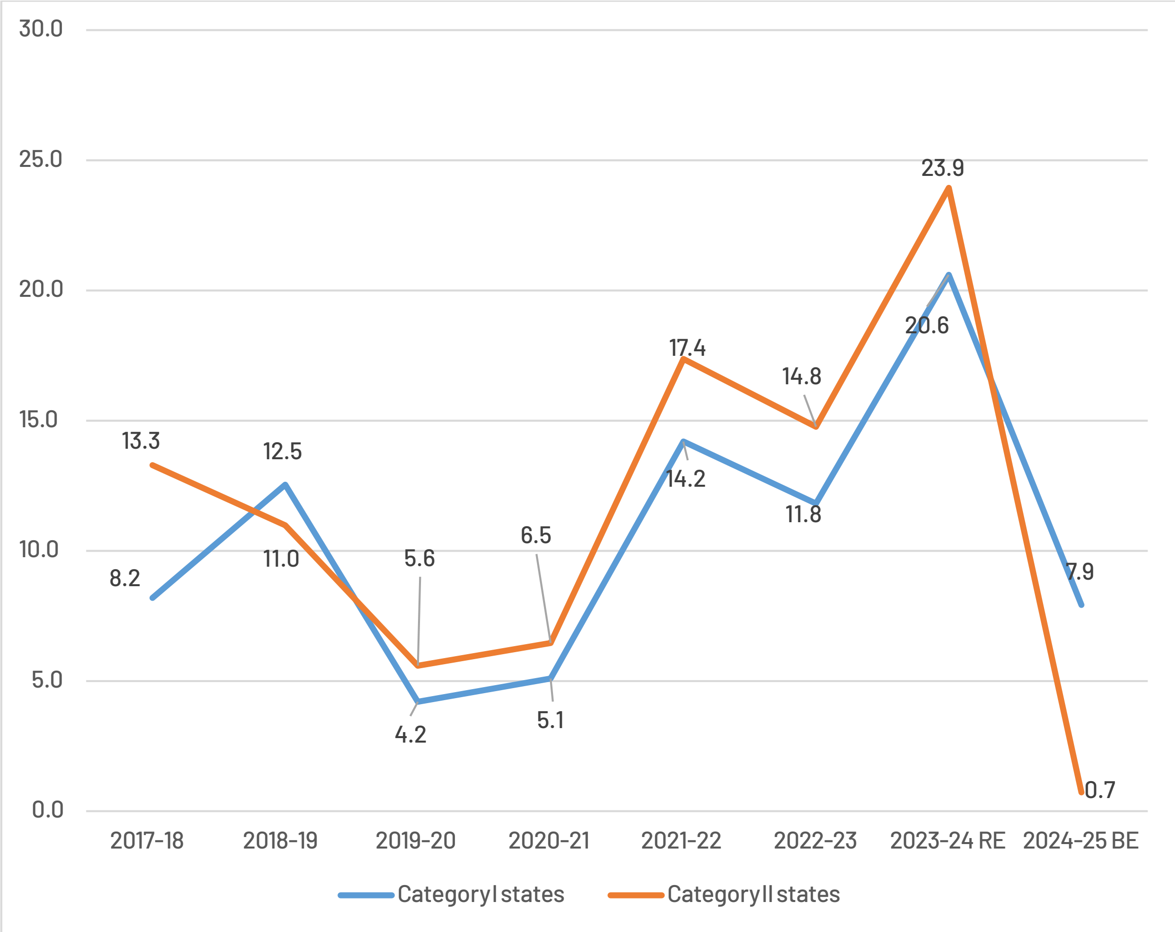
Figure 1 presents the growth of total expenditure (sum of revenue and capital expenditure1) of States from 2017-18 onwards. The growth of total expenditure for both category of states: States other than North eastern and Himalayan states (henceforth, category I states) and North Eastern and Himalayan states (henceforth, category II states) follow similar trend. For category I states, capital expenditure accounts for 12-16 percent of the total expenditure while for category II states, it is slightly higher at 14-20 percent.

Both for category I and category II states, growth in total expenditure registered a sharp decline in 2019-20, which persisted during 2020-21. This significant decrease can be attributed to the negative growth of capital expenditure during these years. Revenue expenditure, typically exhibiting a steady annual growth of 10-12 percent, also grew at a slower rate of 6 percent during this period. The downward trend

[1] Capital expenditure here refer to capital outlay. It does not include net lending (Loans and advances – recovery of loans and advances)

in total expenditure growth reversed in 2021-22 when capital expenditure surged by 28 percent, while revenue expenditure returned to its usual growth rate. In 2022-23, the rapid increase in capital expenditure moderated, thereby slowing the growth of total expenditure. Growth of total expenditure peaked in 2023-24 (Revised Estimates (RE)) due to increase in both revenue expenditure and capital expenditure, with the latter experiencing a particularly sharp growth of approximately 40 percent.

Figure 1: Growth of Total Expenditure

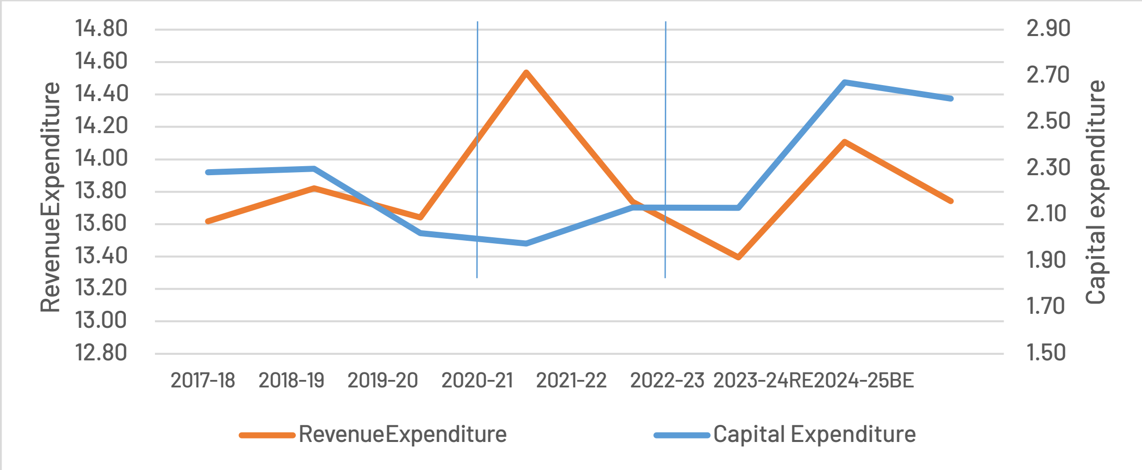


Note: Total expenditure is taken as sum of capital expenditure and revenue expenditure
Source: Finance Accounts, CAG reports, various years.

Figure 2 presents the trend in revenue expenditure and capital expenditure for category I states. As a percentage of GSDP, revenue expenditure hovers around 13-14 percent while capital expenditure lies in a narrow range of 2-2.6 percent. For these states, capital expenditure as a percentage of GSDP registered a decline during 2019-20 and 2020-21 on account of economic slowdown and COVID-pandemic. Since then, it has recovered to reach 2.67 percent in 2023-24 RE.

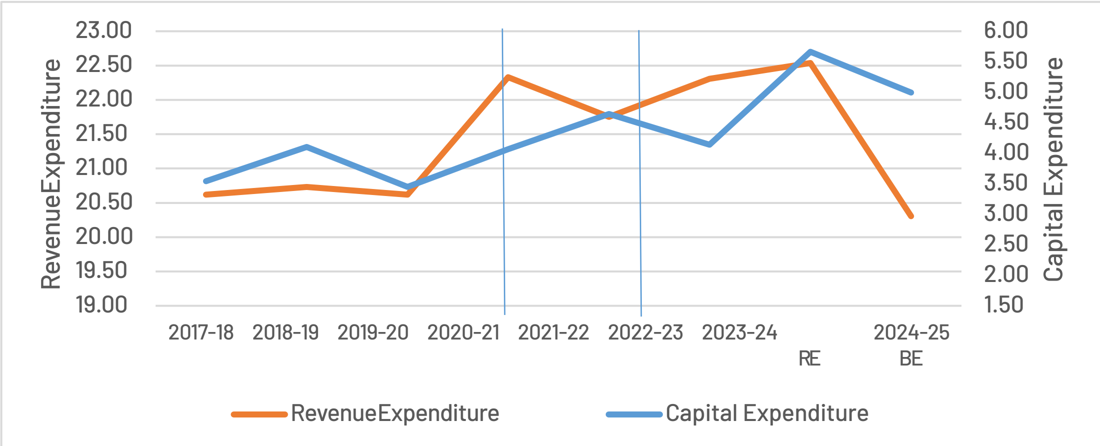
Revenue expenditure, on the other hand, shows very little volatility till 2019-20. However, it rises sharply by 1 percent of GSDP in 2020-21 largely due to negative GSDP growth on account of COVID pandemic. In 2021-22, it is restored to its pre-COVID level as the GSDP growth recovers. In 2022-23, revenue expenditure as a percentage of GSDP declined. This can be attributed to states' efforts to consolidate their fiscal positions as well as the steady growth of GSDP, which outpaced the increase in revenue expenditure.

Figure 2: Trends in Expenditure for Category I states (% of GSDP)



Source: Finance Accounts, CAG reports, various years; CSO, MOSPI.

Figure 3: Trends in Expenditure for Category II states (% of GSDP)



Source: Finance Accounts, CAG reports, various years; CSO, MOSPI

Trend in revenue expenditure and capital expenditure for category II states is presented in Figure 3. For these states, both revenue and capital expenditure as percentage of GSDP are higher as compared to category I states. This could be driven by higher federal transfers (both in share of union taxes as well as grants-in-aids). The peak observed in 2020-21 in revenue expenditure is due to the same reason as category I states, however, after a fall in 2021-22, it rises again with another peak in 2023-24 RE. Capital expenditure for these states is consistently increasing from 2019-20 onwards with a small blip in 2022-23.

While the period of uptick in capex expenditure for both category I and category II states coincides with the provision for 50-year interest free loan extended by Union government for states, it does not seem to be the only factor driving its growth. For instance, the allocation under the special assistance accounted for less than 0.06 percent of the GSDP in 2021-22 (see Table 1) while there was 0.18 percent increase in the capital expenditure. It suggests that post-COVID states pumped some of their own revenue towards capital expenditure bringing the capital expenditure back to its long-term range.

For both category of states, the 2024-25 BE numbers show decline in capital expenditure and revenue expenditure.

Table 1: Allocation under 50-year interest free loan as a percentage of GSDP

Year	Total allocation (Rs cr)	Actual disbursement (Rs cr)	Disbursement (% of GSDP)	Capex (% of GSDP)
2020-21	12,000	11830	0.06	2.08
2021-22	15,000	14185	0.06	2.26
2022-23	107000	81195	0.31	2.23
2023-24 RE	1,30,000	105551	0.36	2.83

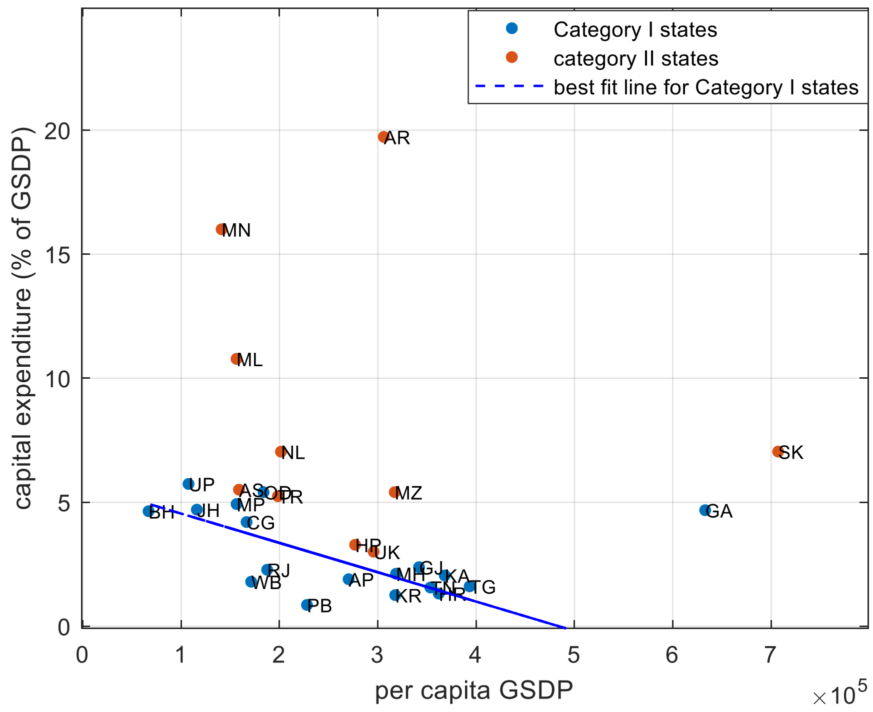
Source: Union budget, 2021-22, 2022-23, 2023-24

3.0 Expenditure pattern of states

To analyse the spending pattern of states, we compare expenditure of states with their per capita GSDP. Figure 4 presents relationship between per capita GSDP and capital expenditure as a percentage of GSDP for the year 2023-24 RE. It is clear that category II states show more variation in capital expenditure percentages, with states like Arunachal Pradesh, Manipur and Meghalaya having very high expenditures relative to their per capita GSDP.

Within category I states, we see three sub-groups emerging. The first is the group of low income states, such as, Bihar, Chhattisgarh, Uttar Pradesh, Madhya Pradesh, Jharkhand and Odisha that have high capital expenditure. This suggests their concerted effort to stimulate economic growth. Another cluster of states, namely, Maharashtra, Karnataka, Gujarat, Tamil Nadu, Haryana, Telangana and Kerala have high per capita GSDP but low capital expenditure. The third sub-group comprising Punjab, West Bengal, Rajasthan and Andhra Pradesh with both low per capita GSDP and capital expenditure, indicating a lag in developmental efforts. These are also states with persistent revenue deficit constraining their space for capital expenditure. Goa is an outlier with very high per capita GSDP as well as high capital expenditure. This analysis is validated by a downward sloping best-fit trend line for Category I states, indicating a negative relationship between per capita GSDP and capital expenditure.

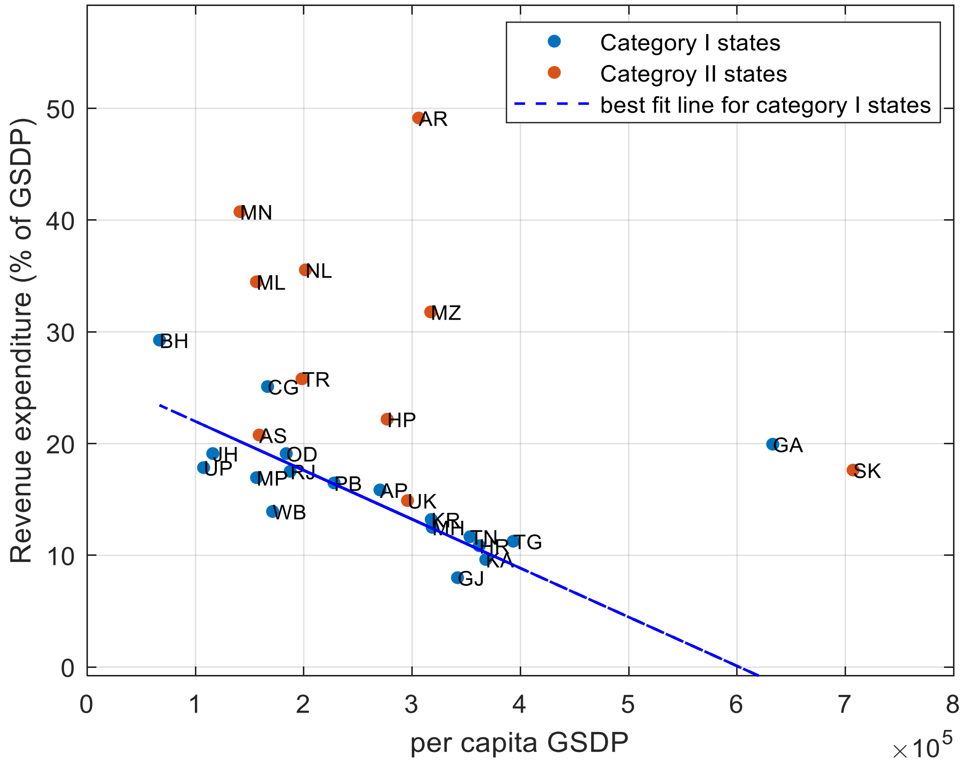
Figure 4: Capital expenditure (% of GSDP) against PCGSDP (2023-24RE)



Source: Finance Accounts, CAG reports for various years; CSO, MOSPI; State's budget documents

Figure 5 presents a similar analysis for revenue expenditure. The negative trend amongst category I states becomes more pronounced in case of revenue expenditure. The best fit line for category I states has steeper slope showing a strong negative correlation between per capita GSDP and revenue expenditure. The observed trend of lower revenue expenditure among richer states might be owing to greater fiscal discipline or economies of scale in service delivery which allow for lower incremental costs upon reaching certain levels of service. Amongst states with low per capita GSDP, Bihar and Chhattisgarh have very high revenue expenditure. While own revenue receipts do not vary as much across states, differences in revenue expenditure are being sustained largely through transfers from Union government.

Figure 5: Revenue expenditure (% of GSDP) against PCGSDP (2023-24RE)



Source: Finance Accounts, CAG reports for various years; CSO, MOSPI; State's budget documents

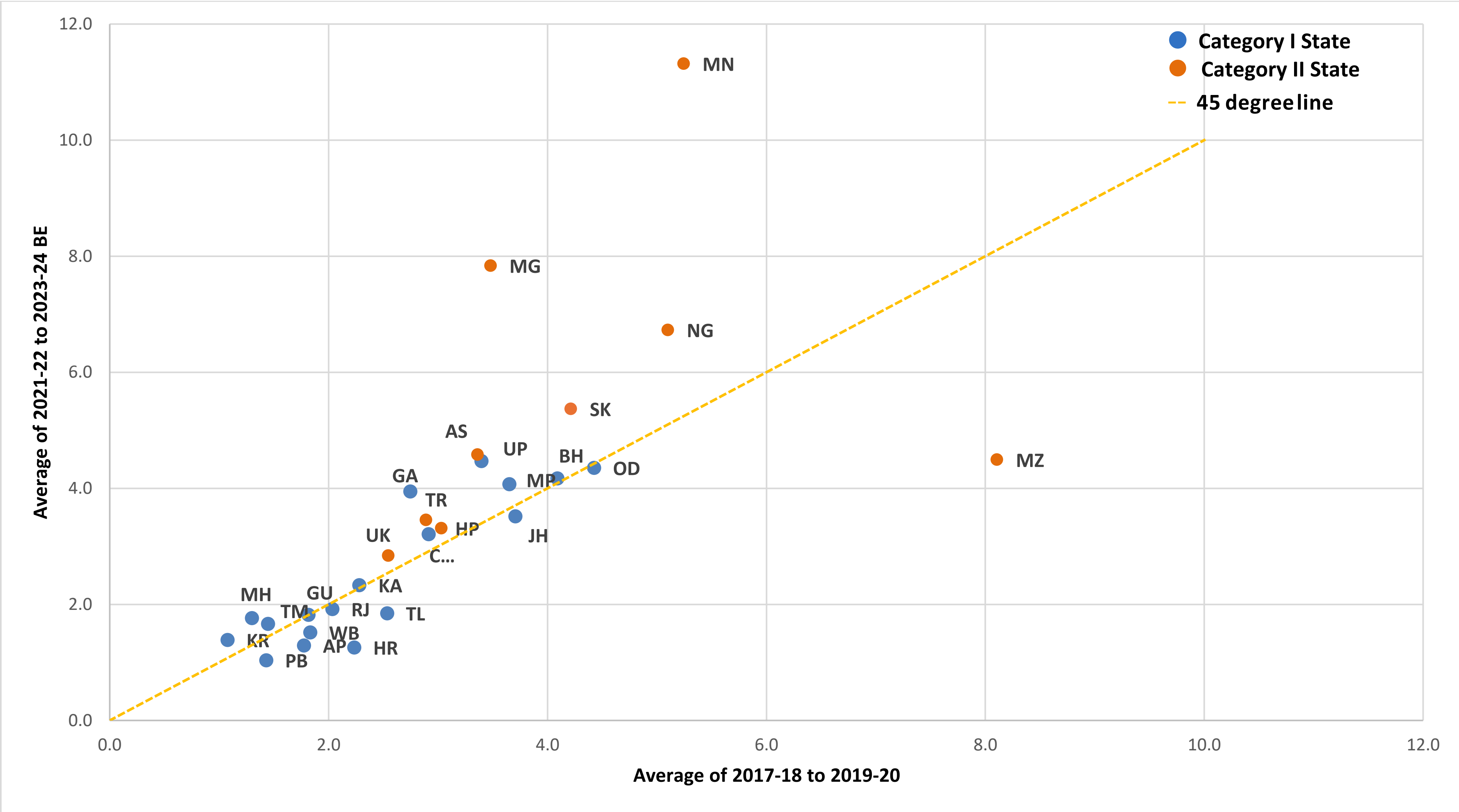
3.1 Impact of COVID

In order to understand the change in expenditure pattern pre-and post-COVID, we present the average capital expenditure and average revenue expenditure for pre-COVID period (2017-18 to 2019-20) and post-COVID period (2021-22 to 2023-24 RE) for the two category of states in Figure 6 and 7, respectively.

As can be seen from Figure 6, all category II states except Mizoram have improved capital expenditure post-COVID with Arunachal Pradesh, Manipur, Nagaland and Meghalaya registering a significant improvement while Mizoram experienced a significant decline. Most category I states lie very near to the 45 degree line, showing slight change in pre-and post-COVID expenditure pattern. Gujarat, Karnataka, Bihar and Odisha are on the line showing no change in the expenditure pattern due to pandemic. Uttar Pradesh and Goa registers significant improvement in capital expenditure in post-COVID period. Maharashtra, Kerala, Tamil Nadu, Chattisgarh, and Madhya Pradesh are other states that witness improvement. Other catergory I states experience deterioration in capital expenditure as a percentage of GSDP post-COVID. Amongst, these Harayana sees most dramatic decline of about 1 percentage points. Telangana, Punjab and Andhra Pradesh also undergo noticable decline.

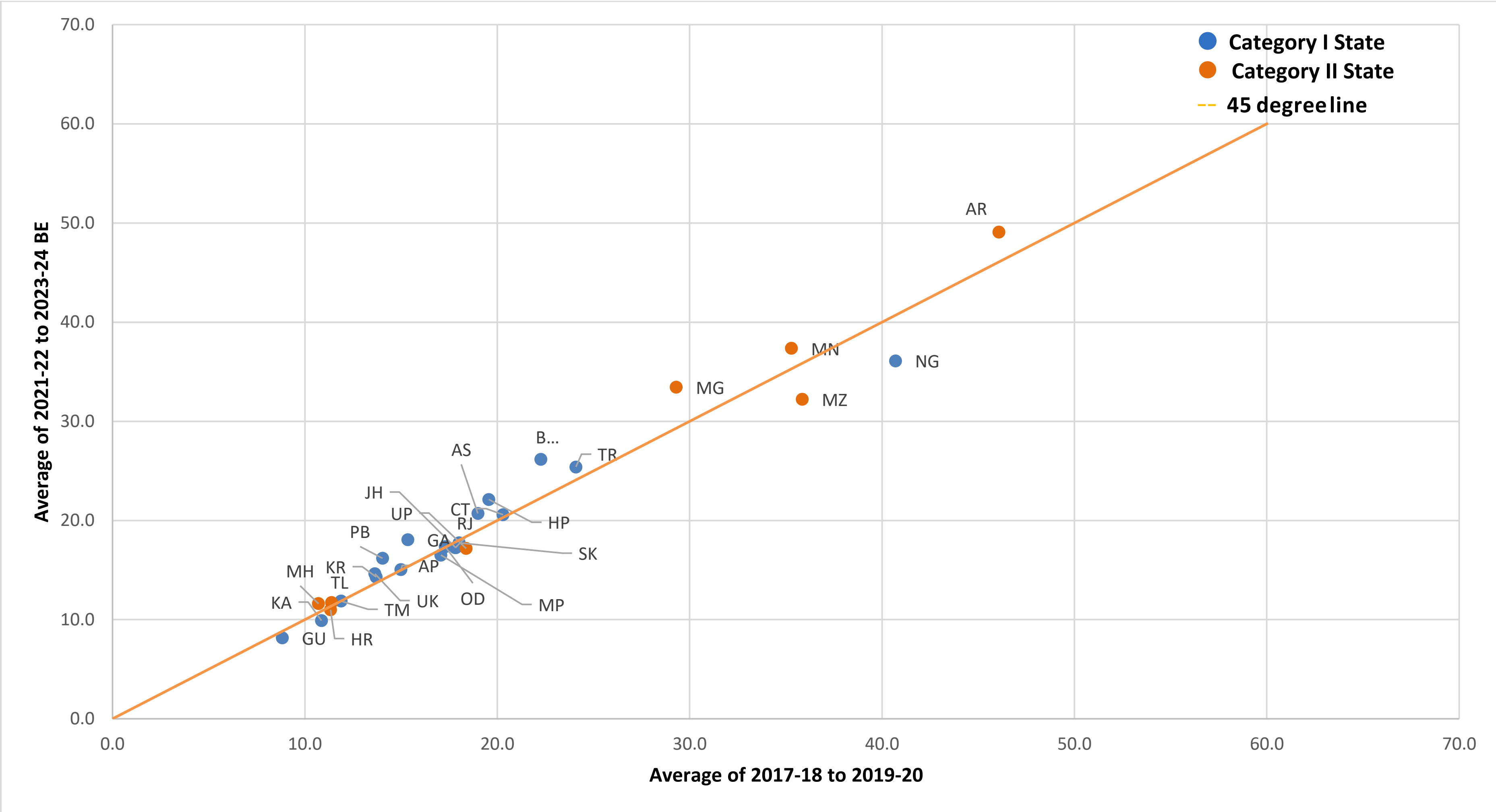
Revenue expenditure, on the other hand, witnesses far less variation pre- and post-COVID for both category I and category II states. Here again, category II states experience more variation than category I states which are all huddled closely on the 45 degree line. Amongst category II states, Mizoram and Nagaland show decline in revenue expenditure post-COVID while others show increase. Amongst category I states, Bihar, Goa and Punjab show small increase in revenue expenditure while others almost follow similar trend.

Figure 6: Capital Expenditure (% of GSDP)



Source: Finance Accounts, CAG reports, various years; CSO, MOSPI.

Figure 7: Revenue Expenditure (% of GSDP)



Source: Finance Accounts, CAG reports, various years; CSO, MOSPI.

4.0 Composition of Expenditure

Composition of revenue expenditure and capital expenditure for the two categories of states is presented in Table 2. The time period for this analysis is divided into sub-periods: pre-COVID period (2017-18 to 2019-20), COVID period (2020-21 to 2021-22), post-COVID period (2022-23 to 2023-24 RE) and 2024-24 BE. Both revenue and capital expenditure can be sub-divided into social services and economic services (together called developmental expenditure) and general services (non-developmental expenditure).

Social services and general services are major constituents of revenue expenditure, accounting for about 40 and 35 percent, respectively. Social services, such as education, health, urban development, family welfare, are crucial for building human capital and enhancing human welfare. General services, which include administrative functions, interest payments and pensions, support the government's operations. Economic services which constitute agriculture, industry, power, transport, and communication etc. account for about 20 percent of the revenue expenditure.

In contrast, economic services form the major constituent of capital expenditure, accounting for over 60 percent for most of the states, reflecting the huge capital investments required by these sectors. Conversely, general services typically comprise less than 10 percent of capital expenditure in most states, making them the smallest component.

Revenue expenditure as a percentage of GSDP swelled during COVID period for both category I and category II states. However, the post-COVID trend differed: Category I states saw a moderation while still being higher from its pre-COVID level, Category II states continued to experience a rise in revenue expenditure. General services and social services were the primary drivers of this surge. Although the increase in general services has reversed, social services spending, particularly driven by COVID-related health and welfare initiatives, remains elevated compared to pre-pandemic levels.

Capital expenditure experienced a decline during the pandemic but has since rebounded significantly, with even higher projections for the ongoing fiscal year (2024-25 BE). While social services increases led to higher capital expenditure in Category I states, all service areas contributed equally to the rise in Category II states.

Table 2: Composition of expenditure (% of GSDP)

	Category I states				Category II states			
	Pre-COVID (2017-18 to 2019-20)	**COVID (2020-21 to 2021-22)**	**Post-COVID (2022-23 to 2023-34 RE)**	**2024-25 BE**	**Pre-COVID (2017-18 to 2019-20)**	**COVID (2020-21 to 2021-22)**	**Post-COVID (2022-23 to 2023-34 RE)**	**2024-25 BE**
Revenue Expenditure	**13.69**	**14.14**	**13.75**↑	**13.83**	**20.66**	**22.04**	**22.42**↑	**20.4**
General Services	4.74	4.94	4.67↓	4.79	8.02	8.70	8.28↑	7.98
Social Services	5.37	5.59	5.51↑	5.67	7.93	8.54	9.44↑	7.9
Economic Services	3.16	3.18	3.15↓	3.0	4.41	4.50	4.39↓	4.10

	Category I states				Category II states			
	Pre-COVID (2017-18 to 2019-20)	**COVID (2020-21 to 2021-22)**	**Post-COVID (2022-23 to 2023-34 RE)**	**2024-25 BE**	**Pre-COVID (2017-18 to 2019-20)**	**COVID (2020-21 to 2021-22)**	**Post-COVID (2022-23 to 2023-34 RE)**	**2024-25 BE**
Grants-in-Aid to local bodies	0.43	0.44	0.42↓	0.42	0.29	0.30	0.31↑	0.35
Capital Expenditure	**2.2**	**2.1**	**2.4**↑	**2.62**	**3.7**	**4.4**	**4.9**↑	**5.02**
General Services	0.1	0.1	0.1	0.2	0.3	0.4	0.7↑	0.9
Social Services	0.5	0.6	0.7↑	0.9	1.0	1.1	1.3↑	1.4
Economic Services	1.6	1.4	1.5↓	1.6	2.4	2.8	2.9↑	2.8

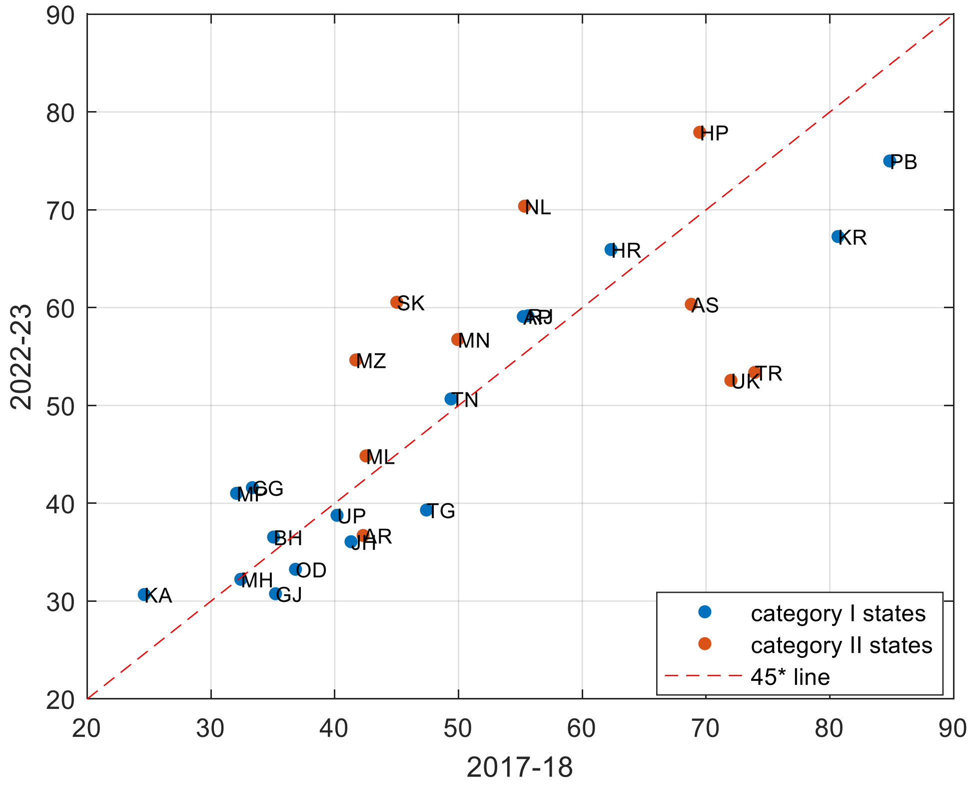
Source: Finance Accounts, CAG reports, various years; CSO, MOSPI.

4.1 Committed Expenditure

Committed expenditure, primarily comprising salaries, pensions, and interest payments, constitutes a significant portion of state budgets, with salary constituting the largest component for most states. In 2022-23, states collectively allocated 44 percent of their revenue receipts to committed items, including 19 percent for salaries and wages, 13 percent for pensions, and 12 percent for interest payments.

Figure 8 shows committed expenditure as a percentage of revenue receipts for two time periods: 2017-18 and 2022-23. There is considerable variation in committed expenditure of different states with the amount ranging from 30-80 percent of their revenue receipts. Among category I states, Kerala and Punjab have highest committed expenditure, accounting for at least 70 percent of their revenue receipts. However, they are also the states with maximum improvement in 2022-23 over 2017-18. On the other hand, Karnataka, Maharashtra, Gujarat, Bihar and Odisha have committed expenditure less than 40 percent of revenue receipts, largely on account of lower expenditure on salaries. Gujarat, Odisha, Telangana and Jharkhand also registered decline in committed expenditure between the two time-periods while other category I states are very close to the 45 degree line, suggesting no significant change.

Figure 8: Committed expenditure (as % of Revenue Receipts)



Source: Finance Accounts, CAG reports for various years.

All category II states have committed expenditure above 40 percent of the revenue receipts. Assam, Tripura, Arunachal Pradesh and Uttarakhand have shown some improvement in 2022-23 while others have deteriorated. A large amount of revenue tied up to serve committed expenditure leaves out very little room for other development activities, and reduces fiscal flexibility to respond to economic shocks and other changing priorities. Moreover rationalizing spending on salaries, pensions, and interest in the short to medium term is challenging.

5.0 Salient Trends

This study assesses the trends and composition of State's expenditure to understand the impact of COVID-pandemic. The analysis is done for 28 states including 10 North Eastern and Himalayan States (category II states) and other states (category I states). To facilitate analysis of pandemic's impact, the time period of this study is divided into sub-periods: pre- COVID period (2017-18 to 2019-20); COVID period (2020-21 to 2021-22); post-COVID period (2022-23 to 2023-24 RE). The figures for 2024-25 BE are presented separately wherever available.

The COVID-19 pandemic significantly impacted the fiscal health of Indian states, necessitating a shift in expenditure priorities. While revenue expenditure growth slowed during the pandemic, capital expenditure growth became negative. After the pandemic, both revenue and capital expenditure have begun to recover, with capital expenditure showing a more pronounced improvement. Although the Union government's 50-year interest-free loans were intended to stimulate capital expenditure, they do not appear to have been the primary driver of this increase. States seem to have undertaken capital spending on their own accord.

At the state level, Category II states generally exhibit higher levels of both capital and revenue expenditure as a percentage of GSDP compared to Category I states. Furthermore, Category I states demonstrate a negative correlation between both capital and revenue expenditure as a percentage of GSDP and per capita GSDP. This implies that states with lower per capita GSDP, such as Bihar, Jharkhand, Uttar Pradesh, Odisha, and Chhattisgarh, put aside higher share of their GSDP for capital expenditure. In contrast, Category II states do not exhibit a clear relationship between these variables.

Since the pandemic, many Category II states have shown substantial improvements in both capital and revenue expenditure. However, Category I states have remained relatively close to pre-COVID levels, with only minor improvements. The composition of expenditure has also evolved. With a greater emphasis on health and welfare initiatives, the share of social services in both revenue expenditure and capital expenditure stands higher for both categories of states.

2

State Finances: Debt, Deficit and Interest Payments

Piyali Das

National Institute of Public Finance and Policy, New Delhi

1.0 Introduction

The financial health of Indian states plays a crucial role in the overall economic well-being of the nation. While the central government sets the overarching fiscal policy framework, it is the states that are responsible for delivering public services and infrastructure development at the grassroots level. Their fiscal performance, therefore, directly impacts the lives of millions of citizens.

In recent years, the Indian economy has faced a series of challenges, including the global financial crisis of 2008, the COVID-19 pandemic, and rising global inflation. These events have put significant pressure on state finances, necessitating a comprehensive analysis of their fiscal performance and the implications for the overall economy.

This paper examines trends in key fiscal indicators across all Indian states during the period 2017-18 to 2024-25BE, with a particular focus on the impact of the COVID-19 pandemic. The study analyses fiscal deficit, revenue deficit, interest payments, and liabilities as a share of Gross State Domestic Product (GSDP). To provide a nuanced understanding of the fiscal dynamics across states, the paper adopts a comparative approach by dividing the states into two distinct categories: Category 1, comprising the majority of states, and Category 2, consisting primarily of the North-Eastern and Himalayan (NEH) states. This categorization allows for a better understanding of regional disparities and the specific challenges faced by different state groups, particularly in terms of their fiscal capacity, revenue generation, and vulnerability to economic shocks.

The analysis delves into pre-COVID fiscal trends, examining the evolution of fiscal indicators and identifying any emerging patterns. It then focuses on the impact of the COVID-19 pandemic on state finances in terms of the deficits, interest burden and debt. Finally, the paper assesses the post-COVID recovery period, analysing the extent to which states have been able to restore their fiscal health and the challenges they face in achieving long-term fiscal stability.

The paper is organized as follows. Section 2 provides an overview of the state finances considering all states and subsequently focussing on states segregated into Category 1 and Category 2 states. This section discusses the trend of fiscal deficit, revenue deficit, and liabilities as a share of GSDP. It also considers interest payments as a share of revenue receipts. Section 3 considers state wise fiscal and revenue deficits pre and post COVID. Finally section 4, concludes.

2.0 Overview of State Finances: All States

We looked at data from 2017-18 until 2024-25BE for all states.2 Fiscal deficit (FD) as a share of GSDP is observed to have peaked twice during the period under consideration as shown in Figure 1. The first happens during the COVID year 2020-21 at 4.04% and the other happened during 2023-24RE at 3.43%. Currently as per the BE estimates it is at 3.09%, higher than the per-COVID level of 2.5%. 3Although FD as a share of GSDP came down sharply post-COVID, the reduction has not been consistent. The 15th Finance Commission recommendation for the Fiscal Deficit-GSDP for 2023-26 was 3%, this is lower than the FD-GSDP figures for 2023-24RE and 2024-25BE.[4]

A similar trend is observed for Revenue Deficit (RD) as a share of GSDP for all states, as shown in Figure 2. In the run-up to the COVID year RD as a share of GSDP has been rising since 2018-19. After a sharp decline of about 1.5 percentage points (from about 2% in 2020-21 to 0.5% in 2021-22) in about a year, the decline in RD has not been a smooth one with fluctuations along the way until the current period. As per the estimates of 2024-25BE, the RD-GSDP ratio is slightly higher than its pre-COVID level. Compared to the glide path for Revenue Deficit to Gross State Domestic Product outlined by the 15th Finance Commission, state governments have struggled to achieve the recommended targets [5]

Fig. 1: All States-Fiscal Deficit/GSDP

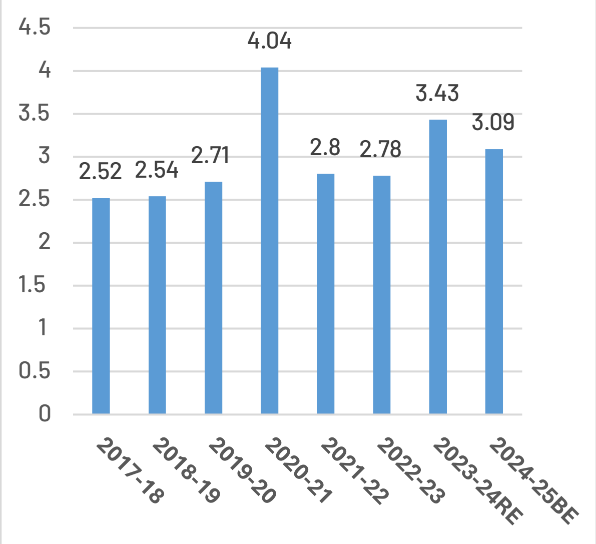
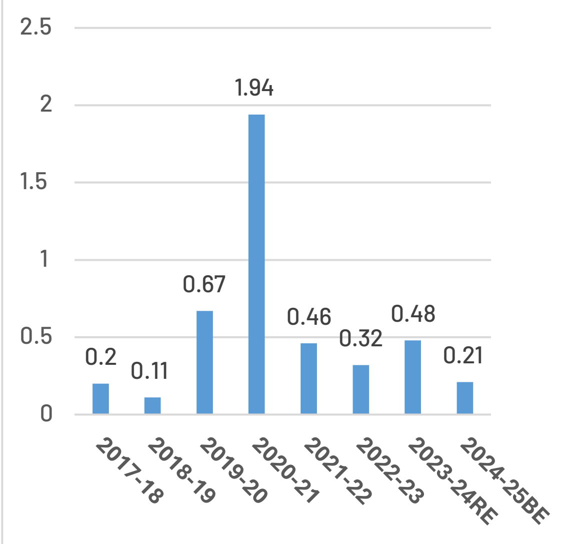


Fig. 2: All States-Revenue Deficit/GSDP



Source: Budget documents, CSO.

The interest payments as a share of GSDP for states show a consistent decline following the COVID surge in 2020-21 when it reached 15.17% from about 12.8% in 2017-18. As per 2024-25BE the IP-RR is about 12.4% marginally higher than the lowest of 12.3% in the pre-COVID period (IP-RR was 12.3% in 2018-19).

---

[2] Excluding Andaman & Nicobar Islands, Delhi, Jammu & Kashmir and Puducherry.

[3] Note: Budget Estimate (BE) numbers are subject to revision.

[4] The 15th Finance Commission recommendation for Fiscal Deficit limits for states were: 4% of GSDP (2021-22) and 3.5% of GSDP (2022-23). The target for 2023-24 until 2025-26 was 3%.

[5] The 15th Finance Commission recommendation for Revenue Deficit-GSDP were -0.1%(2020-21), -0.5%(2021-22), -0.8% (2022-23), -1.2% (2023-24), -1.7% (2024-25), -2.5% (2025-26). The negative sign implies a revenue surplus. See Table 12.4, pg. 373, 15th Finance Commission, Main Report (https://fincomindia.nic.in/asset/doc/commission-reports/XVFC%20VOL%20I%20Main%20Report.pdf).

The Liabilities-GSDP ratio went up from about 25.5% in 2017-18 to about 31% in 2020-21. As seen in Figure 4, during pre-COVID one observes a gradual rise in the ratio and a sharp rise due to COVID. This sharp rise could be attributable to the enhanced borrowing of 2% of GSDP allowed to the states on account of COVID and the additional 0.5% of GSDP borrowing by states, as recommended by the 15th Finance Commission.[6] In the post-COVID recovery period the decline is gradual but is marked by fluctuations. Given the Liabilities-GSDP reduction glide path recommended by the 15th Finance Commission states overall have fared better since the COVID pandemic.[7] From the RE and BE estimates in the post-COVID period we observe a slight upsurge in the Liabilities-GSDP ratio, so that the ratio of about 28.5% in 2023-24RE rose to 28.7% in 2024-25BE.

Fig. 3: All States- IP/RR (%)

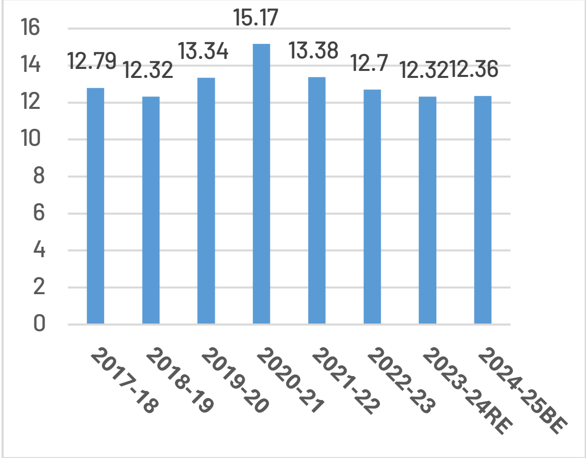
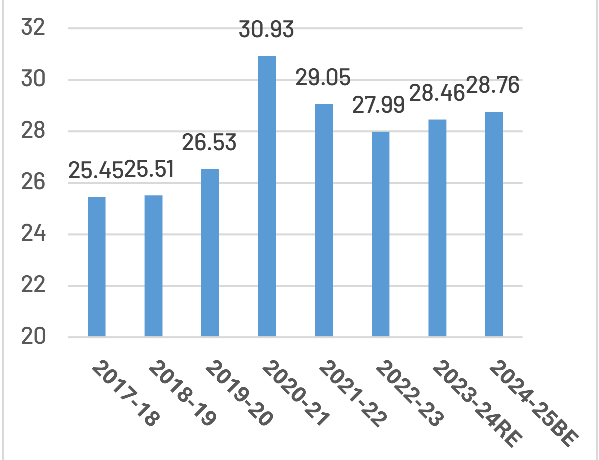


Fig. 4: All States-Liabilities/GSDP (%)



Source: Budget data, Finance Accounts, CSO.
Note: Wherever available we have used liability numbers from Finance Accounts and adjustments were made for missing values. The liability value for a particular year (say, t) and state (say, x) was calculated by taking x's liability at time (t-1), and then adding to it the fiscal deficit value in period t.

2.a. Overview of State Finances: Category 1 and Category 2 States

There is variability across state groups in India when it comes to state finances. To understand the trends in deficit, interest payments and debt/liabilities we segregated the states into two categories: Category 1 and Category 2.[8] Whereas, Category 2 states comprise mostly the North-Eastern and Himalayan (NEH) states, Category 1 states consist of those other than the ones in Category 2. The fiscal and revenue deficits as a share of GSDP is shown in Figures 5 and 6, segregated by Category 1 and Category 2 states.

For Category 1 states, between 2017-18 and 2024-25BE, the surge in FD-GSDP occur during the COVID year (2020-21) however for the NEH states, the peak FD-GSDP occurs much later in the period in 2023-24RE. With an exception of the COVID year, the FD-GSDP is typically higher in the Category

[6] See NIPFP-WP, July 2024, 'Analysis Of State Debt And Operationalisation Of Borrowing Limit: A State Level Analysis' by Pinaki Chakraborty, Resham Nagpal and Piyali Das for details regarding the conditionalities.
[7] "The glide path required the States to reduce total liabilities to 33.1% (FY 2020-21), 32.6% (FY 2021-22), 33.3% (FY 2022-23), 33.1% (FY 2023-24), 32.8% (FY 2024-25) and 32.5% (FY 2025-26) as a percent to GSDP." NIPFP-WP 410, 12-June-2024 'Understanding States' Debt and Bond Markets', by Radhika Pandey, Madhur Mehta, Bency Ramakrishnan, Utsav Saksena, Nipuna Varman and Kriti Wattal.
[8] Category 1 states: Andhra Pradesh, Bihar, Chhattisgarh, Goa, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamil Nadu, Telangana, Uttar Pradesh, West Bengal.
Category 2 states: Arunachal Pradesh, Assam, Himachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Uttarakhand.

2 states compared to Category 1. The FD-GSDP ratio is observed to have been coming down from the peak of COVID year for Category 1 states, with an uneven recovery. During the first two years immediately after COVID, Category 1 states clock decline but then the ratio is seen to have gone up in the last two years. As per the 2024-25BE the average FD-GSDP ratio across the non-NEH states is a little over 3%, this is higher than the pre-COVID average of about 2.6% between 2017-18 and 2019-20. For most years in the period under review, Category 2 states have clocked an FD-GSDP higher than 3% and as per the 2024-25BE the FD-GSDP is about 3.6%. Therefore, overall Category 2 states have not been able to meet the 15th Finance Commission recommendation of 3% FD-GSDP and Category 1 states are barely meeting the target as per 2024-25BE estimates.

The revenue deficit-GSDP (RD-GSDP) across different state groups is shown in Figure 6. In the period under review, Category 2 states clock revenue surpluses in most years (six out of eight years). In fact the Category 2 states were in revenue surplus during the COVID year. For Category 1 states are in deficit for all years and the peak (2.07%) occurs during COVID. Post-COVID the revenue deficit for these states is observed to have been declining but unevenly. As per 2024-25BE, the RD-GSDP is at about 0.3% higher than the pre-COVID level of about 0.2% during 2017-18 and 2018-19. Hence in terms of RD-GSDP, Category 2 states are close to meeting the 15th Finance Commission target as they are in surplus, however, Category 1 states are behind that target as they are in deficit as per 2024-25BE estimates.[9]

Fig 5: FD/GSDP across State groups

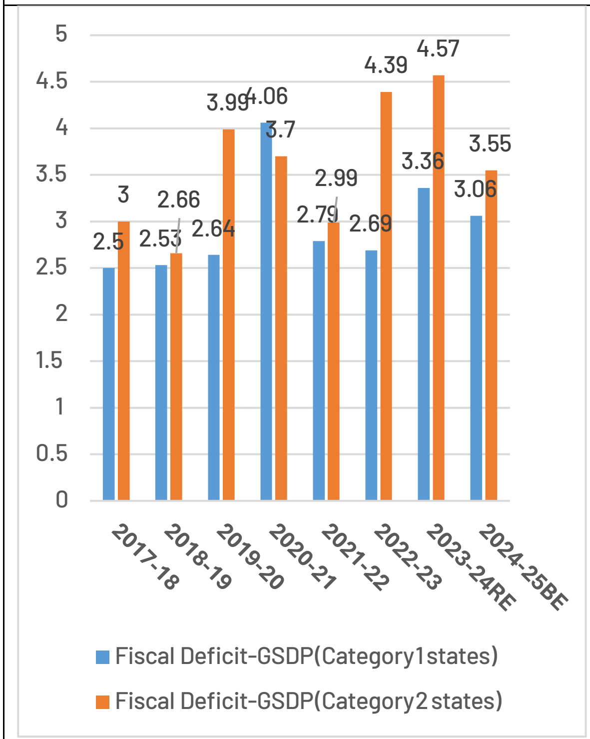
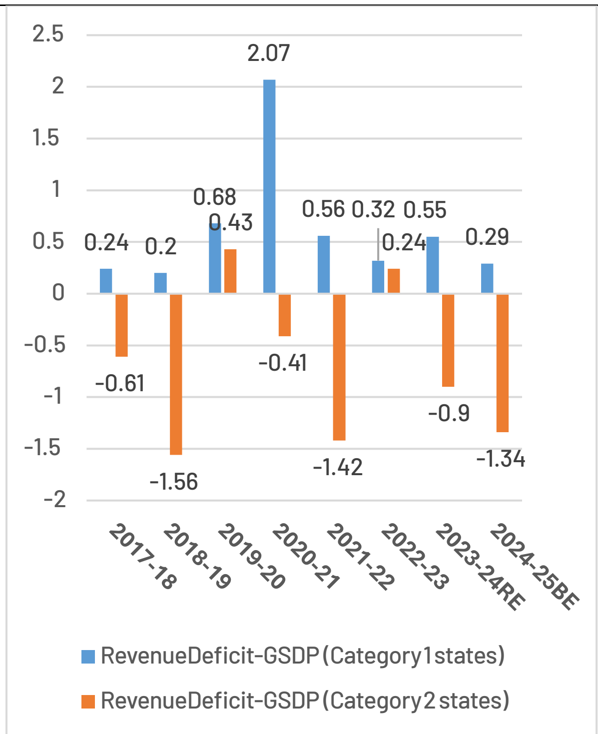


Fig 6: RD/GSDP across State groups



Source: Budget documents, CSO.

The interest payments as a share of revenue receipts (IP-RR) across state groups is shown in Figure 5. The IP-RR for Category 1 states dominates that of the Category 2 states. The average difference in IP-RR during the period under review across these groups was about five percentage points, indicating a higher burden of interest payments for Category 1 states. For both groups one observes a gradual rise

[9] Note the recommended 15^{th} FC target for RD-GSDP was -1.7% (revenue surplus) in 2024-25. See Table 12.4 in the Main Report of 15^{th} FC.

in the IP-RR, peaking during CIOVID and then a gradual and almost consistent decline. As per 2024-25BE the IP-RR of both groups is lower than that in 2017-18.

The Liabilities-GSDP across groups is depicted in Figure 8. Unlike in the case of IP-RR the liabilities-GSDP ratio of Category 2 states is observed to dominate that of Category 1. In the pre-COVID period there appears to be a gradual rise in the Liabilities-GSDP ratio across groups. However, post-COVID the decline is not symmetric compared to the rise. It appears that the post-COVID recovery from the high Liabilities-GSDP (about 35% and 31% for Category 1 and 2, respectively during COVID) seems to be taking longer than it took to reach the peak during COVID. One conjectures that debt or liabilities as a share of GSDP will remain high in the coming years.

Fig 7: IP/RR across State groups

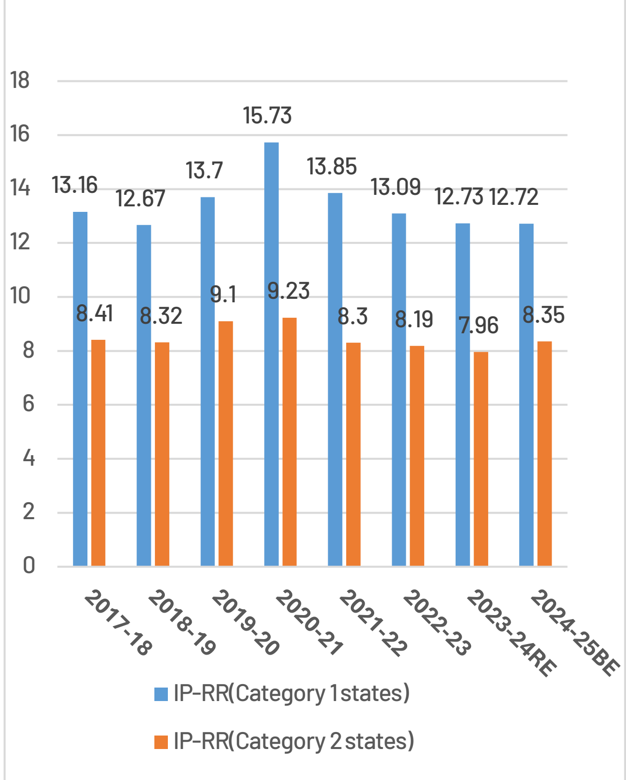
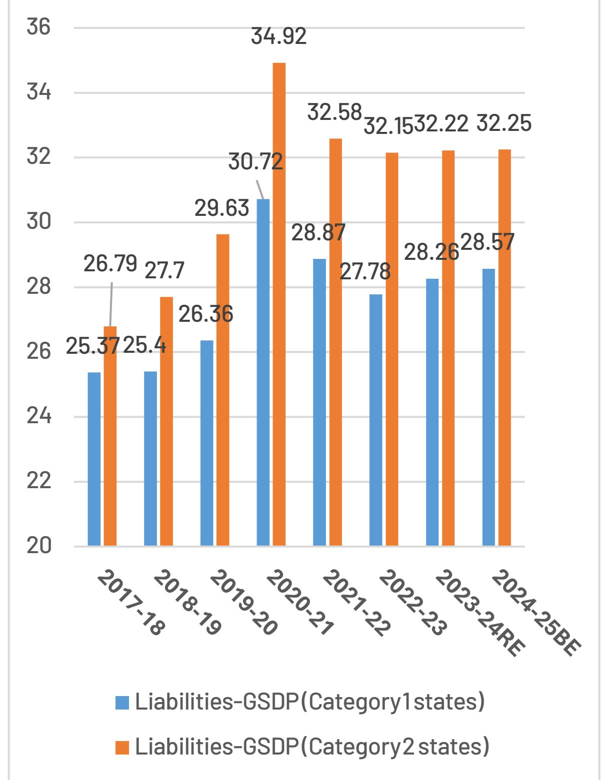


Fig 8: Liabilities/GSDP across State groups



Source: Budget documents, CSO.

Since high debt has been a cause of concern not just in India but globally, we also looked into the relationship between FD and Liabilities-GSDP across state groups. For the Category 1 states it appears that an upsurge in FD is accompanied by an upsurge in the debt/liabilities in most cases (except for the 2024-25BE), suggesting some correlation between FD/GSDP and Liabilities/GSDP. However, such a relation is not apparent for Category 2 states.

3.0 Fiscal and Revenue Deficits pre & post-COVID: State wise

To understand how states are doing with regard to Fiscal Deficit-GSDP position pre- and post-COVID, we look at Figure 11, depicting whether states have reduced their FD-GSDP in the post-COVID period. Of the Category 1 states that have reduced their FD-GSDP post-COVID (or below the 45 degree line) compared to their pre-COVID FD-GSDP are Gujarat, Odisha, Jharkhand, Telangana, Haryana, Andhra Pradesh and of the Category 2 states that share a similar status are Uttarakhand and Tripura. There are 11 Category 1 states and 8 Category 2 states that lie above the 45 degree line indicating that more states in all have not been able to reduce their FD-GSDP level in the years following COVID. Also, there is huddling around the 45 degree line implying that states are closer to their pre-COVID FD-GSDP levels.

The RD-GSDP is shown in Figure 12. Most Category 2 states returned to their pre-COVID revenue surplus position. Among Category 1 states Bihar moves from a revenue surplus to revenue deficit, Goa. Jharkhand, and Odisha maintain their revenue surplus post-COVID. West Bengal and Punjab had higher level of post-COVID revenue deficit.

On the debt front, all states except Uttar Pradesh, Odisha and Gujarat, all other states have recorded higher debt-GSDP ratio post-COVID as seen in Figure 13.

Fig 9: FD/GSDP vs Liabilities/GSDP (Category 1 states)

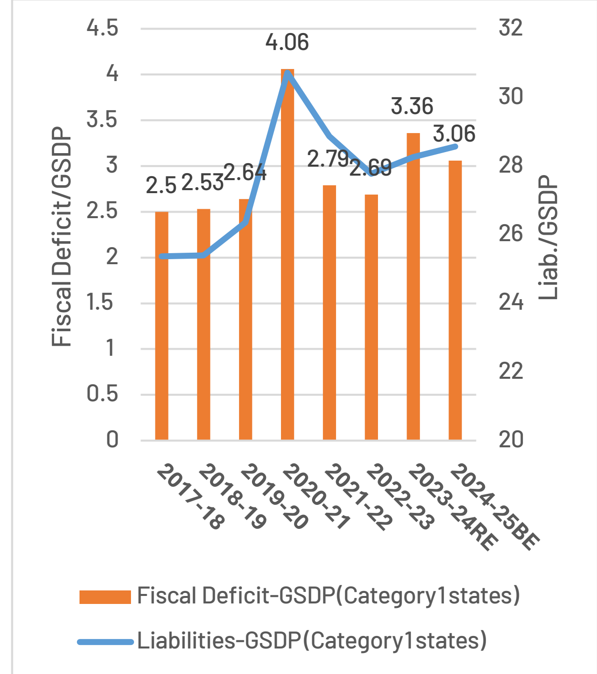
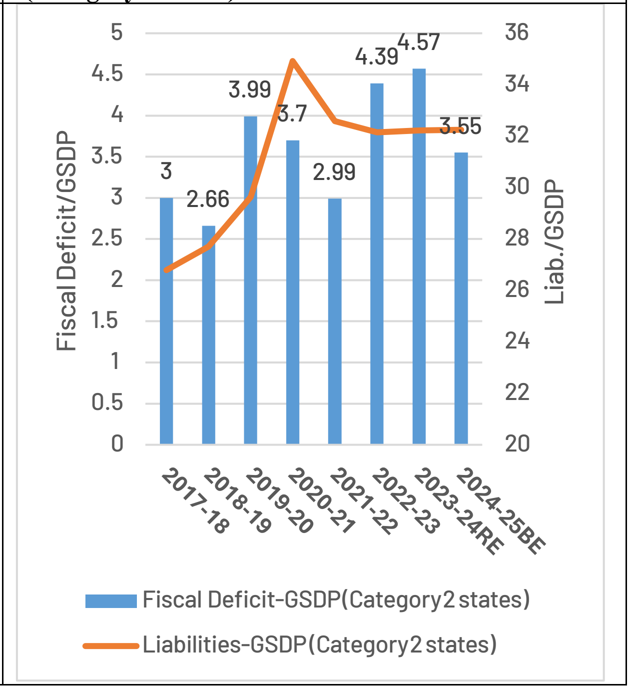
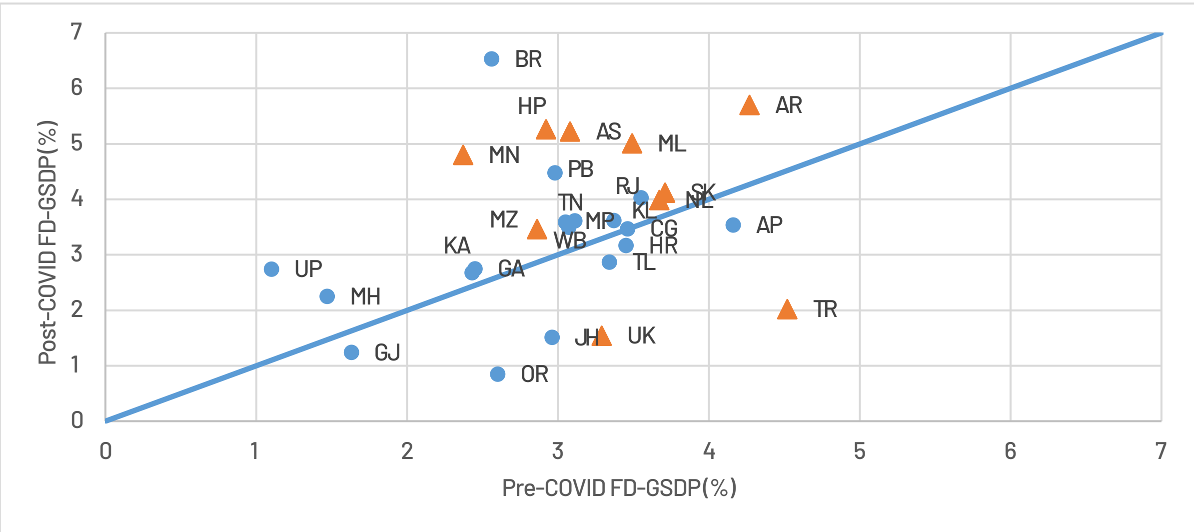


Fig 10: FD/GSDP vs Liabilities/GSDP (Category 2 states)



Source: Budget documents, CSO.

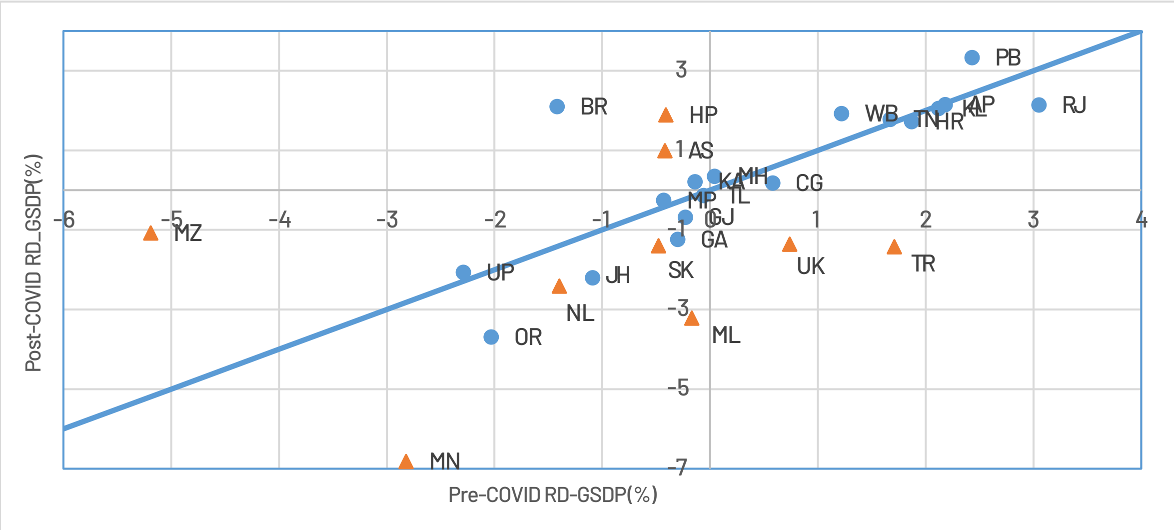
Fig. 11: Fiscal Deficit-GSDP: Pre and Post-COVID across states



Source: Budget documents, CSO.

Note: The blue line represents a 45 degree line wherein pre-COVID FD-GSDP equals post-COVID FD-GSDP. The blue dots represent Category 1 states and the orange triangles represent Category 2 states. Pre-COVID FD-GSDP is the average FD-GSDP from 2017-18 until 2019-20 and post-COVID FD-GSDP is the average FD-GSDP from 2022-23 until 2023-24.

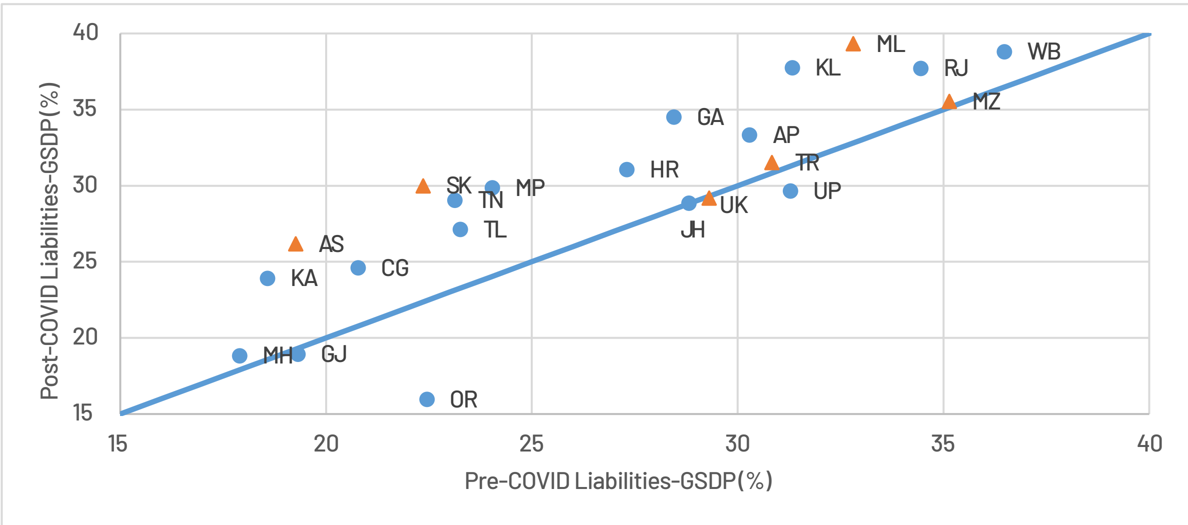
Fig. 12: RD-GSDP: Pre and Post COVID across States



Source: Budget documents, CSO.

Note: The blue line represents a 45 degree line wherein pre-COVID FD-GSDP equals post-COVID FD-GSDP. The blue dots represent Category 1 states and the orange triangles represent Category 2 states. Pre-COVID FD-GSDP is the average FD-GSDP from 2017-18 until 2019-20 and post-COVID FD-GSDP is the average FD-GSDP from 2022-23 until 2023-24.

Fig. 13: Liabilities-GSDP Pre-Post-COVID across States



Source: Budget documents, Finance Accounts, CSO.

4.0 Conclusion

This paper provides an overview of the fiscal performance of Indian states, focusing on the impact of the COVID-19 pandemic and its subsequent recovery. The study reveals variations in fiscal health across states, highlighting the need for targeted policy interventions to address specific challenges. The analysis also underscores the importance of the 15th FC's recommendations in guiding states towards fiscal prudence and promoting long-term fiscal stability.

The analysis indicates that while interest payments as a share of revenue receipts (IP-RR) and revenue deficit as a share of GSDP (RD-GSDP) are generally declining, the IP-RR of Category 2 states is lower than that of the Category 1 states. In terms of all states RD-GSDP, the 15th FC recommendation is not met as the target recommended a revenue surplus as per 2024-25BE. However, Category 2 states record revenue surplus (most years during the period under review) unlike Category 1 states that show revenue deficit throughout the period under consideration.

In terms of Fiscal deficit (FD-GSDP) and liabilities as a share of GSDP remain a cause for concern. These indicators point to a need for a concerted effort to manage state debt and improve fiscal sustainability in the long term. Category 2 states show persistent high FD-GSDP throughout the period under review and this unlike the Category 1 states that are relatively close to the 15th FC FD-GSDP recommendation (as per 2024-25BE). Considering the debt/liabilities-GSDP, overall the states meet the 15th FC target but in terms of state groups Category 2 states show higher debt-GSDP compared to the Category 1 states. Important to note that for both state groups post-COVID the debt-GSDP is persisting at a higher trend and thereby indicating a higher debt-GSDP in the coming years. The sharp rise in the debt-GSDP trend is not being met by an equally sharp decline for both state groups.

Therefore, for a better fiscal space, overall reduction in FD across states and in particular Category 2 states will help reach the desired outcome. This will help bring down the rising debt trajectory and hence the interest burden that is relatively higher for Category 1 states. In line with the 15th FC recommendation, a reduction in the RD-GSDP, particularly for Category 1 states can help make the fiscal space more comfortable for the states. A comfortable fiscal space can in turn help the overall economy, develop and grow and be resilient in a global environment that is subject to frequent and unanticipated shocks.

3

An Overview of State Revenue Receipt in India: A Comprehensive Analysis Through the Pandemic Lens

Sk Md Azharuddin

National Institute of Public Finance and Policy, New Delhi

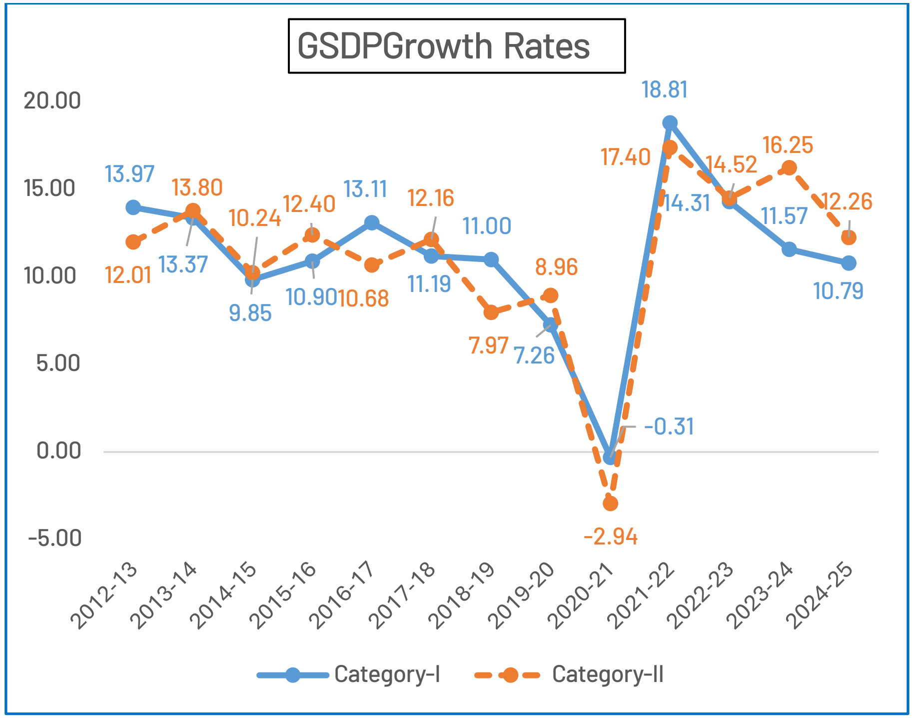
1.0 Introduction

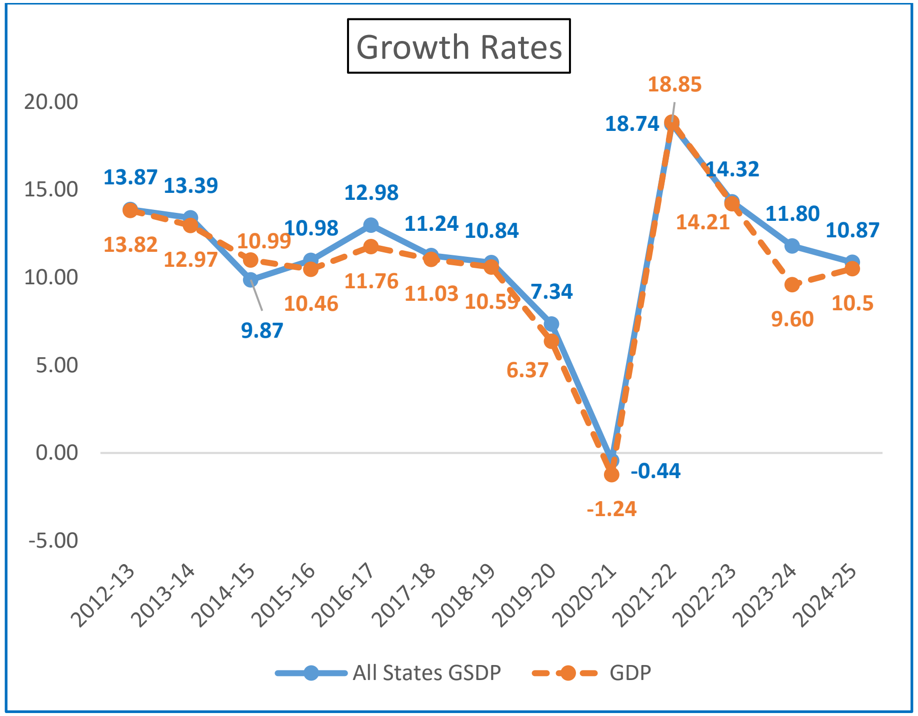
Despite the significant impact of the COVID-19 pandemic, India demonstrated strong resilience and achieved a rapid recovery. Given the fast recovery of the Indian economy, in its review dated January 29, 2024, the Finance Ministry projected that India, currently the fifth-largest economy by nominal GDP, is on track to become the third-largest in the near future and is expected to reach a GDP of $7 trillion by 2030 (The Hindu, January 29, 202410). In the post-pandemic period, the country experienced significant growth in nominal GDP, with a marked increase in 2021-22, primarily driven by base effects (Right Panel, Figure-1). Figure-1 illustrates the growth performance across two state categories: Category-I, which includes 18 states (excluding North Eastern and Himalayan states (NE&H)), and Category-II, comprising [10] NE&H states, along with the overall all-India growth scenario. The left panel of Figure-1 highlights that, as a group, Category-I states demonstrated stronger Gross State Domestic Product (GSDP) growth performance compared to Category-II states during the COVID-19 period (2020-22). However, in the post-pandemic period (2022-23 onward), Category-II states outpaced Category-I states in terms of growth performance. The right panel (Figure-1) compares the growth performance of all states (18 Category-I and 10 Category-II states) with national GDP trends, showing that, over the period from 2012-13 to 2024-25 (BE), the GSDP growth rates across all states have closely aligned with national GDP growth trends.

Similar to GSDP, state finances—both on the revenue and expenditure sides—were significantly impacted by the pandemic. States were compelled to explore their revenue potential and strategically manage expenditures. This study provides an overview of states revenue scenario from 2017-18 to 2024-25 (BE) through the lens of the pandemic. The period of analysis is divided into three distinct phases: the pre-COVID period (2017-18 to 2019-20), the COVID period (2020-21 to 2021-22), and the post-COVID period (2022-23 to 2023-24 RE). Additionally, the analysis incorporates 2024-25 (BE) to offer an aspirational perspective on the fiscal outlook of the states.

[10] https://www.thehindu.com/business/Economy/india-to-become-third-largest-economy-with-gdp-of-5-trillion-in-three-years-finance-ministry/article67788662.ece

Figure 1: GSDP and GDP Growth Rates





Source: MOSPI (2011-12-2023-24), State Budget and Union Budget (2024-25)

Note: GSDP figures for Arunachal Pradesh, Goa, Gujarat, Manipur, Mizoram, and Nagaland for 2023-24 are sourced from the respective State Budgets. For Andhra Pradesh (12%)*, Tripura (14 %), and Sikkim (15.2 %), the 2024-25 GSDP figures are estimated based on the growth rate of the preceding two years. The GSDP figures for Uttar Pradesh (5.82 %) and Meghalaya (11.4 %) for 2024-25 are derived by applying the GSDP growth rates provided in their budgets to the 2023-24 GSDP figures reported by MOSPI.

*Figures in parenthesis are growth rates.

The remainder of this paper is structured as follows. **Section 2** analyses trends in revenue components across the two state categories. **Subsection 2.1** examines the Total Revenue Receipts, highlighting key differences and trends between the states, **Subsection 2.2** focuses on Own Revenue Receipts, providing insights into the states' ability to generate revenue independently, **Subsection 2.3** discusses Central Transfers, assessing states' reliance on central transfers and changes in these transfers over time and **Subsection 2.4** shows the performance of the individual states. **Section 3** summarizes the results, with particular attention to the effects of the COVID-19 pandemic on the observed trends.

2.0 Overview of Revenue Receipts

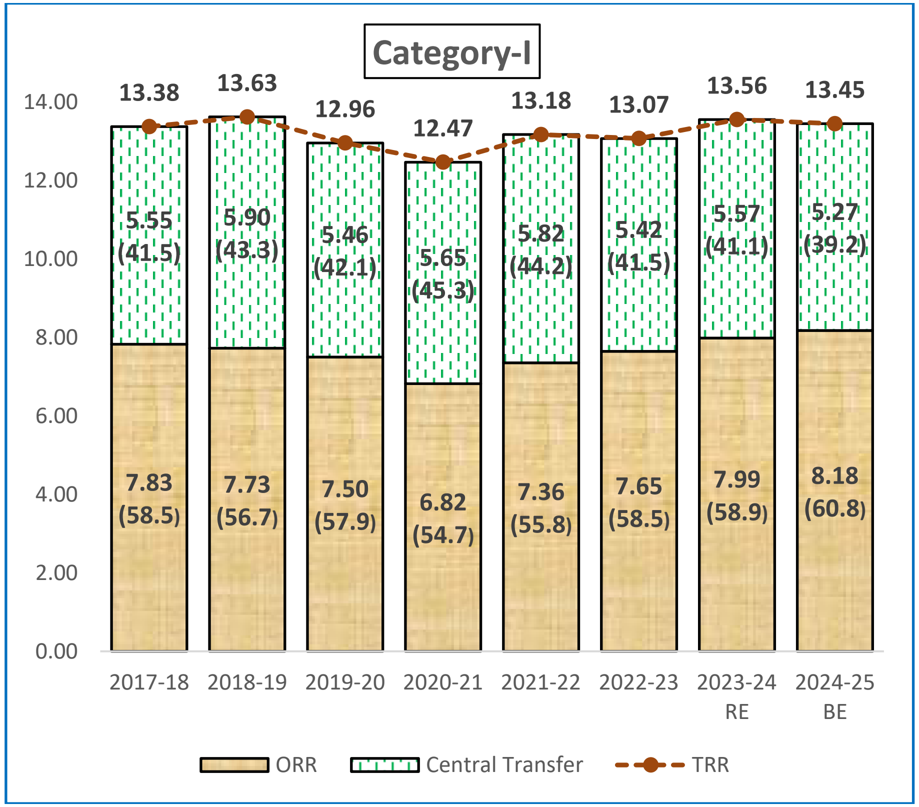
This section compares the revenue performance of Category-I and Category-II states by examining key components such as Total Revenue Receipts (TRR), Own Revenue Receipts (ORR), Own Tax Revenue (OTR), Own Non-Tax Revenue (ONTR) and Central Transfers. It highlights the revenue pattern in both state categories and show the differences in their reliance on own sources versus central transfers.

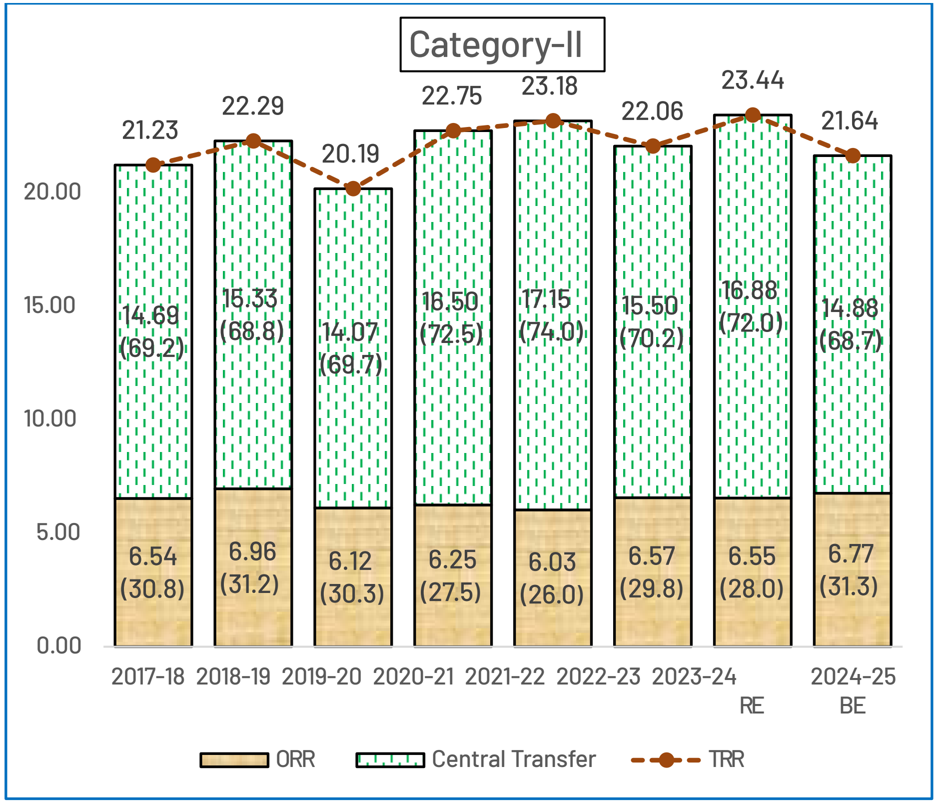
2.1 Overview of Total Revenue Receipts

Total Revenue Receipts (TRR) for a state reflect the total revenue collected by the state government. It is primarily composed of Own Revenue and Central Transfers. Own Revenue includes both Own Tax Revenue and Non-Tax Revenue, while Central Transfers consist of the state's share in central taxes and grants received from the central government.

Figure 2 displays the pattern in total revenue receipts as percentage of GSDP for the two state categories with its components. In Category-I states, during the period under analysis (2017-18 and 2024-25 BE), ORR comprised between 54.7 percentage and 60.8 percentage of TRR, while in Category-II states, it constituted approximately 26 percentage to 31.3 percentage of TRR. For Category-I states, central transfers accounted for between 39.2 percentage and 45.3 percentage of Total Revenue Receipts (TRR) during the period under analysis (2017-18 to 2024-25 BE), while for Category-II states, this figure ranged between 68.7 percentage and 74 percentage of TRR.

Figure 2: Total Revenue Receipts (%of GSDP)





Source: State Budget (TRR, ORR and Central Transfer), CSO (GSDP)

Note: Figures in parenthesis represent share in total revenue receipts

For Category-I states, the Total Revenue Receipts (TRR) as a percentage of Gross State Domestic Product (GSDP) declined in between 2018-19 and 2020-21 from 13.63 percentage in 2018-19 to 12.47 percentage in 2020-21. This decrease was primarily driven by an economic slowdown and the impacts of COVID-19, particularly affecting Own Revenue Receipts (ORR). Throughout the post-COVID period TRR as a percentage of GSDP remained below its pre-pandemic 2018-19 level for the category-I states. Conversely, Category-II states experienced an increasing trend in TRR as a percentage of GSDP, primarily fuelled by higher Central Transfers. For these states, the TRR rose from 21.23 percentage of GSDP in 2017-18 to 23.18 percentage in 2021-22 with a dip in 2019-20 because of economic slowdown. However, in 2022-23, TRR declined due to a significant reduction in Central Transfers, despite an increase in own revenue. The Revised Estimates (RE) for 2023-24 indicate a subsequent rise in TRR due to increased Central Transfers, but a sharp decline is anticipated in the Budget Estimates (BE) for 2024-25.

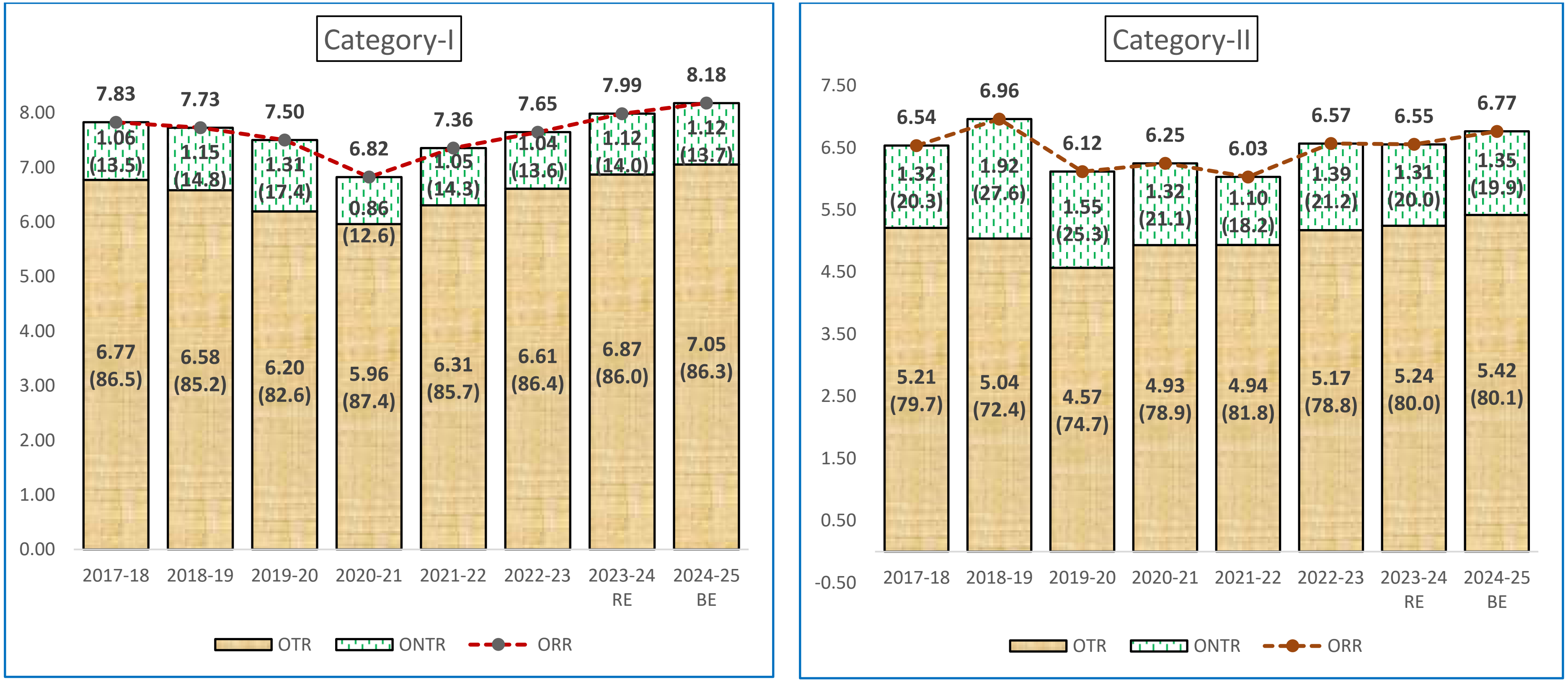
It is worth noting that during the COVID period (2020-21 to 2021-22) increase in central transfers does not fully compensate for the decline in ORR for Category-I states, but over compensates for category-II states.

2.2 Overview of Own Revenue Receipts

Own revenue receipts (ORR) play a crucial role in state finances in India, as it represents the state's ability to generate revenue independently, reducing dependence on central transfers. ORR of a state is composed of Own Tax Revenue (OTR) and Own Non-Tax Revenue (ONTR). Figure 3 shows the contribution of OTR and ONTR in total ORR for the both state categories. For Category-I states, OTR varies from 82.6 percentage to 87.4 percentage of ORR, with the rest coming from ONTR (Figure 3, left panel). Similarly, for Category-II states, OTR’s share of ORR ranged between 72.4 percentage and 81.8 percentage (Figure 3, right panel).

In Category-I states, own tax revenue (OTR) declined from 6.77 percentage of GSDP in 2017-18 to 5.96 percentage in 2020-21, while in Category-II states, it decreased from 5.21 percentage to 4.93 percentage over the same period, initially due to the economic slowdown and later as a result of the pandemic. However, with the economic recovery post-2020-21, OTR in both Category-I and Category-II states saw a sharp increase, reaching 6.87 percentage and 5.24 percentage of GSDP, respectively, in the 2023-24 Revised Estimates (RE), and is expected to rise further in the 2024-25 Budget Estimates (BE), driven primarily by the contribution of GST.

Figure 3: Own Revenue Receipts (%of GSDP)



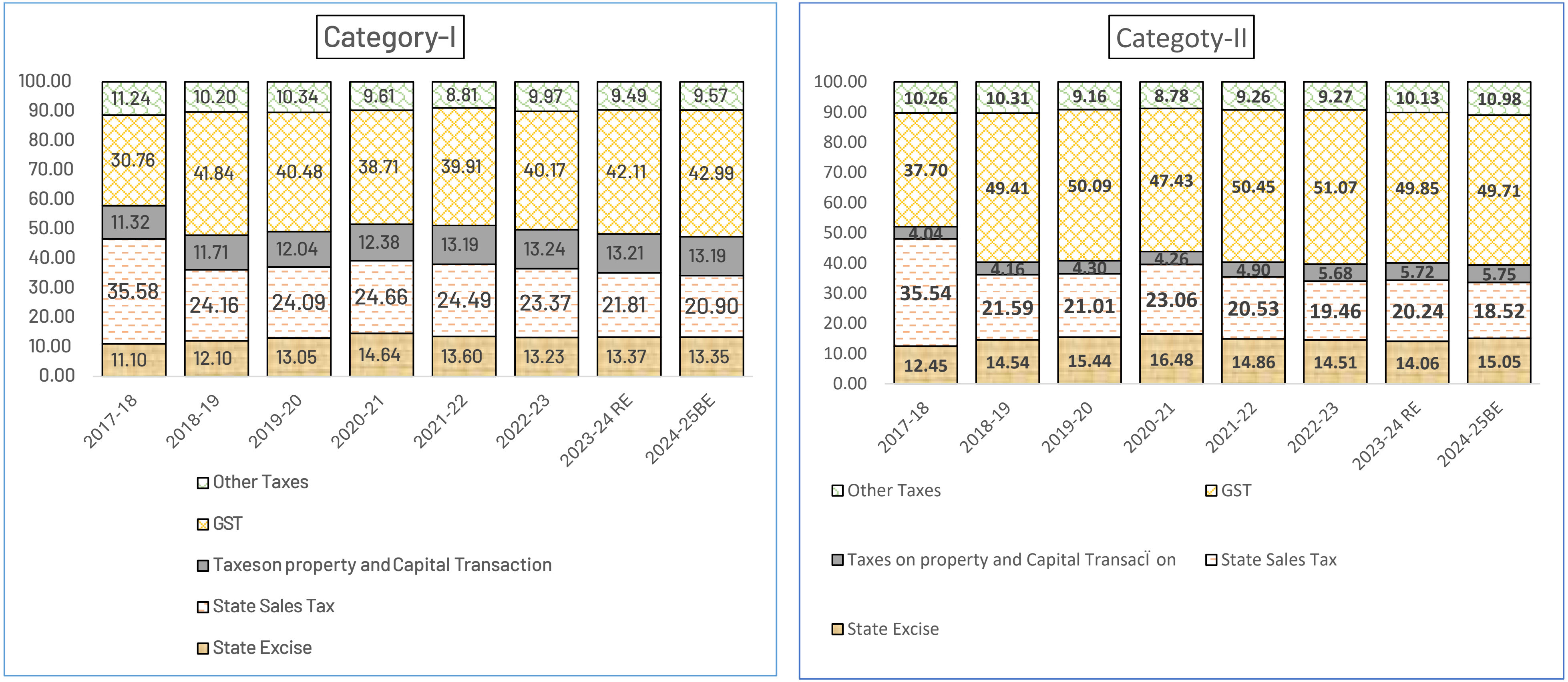
Source: State Budget (TRR, ORR and Central Transfer), CSO (GSDP)
Note: Figures in parenthesis represent share in total revenue receipt

States' own tax revenue consists of various tax components. Figure 4 presents the major components of own tax revenue for both state categories. In both Category-I and Category-II states, GST accounts for the largest share of own tax revenue, followed by state sales tax and state excise. For Category-I states, taxes on property and capital transactions make a significant contribution to own tax revenue, whereas in Category-II states, this tax source is relatively insignificant.

Own non-tax revenue (ONTR) in Category-I states declined from 1.31 percentage of GSDP in 2019-20 to 0.86 percentage in 2020-21 due to the pandemic and has not yet returned to its 2019-20 level (Figure 3). Similarly, in Category-II states, ONTR dropped sharply from 1.92 percentage of GSDP in 2018-19 to 1.10 percentage by the end of the pandemic (2021-22) and, despite showing a steady increase since, has yet to recover to its 2018-19 level.

Own revenue receipts (ORR) as a percentage of GSDP in Category-I states exhibited a sharp decline from 7.83 percentage in 2017-18 to 6.82 percentage in 2020-21, largely due to an economic slowdown, the introduction of the Goods and Services Tax (GST), and the impact of COVID-19. However, ORR is expected to gradually recover, reaching 7.99 percentage in 2023-24 (RE) and is anticipated to rise further to 8.18 percentage in 2024-25 (BE), driven by improvements in the GST system and economic recovery. In Category-II states, ORR increased from 6.54 percentage in 2017-18 to 6.96 percentage in 2018-19, thanks to a sharp rise in own non-tax revenue (ONTR). However, between 2019 and 2022, ORR fell to 6.03 percentage by 2021-22 due to declines in both OTR and ONTR. While ORR has improved since, it has not yet returned to its 2018-19 level.

Figure 4: Share of Major Taxes in OTR



Source: State Budget

2.3 Overview of Central Transfer

Central transfer is another important source of revenue for the states. Central transfers are composed of the state's share in central taxes and grants from the central government. For Category-I states, the share in central taxes constituted the larger portion of central transfers, with this share fluctuating between 51.8 percentage and 67.7 percentage during the analysis period (Figure 5, left panel). The remainder of central transfers consisted of various grants provided by the central government to these states. In contrast, for Category-II states, the share in central taxes in central transfers varied between 39.6 percentage and 52.3 percentage (Figure 5, right panel), while the rest is grants.

Figure 5 presents central transfers, the share in central taxes, and grants (excluding GST compensation) as percentages of GSDP for the two state categories. The share of central taxes as a percentage of GSDP declined for both Category-I and Category-II states between 2018-19 and 2020-21. For Category-I states, it fell from 3.88 percentage to 2.93 percentage, while Category-II states experienced a more pronounced decrease from 8.02 percentage to 6.54 percentage. This decline in both categories was primarily driven by the economic slowdown and the impacts of the COVID-19 pandemic, reflecting lower economic activity across the board. However, the share in central taxes for Category-I states recovered to 3.66 percentage in 2021-22 due to economic recovery and stabilized at 3.43 percentage in 2022-23, with expectations to maintain 3.57 percentage in both the 2023-24 Revised Estimates (RE) and the 2024-25 Budget Estimates (BE). Despite this recovery, the share of central transfers has not yet returned to its pre-pandemic level of 2018-19. In contrast, as the economy improved in 2021-22, the share of central taxes for Category-II states rose to 8.15 percentage and has stabilized since.

Aggregate grants from the central government as a percentage of GSDP increased for both Category-I and Category-II states during the economic downturn and the COVID-19 crisis. For Category-I states, grants rose from 2.06 percentage in 2017-18 to 2.28 percentage in 2019-20 and further to 2.72 percentage in 2021-22 (Table-1). However, excluding GST compensation from total grants reveals a slightly different picture (Figure 5, left panel). For Category-I states, the aggregate central grants as a percentage of GSDP were higher each year from 2017-18 to 2021-22 compared to the 2017-18 level, except for a slight dip in 2018-19 (Table 1). However, when excluding GST compensation, the net grants remained below the 2017-18 level in all years except 2020-21, where there was a marginal increase (Figure 5, left panel). This increase, however, was smaller compared to the overall rise in aggregate grants.

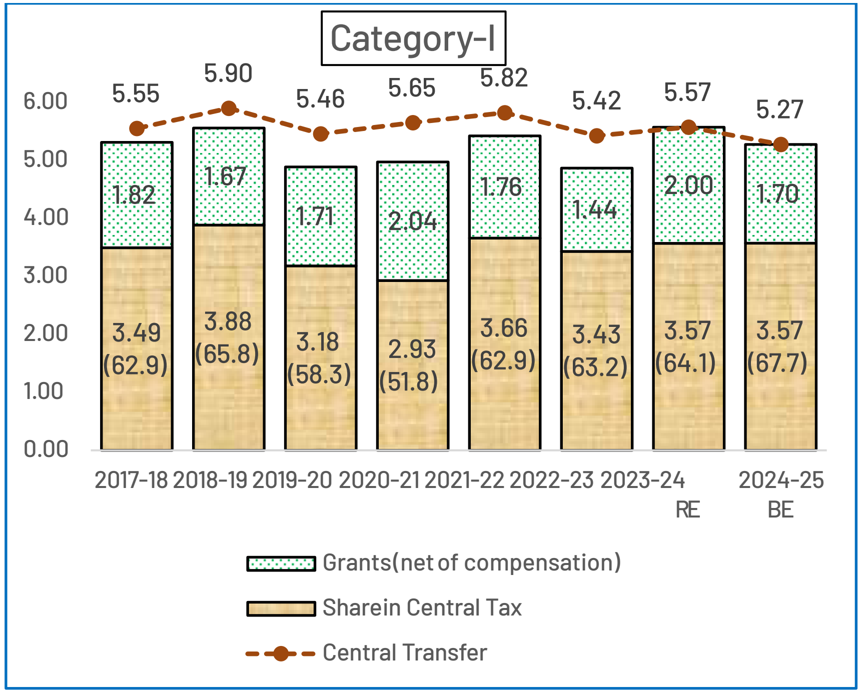
In Category-II states, central government grants surged from 7.65 percentage of GSDP in 2017-18 to 9.96 percentage in 2020-21 and 9 percentage in 2021-22. Excluding GST compensation from total grants does not significantly alter the grants trend for Category-II states.

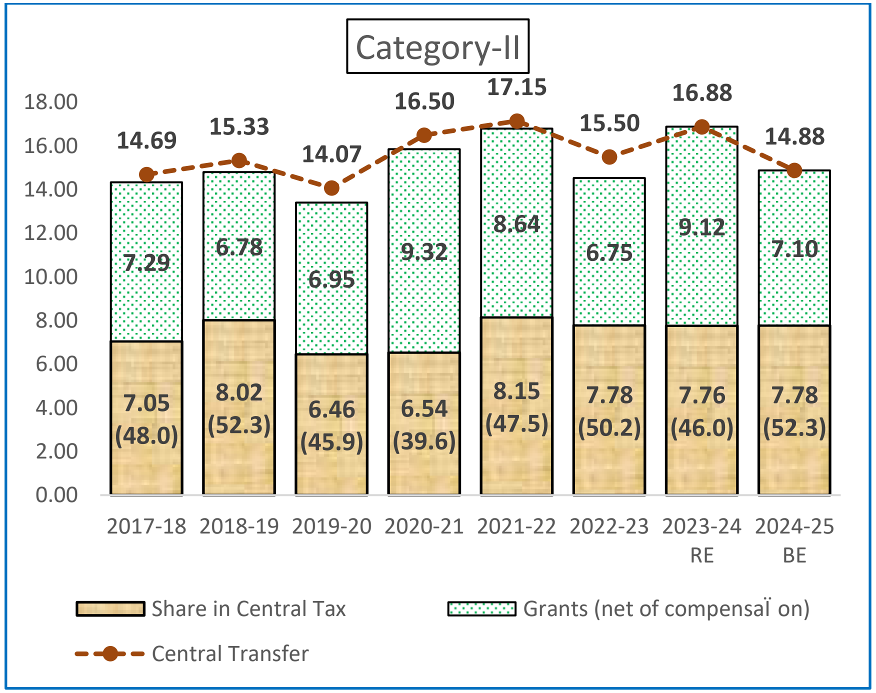
Table 1: Grants from the Centre (% of GSDP)

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24 RE	2024-25 BE
Category-I	2.06	2.02	2.28	2.72	2.16	2.00	2.00	1.70
Category-II	7.65	7.31	7.61	9.96	9.00	7.71	9.12	7.10

For Category-I states, total central transfers exhibited a declining trend, dropping from 5.90 percentage of GSDP in 2018-19 to 5.46 percentage in 2019-20. Despite a slight increase during the COVID-19 period, reflecting the central government's efforts to alleviate the financial impact of the pandemic, central transfers declined to 5.42 percentage of GSDP in 2022-23 and are projected to decrease further in 2024-25 BE (Figure 5, left panel). For Category-II states, total central transfers as a percentage of GSDP showed an upward trend, increasing from 14.69 percentage in 2017-18 to 17.15 percentage in 2021-22. The rise in central transfers during the COVID-19 period (2020-21 and 2021-22) reflects the central government's commitment for mitigating the financial impact of the pandemic. In the post-pandemic period (2022-23, 2023-24 RE, and 2024-25 BE), central transfers as a percentage of GSDP remained higher than pre-pandemic levels.

Figure 5: Central Transfer (%of GSDP)





Source: State Budget (TRR and Central Transfer), CSO (GSDP)

Note: Figures in parenthesis represent share in total revenue receipts

The gaps between the dotted line and bars represent the GST compensation

2.4 Performance of the Individual states

Figures 6 and 7, using a 45-degree line to compare pre-COVID and post-COVID scenarios, show the relationship between own tax revenue recovery and central transfer dependence for states. The horizontal axis represents pre-COVID levels, while the vertical axis represents post-COVID levels. States that lie above the 45-degree line have successfully improved their revenue performance when compared to pre-COVID levels. For central transfers, states that lie above the 45-degree line have seen an increased reliance on central support in terms of central transfer as percentage of GSDP during the post-COVID period, while those below the line have successfully reduced their dependence on central transfers compared to pre-COVID levels. In terms of Own Tax Revenue, West Bengal, Tamil Nadu, Odisha, Madhya Pradesh, Andhra Pradesh, and Karnataka from Category-I are still at their pre-COVID levels of performance, as are Manipur and Mizoram from Category-II. Regarding central transfers, Category-I states such as Haryana, Gujarat, Telangana, Karnataka, Tamil Nadu, Rajasthan, West Bengal, Madhya Pradesh, Odisha, Chhattisgarh, and Jharkhand are still at their pre-COVID levels of central dependence (central transfer as % of GSDP), as are Himachal Pradesh, Mizoram, and Nagaland from Category-II.

3.0 Summary

Table 2 provides a summary of the revenue side for both categories of states with a particular focus on the effects of the COVID-19. For Category-I states, the Total Revenue Receipts (TRR) as a percentage of GSDP remained stable between the pre-COVID and post-COVID periods, although there were notable shifts in the composition of revenue sources. Own Revenue Receipts (ORR) increased slightly, rising from 7.69 percentage of GSDP pre-pandemic to 7.82 percentage post-pandemic. This growth was primarily driven by an increase in Own Tax Revenue (OTR), particularly through gains in Goods and Services Tax (GST) collections. GST as a percentage of GSDP increased from 2.45% before the pandemic to 2.77% in the post-pandemic period for Category-I states. However, Own Non-Tax Revenue (ONTR) declined from pre-pandemic to post-pandemic levels. Additionally, a contraction in central transfers is observed, with the share of central transfers falling from 5.63 percentage of GSDP pre-pandemic to 5.50 percentage post-pandemic, largely due to a reduction in central grants.

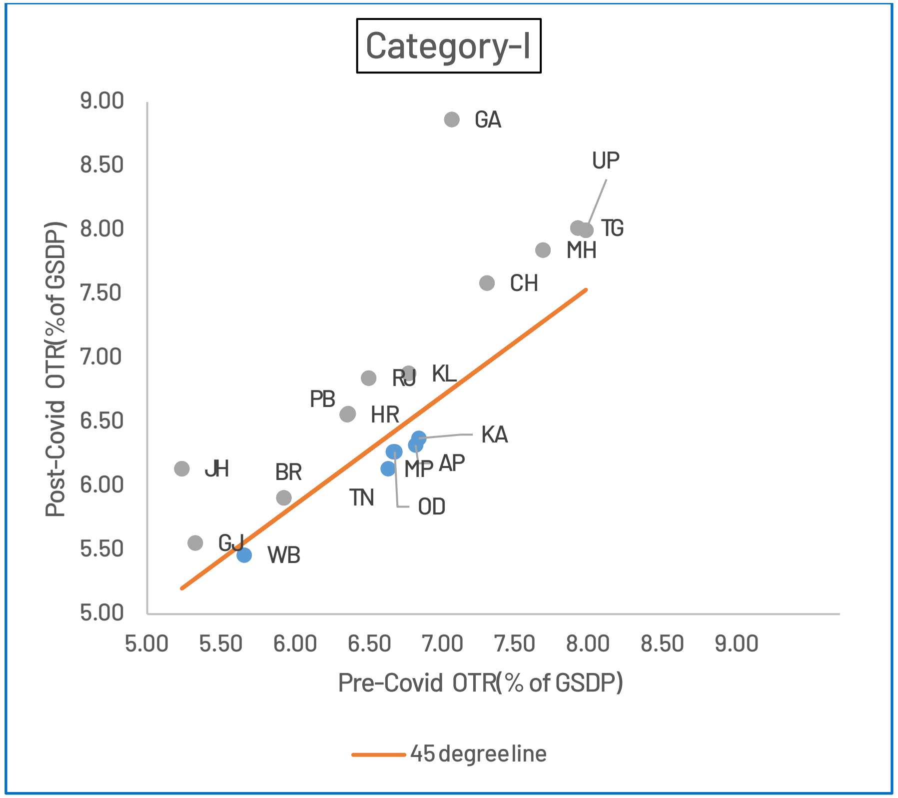
In contrast, Category-II states experienced a 1.51 percentage point increase in TRR, driven by a rise in central transfers. Unlike Category-I states, ORR for Category-II states remained relatively stable between pre and post pandemic years, though there was a shift in its composition. OTR increased from 4.94 percentage of GSDP pre-pandemic to 5.21 percentage post-pandemic, while ONTR saw a significant decline. The rise in Own Tax Revenue (OTR) is attributed to an increase in GST, which grew from 2.25% of GSDP at the pre-pandemic level to 2.63% in the post-pandemic period. Both central grants and the state's share in central taxes increased substantially for Category-II states between the pre- and post-COVID periods, contributing to the overall rise in TRR.

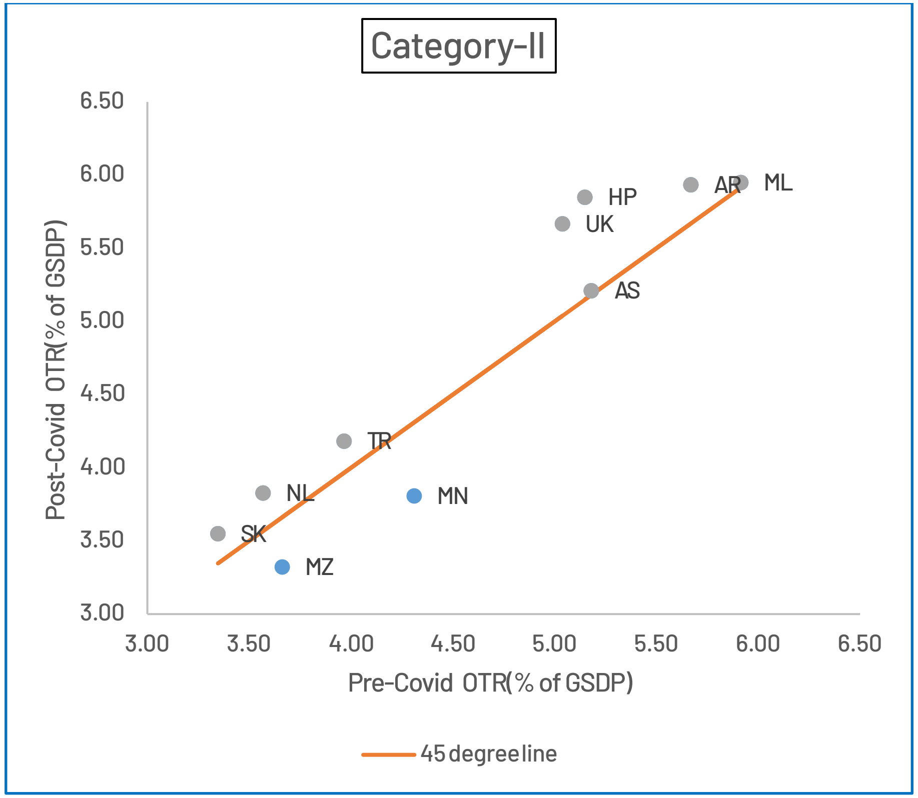
Table 2: Revenue Summary of Category-I and Category-II States

	Category-I				Category-II			
All Components are as percentage of GSDP	**Pre-Covid**	**Covid**	**Post-Covid**	**2024-25 BE**	**Pre-Covid**	**Covid**	**Post-Covid**	**2024-25 BE**
Total Revenue Receipts (TRR) (1+2)	**13.32**	**12.82**	**13.32**	**13.45**	**21.24**	**22.96**	**22.75↑**	**21.64**
1. Own Revenue Receipts (a+b)	**7.69**	**7.09**	**7.82 ↑**	**8.18**	**6.54**	**6.14**	**6.56**	**6.77**
a. Own Tax Revenue (i +ii)	6.52	6.13	6.74 ↑	7.05	4.94	4.93	5.21↑	5.42
i. GST	2.45	2.41	2.77 ↑	3.03	2.25	2.41	2.63↑	2.69
ii. Other Taxes	4.07	3.72	3.97↓	4.02	2.69	2.52	2.58↓	2.73
b. Own Non-Tax Revenue	1.17	0.95	1.08 ↓	1.12	1.60	1.21	1.35↓	1.35
2. Central Transfer (c+d)	**5.63**	**5.73**	**5.50 ↓**	**5.27**	**14.70**	**16.82**	**16.19↑**	**14.88**
c. Share in Central Taxes	3.52	3.29	3.50	3.57	7.18	7.34	7.77↑	7.78
d. Grants-in-aids from the Centre	2.12	2.44	2.00 ↓	1.70	7.52	9.48	8.42↑	7.10

Source: State Budget

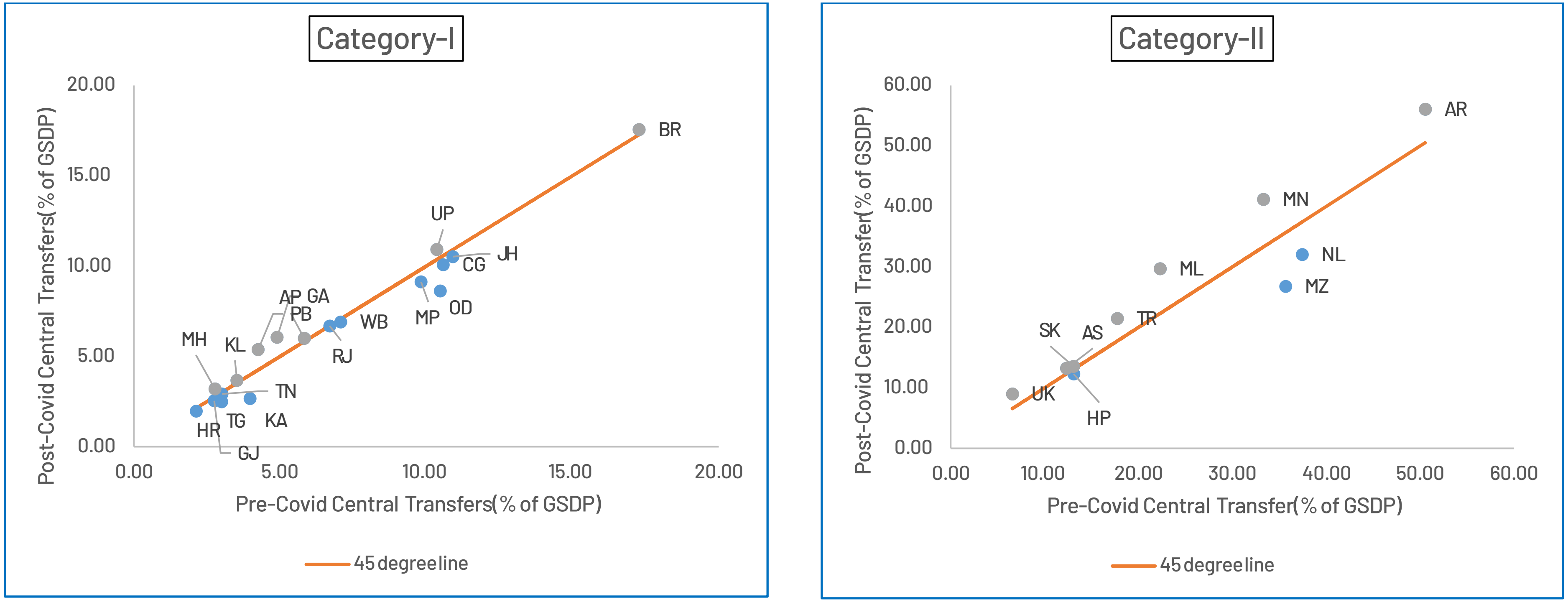
Figure 6: Changes in Revenue Performance (OTR)





Source: State Budget

Figure 7: Change in Dependence on Central Transfer



Source: State Budget

References

Pinaki Chakraborty and Kaushik Bhadra (2024), The RBI Study of State Finances 2023-24: Fiscal Balance Improves but Fiscal Risks Remain, Forum for State Studies, link: https://forumforstatestudies.in/issue-notes/the-rbi-study-of-state-finances-2023-24-fiscal-balance-improves-but-fiscal-risks-remain/

RBI (2023): State Finances: A Study of Budgets of 2023-24, Reserve Bank of India, Mumbai.

State Budget, Various States, Various Years.

State Forum 2024

CHALLENGES IN UTILISATION OF CENTRAL GRANTS

4

Budget Utilization under Centrally Sponsored Schemes: The Case of Health Sector

Mita Choudhury

National Institute of Public Finance and Policy, New Delhi

1.0 Introduction

Centrally Sponsored Schemes (CSS) constitute a major instrument of the Union government for extending support to States for specific expenditures. These schemes are initiated by the Union Government, and implemented at the level of States to achieve pre-defined objectives. Unlike the Finance Commission grants, these are funded using a fixed cost sharing arrangement between the Centre and States.11 Funds under these schemes flow through multiple tiers of administrative hierarchy before they can be spent for the designated goods and services. A variety of factors at different levels of the institutional architecture have a bearing on the utilization of these funds.

2.0 Measuring Utilization

Utilization of funds under CSS may be measured in two ways. The first approach refers to the ratio of 'Actuals' to 'Budget Estimates' (B.E.) in the Union budget, which indicates the volume of releases made to State Governments vis-à-vis the allocated budget. This measure of utilization does not take into account the final expenditure incurred by implementing agencies, and is partial in nature. The second definition is more holistic, where utilization is defined as ratio of the actual expenditure incurred by implementing agencies to the combined allocation of funds by the Centre and States. As information on the final expenditures incurred by implementation agencies are not readily available in the public domain, the former measure is more widely used.

Table 1 shows the utilization of budgets under major CSS in the health sector in recent years using the two different measures of utilization. In recent years, while the releases under the two largest CSS- the National Health Mission (NHM) and Ayushman Bharat- Pradhan Mantri Jan Aarogya Yojana (AB-PMJAY) have been close to 100 per cent, the share of releases in schemes like Pradhan Mantri-Ayushman Bharat Health Infrastructure Mission (PM-ABHIM) and Human Resources for Health and Medical Education (HRHME), has been relatively poor.12

The relatively better performance of NHM in terms of fund releases by the Union Government does not necessarily translate into better utilization at the state-level. A study on NHM across 29 States indicated

[11] In most schemes, the cost sharing ratio between the Centre and states is 60: 40. In north-eastern and hilly states, the ratio is 90:10.

[12] NHM constitutes the single largest CSS accounting for around 75 per cent of the total allocation under CSS in the sector. This is followed by the AB-PMJAY around 15 per cent, and other smaller initiatives like PM-ABHIM and HRHME. PM-ABHIM and HRHME together account for less than 10 per cent of the total allocation under CSS.

that the final fund absorption by IAs was less than 60 per cent in both 2017-18 and 2018-19 (Table 1).13

Table 1: Utilization of budgets under major Centrally Sponsored Schemes in health

First Measure of Utilization (based on Union Budget)		
	Actuals/Budget Estimate (B.E.) in Union Budget (%)	Revised Estimate (R.E.)/Budget Estimate (B.E.) in Union Budget (%)
	2022-23	**2023-24**
National Health Mission	100	100
AB- PMJAY	97	95
PM-BHIM (CSS Component)	29	50
HRHME	26	23
Second Measure of Utilization [based on Actual Expenditure by Implementation Agencies (IAs)]		
	Actual Exp by IAs/Combined allocation by Centre and States **(29 States)**	Actual Exp by IAs/Combined allocation of Centre and States **(29 States)**
	2018-19	**2017-18**
National Health Mission	59	58

Source: Union Budget documents for various years and Choudhury and Mohanty 2020.

3.0 Factors Affecting Fund Absorption in States under NHM

A. Timeliness of Releases

Fund releases from the Union Government are often loaded towards the latter half of the financial year, and this leaves less time for utilization of funds by implementation agencies. An illustration of the schedule of releases in a 'high-focus' relatively poor performing state using information from the SNA portal in the last financial year 2023-24 underscores the issue (Table 2). In 2023-24, the first instalment of NHM funds was received in the state treasury at the end of second quarter of the financial year. Till the end of December 2023, only about 58 per cent of the total allocation by the Union Government was received in the state treasury, leaving only the last quarter of the financial year for spending a substantial amount.14 Earlier studies on fund flow in NHM indicated that bulk of the releases in the last quarter was also concentrated in the month of March (Choudhury and Mohanty 2019). This was likely to be partially responsible for the fact that about 41 per cent of all expenditures under NHM across 29 States was incurred in the last quarter of the financial year, 2018-19 (Table 3). In a number of high-focus States, the share of expenditure in the last quarter was even higher.

13 Even in 2017-18 and 2018-19, releases of funds from the Union Government as a proportion of Budget Estimates (the first measure of utilization) were close to 100 per cent.

[14] The receipt of first instalment from the Union Government is however, dependent on meeting certain conditionalities, and there are EAG States, which have been able to receive the first instalment of funds by June.

Table 2: Central and State share releases under NHM in an EAG state, 2023-24

Scheme	Illustrative of an EAG State 2023-24 (Till 23rd Jan 2024)		
	Central Share		State share
	Receipt in state treasury	Release from State Treasury to SNA Account	Release of State share to SNA Account
	27th Sep 2023 (50 %)	20th Oct 2023 (92%) 6th Nov 2023 (8%)	21st Dec 2023
	29th Dec, 2023 (50 %)	Not released till 23rd Jan	

Source: Finance Department of the EAG State

Table 3: Expenditure by Implementation Agencies under NHM in different quarters of the financial year 2018-19

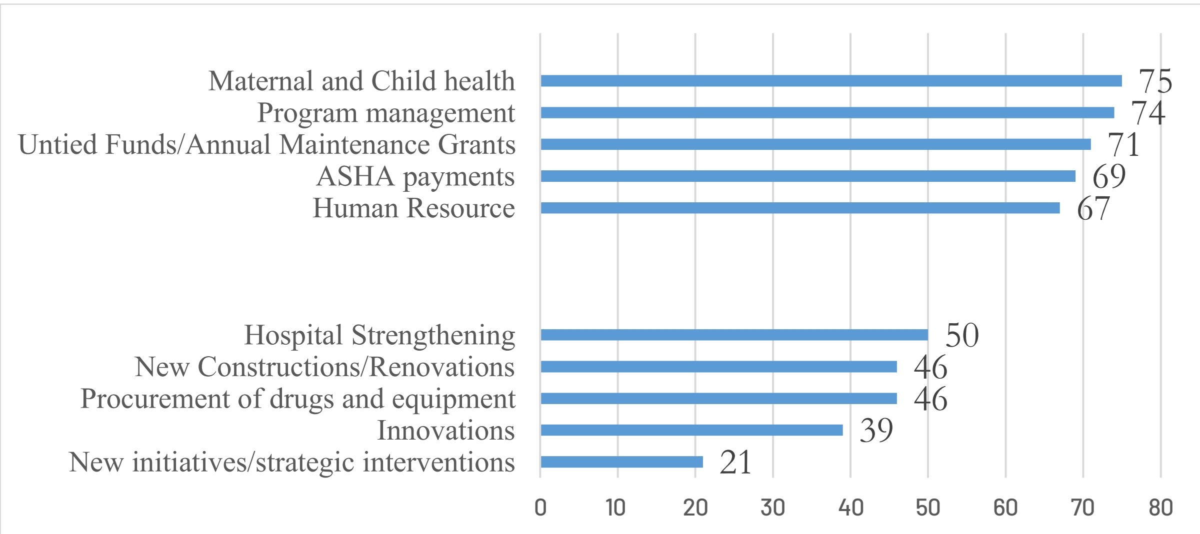
States	Cumulative Expenditure (%)			Expenditure in Q4 (%)
	Q1	Q2	Q3	
High-focus (Relatively poor performing)	5	31	57	43
Non-high focus large states	12	37	62	38
North-eastern States	12	32	57	43
All States	**8**	**34**	**59**	**41**

Source: Choudhury and Mohanty 2020

B. Components involving Complex Processes

Analysis of expenditure by components under NHM shows that utilization was relatively low in components, which involved more complex processes in execution (Figure 1). Procurement of drugs and equipment, new constructions, new initiatives and strategic interventions have lower utilization than components, which involve simpler execution processes. The utilization ratios in elements which predominantly involved direct transfers to beneficiaries and payments towards human resources were relatively high.

Figure 1: Average share (per cent) of budget utilization by components under NHM, 29 States, 2018-19



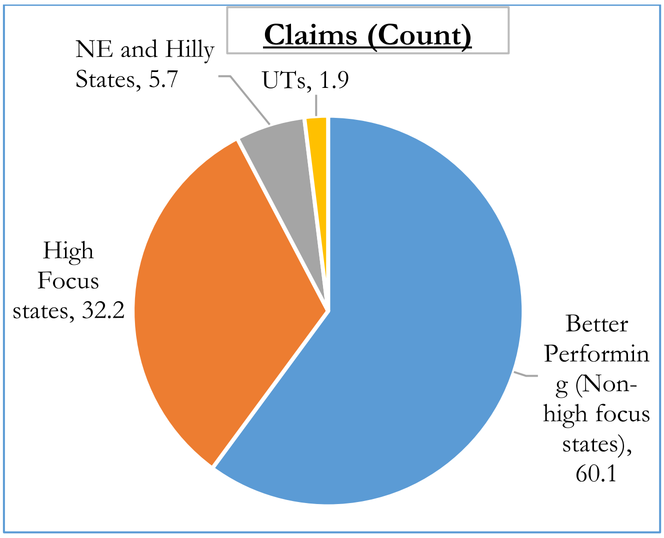
Source: Choudhury and Mohanty 2020

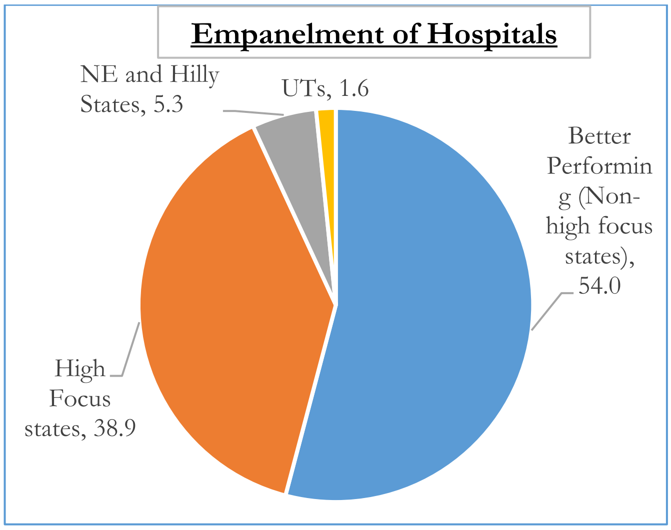
C. Functionality of Health Systems in States

Slack in health systems adversely affect utilization ratios. In particular, deficiencies in human resources pose hurdles in effective health service delivery, which in turn lead to lower levels of fund utilization at the facility-level. Evidence suggests that States with weak health systems have lower utilization ratios under NHM than States with more vibrant health systems. This is indicative of the fact that while NHM funds are intended to provide complementary inputs in health facilities, the absence of a well-functioning health system in States pose impediments to absorption of Central funds.

The role of health systems in fund utilization is also reflected in the context of AB-PMJAY. Around 60 per cent of the claims and 54 per cent of the empaneled hospitals in AB-PMJAY are concentrated in the well performing ('non-high focus') relatively rich states of the country. The six relatively poor 'high focus' states of Bihar, Uttar Pradesh, Madhya Pradesh, Rajasthan, Chhattisgarh and Jharkhand account for only around a third of all claims in the country (Figure 2).

***Figure 2*: Share of Claims (Cumulative) and Empanelment in AB-PMJAY**





Source: National Health Authority (NHA), available at https://dashboard.pmjay.gov.in/publicdashboard/#/

4.0 Factors Affecting Utilization of Funds under PM-ABHIM and HRHME

Several factors have affected the utilization of funds under each of the three components of PM-ABHIM. First, in the AB-HWC component, around 60% of the resource envelope was to be sourced from the health grants recommended by the 15th Finance Commission, whose utilization was adversely affected by complex execution structure of these grants. In the period 2021-22 to 2023-24, only around 45% of the 15th Finance Commission health grants could be utilized. The second component, which included establishment of block-level public health units (BPHUs), and having integrated district public health laboratories (IDPHLs) faced other issues. States were required to integrate public health laboratories under different vertical programs to avoid duplication. This entailed reorganization of the existing implementing structure at the State-level, requiring significant planning, streamlining and coordinated efforts. This retarded the pace of fund utilization. The third component intended to build critical care hospital blocks (CCHBs) in each district again involved construction activities which entail complex procedures.

Even if funds under PM-ABHIM were utilized, realizing the full potential of these investments call for additional fiscal commitment from States. The Union government's support for human resources in these newly created infrastructure is only for the duration of the PM-ABHIM scheme, i.e., till 2025-26. State governments will have to bear the recurring costs in maintaining the physical infrastructure built under the PM-ABHIM after this period. The ability of States to plan and support recurring expenses beyond this period is vital for the productivity of the incurred capital expenditure and utilized funds under the scheme.

Similarly, shortage of health manpower may reduce the effectiveness of expenditures under HRHME. There is a shortage of over 40% in teaching faculty positions in 11 of the 18 newly created All India Institutes of Medical Sciences in the country (Agarwal et.al. 2023). It is even more alarming in State government medical colleges in Empowered Action Group States. In Uttar Pradesh, where 17 government medical colleges were set up between 2019-21, 30% of the teaching faculty positions were vacant in 2022 (Agarwal et.al. 2023). The shortage of specialists could affect the task of setting up medical colleges or upgrading district hospitals to medical colleges. As in rural health statistics 2021-22, more than a third of the sanctioned positions of specialists in urban CHCs and two-thirds in rural CHCs were vacant in March 2022. Thus, as in AB-PMJAY, even if allocations for physical infrastructure were better utilized, filling the sanctioned teaching faculty positions could be challenging.

5.0 Summary

Utilization of funds under major CSS in the health sector has been relatively low and skewed towards the better-off states of the country. In schemes like the National Health Mission, utilization has been affected by timeliness of releases, degree of complexity in execution of specific components of NHM, and functionality of health systems. In schemes like PM-ABHIM and HRHME, which intend to build physical infrastructure, the financial commitment of States towards complementary recurrent spending and bridging gaps in health manpower will be critical for realizing the full potential of these investments.

References

1. Choudhury M. and Ranjan Kr. Mohanty (2020) “Role of National Health Mission in Health Spending of States: Achievements and Issues”, NIPFP Working Paper No. 317

2. Choudhury M. and Ranjan Kr. Mohanty (2019), “Utilisation, Fund Flows and Public Financial Management under the National Health Mission”, Economic and Political Weekly, Vol LIV, No 8, February 23rd

3. Agarwal A. Khushboo Balani and Sandhya Venkateswaran (2023), “Medical Education in India: A Study of Supply-Side Dynamics”, CSEP Working Paper – 55, July 2023

5

Utilisation Patterns under the Major Centrally Sponsored Schemes in School Education

A Discussion Note

Sukanya Bose and Sri Hari Nayudu A.

National Institute of Public Finance and Policy, New Delhi

1.0 The Context: Continuity and Change

Following the National Policy on Education (1986), the Centrally Sponsored Schemes (CSSs) have played an important role in ensuring financial concurrency for education programmes, especially in school education.[15] The inclusion of education in the concurrent list in 1976 further emphasized the case for financial concurrency. A central push was needed to reduce educational imbalances across states and raise *educational investments for greater access, quality, equality and social justice*.[16] The objectives of major flagship CSSs in school education, like the Samagra Shiksha Abhiyan and the Mid-day meal scheme, embody some of these lofty ideals. Another set of CSSs run by the social justice and tribal welfare departments (and the ministry of minority affairs) aims for social justice by addressing the educational needs of socially deprived communities.

With changing policies, the major CSSs have undergone several rounds of adaptation. In the last decade or so, Sarva Shiksha Abhiyan was made the vehicle for implementing the Right to Education (2009), a fundamental right under the Indian Constitution, and was accordingly modified to focus on the mandate of the Act. Another round of transformation ensued with consolidation of the existing schemes of Sarva Shiksha Abhiyan (SSA), Rashtriya Madhyamik Shiksha Abhiyan and Teacher education under one umbrella scheme of Samagra Shiksha Abhiyan (SMSA) in 2018. The programme was extended to cover the entire range from the foundation stage to the secondary stage in school education as per National Education Policy (2020). Similarly, PM-POSHAN, which has replaced the Mid-day meal programme (MDM), proposes to extend the scheme to students studying in pre-primary in government and government-aided primary schools, again indicating the expansionary impulses from within the sector.[17]

Intersecting with the sectoral changes in CSSs, the ecosystem of payments and fund releases on CSSs have undergone marked transformations in recent years, with innovations such as public financial management system (PFMS), Singla Nodal Account and Direct Benefit Transfers. These are aimed at better monitoring the availability and utilization of funds released to the States, more effective cash management and more efficiency in public expenditure management. In the short-run, these may lead to lower expenditure by states/ institutions unable to keep pace with technological innovations. In the macro-fiscal policy domain, a significant shift in intergovernmental transfer ensued with the Fourteenth Finance Commission's (FC), 2015-2020 recommendations on higher tax devolution of central taxes to the states. There were downward adjustments in central allocations on CSSs in response to the higher devolution of central taxes.[18] Thus, contrary to the expansionary impulses within the sector, the

[15] Govinda and Sedwal, 2017
[16] Rao, 1972
[17] A few new CSSs have been added in recent years in school education: STARS programme and PM-Shri schools.
[18] For details see, Bose et al (2022)

impulses originating from macro-fiscal policies and financial management have been contractionary in nature in the context of CSSs in school education.

CSSs accounted for 82% of the centre's expenditure on school education in 2009-10 which rose to 86% in 2014-15, but declined thereafter (Table 1). In 2022-23, CSSs accounted for 76% of central expenditure on school education (the remaining going to central sector schemes (CS)). Compared to school education, CSSs are less prominent for higher education.

Table 1: Union Government's Expenditure on School & Higher Education: CSS and CS

		2009-10	% of Total SE	2014-15	% of Total SE	2018-19	% of Total SE	2022-23	% of Total SE
School Education (SE)	CSS	21794	82	40828	86.1	39473	79.4	46693	75.8
	CS	4778	18	6605	13.9	10249	20.6	14895	24.2
	Total	26572 (61.3)	100	47432 (63.4)	100	49722 (54.3)	100	61588 (58.5)	100
Higher Education (HE)		**2009-10**	**% of total HE**	**2014-15**	**% of total HE**	**2018-19**	**% of total HE**	**2022-23**	**% of Total HE**
	CSS	1750	10.4	4100	15	10106	24.1	7738	17.7
	CS	15010	89.6	23224	85	31782	75.9	35938	82.3
	Total	16760 (38.7)	100	27324 (36.6)	100	41888 (45.7)	100	43676 (41.5)	100
Total		43332		74756		91610		105264	

Source: Expenditure budget of union government across four ministries, MHRD, Ministry of Tribal Affairs, Ministry of Social Justice and Ministry of Minorities Affairs, various years.
Note: Figures in brackets denote the proportion of overall education expenditure of the union government

There appears to be a difference between the Centre and States' approach to CSSs, which is always at play. Generally, States want lower matching shares for CSSs and more autonomy and flexibility in utilisation of funds.[19] And for their financial proposals to be fully funded and not cut. States want the central funds to cover recurring expenditures (like teachers' salary support, among other things). States want adequate unit costs for the interventions and to cover the gaps in spending. On the other hand, the Centre insists on more norm-based financing that can be monitored. It wants to minimise unutilized funds and idle balances (hence innovations such as just-in-time finance). The centre lays more emphasis on monitoring management and evaluation. The centre wants to fund innovations and newer heads of expenditure rather than continue funding old schemes. The development of CSSs in any field has had to endure and negotiate the tension between the central objectives and the States' perspectives.

2.0 The Issue of Utilisation

The problems of unspent funds or under-utilisation in social sector schemes, especially in the major CSS, are highlighted frequently.[20] Whether state administrations have the capacity to absorb the fund flows is an important question to ask, as this would determine the relationship of programmes to a certain set of broadly defined outcomes. In a more limited sense, the extent of utilisation would decide if the funds released would translate to expenditure. The problem is more acute for low-income states.[21]

[19] Refer to views of the States in the Reports of 13th Finance Commission, 14th Finance Commission and 15th Finance Commission, GoI. Also see the discussion on improving utilization in Bose et al, 2022.
[20] Jha et al (2021)
[21] Rao (2017)

States with the highest gaps in funding have shown low capacities to absorb funds. There is a linkage between under-funding/inadequacy of budgets for a sector over a long time and the capacity of the sector to absorb resources in the current schemes.

However, a good plan should be able to break the vicious cycle. Implementation must be an intrinsic part of the plan's design, argues Chakravarty (1987). A good plan not only derives paths to achieve the desired target but also sketches behavioural patterns that can lead the system to the target. Therefore, utilisation patterns can be a guide to planning and course correction.

The following sections analyse the macro-patterns of utilisation of funds for two of the major flagship programmes in school education, Samagra Shiksha Abhiyan (SMSA) and Mid-day Meal Scheme (MDM, now PM-POSHAN), which have been in operation for more than two decades. These two schemes constitute more than 90% of grant-in-aid for school education going to states via CSSs from the central ministries (see Appendix Table 1A). The questions explored include: *what are the utilization rates (URs) for SMSA and MDM allocations in recent years? Have the low-income states caught up with the rest?* What do the component-wise allocations reveal? In the process, we flag some issues and challenges.

Utilization can be measured in different ways. It can be calculated as expenditure against the funds available (releases plus spillovers). In the absence of information on funds available, the proposed state plan, or the approval of the plan, is used as a benchmark against which to evaluate expenditure. Utilisation to funds available is a better measure than utilisation calculated to approval, which implicitly assumes that funds available are the same as approval, an unrealistic assumption given the experience of states.[22] Whatever definition one uses, the availability of consistent data series is a significant challenge in estimating utilisation rates (URs). Much of the data is no longer available in the public domain, as will be repeatedly pointed out.

Annual work plans and budgets (AWP&Bs) of SMSA and MDM are the primary data sources for this analysis. The analysis is based on 12 states. Eight general category states with the maximum gaps in funding, as identified by Bose et al. (2020), are selected. These are Bihar, Jharkhand, UP, Chhattisgarh, MP, Odisha, Rajasthan, West Bengal, along with two special category states, Meghalaya and Nagaland and two educationally advanced states – Tamil Nadu and Karnataka.

3.0 Utilisation Patterns of Samagra Shiksha Abhiyan

Table 2 presents expenditure against approved budget on SMSA for 2023-24.[23] The data, obtained from the PRABANDH portal and reported in AWP&B of states, is only available for the latest year (2023-24) and for nine (out of twelve) states.[24]

The average SMSA utilisation rate (UR) is 78.7% across the nine states. The highest UR is in Karnataka (91.2%), with Bihar (90.9%) and Jharkhand (89.2%) coming close. This means that most states are utilising the CSS funds to a reasonable extent. While there are differences in URs across states, the gap

[22] Utilisation/ Approval = Utilisation/ Funds Available X Funds Available/ Approval so Utilisation / Approval = Utilisation/ Funds Available (if Funds Available/ Approval is 1)

[23] Approved budgets are based on Annual Work Plan and Budgets (AWP&Bs) presented by individual state governments. Budgets projected by states are approved by the Programme Approval Board (PAB) for SMSA (and MDM) under MHRD, after discussions and negotiations with individual state governments.

[24] http://prabandh.samagrashiksha.in/ Under PRABANDH (Project Appraisal, Budgeting, Achievements and Data Handling System) States and UTs may view the Status of GoI Releases, approved outlays, coverage as per UDISE, school wise list of approvals, school wise gaps, cancellations in approvals etc. under Samagra Shiksha. The stated objectives of PRABANDH are (1) To obviate the need for submitting hard copies, except where it is mandated otherwise. (2) To have transparency and accuracy in the System w.r.t Approvals, Releases, Financial Status. (3) To streamline the Financial Management System, to enable more accurate assessment of actual requirement of funds for implementation. (4) For efficient decision- making. PRABANDH data is not accessible to the public.

between advanced and lagging states in overall utilisation is no longer significant. Measured as a proportion of releases, UR would be higher.[25] Odisha is an outlier, with low utilisation rate (55.7%), a pattern seen in other years as well.[26] The approval on recurring heads is mostly utilised, while the major part of the non-recurring head remains unutilised even in states such as Karnataka with otherwise high UR.

Bose et al. (2022) present utilisation rates of Sarva Shiksha Abhiyan for six years (2012-13 to 2017-18) for ten states using the scheme's audited financial statements (data that is no longer available) and AWP&B.[27] This was the period before the scheme was consolidated under SMSA.[28] Expenditure to approved budgets averaged 68.4% during the six years across ten states. Though not precisely comparable since the scheme has changed, the ratios for SMSA in 2023-24 are generally higher than the past ratios.

Table 2: SMSA Expenditure against Approval (in %), 2023-24

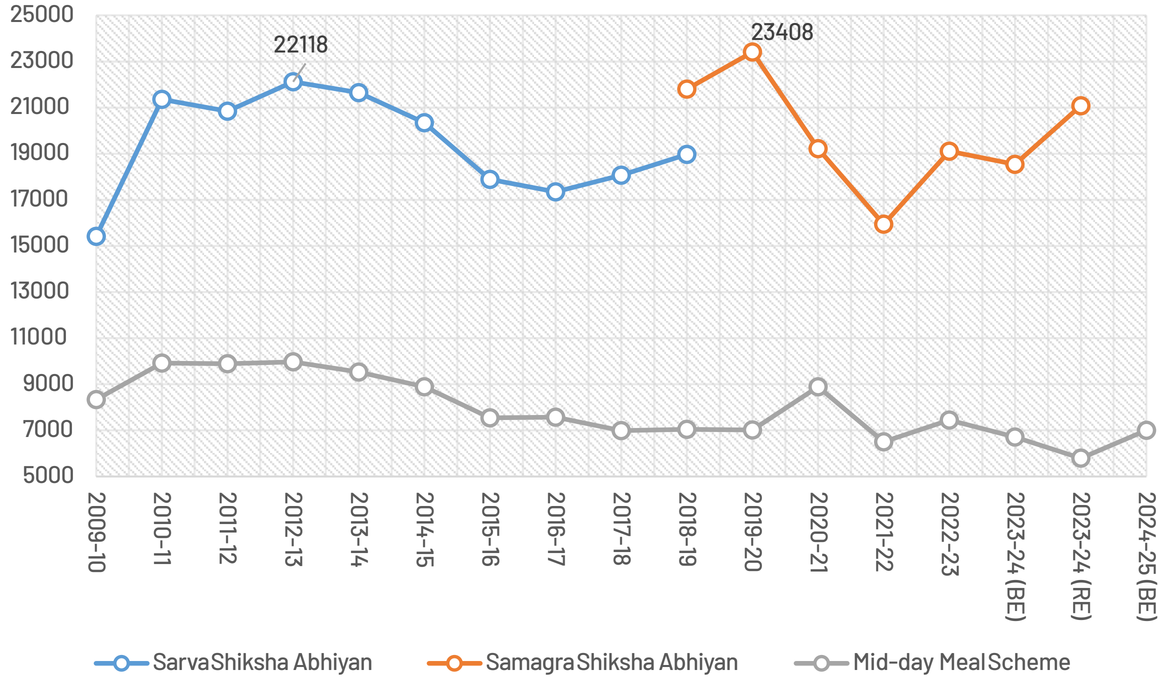
	Recurring	Non-recurring	Total
Bihar	96.1	25.2	90.9
Jharkhand	96.6	17.8	89.2
Karnataka	94.7	46.4	91.2
Meghalaya	96.7	25.4	83.5
MP	92.3	6.9	83.4
Nagaland	100.0	3.9	68.5
Odisha	57.4	39.5	55.7
Rajasthan	83.8	14.8	75.1
UP	78.8	42.2	70.6
Average of 9 states	*88.5*	*24.7*	*78.7*

Source: SMSA AWP&B, 2024-25. PAB minutes are not available for the other 3 states.

It may be noted that the increase in utilisation has come within near stagnant trends in allocations for the CSSs on school education. After some initial buoyancy (2009–12), the union finances on SSA stagnated and then declined consistently (Figure 1). Expenditure under SMSA has been even lower than the pre-merger SSA expenditure in real terms, in several years (Bose, 2024). The same is true of MDM scheme. It would not be wrong to conclude that the stagnant trends in central allocations contributed to higher utilisation of allocations. Generally, given the considerable gaps in spending, especially in the lagging states, better utilisation rates should have been accompanied by higher expenditure, which has not happened. It is supported by the fact that the states have, in several cases, been contributing more than the mandated matching share. For instance, Bihar, one of the states with the lowest per-student expenditure and the highest gaps between the normative requirements vis-à-vis the actual expenditure, contributes 83% to total expenditure on SMSA in 2022-23.[29] By the time the lagging states improved their implementation of the schemes and raised their utilisation ratios, the allocations on the same began to dry up (Bose et al., 2022).

[25] See Bose et al. (2022)
[26] Utilisation vis-à-vis funds available for Sarva Shiksha Abhiyan at 59% (2015-16), 65% (2016-17) and 77% (2017-18) for Odisha was lower than for other states (ibid).
[27] The ten states overlap with the states considered in this note, except for TN and Karnataka.
[28] In 2018-19, in an attempt to bring a "holistic approach to school education", the Sarva Shiksha Abhiyan (SSA), Rashtriya Madhyamik Shiksha Abhiyan (RMSA) and Strengthening of Teacher Training Institutions were merged to form the SMSA.
[29] Source: Appendix V, Finance Accounts, CAG.

Figure 1: GoI's Expenditure on Sarva Shiksha Abhiyan, Samagra Shiksha Abhiyan and MDM Scheme *(at 2011-12 prices)*



Source: Union budget, various years

As per the new system of release of funds, idle and unspent balances are expected to reduce further as the funds will be available only at the time of expenditure (just in time finance). Expenditure is to be done exclusively through PFMS. The States are to adhere to the new financial architecture where CSS funds are being released in 4 instalments, while ensuring 75% expenditure at each stage.[30] Single nodal account (SNA) is a new reform.[31] The full implications of these changes for educational expenditure and utilisation across all levels are yet to be grasped. It would certainly bring greater alignment between the release of funds and expenditure of funds, therefore, better fund allocation. To what extent it can enhance state capacities and whether every state can adapt to these changes swiftly remains to be seen.

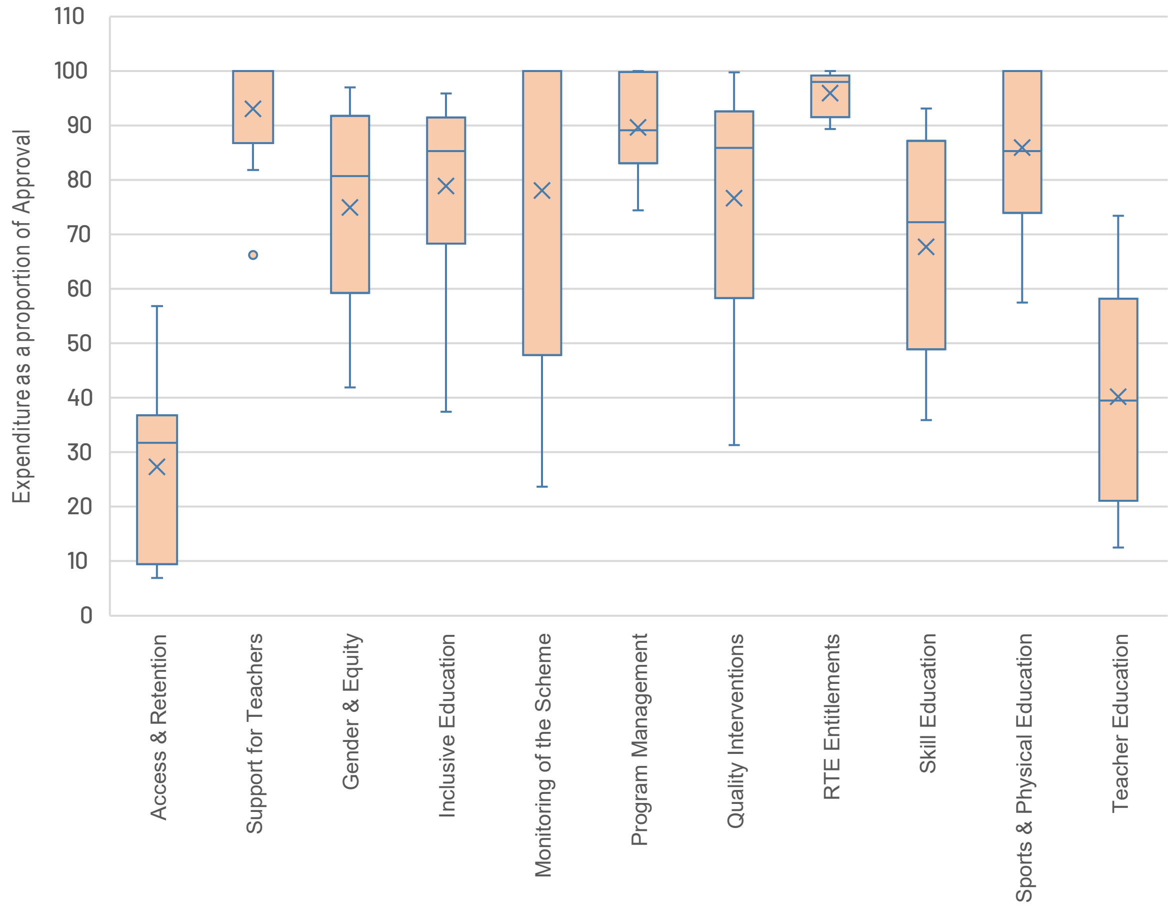
Component-wise utilisation of SMSA

Component-wise UR shows that financial support for teachers and RTE entitlements have the highest utilisation, tending towards 100% (Figure 2). It is uniformly high across states. These also constitute a significant proportion of SMSA expenditure (Table 3). While one is an entitlement under RTE, financial support for teachers is an area with a maximum deficit in most states. URs are approaching an upper bound as allocations for teachers' salaries are restricted under SMSA norms and have low unit costs.

[30] See AWP&B, SMSA, 2024-5.

[31] In line with the revised procedure prescribed by the DoE (MoF), the state government has to transfer funds (Central and State) to SNA within 30 days upon receiving by State Treasury from GoI. In case of delay in transfer of funds, interest shall be charged. In line with the revised procedure prescribed by the DoE (MoF), the state government has to transfer funds (Central and State) to SNA within 30 days upon receiving by State Treasury from GoI. In case of delay in transfer of funds, interest shall be charged as per the guidelines of the MoF. For details on new fund release procedures, see Samagra Shiksha – An integrated scheme for school education, Manual on financial management and procurement, 2024. https://dsel.education.gov.in/sites/default/files/update/FMP_2024.pdf

Figure 2: Component-wise expenditure as % of Approved, 2023-24, SMSA (9 states)



Source: SMSA AWP&B, 2024-25

Utilisation rate for quality interventions, which has the highest share of SMSA spending in the advanced states like Karnataka, varies substantially across states, though the median value is 86%. Over the years, there has been an increase in emphasis on quality interventions in SMSA budgets.[32] Quality is broadly defined here, and the interventions include academic support for CRCs and BRCs, early childhood care and education, ICT initiatives, the Learning Enhancement/Enrichment Programme (Remedial Teaching), etc.[33]

Quality interventions include innovations, which have a component of flexi-funding. According to the scheme guidelines, financial support is provided under state-specific projects as per the allocation of flexi funds under "quality" to the state.[34] The total resources under the innovation component are provided up to 5% of the total AWP&B approved.[35] To what extent do states use the limited flexibility, which is offered/straight-jacketed within a particular head, can only emerge from the states' experiences. Merger of the schemes under the umbrella SMSA was also aimed at providing more flexibility. While

[32] Accountability Initiative, budget brief.
[33] It also includes fund for Safety and Security at School Level, Holistic Report Card for Students, Orientation Programme for Teachers on Safety and Security, Shaala Siddhi, Teacher ID Cards, Youth & Eco Club, Ek Bharat Shresth Bharat. Teacher dairy, student dairy, Celebration of Pravesh Utsav, Instructional residential workshop for Students, Twining of School, Strengthening of Bal Sansad, Student learning Assessment, Project Kala Utsav, Band Competition, etc. (SMSA, AWP&B, 2024)
[34] Flexible funds for innovation are for State Specific Projects for improvement of Quality and access to Education. Activities like Ek Bharat Shreshta Bharat, Kala Utsav, Yoga Olympiad, Band competitions etc. are suggested.
[35] http://prabandh.samagrashiksha.in/download/AWP&B/Annexure-I.pdf

much was expected from the merger, field-based research on Tamil Nadu indicates it has only offered limited flexibility to states as expenditures remain rigidly classified under the same heads as before. Tamil Nadu needs higher funding for secondary education, adolescent education, training or vocationalisation, which is not currently available (CBPS, 2020). Thus, states always complain that the CSS funds are specific and have no flexibility. According to the principle of "subsidiarity," each public service should be provided by the jurisdiction with control over the minimum geographic area, which would internalise the benefits and costs of such provision (Oates, 1972). Flexibility may need to increase in more substantive ways. [36]

The lowest utilisation is in access and retention (Figure 2), with the highest share of non-recurring allocations (CAPEX) going towards infrastructure expansion, etc. This head has the largest spillover and states have surrendered many civil work projects over the years (AWP&B, SMSA). Drawing from another experience of HEFA audit (NIPFP, 2023), it is evident that finance is *one* of the many factors required for completing an infrastructure project on time. Especially when it comes to construction activity, climatic conditions, labour and material shortage, price escalations, contractors abrogating contracts midway, land acquisition issues, litigation, delays in approval, clearance, and permission on environmental sustainability may interfere. Many real impediments can come in the way of effective utilisation. This is an area where just-in-time finance may limit unutilised funds from building up.

Teacher education is another area with low URs. The underutilisation of teacher education funds in SMSA (and in SSA earlier) is a persistent concern. The best-case approaches 75% UR (for Karnataka) with a mean near 40%. The reasons include training fatigue, lack of coordination between line departments and SMSA, shift towards online training, etc. More generally, it may be symptomatic of a situation where the central norms and state priorities do not match. Karnataka still devotes a substantial 5% of SMSA spending to teacher education (Table 3). Karnataka's emphasis on inclusive education and teacher education stands out from other states.

Utilisation also varies across different levels of education (Accountability Initiative, 2020). It is maximum at the elementary level where the structure of schooling is in place and the programme got enough time to take root. In contrast, it is expected to be least in early childhood care and education and only partially better for the secondary level, where the lagging states lack adequate physical infrastructure and teaching resources.

Table 3: Component-wise share in total expenditure, SMSA, 2023-24 (%)

	Financial Support for Teachers	Quality Interventions	RTE Entitlements	Gender & Equity	Program Management	Access & Retention	Skill Education	Teacher Education	Inclusive Education	Sports & Physical Education	Monitoring of the Scheme
Bihar	43.8	24.0	21.5	5.0	3.3	0.3	0.5	0.1	0.7	0.6	0.2
Jharkhand	37.7	25.8	17.3	9.3	4.2	0.7	2.9	0.2	0.4	1.4	0.1
Karnataka	20.1	35.5	22.3	5.5	4.4	1.7	0.9	5.0	3.9	0.3	0.2
Meghalaya	49.7	23.0	9.3	2.6	5.5	3.9	3.0	1.8	0.4	0.6	0.2
MP	34.1	26.9	19.4	4.9	5.1	3.2	3.2	0.8	0.9	1.4	0.1
Nagaland	37.3	31.7	3.5	3.7	7.0	2.8	4.2	8.7	0.3	0.7	0.2
Odisha	42.2	11.8	19.0	8.3	7.1	2.9	2.8	2.0	1.7	2.0	0.0
Rajasthan	42.8	14.0	21.0	4.3	5.2	5.8	3.7	1.0	0.6	1.7	0.0

[36] Also see, Kundu and Rastogi, 2020.

	Financial Support for Teachers	Quality Interventions	RTE Entitlements	Gender & Equity	Program Management	Access & Retention	Skill Education	Teacher Education	Inclusive Education	Sports & Physical Education	Monitoring of the Scheme
UP	38.5	14.0	21.5	13.3	4.9	3.9	0.5	1.4	1.0	1.0	0.1
Average	38.5	23.0	17.2	6.3	5.2	2.8	2.4	2.3	1.1	1.1	0.1
Min	20.1	11.8	3.5	2.6	3.3	0.3	0.5	0.1	0.3	0.3	0.0
Max	49.7	35.5	22.3	13.3	7.1	5.8	4.2	8.7	3.9	2.0	0.2

Source: SMSA AWP&B, 2024-25

To conclude this section, the patterns of utilisation of SMSA, the major flagship CSS, indicates (1) high utilisation rates across states, in general. Odisha is an outlier among the nine states analysed. (2) Some components are approaching 100% utilisation while others show a slack in spending. (3) The highest UR is in financial support for teachers and RTE entitlements, making it evident where the maximum demand for funds lies and indicating the gap between states' requirements and the programmatic norms. (4) Low URs in "access and retention" are connected to the absence of complementary factors (5) States are able to absorb funds for basic-level interventions. For higher-order interventions, the progress is slower. Since the fundamental issues of schools, teachers, and infrastructure are not in place, interventions like inclusive education, which needs special educators or skill training, requires instructors, and perhaps partnerships with industry, have progressed more slowly. (6) While the overall trend shows the gaps in URs between states are closing, there are differences between advanced and lagging states in the pattern of spending and utilisation of funds. (7) Rising URs, however, have not been accompanied by rising expenditures on SMSA. (8) How the recent reforms on financial management would pan out for this diverse field of intervention and actors (down to the school level) and States remains to be seen. Some questions that may need answers include: Can 25% instalment tranches be suitable for every intervention? And whether 75% utilization must be across all interventions because, as we saw, URs differ across heads of expenditure.

4.0 Mid-Day Meal Scheme

Data availability has been a major challenge for calculating URs for MDM scheme (now PM-POSHAN) in recent years. Data on MDM can be collected from two sources (1) MDM is a bottom-up scheme with specified programmatic norms where AWP&B plays a crucial role in planning. AWP&B is designed to provide a comprehensive picture of the present scenario of the scheme's implementation. Before 2021, State/UTs AWP&B documents, State writeup, Factsheet, Appraisal Notes, State Presentation, MHRD Presentation and Minutes were available year-wise. Data on both allocations and releases/expenditures were available. After 2021, only writeups for AWP&B are available without the proforma tables. The performance scorecard with data up to 31st December is the only data available to understand utilisation. (2) CAG's Finance Accounts report data on CSSs (Appendix V), the other data source. However, this data is not reported consistently every year by every state. In many cases, the allocation and expenditure have the same value, making it difficult to use the data. Also, expenditure on CSSs, as viewed from the states' accounts, can be different, as a state may spend more than the minimum mandated amount and implement the scheme in their own way. For instance, central allocations are a small part of the overall expenditure on MDM in Tamil Nadu, which has a much more comprehensive scheme in place (including breakfast and eggs, among other things).[37] The data

[37] 21% of expenditure on MDM in TN is met through central release on MDM in 2022-23 (Source: Finance Accounts, CAG).

collected from the two sources – AWP&B and CAG - then provide different information and need to be interpreted differently.

Table 4 presents URs for overall MDM, taken from the latest AWP&B reports of MDM, for 12 states across time. UR is estimated as funds utilised as a proportion of the approved budget. URs have consistently increased and the dispersion in URs across states has fallen. In Table 5, UR is estimated as funds utilised as a proportion of allocated *for recurrent components* of MDM. Again, overall utilisation levels of funds are high, averaging 85.4%. This concurs with findings from other studies on high URs of MDM (Bose et al., 2022; CBGA, 2020; Accountability Initiative, 2021).

Table 4: Utilisation of MDM funds (in percentage) *(upto 31st Dec)*

	2011-12	2016-17	2019-20	2022-23
Bihar	60.7		99.5	83.1
Chhattisgarh	70.9	81.7	95.4	94.8
Jharkhand	53.0	85.6	60.5	90.2
Madhya Pradesh	71.0	66.0	47.3	95.7
Odisha	99.6	84.1	81.0	97.5
Rajasthan	85.7	101.1	85.6	88.6
Uttar Pradesh	46.4	78.8	99.6	97.6
West Bengal	88.7	99.2	96.8	99.1
Meghalaya	7.4	82.7	100.8	100.0
Nagaland	36.1	42.2	96.5	92.3
Tamil Nadu	75.2	100.0	100.0	86.5
Karnataka	82.4	101.4	97.3	94.4
Average	64.7	83.9	88.3	93.3
Standard Deviation	24.7	17.0	16.7	5.1

Source: AWP&B, MDM. Note: Utilisation is calculated as expenditure/approved budget.

Among the recurring components, cooking costs and honorarium to cook cum helper are the two major expenditure heads and these have high URs across states. States provide additional funds beyond their mandated share to pay the salaries of MDM cooks and helpers. While cooking costs have been revised occasionally, the salary grant has been sticky with little upward revision of unit costs. There is some variation across states in utilizing transport allowances and Management, Monitoring & Evaluation (MME).[38] Funds for MME comprise 3% of the aggregate cost of food grains, cooking cost, Honorarium to Cook-cum-Helpers and Transportation Assistance.[39] The need for more complete utilisation of MME funds is flagged by the Central Ministry every year in the AWP&B meetings.

Similar to SMSA, flexi-funding is introduced in the MDM budget. According to the PM-Poshan guidelines, five percent of the aggregate cost under main components with no additional budgetary support can be utilised for innovation and flexibility.[40]

[38] See PM-POSHSAN guidelines (GoI, 2023) https://pmposhan.education.gov.in/Files/Guidelines/2023/Guidelines%20on%20PM%20POSHAN%20SCHEME.pdf
[39] 90% of MME funds is released to States and UTs and remaining 10% are utilized as national component.
[40] See PM-POSHSAN guidelines (GoI, 2023)

Table 5: Component-wise Utilisation, MDM for 2022-23 (up to 31st Dec)

	Utilisation Ratio					**Component-wise Share in Total Expenditure**				
	Recurring Assistance					Recurring Assistance				
State	Cooking Cost	Honorarium to Cook-cum-Helper	Transportation Assistance	MME	Total	Cooking Cost	Honorarium to Cook-	Transportation Assistance	MME	Total
Bihar	101.4	97.2	85.4	*92.1*	**100.2**	80.7	15.7	1.9	1.6	100
Chhattisgarh	68.7	79.9	65.8	99.9	**71.7**	71.5	24.2	1.8	2.5	100
Jharkhand	86.9	78.6	98.8	65.7	**85.6**	83.7	12.7	2.2	1.4	100
Meghalaya	100.0	100.0	100.0	100.0	**100.0**	77.0	17.7	2.8	2.5	100
Nagaland	67.7	81.5	73.0	65.6	**70.5**	71.4	22.4	3.9	2.3	100
Madhya Pradesh	86.9	96.3	41.8	58.7	**87.3**	75.8	22.1	1.0	1.1	100
Rajasthan	95.0	100.0	29.5	78.6	**94.0**	81.0	16.9	0.7	1.4	100
Uttar Pradesh	97.2	85.4	13.5	88.9	**92.1**	72.6	25.6	0.3	1.5	100
Odisha	88.0	97.2	71.3	57.2	**88.5**	80.9	16.3	1.7	1.0	100
West Bengal	100.5	98.8	78.7	75.9	**99.1**	78.3	18.1	1.8	1.8	100
Tamil Nadu	41.0	85.7	55.3	28.2	**49.5**	63.7	32.6	2.6	1.0	100
Karnataka	81.0	96.4	81.3	77.0	**86.8**	55.0	42.2	1.6	1.1	100
Average of 12 states	**84.5**	**91.4**	**66.2**	**74.0**	**85.4**	**74.3**	**22.2**	1.9	1.6	**100.0**

Source: PM-POSHAN State PAB Report

The recent changes in fund flow mechanisms have implications for the scheme. The central assistance was released in 60% and 40% instalments under the PM-POSHAN Scheme. From 2023-24, the release of funds under the scheme is subject to the guidelines from DoE, MoF. It is reported that the central Ministry of Education was obtaining administrative approval to release two instalments of not more than 25% each in one go (instead of four as per MoF order). The next instalment will be released upon transferring the stipulated State Share to the Single Nodal Account (SNA) under the PFMS and utilizing at least 75% of the funds released earlier.[41] How the states adjust to these significant changes in fund flow patterns, which have been institutionalised and practiced for many years, needs to be studied.

Improving the Quality of Utilisation

Alongside attempts at streamlining financial practices, which are top-down reforms, there is scope to strengthen bottom-up planning, participation, and accountability mechanisms. It would improve the quality of utilisation. Some of the existing mechanisms can be used to achieve this.

State Governments are advised to conduct social audits as per the MDM Scheme guidelines in all the districts in at least 20 schools or 2% schools, whichever is higher. Social audit is a democratic process that ensures public accountability of agencies through a systemic demand for information by the community on programmes implemented. A social audit is not only an audit of expenditure or decisions but also covers the issue of equity and equality in programme implementation and may hold the key to more accountability and better implementation of the schemes.

[41] https://sansad.in/getFile/loksabhaquestions/annex/1714/AU1182.pdf?source=pqals

For MDM, 2022-23, we found:

- Of the 12 states, 3 states (Jharkhand, Odisha and Nagaland) did not conduct social audits
- Some states conducted social audits but only in limited schools, much below the mandated guidelines.
- Different agencies conduct social audits. Gram sabhas are empowered to conduct social audits in Chhattisgarh and MP. In Rajasthan, TN and Meghalaya, specialised institutions conduct social audits. Universities are conducting social audits in UP.
- Submission of reports of social audits and action taken reports are still the exception rather than the rule, though some states have taken it more seriously than others.

Consider the issue of under-coverage of all children under MDM, which is repeatedly flagged (earlier reported in Accountability Initiative, 2020; Bose and Sharma, 2023). For Bihar, UP, Jharkhand, MP (and TN), there is a substantial gap in coverage of students under MDM (Table 6). The share of students approved for MDM is significantly lower than the enrolments reported by the states. Lack of complete coverage at the elementary level, if true, raises questions on the effectiveness of the scheme and its mandate of universal coverage as per NFSA (2013). Exclusions need to be addressed urgently, and one way to settle the question is to conduct regular audits, including social audits. Expenditure on social audit is part of MME, and there is a slack in utilisation which states can tap.

Table 6: Coverage of Mid-day Meals in 2022-23

	Percentage of Students approved for PM-Poshan vis-à-vis enrolment		
	Bal Vatika	**Primary**	**Upper Primary**
Bihar	-	59	61
Madhya Pradesh	-	81	78
Odisha	100	98	96
UP	-	62	59
Jharkhand	114	78	74
Rajasthan	358	96	91
Chhattisgarh	100	96	94
Meghalaya	105	101	97
Nagaland*	89	105	94
WB	91	97	96
Tamil Nadu	-	95	80
Karnataka	-	95	95

Source: PM-POSHAN State PAB Reports

To summarise this section,

(1) Data availability has declined in recent years as discussed from MDM data, whereas data dissemination contributes to transparency and accountability. CAG should request the state governments to consistently report data on CSS's allocation, releases and expenditure as part of Finance Accounts. (2) URs of recurring assistance are high, on average. Cooking costs and honorarium to cook cum helper, which constitute about 95% of recurring assistance, show very high levels of utilisation across states. (3) Besides the state share for MDM, states regularly incur their own expenditure to pay salaries to cook cum helper, which has unit costs at historical rates under MDM. It reflects the reluctance of the GoI to contribute to salary costs, though salary costs form most of the education expenditure (and social sector expenditure, in general). (4) MME utilisation is lower than the overall UR. PAB of MDM has asked states to raise utilisation on MME. (5) Social audits are a part of MME process. Social audits present important possibilities of a bottom-up approach for greater transparency, accountability and improving the quality of utilisation. Issues such as incomplete coverage of students under MDM can be

handled through such mechanisms. States need to institutionalise the practice of social audits and conduct it regularly, which is not happening at present.

5.0 Conclusion

This note explored the macro-picture on utilisation of funds for the major flagship CSSs in school education - SMSA and MDM - over the recent period. The problems of unspent funds or under-utilisation are said to be more acute for low-income states, with limited administrative capacity and a lack of complementary resources. While the overall trends indicate rising utilisation rates (URs) over the years (barring a few exceptions), with gaps across states closing, there are differences between advanced states and lagging states in the pattern of spending and utilisation of funds. The latter can absorb funds for basic level interventions, whereas the progress is slower for higher-order interventions. For some of the heads of expenditure, like teacher support, URs hit the upper bound, whereas there is slack for others. Issues of supply-constrained interventions as well as areas where state capacities are still to be fully developed, like interventions to improve quality of education or inclusive education need to be addressed. Alongwith raising URs, the quality of utilisation can be improved through bottom-up planning, people's participation in implementation and more robust accountability mechanisms such as social audits. Greater flexibility in the design of the schemes than is presently available to the states could improve utilisation and ownership of the programmes. Rising utilisation rates for low-income states are not accompanied by increasing central spending on these CSSs, reasons for which can be found in macro-fiscal policies. In a fund-constrained situation, the new financial management guidelines, which reduce the funds available to a state at any given time and make the releases conditional on utilisation may present newer challenges in implementation for states. From the centre's point of view, it would free up fiscal space and align releases to expenditures. Data availability presents challenges for analysis, whereas dissemination of data contributes to transparency and accountability.

References

1. Accountability Initiative (2020). Samagra Shiksha 2020-21. Budget Brief-Vol 12. Issue 11. https://accountabilityindia.in/wp-content/uploads/2020/01/Samagra-Shiksha-2020-21.pdf
2. Accountability Initiative (2021). Mid day Meal Scheme. Budget Brief-Vol 13. Issue 10. https://accountabilityindia.in/wp-content/uploads/2021/02/Mid-Day-Meal-2021-22.pdf
3. Bose, S, P Ghosh and A Sardana (2020): The RTE and the Resource Requirements: The Way Forward, NIPFP-Eklavya.
4. Bose, Sukanya, Noopur, Sri Hari Nayudu (2022). Intergovernmental Fiscal transfers and Expenditure on Education in India: State level analysis, 2005 to 2020, NIPFP Working Paper No. 377
5. Bose, Sukanya and Harshita Sharma (2023): "Public Spending on School Education in Delhi: The Gaps that Covid-19 Highlights," National Coalition for Education, http://nceindia.org.in/wp-content/uploads/2023/03/Public-Spending-Delhi.pdf.
6. Bose, Sukanya (2024). Right to Education and the Union Budget Need for Renewed Focus. Economic and Political weekly, Vol LIX No 10
7. CBGA (2020). The Budget Trails: Fiscal Governance Reforms at District Level for Improving Fund Flow and Utilisation in Development Schemes. CBGA and TATA Trusts. CBGA India.
8. Chakravarty, S. (1987). Problems of Plan Implementation in Sukhamoy Chakravarty (Ed.) "Development Planning: The Indian Experience", Oxford: Clarendon Press.
9. GoI. (2009). *Report of the 13th Finance Commission, 2010–2015*. Finance Commission of India.
10. GoI. (2014). *Report of the 14th Finance Commission, 2015–2020*. Finance Commission of India.
11. GoI. (2020). *Report of the 15th Finance Commission, 2021–2026*. Finance Commission of India.
12. Jha, A.N, Yash Jaluka, Pinaki Chakraborty. (2021) Report on Centrally Sponsored Schemes: Restructuring and Rationalisation. PM-EAC.
13. Govinda, R. & Sedwal, M. (2017). Introduction: Basic Education for All in India-Tracking Progress. In R. Govinda & M. Sedwal (Eds.), India Education Report: Progress of Basic education (pp. 1-29). New Delhi, Delhi: Oxford University Press.
14. Kundu, P. & Rastogi, Drishti (2020). Budgetary Analysis of Samagra Shiksha Abhiyan: A Case Study of Two Districts in Andhra Pradesh & Uttar Pradesh. *CBGA*, New Delhi, India.
15. CBPS (Centre for Budget and Policy Studies) (2020). *Public Expenditure Review of Secondary Education in Tamil Nadu* CBPS-UNICEF.
16. NIPFP (2023). HEFA Audit Report. Ministry of Education.
17. Oates, W. (1972) Fiscal Federalism. New York: Harcourt Brace Jovanovich.
18. Rao, M Govinda (2017): "The Effect of Intergovernmental Transfers on Public Services in India," National Institute of Public Finance and Policy, Working Paper No 218.
19. Rao, V K R V (1972): "Centre State Relations in the Field of Education," The Union and the States [Papers and Proceedings], SN Jain, SC Kashyap and N Srinivasan (eds), New Delhi: National Publishing House, pp 178–186.

Appendix

Appendix Table-1A: Centrally Sponsored Schemes on School Education

Schemes (in Rupees Crores)	2014-15	% Share	Schemes	2018-19	% Share	Schemes	2022-23	% Share
SSA	24097	60.4	SSA	25616	64.9	Samagra Shiksha	32515	69.6
MDM	10523	26.4	MDM	9514	24.1	PM POSHAN	12681	27.2
RMSA	3398	8.5	RMSA	3399	8.6	STARS	473	1.0
6000 Model Schools	980	2.5	Strengthening of Teachers Training Institutions	373	0.9	Pre Matric Scholarship for OBCs, EBCs and DNTs	361	0.8
Pre-Matric Scholarship Scheme SC (State Plan)	499	1.3	Tribal Education*	311	0.8	Pre- Matric Scholarship for STs	357	0.8
Tribal Education*	170	0.4	Pre-Matric Scholarship Scheme OBC	122	0.3	Pre Matric Scholarship for SCs and Others	209	0.5
SPQEM	119	0.3	Pre-Matric Scholarship Scheme SC	116	0.3	New India Literacy Programme	76	0.2
Pre-Matric Scholarship Scheme OBC	110	0.3	SPQEM	18	0	Boys and Girls Hostel for OBCs	19	0.0
Pre-Matric Scholarship Scheme SC	15.1	0	Pre-Matric Scholarship (CUO)	3	0	Top Class Schools	2	0.0
School Assessment Programme	2.5	0	Access and Equity	0.2	0	PM Schools for Rising India (PM SHRI)	0.0	0.0
Access and Equity	1.1	0						
Pre-Matric Scholarship (CUO)	0.9	0						
	40828	100		**39473.3**	100		**46693**	100

Source: Expenditure budget of union government across four ministries, MHRD, Ministry of Tribal Affairs, Ministry of Social Justice and Ministry of Minorities Affairs, various years.

Note: Acronyms used: SSA: Sarva Siksha Abhiyan: MDM: Mid-Day Meal; RMSA: Rashtriya Madhyamik Siksha Abhiyan; SPQEM- Scheme to Provide Quality Education in Madrasas; Pre-matric scholarship (CUO): pre-matric scholarship for children of those engaged in unclean operations; PM POSHAN: Pradhan Mantri Poshan Shakti Nirman; STARS: Strengthening Teaching-Learning and Results for States.

(Updated from Bose et al (2022))

MHRD

Social Justice

Tribal Affairs

Appendix Table-1B: Expenditure by Union Government on CSSs on Higher Education

Schemes *(in Rs crores)*	**2014-15**	**% Share**	**Schemes**	**2018-19**	**% Share**	**Schemes**	**2022-23**	**% Share**
Post Matric Scholarship for SC	1960	47.8	Post Matric Scholarship Scheme for SC	5928	58.7	Post Matric Scholarship for SCs	4393	56.8
Post Matric Scholarship Scheme for ST	889	21.7	Post Matric Scholarship Scheme for ST	1648	16.3	Post- Matric Scholarship for STs	1965	25.4
Post Matric Scholarship Scheme for OBC	783	19.1	RUSA	1350	13.4	Post Matric Scholarship for OBCs, EBCs and DNTs	1008	13.0
RUSA	408	9.9	Post Matric Scholarship Scheme for OBC	1000	9.9	RUSA	361	4.7
Boys and girls' hostel for OBC	25	0.6	Tribal Research Institutes	100	1	Support to Tribal Research Institute	12	0.2
Girls Hostels	19	0.5	Boys and Girls Hostel for SC	37	0.4			
Boys and Girls Hostel for SC	10	0.3	Boys and girls hostel for OBC	36	0.4			
Boys Hostels	4	0.1	Grants-in-aid to UT	8	0.1			
	4100	**100**		**10106**	**100**		**7738**	**100**

Source: Same as Table 2
Acronyms used: Rashtriya Uchhatar Shiksha Abhiyan (RUSA)
(Updated from Bose et al (2022))

MHRD
Social Justice
Tribal Affairs

6

Finance Commission Grants - Quantum and Utilisation

Manish Gupta

National Institute of Public Finance and Policy, New Delhi

Introduction

The Finance Commission's terms of reference (ToR) are specified in the Constitution under Article 280(3). They include (a) distribution and allocation of net proceeds of shareable taxes between the union and states, and (b) principles governing the grants-in-aid of revenues of the states out of the Consolidated Fund of India. Subsequently, the 73^{rd} and 74^{th} constitutional amendments in 1992 added two sub-clauses, which required the Finance Commission to recommend measures needed to augment the Consolidated Fund of a state to supplement the resources of panchayats and municipalities therein on the basis of the recommendations of the State Finance Commission. These are the core ToR of a Finance Commission. Further, the President can refer any other matter to the Finance Commission in the interest of sound finance.

There exists considerable heterogeneity among states in terms of their size, population, per capita incomes, etc. Also the gap between capacity to collect revenue and expenditure needs varies across states depending upon initial endowments, historical backgrounds, and the levels of development. This gives rise to a horizontal imbalance. Finance Commissions have used a number of criteria for the distribution of the shareable central tax revenue among states for addressing the horizontal imbalance. Additionally, horizontal imbalances across states are also addressed by Finance Commissions by recommending grants-in-aid of revenues from the consolidated fund of India. Under Article 275 of the Constitution, Finance Commissions are mandated to recommend the principles and the quantum of grants-in-aid to States that are in need of assistance and that the Commission can recommend different sums for different States.

The paper examines the various grants recommended by recent Finance Commissions, their quantum and utilisation across different states.

Evolution of Finance Commission Grants

Examination of the reports of Finance Commissions reveal that the grants recommended by them are predominantly in the nature of general purpose grants meeting the difference between the assessed expenditure on non-plan revenue account of each state and projected revenues including state's share in central taxes. These are referred to as 'gap filling grants' (Rao 2010; Srivastava and Rao 2009; Vithal and Sastry 2001). Up to the Fifth Finance Commission, grants were recommended for meeting the post devolution non-plan revenue deficits of states with a few exceptions. From the Sixth Finance Commission there was a change in the ToR and the Commission was asked to consider requirements of States which were backward in standards of general administration so as to bring them to the levels of the more advanced States. The Seventh, Eighth and Tenth Finance Commissions were asked to consider upgradation of standards in non-developmental sectors. Accordingly, grants were recommended for meeting the revenue expenditure deficiencies of certain States in areas like general administration, administration of justice, jails, police, primary education, medical and public health, welfare of scheduled castes, scheduled tribes and other backward classes, administration of taxes, treasury and accounts administration and for sectors like education and health. Such specific grants were essentially to enable the states to meet deficiencies in basic service provisioning.

Over the years, the scope of grants to States was extended further to cover special problems. Eighth, Ninth, Tenth, Eleventh, Twelfth and Thirteenth Finance Commissions, all recommended grants for addressing special problems of states. Twelfth Finance Commission extended the scope of grants to achieve partial equalization of expenditure across states in education and health sectors. It recommended grants for maintenance of roads, bridges and public buildings, maintenance of forests and heritage conservation. The Thirteenth Finance Commission gave grants for improving outcomes, protection of forests and incentive grants for grid-connected renewable energy and water sector. It also recommended grants for elementary education. The Fourteenth FC did not recommend any state and/or sector specific grant.

Following the 73rd and 74th amendments to the Constitution in 1992, Finance Commissions were charged with the additional responsibility of recommending measures to augment the Consolidated Fund of a State to supplement the resources of local bodies. This further expanded the scope of Finance Commission grants. Grants for local governments have been prescribed by Finance Commissions since the Tenth FC.

Although, a large number of grants have been recommended by Finance Commissions, these can be broadly classified into five broad categories:

(a) revenue deficit grants,
(b) grants for local governments,
(c) grants for disaster management,
(d) sector-specific grants and
(e) state-specific grants.

Other than the revenue deficit grants, most of these grants were often conditional and performance-based. Grants recommended by recent Finance Commissions (i.e, starting from the FC-XII) is presented in Table 1.

Table 1: Grants Recommended by Finance Commissions

	Grants	FC-XII (2005-10)	FC-XIII (2010-15)	FC-XIV (2015-20)	FC-XV-1 (2020-21)	FC-XV-2 (2021-26)
	NPRD/RD	yes	yes	Yes	yes	yes
	Local Bodies	yes	yes	Yes	yes	yes
	Calamity Relief / Disaster Management	yes	yes	Yes	yes	yes
	State Specific Needs	yes	yes	×	×	yes
	Health Sector/Nutrition	yes	×	×	yes	yes
	Education Sector (Elementary Education; Higher Education; School Education)	yes	yes	×	×	yes
	Maintenance of Roads & Bridges/PMGSY Roads	yes	yes	×	×	yes
	Maintenance of Buildings	yes	×	×	×	×
	Heritage Conservation	yes	×	×	×	×

	Grants	FC-XII (2005-10)	FC-XIII (2010-15)	FC-XIV (2015-20)	FC-XV-1 (2020-21)	FC-XV-2 (2021-26)
	Performance Incentive	×	yes	×	×	×
Environment	Maintenance of Forests	yes	yes	×	×	×
	Renewable energy	×	yes	×	×	×
	Water Sector Management	×	yes	×	×	×
Improving outcomes	Reduction in IMR	×	yes	×	×	×
	Improvement in Justice Delivery/Judiciary	×	yes	×	×	yes
	Incentive for issuing UIDs	×	yes	×	×	×
	District Innovation Fund	×	yes	×	×	×
	Improvement of Statistical Systems at State & District Level	×	yes	×	×	yes
	Employee & Pension Database	×	yes	×	×	×
	GST Compensation	×	yes	×	×	×
	Agriculture	×	×	×	×	yes
	Grant for aspirational districts & blocks	×	×	×	×	yes
	Number of Grants	**10**	**17**	**3**	**4**	**11**

Note: RD: Revenue deficit; NPRD: Non-plan revenue deficit
Source: Finance Commission reports; Gupta et al (2024).

On the relative roles of tax devolution and grants-in-aid, the Finance Commissions were of the view that dominance of tax devolution weakens the equalising capacity of Finance Commission transfers, even though successive Commissions have tried to redress this shortcoming by introducing redistributive elements in the devolution formula (FC-XI). Further, the FC-XII was of the view that grants had unique characteristics, as they could take better account of cost disabilities and redistributive considerations that were not adequately captured in the tax devolution formula. The FC-XIII observed that grants are an important instrument of financing that enabled more comprehensive transfers and allowed the Commission to make corrections for cost disabilities faced by many States. FC-XV was also of the view that grants can make corrections for cost disabilities and other redistributive requirements which can be addressed only to a limited extent in any devolution formula. It further pointed out that grants are more directly targeted and used to equalise the standards of basic social services.

The FC-XIV pointed was of the view that sector specific grants recommended by Finance Commissions constituted a small percentage of total grants going to the States in a particular sector and although these grants covered a large number of sectors, there was discontinuity in the sectors recommended for grants by the past Finance Commissions and only a few sectors like health and education have been considered on a regular basis. Also there is an issue of duplication and overlap on account of grants flowing through multiple channels. Moreover, it felt that the limited tenure of the Commission also adds to the constraints in designing the grants. It was of view that grants for both sector-specific and state-specific schemes by the Finance Commission are not necessary. The Commission, therefore, did not recommend any sector or state specific grants.

Quantum of Finance Commission Grants

Though the scope, coverage and number of Finance Commission grants have increased over the years, their share in total transfers recommended by them has remained small as evident from Table 2. The grants have varied from 8 percent of total Finance Commission transfers (FC-VII) to 27 percent (FC-IV). The grants recommended by the FC-XV in its report of the period 2021-26 accounted for about 19.7 percent of the total transfers recommended by it. Tax devolution accounted for a sizeable portion of total transfers by Finance Commissions.

Table 2: Composition of Finance Commissions Transfers (%)

Finance Commission (award period)	Tax Devolution	Grants-in-aid	Total
FC-III (1962-66)	77.13	22.87	100.00
FC-IV (1966-69)	72.66	27.34	100.00
FC-V (1969-74)	85.12	14.88	100.00
FC-VI (1974-79)	74.58	25.42	100.00
FC-VII (1979-84)	91.96	8.04	100.00
FC-VIII (1984-89)	88.95	11.05	100.00
FC-IX (1989-95)	86.20	13.80	100.00
FC-X (1995-2000)	90.12	9.88	100.00
FC-XI (2000-05)	84.16	15.84	100.00
FC-XII (2005-10)	83.67	16.33	100.00
FC-XIII (2010-15)	85.83	14.17	100.00
FC-XIV (2015-20)	88.03	11.97	100.00
FC-XV-1 (2020-21)	80.96	19.04	100.00
FC-XV-2 (2021-26)	80.35	19.65	100.00

Source: Gupta and Sarma (2022); Report of the 15th FC

From the examination of Finance Commission grants starting from FC-XII it is observed that since FC-XIII local body grants are the largest of all the Finance Commission grants. Three grants - deficit (non-plan revenue deficit/revenue deficit) grant, local body grants and disaster grants account for most of the grants recommended by Finance Commissions. Their shares varying between 52 percent (FC-XIII) to 100 percent (FC-XIV) of the total Finance Commission grants (Table 3). The share of sector specific grants in total Finance Commission grants is low.

Table 3: Share of different grants in total grants recommended by Finance Commissions (%)

	Grants	FC-XII (2005-10)	FC-XIII (2010-15)	FC-XIV (2015-20)	FC-XV-1 (2020-21)	FC-XV-2 (2021-26)
1	NPRD/RD grant	39.9	16.3	36.3	35.8	28.5
2	Local bodies	17.5	27.5	53.4	43.3	42.2
3	Calamity relief /disaster management	11.2	8.3	10.3	13.9	11.9
4	GST compensation	--	15.7	--	--	--
5	State specific needs	5.0	8.8	--	3.3	4.8
6	Sector specific grant (a+b+c+d+e)	26.4	23.4	--	3.7	12.6
a)	- Health sector/nutrition/IMR	4.1	1.6	--	3.7	3.1
b)	- Education sector	7.1	7.6	--	--	1.1
c)	- Environment	0.7	4.8	--	--	0.0
d)	- Agriculture	--	--	--	--	4.4
e)	- Others	14.5	9.4	--	--	4.0
	All Grants (1+2+3+4+5)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Note: RD: Revenue deficit; NPRD: Non-plan revenue deficit
Source: FC reports; Gupta et al (2024)

Expressing sector specific grants recommended by Finance Commissions as percentage of states' revenue and total expenditure on the respective sectors it is observed that their share is even smaller (Table 4). For example, the grant for education under FC-XII accounted for only 1.88 and 1.83 percent of all-states revenue and total expenditures in education. A similar trend is visible for the health and agriculture sector grants. Given the magnitude of sector specific grants recommended by Finance Commissions in comparison to the sectoral expenditures (both revenue and total expenditure) by state governments, one can infer that such grants are too small to bring about a behavioural change in the expenditure pattern of the states.

Table 4: FC Grants as Percent of States' Sectoral Revenue and Total Expenditure (%)

Sectors	FC-XII (2005-10)		FC-XIII (2010-15)		FC-XV (2020-21)		FC-XV (2021-26)	
	% of Rev exp	% of Total exp	% of Rev exp	% of Total exp	% of Rev exp	% of Total exp	% of Rev exp	% of Total exp
Health/nutrition/ Reduction in IMR	4.35	3.90	1.62	1.46	4.38	4.00	4.46	3.85
Education sector	1.88	1.83	1.94	1.89			0.58	0.55
Agriculture							6.21	5.66

Source: FC reports, various years. Union government budget documents, various years; Gupta et al (2024)

Acceptance/Rejection and Utilisation of Finance Commission grants

The action taken reports (ATRs) on the recommendations of Finance Commissions brought out by the Ministry of Finance presents the status of Finance Commission recommendations. Examination of ATRs of the last four Finance Commissions (i.e., FC-XII, FC-XIII, FC-XIV and FC-XV) reveal that all the grants recommended by recent Finance Commissions have been accepted with the exception of some of the grants recommended by the FC-XV for the period 2020-26. The revenue deficit grants, the local body grants and the disaster relief grant were accepted by the Union government while those addressing state specific needs, and for agriculture, improvement in supply of justice and statistical systems have not been accepted.[42] The status of acceptance/not-acceptance of grants since FC-XII is presented in Table 5.

Table 5: Acceptance/Non-Acceptance of Grants Recommended By Finance Commissions

Grants	FC-XII (2005-10)	FC-XIII (2010-15)	FC-XIV (2015-20)	FC-XV-1 (2020-21)	FC-XV-2 (2021-26)
RD grant	A	A	A	A	A
Local body grants	A	A	A	A	A
Calamity/disaster relief	A	A	A	A	A
State specific needs	A	A			R
Health/nutrition	A			R	R
Education	A	A			R
Maintenance of roads & bridges	A	A			R
Maintenance of buildings	A				
Heritage conservation	A				
Performance incentive		A			
Maintenance/protection of forests	A	A			
Renewable energy		A			
Water sector management		A			
Reduction in IMR		A			
Improvement in supply of justice		A			R
Incentive for issuing UIDs		A			
District innovation fund		A			
Improvement of statistical systems		A			R
Employee & pension database		A			
GST implementation		A			
Agriculture					R
Grant for aspirational districts & blocks					R

Notes: A: Accepted; R: Rejected
Source: FC reports, various years; Gupta et al (2024)

While acceptance of recommendations is the first step towards implementation. It, however, does not guarantee releases and utilization (i.e., absorption) of funds. For this one needs to examine the actual releases of funds allocated under the grant and actual expenditure to correctly assess their utilisation. As data on utilization is not available we have considered releases as a proxy for utilization. The ratio of allocation to releases under each of the grants will give for each state the status of utilisation. Further, in the absence of releases data for all the grants recommended by recent Finance Commissions, we have examined utilisation of grants for those sectors for which such data was available. These include grants for health, education, forest conservation, water resources, and rural local bodies. Table 6 shows the average utilisation of some of the grants recommended for health, education, forest conservation, water resources, and rural local bodies. State-wise utilisation numbers are presented in Tables 7 and 8.

[42] For state specific grants the ATR mentions "keeping in view the untied resources with state governments and the fiscal commitments of central government, due consideration will be given to the above recommendation". In case of sector specific grants the ATR says "government will give due consideration to sectors identified by the Commission while formulating and implementing existing and new Centrally Sponsored and Central Sector Schemes". In other words, both these recommendations were not accepted by the union government.

Table 6: Utilisation of select Finance Commission grants (%)

FC Grant	FC-XII (2005-10)	FC-XIII (2010-15)	FC-XIV (2015-20)	FC-XV (2020-26)
Forest	93.4	88.6		
Water sector		28.3		
Grants for Rural Local Bodies	94.6	89.4	91.5	96.5
Elementary Education		92.1		
Health/ Improving IMR		100.0		44.8

Note: 1) Utilisation is defined as the ratio of releases to allocations
2) Only those grants for which state-wise data on releases were available have been considered.
Source: Finance Commission Reports; Ministry of Finance, Ministry of Environment, Forest and Climate Change; Rajya Sabha Question; Ministry of Panchayati Raj; Gupta et al (2024)

Grants for Maintenance of Forest: Data on forest grants shows that all-state utilisation has been above 88 percent for both FC-XII and FC-XIII with the exception of Maharashtra, Meghalaya and Tripura during FC-XII period and Assam, Bihar, Goa, J&K, Meghalaya, and Telangana during FC-XIII period. The utilisation for Telangana is the lowest at 25 percent. This could be due to the fact that the state came into existence in June 2014. The forest grant was an unconditional grant under FC-XII while FC-XIII had imposed certain conditions. For the first two years of FC-XIII award period the grant was untied, but for the remaining three years of the commission's award period, the release of the grant was linked to the number of approved working plans with 25 percent specifically earmarked for preserving forests while the remaining 75 percent was to be used for other developmental purposes by states. Imposition of conditionality in the last three years of the Commission's award period might explain a slight fall in its utilisation as compared to that during FC-XII period. State-wise utilisation numbers are presented in Table 7.

Grant for Water Sector Management: It was observed that while Maharashtra was able to fully absorb this grant, most of the other states have been able to absorb only 25 percent of the recommended grant. Arunachal Pradesh, Chhattisgarh, Goa, Karnataka, Kerala, Manipur, Meghalaya, and Sikkim show zero utilisation (Table 7). Low utilisation may be attributable to the conditions associated with the release of the grant namely, (i) grants to be spent only on non-salary maintenance items for public MMI and MI irrigation schemes; (ii) grants should be budgeted and spent for meeting non-plan revenue expenditure only under heads 2700, 2701 and 2702; (iii) recovery rate for irrigation has been taken as the ratio of NPRR under major heads 700, 701 and 702 to NPRE under major head 2700, 2701 and 2702. The states should fulfil the following criteria in respect of recovery rate for irrigation (a) Special category states should step up recovery rate for irrigation by at least 3 percent points in 2011-12 over 2009-10 (BE) and then by 3 percent points in every successive year during the forecast period; (b) General category states should have a step up recovery rate for irrigation of at least 20 percent in 2011-12 and then should step it up by 5 percentage points in every successive year during the forecast period, if it is not already above 75 percent and (iv) Grants should be released to only those states in the third year (i.e., 2012-13) which have set up statutory and independent water resources regulatory authority through appropriate legislation and notified all relevant provisions by 31 March 2012. However, this condition will not be applicable to north-eastern states except Assam.

Grant for Elementary Education: In case of grants for elementary education recommended by FC-XIII the state-wise utilisation pattern reveal that with the exception of the special category states, most of the states have an utilisation rate above 70 percent resulting in an all-state utilisation ratio of 92.1

percent (Table 7). The Commission adopted the SSA norms and the estimates of annual funding requirement provided by MHRD to derive state-wise distribution of this grant. This ensured that all states potentially receive this grant. Although majority of the states were able to utilize this grant well, the low figures of utilisation for the special category states reveals that the estimations of gaps and shortfalls to bring in uniform utilization by all states was still not materialized.

Health Grants: The utilisation details for health grants through local bodies given during the FC-XV period presented in Table 6 shows that it has been in general on the lower side with the all-state utilisation level at 44.8 percent. Odisha, Telangana, and Andhra Pradesh have the highest utilisation rate followed by Kerala and Gujarat (Table 7). Whereas, Maharashtra had the lowest utilisation rate at 19 percent. Majority of the states have an utilisation rate lower than the all-state average, despite the FC-XV's focus on health on account of unprecedented challenges from the Covid-19 pandemic.

Grant for Reduction in IMR was a performance based incentive grant given by FC-XIII which targeted reduction of states' IMR in three years. The SRS measuring IMR for 2009 was taken as the base line from which improvement of each state will be measured. The states were rewarded both for the improvement in the parameter as well as the level at which the improvement is made i.e., if the improvement/change is above the median value of the parameter for all states. From Table 7 we observe that incentive based target to reduce state's IMR was a success if one were to examine it from the lens of utilisation of the grant. State-wise utilisation of the grant was 100 percent for all the states.

Table 7: State-wise utilisation of select sector specific Finance Commission grants (%)

States	FC-XII Forest Grant	FC-XIII Forest Grant	FC-XV Health grant through local bodies	FC-XIII Grant for Water Management	FC-XIII Elementary Education	FC-XIII Reducing IMR
Andhra Pradesh	100.00	94.72	64.41	25.00	100.00	100.00
Arunachal Pradesh	100.00	81.25	30.88	0.03	16.67	100.00
Assam	100.00	43.75	31.37	25.00	75.21	100.00
Bihar	100.00	55.00	31.76	25.00	100.00	100.00
Chhattisgarh	100.00	100.00	32.24	0.00	100.00	100.00
Goa	100.00	50.00	32.42	0.00	18.18	100.00
Gujarat	100.00	100.00	51.05	25.00	100.00	100.00
Haryana	100.00	100.00	32.23	25.00	100.00	100.00
Himachal Pradesh	100.00	100.00	32.24	25.00	100.00	100.00
J&K	90.00	58.00	--	0.00	56.79	100.00
Jharkhand	80.00	100.00	32.11	0.00	76.51	100.00
Karnataka	100.00	100.00	43.25	0.00	100.00	100.00
Kerala	99.00	91.69	56.49	25.00	100.00	100.00
Madhya Pradesh	100.00	100.00	63.14	25.00	75.77	100.00

States	FC-XII Forest Grant	FC-XIII Forest Grant	FC-XV Health grant through local bodies	FC-XIII Grant for Water Management	FC-XIII Elementary Education	FC-XIII Reducing IMR
Maharashtra	60.00	100.00	19.25	100.00	100.00	100.00
Manipur	100.00	100.00	31.30	0.00	40.00	100.00
Meghalaya	70.45	62.50	32.23	0.00	76.92	100.00
Mizoram	91.32	86.50	32.15	25.00	20.00	100.00
Nagaland	80.00	81.25	32.21	50.00	57.14	100.00
Odisha	100.00	93.19	64.38	25.00	57.09	100.00
Punjab	80.00	81.25	32.10	25.00	61.61	100.00
Rajasthan	80.00	100.00	32.23	25.00	100.00	100.00
Sikkim	100.00	93.75	32.28	0.00	40.00	100.00
Tamil Nadu	100.00	100.00	97.80	25.00	76.57	100.00
Telangana	--	25.00	64.37	--	--	--
Tripura	50.00	87.50	31.85	25.00	39.13	100.00
Uttar Pradesh	100.00	100.00	32.22	25.00	100.00	100.00
Uttarakhand	100.00	81.25	32.28	25.00	100.00	100.00
West Bengal	100.00	100.00	64.43	25.00	100.00	100.00
Total	**93.38**	**88.64**	**44.76**	**28.32**	**92.07**	**100.00**

Note: Utilisation rate is the release to allocation ratio
Source: Forest grant - Ministry of Environment, Forest and Climate Change (MoEFCC); Health grant - Rajya Sabha question; Other grants - Ministry of Finance and Gupta et al (2024)

Local body grants: Data on utilisation of rural local body grants is available for four Finance Commissions – FC-XII to FC-XV. Finance commissions prior to FC-XIII had very granular usage prescriptions for the local grant, for example, requiring that half of the urban grant be earmarked for solid waste management through public private partnership, which led to delays in usage certification at the state government end, and thereby to delays in releases by the centre. Therefore, FC-XIII divided its local body grant into a two-parts, one a condition-free basic grant, and the other a conditional performance grant. The basic grant accounted for roughly two-thirds of the total local grant while the performance grant accounted for the remaining one-thirds. The FC-XIV has retained the two-part structure of the FC-XIII, with a basic unconditional component which at 90 percent for gram panchayats[43] and 20 percent for urban local bodies was a more dominant component of the total. FC-XV in its first report for 2020-21 increased the tied component of local body grant to 50 percent and further to 60 percent in its final report for 2021-26 (Table 8).

[43] FC-XIV did not recommend any grants for the Block Panchayats and District Panchayats. Its rural local body grants were meant for gram panchayats only.

Table 8 also shows the all-state utilisation of rural local body grants recommended by Finance Commissions from FC-XII onwards while state-wise utilisation numbers are presented in table 9. For both FC-XIII and FC-XIV, we find the utilisation percentage is lower for the performance grant which are conditional in nature. In some of the states, especially the north-eastern states the overall utilisation rates are very low across all the four Commissions.

Table 8: Grants for Rural Local Bodies: Conditionalities and Utilisation

Finance Commission	RLB Grant	Utilisation (%)	Conditionalites
FC-XII	RLB Grant	94.63	no conditionality
FC-XIII	Basic Grant	95.07	1/3rd conditional
	Performance Grant	79.30	
	Total Grant	89.63	
FC-XIV	Basic Grant	98.44	10% for Gram Panchayats & 20% for urban LBs conditional
	Performance Grant	27.02	
	Total Grant	91.49	
FC-XV	RLB Grant	96.54	2020-21: 50% tied (65.78% for ULBs) 2021-26: 60% tied (72.62% for ULBs)

Note: FC-XV utilisation data is for the period 2020-21 to 2023-24. For FC-XV, releases data were not separately available for condition and non-conditional components. Data on releases is up to 15 May 2024.
Source: Finance Commission Reports; Ministry of Panchayati Raj (MoPR)

In addition, even for the basic grants which are unconditional in nature, there are rigidities involved in the working mechanism of the utilization of grants, which in turn might impact utilisation levels. For instance, despite the unconditional nature of the FC-XIII basic grant, the administrative guidelines introduced an extra requirement: that local body elections be conducted punctually. Another stipulation was that the state should have distributed the prior installment to local governments within five days of receiving it from the centre (in case of states with easily accessible banking infrastructure) and ten days (in case of states with inaccessible banking infrastructure), with additional interest applied for any delays beyond that. While not a requirement, it would have increased the complexity of the utilization certification and contributed to the delay in transactions (Rajaraman and Gupta, 2016).

Table 9: Utilisation of Rural Local body grants (%)

		FC-XII	FC-XIII			FC-XIV			FC-XV
		RLB Grant	Basic Grant	Performance Grant	Total Grant	Basic Grant	Performance Grant	Total Grant	RLB Grant
1	Andhra Pradesh	100.00	82.09	99.80	88.06	99.69	39.93	93.88	98.98
2	Arunachal Pradesh	40.00	51.68	6.97	36.24	99.91	17.35	91.88	41.74
3	Assam	70.00	100.00	64.13	87.62	100.00	40.19	94.18	100.00
4	Bihar	100.00	100.00	97.66	99.19	98.04	15.36	90.00	99.81
5	Chhattisgarh	100.00	100.00	84.64	94.70	100.00	40.19	94.18	100.00
6	Goa	44.28	13.88	6.87	11.46	100.00	40.21	94.18	53.06
7	Gujarat	100.00	100.00	21.24	72.80	100.00	40.19	94.18	100.00

		FC-XII	FC-XIII			FC-XIV			FC-XV
		RLB Grant	Basic Grant	Performance Grant	Total Grant	Basic Grant	Performance Grant	Total Grant	RLB Grant
8	Haryana	100.00	100.00	98.36	99.43	100.00	40.19	94.18	90.03
9	Himachal Pradesh	100.00	100.00	98.33	99.42	100.00	17.38	91.96	84.83
10	Jammu & Kashmir	18.81	86.12	21.26	63.72	57.90	14.08	53.64	--
11	Jharkhand	0.00	100.00	68.89	89.26	100.00	17.38	91.96	88.20
12	Karnataka	100.00	100.00	97.63	99.18	98.88	39.70	93.12	92.66
13	Kerala	100.00	100.00	98.38	99.44	100.00	37.74	93.94	100.00
14	Madhya Pradesh	100.00	86.31	97.63	90.22	100.00	39.87	94.15	97.98
15	Maharashtra	100.00	100.00	97.64	99.18	100.00	17.38	91.96	90.35
16	Manipur	46.00	99.99	54.83	84.40	100.00	40.18	94.18	41.81
17	Meghalaya	80.00	51.68	7.10	36.29	--	--	--	37.21
18	Mizoram	80.00	51.69	26.73	43.07	--	--	--	57.77
19	Nagaland	100.00	22.78	6.99	17.33	--	--	--	52.93
20	Odisha	100.00	100.00	7.05	67.90	100.00	40.19	94.18	100.00
21	Punjab	80.00	100.00	54.71	84.36	100.00	17.38	91.96	86.97
22	Rajasthan	100.00	100.00	98.40	99.45	100.00	40.19	94.18	98.46
23	Sikkim	90.00	87.38	21.19	64.53	100.01	40.21	94.19	92.86
24	Tamil Nadu	100.00	100.00	21.24	72.80	93.07	17.38	85.71	100.00
25	Telangana	--	143.62	128.28	137.40	99.95	40.19	94.13	99.90
26	Tripura	70.00	74.77	54.82	67.88	100.00	40.18	94.18	92.92
27	Uttar Pradesh	100.00	100.00	97.64	99.18	99.93	17.33	91.89	100.00
28	Uttarakhand	80.00	100.00	7.06	67.91	100.00	29.16	93.11	92.50
29	West Bengal	100.00	74.77	69.60	72.98	96.57	16.80	88.81	99.80
	All States	**94.63**	**95.07**	**79.30**	**89.63**	**98.44**	**27.02**	**91.49**	**96.54**

Note: For FC-XV data of releases is as on 15.05.2024. Utilisation is calculated for the years 2020-21 to 2023-24
Source: Finance Commission Reports; Ministry of Panchayati Raj (MoPR)

The study by Rajaraman and Gupta (2016) show that year-wise releases of both basic and performance local body grants are affected by factor like fiscal stress at the union government. The way the basic and performance grants were designed by the FC-XIII there should have been no shortfalls in the release of the basic grant (except on account of states not holding local elections on time), and no shortfalls in respect of the performance grant either. In case of the performance grant, If no state qualified for the grant no funds would be released, but if even a single state qualified in any year, the performance grant was designed to be fully disbursed in that and all subsequent years. The Rajaraman and Gupta (2016) study finds that for both basic and performance grants the years when the shortfall in releases were high were also the years when the fiscal deficit of the union government was high (the fiscal deficit of the union government was 5.8 percent of GDP in 2011-12 and 4.9 percent of GDP in 2012-13). Thus, the statutory sanctity of the transfer was bent to accommodate fiscal stress at the Centre.

Conclusion

Although a large number of grants have been recommended by Finance Commissions, they account for a small proportion of total transfers recommended by them. The share of Finance Commission grants in total central transfers to states is even lower. Deficit grants, local body grants and grants for disaster management account for a sizeable portion of Finance Commission grants and the share of sector specific and state specific grants is small.

The utilisation of sector specific grants at the state level shows that in some sectors it was as low as 50 percent. The utilisation of such grants was even lower for North-eastern and Himalayan states. Further, the sector specific grants recommended by Finance Commissions are very small as compared to states' revenue and total expenditure on the respective sectors. In other words, sector specific grants are too small to bring about a behavioural change in the expenditure pattern of the states.

Almost all states have raised concern over the growing trend of attaching conditionalities to the grants, which adversely affected the overall utilisation of these grants. Stringent conditions attached to the release of grants were responsible for the utilisation of grants remaining low. They pointed out that in additions to the conditions set out by the Finance Commissions, the Ministry of Finance and other Union ministries and departments stipulate their own conditions. They were of the view that the Finance Commission should ring-fence its conditions so that no additional conditions for the release of grants can be imposed by the different Union ministries. Overall, majority of States felt that conditions, if required, should be minimum, pragmatic and implementable.

This give rise to the question: are the states being paid too little money in the form of grants and being asked for too much in the form of performance? Especially drawing from the fact that despite a rise in the number, scope, and coverage of Finance Commission grants over time, their percentage in the share of total Finance Commission transfers has stayed low (Gupta and Sharma, 2022). It ultimately boils down to the conclusion that given the complexities associated with the utilisation of grants, conditionalities attached, the Finance Commission grants (sector specific grants) are too small in magnitude to impact a significant behavioural change in the states.

References

1. Finance Commission (2000): Report of the Eleventh Finance Commission for 2000–05, New Delhi.
2. Finance Commission (2004): Report of the Twelfth Finance Commission for 2005–10, New Delhi.
3. Finance Commission (2009): Report of the Thirteenth Finance Commission 2010–2015, New Delhi.
4. Finance Commission (2014): Report of the Fourteenth Finance Commission, New Delhi.
5. Finance Commission (2019): Fifteenth Finance Commission: Report for the Year 2020-21, New Delhi.
6. Finance Commission (2020): Finance Commission in Pandemic Times: Report for 2021-26, Fifteenth Finance Commission, New Delhi.
7. Gupta, Manish and A. Sarma (2022), Growing Role of Finance Commissions in Intergovernmental Fiscal Management, *Economic and Political Weekly,* Vol. LVII, No.6, pp. 43-50,
8. Gupta, Manish, M. Mahesh and A. Chaudhary (2024), "Finance Commission Grants: Conditionality, Absorption, and States' Fiscal Behaviour", Paper presented in the Conference on Issues Before the Sixteenth Finance Commissions organized by NIPFP during 15-16 July 2024, New Delhi.
9. Rajaraman, Indira and M. Gupta (2016), Preserving the Incentive Properties of Statutory Grants, *Economic and Political Weekly*, Vol. LI, No.9, pp. 79-84,
10. Rao, M.G. (2010): "A Review of Indian Fiscal Federalism," Report of the Commission on Centre-State Relations, Supplementary Volume II: Research Studies, New Delhi.
11. Reddy, Y.V. and G.R. Reddy (2019): Indian Fiscal Federalism, New Delhi: Oxford University Press.
12. Srivastava, D.K. and C.B. Rao (2009): Review of Trends in Fiscal Transfers in India, Chennai: Madras School of Economics
13. Vithal, B.P.R. and M.L. Sastry (2001): Fiscal Federalism in India, Oxford University Press, New Delhi.

7

Challenges in Utilization of Central Grants in Mizoram

Lalhmingmawia Sailo and C Lungmuanpuia

Government of Mizoram

1.0 Revenue Receipts of Mizoram

1.1 Grants received by state governments from the central government form a significant part of the non-tax revenues for states. For states like Mizoram, which have limited internal resources, whether in the form of own tax revenue or own non-tax revenue, these grants-in-aid from the central government become crucial for sustaining their financial needs. Grants to the states are typically disbursed through two main channels: Centrally Sponsored Schemes (CSS) and Finance Commission (FC) grants. These grants play a pivotal role in supporting developmental projects, welfare schemes, and essential state functions, especially in regions with constrained fiscal capacities. In states like Mizoram, where own- tax revenues and own non-tax revenues are minimal, grants from the central government provide a lifeline, allowing the state to meet its expenditure commitments. The dependence on these grants is quite high, and their share as a percentage of total revenue receipts highlights their importance. The following table illustrates the percentage of grants in relation to the total revenue receipts of Mizoram, showcasing the extent of reliance on central assistance.

Table 1: Revenue Receipts of Mizoram

Rs.crore

COMPONENTS	2019-20	2020-21	2021-22	2022-23	2023-24 (RE)	TOTAL	Percentage share
Own Tax Revenue	730.98	647.56	853.93	1101.82	1182.80	4517.09	9.11
Own Non-Tax Revenue	522.35	561.56	622.11	1027.77	901.99	3635.78	7.33
Share of Union Taxes and Duties	3017.80	3010.55	4222.87	4745.25	5522.48	20518.95	41.36
Grants in Aid from GoI	5387.13	3520.80	3460.83	3407.22	5158.49	20934.47	42.20
Total	9658.26	7740.47	9159.74	10282.06	12765.76	49606.29	100.00

Source: Budget Documents

1.2 As per the data in the table, the total own tax revenue collected over the five years amounts to Rs.4,517.09 crore, which constitutes only 9.11% of the total revenue receipts. This shows that Mizoram has a relatively narrow tax base and limited capacity to generate its own resources, necessitating heavy reliance on external sources of funding. This own non tax revenue is also relatively small, and like own tax revenue which also indicates that the state's ability to generate income from within is limited.

1.3 One of the major components of the revenue receipts is share of Union Taxes and Duties, which is a constitutionally mandated devolution from the central government based on the recommendations of the Finance Commission. This component has grown significantly, from Rs.3,017.80 crore in 2019-

20 to Rs.5,522.48 crore in 2023-24. The total share of Union taxes over the five-year period is Rs. 20,518.95 crore, making up 41.36% of the total revenue receipts.

1.4 Grants-in-Aid from the central government constitute the largest component of revenue receipts of Mizoram. These grants are transferred mainly under Centrally Sponsored Schemes (CSS) and Finance Commission grants. Overall, the grants-in-aid was Rs.20,934.47 crore during the last five years, accounting for 42.20% of the total revenue receipts. This highlights heavy reliance on central assistance to finance expenditures, indicating a significant dependence on external sources to maintain fiscal stability.

2.0 Components of grants in aid

2.1 As previously mentioned, grants from the central government are channeled to the state primarily through two major sources: Centrally Sponsored Schemes (CSS) and Finance Commission grants. These grants play a critical role in supporting the development and welfare programs, particularly in states like Mizoram, which have limited internal revenue sources. Table 2 provides a detailed breakdown of the grants received by Mizoram from the central government over the past five years, highlighting the state's dependence on these transfers to meet its fiscal and developmental needs.

3.0 Table 2: Grants received from Central Government

Rupees crore

Particulars	2019-20	2020-21	2021-22	2022-23	2023-24 (RE)	TOTAL	% share
FC Grant	2778.72	1725.48	1910.29	1722.10	1635.00	9771.59	46.68
CSS	2103.97	1329.93	1334.93	1599.97	3423.55	9792.35	46.77
Others	504.43	465.38	215.60	85.14	99.93	1370.48	6.55
Total	**5387.12**	**3520.79**	**3460.82**	**3407.21**	**5158.48**	**20934.42**	**100.00**

Source: Budget Documents

2.1 The table illustrates the breakdown of grants received by Mizoram from the central government over the past five years, categorized into three key components: Finance Commission (FC) grants, grants from Centrally Sponsored Schemes (CSS), and other miscellaneous grants. The total grants received during this period amounted to Rs.20,934.42 crore, underscoring the importance of central assistance in the state’s fiscal framework.

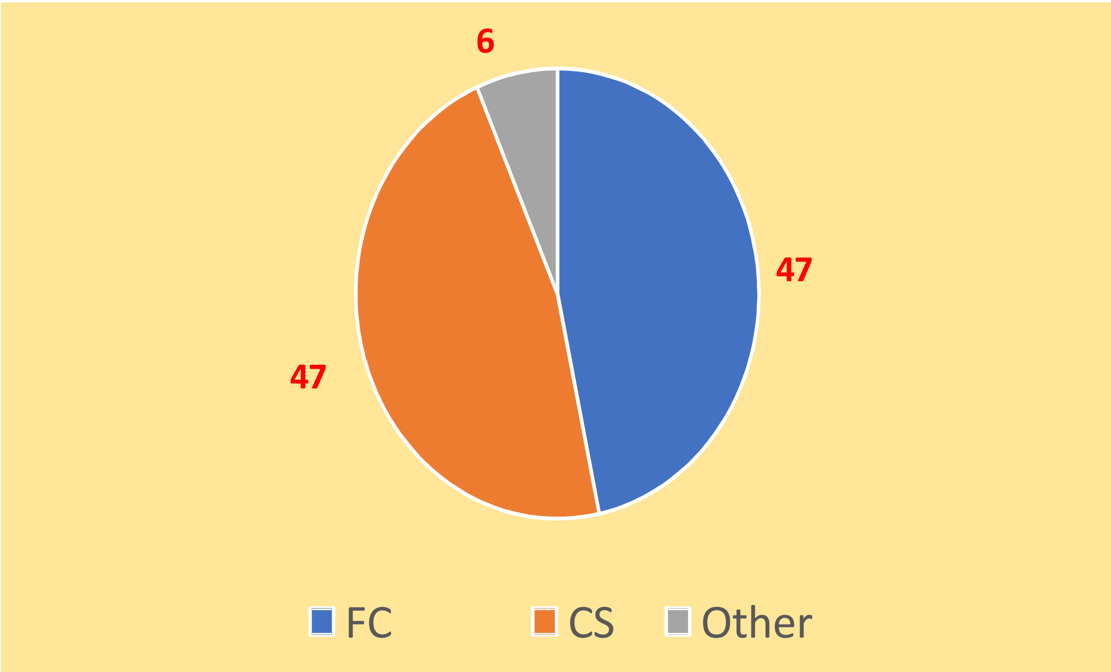
2.2 Finance Commission grants, which are designed to balance fiscal inequalities among states, have been a major source of revenue for Mizoram. Over the five-year period, the state received Rs.9,771.59 crore through FC grants, contributing 46.68% to the total grants received. This reflects significant reliance on the Finance Commission to support its fiscal needs.

2.3 CSS grants, which are intended to fund state-level implementation of central schemes, account for Rs.9,792.35 crore during the same period, contributing slightly more than FC grants at 46.77% of the total.

2.4 The third category, labeled as "Others," includes grants from North Eastern Council (NEC), Non-Lapsable Central Pool of Resources (NLCPR) and Central Road Fund. Over the five years, these grants have contributed Rs.1,370.48 crore, which is 6.55% of the total central assistance. While their contribution is smaller, these grants still provide essential supplementary funding, especially for specific purposes.

2.5 In total, Mizoram received Rs.20,934.42 crore in grants over the five-year period, with Finance Commission grants and CSS grants together comprising 93.45% of the total.

Chart : Components of Central Grants



3.0 Types of Finance Commission Grants

3.1 The grants received by Mizoram on the recommendations of the Fifteenth Finance Commissions play a pivotal role in addressing the state's fiscal challenges and supporting its development efforts.

3.2 Post-Devolution Revenue Deficit Grants is a lifeline for states like Mizoram, which continue to experience revenue shortfalls even after receiving their share of central taxes through devolution. The purpose of the Post-Devolution Revenue Deficit Grant is to bridge the gap between income and expenditure needs, and this grant is crucial for fiscal stability.

3.3 Rural Local Body Grants are essential for empowering the rural local bodies, providing them with the financial resources needed to manage local governance and development more effectively. The funds are allocated to enhance rural infrastructure, improve sanitation, and provide basic services in villages. In a state like Mizoram, where the majority of the population lives in rural areas, this grant is instrumental in improving living standards and supporting local economic development.

3.4 With urbanization, the Urban Local Body Grants provide much-needed financial support to municipalities. These funds help strengthen urban governance and improve essential services, such as water supply, waste management, and are useful for providing various amenities.

3.5 Mizoram, being prone to frequent natural disasters such as landslides, floods, and earthquakes, relies heavily on the State Disaster Risk Management Fund (SDRMF) to manage disaster risks. The fund is used for disaster mitigation, preparedness, and response, as well as post-disaster relief and rehabilitation. With the increasing frequency of natural disasters due to climate change, this grant is vital for protecting vulnerable communities and minimizing the economic and social impacts of such events.

3.6 In earlier Finance Commissions, such as the Eleventh FC, Twelfth FC, and Thirteenth FC, Mizoram benefited from State-Specific Grants and Sector-Specific Grants. These grants were provided to address the unique developmental challenges faced by the state and its key sectors.

3.6.1 The FC-X (1995-2000) recommended Rs.57.00 crore for construction of Airport at Lengpui. The airport integrates Mizoram into the national and global aviation network, fostering greater interaction and exchange. Lengpui Airport is crucial for medical and emergency services in Mizoram. It also holds strategic importance for Mizoram and India. Its location in the north-eastern region, bordering Myanmar and Bangladesh, makes it a key asset for national security and defence logistics.

3.6.2 The FC-XI (2000-2005) recommended Rs. 40.00 crore to undertake the New Capital Project at Khatla. It also recommended Rs.5.00 crore for reconstruction of the Raj Bhavan complex and Rs.2.00 crore for the infrastructure required to set up tourist information centres at Guwahati, New Delhi and Calcutta.

3.6.3 The FC-XII (2005-2010) recommended Rs.40.00 crore for tackling the problems of rodents arising out of impending bamboo flowering. It also recommended Rs.25.00 crore for construction of sports complex in Aizawl.

3.7 In the financial year 2021-22, Mizoram received a health grant as part of the FC-XV's recommendations. This grant aimed to support the state's healthcare system by improving infrastructure, equipment, and services. However, this health grant was not continued in subsequent years, limiting its long-term impact.

Table 3: Finance Commission Grants Received Year-wise by Mizoram

Rupees crore

Particulars	2021-22	2022-23	2023-24 (RE)	TOTAL
Deficit Grant	1790.00	1615.00	1474.00	4879.00
Rural Local Body Grant	34.50	53.60	72.00	160.10
Urban Local Body Grant	17.00	39.20	37.00	93.20
SDRMF	37.60	53.50	52.00	143.10
Health Grant	31.19	-	-	31.19
Total	**1910.29**	**1761.30**	**1635.00**	**5306.59**

Source: Budget Documents

3.8 The table presents the breakdown of grants received by Mizoram over the financial years 2021-22, 2022-23, and 2023-24 (RE) based on the recommendations of the Fifteenth Finance Commission. The total grants received over this period amount to Rs.5,306.59 crore. The largest component of the grants is the Post-Devolution Revenue Deficit Grant, amounting to Rs.4,879.00 crore over the three years.. The grant shows a gradual decline from Rs.1,790.00 crore in 2021-22 to Rs.1,474.00 crore in 2023-24 (RE).

4.0 Purposes of Finance Commission grants

4.1 Among the various grants recommended by the Finance Commission, the Revenue Deficit Grant is the most flexible, as it comes with no conditions on its utilization. This makes it a frictionless grant, allowing states to use the funds freely to address fiscal shortfalls without specific restrictions.

4.2 In contrast, Local Body Grants are tied to specific conditions to ensure that the funds are used effectively to improve governance, infrastructure, and services at the local level. These conditions promote accountability and proper utilization of resources by local governing bodies.

4.3 Disaster Grants, allocated under the State Disaster Risk Management Fund (SDRMF), must be used in accordance with detailed guidelines framed by the Ministry of Home Affairs. These funds are designated for disaster preparedness, response, and recovery efforts, and their utilization is closely monitored to ensure that they meet the objectives of disaster risk management.

4.4 Sector-Specific Grants, on the other hand, must be utilized according to conditions prescribed by both the Finance Commission and the relevant central ministries. These grants are earmarked for specific sectors such as health, education, or infrastructure, and their usage is subject to detailed guidelines aimed at achieving targeted outcomes in those sectors.

4.5 Similarly, State-Specific Grants also come with conditionalities outlined by the Finance Commission. These grants are designed to address the unique needs of individual states and must be used in line with the specific requirements set forth by the Commission. The conditions specified by various Finance Commissions for the utilization of the grants they recommended are outlined in the following sections.

5.0 Local Body Grants

5.1 FC-XIII recommended basic grants and performance grants for rural local bodies. Amounts of grants recommended for Mizoram are shown in the Table 4.

Table 4: Basic Grants and Performance Grants under FC-XIII

Rupees crore

Year	Basic Grants	Performance Grants	Total
2010-11	20.12		20.12
2011-12	23.34	7.98	31.32
2012-13	27.30	18.73	46.03
2013-14	32.34	22.10	54.44
2014-15	38.27	26.05	64.32
Total	141.37	74.68	216.23

Source: FC-XIII Report

5.2 While basic grants could be utilized without specific conditions, the FC-XIII made nine conditions in respect of performance grants and State Government would be eligible to draw down its share of the general performance grant only if it complied with the nine conditions. These conditions must be met by the end of a fiscal year (31 March) for the state to be eligible to draw down its performance grant for the succeeding fiscal year. Some of the conditions are reproduced below.

5.2.1 The State Government must put in place a supplement to the budget documents for local bodies (separately for PRIs and ULBs) furnishing the details (other than those relating to Finance Accounts). They should require the PRIs to maintain accounts as specified in paras 10.111 and 10.112 of the Report of the Commission.

5.2.2 The State Government must put in place an audit system for all local bodies (all categories of ULBs and all tiers of PRIs) as indicated in Para 10.121 of the Report of the FC-XIII. The C&AG must be given role of Technical Guidance &Supervision over the audit of all the local bodies in a state at every tier/category and his Annual Technical Inspection Report as well as the Annual Report of the Director of Local Fund Audit must be placed before the state legislature. Certification from the C&AG will demonstrate compliance with this condition.

5.2.3 The State Government must put in place a system of independent local body ombudsmen who will look into complaints of corruption and maladministration against the functionaries of local bodies, both elected members and officials.

5.3 The State Governments must put in place a system to electronically transfer local body grants provided by this Commission to the respective local bodies within five days of their receipt from the Central Government.

5.4 The State Governments must prescribe through an Act the qualifications of persons eligible for appointment as members of the SFC consistent with Article 243I (2) of the Constitution.

5.5 Due to the prolonged process of meeting the numerous conditions attached to performance grants for rural local bodies, the State Government was able to utilize only Rs.18.82 crore (Rs.1.16 crore in 2012-13 & Rs.17.66 crore in 2014-15) out of the total recommended amount of Rs.74.68 crore. Performance grants available under FC-XIII for the urban local body was Rs.27.62 crore and amount utilized was Rs.24.69 crore which was better utilized than rural local body grants.

5.6 FC-XIV in its recommendations stated that considering the existing provisions in the Constitution and the ToR, it could not recommend grants to areas where Part IX and Part IX-A do not apply, and where States have not enacted laws for establishing duly-elected panchayats and municipalities. It also left areas under Schedule VI in Meghalaya, Mizoram, Tripura and Assam, the areas in the hills districts of Manipur, rural areas of Nagaland and Mizoram outside the ambit of the measures it had recommended for panchayats and municipalities. Hence, Rural Local Body grant was not received by Mizoram under FC-XIV.

5.7 Although the FC-XIV did not recommend grants for rural local bodies, it did recommend basic grants and performance grants for urban local bodies. The performance grants for ULB recommended by the FC-XIV and amounts actually utilized are indicated in the Table 5.

Table 5: Basic Grants and Performance Grants for ULB under FC-XIV

Rupees crore

Particulars	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Basic Grant	11.54	15.97	18.46	21.35	28.85	96.17
Performance Grant Recommended		4.71	5.34	6.06	7.93	24.04
Performance Grant Utilized		4.71	5.34			

Source: FC-XIV Report and Budget Documents

5.8 FC-XIV prescribed conditions for receiving and utilizing performance grants for urban local bodies. To be eligible, the urban local body will have to submit audited annual accounts that relate to a year not earlier than two years preceding the year in which it seeks to claim the performance grant. It will also have to show an increase in own revenues over the preceding year, as reflected in these audited accounts. In addition, it must publish the service level benchmarks relating to basic urban services each year for the period of the award and make it publically available. The service level benchmarks of the Ministry of Urban Development may be used for this purpose. The improvement in revenues will be determined on the basis of these audited accounts and on no other basis. For computing the increase in own revenues in a particular year, the proceeds from octroi and entry tax must be excluded. In case some amount of the performance grant remains after disbursement to the eligible urban local bodies, the undisbursed amount should be distributed on an equitable basis among all the eligible urban local bodies that had fulfilled the conditions for getting the performance grant. The conditions set by FC-XIV are fewer in number and less stringent than conditions set by FC-XIII.

5.9 Under FC-XV, both RLB grants and ULB grants are received but the FC- XV did not recommend performance grants. However, it introduced tied and untied grants for both Rural Local Bodies (RLB) and Urban Local Bodies (ULB).

5.10 In respect of rural local body grants, 40 per cent of the total grants shall be untied and can be used by them for felt needs under the twenty-nine subjects enshrined in the Eleventh Schedule, except for salaries and other establishment costs. Tied grants which constitute 60% of total grant in each year and 30 per cent shall be earmarked for drinking water, rainwater harvesting and water recycling and the remaining 30 per cent shall be earmarked for sanitation and maintenance of ODF status, and this should include management and treatment of household waste, and human excreta and faecal sludge management.

6.0 Utilization of Grants

6.1 Since auditing is necessary to ascertain the transparency and accountability of public funds and this has remained an unfinished task so far, FC-XV recommended the online availability of both provisional accounts of the previous year and audited accounts of the year before previous as entry level condition to avail of the grants. In the first and second year of the award period (2021-22 and 2022-23), States need to ensure that at least 25 per cent of the rural local bodies have both their provisional accounts for the previous year and audited accounts for the year before the previous available online in the public domain in order for them to avail of the full grants in that year. From the third year (2023-24) onwards, States will receive total grants due to the rural local bodies having both provisional accounts of the previous year and audited accounts for the year before previous and making these available online. For example, if for a particular State only 35 per cent of rural local bodies have both provisional accounts for the year 2022-23 and audited accounts for the year 2021-22 and these are available online in 2023-24, then in 2023-24, the State will receive total amount due to these 35 per cent of rural local bodies for the year 2023-24.

6.2 In order to implement recommendation of FC-XV regarding RLB grants, Village Councils in Mizoram have to prepare Gram Panchayat Development Plan (GPDP) and the Plans are to be placed before Gram Sabha for its approval. After the Gram Sabha approves the GPDP, they are uploaded to e-Gramswaraj portal. Plan and estimates are prepared separately for tied and untied portions of grants and works are then executed with geo-tagged photographs of works. Then online audit is conducted by Directorate of Local Fund Audit and audit certificates are generated by auditors. All information are available in the e-Gramswaraj portal. Online audit for the year 2021-2022 is going on as in August 2024 and grant has been released by Government of India up to the first installment amounting to Rs.35.50 crore against the recommended amount of Rs.71.00 crore for the year 2022- 23.Table 6: RLB Grants Corresponding to Year of Award under FC-XV

Particulars	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Grant Recommended	93.00	69.00	71.00	37.00	39.00	40.00
Grant Received	93.00	69.00	35.50			

Source: FC-XV Reports & Local Administration Department

6.3 In order to conduct Audit online for RLB grants, the auditors must be able to access directly e-Gram Swaraj portal through AuditOnline portal. Currently, auditors under Directorate of Local Fund Audit of Mizoram cannot access e-Gram Swaraj portal and hence data of Village Councils including geo-tagged assets and works executed by Village Councils cannot be audited online. Due to this problem, the auditors are facing setback in auditing of accounts of 834 Village Councils. Efforts are being taken to enable access of e-Gramswaraj through the Audit Online portal.

6.4 Similar to rural local body grants, 40 per cent of urban local body grant is untied and can be used by the urban local bodies for felt needs under the eighteen subjects enshrined in the Twelfth Schedule, except for salaries and other establishment costs. The remaining 60 per cent of the grants should be tied to supporting and strengthening the delivery of basic services. Thirty per cent of the total grants to be disbursed to urban local bodies shall be earmarked for sanitation and solid waste management and attainment of star ratings as developed by the MoHUA. 30 per cent of the total grants to be disbursed to urban local bodies shall be earmarked for drinking water, rainwater harvesting and water recycling. However, if any urban local body has fully saturated the needs of one category and there is no requirement of funds for that purpose, it can utilise the funds for the other category.

6.5 As in the case of the rural local bodies, in order to be eligible for grants, the urban local bodies too have to mandatorily prepare and make available online in the public domain annual accounts of the previous year and the duly audited accounts of the year before previous. Such audited accounts should include the minimum of a) balance sheet; b) income and expenditure statement; c) cash flow statement; and d) schedules to balance sheet, income and expenditure statement and cash flow statement.

6.6 In the first year of the award period, that is 2021-22, a State needs to ensure online availability of at least 25 per cent of both unaudited urban local body accounts for the previous year and audited accounts for the year before the previous to avail the full grants in that year. States are also expected to notify the floor rates of property tax and operationalise the relevant arrangements in 2021-22. The condition of notifying the floor rates of property tax will apply for eligibility of grants from 2022-23 along with which a State needs to ensure online availability of at least 25 per cent of both unaudited urban local body accounts for the previous year and audited accounts for the year before the previous to avail the full grants in that year.

6.7 After notifying floor rates for property tax, the states are required to show consistent improvement in collection in tandem with the growth rate of State's own GSDP. This condition in the report for 2020-21 shall continue to be applicable as an entry level condition for all the urban local bodies for availing the grants. Further, this condition is over and above the requirement of timely online availability in the public domain of both unaudited accounts for the previous year and audited annual accounts for the year before previous.

6.8 In pursuance of the recommendation of the FC-XV, Government of Mizoram notified floor rate of property tax at 3% of Annual Property Value for all Urban Local Bodies in Mizoram (vide No.B.13017/45/2022-UD&PA dated 29.03.2022). Rate of property tax was revised from 3% to 3.42 % of Annual Property Value for the year 2022-2023 (Vide No.B.13017/45/2012-UD&PA dated 08.12.2021). Audited Accounts of Aizawl Municipal Corporation (AMC) for the years 2021-2022 & 2022-2023 were uploaded at AMC website amcmizoram.com and City Finance Portal. Accounts of AMC for FY 2023-24 have also been uploaded in AMC website.

Table 7: ULB Grants under FC-XV

Particulars	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Grant Recommended	45.00	34.00	35.00	37.00	39.00	40.00
Grant Received	45.00	34.00	35.00	18.50		

Source: FC-XV Report and UD&PA Department

6.9 The conditions laid down by the Fifteenth Finance Commission (FC-XV) for the utilization of local body grants are more relaxed compared to those of the Fourteenth Finance Commission. FC-XV has reduced the stringency of guidelines and allowed greater flexibility for local bodies, making it easier for them to access and utilize the grants. As a result, local bodies in Mizoram did not face significant challenges or bottlenecks in the utilization of FC grants under FC-XV. In contrast, the stricter conditions under FC-III and FC-XIV often led to delays and complications, as local bodies struggled to meet the set requirements for fund disbursement and utilization. This shift towards more flexible conditions under FC- XV has facilitated smoother grant allocation and utilization, contributing to the more effective functioning of local governance institutions.

7.0 Other Grants from Finance Commissions

7.1 In addition to local body grants, other significant types of Finance Commission grants include post-devolution revenue deficit grants, sector-specific grants, and state-specific grants. Each type serves distinct purposes and comes with different conditions for utilization. The revenue deficit grant is an unconditional grant provided by the Finance Commission to states facing a shortfall in revenue after tax devolution. Since this grant is unconditional, states have considerable freedom in its utilization, and therefore, there are no major challenges or hurdles in its use. It primarily aims to ensure that states can maintain their current level of services despite revenue shortfalls.

7.2 Sector-specific grants and state-specific grants come with a number of conditions set either by the Finance Commission or by the concerned ministries. These conditions often relate to the intended purpose of the grant and require states to adhere to specific guidelines or achieve certain outcomes. This conditionality can create challenges in the timely and effective utilization of the grants, particularly for states with limited administrative capacity or difficulty in meeting compliance requirements.

Table 8: Sector Specific Grants Recommended by Finance Commissions

Rupees crore

Serial No	Finance Commission	Total grants in aid	Sector specific grants	% of sector specific grants
1	FC-XII	3194.39	95.41	2.99 %
2	FC-XIII	4923.61	309.36	6.28%
3	FC-XIV	12387.21	NIL	0.00
4	FC-XV	10646.64	986.64	9.27%
	Total	**31151.85**	**1391.41**	**4.46%**

Source : FC Reports

7.3 It is important to note that the Fourteenth Finance Commission did not recommend sector-specific grants or state-specific grants. As a result, there was no question of facing challenges in their utilization during the FC-XIV period, as these types of grants were absent from the commission's recommendations. In contrast, the Fifteenth Finance Commission did recommended a range of sector-specific and state-specific grants aimed at addressing critical areas such as health, education, agriculture, and infrastructure, as well as addressing the unique needs of individual states. However, despite the recommendations, the Central Government did not implement these grants except the health grant, which is tied to existing schemes and programs in the health sector. This tie-up with ongoing schemes somewhat limits the flexibility of states in utilizing these funds, as they must align their activities with pre-existing guidelines and objectives of the centrally sponsored schemes.

8.0 Centrally Sponsored Schemes (CSS)

8.1 Centrally Sponsored Schemes are initiatives funded by the Government of India but implemented by state governments. They play a crucial role in delivering various services and infrastructure, especially in sectors like health, education, rural development, and agriculture. CSS are aimed at addressing national concerns and they are funded by both the central and state governments. Typically, the central government provides the larger share, while states contribute a smaller percentage. The ratio of funding can vary depending on the scheme and it is 60:40 for most states, but for special category states, the ratio is usually 90:10. Although states are responsible for implementing the schemes, the central government maintains oversight through regular monitoring and review processes. This helps ensure the schemes are carried out efficiently and funds are utilized appropriately.

8.2 Like other states, central schemes are widely implemented in Mizoram, and in most cases, they proceed without major hurdles. However, challenges often arise during the execution phase, particularly related to the scheme guidelines, which can impact proper utilization. These challenges, which are unique to the state's context in respect of a few departments are discussed in the following paragraphs.

8.2.1 In the case of Health Department, amongst many schemes being implemented, the three schemes namely National AYUSH Mission, State Medical Plants Board and AOGUSY (Ayush Oushadhi Gunvattaevam Uttpadan Samvardhan Yojana) will be discussed here.

8.3 Under National Ayush Mission, only 4% of the net funds available for the State is earmarked for administrative costs under the mission. Apart from the monthly salary, administrative costs of office expenditure like travelling, contingency, Annual Maintenance Cost (AMC) of infrastructure including equipment, computer, software etc training & capacity building under each component, audit monitoring & evaluation and project preparation need to be met under the administrative cost provision. For smaller states like Mizoram, meeting these administrative costs is particularly challenging, as the annual allocation for administrative expenses is typically determined on population basis, resulting in limited funds. An increase in funds earmarked for administrative costs would significantly enhance the state's capacity to better utilize the overall funding.

8.3.1 The financial assistance is often insufficient to implement activities as envisioned. Mizoram being a hilly state with a widely dispersed population living in small and remote villages, reaching every corner of the state presents significant logistical challenges. Poor road conditions and difficult terrain further exacerbate these difficulties, making it far more complex and costly to deliver healthcare services compared to states in the plain areas. The cost of essential services, such as hiring vehicles for outreach activities and printing Information, Education, and Communication (IEC) materials, is considerably higher in Mizoram than in mainland India. The current fund provisions, set in accordance with standardized guidelines, often fail to account for these expenses. As a result, the limited financial assistance constrains the state's ability to fully implement the health programs as desired. For effective delivery of health services in such geographically challenging areas, it is essential to re-evaluate and adjust the financial allocations in line with the unique needs of the state.

8.4 Although the Ministry of AYUSH has incorporated a 5% annual salary increment for certain categories of manpower, this benefit has not been extended to key personnel such as doctors and supporting staff working under Integrated AYUSH Hospitals. The Ministry contends that their salaries are provided as part of a fixed package, which cannot be exceeded. As a result, over time, a disparity has emerged among staff performing similar roles. While some personnel benefit from the yearly increment, other staffs are left without any salary increments, leading to unequal compensation for comparable work. This growing inequality among employees can create dissatisfaction and may ultimately impact morale and the effective functioning of AYUSH healthcare services. Addressing this imbalance is essential to maintaining fairness and ensuring that all staff receive equitable treatment.

8.5 The current remuneration for the staff of the State Medicinal Plants Board (SMPB) is considerably lower compared to other sectors, leading to dissatisfaction and diminished morale among employees. Presently, remuneration rates are inconsistent across various scheme. Besides, some employees receive annual increments while others are paid fixed remuneration with no adjustments over time. This lack of uniformity contributes to further inequity and dissatisfaction.

8.6 In the case of Mahatma Gandhi National Rural Employees Guarantee Scheme (MGNREGS), many permissible works outlined in existing guidelines are not feasible in hilly areas, particularly in the northeastern region. Given the unique geographical and infrastructural challenges in these regions, it is recommended to develop separate lists of permissible works for plain areas and hill areas or customization to suit local needs may be allowed. Allowing customization of the works to suit local needs would ensure that the guidelines are more adaptable and practical for these regions. This approach would enhance the effectiveness and efficiency of implementation, taking into account the specific demands and constraints of hilly terrains.

8.6.1 Capturing attendance through the National Mobile Monitoring System (NMMS) is often impractical in hilly areas, where most worksites are situated in remote locations between hills and jungles with little to no mobile signal coverage. The lack of reliable connectivity makes it challenging to use the NMMS effectively in such regions. To ensure accurate attendance tracking in these areas, alternative solutions that account for the geographical and infrastructural limitations need to be considered.

8.6.2 Although the Supreme Court has ruled that Aadhaar is not mandatory, it is required to become a beneficiary under MGNREGS. Since there are job card holders who do not have Aadhar and since they cannot be beneficiaries, it adversely affects achievement rate.

8.7 Achievement rate in Pradhan Mantri Awaas Yojona-Gramin (PMAY-G)- Housing For All is lower in remote and hilly regions due to the higher cost of materials compared to plain areas. Beneficiaries are often required to contribute more than the central share to complete housing construction, making it difficult for some needy families to finish their homes. This challenge arises primarily because uniform cost norms are applied across both plain and hilly or remote areas, without reflecting the regional variations in material costs.

8.8 Deendayal Antyodaya Yojona-National Urban Livelihood Mission (DAY- NULM) aims to alleviate urban poverty by enhancing livelihoods through skill development and improving access to social security for the urban poor. It promotes the formation of Self Help Groups (SHGs), encourages entrepreneurship, and provides shelters for the urban homeless. However, the existing revolving fund for SHGs is only Rs.10,000, which is insufficient to meet their needs. Additionally, the maximum loan amount of Rs.2,00,000 available under DAY-NULM is inadequate for starting sustainable businesses or ventures. While the scheme's objectives are commendable, the financial support provided is not enough to achieve them effectively.

8.9 Krishonnati Yojana -Agriculture Extension aims to create a farmer-driven, accountable system for disseminating technology through new institutional frameworks, such as the Agricultural Technology Management Agency (ATMA), at the district, block, and village levels. The scheme is currently implemented in eight districts of Mizoram: Aizawl (undivided), Champhai, Lunglei, Siaha, Lawngtlai, Mamit, Kolasib, and Serchhip. The establishment of ATMA in three additional districts is under consideration. Across these districts, 118 scheme-borne staff are deployed at the district, block, and headquarters levels. The scheme offers specific pay structures, including a 10% annual increment for fixed-pay employees. However, a committed liability of Rs.525.00 lakh, resulting from integration issues between IFMIS and PFMS in 2022-23, remains unpaid. This liability has been included in the approved Annual Action Plan for 2024-25. As a result, staff under the ATMA scheme have not received their monthly remuneration for nearly eight months.

8.10 National Food Security and Nutrition Mission (NFSNM) is the scheme which aims to increase production of rice, pulses, maize and nutri-cereals (millets) through area expansion and productivity enhancement in a sustainable manner across the identified districts of the state. Restoring soil fertility and productivity at the individual farm level and enhancing farm level economy to restore confidence amongst the farmers. Enhancing post-harvest value addition at farm gate for better price realization to farmers through efficient market linkages.

8.10.1 The guidelines allow for the engagement of two Technical Assistants, with a minimum qualification of B.Sc. in Agriculture, who receive a fixed remuneration of ₹40,000 plus DA per month, without annual increments. Both positions are currently filled. Since the inception in 2011, there has been a significant reduction in fund allocation, which has continued into the 2024-25 financial year. Increasing the funding would enhance the production of targeted crops in the state.

8.10.2 Due to the small-scale cultivation of commercial crops like sugarcane, the state is not eligible for the NFSM-Commercial Crops component. Sugarcane is a crucial commercial crop for over 3,000 farmers who rely solely on its cultivation for their livelihood. The Ministry should consider including sugarcane under the scheme and allocate funds for its promotion. Given the food habits of the Mizo people, post-harvest issues, and market potential, a lower allocation may be made for the Nutri-Cereals component.

8.11 Sub-Mission on Seeds and Planting Materials (SMSPM) is the scheme that focuses on increasing the production of quality and certified seeds, with a particular emphasis on raising the Seed Replacement Rate (SRR), especially for crops such as paddy, maize, pulses, and oilseeds. Efforts are directed at improving the quality of farm-saved seeds, targeting 10% of villages annually, and enhancing seed production through farmer-led participatory programs while promoting new crop varieties. The initiative also aims to introduce advanced technologies and methodologies in seed production, processing, and testing. Additionally, seed treatment, particularly for farm-saved seeds, is encouraged, along with strengthening the seed multiplication chain by supporting both the public and private sectors.

8.11.1 A key issue with this scheme is the lack of provisions for administrative costs or flexible funds, which are typically included in most other centrally sponsored schemes. Given the logistical and transportation challenges in the state, the assistance for quality seeds should be increased across all crops. Moreover, the exact amount of assistance for each seed type—pulses, paddy, oilseeds, cereals, and coarse cereals—should be clearly specified, rather than using percentage-based allocations like 50% or 60%, to ensure clarity and better support for farmers.

8.11.2 The scheme of National Mission on Edible Oils - Oil Palm (NMEO-OP) aims to expand the cultivation area of oil palm, establish seed gardens for the production of quality oil palm seeds, and increase crude oil palm production. The guidelines provide for the engagement of a Consultant (experienced technical expert) and a Technical Assistant (with B.Sc. Agriculture or higher qualifications), with fixed remunerations of ₹65,000 and ₹35,000 respectively, but no provision for annual increments.

8.12 Under Rashtriya Krishi Vikas Yojona (RKVY), the sub-scheme Per Drop More Crop (PDMC) aims to expand the adoption of micro irrigation technologies in agriculture to improve water use efficiency. It seeks to boost crop productivity and farmers' income through precision water management. Additionally, the scheme promotes the use of micro irrigation for water-intensive crops such as sugarcane, banana, cotton, and paddy, while emphasizing the extension of these technologies to field crops.

8.12.1 This scheme has been implemented in the State since 2015-16. According to the Operational Guidelines of the Per Drop More Crop (PDMC) scheme, the Central Government used to release 60% of the funds as the first installment once the State submits its proposal in the prescribed format. However, with the introduction of the Single Nodal Agency (SNA) system in 2021-22, changes in the fund release pattern have created challenges for the State in fully utilizing the allocated funds. Under this new system, funds are disbursed in four installments, with only 25% of the total released as the first installment. Due to the uncertainty surrounding the release of subsequent funds, the Department is unable to make firm commitments regarding the expenditure for the remaining amount required to complete the project. As a result, only 25% of the project is being implemented in a phased manner. This partial implementation not only hampers the overall progress but also results in suboptimal utilization of the funds that have already been allocated. Consequently, the project's achievements remain below expectations, with limited outputs and delayed outcomes. The lack of timely fund disbursement thus creates a vicious cycle of inefficiency, where the restricted budget prevents the Department from achieving its full project goals, further complicating future funding justifications. This scenario underscores the critical need for timely and adequate funding to ensure the project's successful and comprehensive execution.

8.13 The Sub Mission on Agricultural Mechanization (SMAM) aims to expand access to farm mechanization for small and marginal farmers, particularly in regions with limited availability of farm power. The scheme promotes the establishment of Custom Hiring Centers (CHCs) to address the economic challenges faced by small landholders and reduce the high costs associated with individual ownership of farm machinery. Additionally, it focuses on creating awareness among stakeholders through demonstrations and capacity-building initiatives.

8.13.1 The introduction of the Single Nodal Agency (SNA) system in 2021-22 has significantly affected the implementation of this scheme. The new fund release pattern of the scheme, which disburses funds in four installments with only 25% provided as the first quarterly installment, has made it challenging for the State to fully utilize the allocated funds.

8.14 A common challenge across CSS under Agriculture sector since FY 2022- 23 is the release of funds in four installments. Delays in fund disbursement to the Single Nodal Agency (SNA) account hinder the timely implementation of schemes, especially since agricultural activities are season-dependent. Additionally, new funds can only be released once 75% of the previous releases have been utilized, further complicating the efficient execution of these schemes. Women and Child Development Department is implementing three Centrally Sponsored Schemes (CSS) — Mission Shakti (Samarthya & Sambal), Saksham Anganwadi and Poshan 2.0, and Mission Vatsalya. Each of these schemes has its own unique PFMS code. Additionally, each scheme comprises at least four sub-schemes, which operate under the PFMS codes of their respective main schemes.

8.14.1 For instance, the PFMS code for Samarthya is 3980. Under Samarthya, there are seven sub-schemes. Unless the fund for any one of these sub-schemes is transferred to the SNA account from the State Treasury, funds for the remaining sub-schemes cannot be received, even if Utilization Certificates and interest remittances are completed. Consequently, delays in transferring funds under one sub-scheme lead to delays in fund releases for all other sub-schemes. This often results in some sub-schemes not receiving their full earmarked funds for the year. It is believed that assigning unique PFMS codes to each sub-scheme would prevent delays in one sub-scheme from affecting fund releases for the others.

9.0 State Matching Shares

9.1 Centrally Sponsored Schemes being joint initiatives of the Central and State Governments in India, both share the financial responsibility. The Central Government provides a significant portion of the funding, but States are required to contribute a matching share based on a pre-determined ratio. This ratio varies depending on the type of scheme and the category of the state. Typically, for most schemes, the ratio is 60:40, where the Central Government provides 60% and the State contributes 40%. For Special Category States like Mizoram, the ratio is 90:10, where 90% of the funds come from the Centre, and 10% from the State. States must allocate their matching share in their budgets. Failure to provide the required funds on time can lead to delays in the release of central funds, affecting the timely implementation of the schemes. Financially weaker states often struggle to meet their matching share obligations, leading to underutilization of central funds and affecting the success of CSS in those regions.

9.2 Department-wise status of CSS implementation and matching contributions during the year 2023-24 and current year 2024-25 in Mizoram are shown in the Table 7 and Table 8.

STATEMENT SHOWING CENTRALLY SPONSORED SCHEMES(CSS) BEING IMPLEMENTED UNDER THE GOVERNMENT OF MIZORAM AND AMOUNT SPENT ON MATCHING CONTRIBUTION DURING 2024-25

Table 9: State Matching Shares for CSS During 2024-25 (ongoing)

Rupees lakh

Sl. No	NAME OF DEPARTMENT	NO OF SCHEMES	MATCHING SHARES
1	Agriculture	6	278.96
2	Animal Husbandry & Veterinary	7	169.93
3	Art & Culture	1	15.00
4	Cooperation	1	0.58
5	Commerce & Industries	1	1031.10
6	DC&MA	2	389.00
7	Disaster Management & Rehabilitation	2	600.00
8	Environment, Forest & Climate Change	4	15.83
9	Fisheries	1	138.95
10	Food, Civil Supplies & Consumer Affairs	1	218.00
11	Health & Family Welfare	4	993.14
12	Horticulture	3	188.90
13	Law & Judicial	4	97.40
14	Labour, Employment, Skill Development & Entrepreneurship	1	30.37
15	Local Administration Department	1	1031.10
16	Power & Electricity	1	26.48
17	Public Health Engineering	1	27.75
18	Public Work Department	1	36.40
19	Rural Development	8	1344.62
20	School Education	3	110.91
21	Social Welfare	14	1047.32
22	Transport	2	86.33
23	Urban Development & Poverty Alleviation	3	886.30
	Total	**72**	**7722.94**

Source: Finance Department (Budget)

STATEMENT SHOWING CENTRALLY SPONSORED SCHEMES(CSS) BEING IMPLEMENTED UNDER THE GOVERNMENT OF MIZORAM AND AMOUNT SPENT ON MATCHING CONTRIBUTION DURING 2023-24

Table 10: State Matching Shares for CSS During 2023-24

Rupees lakh

Sl. No	NAME OF DEPARTMENT	NO OF SCHEMES	MATCHING SHARES
1	Agriculture	18	570.47
2	Animal Husbandry & Veterinary	9	52.14
3	Commerce & Industries	4	310.25
4	DC&MA	3	156.17
5	Disaster Management & Rehabilitation	1	98.62
6	Environment, Forest & Climate Change	10	302.38
7	Fisheries	2	156.90
8	Food, Civil Supplies & Consumer Affairs	3	286.69
9	Health & Family Welfare	13	2208.14
10	Higher & Technical Education	2	242.11
11	Horticulture	8	628.83
12	Information & Public Relation	1	60.00
13	Law & Judicial	4	71.78
14	Labour, Employment, Skill Development & Entrepreneurship	1	22.05
15	Local Administration Department	1	1001.70
16	Planning & Programme Implementation	1	40.00
17	Power & Electricity	2	251.91
18	Public Health Engineering	6	3915.45
19	Public Work Department	2	173.90
20	Rural Development	15	6136.57
21	School Education	7	3714.80
22	Social Welfare	12	1073.07
23	Sports & Youth Services	1	200.00
24	Transport	1	43.40
25	Urban Development & Poverty Alleviation	5	2064.50
	Total	**131**	**23782.28**

Source :Finance Department (Budget)

9.3 As Mizoram is a small State with a predominantly rural population, it has limited capacity to generate its own revenue. Its tax base is narrow, and its geographical constraints limit economic growth. Though matching contribution appears not high in terms of percentage, the total cumulative amount across all CSS projects is huge as multiple schemes require significant portions of limited resources as matching contributions. For a financially constrained State like Mizoram, even the relatively small 10% can be overwhelming when applied across numerous large-scale projects. Sometimes, the State could not release it share to SNA accounts of the scheme. This resulted in withholding of the second installment of Central shares. This in turn delayed project implementations. After the completion of projects, the responsibility for maintenance shifts to the State. In the case of infrastructure projects such as roads, schools, hospitals, or irrigation systems, the cost of maintaining these assets is a recurring expense that Mizoram must bear. This adds a significant financial burden that grows over time.

10.0 Challenges in utilization of CSS

10.1 Guidelines of many Central schemes do not always account for the geographical and socio-economic realities of Mizoram. The state's rugged terrain, scattered population, and difficult connectivity can make it hard to implement schemes in the same way as in other parts of the country. For instance, transportation of materials, labor mobilization, and monitoring of projects in remote areas become costly and time-consuming, often leading to delays and increased expenditure, which the guidelines may not sufficiently accommodate.

10.2 Another issue arises from inflexible timelines and performance targets imposed by the scheme guidelines. Many Central schemes are designed with timelines that may not align with the state's monsoon-dominated climate, where heavy rainfall can make construction work or other project activities impractical for months at a time. This often results in delays or rushed work to meet deadlines, compromising the quality of implementation.

10.3 Limited institutional capacity in terms of manpower, technical expertise, and infrastructure further complicates scheme execution in Mizoram. With relatively few skilled professionals, the state often struggles to meet the technical requirements or performance expectations set by Central schemes. The absence of sufficient local capacity leads to frequent reliance on external consultants, which in turn increases costs and can affect project ownership and sustainability.

10.4 Over-centralized decision-making in some schemes limits the state's ability to adjust the projects to its unique needs. Centralized approval processes and one- size-fits-all frameworks can result in projects being less effective in addressing local issues, as they may not be designed to suit the specific demands of diverse communities.

10.5 To improve the implementation of Centrally Sponsored Schemes (CSS), several suggestions can be made based on the observations regarding delays in fund utilization, release of funds, and the impact of insufficient remuneration adjustments for inflation. Guidelines should be flexible to address State-Specific Needs. This would ensure that the schemes align with the unique socio-economic and geographical challenges of each state, reducing delays caused by rigid, one- size-fits-all rules.

10.6 Regular adjustments to the remuneration of personnel engaged in CSS projects should be institutionalized to keep pace with inflation. This would help attract and retain skilled manpower and improve project execution. Besides, service conditions of CSS employees are different across the departments. For instance, employees under NHM get increments @5% while such increments are not available in other CSS. At the same time, 10% annual increments are admissible for CSS employees under agriculture sector. In addition to the lack of uniformity in increments, the rates of remuneration also vary across different schemes.

10.7 Many delays occur due to states' inability to meet matching fund requirements or lack of institutional capacity. Strengthening state institutions, enhancing training for officials, and offering technical support for project management can address this challenge.

10.8 Central schemes often have guidelines that may not align with unique geographical and socio-economic conditions of States. For instance, as per the guidelines of PMGSY, cost of maintenance covering routine maintenance for initial 5 years after construction and also for further 5 years including periodic renewal as per requirement, special repairs and emergency maintenance shall be fully borne by the respective State/UT. This uniform period poses challenges in Mizoram as it experiences heavy monsoon rains, which cause faster deterioration of roads due to waterlogging, erosion, and landslides. The uniform maintenance period and financial responsibility do not account for the additional burden caused by adverse weather conditions. Mizoram is prone to frequent landslides, particularly during the rainy season, which can severely damage roads soon after construction. It lacks an adequate supply of high-quality boulders and construction materials needed to build durable roads. This often leads to the use of inferior materials, which accelerates road damage. In contrast, States with better access to good construction materials and with less rainfall enjoy longer-lasting roads. The uniform maintenance requirement does not account for this challenge, further increasing Mizoram's maintenance costs.

10.9 Another example is Pradhan Mantri Awas Yojana (Gramin). Under this scheme, the government provides a fixed amount to beneficiaries for the construction of houses. Financial assistance for construction of a new house under PMAY-G is Rs.1,20,000 in plain areas and Rs.1,30,000 in hilly/difficult areas. However, the cost of construction in Mizoram is much higher than in the plains due to the difficult terrain and lack of locally available materials. Hence, Central schemes should be designed to address unique and specific situations of Sates

10.10 Centrally Sponsored Schemes often provide funds for the creation of new assets, such as buildings, roads, bridges, and machinery. While the creation of these assets is crucial for the development of infrastructure and public services, their long-term maintenance and management raise significant concerns for state governments. New assets often necessitate the recruitment of additional staff to manage and maintain them, leading to increased recurring expenditures, including salaries and operational costs. At the same time, many existing assets across states are deteriorating due to insufficient funds for routine maintenance and repairs, creating an imbalance between asset creation and preservation. Given this scenario, CSS should not only focus on adding new assets but also emphasize the upkeep of existing infrastructure.

11.0 Suggestions

11.1 Every CSS that provides funding for the creation of new assets should also include a dedicated budget for their long-term maintenance. This fund should cover periodic repairs, operational costs, and any necessary upgrades to ensure that these assets remain functional and serve their intended purpose. Furthermore, CSS guidelines should mandate the allocation of a portion of the funds for the maintenance of pre-existing assets, helping states balance asset creation with preservation.

11.2 A CSS should include provisions for regular audits of existing assets, identifying those in need of urgent maintenance. These audits would help prioritize the use of funds to ensure that critical infrastructure, such as health centers, schools, roads, and bridges, are maintained properly before new assets are created. The results of these audits should inform the allocation of both central and state resources to ensure that maintenance is not neglected.

11.3 States should be given more flexibility in utilizing CSS funds. For instance, states facing severe infrastructure maintenance challenges should have the option to redirect a portion of funds allocated for new assets toward the upkeep of existing ones. This would allow states to address their unique infrastructural needs while adhering to CSS goals. CSS guidelines should be adjusted to allow for this reallocation based on the state's existing asset conditions.

11.4 The central government could introduce a dedicated maintenance grant under CSS to ensure that states have the necessary funds to maintain their existing assets. This grant could operate on a matching basis, where states are required to contribute a portion of the funding, thereby promoting state ownership of asset maintenance. This co-funding model would ensure that both the Centre and the states are jointly responsible for sustaining public assets.

11.5 The role of Centrally Sponsored Schemes (CSS) in financing State-level projects should be reduced, and instead, funds transferred by the Union Government for expenditure on State subjects should be subsumed as many as possible under vertical devolution of taxes. This approach would not only respect the principles of fiscal federalism but also provide States with greater flexibility and autonomy in utilizing funds according to their specific needs and priorities. Subsuming CSS funds under vertical devolution would also simplify the fiscal transfer process. The current system of CSS involves complex reporting, compliance with central guidelines, and frequent delays in fund release due to administrative bottlenecks. By providing funds directly through devolution, States can plan their budgets more effectively and avoid delays tied to the release of CSS funds subsuming CSS funds under vertical devolution would also reduce the perception that States are mere agents of implementation of centrally designed programs, enhancing their role as key decision-makers in their own development.

11.6 Shifting the focus from input-based monitoring (expenditure, completion of procedures) to outcome-based monitoring where tangible outputs are evaluated would encourage efficient and timely implementation rather than mere compliance with guidelines.

11.7 The salary structures, remuneration rates, and annual increment benefits for CSS employees across sectors or Ministries should be standardized and uniform to promote equity among employees.

11.8 The release of funds for a specific scheme or sub-scheme should not be contingent upon the utilization of funds from other schemes or sub-schemes. Each scheme or sub-scheme has its own set of objectives, timelines, and operational requirements, and linking their funding could cause unnecessary delays and bottlenecks in project execution. This separation is crucial to ensure that the implementation of one program is not delayed or hindered due to the unspent balances or utilization issues in other unrelated schemes.

11.9 Funds should be released in fewer installments to streamline the tender process, allowing it to be completed in one or two rounds. This approach will not only expedite project execution but also significantly reduce administrative paperwork and procedural delays. By minimizing the frequency of fund releases, it will enhance operational efficiency and ensure a more effective use of resources.

11.10 Centrally Sponsored Schemes (CSS) are vital for fostering development and asset creation, with their success heavily reliant on the timely release of funds. Once the Annual Action Plans or Detailed Project Reports (DPRs) are approved, funds should be released by Central Government promptly, particularly for staff remuneration. To ensure smooth implementation, state governments must also expedite the release of the State Matching Share (SMS). Furthermore, the procurement of goods, services, and works, as detailed in the approved Annual Action Plans (AAP), should be accelerated by implementing departments to prevent delays and enhance the overall efficiency and impact of these schemes.

8

An overview of Challenges in Utilisation of Central Grants

Deepak Kumar, IAS, Additional Chief Secretary (Finance)
Sameer, IAS, Special Secretary (Finance)
Government of Uttar Pradesh

Challenges in Utilisation of Central Grants

1.0 Introduction

There exists considerable heterogeneity among states in terms of their size, population, per capita income, revenue generation, GDP size, growth rate etc. and also the gap between the capacity to collect revenue from state's own sources and the expenditure. This gap is majorly attributed to initial endowments, historical backgrounds, and the levels of development. Developing state's capacity to become revenue sustainable and surplus at the same time, requires a greater degree of fiscal prudence aligned with political discourse and will. In a federal structure where the balance of financial power is towards the centre, managing resources and exploring newer areas of revenue collection leaves states perplexed. There is a vertical as well as horizontal imbalance among the states. This may be due to various reasons, like geographical advantages, entrepreneurship of the state, cheaper labour and raw material availability, access to market, smart governance, sustained government, continuous economic policies and above all disciplined fiscal prudence.

The vertical imbalance is between the Union Government and the States and the horizontal imbalance is among the States. In Indian federal system these imbalances are primarily financial in nature and like other federal governments, these imbalances are ameliorated by a system of intergovernmental transfers, mainly through tax devolution and grants. The quantum of tax devolution and grants are recommended by the Finance Commission (FC). Under Article 275 of the Constitution, Finance Commissions are mandated to recommend the principles and the quantum of grants-in-aid to States that are in need of assistance. The Commission can recommend different sums for different States.

As per Article 280(3) of the Constitution of India one of the Terms of Reference of a Finance Commission is to make recommendations as to the "principles governing the grants-in-aid of revenues of the states out of the Consolidated Fund of India" Finance Commissions have addressed vertical imbalance across states through the distribution of shareable central taxes using a number of criteria, horizontal imbalances still persist due to unequal distribution and devolution of central share and grants among the states. This is due to the unique positioning of every state. However, Finance Commissions have addressed horizontal imbalances across states by recommending grants-in-aid of revenue from the consolidated fund of India, in a more formal and calculated manner.

A careful examination of FC reports over the years have revealed that the grants recommended by them are predominantly in the nature of general-purpose grants meeting the difference between the assessed expenditure on non-plan revenue account of each state and projected revenues including state's share in central taxes. These are referred to as *'gap filling grants'* (Rao 2010; Srivastava & Rao 2009; Vithal & Sastry 2001).

Grants recommended by FCs can be broadly classified into five broad categories:
(a) deficit grants,
(b) grants for local governments,
(c) grants for disaster management,
(d) sector-specific grants and
(e) grants for state-specific needs

Quantum of Finance Commission Grants:

Composition of Finance Commission Transfers (%)

FC Award Period	Tax Devolution	Grants-in-aid	Total
FC III (1962-66)	77.13	22.87	100.00
FC IV (1966-69)	72.66	27.34	100.00
FC V (1969-74)	85.12	14.88	100.00
FC VI (1974-79)	74.58	25.42	100.00
FC VII (1979-84)	91.96	08.04	100.00
FC VIII(1984-89)	88.95	11.05	100.00
FC IX (1989-95)	86.20	13.80	100.00
FC X (1995-2000)	90.12	09.88	100.00
FC XI (2000-05)	84.16	15.84	100.00
FC XII (2005-10)	83.67	16.33	100.00
FC XIII (2010-15)	85.83	14.17	100.00
FC XIV (2015-20)	88.03	11.97	100.00
FC XV 1(2020-21)	80.96	19.04	100.00
FC XV 2(2021-26)	80.35	19.65	100.00

(Courtesy: Gupta and Sarma 2022, report of XV-FC)

Though the scope, coverage and number of Finance Commission grants have seen a surge over the years, their shares in total transfers have remained not of much significance. A more detailed analysis reveals that since XIII - FC report, local body grants have been the largest. Grants, like deficit grant, local body grants and disaster management grants account for most of the grants while share of sector specific and state specific grants are low.

FC Sector wise grants as (%) of State's revenue and expenditure

Sectors	FC-XII (2005-10		FC-XIII (2010-15)		FC-XV (2010-21)		FC-XV (2021-26)	
	% of Rev. Exp.	% of Total Exp.	% of Rev. Exp.	% of Total Exp.	% of Rev. Exp.	% of Total Exp.	% of Rev. Exp.	% of Total Exp.
Health and allied	04.35	03.90	01.62	01.46	04.38	04.00	04.46	03.85
Education	01.88	01.83	01.94	01.89			00.58	00.55
Agriculture							06.21	05.66

(Courtesy: Finance Commission Reports, Central Budget)

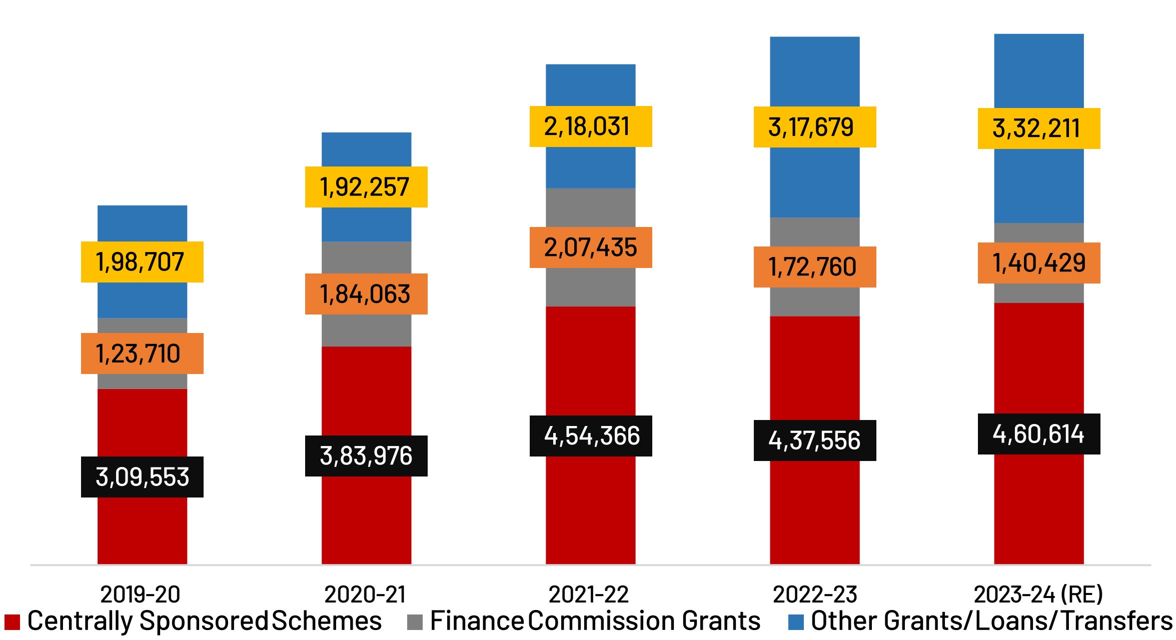
The statutory tax devolution comprises more than 80 per cent of the total transfers provided by the last Finance Commission, that is, Fifteenth Finance Commission (Report of 15th Finance Commission). While tax devolution is completely unconditional, the rest of the FC transfers are often tied with several conditions and these central grants comprises around 20 per cent of total central transfers during the 15th Finance Commission award period. Apart from the FC grants, there are some other central grants, which are transferred to the States for various developmental activities on the subjects which comes under the concurrent list of the Constitution of India. These schemes, known as centrally sponsored schemes (CSS), are jointly financed in specific ratios by the Centre and the States and are implemented by the latter. These schemes have various norms, one size fit approach and lack of flexibilities. Due to the conditionalities, along with some other systematic bottlenecks in the fiscal governance system, a portion of the grants remain unspent across the States. Given the resource crunch faced by almost every States, under-utilisation of this scarce resource is quite undesirable. Some appropriate measures from both the Centre and the States are required for full / optimum utilisation of the central grants and in turn, to achieve the desired outcomes from those public expenditures.

2.0 Central Grants

After the abolition of Planning Commission, the transfers of central grants to the States have become reasonably simpler and currently, central grants to the States are transferred in three forms, viz, finance commission grants (including revenue deficit grants), grants for centrally sponsored and central sector schemes. Among these grants revenue deficit grants are totally unconditional. But some portion of the remaining grants recommended by the Finance Commissions, that is, sector specific/ state specific grants are tied with some conditionalities/performance indicators. Central sector scheme is fully financed and implemented by the Centre in the state level. For Centrally Sponsored Schemes (CSS), starting from providing matching grants, States needs to fulfill a number of compliances to get installments of fund for CSSs from the Centre.

Before going into the details of the specific challenges of utilisation of central grants, it would be adequate to give a broader picture of flow of central grants to the States in aggregate (to all States) as well as to Uttar Pradesh. Figure -1 shows the trends of different types of central grants in aggregate level. It is evident that CSS grants constitute the largest share of total grants at ~50%. During the period from 2019-20 to 2023-23, CSS grants registered a growth rate of 10.4 per cent per annum whereas the total budget in the same period has grown at 13.7 per cent CAGR. During the last three years, proportion of CSSs as a share of total grants has remained relatively constant. Meanwhile, the proportion of FC grants in total grants has declined from a high of 24% in 2020-21 and 2021-22 to 15% in 2023-24 (RE).

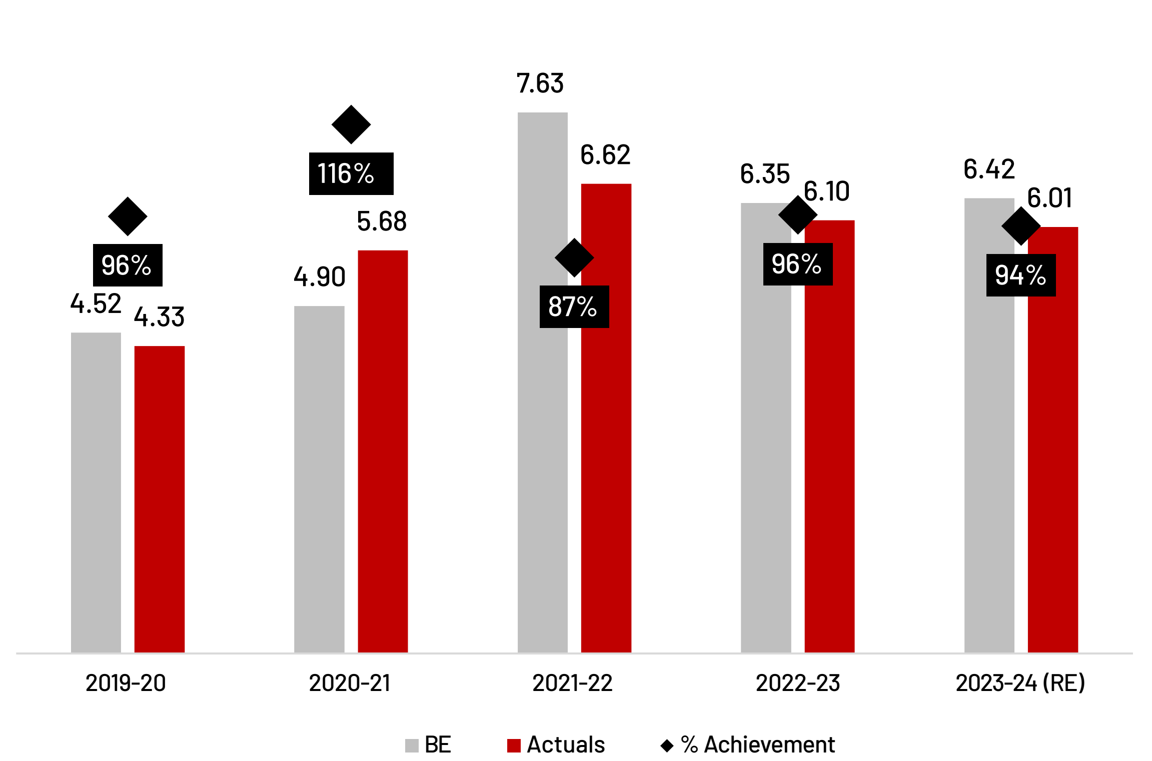
Figure 1: Composition of Central Grants (in INR crores)



(Source: Union Budgets, multiple years; Other grants/loans/transfers primarily include GST compensation, transfers to UTs and loans for capital expenditure.)

Over the years, the funds budgeted towards central grants have been underutilised, except the FY 2020-21 (pandemic), in every year, a portion of total allocated funds for the CSSs & FC grants remained unspent. In 2023-24, the revised estimate for CSS and FC grants stood at INR ₹ 6.01 lakh crore against the budget estimate of ₹ 6.42 lakh crore – indicating the underutilisation of grants by ₹ ~41,000 crores.

Figure 2: CSS and FC grants – Budgeted vs Actual (in INR lakh crore)



(Source: Union Budget, multiple years)

Grants from the Center – Budgeted vs Actuals:

- The actual expenditure of CSS and FC grants has been 87- 96% of the budgeted amount in the last three years.
- In absolute amount, the underutilization in 2023-24 (RE), stands at ₹ 0.41 lakh crore - which could impact development activities across states.
- Over the last 3 years, the aggerate actual expenditure was less than the budgeted figure by ₹ 1.66 lakh crores.
  It can be taken as an observation on the state's capacity to spend.

3.0 Challenges in Utilization of Central Grants – Empirical Evidence:

Literature suggests there have been several challenges in utilization of central grants that has impacted achievement of the intended outcomes. The prime determinant of under utilisation, along with other reasons, was delay in fund disbursal and limited capacity of the states to spend. Despite a range of public financial management (PFM) reforms over the years, delays in fund disbursal, low utilisation and unequal expenditure pattern across different quarters of a financial year is still an area of concern in the PFM system in India. It would be evident in both aggregate level as well as scheme level. State's own capacity to spend and compliance burden is also an issues which needs scanning.

Historically, due to several other inherent systemic weaknesses, the prevailing system in India was constrained by inefficiencies in distribution of funds across States and their implementing agencies, delays in fund flows-leading to uncertainty on fund availability, limited visibility on funds provided, and diversion of funds to purposes other than the intended ones. Further, gaps in the flow of fiscal information across different tiers of governments, season led demand, state's rules and regulations, absence of scheme rationalization, multiplicity of sub schemes under the same umbrella scheme, each having their own set of compliance requirement, releases in the last month of the financial year etc., have led to accumulated unutilised funds under various development schemes.

In such a backdrop, the Public Financial Management System (PFMS) was introduced with the objectives of tracking funds released under all plan schemes of Government of India and real time reporting of expenditure at all levels of programme implementation. Subsequently, the scope of PFMS was expanded to cover the Direct Benefit Transfers (DBT) schemes. However, these PFM reform initiatives was not completely successful in expediting fund flow, addressing the issue of limited visibility on funds provided, and in bringing allocative efficiency under CSSs. Systems like SNA and CAN have also created liquidity crunch for the states, where unutilised amount is parked in the banks.

Scrutiny of scheme level data/ information could also reveal that despite various kind of PFM reforms in the recent years, still delays in fund disbursal and low utilisation of funds under CSSs have remained major problems in this domain. For example, one of the major flagship programme in India is the National Health Mission (NHM). The 14th Common Review Mission Report 2021 of NHM found delays in fund disbursal from the State Treasuries to the State Health Societies (SHS). This delay in States like Arunachal Pradesh, Bihar, Haryana, Odisha, Rajasthan, Sikkim and Uttar Pradesh ranged from 60 to 100 days, whereas in Mizoram and Puducherry the delay was more than 150 days. Similarly, delays were reported in fund transfer from the State Health Society to the district level which has a direct effect on the utilization of these funds for different health programmes. Such observations also put a question mark on state's business operations.

Table 1: Delays in NHM funds transfers from State treasury to the State Health Societies (SHS)	
State	till the 2nd quarter for the FY 2021–22 (Delay in No. of Days)
Mizoram	>150
Puducherry	>150
Tripura	65
West Bengal	33
Arunachal Pradesh, Bihar, Haryana, Odisha, Rajasthan, Uttar Pradesh	60 to 100

(Source: 14th CRM Report 2021)

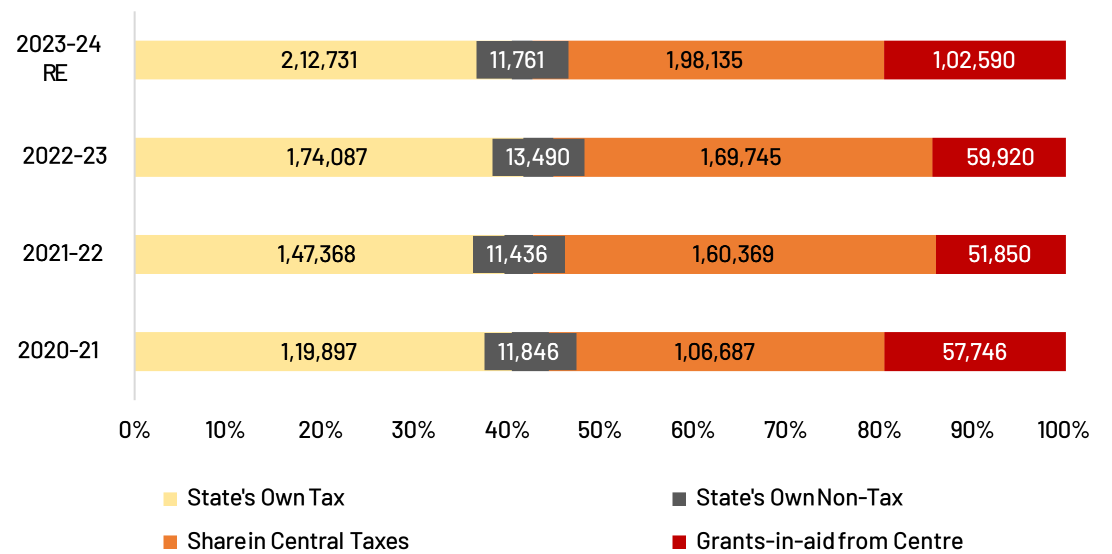
Kapur, Shukla & Pandey (2023) also observed low utilization of NHM funds across several states & UTs, viz., Nagaland (47%), Bihar (45%), Meghalaya (45%), Arunachal Pradesh (43%), Sikkim (37%), and Manipur (32%). Underutilization of NHM funds mainly attributable to delay in fund transfers across different tires of governments/agencies. A district level study in few states revealed that delay in fund flow is one of the major factors causing underutilisation.

For addressing the problems of delay in fund flow and in turn, to improve in utilisation of funds, a new PFM reform has been initiated which is discussed in the subsequent section.

4.0 Role of Central Transfers in Uttar Pradesh Budget

Like several other states, central transfers provide substantial support to the annual budget of Uttar Pradesh. Central transfers account for over 50 percent of UP's revenue receipts, indicating a substantial dependency of the State on central transfers. Figure - 3 shows that during the financial year 2023-24 (RE), total revenue receipts of the Government of UP was ₹ 5,25,217 crore, of which ₹ 3,00,725 (57% of total revenue receipts) was central transfers (share in central taxes and grants-in-aids). Total central transfers comprise of ₹ 1,98,135 crore (66%) of share in central taxes and ₹ 1,02,590 crore (34%) of grants-in-aid.

Figure 3: Composition of Revenue Receipts (in INR crore)



(Source: Uttar Pradesh Budget, multiple years)

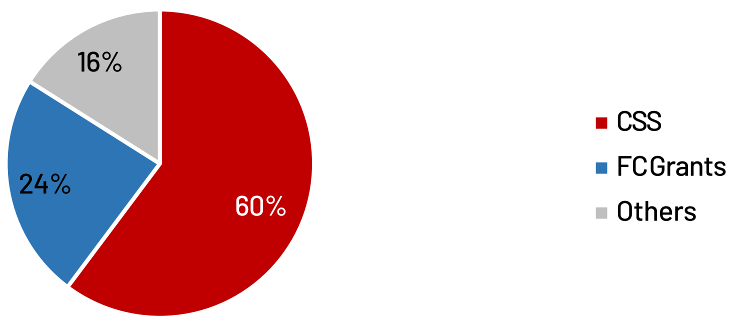
As the share in central taxes is completely unconditional statutory transfers, there are no challenges in receiving this fund from center and as well as its utilisation by the States. On the other hand, central grants which account for 15-20% of the total revenue receipts over the last few years (Figure 3), have some specific issues regarding utilisation. Accounting for about 19.5 percent of the total revenue receipts in UP, central grants have enormous implications for shaping the development agenda of the state.

5.0 Central Grants are dominated by Centrally Sponsored Schemes (CSS)

If the central grants to UP are further divided, it would be visible Figure - 4 that centrally sponsored schemes constitute the largest proportion with a share of 60 percent of total grants to the state. Finance Commission grants have 24 % share and other components (central sector schemes, loans, etc.) have 16% of the total grants. Further, a substantial portion of FC grants are unconditional, keeping a small portion subject to the conditions and performance indicators.

As the CSSs have the lion's share of the central grants and many development activities in a state are being done through CSSs, proper implementation can create a significant impact on development indicators in a state. In addition, States need to mobilize a substantial part of financial resources in the form of matching grants and employ a large number of human resources for implementing the CSSs. Given this backdrop, a collaborative effort between Centre and the States is the imperative to address the various challenges in implementing the centrally sponsored schemes.

Figure 4: Composition of Central Grants in UP



(Source: Uttar Pradesh Budget documents)

6.0 Outcomes from Centrally Sponsored Schemes (CSS)

It should be noted that despite the existing challenges for implementing the CSSs, the collective initiatives of both the Central and State governments, there has been marked improvements in various developmental indicators over the years in the key social sectors like health, education, sanitation, nutrition, etc. CSSs has supported the State to achieve multiple outcomes that have helped improve the socio-economic profile. UP is quick to adopt CSSs and initiatives for related schemes to extend the benefits to additional beneficiaries through state schemes.

UP's commitment for socio-economic development is reflected in achieving the highest number of beneficiaries in the state across several schemes through successful implementation, viz., Pradhan Mantri Jan Dhan Yojana (PMJDY), Mudra Yojana, PM SVANidhi, PMSBY, PM Jeevan Jyoti Bima Yojana, Atal Pension Yojana, SAMAGRA Siksha, NHM, AMRUT, Har Ghar Jal - Jal Jeevan Mission etc.

Apart from that UP has achieved several outcomes supported by CSSs. For instances, Delhi–Meerut Regional Rapid Transit System was developed with 20% funding from the Government of India. Under Pradhan Mantri Awas Yojana (PMAY) total 47.82 lakh homes have been completed. Total 73 medical colleges set up through CSS fund in UP.

7.0 Utilization of CSS Grants

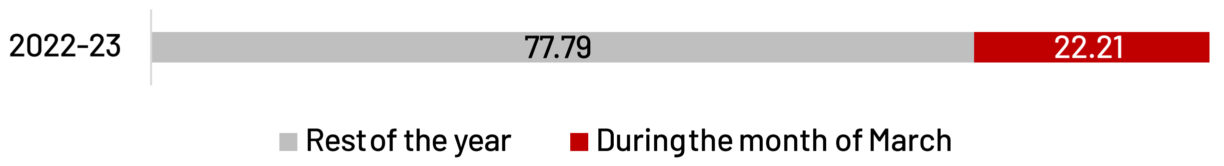
Challenges in utilization of funds for select key CSSs:

It is well documented that while the centrally sponsored schemes are designed to address various developmental needs, their effectiveness are getting hampered by existing challenges in fund utilization. The challenges that are faced by the States are mostly common in nature. In Uttar Pradesh, expenditure of CSS has been challenging over the years due to high compliance, delayed availability of funds and other challenges.

Across schemes, funds are usually disbursed in four equal installments. After receiving the first installment, utilisation certificates (UCs) are to be provided to receive subsequent instalments. The process for the same takes 2-3 months for each installment.

Due to the lengthy process, in most of CSSs', an expenditure rush happens in the last quarter/last month of the financial year. It has been observed that in few key schemes in UP, around 30-40% funds are received in March. It makes difficult for the concerned authorities to utilize the funds. It leads to limited capacity of utilization and delay in submission of UCs. For the financial year 2022-23 in UP, 22.21 per cent, that is, more than one fifth of the total CSS grants disbursed in the last month of the financial year.

Figure 5: Proportion of Central share of CSS received in March of the year in UP

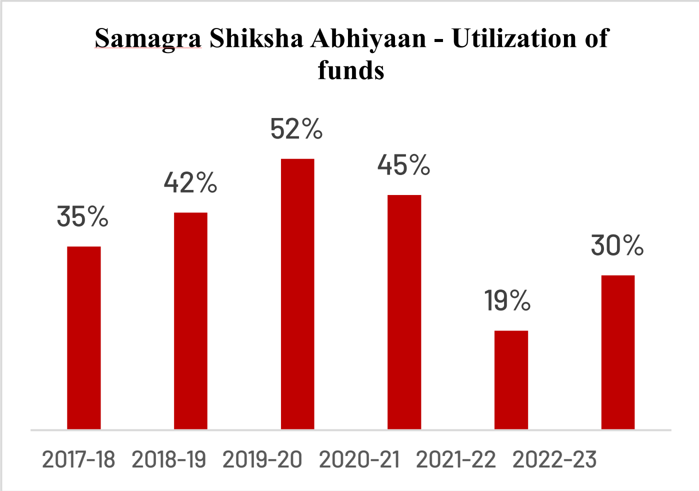


(Source: Finance Department, Government of Uttar Pradesh)

Certain scheme's timeline does not match with the seasonal and geographical restrictions prevailing in the state, which delays the work completion. There are schemes like PMAY (R) in which the actual cost of construction varies depending upon various reasons. This leads to poor execution of the scheme. CSS generally does not include land acquisition and maintenance cost, which is a major part of the expenditure. States may perhaps be given more elbow room to execute the schemes with minor alterations as per local requirement. Monitoring of the output along with the input parameters like investment and expenditure is also required. Release of funds in the month of March leads to inaction on part of states, as there remains less time to complete the tender and other formalities.

After conducting a detailed scrutiny of several key schemes, the Finance Department, Government of Uttar Pradesh has noticed the following problems across some of the key schemes:

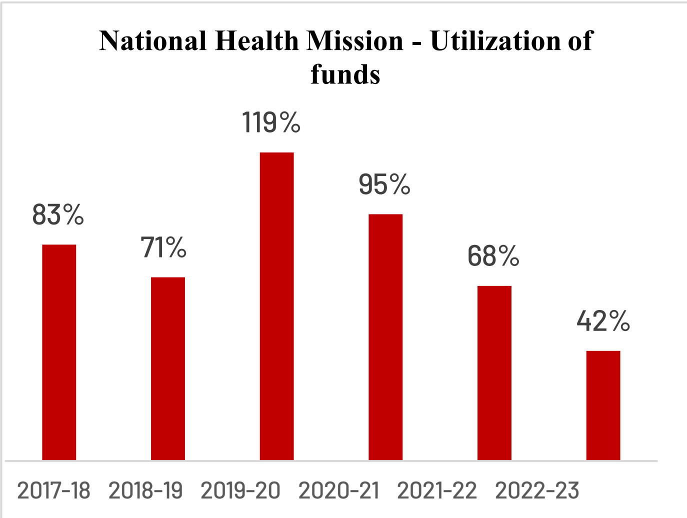
Samagra Shiksha Abhiyaan (SSA)



The utilization of funds under SSA has been substantially low, ranging between 19-52% over the last few years. This is due to a number of factors including timeliness of fund availability, time taken for provision of UCs, utilization capacity etc.

- Funds are disbursed in 4 equal installments of 25% each. Provision of documents including UCs, for each instalment takes 2-3 months, post the utilization. This significantly delays the fund availability and disbursement. It's more challenging in April, when the academic year begins. The first instalment is often received in August – several months after the commencement of the academic year.
- Around 30-40% funds for SSA are received in March. This makes the utilization in the given year difficult and creates pressure for quick utilization. Considering the time taken for procurement, construction etc. the funds received in March remain mostly unutilized in the financial year.

National Health Mission (NHM)

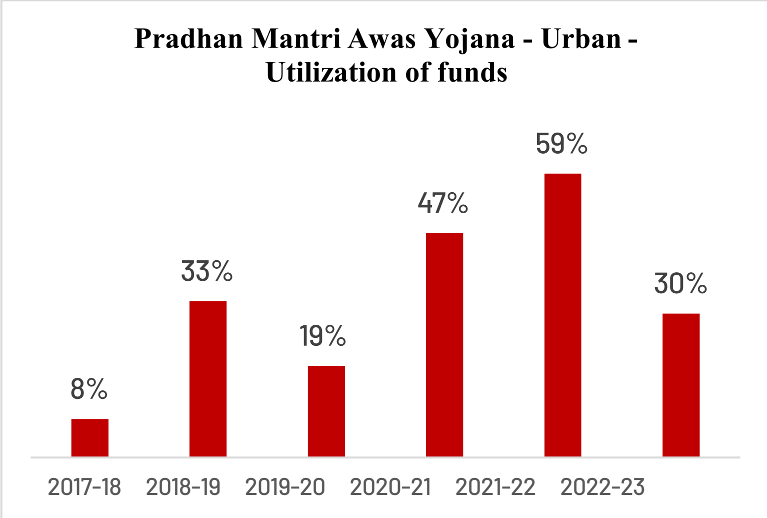


The utilization of grants under NHM showed an uptake in the years impacted by Covid-19. Without considering these years, the utilization remains steady – higher than a number of other CSS but not fully utilized. This is due to a number of reasons, and some reasons for specifically lower utilization of grants for NHM are as follows:

- For grants greater than Rs. 500 crores, even if demands are submitted at the beginning of the month the funds are disbursed only after 20th of the month. This causes a delay in fund availability, especially in large scale projects.
- Funds required for construction are needed to be provided as an advance to contractors. In such cases, the State has to provide the funds, burdening the state finances. The funds are made available from the center only post 75% utilization. Construction activities take at least 3-4 months, creating a substantial burden on the state finances for the interim period.

Pradhan Mantri Awas Yojana – Urban (PMAY-U)

The utilization of funds under PMAY-U has remained exceptionally low, with the exception of 2021-22, the Covid-19 recovery year. This is due to a number of factors such as timeliness of fund availability, time taken for procurement and contraction etc. Some of the key reasons for low utilization of funds in PMAY-U is as follows:



- Funds are disbursed in 4 equal instalments of 25% each. Considering the primary activity under the scheme is construction-related, substantial time is taken for procurement and construction activities. If the funds are received towards the end of the year, it is difficult to utilize the same in the financial year. Front-loading of the funds, with a higher proportion of funds being made available at the beginning of the year, will help smoothen the process.
- For the progress made under the scheme, the MIS portal captures the physical progress while the PFMS captures financial progress. However, the two systems are not integrated – often leading to a mismatch in the information. This leads to several rounds of clarification which further delays the process and disbursement of funds.

Efforts Undertaken by the Centre & the state:

Over the years, several initiatives were taken to address various problems of PFM system. The most recent initiative made by the Centre and State to resolve aforementioned challenges is implementation of SPARSH.

1. Single Nodal Agency (SNA)

As part of the SPARSH, central Government has moved to the SNA model which envisages *'Just in Time'* transfers and reducing delay in fund transfers and in turn, reducing 'floats' parked in the bank accounts and reducing interest costs.

It would be worthwhile to mention that effective utilisation of government's financial resources and timely execution of payment obligations critically hinges on an efficient banking arrangements and cash management practices (RBI 2023). Multiple accounts maintained by numerous revenue collecting and spending agencies (including autonomous and statutory bodies) along with fragmented banking arrangements may lead to inefficient cash management practices. This inefficient cash management practices often manifested with idle cash balance held by some agencies while other agencies facing payment difficulties due to shortage of funds.

For funding these cash deficient agencies, the governments resort to short-term borrowings incurring additional interest burden in the process (RBI 2023). To address the drawbacks in the existing cash management system, in line with recommendations of the Expenditure Management Commission (2015), firstly, initiatives were taken to bring Autonomous Bodies (ABs) under a Treasury Single Account (TSA) for comprehensive oversight and centralised control over the government's financial resources (Bhattacharya, 2024). TSA for ABs is just an assigned bank account maintained with the RBI to receive all grants from the Centre. More than 200 ABs were brought under the TSA by 2022 (Yadav 2022).

To address various problems in fund flows across different tires of government/agencies and to bring efficiency in the existing system, since July 2021, initiatives were taken to extend the TSA model to the States and implementing agencies receiving funds under the Central Sector (CS) schemes and Centrally Sponsored Schemes (CSS). The TSA model used for the CSS is called Single Nodal Agency (SNA) in which each State designates an SNA for each CSS which opens a single nodal account with a commercial bank. The implementing agencies use the SNA's account through zero-balance subsidiary accounts with predefined drawing limits. The Centre's share for each CSS is released to the state's account with the RBI, which then transfers the amounts to the SNA's account. This arrangement has eliminated delays, enabling the 'just in time' release of funds for payments. More than 3000 SNAs have been created, so far, by linking around eight lakh implementing agencies (Bhattacharjee 2024). For CSS, funds are promptly released by the Central Ministries to SNA and the float in the account is kept at a minimum.

2. Capacity building initiatives

For transition to a new system, the Central Government organizes periodic 1or 2-day trainings across States to build capacity of officials to adopt the new fund flow mechanism. Capacity building is essential for moving to a new system. To supplement Centre's initiatives for capacity building, Govt. of UP also putting its own efforts of capacity building.

3. Linkage of current IFMIS.

UP is undertaking initiatives to adopt the new fund flow mechanism in the existing IFMIS implemented in the State. For this objectives, capacity building of staffs and creating basic infrastructure are integral components.

- To complement the initiatives undertaken by the Central Government, UP has been undertaking training and capacity building initiatives in Finance Department and other lines departments to smoothly adopt the new fund flow mechanism and sensitize for timely completion of compliances. However, some challenges remain that require efforts from the Centre as well as State initiatives. Code mapping and integration between IFMIS and PFMS required for transition to a new PFM system. As it is a time-consuming process, adequate time should be given to the state for implementation of SPARSH.
- Infrastructure readiness is key for successfully adopt a new system. Customization of IFMIS in line with SNA under SPARSH is the prerequisite in this regard. Support should be given to the state for this. For implementing the SNA, center's capacity building initiative so far is inadequate and sporadic. It is not enough for proper capacity building of staffs to adopt new mechanism. More support must be provided by the Centre.

What the Centre can do for better utilization of funds

- **Release of funds in fewer instalments**
  A mechanism, for timely release of funds with fewer number of installments, needs to be developed. It is particularly essential in schemes in sectors such as agriculture with two seasons, construction which requires more front-loading of expenditure etc. Centre should initiate appropriate measures for this.
- **More freedom to states for fund utilization**

  Centre should make reduction in utilization criteria with freedom to states for utilization of a proportion of funds per state requirements. It would enhance the utilization of funds in time and in the priority areas.

- **Simplified mechanism for fund disbursement**

  Some CSSs have multiple SNAs under one umbrella scheme while some SNA's cover schemes implemented by multiple departments. It creates complexity in fund transfers and its utilizations. – Centre should take appropriate measures for rationalization of SNAs in this regard to reduce compliance burden.

- **Realistic timelines for capital expenditure disbursement**

  It is time taking for planning and onboarding a vendor for capital expenditure. Concerned Authorities needs to follow a particular process. So, the center must give the State Government a realistic timeline for capital expenditure.

Conclusion:

Despite recommendation of a sizable grants by FC, still they account for a small proportion of total FC transfers, share even smaller in total central transfer. Local body grants, deficit grants and grants for disaster account for a sizeable portion of FC grants while share of other sector and state specific grants is smaller. It has been observed that utilization in some sector specific grants is comparatively lower. Conditions linked to the expenditure of grants have hampered their utilization rate. Along with the conditions imposed by FC there are certain compliances and scheme guidelines framed by the concerned ministries and departments, which further reduces the utilization. Many are of the view that there should not be additional or top up conditions and compliance burden should be minimal.

Government of Uttar Pradesh has taken steps like strategic top-down budgeting with advanced communication of budget ceiling to every line department through it's inhouse built system FINRMS (Financial Release Management System). For a more realistic estimation of revenue generation and expenditure a medium-term framework and analysis is used as a reference point to decide the annual budget allocations. Sharing of revenue and expenditure details of the administrative departments periodically, increases their efficiency. Depending upon the need and critical analysis of expenditure supplementary budget is also proposed. Administrative departments are prompted to priorities their programs and schemes for budget preparation. It reduces the gap between the demand and actual proportioning of the budget. For a more disciplined budget exercise departments are also briefed about the envelope size considered for their them so that they can plan their line of action within that limit.

State Forum 2024

FISCAL RULES, SUSTAINABILITY AND GROWTH

9

Balanced Growth & Fiscal Management

The Maharashtra Story

Saurabh V ijay
Principal secretary (expenditure)
Government of Maharashtra

Maharashtra, a state with diverse cultural, economic, and geographical characteristics, has set a vision to make its economy a USD one trillion by 2028. Achieving this ambitioustarget requires a multidimensional approach to socio-economic progress, balanced growth, and sustainable development. The Maharashtra Socio-development model focuses on liberating the state's potential across various sectors by addressing systemicbarriers to growth and enhancing socio-economic conditions for all citizens. This model aims to promote inclusive growth by emphasizing education, health, and employment opportunities.

A. MAHARASHTRA- A SNAPSHOT

Maharashtra is second largest state in India with 112 Mn population, and third largest in area (~30,8000 sq Km).

- Literacy Rate: 82.3% with female literacy rate at 76%.
- Key Industries and services: Pharma, Biotechnology, IT-ITES, Auto and auto components, Textiles, Engineering, Oil & Gas, Food & Agro processing, Gems & Jewellery, Banking, Financial services, Insurance.
- The working age group (15-59 years) population in the state is 63%.
- With median age of population at 28.2 years and proportion of elderly people higherthan the national average indicates demographic trends.
- As per census 2011, the state is the most urbanized in terms of population residing inurban areas at 46%.
- The state has strong administrative institutions with 36 districts, 6 revenue divisions.
    - Urban - 28 Municipal Corporations, 245 Municipalities, 139 Nagar Panchayats
    - Rural – 27,832 Gram Panchayats, 351 Panchayat Samitis, 34 Zilla Parishads
- 4 UNESCO sites, 350+ forts, 6 national parks, 50 wildlife sanctuaries, ~720 kms ofcoastline.

Key economic highlights of Maharashtra:

Considering its size and share in Indian economy as mentioned below, the State is important in realizing Hon. Prime Minister's vision of Viksit Bharat by 2047.

- The State contributes **13%** of country's at GSDP – **Rs. 42.66** Lakh Cr**.**
- At **150.7%** of National Average – state has one of the highest Relative Per capita incomes in the country.
- The state is leader in Manufacturing with **13.8%** share in National Industrial Output.
- Largest FDI attracting state with **30% Share** in India's FDI (Oct. 1999-Dec.2023)
- Leader in Exports with **17% Share in India's exports** from 2021-22
- The state has **8% of total MSMEs** in India, contributing to 11% of India's MSME GVA
- Maharashtra's **GST collection Rs. 3.20 Lakh Cr** which is 16% share of India's collection.
- The state has highest number of cooperative societies across multiple sectors (**26.2%**of the country) - one of the strong institutional frameworks in the state.

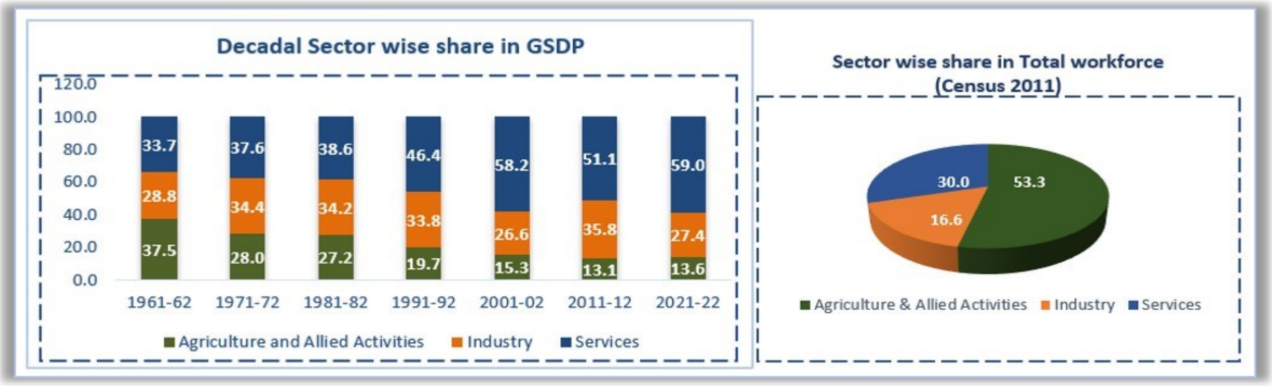
The Cornerstone for Maharashtra's economic growth so far has been led by public investments in Infrastructure with a few PPP projects. It boasts of one of the best physical infrastructures in the country making it top destination of private investments including foreign investments.

- **National Highway Length (kms)**: The overall length of highway is 140,995km outof which Maharashtra has 18,317 (13%)
- **Airports**: Out of nations 129 airports, Maharashtra has 29 airstrips.
- **Ports**: India has 13 major and 187 minor ports, Maharashtra alone has 2 majorand 48 minor ports
- **The state has 290 industrial areas** (143 large, and 108 mini-industrial areas and39 growth centers)
- **SEZs**: Out of 262 SEZ in India, Maharashtra has 37 which is 14.12% of total.
- **Power:** The state is Power surplus state.

A.1. Shift in Sectorial GSDP

There has been major shift in GSDP share of Agriculture, Industry and Services since 1961-62. Agriculture's contribution is now reduced to almost a third in sixty years, with major contribution of GSDP coming from the services sector. Yet, structural challenge lies as similar change has not happened in workforce with Agriculture and allied sector still contributing 53.3% workforce.

Figure 1: GSDP Sectoral Shift

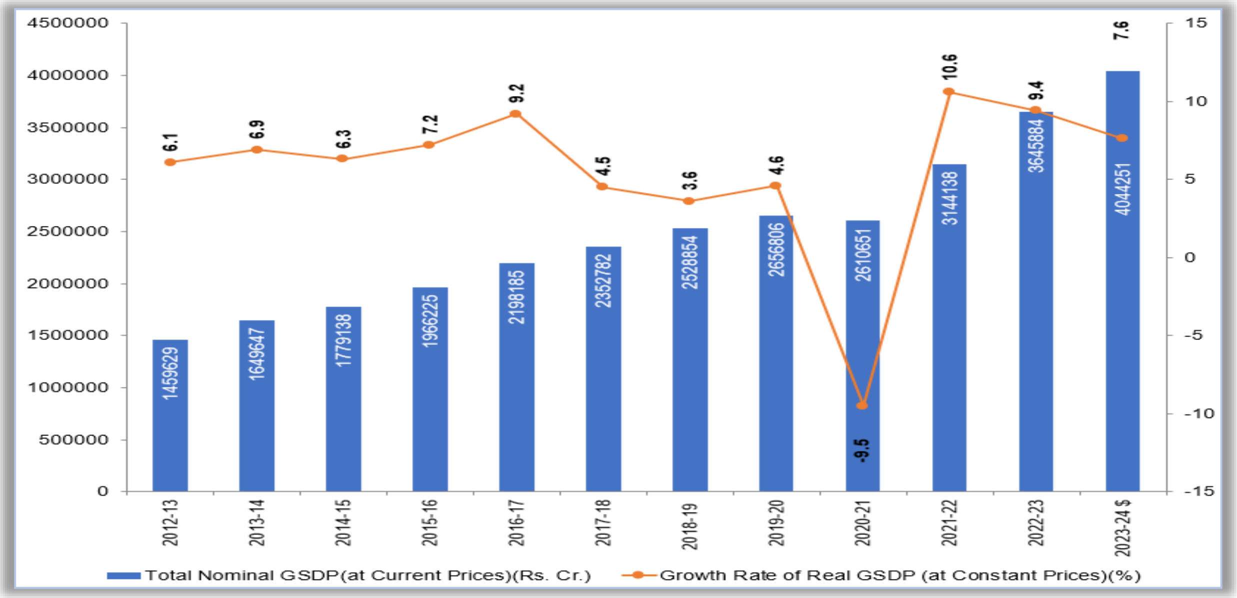


B. Challenges and socio-economic growth strategies for balanced economic growth

Maharashtra is pivotal for national economic growth. The Government has earmarked substantial capital expenditure for various projects across transportation, urban development, energy, and water resources management sectors.

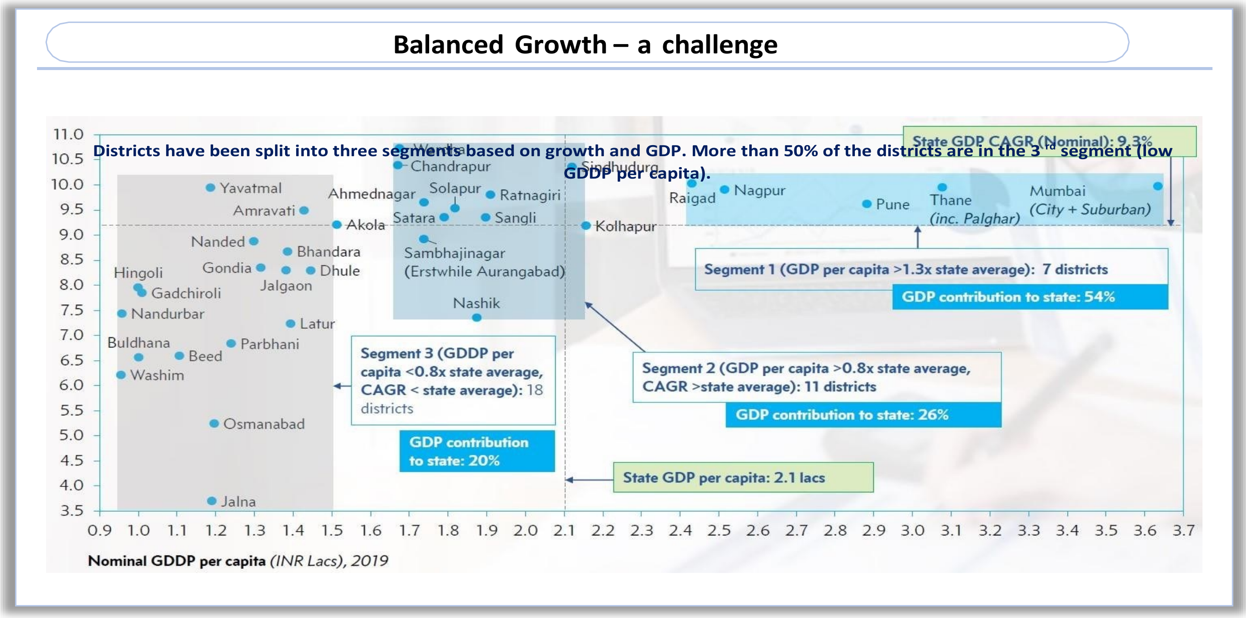
The State infra-led growth is reflected in State Nominal GSDP which has grown at ~15.7%nominal rate post Covid period showing resilience. The real GSDP growth rate is below 6% though, which is a challenge to the economy.

Figure 2: Total Nominal GSDP & Growth Rate



B. 1 Challenges

Figure 3: Balanced Growth- a Challenge



Besides low GSDP growth rate, there are serious challenges of regional imbalances in the State with mere 7 districts contributing to 54%of State GDP. 18 districts have a growthrate less than 0.8x of the GSDP growth rate and per capita income below average state income. In fact, with state per capita income being 150% of the national average, 14 districts of the state have their per capita income below the national average.

There are **structural disparities** in the economy as well, with 53% of the workforce still employed in the agriculture sector, which contributes just 13% of GSDP. Also, manufacturing sector growth has slowed compared to some better-performing states, shrinking the GVA contribution to a mere 16% in the state economy. This has led to serious issues related to employment. The participation of women is also low in the economy. With rising urbanization and demographic shifts, with a median age of 27 years, training and employing youth effectively are major challenges.

B. 2 Maharashtra's Multi-Dimensional Socio-Economic Development

Maharashtra is home to over 120 million people with a diverse economy, encompassing agriculture, manufacturing, and services, but it still it suffers challenges such as Poverty and inequality, unemployment, quality of education and healthcare, and infrastructure gaps. To address the problem, the state is at the forefront of launching innovative schemes that are leading to positive outcomes.

The State was a pioneer in launching the Human Development Mission in 2011 to improveHDI with talukas as its focus. As a result, the HDI of Maharashtra improved to 0.701 (2019) from 0.549 (2012).

Poverty alleviation measures and overall economic growth with focus on social welfaremeasures has shown positive trends, with population of multidimensionally poor people falling from 14.8 % to 7% of population in a 4-year period.

Specific steps to improve learning outcomes with one such program, the Pahile Paul program to ensure school readiness. ('Pahile Paul' (First Step), parents of these children are given orientation and guidance by teachers to ensure basic foundational literacy and numeracy (FLN) abilities before they begin school).

For better targeting and last mile coverage of schemes, all individual beneficiary schemesare implemented through Direct Benefit Transfer into Aadhaar-linked accounts of beneficiaries**.**

MahaDBT transfers in the last 5 years:

- 12.6 million student scholarships were disbursed under 50 post-matric schemes across 11 departments, amounting to INR 212 billion
- 5.7 million scholarships to students, incl. from minority and weaker sections.
- More than 10 million farmer beneficiaries received financial assistance under GoI/ State schemes.

B 2.1 Women Empowerment:

The State has also taken giant strides in Women empowerment:

- 20,00,000 SHG members – (Mahila Aarthik Vikas Mahamandal) MAVIM's Mission Shakti has provided women bank credit of INR 66.4 billion.
- 31.6% Female work participation rate in Maharashtra is higher than the national rate (Census 2011)
- 2nd Rank for female-headed households (3.13 million households)
- 6,00,000 women- State Rural Livelihood Mission provided financial assistance to women SHGs.
- 250 Working Women Hostels mission to establish safe accommodation for working women.

B 2.2 Healthcare

Key outcomes Public Health spending has helped state achieve National Health Policy targets:

- Infant Mortality Rate (IFR) of MH is 16; lower than national average of 28.
- Under Five Mortality Rates (U5MR) of MH is 18; lower than national rate of 32.
- Neo-natal Mortality Rate (NMR) of MH is 11; lower than national rate of 20.
- Maternal Mortality Ratio (MMR) of MH is 33; lower than national ratio of 97.

The State focused on healthcare by increasing the budget from Rs.14810cr in 2019-20to Rs.22536 in 2022-23 which is CAGR growth of ~15%.

- **Universal health coverage:** Entire 12 crore population of the State is covered under this scheme which provides health coverage of Rs.5 lakhs per year on a family floater basis which means that it can be used by one or all members of thefamily, Cashless secondary and tertiary healthcare procedures in network hospitals. Medical services of surgeries/treatments requiring hospitalization under 34 Specialties. The ailments covered are now increased to 1900 plus.
- **Poshan 2.0:**
  It aims to provide key nutrition parameters for women and children. Tackling malnutrition through interventions under Poshan 2.0 in 110,429 Anganwadi centers 7.4 million beneficiaries - pregnant women to children up to 6 years
- **Rajmata Jijau Mission:**
  Dedicated state nutrition mission to tackle stunting– the Mission to support ICDS interventions through policy development, building data systems and technological solutions.
- **Aarambh ECD:**
  Early Childhood Development program for 0–3-year-old addressing stunting. To tackle the socio-economic disparity, the State Government took agile interventionsin form of schemes which were also extensions of Central Government vision as well.

B 2.3 Key interventions in last 2 years to accelerate social development

The key interventions have resulted in significant rise in Revenue Expenditure for socialwelfare schemes which is approximately 25% of Revenue Expenditure.

Table 1: Key Interventions

Beneficiary Group	Names of Schemes	Expected Annual Exp.
Women	Mukhyamantri Majhi Ladki Bahin Yojana/Lek Ladaki Yojana/ Mukhyamantri Annapurna (Ujjwala+)/Free higher education to girls/ Nav Additional Revolving Funds for Women Self Help Groups	47985 Cr
Farmers	Namo Shetkari Mahasanman Nidhi Yojana/ Loss of Crops –Re. 1 Crop Insurance, Assistance/Jalyukta Shivar Abhiyan/ Project on Climate Resilient Agriculture (PoCRA 2.0)/ Agri-business & Rural Transformation (SMART) Project/Agri Pumps Electricity Bill Subsidy & Solar Pumps	19875 Cr
Youth	Mukhya Mantri Yuva Karyaprashikshan Yojana/	19540 Cr

Beneficiary Group	Names of Schemes	Expected Annual Exp.
	Concessions & Scholarships for students in HigherEducation	
Old Age	Shravanbal Seva Rajya Nivrutti Vetan Yojana / Sanjay Gandhi Niradhar Anudan Yojana/Vayoshri Yojana	8631 Cr
Health for all	Mahatma Phule Jan Arogya Yojana -Cashless Health insurance cover increased from Rs. 1.5 to Rs. 5 Lakhs perfamily	2403 Cr

Table 2: Description of Schemes in Brief

S. No.	Scheme	Description
1	Mukhyamantri Majhi LadkiBahin Yojana	The state government will provide Rs 1,500 per month to eligible women aged between21 and 60 years.
2	Lek Ladki Yojna	Financial aid of ₹1,01,000 to eligible girls, indifferent phases and based on their age andclass level, to ensure equal opportunities.
3	Mukhyamantri Annapurna (Ujjwala+)	More than 52 lakh families will be provided with three free gas cylinders per year.
4	Additional Revolving Funds for Women Self Help Groups	SHG groups under MSRLM were provided additional Rs.15000/- each amounting toRs.1000cr.
5	Namo Shetkari Mahasanman Nidhi Yojana	Under this scheme an additional amount of Rs. 6000/- will be transferred in AADHAR accounts of farmers annually in three equal instalments.
6	PoCRA 2.0	After successful implementation of the Project on Climate Resilient Agriculture 1.0,which was conceptualized by the Department of Agriculture and the World Bank to develop a drought-proofing and climate-resilient strategy for the agriculture sector, is now extended to PoCRA 2.0.
7	Agri-business & Rural Transformation (SMART)Project	To support the development of inclusive andcompetitive agriculture value chains,focusing on smallholder farmers and Agri entrepreneurs in Maharashtra
8	Mukhya Mantri Yuva Karyaprashikshan Yojana	It is an initiative to provide apprenticeship to youth across Maharashtra to improve their employability by providing Rs.10000/- monthly stipend for six months.
9	Shravanbal Seva RajyaNivrutti Vetan Yojana	Under this Scheme every destitute person ofage 65 years & above &whose annual family income is below Rs. 21000/- & whose name is not included in the BPL List get Rs.1500/-per month from the State Government.

10	Sanjay Gandhi NiradharAnudan Yojana	It's a state sponsored scheme applicable to destitute of age below 65 years, orphan children, handicapped, and persons with critical illness, widows of farmers who committed suicide etc. Under this scheme, Rs.1500 per month is given to single beneficiary. The annual family income shouldbe less than Rs.21000/- .
11	Vayoshri Yojana	The scheme is for economically weak old age persons above age of 65 years. Under the scheme assistance of Rs.3000/ month will be provided. The State Government hasmarked an annual budget of Rs.480cr towards the scheme.
12	Mahatma Phule Jan Arogya Yojana	The objective of the scheme is cashless quality medical care to beneficiaries which include critical illness, hospitalization surgeries and therapies. Cashless Health insurance cover increased from Rs.1.5 to Rs.5 Lakhs per family.

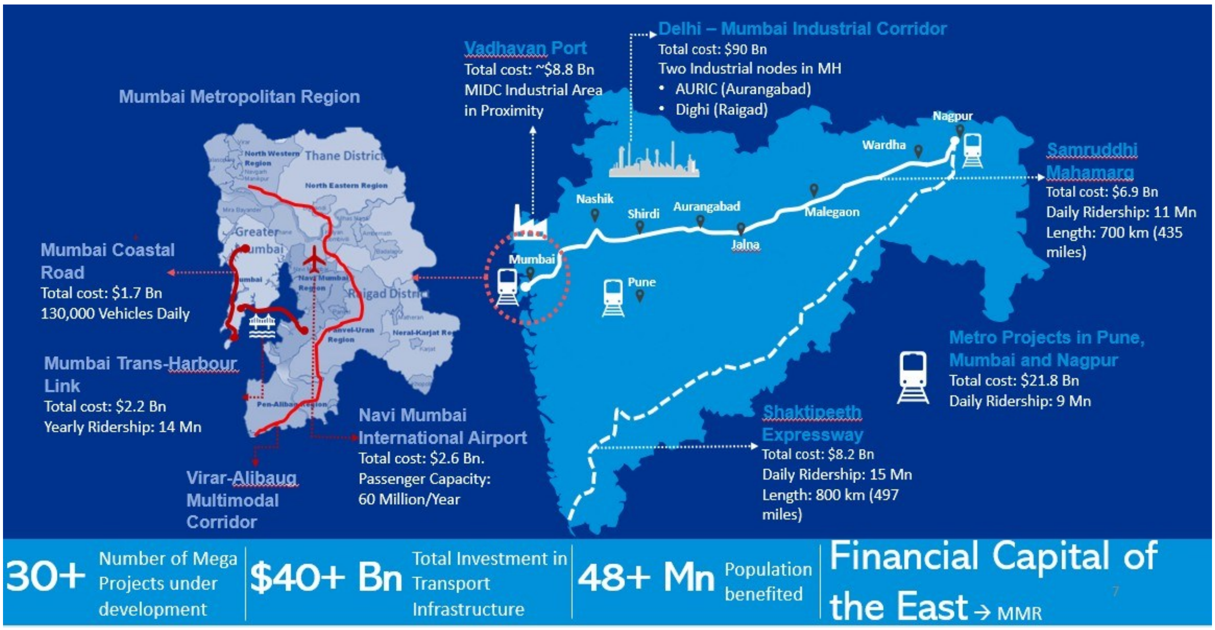
B 2.4 Capex increase to boost economic growth:

Maharashtra has always believed in strong physical infrastructure led development and dedicated huge resources to make it top investment destination in the country, but a trillion-dollar economy means further investments in infrastructure to build world class expressways, ports, multimodal corridors, metros, energy infrastructure particularly renewable energy, and new industrial/city infrastructure. Besides Government spending Maharashtra will have to continue to attract large private investments and make PPP an integral part of growth strategies.

Major support for infrastructure development comes from Government pushed capital expenditure directly from budget which is around 12% this fiscal year to a similar push from parastatals.

Maharashtra is fortunate to have some of the best PSUs like MMRDA, MIDC, MSRDC, CIDCO, MHADA, MSEDCL, MahaGenco, Mumbai Metro, Maha Metro, etc. which have led from the front in creating excellent infrastructure in Maharashtra and will continue to contribute as we hope for higher economic growth rate. These parastatals have been adequately backed by the state Government in form of state guarantees to back their debt raising effort and initial equity to support mostly land acquisition efforts related to projects.

Figure 4: Infrastructure led Growth



There are more than 30 mega projects, with more than $40 Bn investment in Transport.This infra led growth will benefit more than 48 million people across state. Some of the major ongoing game-changing developments are:

- **Mumbai Coastal Road Project**: The total cost is estimated $1.7 Bn, with estimated commuting of 130000 vehicles daily. The impact is expected to reduce travel time and enhance connectivity along the coastline, promoting tourism and local business.
- **Mumbai Trans-Harbour Link**: Total Cost $2.2 Bn with estimated yearly ridershipof 14 Mn.
- **Navi-Mumbai International Airport**: Total cost estimated at $2.6 Bn with passenger capacity of 60 million a year.
- **Mumbai Metro expansion, Pune, and Nagpur**: The estimated cost is $21.8 Bn with daily ridership of 9 Mn. The projects will facilitate public transport, reduce air pollution, and provide an alternative to road transport, thereby addressing congestion.
- **Sammruddhi Mahamarg**: the total cost estimated is $6.9 Bn. The plan is to develop 700 km access-controlled expressway, which will enhance connectivity between two major economic hubs, facilitating trade and reducing travel time.
- **Vadhavan Port**: The Vadhavan airport is planned capex of ~$8.8 Bn and has MIDC Industrial area in proximity.
- **Pune Outer Ring Road, Jalna**-Nanded Expressway, Vasai-Alibag multi modal corridor and Vidarbha expressways.

Apart from above, Delhi-Mumbai industrial corridor is planned with two industrial nodesof Aurangabad and Dighi (Raigad) with planned capex of $90 Bn.

There is also a planned capex of $8.2 Bn for developing Shaktipeeth Expressway of length of 800 km with 15 Mn daily ridership.

The year wise trend of capex by Parastatals and State is given below:

Table 3: Capex through Parastatals

Year	Capex through State Budget (Rs crores)	Capex though parastatals (Rs crores)	TOTAL CAPEX (Rs crores)
2018-19	36594	35036	71630
2019-20	38385	62791	101176
2020-21	32029	54175	86204
2021-22	49106	61212	110318
2022-23	66308	61234	127542
2023-24	77350	72666	150016

Besides debt and initial equity support from Center/State Government, suitable enablingpolicies like land monetization, TDR, FSI, Transit Oriented Development (TOD) along metro routes, Slum Rehabilitation, toll revenue monetization, stamp duty cess support financing these projects.

B 2.5 Commitment to Sustainable Development Goals and Climate Action

Sustainability is now a major factor in planning and state has some of the latest policies that push SDG agenda and Climate Action Plan. The State Government has undertakenvarious initiatives and formulated a comprehensive action plan focusing key sectors such as energy, transport, building, industry, agriculture, and urban development to align withthe SDGs particularly those related to climate action (SDG 13), clean energy (SDG 7) and sustainable cities and communities (SDG 11). Implementation Coordination Centre (SDG-ICC) has been established to coordinate with MoSPI, NITI Aayog and the line departments in state. The State aspires to be in Top 3 in SDG in next three years.

The state is pioneer in coming out with Green Hydrogen policy, EV policy, solarizing agriculture feeder in mission mode under MSKVY 2.0 are some of the transformative efforts in this direction. The State has prioritized key sectors for climate action:

- ❖ Energy: Decarbonizing Power
- ❖ Transport: Electric, shared, public and non-motorized
- ❖ Build: Sustainable, low carbon infrastructure footprint
- ❖ Industry: Modern & Clean technology (Green Hydrogen)
- ❖ Agriculture: Sustainable practices (solarization of Agri feeders, solar Pumps installation)
- ❖ Urban: Make cities livable

Following framework/authorities are created for monitoring Climate action plan:

- **Maharashtra Council for Climate Change (MCCC)** is established under the chairmanship of Hon'ble Chief Minister and Hon'ble Deputy Chief Minister to monitor action plan for climate change.
- **State Action Plan for Climate Change (SAPCC)** - framework for responding to the effects of climate change.

- **Maharashtra Coastal Zone Management Authority (MCZMA)** for protecting and improving the quality of the coastal environment and preventing, abating, and controlling environmental pollution in coastal areas.

An example in Sustainable Development and Climate Action- a win-win for all stakeholders

Maharashtra is promoting renewable energy, particularly solar power, in effort to reduce dependency on fossil fuels and transition to low carbon economy. It has put plans in placeto have RE share to grow to 50% of the installed capacity by 2030 to achieve NDC target.Having stalled more than 2 lakhs off grid solar pumps, 10 lakhs more such pumps will beinstalled in next 3 years. Maharashtra is home to more than 1cr farmers contributing 30%of state's electricity consumption and has highest agriculture electricity demand 36000MUs.

Total Agri feeder connections -45 lacs accounting for 30% of energy demand.

Electricity Supply to Agriculture is on 8 Hrs. rotational basis. 50% of farmers get electricity during nighttime leading to productivity issues.

As agriculture power tariff is subsidized, total Energy subsidy: Direct-Rs 11,319 crore putting burden on commercial and industrial tariffs leading to Cross subsidy- Rs15,336 cr. This makes industrial production and many services non-competitive compared to many states.

The State Government decided to separate this agriculture demand through solarized Agri feeders in distributed way under **Mukhyamantri Saur Krushi Vahini Yojana (MSKVY 2.0)**. Maharashtra's solar power landscape is set to expand as MSEB Solar AgroPower (MSAPL), subsidiary of MSEB Holding Company, undertakes the development of entire 16000 MW Agri energy demand through a feeder-level solarization program- 9200MW or 30% by 2025 in mission mode wherein decentralized solar projects within the 5-10 km radius from Agri load dominated sub-stations will be installed with the capacity from 0.5 MW to 25 MW for giving day time power to farmers. Most of the target is tenderedand awarded in PPP mode, and now we are seeing commissioning of such projects. It utilizes 30% central assistance under KUSUM-C, a CSS to the maximum, besides State Government and MFI support. This initiative is poised to play a pivotal role in harnessing solar energy for agricultural purposes, aligning with the state's commitment to sustainable and renewable power generation. 75% of capacity is coming in 10 districts with high agriculture density. (Ahmednagar, Solapur, Nasik, Pune, Jalgoan, Aurangabad, Nanded, Sangli, Latur and Satara).

This will lead to win-win for all stakeholders:

Reduction in cost of supply to agriculture and cross-subsidy burden on industries.

Investment of Rs.30,000 crore across various districts in Maharashtra

Day-time electricity supply to farmers and agriculture

Over 20,000 direct rural jobs and development of solar ecosystem and skills.

Contributes to national and solar targets, CO_2 emissions savings.

Maharashtra has created Energy transition blueprint for 2030 to facilitate full energy transition in which 52% renewable energy is envisaged.

C. VISION: Maharashtra USD One Trillion economy by 2028

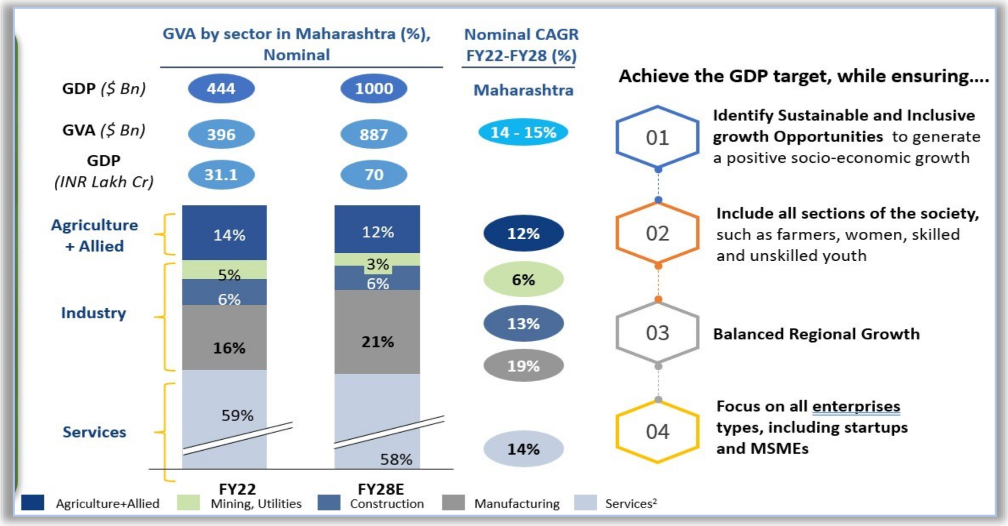
Maharashtra has set a vision to become US one Trillion-dollar economy by FY 2028-29, by identifying inclusive, sustainable economic growth opportunities and improving economic well-being and quality of life for all its citizens. Maharashtra Economic Advisory Council (EAC) was established under chairmanship of Shri N. Chandrasekaran, Chairman TATA Sons to provide guidance and recommendations to achieve this vision. MEAC has submitted its recommendations to the State Government in July 2023.

The vision requires aspirational economic growth scenario- CAGR of 14-15% nominal GSDP from current 9% which means focused strategies backed with adequate financial resources. Sub-Sector wise opportunities contained in MEAC report identifies strategies in manufacturing based on existing opportunities in Maharashtra for major as well as sunrise sector. It aspires this sector to grow at 18-19% and increase its share in total GVAcontribution to 21% from current 16%. This will help restore some balance in structural composition of economy and workforce, stagnant at around 50% in agriculture, to move out. Similarly, opportunities in financial services, real estate, construction, IT & ITeS, Tourism and Healthcare need to be realized for higher growth rate which call for further investments.

C 1.1 The sub-sectoral growth recommendations by MEAC

MEAC aspirational growth scenario sector-wise to achieve one trillion-dollar economy goal is summarized below. There are 350 plus recommendations which are classified department-wise to act in a timebound manner. MITRA, Maharashtra Institution for Transformation-thinktank on lines of NITI is working to implement these recommendations.

Figure 5: Balanced Growth



1. Manufacturing: MEAC envisages its share to rise to 21% of state GVA from present16%. It has identified 40+ opportunities in 16 focus industries which has strong base in Maharashtra like capital goods, food processing, metals, auto, textiles, chemicals, pharma etc.
2. Services: MEAC recommends working on opportunities in financial services, IT& ITeS, tourism and health care for aspirational growth scenario of 14-15%.
3. Agriculture and allied sector: MEAC identifies opportunities in horticulture, poultry, dairy,

aqua and sericulture sub-sector to boost farmers income.

4. Construction and Real Estate also hold good potential for aspirational growth with massive in public spending on creating new infrastructure.

MEAC recommendations spells out enablers to work on these opportunities like renewable energy share, ease of doing reforms, policy initiatives, MSME support and land reforms to name a few.

C 1.2 Mumbai Metropolitan Region: MMR

There is a special focus on MMR as State has a vision to develop it as Growth Hub to achieve State target to make $300 billion economy from the present $140 billion by 2030 and $1.5 trillion by 2047. An Economic Master Plan is also formulated by Niti Aayog for this city Growth hub pilot. It is in MMR, where Parastatals play significant role in mobilizing resources both public and private to implement some of the biggest infrastructure projects.

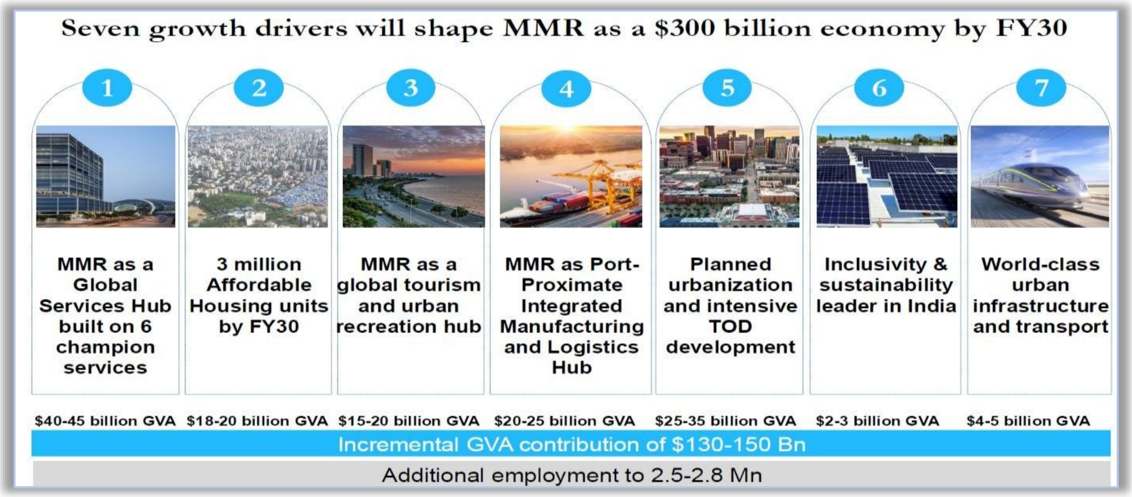
Figure 6: MMR Plan

	MMR	Maharashtra	
Population, 2023[1]	25.8 Mn	126 Mn	20% of Maharashtra
Area (Sq Km)[2]	6,328	308K	2.8% of Maharashtra
GDP[3] (current prices, FY23)	$140 Bn	$440 Bn	31.2% of Maharashtra
GDP per capita (current prices, FY23)[4]	$5,248	$3,485	India's GDP per capita - $2,500
Jobs (FY23[5])	10 Mn	55 Mn	18.1% of Maharashtra

Historically, MMR grew at 6.1% (FY12-20, real) against Maharashtra at 5.8% and India at 6.6% CAGR

	FY 2023	FY 2030	FY 2047
$ GDP	$140 Billion (6.1% CAGR, real)	$300 Billion (9-10% CAGR, real)	$1.5 Trillion
Jobs	10 Million	12.5 – 12.8 Million	20 Million
GDP/ Capita	$5,248	$10,000-12,000	$38,000

Figure 7: Growth Drivers for MMR



The social and economic outcomes envisaged in the Master Plan will lead to jobs creation, increased per capita, drive sustainability, financial inclusion, enhance quality of life in MMR.

C 1.3 District Strategic Plans – balanced economic growth

Planning Department has led an exercise to formulate District Strategic Plans for accelerating economic growth based on their relative strengths. State has increased District Annual Plan outlay by 20% to Rs 18,000 cr. this fiscal to help district administration to fund their growth strategies in a strategic manner. Districts are directed to spend minimum 25% of their outlay for their Annual Plan.

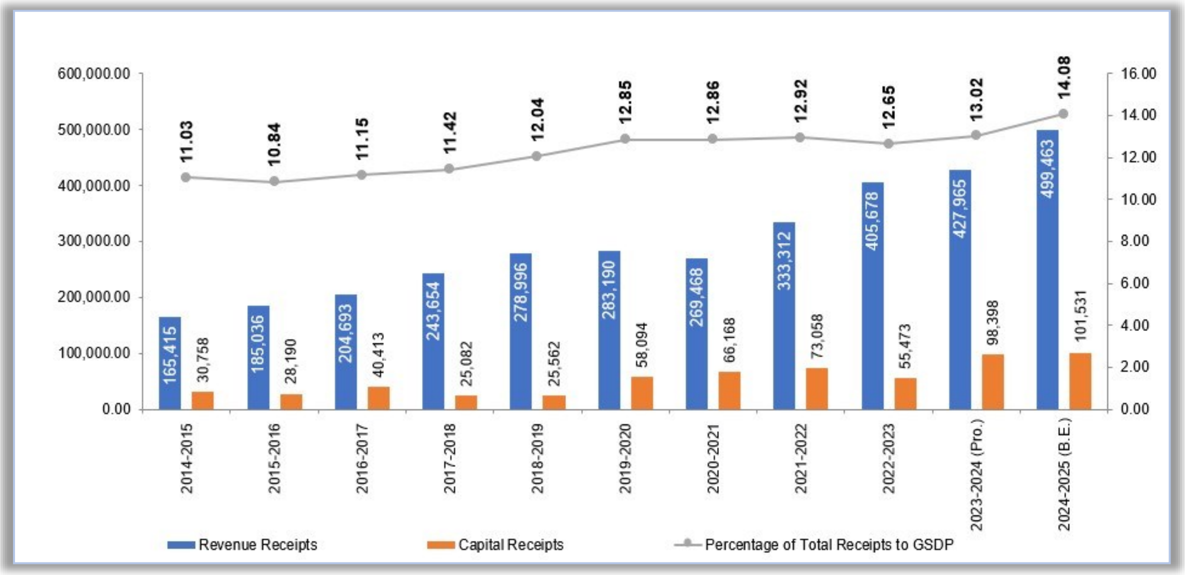
FISCAL MANAGEMENT: Balancing aspirational growth scenario

Maharashtra Financials Snapshot:

Table 4: Brief Information of Budget

Brief Information of Budget- Maharashtra				
				(Rs. Cr)
Sr. No.	Details	2022-23 (Actual)	2023-24 (Prov. Actuals)	2024-25 (BE)
1	Revenue Receipts	4,05,677.93	4,27,964.81	4,99,462.84
	A) Own Tax Revenue	3,37,487.29	3,71,662.28	4,19,972.28
	B) Non Tax Revenue	68,190.65	56,302.53	79,490.56
2	Revenue Expenditure	4,07,614.40	4,39,529.47	5,19,513.53
3	Revenue Deficit (1-2)	1,936.47	11,564.66	20,050.69
4	Capital Receipts	55,472.78	98,397.95	1,01,531.17
	A) Recovery of Loans	642.62	551.88	2,475.10
	B) Borrowings & Other Liabilities	54,830.16	97846.07	99,056.07
5	Capital Expenditure	66,308.02	77350.46	92,779.63
6	Total Receipts (1+4)	4,61,150.71	5,26,362.76	6,00,994.01
7	Total Expenditure (2+5)	4,73,922.42	5,16,879.93	6,12,293.16
8	Fiscal Deficit (4B-(6-7))	67,601.87	88,363.24	1,10,355.22

Figure 8: Trends in Receipts (Rs. Cr)



The revenue receipts as percent of GSDP has shown steady growth, more so postCovid-19, mainly due to GST revenue growth.

Figure 9: Break up of Revenue Receipts (Rs. Cr)

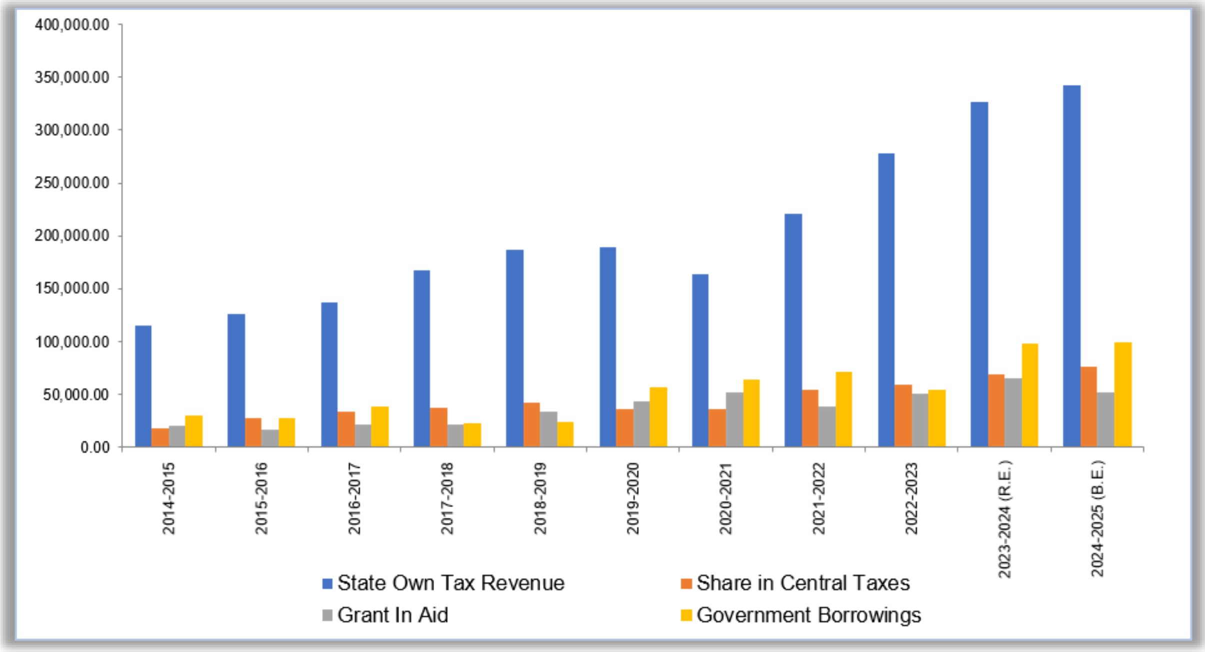
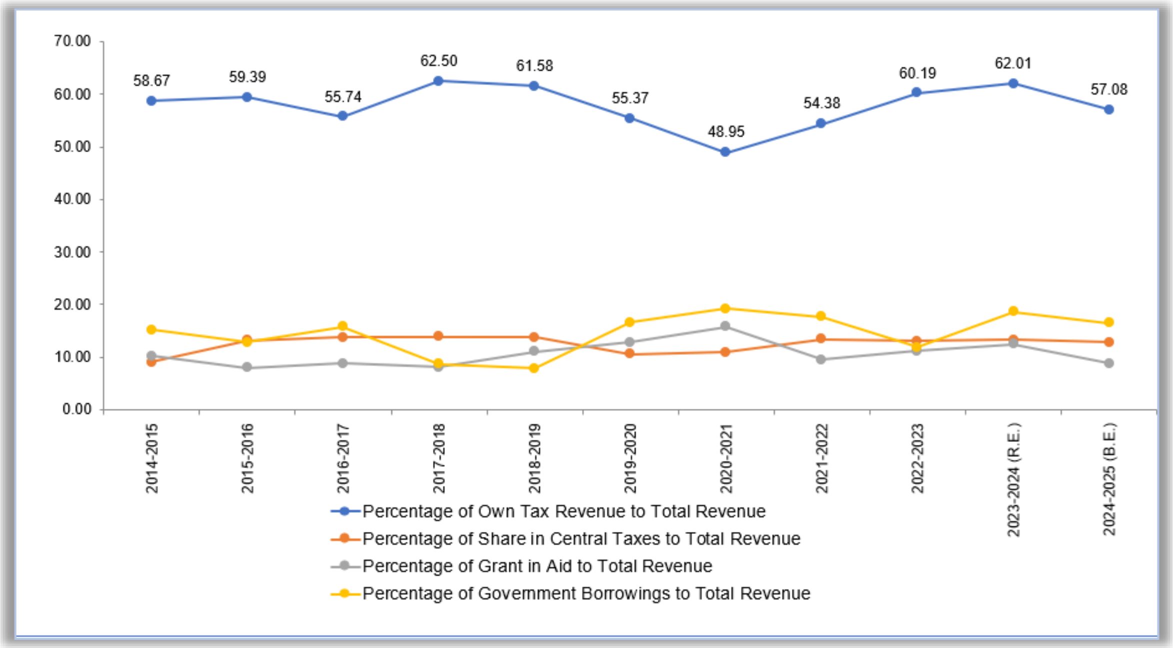


Figure 10: Composition Trend in Revenue Receipts



Own Tax Revenue is 62% of the total receipts which is approximately 8% of GSDP. Maharashtra is one of a few states where SOTR is majorly supporting state expenditure. The huge GST base with other tax receipts from stamps & registration, excise constitute major tax revenues. The percent share of Central taxes in receipts has remained constantbut have been an important support for state development.

Figure 11: Own tax Revenue as a percentage of GSDP (Rs. Cr)

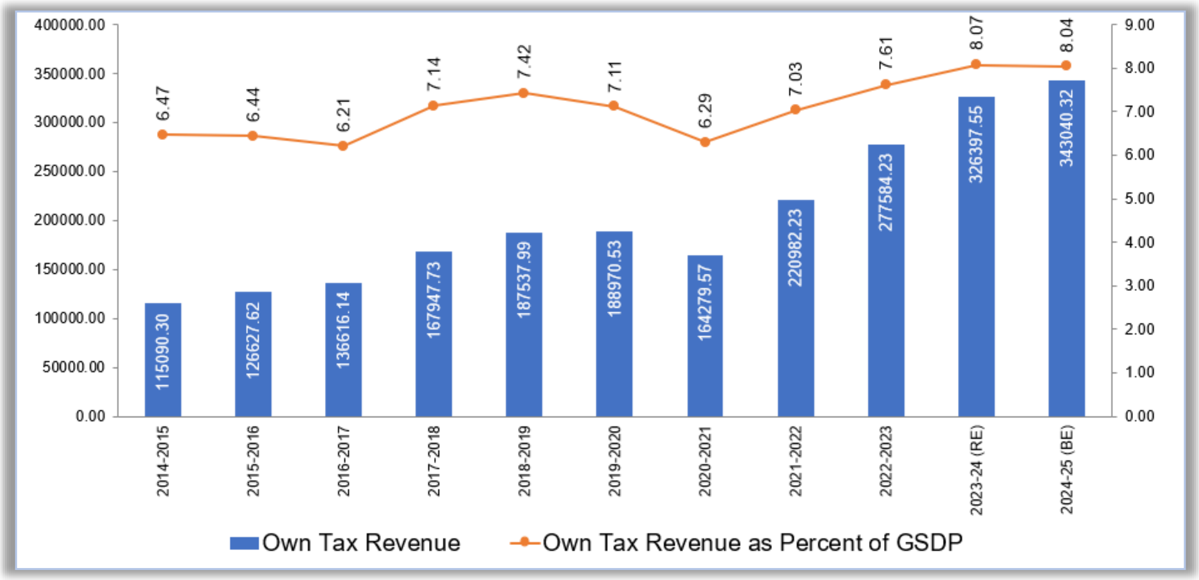
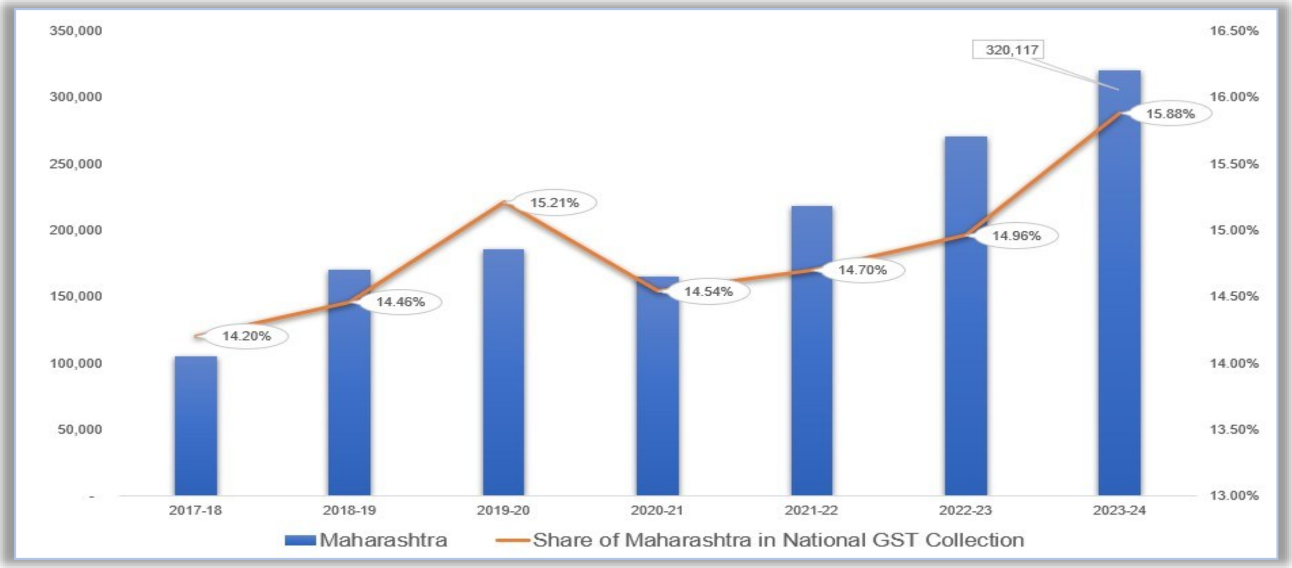


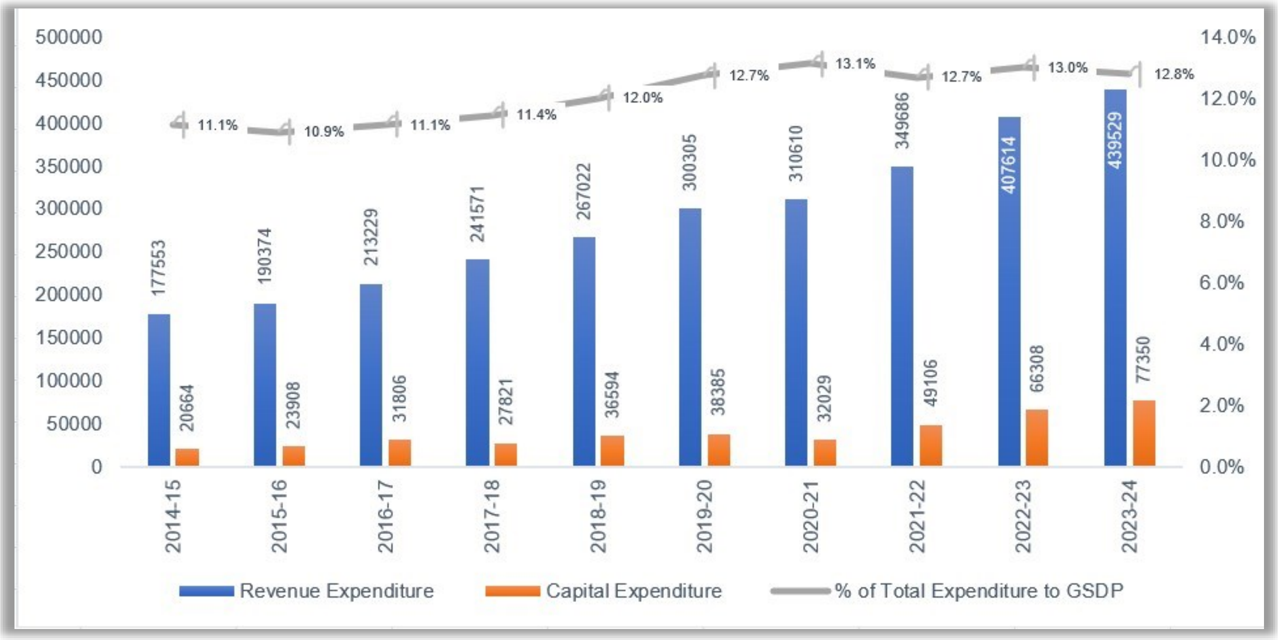
Figure 12: GST Collection (Rs. Cr)



Maharashtra is the largest contributor of country's GST with approximately 16% collection in 2023-24. In 2024-25, State GST is estimated to be the largest source of own tax revenue (45% share)

Capital and Revenue Expenditure trends in the state.

Figure 13:Trends in Expenditure (Rs. Cr)



The Revenue Expenditure is consistently at controlled at ~13% levels of GSDP. State has focused majorly on increasing spending in social welfare schemes, particularly in last two budgets post COVID-19.

25% of revenue expenditure is going towards welfare of women, youth, farmers, and Senior citizens. For better targeting and transparency, DBT in Aadhar linked account of beneficiaries is now accepted delivery tool for all individual beneficiary schemes.

Figure 14: Percentage of Revenue & Capital Expenditure to GSDP

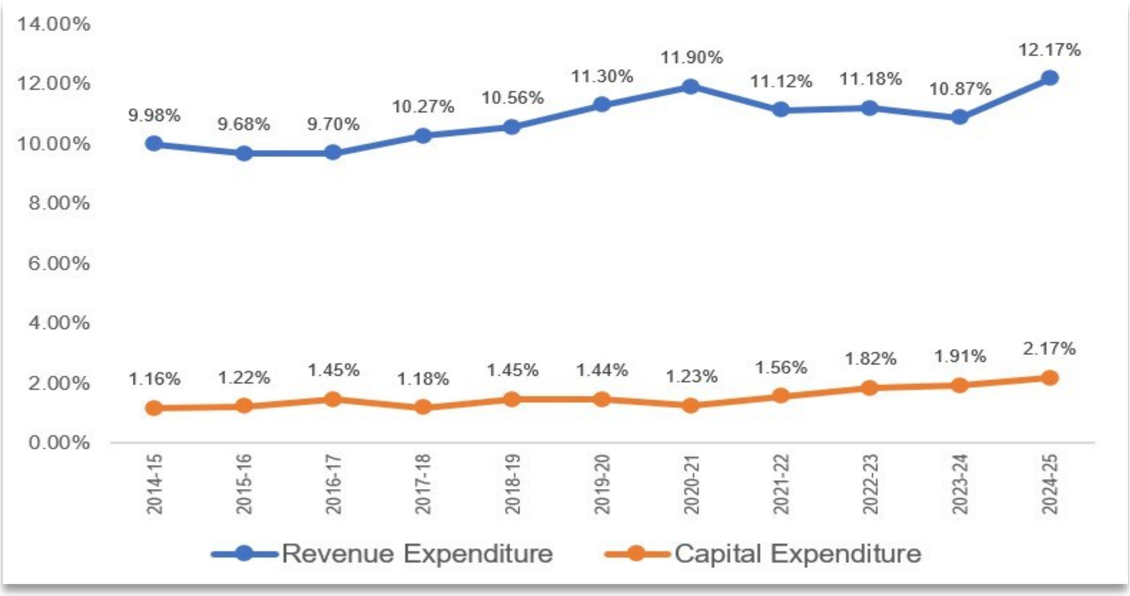
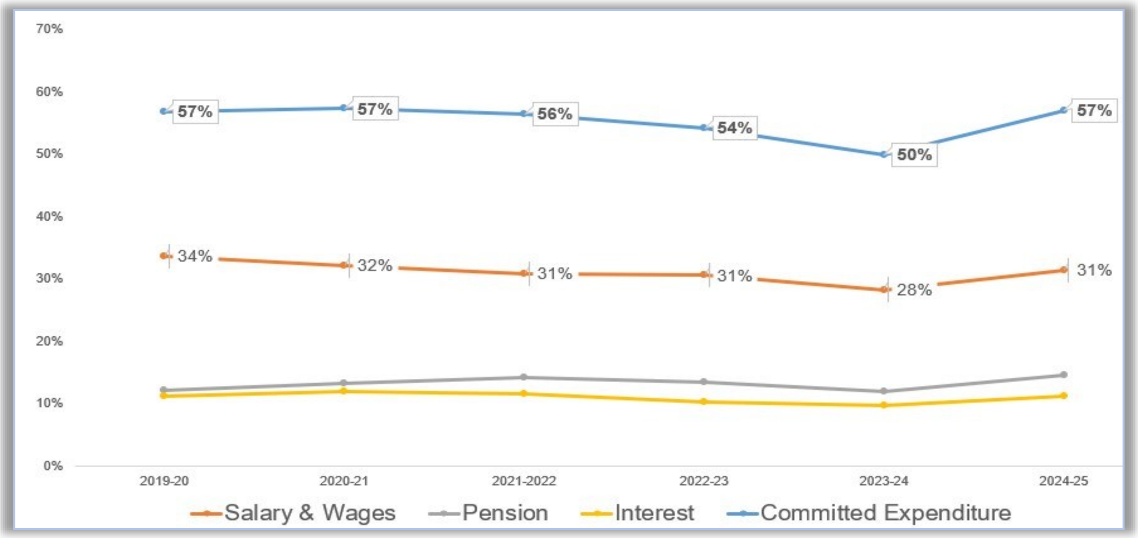
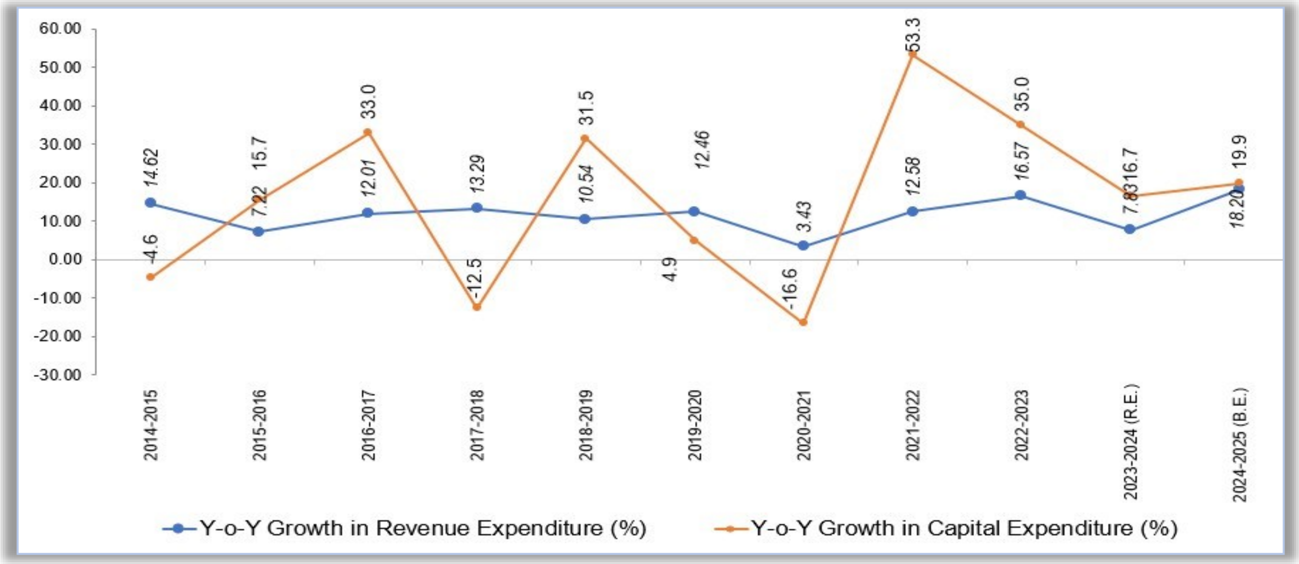


Figure 15: Committed Expenditure compared to Overall Receipts



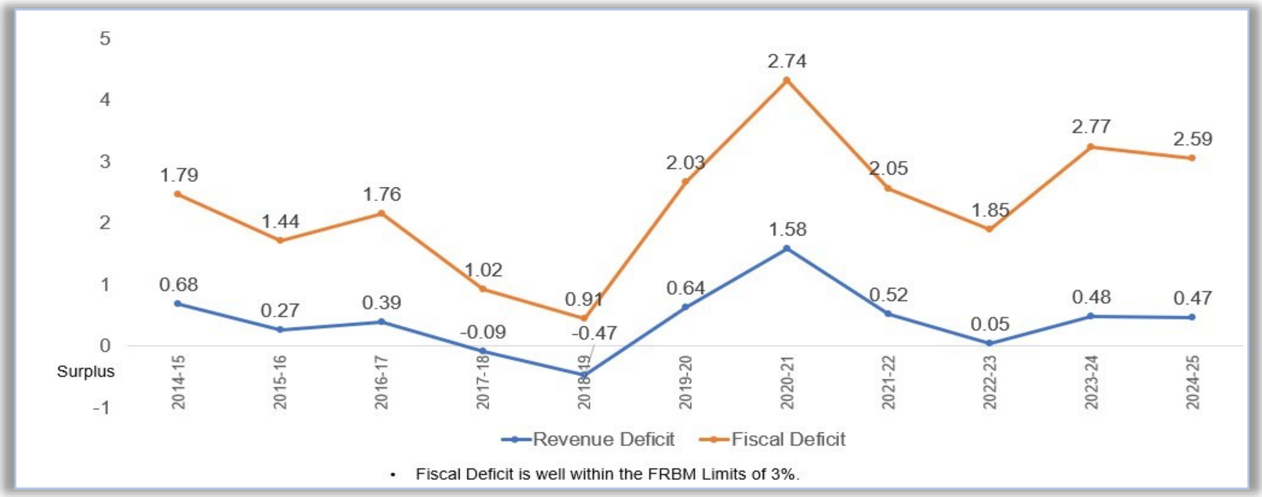
57% of Maharashtra expenditure is constituted by Salary & Wages, Pension, and Interest payments, which is slightly worrying. One observation is use of IT is not leading to reduction commensurate decrease in salaries and wages over the years. Similarly, increased spending in Health and education needs to be corelated with better outcomes, not merely on salaries and wages. It needs bolder approach asking to review dated policies and approach.

Figure 16: Annual Growth in Expenditure (YoY) (%)



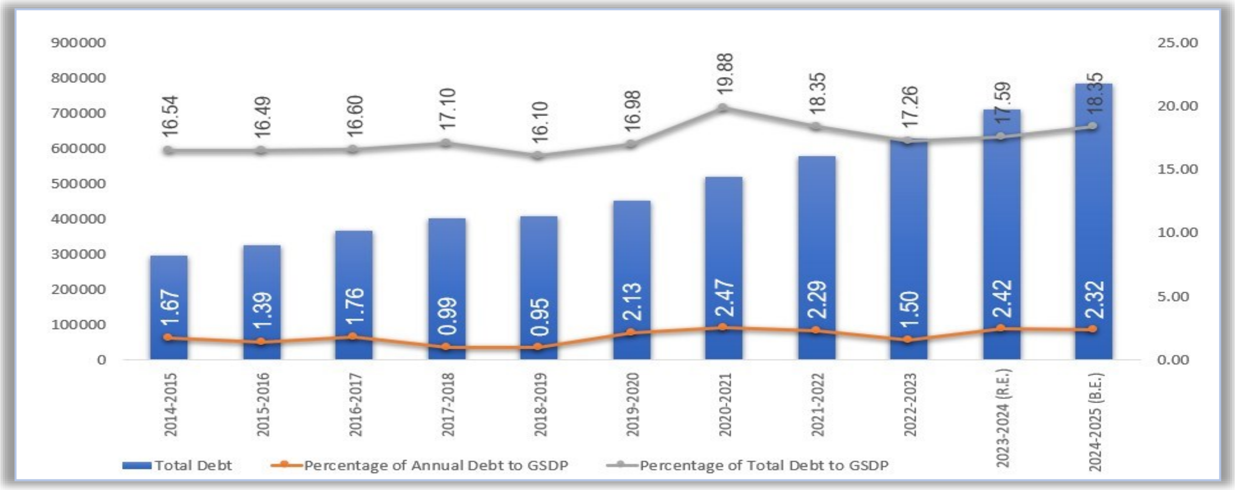
The capital expenditure growth shows greater variation YoY basis compared to revenue expenditure which is growing at steadier rate. The newly announced schemes/welfare measures will lead to further rise this fiscal and coming years unless rationalization exercise leads to additional fiscal space to accommodate the same.

Figure 17:Trends in Fiscal and Revenue Deficit



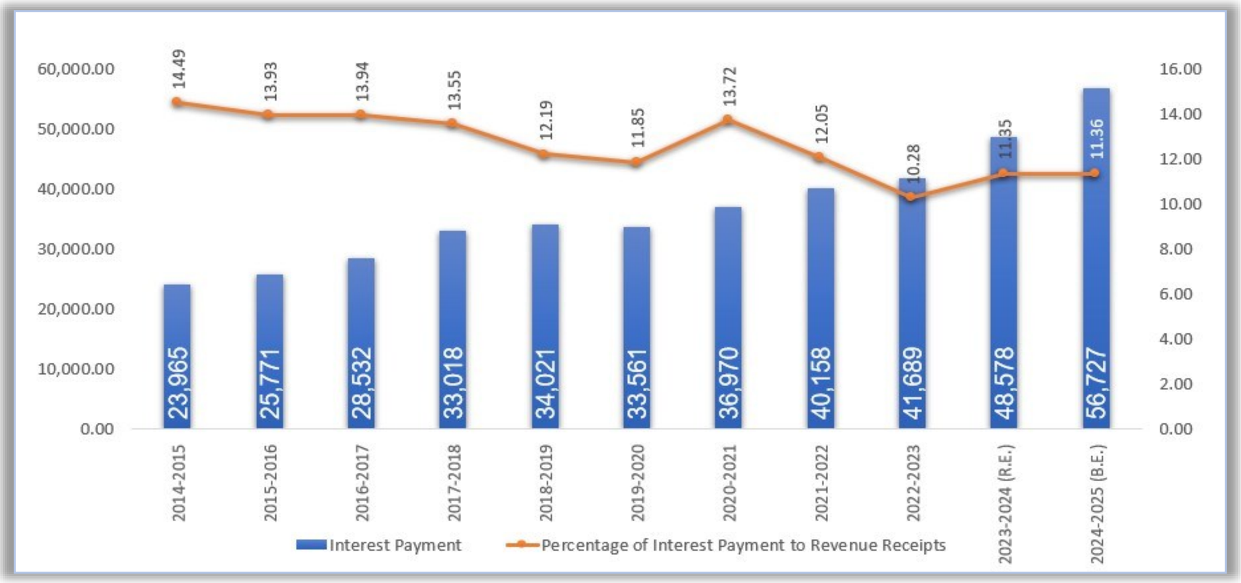
The state has so far managed its debt well to stay well within 25% of GSDP with currentdebt-GSDP ratio at 18%. Annual borrowing as indicated in fiscal deficit is within 3% limit.Debt stock is at 157% and interest payments are less than 11% of revenue receipts betterrelatively when compared to most states. Similarly, State revenue receipts have maintained healthy growth rate with GST collections growing at CAGR of over 15% in last 6 years. Rising committed expenditure, which is now at 57% of Revenue receipts, limits fiscal space to increase capital expenditure at accelerated pace.

Figure 18: Debt to GSDP %



The Debt to GSDP ratio of Maharashtra is at comfortable levels of around 18%. The State will calibrate Debt which will leverage the infrastructure led economic growth withcreative debt raising and financing.

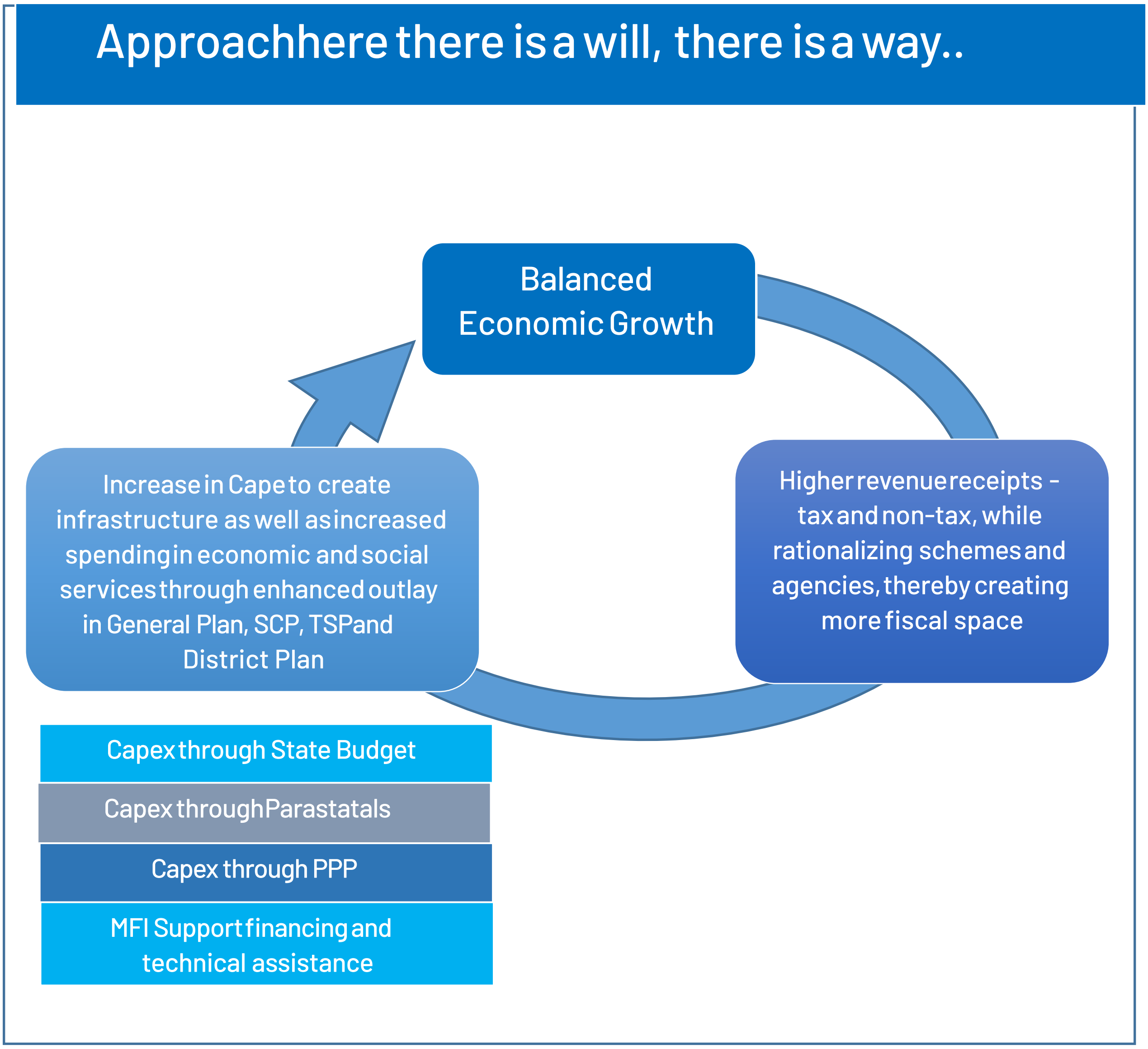
Figure 19: Interest Payment (Rs. Cr)



Interest Payments to the Revenue Receipts is around 11.36% in FY 2024-25 which is atsimilar levels of revised estimates of FY 2023-24.

D. BALANCED ECONOMIC GROWTH MODEL

Figure 20: Balanced Growth Model



The State will target ***balanced growth in aspirational scenario*** to realize its vision of USD one trillion economy. While prudent debt management policy will be anchored in state expenditure plans, the state shall push for Capex increase with support from public and private as well as MFI support. The State will enhance share in CSS like we have strategized for MSKVY 2.0 from KUSUM-C funds or worked to get maximum funds in zero percent Central Assistance loan for capital expenditure. Besides widening tax net to increase State own tax revenues, asset monetization of public infrastructure, innovative financing tools like InvITs, better user fee collection can make crucial resources available for higher economic growth scenario. We also plan to cut down wasteful expenditure and intend to rationalize state schemes and agencies/State PSUs. This is also spelt in Hon. FM's budget speech of July 2024. Greater adoption of technology like MahaDBT platform, SEWARTH portal, linking ADHAR with ration cards, students' attendance has helped reduce revenue expenditures including in salaries and pensions.

Going forward, the approach would be more Capex spending by State including parastatals in partnership with private sector to generate high but balanced economic growth leading to more revenue receipts while rationalizing schemes, which further create fiscal space to boost CAPEX.

The State Approach can be summarized in four-fold approach:

1. **Debt Sustainability:**

   Total debt burden is expected to reach Rs.7.82 Lakh Cr – 157% of Revenue receipts. The state has managed to keep total debt well within 25% of GSDP and annual borrowing is less than 3% of GSDP. There is fiscal space to further spend.However, thin spreading of financial resources, project management issues, rise in committed liabilities, non-merit Subsidies and freebies pose risks. Hence spending wisely is key in fiscal balance through strategic planning.

2. **Accelerating Capital Expenditure to boost economic growth:**
   Effectiveutilization of CSS like Scheme for Special Assistance to States for Capital Investment, PM KUSUM-C. State Infrastructure Pipeline in line with
   Trillion-dollar economy vision.
   Innovative financing- InvITs
   MoM (Memorandum of Minutes) with State PSUs for guarantees and equitysupport
   Incentivizing private investments- PPPs

3. **Growth in State Own Tax Revenue and other Receipts**
   Tax base- For taxes other than GST efforts are on to plug the gaps in assessment.(State Excise/ Tax on vehicles)
   Digitization to increase tax base (GIS) & strengthen audit systems.
   Formalization of informal sector.
   Explore Asset monetization of state infrastructure assets, leasing public spaces,better user fee collection.

4. **Rationalizing Revenue Expenditure**
   Rationalizing schemes and agencies (Budget Speech 2024).
   Redundant schemes will be discontinued.
   Various schemes providing benefits to same set of beneficiaries will be merged toavoid duplication.
   Check on non-merit subsidies and freebies, direct targeting-DBT.
   HR - optimal utilization, staffing pattern reviews and increased IT use.

To sum up, Maharashtra while realizing its vision of aspirational but balanced economic growth, is committed to social and economic well-being of its citizen with sound fiscal policies.

State Forum 2024

DATA VISUALIZATION

10

Public Finance Review Data Visualization Tool: An Application to Indian States[44]

Rishabh Choudhary and Emilia Skork

World Bank

1.0 Understanding Public Finance Reviews: What, Why and How?

Public Finance Reviews (PFRs) are a World Bank core diagnostic tool for analyzing key functions of allocation, distribution and stabilization. The efficiency and effectiveness of public expenditure is essential for growth and development as it funds critical infrastructure, supports social programs, and ensures efficient resource allocation. Through its distributive role, fiscal policy can reduce inequality by reallocating resources to marginalized groups, ensuring a more equitable distribution of public services, and fostering inclusive economic growth. Regular PFRs help create a resilient public finance system by identifying inefficiencies and areas for improvement, including budget institutions, thereby enhancing the overall effectiveness of fiscal policies. While subnational entities will not be directly responsible for short-term stabilization and some key areas need to be adapted for the subnational context, many of the core principles of sound public finance apply across all levels of government.

This note delves into the what, why, and how of PFRs, highlighting also the scope for subnational PFRs and the adaptation of key tools, like the PFR Data Visualization Tool in facilitating analyses at the subnational level. We begin by discussing the key elements of PFRs, the broader objectives and benefits of PFRs, and the steps to implementing PFRs. Next, we elaborate on key analytical approaches and tools. Then, we present several country-level examples. Finally, we highlight modifications in the key public finance issues and policy questions for application at the subnational level and demonstrate the PFR Data Visualization Tool adapted to Indian states.

a. What are PFRs?

PFRs are comprehensive assessments aimed at evaluating a government's fiscal policies and public finances. They focus on analyzing the efficiency and effectiveness of public spending, the sustainability of revenue systems, and the strength of budgetary institutions. The primary goals of PFRs include assessing fiscal sustainability by evaluating whether current fiscal policies can be maintained over the long term without leading to excessive debt. They seek to underpin revenue mobilization by identifying ways to improve tax collection and other revenue sources, improve expenditure efficiency to ensure that public spending is effective in achieving desired outcomes (allocated to maximize social and economic benefits),

---

[44] This note serves as a write-up for the presentation by Emilia Skrok and Rishabh Choudhary at the NIPFP States Forum 2024. Contributions from Christian Eigen-Zucchi and Fernando Blanco (PFR guidance), Julio Velasco (subnational PFR tool development), Franz Ulrich Ruch (cyclically adjusted fiscal balances), and John Nana Darko Francois and Hironobu Isaka (spending efficiency) are acknowledged. We would also like to thank conference participants for their useful comments, which helped improve the note. The findings, interpretations, and conclusions expressed in this note do not necessarily reflect the views of the World Bank, the Executive Directors of the World Bank or the governments they represent.

and strengthen budget institutions by enhancing the processes and institutions involved in budget formulation, execution, and oversight.

b. Why are PFRs important?

PFRs support government efforts to ensure fiscal sustainability, and promote economic growth, development, and transparency. PFRs are an impactful diagnostic for several reasons, including providing policymakers with data-driven insights to make informed fiscal policy decisions, identifying areas for improvement in revenue collection and public spending, facilitating the formulation of effective policy reforms to enhance fiscal sustainability and efficiency, and promoting transparency and accountability in public financial management. PFRs can underpin significant improvements in fiscal performance, such as increased revenue through enhanced tax collection and other revenue sources, more effective allocation and utilization of public funds, long-term fiscal sustainability, reduced debt levels, and strengthened budgetary institutions and processes. PFRs include policy recommendations that align closely with the diagnostics, supporting evidence-based policy making.

c. How are PFRs conducted?

PFRs typically involve a multi-step process involving data collection and analysis, followed by the formulation together with the client of policy recommendations that aim to be feasible and meaningful. Data collection involves gathering relevant fiscal data from various sources, such as government financial statements, tax records, and expenditure reports. Diagnostic analysis uses analytical tools and frameworks to assess fiscal performance, including evaluating tax potential and effort, spending efficiency, fiscal policy cyclicality, among other key public finance issues. The effort also emphasizes benchmarking, which compares the fiscal performance of the subject entity (such as a state or country) against peers and broader international standards to identify best practices and areas for improvement. Finally, actionable policy recommendations are developed in close consultation with government counterparts aimed at helping address identified issues and enhance fiscal performance.

A PFR includes a core macro and public finance profile, with diagnostic analysis of key thematic areas relevant to the country or state. The macro-fiscal framework addresses the main macro-fiscal challenges, including fiscal sustainability, fiscal risks, and the effectiveness of fiscal policy in supporting stabilization and development. Revenue and spending analysis examines the scope for increasing revenue mobilization, simplifying the tax system, enhancing its efficiency, and improving public spending to promote growth, efficiency, and equity. Other thematic areas can include exploring the macro-fiscal implications of the green transition, public sector wage bill reform, managing fiscal risks associated with pensions, and designing effective fiscal rules.

The macro-fiscal framework assesses several key challenges, including the drivers of growth, inflation, poverty, income distribution, and public debt. It evaluates whether the current fiscal stance is conducive to fiscal sustainability by examining fiscal trends, balance, and their drivers, as well as debt sustainability and fiscal consolidation scenarios. It also identifies key fiscal risks, such as the medium- to long-term impact of demographic transitions on pensions, as well as the composition of debt, or the impact of climate change. Additionally, it assesses whether fiscal policy is effectively supporting output stabilization and addressing development challenges by analyzing the cyclically adjusted balance and progress towards meeting the Sustainable Development Goals (SDGs).

The revenue analysis delves into the scope for increasing revenues and improving tax system efficiency and effectiveness. The approach involves assessing whether there is scope to increase revenues by examining tax performance, trends, and components, as well as tax effort and potential. It can include potential revenue gains from closing tax gaps. The efficiency of the tax system can be enhanced through improving tax productivity, eliminating redundant tax expenditures, and reducing compliance burdens. The effectiveness of the tax system in correcting for externalities can be evaluated by considering environmental and health impacts. For instance, estimates of consumption changes due to taxation on tobacco and alcohol can provide insights into the system's effectiveness in addressing health externalities.

The spending analysis can provide insights on public spending to enhance growth, efficiency, infrastructure, and social protection, benchmarked against peer performance. Evaluating spending involves determining whether public spending can better support sustainable, long-term growth by analyzing levels, trends, composition, and execution rates of spending, categorized by economic and functional classification and benchmarked against peers. It also examines the rigidity of public spending, fiscal multipliers, and infrastructure financing gaps. To enhance the efficiency of public expenditures, it is essential to identify spending efficiency gaps across key sectors compared to peers and identify potential gains in select development outcomes from efficiency improvements. Enhancing the system's efficiency further involves evaluating public spending on social protection in relation to key socioeconomic outcomes, such as multidimensional poverty rates, over time and compared to peers. This includes assessing the adequacy, composition, incidence, efficiency, and targeting of social protection transfers.

PFRs can shed light on decentralization issue or focus entirely on a subnational entity—regional, state, or city—addressing unique subnational questions. PFRs can assess fiscal decentralization by examining expenditure and revenue assignments, vertical and horizontal fiscal gaps, intergovernmental transfers, and subnational fiscal discipline and debt controls. In addition, some of the PFR tools can be applied to individual subnational governments for assessing their fiscal profile, revenue capacity and revenue collection effort, and expenditure efficiency across regional, provincial or local levels, while placing less focus on economic stabilization, given subnational governments' limited influence over economic fluctuations and inflation.

The PFRs conclude with a strong set of policy recommendations aimed at underpinning evidence based policymaking. Well-formulated policy recommendations enable the analysis to inform policy reforms and facilitate the effectiveness of financing. It is essential to formulate policy recommendations that relate to the diagnostics and key challenges facing client countries and states. To this end, a table of policy recommendations can include: the policy context; policy action and timeline; potential fiscal impact; and expected effects on efficiency, equity, and climate change (Table 1).

Table 1. Recommendations should be presented in a systematic way
Model of recommendations

			Impact on:		
Policy Context	**Policy Action**	**Fiscal Impact**	**Efficiency**	**Equity**	**Climate Change**
Policy context—describing the current policy weaknesses as revealed by the analysis in the PFR	Policy action—a policy option that addresses the weakness	Expressed as a share of GDP	expected impact, expressed simply as positive (+), negative (-), or neutral/not appliable (n.a.) or quantified if the data allows.		
Policy Context	Policy Action	X% of GDP	+/-/n.a.	+/-/n.a.	+/-/n.a.

2.0 PFR Analytical Tools

Several analytical tools are employed in PFRs to provide comprehensive insights into fiscal policies and their impacts, with potential for subnational applications. These include Tax potential estimates (measuring the gap between actual and potential tax revenues), Spending efficiency assessment (evaluating the effectiveness of public spending in achieving desired outcomes), Fiscal policy cyclicality analysis (examining the impact of fiscal policy on economic stabilization and determining whether fiscal measures are counter-cyclical or pro-cyclical), and Total carbon pricing (estimating the net carbon price signal in an economy and providing insights into the effectiveness of carbon pricing mechanisms in reducing emissions).

Measuring tax potential at central and subnational levels helps gauge revenue mobilization capacity. Estimating tax potential identifies gaps between actual and potential revenue, informing policy for efficient tax systems. Several approaches (parametric and non-parametric methods) can be used to determine tax effort for individual countries or states, fundamentally differing in how they calculate the key variable of potential tax revenue. The literature on estimation of tax potential has evolved over the years as several studies adopted a regression-based approach that accounts for country-specific observable determinants of tax potential, categorized into economic, institutional, and demographic variables. Some studies in this vein have also included fixed and random effects to improve the overall estimates[45]. Although the traditional regression-based approach is useful for generating estimates for international comparison, it is limited in informing policy reform due to its reliance on structural features that are often immutable in the short term. The stochastic frontier approach is preferred when estimating tax potential[46]. It improves upon the estimates from a regression-based approach by accounting for inefficiencies and providing country-specific measures of potential tax revenues. By estimating the maximum possible amount of tax revenue that a country or state can collect, the estimates from the stochastic frontier approach provide insights into how much tax revenue is being lost due to country-specific inefficiency and where improvements can be made[47].

Public spending efficiency analysis remains a core component of public expenditure analysis in PFRs. Given tight fiscal space faced by some states due to low revenues and/or high levels of debt, making the most of existing public spending is critical. Public spending efficiency analysis is particularly valuable in key areas such as education, health, and infrastructure, where strategic investment in physical and human capital is essential for driving economic growth. By thoroughly examining how resources are currently used, it pinpoints opportunities for enhancing efficiency, ensuring that limited budgets are utilized to their fullest potential. This approach of prudent resource management and strategic investment is crucial for promoting sustainable economic growth within a challenging macro-fiscal environment. Consequently, a comprehensive analysis of public spending efficiency in key areas is a core element of public expenditure analysis in PFRs. The PFR tool employs a variety of standard and novel methodologies, encompassing Data Envelope Analysis (DEA), Free Disposal Hull (FDH), bootstrapped DEA, bootstrapped FDH, and Stochastic Frontier Analysis (SFA), each contributing in different ways to the robust assessment of public spending efficiency.[48] A Composite Efficiency Score (CES) computed from the five approaches provides a balanced efficiency measure that mitigates the biases and variances from the individual approaches.

Understanding the fiscal policy stance as it relates to the business cycle, and whether an economy is in recession or overheating, is critical for policymakers to effectively support output stabilization. Countercyclical fiscal policies attenuate business cycle fluctuations by lowering taxes or increasing expenditure in downturns, thereby increasing aggregate demand (and vice versa in upturns). When the fiscal policy stance is procyclical, fiscal actions amplify the business cycle—with expansionary fiscal policy during economic upswings and fiscal retrenchment adopted during economic contractions. But the business cycle also affects revenue, hence, understanding the discretionary part of policy requires removing the business cycle from the primary balance. This cyclically-adjusted primary balance is calculated in by first removing the cyclical component of expenditure and revenue.[49] Then to determine the fiscal stance this cyclically-adjusted balance is compared to the output gap, defined as the difference between actual output and a benchmark measure of potential output. The output gap is estimated using filters and the production function.[50]

---

[45] Stotsky and WoldeMariam, 1997; Kwaja and Iyer, 2014
[46] Cyan et.al, 2013, McNaab, 2021.
[47] Cyan et. al, 2013; Langford and Ohlenburg, 2015; Benitez et. al., 2023.
[48] See Annexure A1 for details.
[49] Burnside and Meshcheryakova, 2005.
[50] Burns et al. (2019)

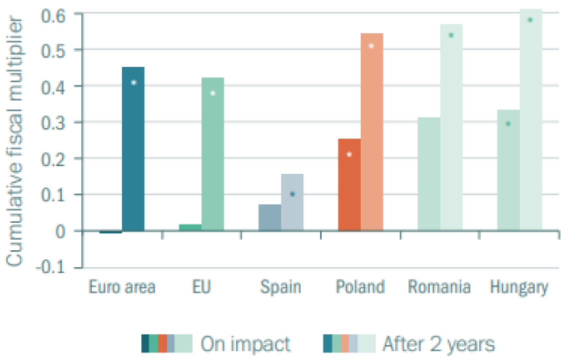
The PFR Data Visualization Tool is a comprehensive and user-friendly platform designed to enhance the analysis of public finances (currently in a pilot phase and used internally in the World Bank). It offers several key features that make it an invaluable resource for conducting PFRs. The tool is organized into data modules that present key information through tables and charts, covering areas such as the macro-fiscal profile, revenues, and expenditures. This modular approach ensures that users can easily navigate and access the information they need while answering core questions of the PFR. Additionally, the tool enables international benchmarking, allowing users to compare performance against countries with similar characteristics. This feature helps identify best practices and areas where improvements can be made.

The PFR Data Visualization Tool incorporates various analytical inputs, including tax potential and effort, spending efficiency among others. Findings from different analytical tools, discussed above, can be provided in the Data Visualization Tool. One of the primary benefits of the tool is its ability to offer data-driven insights through a comprehensive and visual representation of public finance data. This helps policymakers identify priority areas for spending, revenue mobilization, and policy reforms. The tool's comparative analysis feature allows for benchmarking against international peers, facilitating the identification of best practices and areas for improvement. Overall, the PFR Data Visualization Tool is an essential resource for the analysis and management of public finances, providing the insights needed to drive effective fiscal policies.

3.0 PFRs: Country Applications

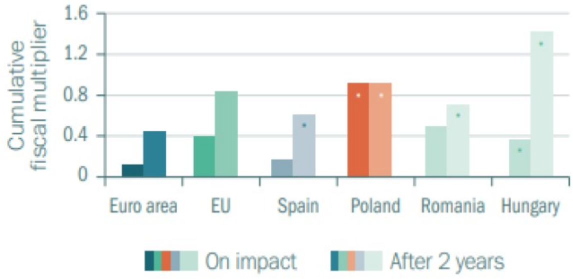
A key objective of PFRs is to direct public spending toward growth. In Poland, output responses to public spending are estimated to vary with the policy mix and business cycle phase[51]. Fiscal multipliers, measuring the output response to a unit increase in spending, are central to this analysis. Fiscal spending multipliers are particularly sensitive to the type of expenditures and the business-cycle phase. Government spending multipliers are estimated using a local projection model and range from 0.3 in the short term to 0.5 in the long term. These figures are comparable to those of other Central European economies and are larger than those in advanced EU countries (Figure 1). Notably, capital spending multipliers are nearly twice as large as the multipliers for total government expenditures, which has significant implications for the upcoming Next Generation EU funds (Figure 2). Consistent with the literature, both measures of spending multipliers for Poland are larger during recessions. Capital expenditure multipliers are particularly substantial during periods of weak labor markets, suggests that increased spending on public investment will be particularly impactful when the unemployment rate is above its trend level.

Figure 1: Total expenditure multipliers



Sources: David and Leigh (2018); Eurostat; World Bank.

Figure 2: Capital expenditure multipliers



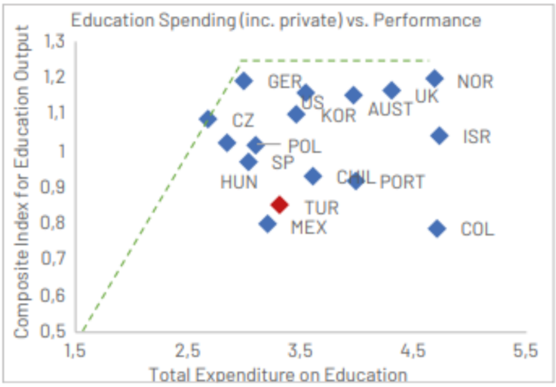
Sources: David and Leigh (2018); Eurostat; World Bank.
Notes: "*" indicate significance at 10% significance level; EU and euro area refers to aggregates for the European Union and euro area, respectively.

Note: Sourced from World Bank 2021, Poland Public Finance Review.

[51] World Bank 2021, Poland Public Finance Review.

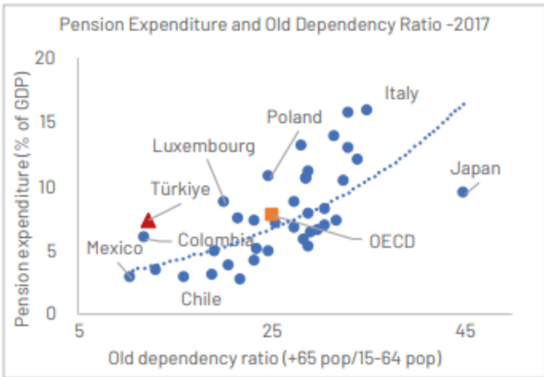
PFRs can explore the issue of long-term fiscal sustainability. The Türkiye PFR analyzes fiscal policy and performance trends in Türkiye, addressing current challenges and identifying priority reforms to restart long-term fiscal improvements.[52] The PFR can be summarized in six key messages. Macroeconomic instability warrants a change in the policy mix, allowing fiscal policy to play a larger role relative to monetary policy in stimulating short-term growth. Despite the modernization of the tax system, economic instability and tax complexity have reduced the efficiency of tax collections. Increased efforts are needed to address gaps in labor taxes, VAT, and Corporate Income Tax. While spending has gradually aligned with development needs, there is potential to spend both more effectively and more extensively (Figure 3). This is crucial given Türkiye's labor market challenges, evolving health needs, aging population, and social security demands (Figure 4). Türkiye has built strong human capital foundations. Advancing to the next stage will require a public expenditure approach that integrates social expenditures more systematically. Social assistance expenditures have supported poor and vulnerable households by providing access to basic income and services and helping them cope with adverse situations. However, there is room to improve the adequacy and coverage of these programs. More comprehensive taxation of pollution, including greenhouse gases, will raise revenue that can be used to compensate poor households for the effects of these pollution taxes.

Figure 3: Scope to improve efficiency



Sources: WB Staff, various sources (see chapter 3)

Figure 4: Big pressures from pensions



Source: WDI World Bank and OECD

Note: Sourced from World Bank 2023, Türkiye PFR.

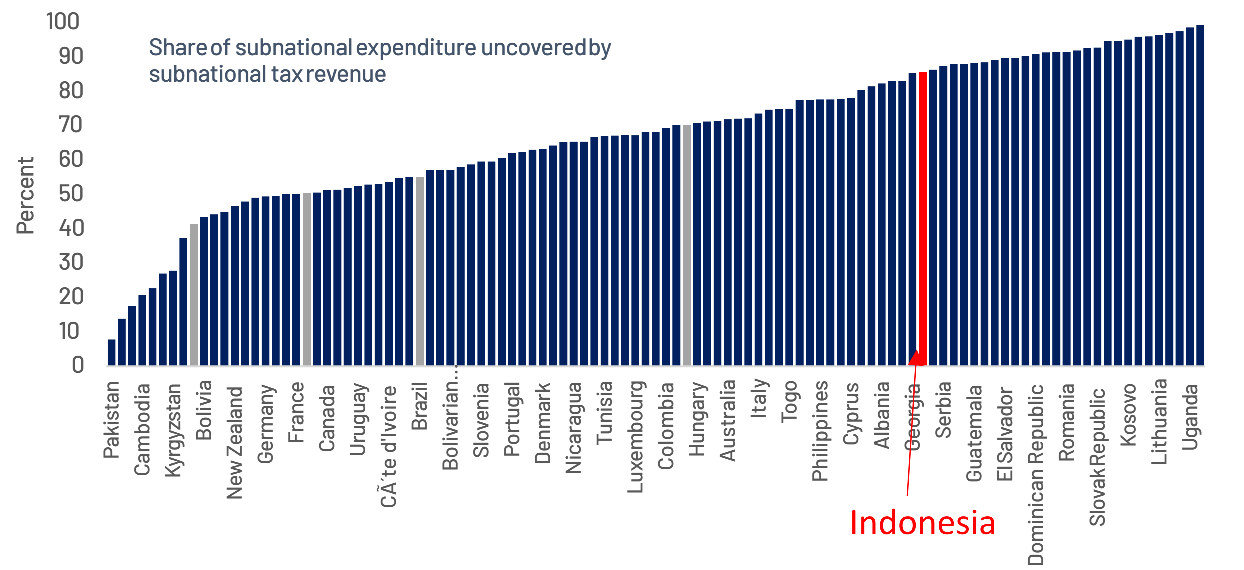
Revenue mobilization is a key issue explored in PFRs. Bulgaria's PFR provides insights into the fiscal landscape and highlights ways to boost revenue and health outcomes by improving VAT compliance and reforming health taxes.[53] It focuses on opportunities to increase revenue collection, particularly through addressing the value-added tax (VAT) compliance gap and optimizing health taxes on tobacco and alcohol products. A novel bottom-up study on Bulgaria's VAT gap suggests that top-down estimates may be too low, indicating a greater potential for increasing VAT revenues through improved audit processes and compliance activities. The study identifies taxpayer groups with high rates of VAT noncompliance, such as medium-sized businesses and certain sectors like services, agriculture, and companies not reporting their sector. It also notes that while current audits are effective in some areas, there is room to enhance audit programs to boost voluntary compliance and recover more unreported taxes. Health taxes are another underutilized revenue source in Bulgaria. Despite contributing 2.3 percent of GDP and 7.1 percent of total tax revenues, Bulgaria's excise rates on tobacco, spirits, and beer are among the lowest in the EU, with zero taxation on wine. Real income growth and stagnant excise rates have increased the affordability of these products, undermining health objectives. Simulation results indicate that an ambitious health tax reform could generate an additional 0.3 percent of GDP in revenue while reducing alcohol and tobacco consumption.

[52] World Bank 2023, Türkiye PFR.
[53] World Bank 2023, Bulgaria PFR.

4.0 PFRs: Subnational Applications

Subnational public finance does not address macroeconomic stabilization directly but draws on key principles of sound public finance (like efficiency) and raises issues like vertical fiscal imbalances. For instance, fiscal decentralization has often been more pronounced on the expenditure side than on the revenue side, creating vertical fiscal imbalances and limiting fiscal space (Figure 5 highlighting the case of Indonesia). Consequently, subnational governments must carefully assess their public finances. Subnational public finances are shaped by intergovernmental fiscal arrangements, which encompass four main interconnected dimensions: (i) revenue assignments; (ii) distribution of expenditure and service delivery responsibilities; (iii) intergovernmental transfer systems; and (iv) borrowing controls.

Figure 5: Indonesia: Vertical fiscal imbalances



Source: SNG-WOFI database; covering latest year (2020)

Note: (1) 2020 is the only year with available data; *(2) VFI = (subnational expenditure - subnational tax revenue) / subnational expenditure; (3) Data available on subnational tax revenue only.*

Asymmetries between revenue and expenditure decentralization are common in federal systems. Major tax bases, such as personal and corporate income taxes and consumption taxes, are more efficiently administered at the federal level due to their sensitivity. However, subnational governments (SNGs) are often better equipped to provide public goods and services tailored to local needs. This combination of centralized tax collection and decentralized service provision—known as "asymmetric decentralization"—creates vertical fiscal gaps in federal republics and decentralized fiscal systems worldwide.

In developing countries, large interregional disparities in socioeconomic conditions result in significant horizontal fiscal gaps, with lagging regions experiencing substantial differences between their revenue collection capacity and expenditure needs. Intergovernmental fiscal transfer systems are designed to mitigate vertical and horizontal fiscal gaps, equalize public service provision across regions, and advance national development goals. However, the heavy dependence of many subnational governments, especially in lagging regions, on intergovernmental transfers can be problematic. In developing countries, subnational entities rely on intergovernmental transfers for 60-70 percent of their total revenues, and in lagging regions, this dependence can reach 95 percent. With low revenue capacity and increasing spending needs for service delivery, subnational governments have very limited fiscal space for investment, which is mostly financed through borrowing[54]. To avoid unsustainable indebtedness, fiscal federalism arrangements include subnational debt regulations and, in some cases, subnational fiscal rules.

Given this context, subnational PFRs should address several key policy topics.

First, **revenue dependence** is crucial. An initial step is to measure a subnational government's reliance on transfers. Analyzing the revenue structure—comprising own revenue, tax revenue, fees, and user charges compared to intergovernmental transfers—provides a snapshot of fiscal autonomy. A detailed breakdown of intergovernmental transfers into revenue sharing, conditional, equalization, and capital transfers can offer a more accurate assessment of fiscal autonomy.

Fiscal capacity and tax collection effort are also important. Since SNGs' tax policies are limited by national revenue assignments, increasing fiscal capacity depends heavily on tax collection efficiency. The PFR tool for tax capacity helps determine whether a subnational government's tax collection efficiency is comparable to other jurisdictions with similar tax structures.

Intergovernmental transfers and tax collection efforts must be examined as well. Transfers can impact the recipient governments' tax collection efforts. Studies show a negative correlation between subnational governments' tax collection efforts and the share of intergovernmental transfers in total revenues. This analysis begins with calculating the tax collection capacity of state governments, followed by assessing the efficiency of tax collection as the ratio between observed and potential collections. Finally, this efficiency is correlated with the weight of transfers on total revenue.

Expenditure efficiency is another critical area. Measuring expenditure efficiency is straightforward in decentralized systems where expenditure responsibilities are similar across jurisdictions. This reduces the impact of non-observed characteristics in cross-country comparisons.

The relationship between **expenditure efficiency and intergovernmental transfers** is complex. While transfers aim to reduce vertical and horizontal fiscal imbalances, they can create perverse incentives for subnational governments. Research shows that transfers, compared to own tax revenue, tend to increase overall expenditures and government size. Many subnational governments rely heavily on federal transfers for current and capital expenditures, reducing incentives to improve spending efficiency. Since transfers are funded through federal taxes and perceived as free money, the quality of spending associated with them is often lower than with revenue raised through own taxation.

Expenditure rigidity is a significant concern. The decentralization of basic public service delivery responsibilities, such as education, health, and security, makes subnational budgets highly rigid due to labor-intensive services. Additionally, earmarked transfers for specific sectors limit the discretion of subnational governments in resource allocation. PFR tools can measure expenditure rigidity and identify whether it stems from mandatory spending increases, revenue earmarking rules, or both.

Finally, **subnational debt sustainability** must be assessed. Evaluating fiscal trends and projecting scenarios can indicate the sustainability of subnational public finances. Tailored MTFFs can consider projected expenditure needs, tax revenue capacity, and shared federal tax revenues. This assessment can also verify compliance with national fiscal rules for SNGs and assess risks of non-compliance.

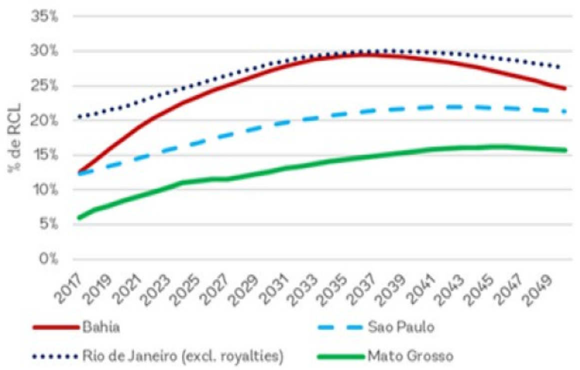
Subnational PFRs have assessed various sectoral issues. In Indonesia, a subnational education expenditure review[55] revealed that subnational governments have taken on a greater role in education management[56], replacing the central government in managing education service delivery within their jurisdictions. Consequently, the recommendations emphasized the need to: (i) reassess districts' financial and technical capacity in delivering education services, (ii) consolidate and prioritize education programs

[54] However, limited access to credit markets among certain SNGs, especially local governments or provincial governments in poor regions, requires that capital transfers finance a significant share of public infrastructure investment.
[55] World Bank 2020, Indonesia Subnational Education Public Expenditure Review.
[56] 60 percent of the education budget is managed by subnational governments.

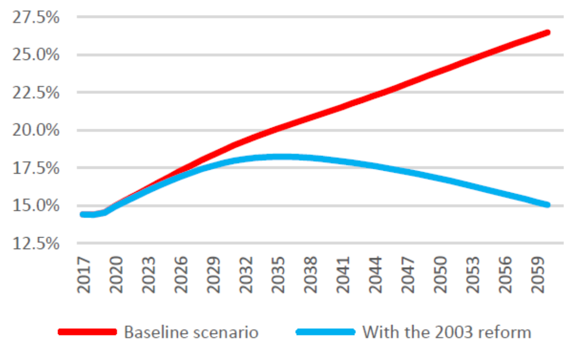
that effectively increase learning outcomes, and (iii) leverage technology to strengthen accountability. PFRs in Croatia and Peru (both under preparation) are evaluating expenditure efficiency in health, education, and urban services delivered by local governments. By analyzing expenditure levels allocated by local governments and output/service delivery indicators in these sectors, efficiency scores are calculated, enabling the identification of good performers and best practices. In Brazil, the analysis identified key challenges in managing pension spending at the state level, highlighting growing pension deficits and an increasing need for reform (Figure 6).

Figure 6: Projection of pension obligations in Brazil

6A: Pension deficits (%NCR), 4 States estimated by World Bank (PROST)



6B: Rio de Janeiro Municipality, Projected Pension System Deficit (% of Net Current Revenues)



Source: Policy Note on Intergovernmental Fiscal Issues, World Bank

5.0 PFR Data Visualization Tool - Subnational Customization for Indian States

One of the standout features of the PFR tool is its flexibility which allows it to be customized for the subnational level. The customization to Indian states will enable benchmarking public finance for a selected state against various peer groups. It allows states to compare their performance with relevant peers such as structural peers or peers based on geography (or any other criteria). Structural peers can be identified using K-means clustering,[57] with criteria such as per capita income and population. The tool leverages the Reserve Bank of India's state finances database as the primary source for public finance statistics, while also incorporating data from other sources like Ministry of Statistics and Program Implementation and NITI Aayog.

The example of the tool application in Uttarakhand provides valuable insights into how the tool can effectively analyze key questions related to the state's fiscal policy for growth and development. The key questions include: Whether sufficient funds are allocated to welfare schemes and capital outlays; how does spending on education and health compare with peer states[58]; whether existing social spending should be increased or there is a scope to improve spending efficiency; how Uttarakhand's own tax revenues and central government support compare to peer states; evaluating the resilience of its macro-fiscal position. The Uttarakhand example is provided solely for illustrative purposes to demonstrate how the tool can be utilized. No specific inferences should be drawn from the findings presented, as they are still subject to further review and analysis.

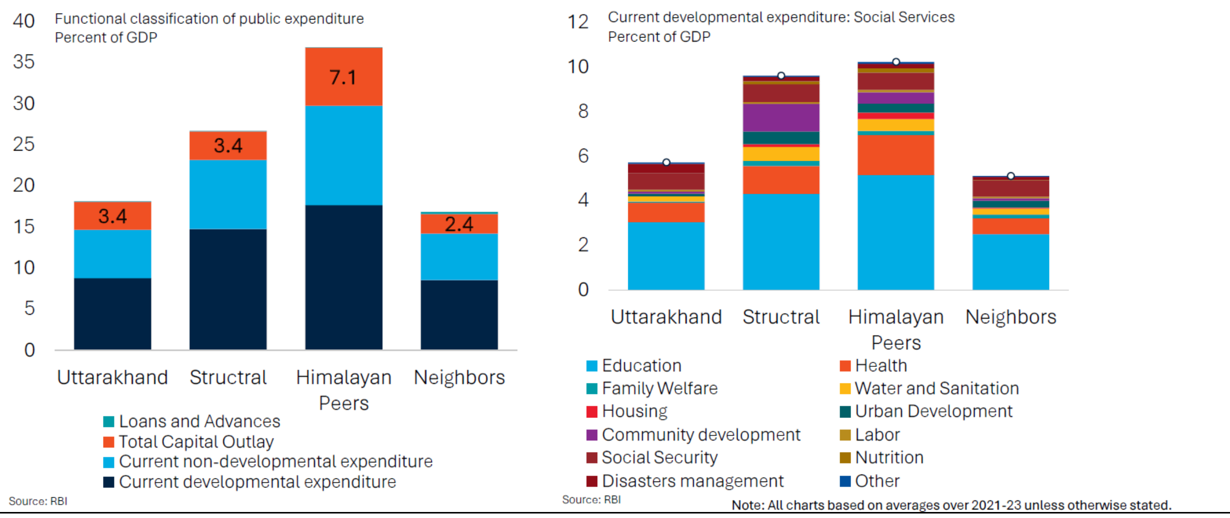
[57] K-means clustering is a machine learning algorithm used for partitioning a dataset into a pre-defined number of clusters. The goal is to group similar data points together and discover underlying patterns within the data.

[58] For structural peers, we use per capita income and population as the criteria. We also include Himalayan/Hilly states and Neighbors as additional peer groups.

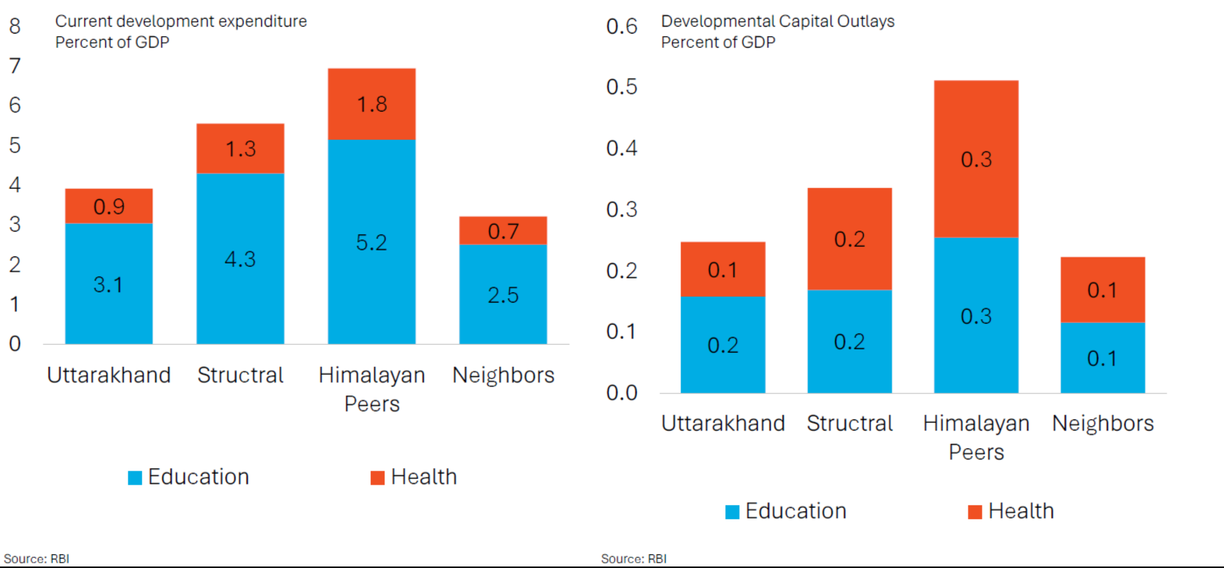
For each of these questions, illustrative figures from the PFR Data Visualization Tool are provided to show the potential value of the tool in facilitating such analysis. In Figure 7, the first question is addressed by comparing the state's capital and current development expenditures across different types with its structural peers, Himalayan peer states, and neighboring states. The third question is tackled by comparing the state's educational outcomes and educational spending per capita against the efficiency frontier, which is drawn based on all other states (leftmost figure). Additionally, potential gains from improving spending efficiency by closing the gap with the frontier are illustrated (rightmost figure). The fourth question is answered by comparing revenue collections by type against peers. Finally, the macro-fiscal profile is analyzed by providing a table with indicators on macro performance, including real GDP per capita, economic growth by key sectors, fiscal snapshot with key indicators like fiscal balance and total liabilities, and additional indicators on poverty and climate, which can be further tailored to the state-specific context.

Figure 7: Uttarakhand: Fiscal Policy for Growth and Development

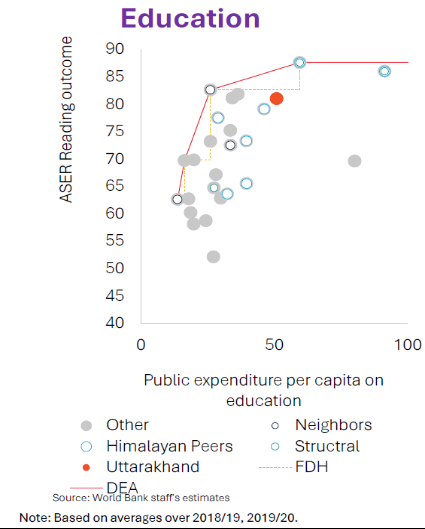
Q1: Are we allocating sufficient funds to welfare schemes and capital outlays?

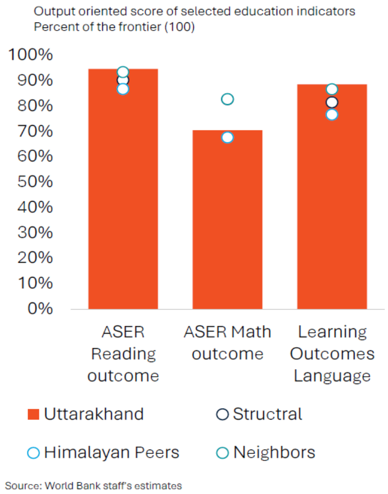


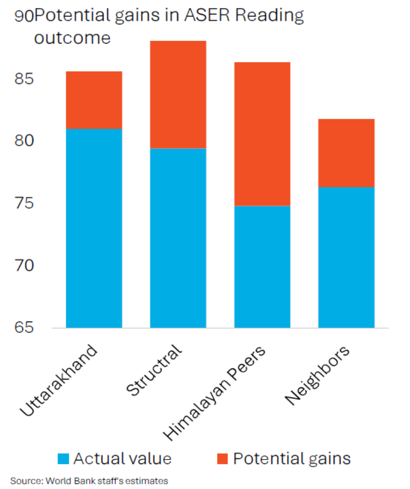
Q2: How does our spending on education and health compare to that of our peers?



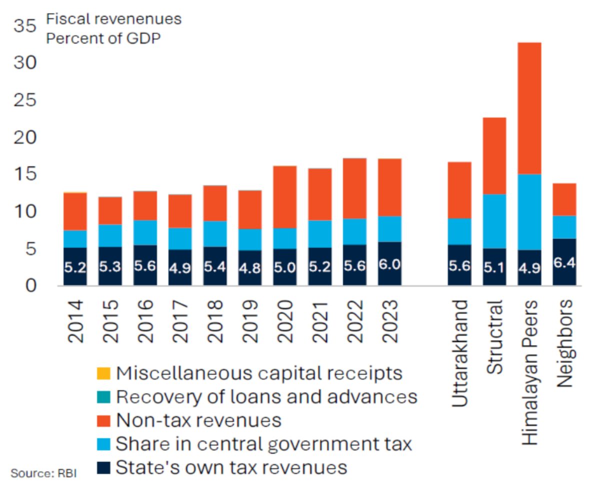
Q3: Should we increase spending or focus on improving the efficiency of existing expenditures?

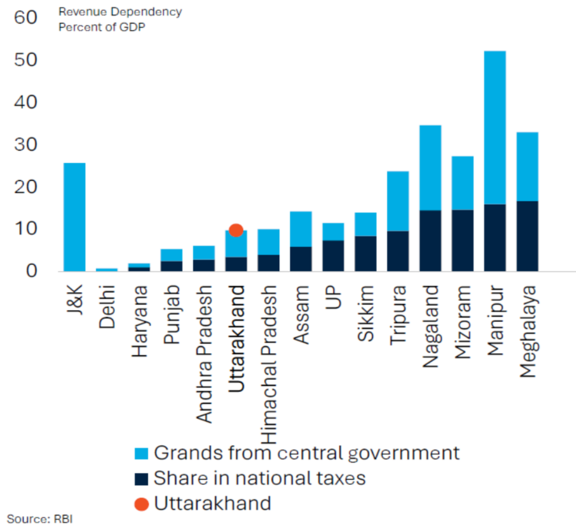






Q4: How do our own tax revenues and support from the central government stack up against other states?





Q5: Is our macro-fiscal position resilient compared to our peers? Where are the gaps?

Key economic indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Period average, 21-23: Uttarakhand	Structral	Himalayan Peers	Neighbors
Growth of real per capita income	5.4	7.0	9.1	6.6	1.5	0.4	-15.3	9.8	6.6	6.5	7.6	8.5	6.6	6.7
GDP growth, percent	5.3	8.1	9.8	7.9	2.8	2.0	-12.1	10.5	7.6	7.6	8.6	9.1	8.1	7.9
Sector decomposition, percentage points														
Agriculture	0.0	-0.2	0.4	0.0	0.2	0.3	0.1	0.0	-0.2	0.1	0.0	0.6	0.3	0.6
Industry	1.6	3.7	5.0	3.8	0.3	-0.5	-6.0	5.1	3.7	4.3	4.4	3.7	3.1	2.4
Services	4.8	5.8	4.5	4.2	2.9	3.4	-6.7	7.2	5.5	4.2	5.6	5.7	5.5	5.0
Other	-1.1	-1.2	-0.1	-0.1	-0.6	-1.3	0.5	-1.8	-1.3	-1.0	-1.4	-0.9	-0.7	0.0
Inflation	5.0	3.2	3.7	3.9	4.0	5.8	8.1	5.1	6.5	5.6	5.7	5.8	5.1	5.4
Fiscal revenues, percent of GDP	12.7	12.0	12.8	12.3	13.6	12.8	16.1	15.8	17.2	17.2	16.7	22.8	32.8	13.9
Total expenditures	16.3	15.5	15.6	15.9	16.7	16.0	18.4	17.2	19.9	19.9	19.0	26.7	37.2	17.2
Total current expenditure	13.1	13.0	13.0	13.2	14.0	13.7	15.7	14.3	16.4	15.8	15.5	23.2	30.0	14.6
o.w. interest payments	1.5	1.7	1.9	1.8	1.9	1.9	2.0	1.8	2.0	1.9	1.9	2.1	2.3	2.0
Capital Outlay	3.1	2.4	2.5	2.7	2.7	2.3	2.8	2.8	3.5	3.9	3.4	3.4	7.1	2.4
Loans and Advances by State Governments	0.1	0.0	0.1	0.0	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.3
Fiscal balance	-3.6	-3.5	-2.8	-3.6	-3.2	-3.2	-2.3	-1.4	-2.7	-2.7	-2.3	-4.0	-4.3	-3.3
Primary balance	-2.1	-1.8	-0.9	-1.8	-1.2	-1.3	-0.3	0.4	-0.7	-0.9	-0.4	-1.9	-2.0	-1.3
Total liabilities	21.1	22.7	22.8	24.1	25.8	28.2	31.8	29.4	29.2		29.3	38.9	36.8	30.1
GDP per capita (in '000)	141.3	152.7	167.7	181.0	186.1	189.7	166.8	184.3	198.3	213.4	198.7	307.2	78.6	625.1
Multilateral porvety index		17.7				9.7			6.9		6.9	3.9	9.0	6.8
Climate Vulnerability Index								0.5			0.47	0.55	0.54	0.50

Source: MOSPI, RBI State Finance Database, NITI, DST.

Source: World Bank's PFR Data Visualization Tool.
Note: The figures are for illustrative purpose only and authors intend to provide no interpretations.

6.0 Concluding Remarks

Public Finance Reviews (PFRs) are comprehensive assessments aimed at evaluating a government's fiscal policies and public finances. PFRs assess fiscal sustainability, revenue and expenditure profiles to enhance efficiency and transparency. They provide data-driven insights for policy reforms, promoting long-term fiscal health and effective public fund allocation. PFRs involve data collection, diagnostics, benchmarking, and policy recommendations, covering macro-fiscal issues, revenue, spending, green transition, and fiscal risk management.

Subnational PFRs should address key policy topics, including revenue dependence, fiscal capacity, and tax collection effort. Measuring a subnational government's reliance on transfers and analyzing its revenue structure provides insight into fiscal autonomy. Efficiency in tax collection is crucial, as SNGs' tax policies are limited by national assignments. Intergovernmental transfers can impact tax collection efforts, often negatively correlating with tax collection efficiency. Expenditure efficiency and rigidity are also critical, with transfers potentially creating perverse incentives and rigid budgets. Finally, assessing subnational debt sustainability through fiscal trends and tailored MTFFs is essential to ensure compliance with national fiscal rules and manage risks.

Subnational PFRs can also be useful for understanding regional disparities and tailoring fiscal policies to local needs. The PFR Data Visualization Tool's subnational customization feature allows for benchmarking Indian states against various peer groups, enabling a more granular analysis of fiscal performance. States can compare their spending on education, health, and welfare schemes with that of structural and geographical peers. By leveraging data from the Reserve Bank of India, MOSPI, and NITI Aayog, the tool provides a comprehensive view of state finances. This enables states to assess the efficiency of their expenditures, identify gaps in their macro-fiscal position, and make data-driven decisions to enhance growth and development. Subnational PFRs can thus play a vital role in fostering regional development and ensuring that fiscal policies are both effective and equitable.

Potential extensions of the tool could enhance its capabilities and provide deeper insights. These extensions include assessing tax potential and tax efficiency to identify areas for revenue improvement, fiscal savings analysis to lower fiscal costs of wage bill, pension payments, purchases of goods and services, capital spending, and social protection payments, analysis (and compliance) of subnational fiscal rules, subnational debt management, fiscal risks analysis, total carbon pricing to evaluate environmental impacts, analyze sectoral spending efficiency to optimize resource allocation, and examine budget rigidity to identify constraints in fiscal flexibility. It should be noted that the Data Visualization Tool is one component of the PFR toolbox, which can be used independently and flexibly to benchmark and analyze the fiscal performance of any state. However, the additional enhancements would enable a more comprehensive public finance review.

References

1. Benitez, Juan Carlos, Mansour, Mario, and others (2023). Building Tax Capacity in Developing Countries. Staff Discussion Note SDN/2023/006. International Monetary Fund, Washington, DC

2. Burns, A., Campagne, B., Jooste, C., Stephan, D., and Bui, T., 2019. The World Bank Macro-Fiscal
3. Model Technical Description. Policy Research Working Paper No. 8965. Washinton, DC: World Bank.

4. Burnside, C. And Y. Meshcheryakova (2005): "Cyclical Adjustment of the Budget Surplus: Concepts,"
5. Fiscal sustainability in theory and practice: a handbook, 396, 113.

6. Cyan, Musharraf, Jorge Martinez-Vazquez, and Violeta Vulovic (2013). "Measuring tax effort: Does the estimation approach matter and should effort be linked to expenditure goals?".

7. Jondrow, J., Lovell, C.A.K., Materov, I.S. and Schmidt, P. (1982): "On the Estimation of Technical Inefficiency in the Stochastic Frontier Production Function Model", Journal of Econometrics, 19, pp. 233-238

8. Kapsoli, Javier, Tewodaj Mogues, and Genevieve Verdier (2023) “Benchmarking Infrastructure using Public Investment Efficiency Frontiers” IMF Working Paper WP/23/101.

9. Khwaja, M. S., & Iyer, I. (2014). Revenue potential, tax space, and tax gap: a comparative analysis. World Bank Policy

10. Langford, Ben, and Tim Ohlenburg (2015). Tax revenue potential and effort. International Growth Centre Working Paper.

11. McNabb, Kyle, Michael Danquah, and Abrams ME Tagem (2021). Tax effort revisited: new estimates from the Government Revenue Dataset. No. 2021/170. WIDER Working Paper.

12. Simar, L., and P. Wilson (1998) Sensitivity analysis of efficiency scores: How to bootstrap in non-parametric frontier models. Management Science. Vol. 44, No. 1, January

13. Simar, L., and P. Wilson (2000). Statistical Inference in Nonparametric Frontier Models: The State of the Art. Journal of Productivity Analysis 13, 49–78.

14. Stotsky, Janet G. and Asegedech WoldeMariam (1997) "Tax Effort in Sub-Saharan Africa." IMF Working Paper. The International Monetary Fund: Washington, DC.

15. World Bank. 2020. Indonesia Subnational Education Public Expenditure Review (English). Washington, D.C. : World Bank Group.

16. World Bank. 2021. Poland Public Finance Review (English). Washington, D.C. : World Bank Group.
17. World Bank. 2023. Bulgaria Public Finance Review 2023. © Washington, DC: World Bank. http://hdl.handle.net/10986/40804 License: CC BY-NC 3.0 IGO.

18. World Bank. 2023. Türkiye Public Finance Review : Leveraging Fiscal Resources for Stability and Resilience (English). Washington, D.C. : World Bank Group.

Annex:

Table A1: List of datasets used in the subnational PFR Data Visualization tool.

Data	Source
State's public finance data including expenditure (functional classification) and revenue categories	RBI State finance database
State's macroeconomic data: GDP, Sectoral GVA (Agri, industry, services)	MOSPI, CEIC
State-wise Population	MOSPI
State Consumer price index	MOSPI
Multidimensional poverty index	NITI Aayog
State-wise total liabilities	RBI
Wages and Salaries, Expenditure on Operations and Maintenance, Social sector expenditure	RBI
Climate Vulnerability Index	DST
State Energy and Climate index with 6 dimensions: DISCOM Performance, Access, affordability and reliability, Clean Energy Initiatives, Energy Efficiency, Environment Sustainability, New Initiatives.	NITI Aayog
Cyclical component of current spending, capital outlays, loans and advances, real GSDP	WBG Staff Estimates
Potential component of current spending, capital outlays, loans and advances, real GSDP	WBG Staff Estimates

A1: Spending efficiency measures

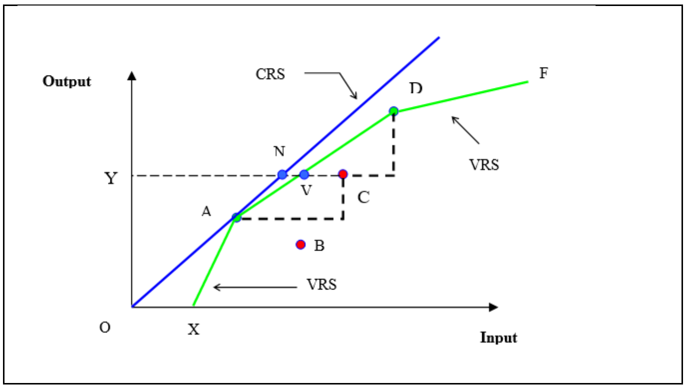
Efficiency is commonly computed using parametric or non-parametric methods and categorized as stochastic or deterministic. The parametric approach assumes a specific functional form for inputs, outputs, and inefficiency, while the non-parametric method calculates the frontier directly from the data without functional assumptions. Parametric methods rely on econometrics, and non-parametric methods use mathematical programming. Deterministic models attribute all deviations from the frontier to inefficiency, whereas stochastic models account for both inefficiency and random shocks. This analysis uses both parametric and non-parametric methods.

(a) Non-parametric approach

(i) Data Envelope Analysis (DEA) and Free Disposal Hull (FDH)

Data Envelopment Analysis (DEA) assumes convexity in the production set, creating a piecewise linear frontier that connects efficient decision-making units (DMUs). In contrast, the Free Disposal Hull (FDH) method does not assume convexity, resulting in a step-wise frontier. For example in Figure A1, DMU C is evaluated against real performers A and D, as well as a virtual DMU, V, which is a weighted combination of A and D. While C would be efficient under FDH, it falls below the DEA frontier, XADF, which reflects variable returns to scale (VRS, further defined below), leading to lower DEA efficiency scores. The input-oriented technical efficiency of C is defined as TE = YV/YC.

Figure A1. DEA and FDH Production Possibility Frontier



In this analysis, we focus on variable returns to scale (VRS). Under constant returns to scale (CRS), the efficient frontier is represented by a ray from the origin through the efficient DMU (ray OA), making only A efficient. The VRS frontier (XADF) captures increasing returns to scale (IRS) on segment XA and decreasing returns to scale on segments AD and DF. CRS technical efficiency (CRSTE) equals the product of VRS technical efficiency (VRSTE) and scale efficiency (SE). For example, DMU D is technically efficient but scale inefficient, while DMU C is neither.

(ii) Bootstrapping DEA and FDH

The limitations of the non-parametric method primarily stem from its sensitivity to sampling variability, data quality, and the presence of outliers. To address these issues, we calculated efficiency scores using different samples, such as including and excluding advanced economies, removed outliers, and applied both non-parametric and parametric approach. While standard DEA is deterministic and doesn't account for random errors, potentially biasing efficiency estimates, Simar and Wilson (1998, 2000) recommended using bootstrapping to enhance DEA and FDH estimate reliability. Bootstrapping simulates the data generation process to create replicate samples, forming a distribution for more accurate parameter estimation and bias correction. By repeating the bootstrap procedure 2,000 times, we establish confidence intervals for the efficiency scores, mitigating the upward bias inherent in DEA and providing more reliable insights.

(b) Parametric approach

Stochastic frontier analysis (SFA) constitutes the flagship approach of the parametric family of frontier estimation methods. As in any parametric model, the SFA is based on assumptions about the model's functional form and its underpinning distributions Kapsoli et al (2023). In the case of cross-sectional data, in the case of its analysis, the canonical SFA model is given as:

$$ln\, y_i = \beta_0 + \sum_{n=1}^{N} \beta_n\, ln\, x_{ni} + V_i - U_i. \qquad (4)$$

Let $E_i = V_i - U_i$, where E_i is referred to as the "composed error", $V_i \sim N(0, \sigma_V^2)$ is a two-sided "noise" component that captures features like measurement and specification errors in the model, and $U_i \sim F$ is the non-negative technical inefficiency component of the composed error term (see, Jondrow et al., 1982). The user must make an assumption about the distribution $\boldsymbol{F}$ of the inefficiency term to make the model estimable. There are several options to choose from including the half-normal distribution, exponential, truncated normal, and the Gamma distribution. Practitioners often select the half-normal distribution. The model represented by equation (4) is referred to as the composed error model since the error term E_i comprises two terms.

State Forum 2024

INNOVATIONS BY STATES

11

Impact of National Pension System (NPS)-Old Pension Scheme (OPS) on the fiscal sustainability of states and on the financial prospects of civil servants when they retire.

Noorul Quamer, IAS 2020 batch
Currently Deputy Secretary Finance
Government of Andhra Pradesh

Introduction

Section 1: Pay and emoluments of civil servants

The pay of the civil servants in India consists of basic pay, Dearness Allowance (compensation for Inflation), House Rent Allowance and myriad range of other 40 different allowances. The civil servants are also entitled for healthcare benefits, Leave Travel Compensation and various retirement benefits.

The pay of the civil servants are determined by a commission which government generally appoints every ten years. Currently for the central government employees, seventh pay commission which came into effect in Jan-2016 is in operation. Various state government follows different timelines for pay commissions, some of which are synchronised with central pay commission, while other states revises more frequently. The detailed 7th pay matrix is annexed (Annexure-1)

The pay of the civil servants are bottom heavy with the maximum pay only 13.89 times of the minimum pay. It is one of the flatest pay structure in the world. The minimum pay is 18,000 plus DA (currently 50% DA), which is 100% more compared to the entry level pay in the corporate sector which pays just the statutory minimum pay which currently ranges from Rs 10,000-18,000 in different states. While the maximum pay for civil servant is Rs 4.5 million currently (of Cabinet Secretary) in the corporate sector it touches Rs 100 million, which is more than 20 times.

The attractive initial pay, assured pay at the month end and security of employment attracts young talent to the Indian civil services.

Section 2: Pensions for civil servants

The pension for civil servants are kind of salary paid post-retirement. Historically states in the pursuit of its objective to function as a model employer, were the first to assume the responsibility to support the civil servants and their families when they retire. Accordingly in majority of the countries, civil services pension predates pension offered by the other private establishments.

Throughout the world, civil servants pension vary considerably due to various reasons mainly their historical experience and political systems. In most countries civil servant pensions continue as separate scheme even after introduction of broad based social security schemes. Since World War-II, separate generous civil services pension attracts severe criticism especially in the backdrop of development of social security systems based on equity and resurgence of rightist politics in major economies of the world.

The pension systems can be divided into mainly two groups

1. Defined Benefit Pension Plan: The simplest form of this can be some fixed percentage of last drawn / average salary.
2. Defined Contribution Pension Plan: The employer and employee contribution is defined based on certain formula and pension payout depends on accumulated corpus and market conditions.

Efforts to reform the civil services pension throughout the world has intensified from the last 25 years or so. Many countries have introduced higher retirement age, or longer service periods, increasing employee contribution rates etc.

Pension reforms involve mainly the following points

1. Moving from unfunded to partially to fully funded pension requiring contribution from employers and employees
2. Moving from Defined Benefit to Defined Contribution
3. Integrating the civil services pension with the common social security schemes

Section 3: The old Pension Scheme (OPS)

From time immemorial, the social security system in India is inbuilt in it's culture through the joint family system, where the young generations take cares of financial as well as caregiving needs of the older generations.

The formal pension system evolved in India during the colonial times, where pensions were introduced for the civil servants of British administration. India continued the inherited pension system (which is now called Old Pension Scheme in comparison to National Pension System) till a major overhaul in 2003-2004 mainly necessitated by public finance constraints.

India's OPS paid 50% of last drawn salary as pension subject to certain conditions. Pension also included Dearness Relief (equivalent to Dearness Allowances to compensate for inflation) and the base of the pension was revised periodically as a part of the revision as recommended by the "Pay Commissions'. After the death of the service pensioner, the family members got 50% of service pension subject to certain conditions.

The old pension scheme ensured that the purchasing power parity of the retired civil servants remained intact during the continuation of the same pay commission and purchasing power increased after the implementation of the next pay commission as the pension increased by a factor after subsuming the dearness relief.

Section 4: The National Pension System (NPS), An Overview

As the OPS increasingly became unaffordable the government of India had appointed a committed popularly known as "OASIS- Old Age Social & Income Security Committee". Appointment of this committee is considered as the first serious attempt to overhaul the OPS. The committee recommended to introduce defined contribution scheme in the place of defined benefit scheme and named the system "New Pension System". The recommendation of the OASIS committee was reiterated by the Report of High Level Expert Group on New Pension System, Govt. of India- 2002 and finally by B.K. Bhattacharya Committee. Current National Pension System is on the similar lines.

National Pension System is a defined contribution scheme with the following features:

- The employee contributes 10% of their pay while the government contributes 14% of the pay of the employee (some state govt only 10%)
- The combined contribution is being invested in specially designed funds for the purpose in the name of the civil servant
- On retirement the accumulated corpus becomes the base on which pension can be fixed

The employee must buy annuity of at least 60% of the corpus which will be like a pension. Employee may chose from range of available options. Remaining 40% is withdrawable at the option of civil servant as a lump-sum amount.

The NPS has ensured that India has achieved almost all the objective of pension reform namely

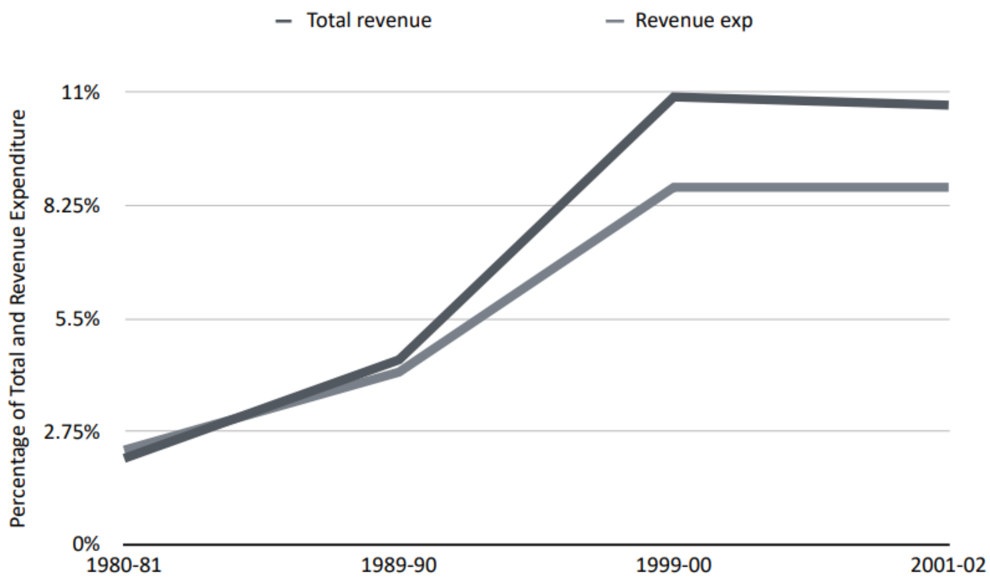
- Reducing pension liability for the government
- Shifting towards advanced funding instead of PAYG model
- Portability of pension systems between various pension funds and different employers in a life cycle mode
- Harmonising compensation component to attract and retain talent

The NPS is having limitation only in the last of the objective of pension reform, of-course which has a fine trade-off between pension liabilities for the government

Section 5: Significance of NPS and need to study NPS

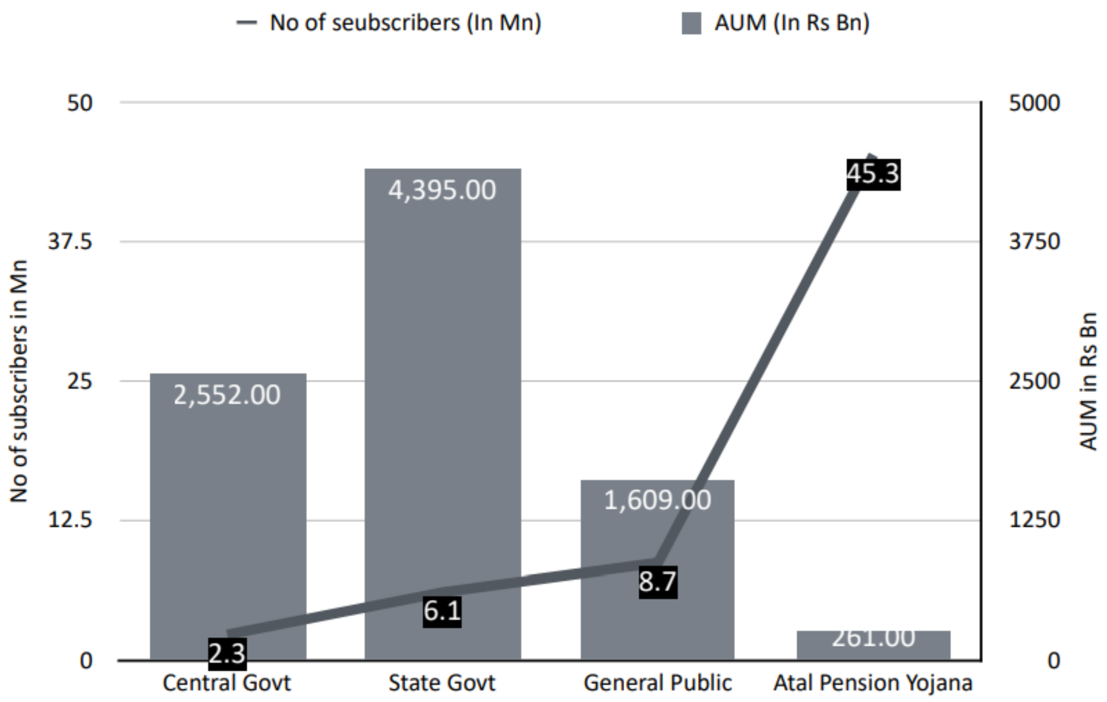
The NPS is defined contribution scheme which pays pension out of the accumulated corpus. The NPS was adopted on the backdrop of LPG (Liberalisation, Privatisation and Globalisation) adopted by government of India in 1991 and subsequent focus on market based solutions for the key issues faced by the country.

The scheme has contributed to strengthening the fiscal position of the respective governments and has entailed fiscal responsibility and intergenerational equity. NPS scheme is ensuring that the cost of pension is being recovered and provision made during the working phage of the employees, while the OPS was pay-as-you-go model, paid out of current taxes to the employees who rendered services in the past.



Graph 2: Pension payments as a % of Total Revenue receipts and expenditure of the state government[59]

The expenses on the OPS has sharply increased from 2% of total revenue in 1980-81 to 11% in 1999-01 of total revenue of the states thus leaving smaller amount for undertaking the developmental work for the general public.



Graph 3: Number of subscribers and AUM in NPS schemes in various sectors (All figures as on March-2023)[60]

The institutional framework of NPS has given government an option to introduce social security schemes for the uncovered masses in low cost and affordable manner. Small ticket investments using the power of digital technologies (JAM- Jan Dhan Accounts, Aadhaar and Mobile) has enabled the access of social security to the poorest of the poor.

This reforms in one hand has emboldened the prudence of fiscal proprietary of the respective governments, while on the other hand has negatively impacted the employees prospects in the following major ways compared to the OPS

- As NPS is defined contribution scheme, the employee has to contribute out of their salary, thus reducing their disposable income
- The accumulated amount is being invested in the market, thus the supposed corpus is subject to market risk
- Out of the corpus, the employees has to purchase annuity which is further subject to market risk

Combined effect of these has led to dissatisfaction among the employees thus leading to demand to restore the old pension scheme.

[59] Source: Report of the Group to Study the Pension Liabilities of the State Governments chaired by B.K Bhattacharya report, Oct 2003

[60] PFRDA press release https://pib.gov.in/PressReleasePage.aspx?PRID=1905533

The OPS-NPS conundrum has become a hot potato political issue with five Indian states already reverting back from NPS to OPS and some may be awaiting.

Methodology

Section 1: Objective of the research paper and primary research questions

The primary objective of this research paper is to understand the OPS and NPS and how these schemes impact the fiscal position of government and financial prospects of the employees when they retire.

We have posed the following substantive questions

1. Is the current structure of the NPS is efficient and effective?
2. What has been the impact of implementation of NPS
    1. On the fiscal position of the government
    2. On the financial prospects of the employees after retirement
3. Is the OPS affordable for the government?

Section 2: Primary data

The present paper uses robust excel model to forecast the pension payout on various assumptions.

The data generated through primary sources has been used extensively to argue the case for civil servants, since there are lack of quality research papers on the impacts of OPS-NPS on the financial prospects for the civil servants when they retire.

Further, the case study of Andhra Pradesh has been prepared by analysing the primary data using the financial modelling.

Section 3: Secondary data collection

The study is relying on the extensive use of secondary data collected from various online sources. Reliable sources of data are available to study the NPS systems, while OPS research papers by renowned academicians and institutes are widely available. Main sources are described below:

1. **Annual Reports of NPS Trust**

NPS Trust's annual reports, featuring data from low-cost, digitally managed transactions, provided insights into the system's governance, efficiency, and effectiveness.

2. **RBI Reports on the questions of OPS-NPS**

The RBI report "Fiscal Costs of Reverting to the Old Pension System by the Indian States – An Assessment-2023" by Solanki (2023), offered essential data and analysis on the financial impacts of transitioning from NPS back to OPS.

Research findings and Analysis

Section 1. Is current structure of NPS efficient and effective?

a) Is the Current NPS structure efficient?

The efficiency of the NPS structure is planned to be answered using two matrices

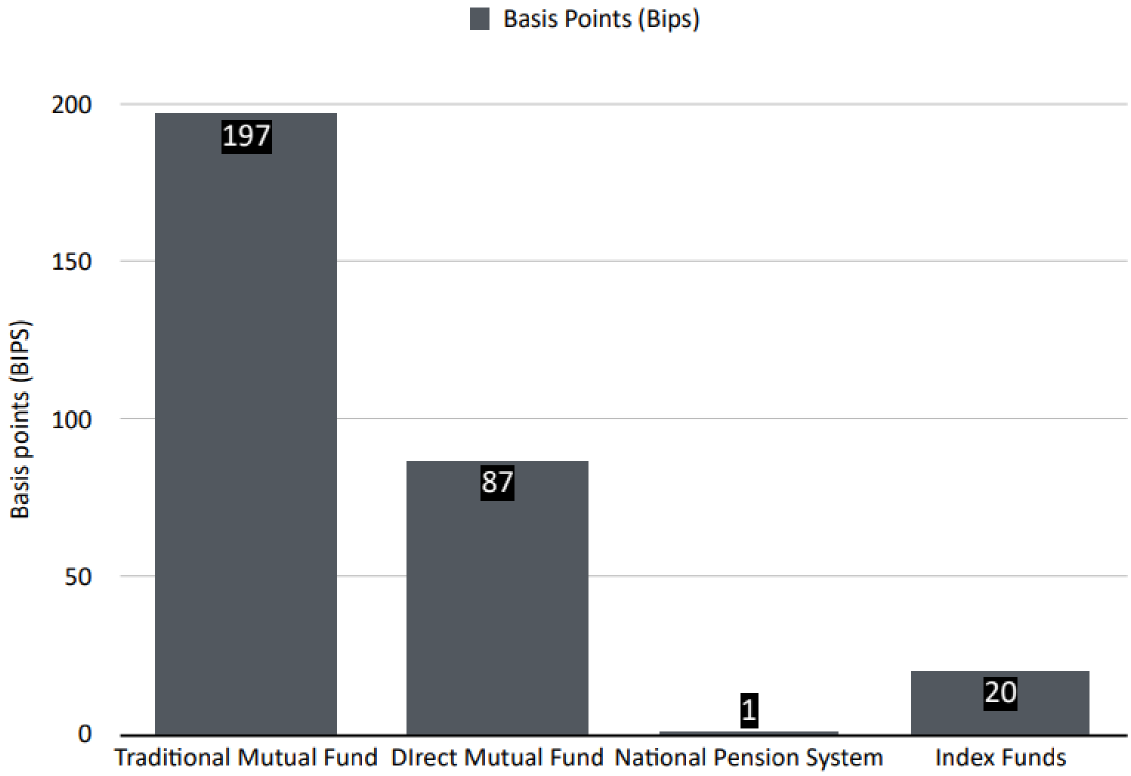
A. Comparison of expense ratio of NPS with other funds

B. Comparison of gross rate of returns on the NPS and benchmark indices

1. Comparison of expense ratio of various funds

The expense ratio is "the charge the fund management company charges from the investors to manage the funds" and generate profit on behalf of the investors.

Component of the expense ratio are:- management fees, administrative and compliance costs, distribution cost etc.



Graph 4: Showing expense ratio of various funds per year[61]

Regular Mutual fund (ELSS category) charges on average 197 basis points, while the new age Direct Mutual Fund charges on an average 87 basis points, even the passive Index Fund charges 20 basis points, whereas NPS charges impressively low 1 basis points as expense ratio.

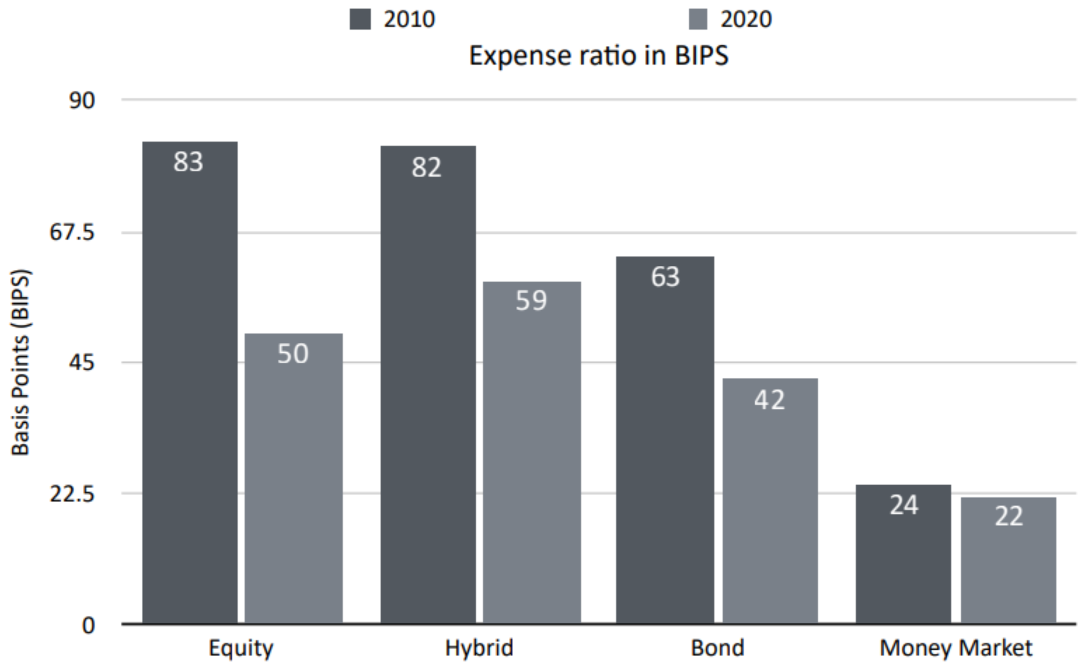
Following are the reasons for impressively low fund management charges for the NPS

1. Impressive volume
2. Predictable inflow of the funds
3. Zero cost inflow into the fund house, zero transaction cost
4. Robust NPS architecture consisting of specialised agencies
5. Zero / negligible advertisement cost for the fund managers

The extraordinary small expense ratios of NPS is much smaller even compared to the average expense ratio of the matured markets like the US where the volumes are high and the fund managers chase the smaller

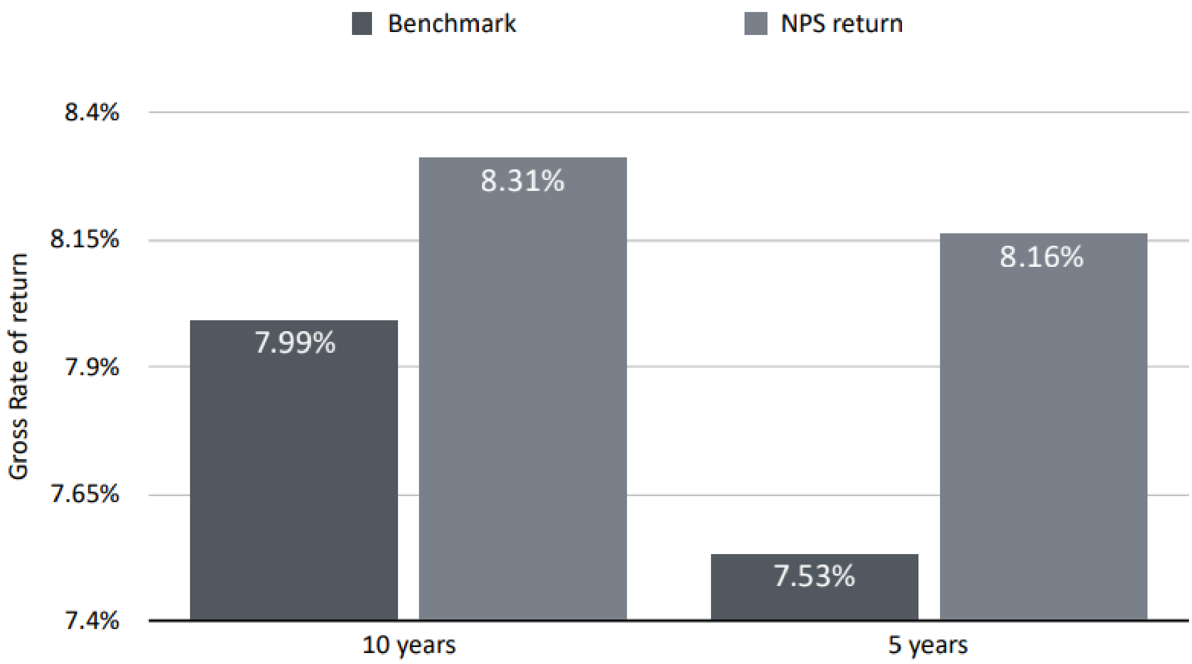
[61] Source: https://primeinvestor.in/mutual-fund-expense-ratios-direct-vs-regular/

returns compared to the higher returns in India. The rates have come down but still incomparable to NPS rates.



Graph 5: Showing the expense ratio in BIPs of various class of mutual funds in the US market (Source: ICI RESEARCH PERSPECTIVE, Mar-2021, Vol 27, No.3)

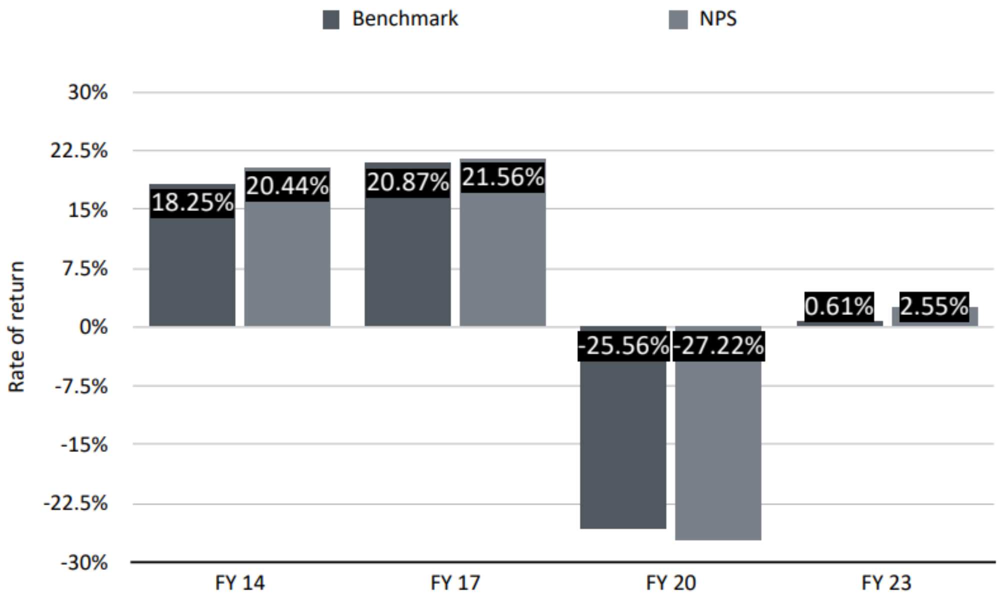
2. Comparison of rate of return on various funds



Graph 6: Showing gross return on benchmark and NPS on similar mix of securities (80% G-sec and 20% state development loans)[62]

The graph 6 clearly shows that, in the G-sec and state development loan funds, the NPS has taken impressive lead in the 10 years as well as 5 years rate of return from the benchmark index in the same ratio. This may be due to the impressive size of the NPS fund managers investing in fixed income securities compared to other small funds investing in these fixed income securities and their smaller transaction costs.

However, the same impressive lead is not visible in the NPS investment returns in the equities market (Graph 7), mainly due to the more volatile nature of the equites market and considerable depth of the market which gives no advantage to even the NPS fund managers.



Graph 7 : Showing gross return on benchmark and NPS on equity7

The above analysis shows that expense ratio under NPS is unmatchable and is merely 1 basis points, the nearest competitor, the index funds are 20 times more expensive. However, in terms of returns, the NPS has a little edge on other investment vehicles that may have arisen from the better quality of research and prudence guidelines. Overall, at-least 20-30 BIPS lead in expenses ratio gets converted into the better returns for the investors thus making NPS architecture efficient.

b) Is Current NPS structure effective ?

The effectiveness of the NPS structure would be answered using the best in class fund management and administrative structure comparisons and the data on the voluntary adoption of the NPS by common citizens and corporates would be taken as a proxy of the effectiveness of the NPS architecture.

The NPS architecture almost in its totality was set-up on the recommendation of the Project OASIS of the Ministry of Social Justice and Empowerment. The following are the institutional framework of the NPS architecture

1. **FRDA**

[62] Source: Page No 62 https://www.npstrust.org.in/sites/default/les/annual-reports-document/ 6 V16-Annual_Report_of_NPS_2023.pdf

PFRDA stablished in 2003 and given statutory status in 2013, PFRDA regulates the pension sector, including NPS.

2. **NPS Trust**

Registered by PFRDA, the NPS Trust is the legal owner of NPS assets, with subscribers as beneficial owners. Pension funds operate on behalf of the Trust.

3. **Central Recordkeeping Agency (CRA)**

CRAs handle recordkeeping, administration, and customer service for NPS subscribers. Currently, PFRDA has authorised three CRAs.

4. **Trustee Bank**

It facilitates daily banking for smooth NPS operations, enabling fund transfers from subscribers to security sellers and other intermediaries, under the NPS Trust's supervision.

5. **Custodian of Securities**

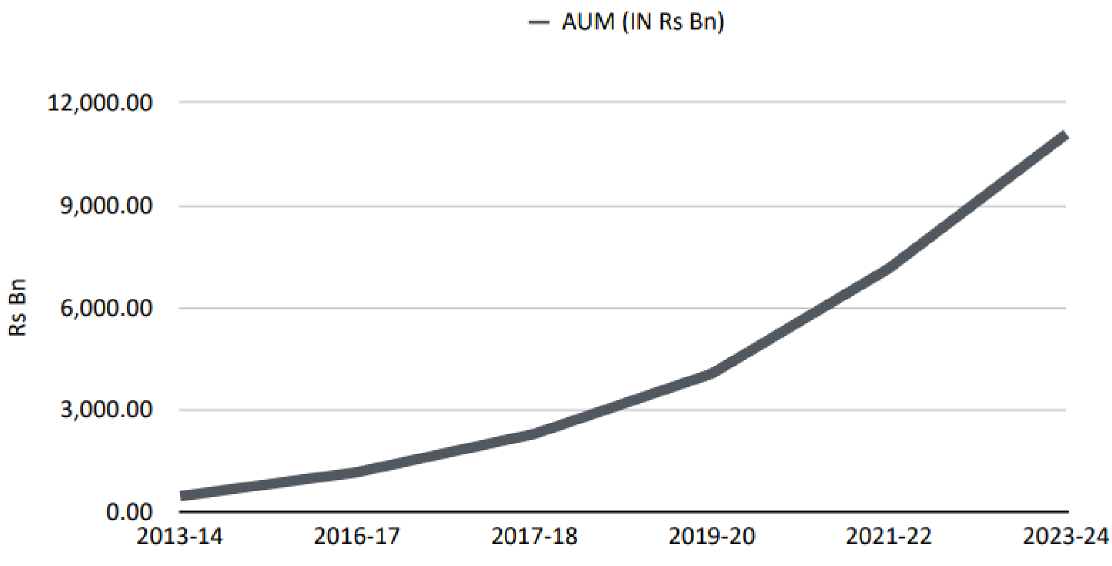
It holds securities for NPS Trust, handles settlement, records and maintains receipts, monitors corporate actions, and collects benefits like dividends or other incomes that accrue to the securities.

6. **Pension Funds**

These entities invest and manage the NPS corpus on behalf of NPS Trust, using professional advisors to generate returns through securities

7. **Annuity Service Providers**

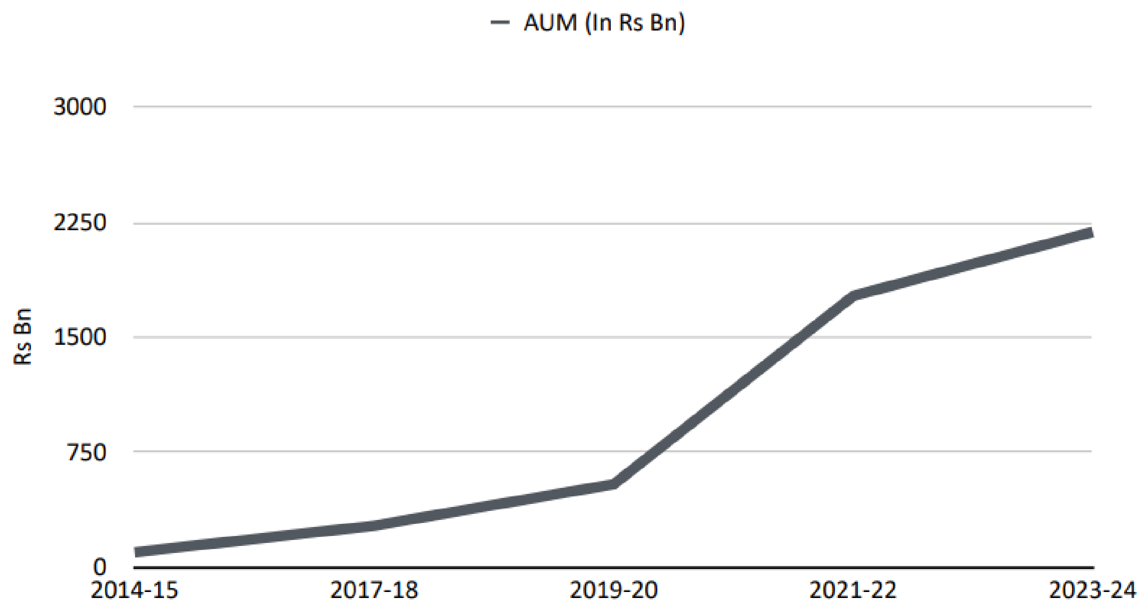
IRDA-approved life insurance companies, empanelled by PFRDA, manage annuity funds and provide pension payments after retirement.



Graph 8: Showing AUM under NPS (In Rs Bn)[63]

The fund growth under NPS has been impressive by any standards, growing 23 times in under 2 decades. Pension Funds of developed countries took 6-7 decades of accumulation to amass impressive amount of AUM.

[63] Source: https://www.npstrust.org.in/



Graph 9: shows the adoption of NPS by the corporates and general public without any compulsion from the government, based solely on the merits of the NPS[64]

World class NPS architecture, zero investment charges gives NPS the tag of effective vehicle for accumulation of wealth and vehicle for planning the retirement for the millions of Indians. These combined with the trust of corporates and general public makes it effective.

During unstructured interview with the finance department executives, they showed satisfaction on the functioning of the NPS system and concluded that in the given Indian circumstances, NPS architecture is most effective. They feared that, if NPS architecture would not have been robust, then the funds may have flown to some politically connected firm indirectly instead of going to the most efficient fund managers.

The qualitative and quantitative analysis shows that the NPS architecture is effective and it's 21st century infrastructure is capable of handling the challenges of the future.

Section 2. What has been the impact of the implementation of the NPS ?

The impact of the NPS on the fiscal position of the government and on the financial prospects of the employees when they retire are having negative correlation and having a trade-off between them. Therefore pertinent question to ask here is

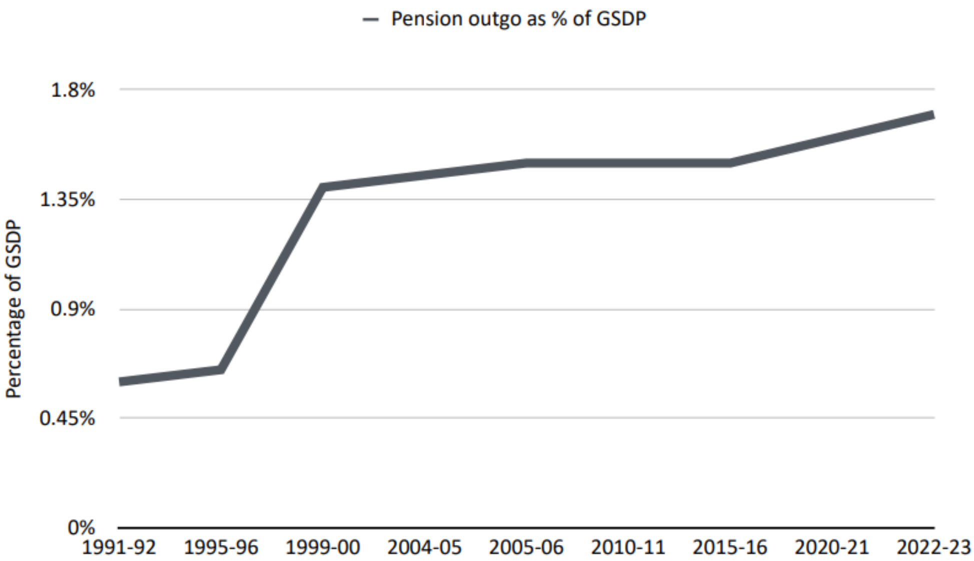
1. What has been the impact of the NPS on the government finances? and
2. What has been the impact of the NPS on the financial prospects of the civil servants when they retire?

a) Impact of the implementation of the NPS on the fiscal position of the government

The Indian states pension outgo had sharply increased from 0.6% in early 1990s to 1.7% in 2022-23 (Rachit Solank, 2023).

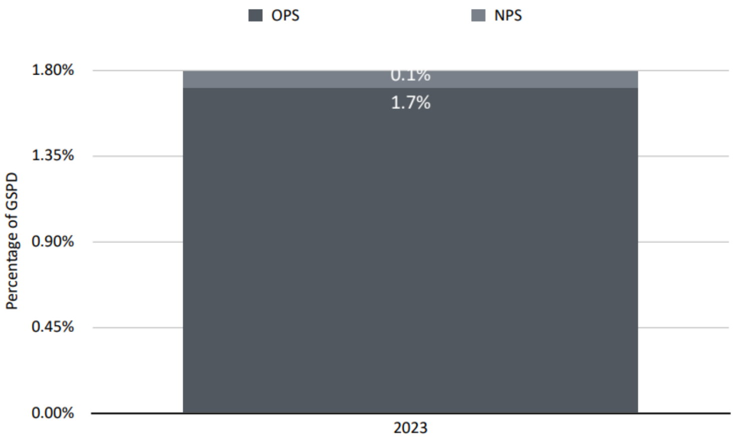
The pension outgo of the Indian states has increased considerably during the 1990s and has reached 1.4% in early 2000s and has been hovering between 1.5% to 1.7% since then. By the end of this decade, the pension payments would start coming down as the number of pensioners under OPS would decrease because the number of deaths of earlier OPS pensioners would not be replaced by new OPS pensioners but by the NPS pensioners.

[64] Source: https://www.npstrust.org.in/



Graph 10 : Showing Indian states pension outgo as a percentage of GSDP[65]

The dual burden of NPS employees' contribution and OPS pensioners pension has for the time being increased burden for the government. It has led to the increase of cost to the government by 0.1% of GDP (Rachit Solank, 2023) in the form of contribution while keeping the current pension outgo in the form of OPS unchanged.



Graph 11 : Showing double burden for states under OPS and NPS

In conclusion, the implementation of the NPS has increased the short term cost to the government by 0.1% of GDP in the form of NPS contribution and in the long term, the government would save at-least 0.8% of GDP in the form of then foregone OPS pension (Refer graph 12).

b) Impact of the implementation of the NPS on the financial prospects of the civil servants when they retire

Age of entry years (Service)	Contribution rate (Govt: Employee)	Life after retirement	Replacement rate (Assumptions*) (NPS/OPS)	Replacement rate in case of family pension# (NPS/OPS)
25 (35)	24 (14:10)	20	35% (70%)	32% (64%)
25 (35)	20 (10:10)	20	29% (58%)	26% (52%)
25 (35)	20 (10:10)	25	25% (50%)	23% (46%)
27 (33)	20 (10:10)	20	29% (58%)	26% (52%)

[65] Source: https://rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=22058#:~:text=The%20NPS%20is%20a%20DC,from%20the%20State%20government%204

Age of entry years (Service)	Contribution rate (Govt: Employee)	Life after retirement	Replacement rate (Assumptions*) (NPS/OPS)	Replacement rate in case of family pension# (NPS/OPS)
27 (33)	20 (10:10)	25	25% (50%)	23% (46%)
30 (30)	20 (10:10)	20	26% (50%)	23% (46%)
30 (30)	20 (10:10)	25	22% (44%)	20% (40%)

Table 2 : Showing the rate of replacement of last drawn pay (OPS pays 50% of last drawn pay subject to certain conditions)

* Assumptions at Annex-2

Difference between the death of spouse is 6 years. Difference between male and female life expectancy is 3 years. Family pension is 50% of service pension

Employees under the NPS will get on an average of 55%-60% less as the first pension. This is leading to dissatisfaction among the employees as to why the civil servants working in the same job with same intensity would get dramatically different after retirement benefits.

After getting 55-60% less amount as the first pension, the difference will grow between the OPS and NPS pensions over time, as there is no concept of DA and fitment in the NPS system unlike the OPS system.

The following table shows the impact of DA and fitments in the OPS

Years after retirement	1	3	6	9	12	15	18	20
Pension at nth year of retirement	100	108%	129%	152%	160%	189%	200%	232%

Table 3 : Showing the impact of DA and pay commission awards on the pensioners. (Assumptions in Annex-2)

The above figures for 20th years of pension are based on conservative estimates of only 4% annual inflation. The actual 20th pension currently are reaching more than 400% of initial pensions.

Age of entry years (Service)	Contribution rate (Govt: Employee)	Present Value of all the receivables at the time of retirement under OPS	Present Value of all the receivables at the time of retirement under NPS	Replacement rate in case of DA and pay commission awards annuity
25 (35)	24 (14:10)	100%	42%	21%
25 (35)	20 (10:10)	100%	35%	17.5%
27 (33)	20 (10:10)	100%	30%	15%
30 (30)	20 (10:10)	100%	23%	11.5%

Table 4 : Showing Present Values of total benefits received by the OPS and NPS pensioners (Assumptions in Annex-2)

The annuity the civil servants would get, would be based on the market annuity rates which are very conservative in nature, the actual replacement rate would dip to 12-20% in terms of present value of all the pension received.

Further, if the civil servants die prematurely within few years of joining the services, then the family of the civil servants would get very minimal pension just based on the few years of small accumulated corpus, whereas under OPS when the civil servants dies the family is entitled to full pension irrespective of the years of service.

Further, the pensioners under OPS gets additional quantum of pension at the rate of 20% extra pension if the civil servants attains the age of 80% to coup with the additional burden of medical and other old age care expenses. These are not available under the NPS.

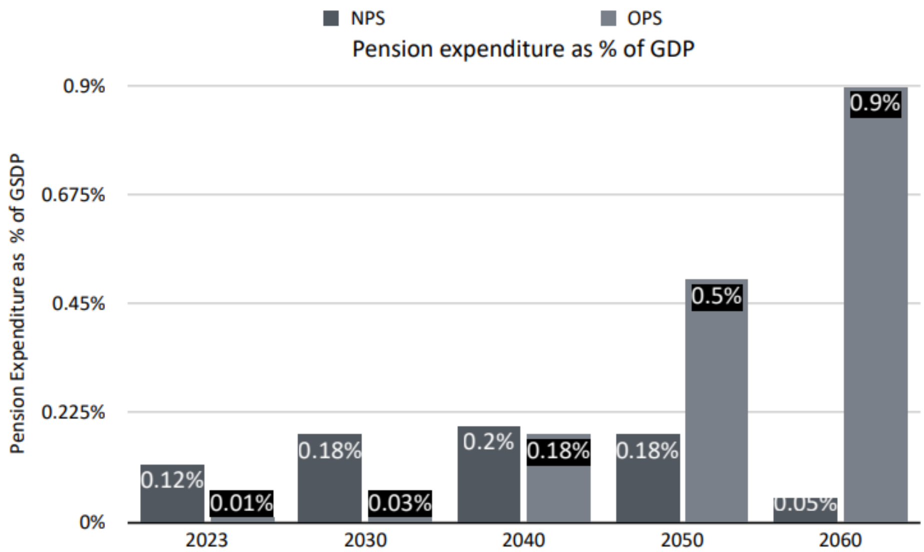
Section 3. Is the OPS affordable for the government ?

OPS is the pay-as-you-go model under which the government pays to the pensioners who rendered services in the past from tax collected from the present tax payers.

The government is not making any provision for the pension liabilities therefore, exact liabilities owed to the pensioners are not known and never estimated except by the researchers. The liabilities as estimated by the researchers are not taken on record by the government in budget records.

The affordability of the OPS scheme would be analysed using the fiscal deficit in lieu of the pension payments for the state governments. Reportedly, government of India has enacted Fiscal Responsibility and Budget Management (FRBM) Act 2003 and successive Finance Commissions have emphasised the following rules for states' fiscal position 1) Fiscal deficit of states within 3% of GSDP 2) Eliminate Revenue Deficits by states.

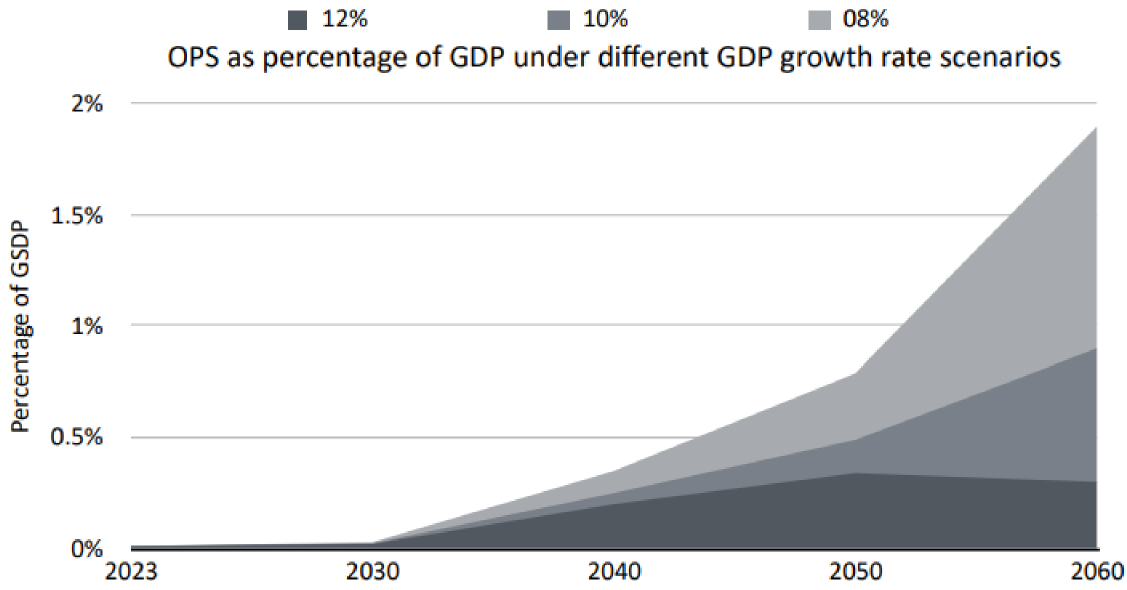
Rachit Solanki along with his colleagues has analysed the OPS and NPS conundrum in "Fiscal Costs of Reverting to the OPS by the Indian States – An Assessment". They found that till 2037 the outgo under NPS would be higher than the outgo under the OPS where the NPS contribution by the govt would peak at 0.20% of GDP, subsequently the outgo under NPS would remain flat and start decreasing from 2043 onwards while outgo under OPS would gradually increase and would reach 0.9% of GDP in the best case scenario where the nominal CAGR GDP growth till 2060 is assumed to be 10% pa. (Refer the graph No 12)



Graph 12: Showing pension expenditure as a percentage of GDP in OPS and NPS scenarios for employees who are currently under NPS. (CAGR Nominal GDP growth rate assumed as 10%)

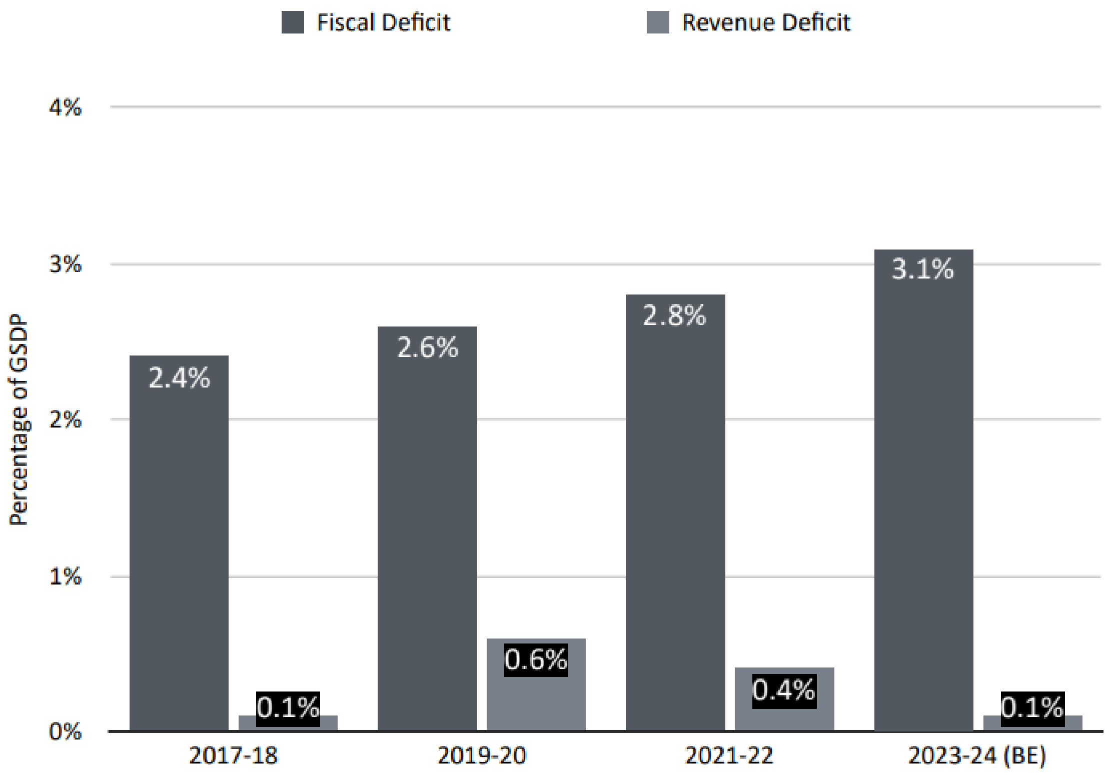
Further, if CAGR nominal growth rate of GDP declines the fiscal position becomes even tighter. The payments to the civil servants in the form of salary is not linked to GDP growth rate and yearly increment is fixed along with the periodic promotion and increment on promotion. Only DA component depends on the inflation index which in turn is having weak correlation with the GDP growth rates.

Therefore if the GDP growth rate declines and the pay revisions and increments is not revised downwards which seems difficult given the competitive polity, and if the states revert to OPS the pension burden would become unsustainable.



Graph 13 : Showing the OPS burden of states if they revert to OPS scheme from NPS scheme under different GDP growth rate scenarios

In the same paper, Rachit Solanki and his colleagues found that, if nominal CAGR of GDP growth rate from 2023 till 2060 remains 12% then pension outgo would be 0.3% of GDP, if CAGR remains 10% then OPS outgo would be 0.9% of GDP. If the CAGR is 8% then the pension outgo would be more than 1.9% of GDP. These pension burdens were calculated for states only. If we include central employees pension burden, the burden would increase by 30-35%. Refer Graph No 13

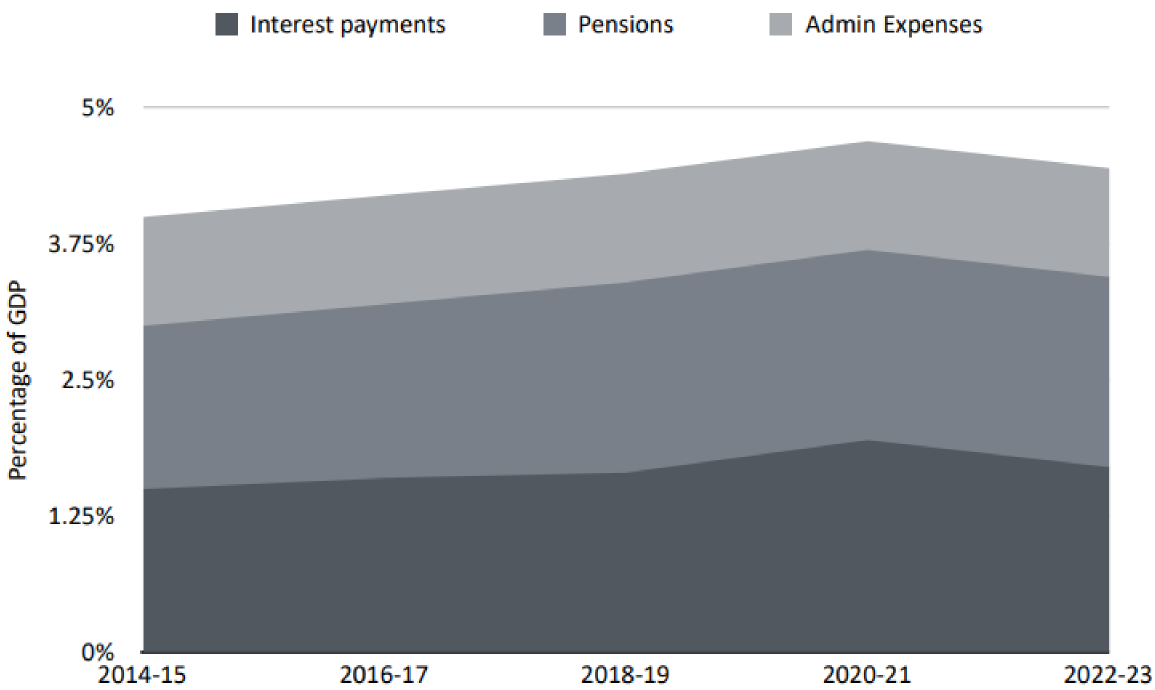


Graph 14: Showing the fiscal deficits and Revenue Deficits of Indian states[66]

The Graph No 14 shows the states are having limited fiscal maneuverability as the states are operating on the brink of 3% fiscal deficit targets and 0% Revenue deficit targets. At the disaggregated level, 19 states and UTs have budgeted fiscal deficit exceeding the FRBM limit of 3%.

Pension expenditure alone accounts for 12.4% (Average of 2017-18 to 2021-22) of total Revenue Expenditure of 10 most indebted states [67]and it was estimated that the pension outgo will be in the range of 0.7-3% of GSDP for these states until 2031 (RBI Bulletin Jun-22).

Group to Study the Pension Liabilities of the State Governments (2003) had concluded that continuation of OPS without modification would be unsustainable and would deteriorate the fiscal position of the state governments. In another study it was concluded that Pension liabilities are on an average 4 to 5 times higher under OPS compared to NPS (Vaidyanathan, 2022).



Graph 15 : Committed Expenditure of the states over the years[68]

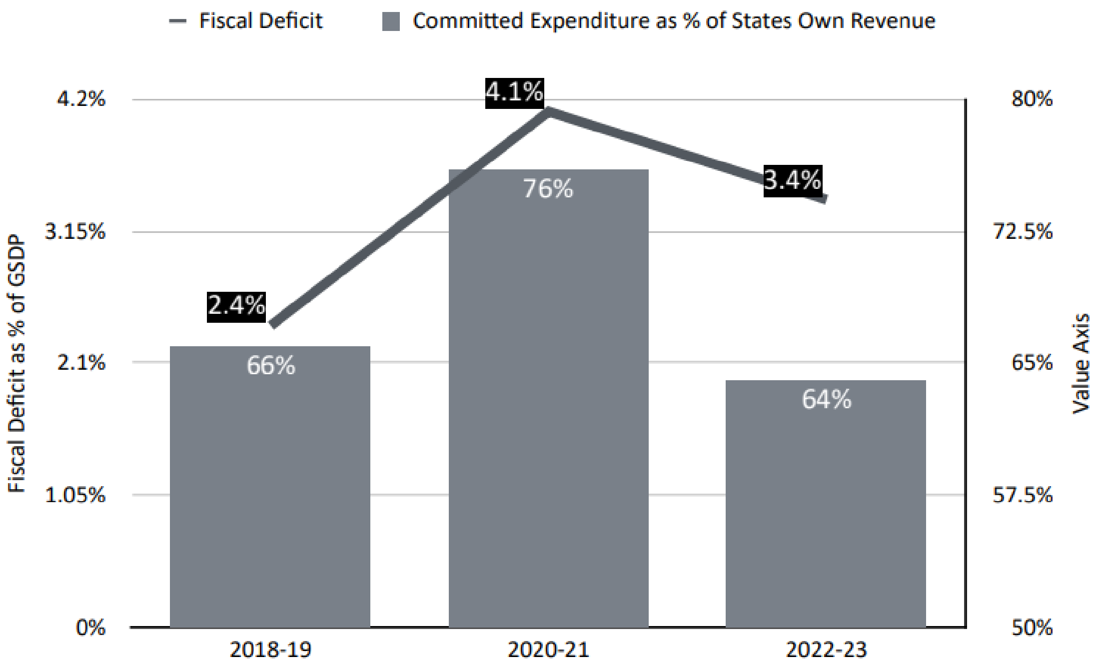
The graph 15 shows that the committed expenditure of the states (Admin cost, pension cost and interest payments) ranges between 3.8% to 4.6% of GSDP. If we will eliminate or drastically reduce the pension payments, these committed expenses would come down to 2% to 3% of GSDP.

---

[66] Source: State Finances: A Study of Budgets of 2023-24 by RBI. https://rbi.org.in/Scripts/AnnualPublications.aspx?head=State%20Finances%20:%20A%20Study%20of%20Budgets

[67] Andhra Pradesh, Bihar, Haryana, Jharkhand, Kerala, Madhya Pradesh, Punjab, Rajasthan, Uttar 12 Pradesh, West Bengal

[68] Source: State Finances: A Study of Budgets of 2023-24 by RBI. https://rbi.org.in/Scripts/ 13 AnnualPublications.aspx?head=State%20Finances%20:%20A%20Study%20of%20Budgets



Graph 16 : Showing the states Fiscal Deficit and committed expenditure as % of Own Revenue of states14

The states are having only 25%-30% of their own revenues to manoeuvre and the central transfers are more or less directed revenues which needs to be spent for the purposes they are being provided, therefore the states needs to augment and free their States Own Revenue to take up work of its interest.

The above analysis shows that the OPS would become unaffordable if the nominal CAGR comes down below 8% which is likely in the long term.

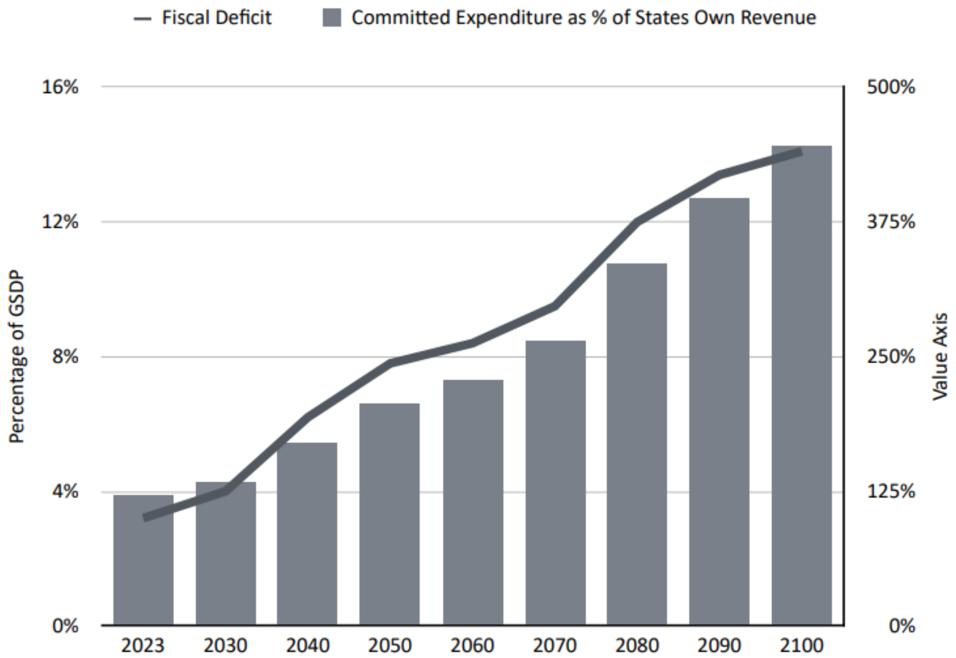
a) Case study of Andhra Pradesh

State government employees under its Union JAC “Joint Action Committee’ demands restoration of the OPS for the employees of the state government who joined under NPS scheme. Government of Andhra Pradesh analysed in detail the various possibilities and outcomes of the implementation of OPS for its state government employees.

The group looked into various alternatives to analyse whether implementing OPS would be fiscally sustainable. Some of the alternatives are reproduced here

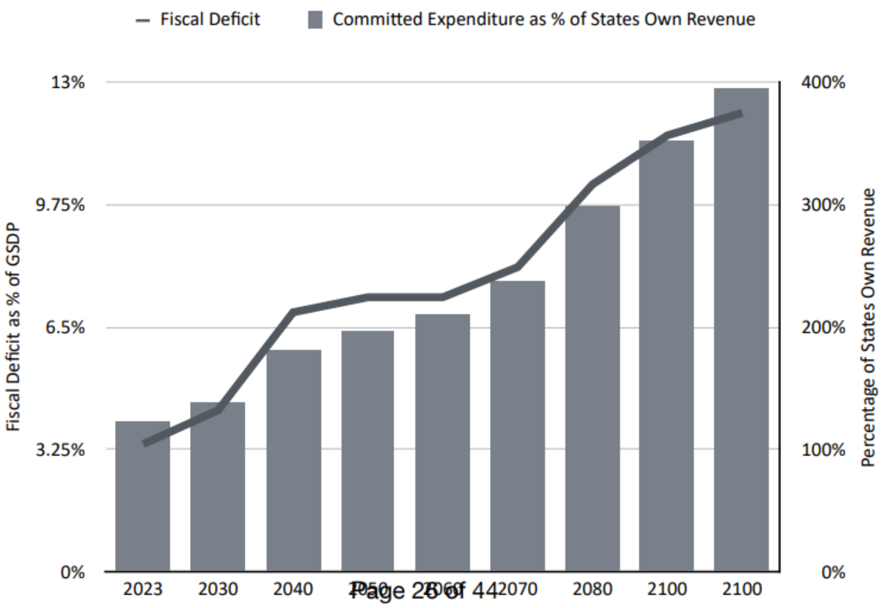
1) OPS Outflow for employees currently under NPS, if the contribution is not paid The analyses showed that the state government would face the brunt of the pension payments starting from 2041, since for initial few years of retirement already accumulated corpus (Accumulated under NPS by contribution by the government) would pay the pension. These numbers seems unreasonable and questions our model, but when we plotted the same numbers with same assumptions under NPS the fiscal position was robust.

The committed expenditure as % of States Own Resources are currently under pressure at 122%, which implies that the state government depends on either central transfers or borrowings to pay the committed expenditure only. Further in the present scenarios, the committed expenditure would reach to 226% by 2060, 336% by 2080 and 446% by 2100 which is clearly unaffordable for the government.



Graph 17 : Showing the Fiscal deficit and committed expenditure in the scenario of NPS employees don't pay the contribution and they get the OPS benefits (Assumptions- Annex-3)

2) OPS Outflow for employees currently under NPS, if the contribution paid

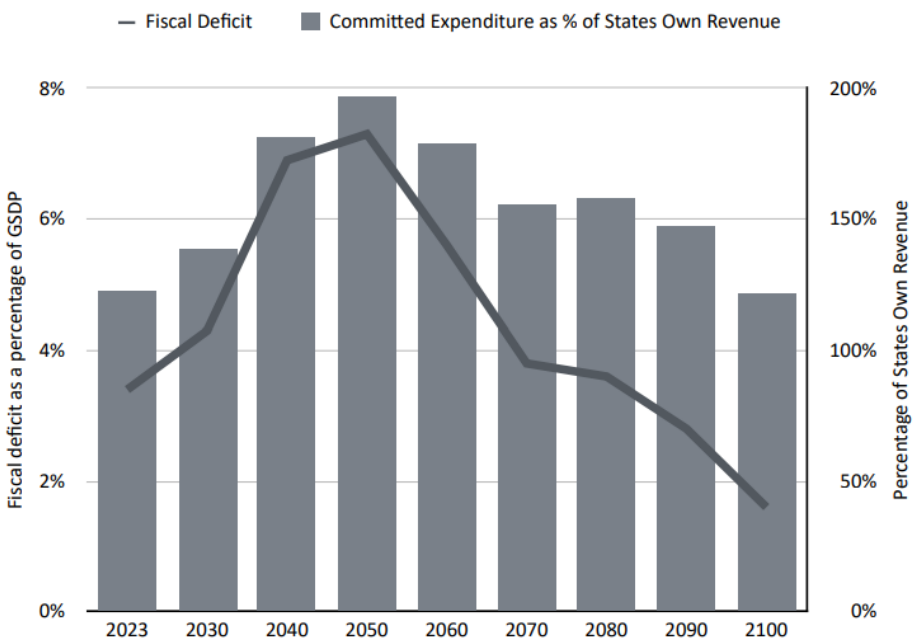


Graph 18 : Showing the Fiscal deficit and Committed expenditure in the scenario of NPS employees pay the contribution and they get the OPS benefits (Assumptions- Annex-3)

In this scenarios, the committed expenditure shows marginal improvement as expected, but would reach 210% by 2060, 300% by 2080 and 395% by 2100.

3) If the NPS scheme is continued as it is

The committed expenditure which is currently at 122% of States Own Revenue would peak in 2050 to 197% and would gradually come down to 179% by 2060, 158% by 2080 and would reach the current level of 121% by 2100.



Graph 19 : Showing the Fiscal deficit and committed expenditure in the scenario of NPS employees remain under NPS scheme (Assumptions- Annex-3)

The reasonable fiscal deficits as well as committed expenditure validates the robustness of our model which were questioned by the two scenarios of OPS.

Discussions and Policy Implications

Section 1. Efficiency and effectiveness of NPS system

It was concluded in the study that the NPS system is brutally efficient in terms of expense ratio and fairs well in terms of rate of return compared to the benchmark rate of return.

It also came to the forefront that while on the one hand the civil servants are more risk averse than corporate executives and the equity pays more than the fixed income securities, therefore the PFRDA has done well to liberalise and gave flexibility to the subscribers to chose the pension funds as well as the securities mix in their portfolio without much cost. To maintain the predictability for the system, the PFRDA has prescribed that such changes can be carried out only once a year by the subscribers.

While on one hand, PFRDA has worked very hard on the efficiency of corpus management, the same intent is missing from the annuity market reforms and regulation.

Policy Implications:

1. It is noted with caution that while on one hand the fund management cost for NPS is only 2-5% of fund management costs for other funds (Other funds expense ratios ranges from 0.5%-1%, NPS charges only 0.01%), the annuity providers are not having any specialised cost effective product for the NPS subscribers, therefore PFRDA would do well to workout the modalities to reduce the annuity costs. Unsurprisingly current annuity plans offers 3-4% returns which is not even defeating the inflation.

2. Incentives of the key actors: The existing life insurers may resist in reducing the costs of annuity which would put pressure in their margins, while on the other hand new entrants may be aspiring on the lucrative opportunity to serve a huge market with almost zero cost on onboarding and cross-sells.
3. Political and Administrative feasibility: The above action would not have much political overtones as it would be an administrative decision and in the long run, it may pay political dividend.
    a. Administratively, it would be challenging to balance the trade-off of costs of annuity and solvency of the life insurers. The cut-throat competition may pave the way for mutual bankruptcies of life insurers

Section 2. Impact of the implementation of the NPS on government and employees and affordability of the OPS for the government

It was concluded unambiguously that the impact of NPS on the government has been little negative in the short term and hugely positive in the long term while the civil servants would get far less than what they were getting under the OPS and additionally they need to bear the risk of the market forces during the career and most importantly at the year of retirement.

Now lets recall the major findings, in alternative cases of NPS and OPS for the same set of employees (Rachit Solanki, 2023)

1. By 2050, OPS would entail an expenditure of 0.5% of GDP if nominal CAGR GDP grows by 10% pa and would reach 0.9% of GDP if the nominal CAGR GDP grows by 8% pm
    i. Further by 2060, OPS would entail expenditure of 0.9% of GDP and 1.9% of GDP in the two growth rate scenarios
    ii. While NPS would entail expenditure of only 0.05% of GDP in both the cases

On the other hand, we also concluded unambiguously that the impact of NPS on employees would be negative.

1. Best case scenario replacement rate would be 32% (64% of OPS- since OPS is 50% of last drawn salary), while the worst case can be as low as 15% even in case of full length of services and without taking into account the downside market risks
2. On top of it, the life-time pension receipt would be less than 30% of what their counterparts in OPS would get and PV replacement rate would be less than 15%.

Policy Implications

1. The road to OPS is laid with un-sustainability risks, it would be wise to avoid any reference to the OPS in the pension reform proposals. The following components of OPS are more fiscally un-sustainable than others
    I. DR (Dearness Relief) which provides bi-annual escalation in the pensions
    II. Fitments which provides subsuming of DR and one extra multiplication factors
    III. Additional Quantum of 20% pensions for persons who attains the age of 80 years
2. Any and every pension plan should be contributory and funded

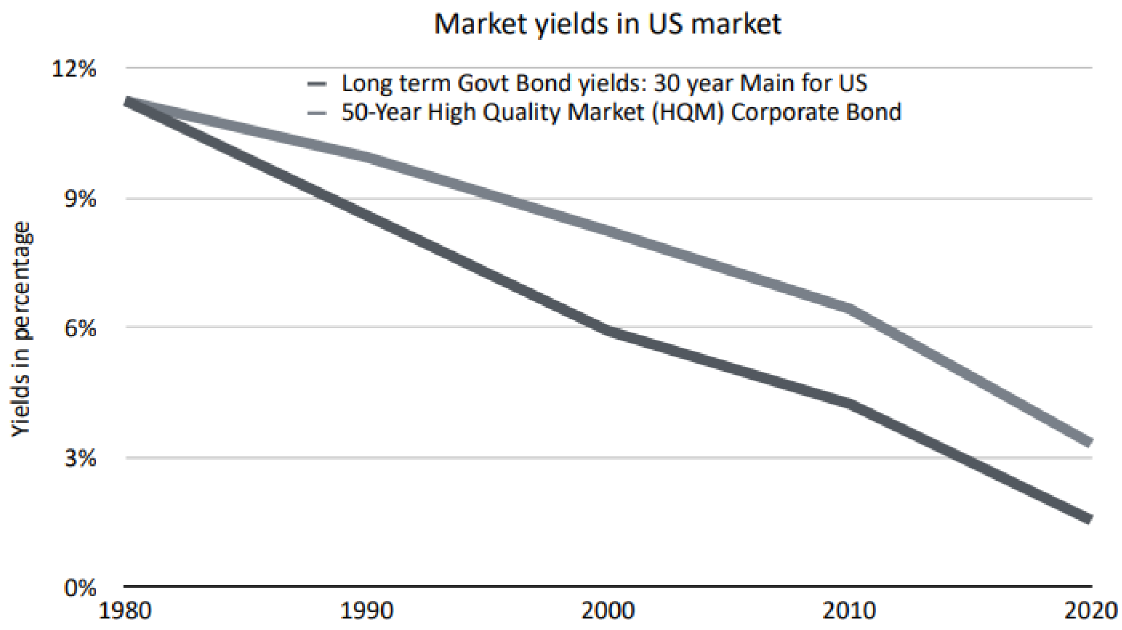
3. The following components of NPS presents more vulnerability than others to the civil servants when they retire
    I. The corpus is dependent on the market forces, especially if market crashes close to the year of retirement and remains so for some time
    II. Sudden demise of the civil servants at the start of the career
    III. Health emergency requiring huge sum after retirement
    IV. No Family pension
4. Incentives of the key actors: The Civil Services Unions may oppose such a resistance to preclude any reference to costly features of the OPS. The government may do well to explain the offer on hand and what that would mean to the civil servants vis a vis NPS not vis a vis OPS.
5. Political and administrative feasibility: The policy recommendation is politically difficult choice in the face of strong resistance of the Joint Action Committees who are campaigning for the restoration of the OPS for the civil servants. On the other hand, there are practically no alternatives
    I. Administratively, it would be easy to design and implement any version of pension plan on the sound architecture of the NPS

Section 3. Alternate designs of pension systems to supplement the NPS by keeping in mind the policy recommendations

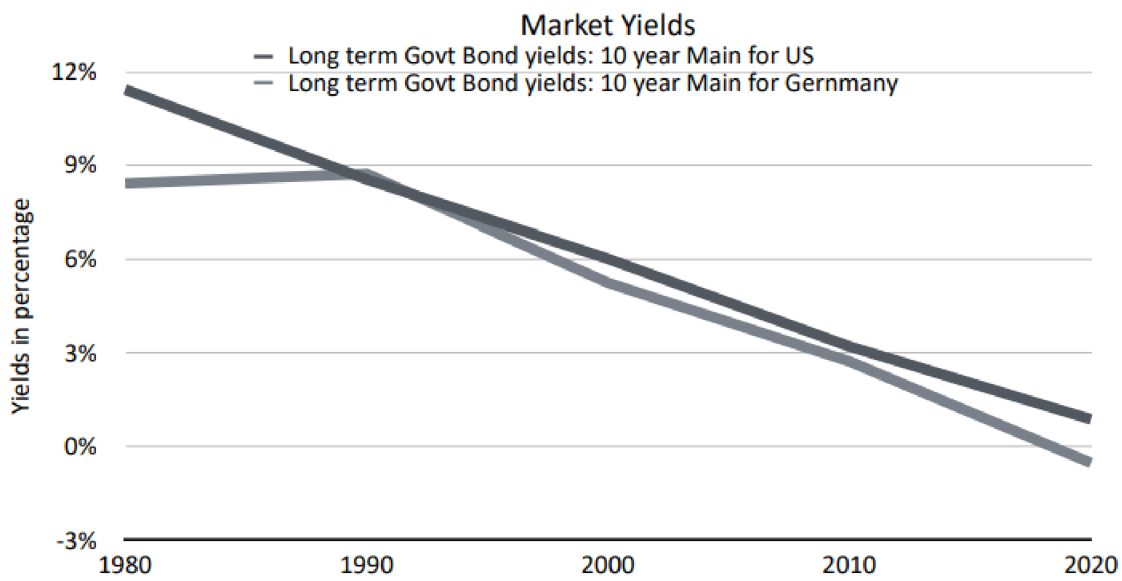
Government may design a pension plan with fixed annuity, the government could then guarantee a certain percentage of the salary as a fixed annuity pension. This guarantee should reflect the triple threat observed in the pension sustainability analysis

1. Employer and Employees contribution: To ensure funded pensions
    I. UK Civil Services Pension scheme: Employee contribution ranges from 4.6% to 8.05%, employer contribution 28.97%[69]
    II. Employee and Employer contribution of 24% (in some states 20%) is healthy in India compared to the world standards
2. Investment returns: (Refer graph No 20, 21 and 22 and table No 5)
3. Demography and life expectancy: The general dependency ratio in India is 47.5% [70]and would decline before rising
    I. Double whammy of declining fertility rate and increasing life expectancy would put pressure on the dependency ratio (Refer graphs)

[69] https://www.civilservicepensionscheme.org.uk/your-pension/managing-your-pension/ 15 contribution-rates/
[70] https://www.statista.com/statistics/1323770/india-dependency-ratio/



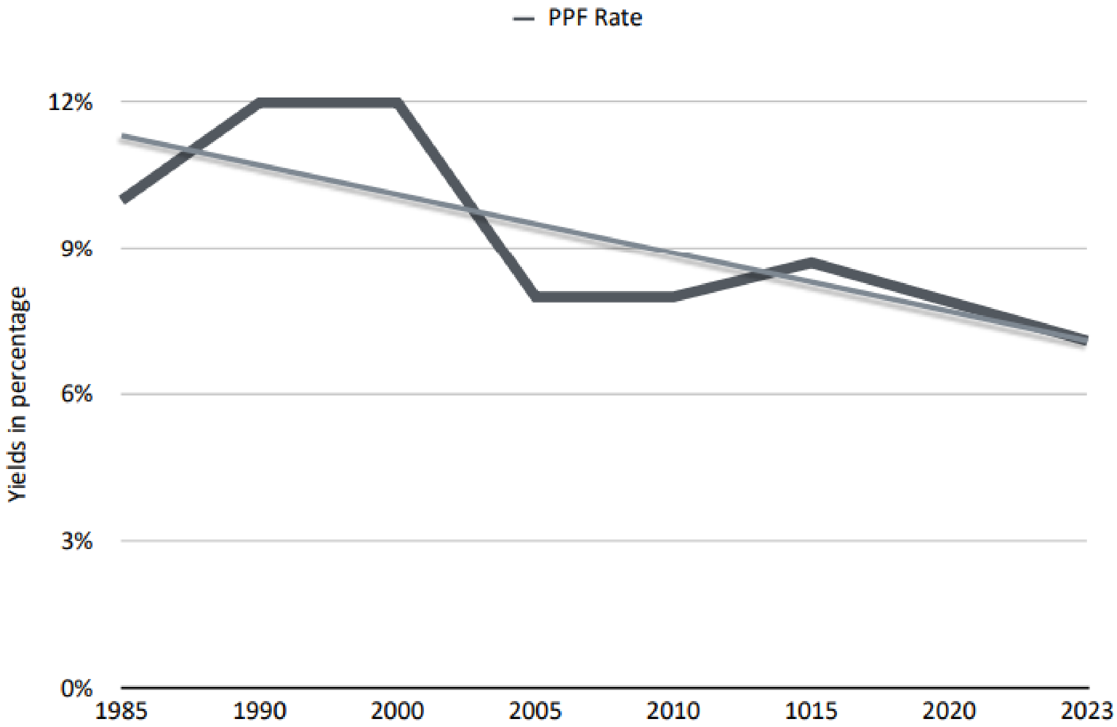
Graph 20 : Graph: Showing declining trend of market yields[71]



Graph 21 : Declining trend of market yields on US and German Treasury Bonds[72]

Graph 22 : Declining trend of Public Provident Fund rates in India[73]

[71] Source: https://fred.stlouisfed.org/series/CAOSOC
[72] Source: https://fred.stlouisfed.org/series/CAOSOC
[73] http://dailytools.in/PPFCalculator/Article/PPF_KT_PPFInterestRateHistory



The graphs 20, 21 and 22 shows the secular trend of declining interest rates from 1980s and is continuing. The investors are chasing the returns in the developing market which may dry up sooner than expected.

The Following table shows the Pension Fund Returns in the recent past of the major pension funds around the world.

Country	5-year	10-year	15-year
Australia	6%	7.5%	6.2%
Canada	6.4%	6.9%	6.4%
Germany	3.4%	3.7%	3.8%
Italy	2.5%	3.1%	2.9%
Norway	6.0%	5.9%	5.7%
Portugal	3.3%	3.4%	3.3%
Switzerland	4.5%	4.3%	3.3%
United States	5.9%	4.9%	3.1%

Table 5 : Showing the Nominal Returns on the major pension funds[74] The declining rate of return signals plenty of capital availability and the

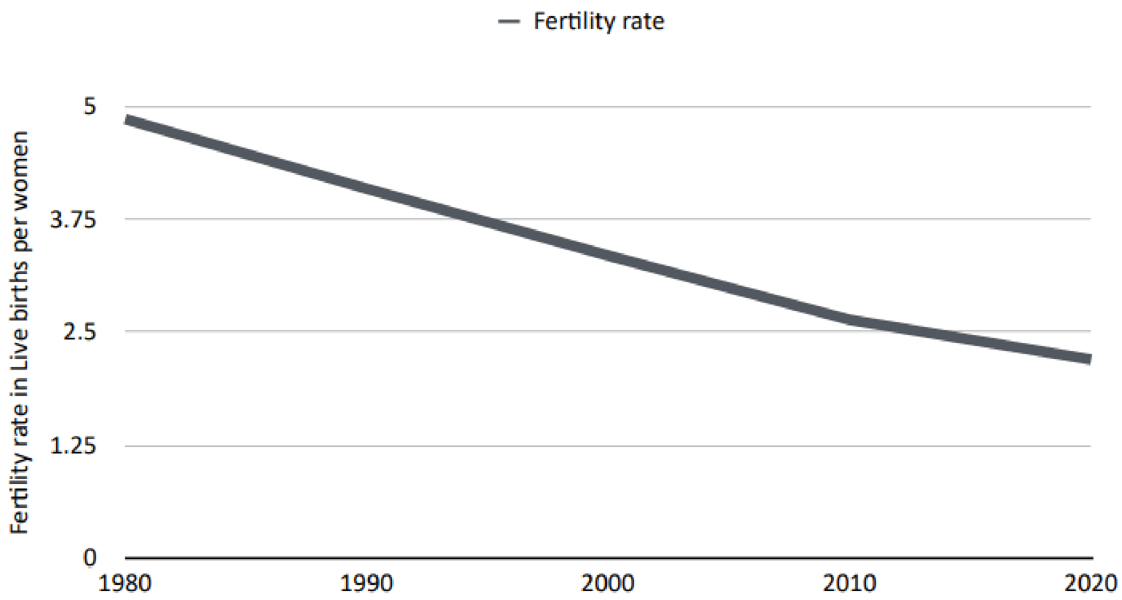
entrepreneurs' reluctance to invest in new factories because of expectations of weak demand of goods and services. Further, this signals high dependency ratio which means savers which are generally older people are more than the workers.

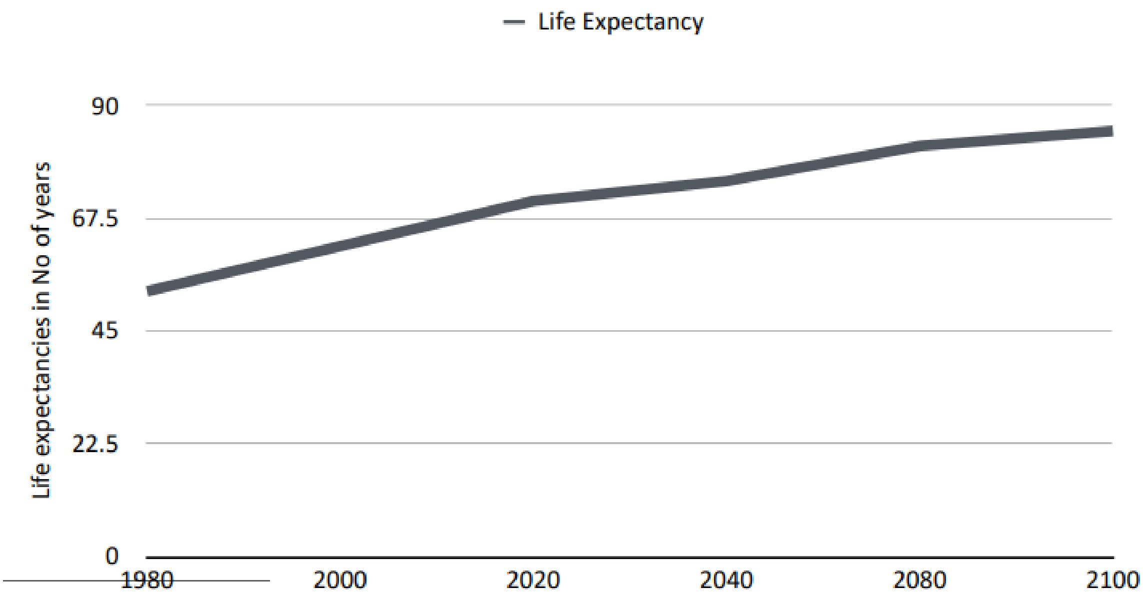
India is recording a secular decline in the fertility rates starting from Indian Independence in 1947. India initiated family planning in 1952 but the results comes with a lag in the demographic intervention in the democratic countries. The rate of annual decline in the fertility rates was less than 0.05% till 1964 and it touched 0.5% in 1964 and have remained high since then. Further in 1969 it touched 1% and have remained

[74] Source:https://www.oecd-ilibrary.org/finance-and-investment/pensions-at-a- glance-2021_ca401ebd-en

1% till 2018. The declines in the fertility rates remained more than 2% starting 2001 ad remained above 2% till 2013.

Graph 23: Showing declining fertility rate of India[75]

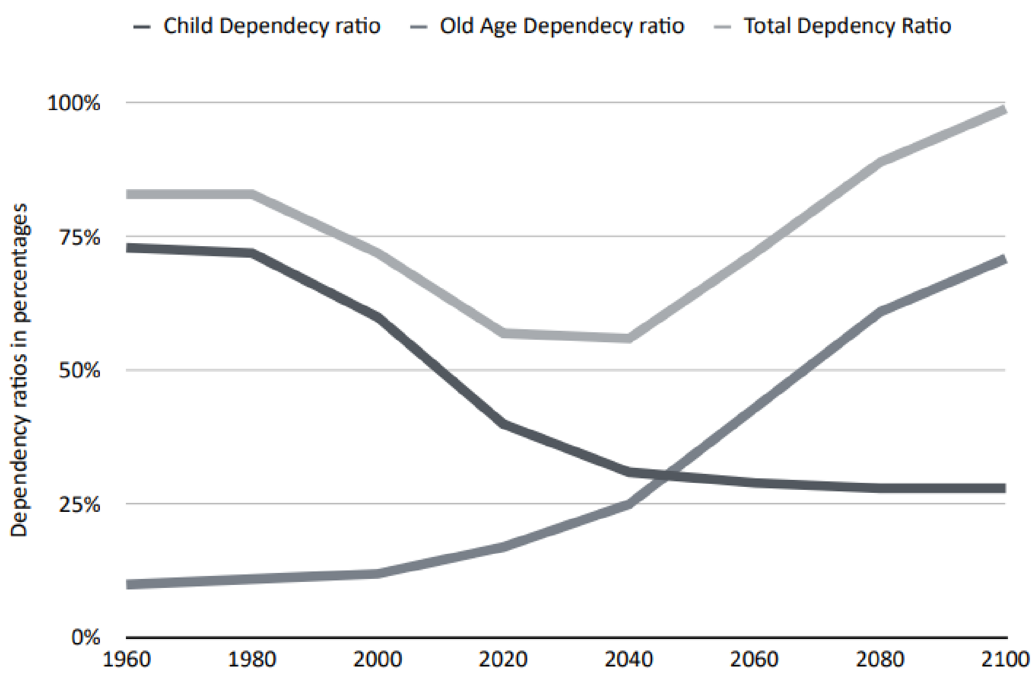




Graph 24 : Showing increasing life expectancy in India22. After 2020, projections*

Further the World Population Prospects 2022 projects India's fertility rate to come below replacement level of 2.1 by 2024-25 and further decline to 1.7 by 2070s.

[75] Source: https://www.macrotrends.net/global-metrics/countries/IND/india/fertility-rate



Graph 25 : Showing child and Old age dependency ratio (Working age-15-59*). [76]From 2040 onwards-projections*

Currently India is going through the demographic transition and enjoying the demographic dividend with the working age population bulge. This demographic dividend would last another 2 decades and would subside in late 2040s and early 2050s. Incidentally around same time India's child dependency ratio and old-age dependency ratio would be equal and the the old-age dependency ratio would continue to rise sharply while the child dependency ratio would decrease although only marginally, thus sharply increasing the overall dependency ratio.

The combined effect of declining fertility rate and increasing life expectancy ensures that the dependency ratio increases with a bias towards older people. Current high dependency ratio in India is because of younger people are expected to enter the labour market in the near future. The high dependency ratio in the future starting 2040s would be driven by older people with little hope of declining of the dependency ratio. Unsustainably high dependency ratio would put pressure on the fiscal position of the government and may put unbearable burden of taxes on the already smaller workforce.

a) Proposed Pension Design: Guaranteed Pension Scheme

The proposed pension plan should take care of the major policy recommendations arrived in the present research paper namely

1. Some guaranteed pension
2. Contributory
3. No DR, No Fitment, No Additional Quantum
4. Cover in case of unfortunate death / accident causing disability
5. Cover for health emergency after retirement
6. Family Pension

1. Some Guaranteed Pension

The Government may guarantee a certain percentage of last drawn salary as a fixed annuity pension

[76] https://population.un.org/wpp/Graphs/Probabilistic/Ratios/TDR/0-14/60plus/15-59/356

i. This guarantee should reflect the secular declining trend in interest rates, demographics and India's stage of economic development all of which would likely lower the rate of return on the corpus

ii. This guaranteed pension should insure the civil servants against adverse market volatility during the service tenures and in the retirement years

2. Contribution

The current contribution rate of 14% by the government and 10% by the employees may be continued. The states which has still not increased its contribution from 10% to 14% may increase, so that the deficit at the time of retirement is minimum.

3. No DR, No Fitment and No Additional Quantum of Pension

The proposed pension would be a fixed annuity just like a market based product with just one exception of minimum guaranteed annuity.

4. Unfortunate Death / Accidental Disability cover

In case of unfortunate death / disability causing stopping of contribution, the pensioner / family can withdraw the accumulated corpus in the form of annuity. But since the contribution has been made for just a few years, the corpus is not enough to financially support the pensioner / family through annuity.

Level in the 7th Pay Matrix of Govt of India	Current pay of the employees (Basic+DA at 50%)	Annual Annuity required (Assuming 40% Guaranteed Pension)	Life Insurance Cover required to support the annuity	Annual Premium to be born by the government
1	3,24,000	1,29,600	26,00,000	1,750
5	5,25,600	2,10,240	34,00,000	2,210
10	10,09,800	4,03,920	66,00,000	4,290

The gap in the NPS can be bridged by providing life insurance cover large enough to financially support the employee / family in the form of annuity equivalent to the guaranteed pension amount. The following table shows the probable life insurance cover to the civil servants

Table 6 : Showing the Life Insurance and premium required (Assumptions in Annex 4)

The above life insurance cover may be made flexible depending on the pay of the civil servants. The Life insurance cost comes out to be mere 0.5% of the annuity.

5. Cover for Health Emergency

The current employee health insurance scheme may be extended to the civil servants when they retire. The average premium comes out at Rs 3,000 per year[77] which may be shared equally between the government and pensioners. The average health insurance cost would come as 0.5% of annuity each for the pensioner and the government.

[77] Source: Estimation based on the Govt of AP Employee Health Scheme for working civil servants

6. Family Pensions

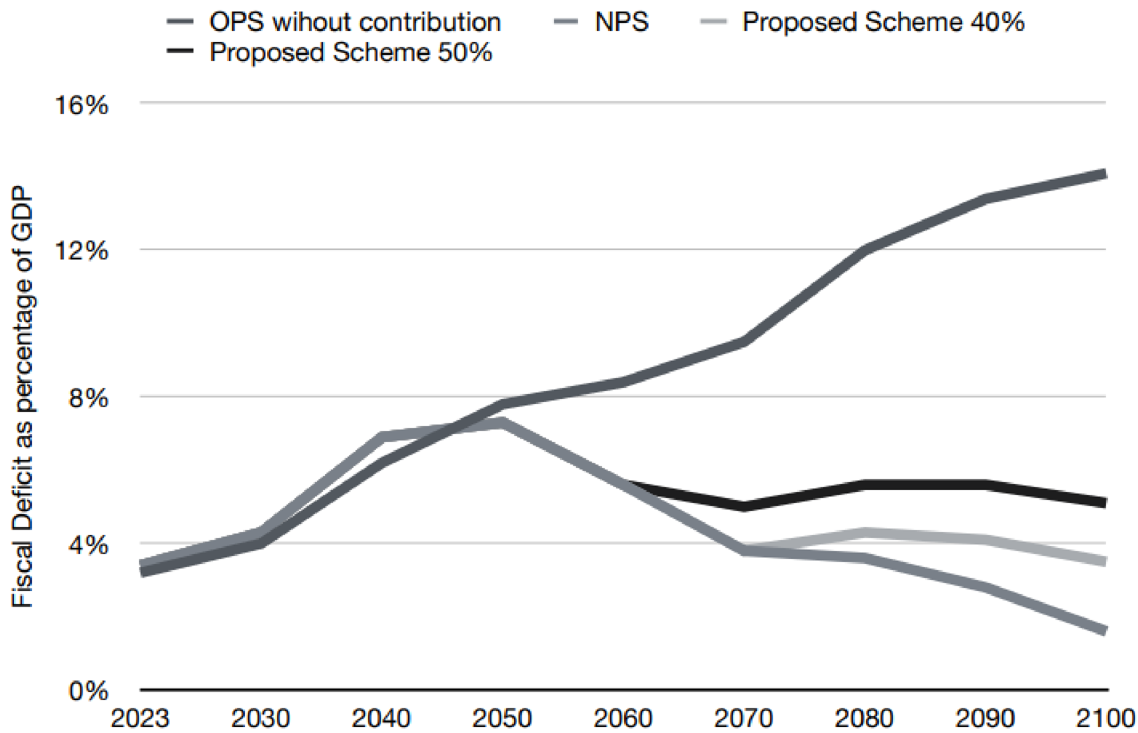
The NPS scheme is market based scheme and as described in the point No 4 (Unfortunate Death / Accident Disability Cover), in the unfortunate circumstances the corpus is not sufficient to provide meaningful annuity to the family of the employees.

Moreover, in case the civil servant retires and gets annuity and dies, the family again becomes financially vulnerable. Therefore, we need to design the annuity to support the spouse as well. The joint life annuity is on an average 10-12% costly than the single life annuity. If we provide 50% of annuity to the second life, then it becomes

5-6% costly compared to single life annuity. The joint life annuity may be provided in the form of guaranteed pension and 50% of service pension may be provided as family pension which would increase cost by 5-6%.

Now, lets look at the impact of the such a model on the fiscal position of the government and on the financial prospects of the civil servants when they retire

Impact of the proposed model on the fiscal position of the Government

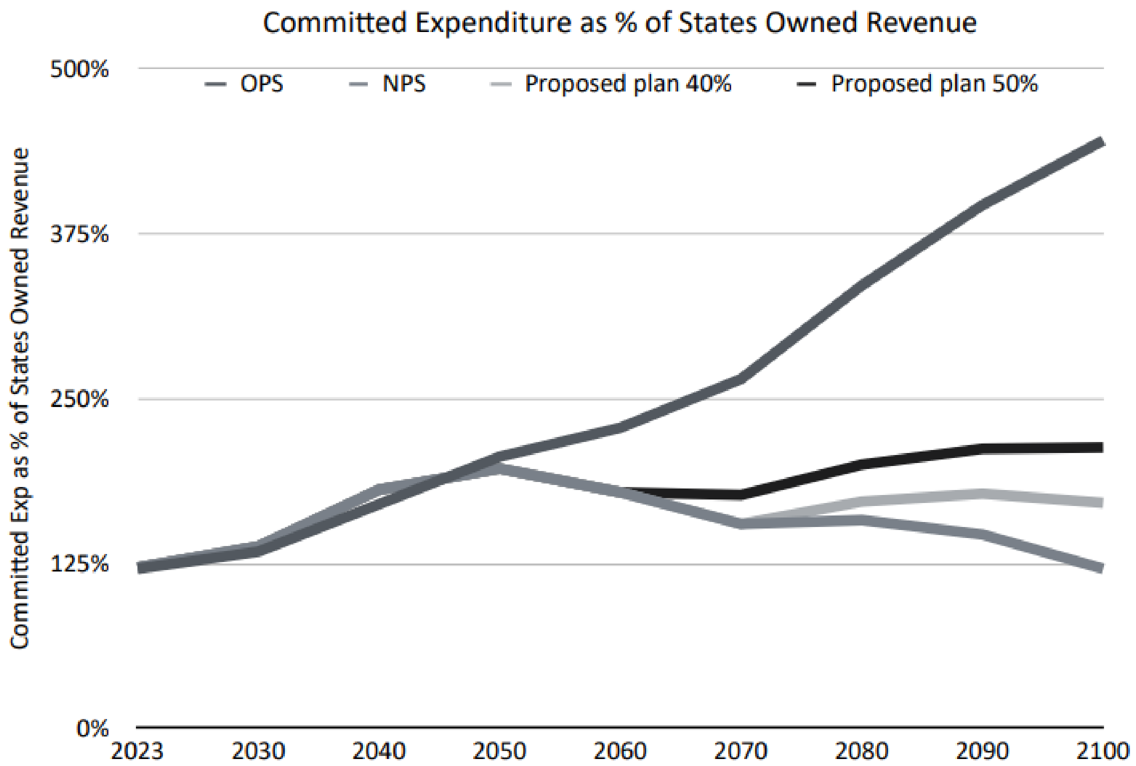


Graph 26 : Showing the impact of various pension schemes on the fiscal deficit of Andhra Pradesh[78]

The above graph 26 shows that there are no much adverse impact on the fiscal position of the states in implementing the proposed pension plan. The calculations are based on the assumptions that, once the government exhausts the NPS corpus of the concerned employees then only the government supplements through budget, therefore till 2060, there are no difference of fiscal position between the NPS and the proposed scheme of 50% guaranteed pension and till 2070 no difference between proposed 40% guaranteed pension and NPS, whereas under OPS the fiscal deficit sharply rises after late 2040s.

[78] Numbers are based on calculations of Andhra Pradesh. All Assumptions of Annex 3 Apply

In the proposed 40% (50%) of last drawn salary as guaranteed pension model, after 2070 (2060) when there is marginal impact on the fiscal deficit of the states as shown in the graph 26, the fiscal deficit stays almost flat at the same level for the next three decades, which is declining in case of NPS being continued.



Graph 27 : Showing the impact of various pension schemes on the Committed Expenditure as % of States Owned Revenue for AP[79]

The same data is being plotted for the committed expenditure as % of States Own Revenue (SOW). We get the same result where for 40% (50%) of last drawn salary as guaranteed pension model, till 2070 (2060) there is no difference between it and NPS scheme and it has marginal effect after 2070 (2060) which is stabilising around 175% (200%) of States Owned Revenue (SOW) for the next 2-3 decades. As for the fiscal deficit, for SOW analysis also, these two models are not deteriorating the SOW position after the model's effect comes into force, but are keeping at the same high level for the next 2-3 decades.

Impact of the proposed model on the financial prospects of civil servants when they retire

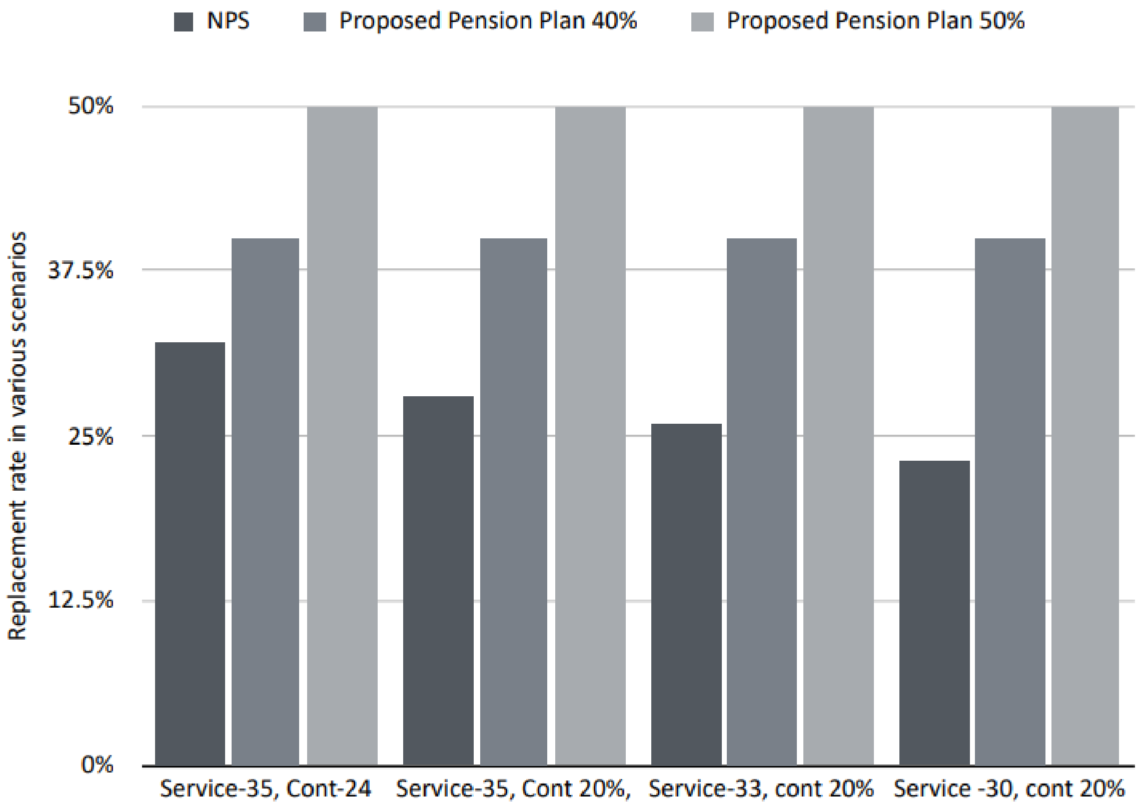
Now lets compare the financial prospects of the civil servants under the proposed schemes.

In case of 40% guaranteed pension, in the best case scenarios also, the civil servants would get 25% more pension (32% Vs 40%) and in the other cases of 30 years of service and 20% contribution, this increase is more than 70% (23% Vs 40%). The benefits would increase by further 25% in case states decides to implement the 50% guaranteed annuity model.

Only two variables are taken for analysis namely Service tenures and contribution rate. The other variables like rate of return during the service of the civil servants, annuity discounting rates also would have affect but since those two are subject to market risks and not dependent on civil servants and govt, therefore has not been taken into account as variables and assumed as fixed as per the assumptions in Annex-2.

---

[79] Numbers are based on calculations of Andhra Pradesh. All Assumptions of Annex 3 Apply



Graph 28 : The replacement rate under NPS and proposed civil services pension schemes[80]

The proposed plan is an attempt to even these hiccups out in the capacity of welfare state for the welfare of the civil servants who has served the state.

Possible working of the proposed pension system

(I) The civil servants and government would continue NPS as per existing guidelines

(II) At the time of retirement of the civil servants

(a) If annuity comes out to be more than guaranteed pension, civil servants would go ahead with market based product

(b) If annuity comes out less than guaranteed pension, the government would bridge the gap either by yearly budgetary support or create a fund specifically for it

Conclusion

Section 1. Limitations of the study

The main objective of the study was to understand the OPS-NPS conundrum and how the scheme interact with the fiscal position of the government and on the financial prospects of the civil servants whey they retire and look for solutions for the long standing problem of pension sustainability and employee welfare.

The following are the limitations of the study

[80] Source: Excel Model, All Assumptions of Annex-2 apply

1. The issues of financial sustainability are long term issues and needs to be studied well into the past date sets and future data projections. The present study focussed on the readily available secondary sets of data of RBI and other budget related documents.
2. The study relied disproportionately on the secondary data instead of generating primary data. Already available secondary data are having institutional biases and favours fiscal prudence at the cost of employee welfarism. To that extent, the present study is also biased as it relied on the institutional data to back its analysis

Section 2. Conclusion

The research findings conclude that the OPS was sustainable in the era of limited state functioning and when the states took limited responsibilities for the welfare of its citizens, where the states core functions were limited to defence and law and order. The investments in health, education, roads and railroads were limited, therefore the OPS system was affordable in the backdrop of limited government.

With the advent of welfare state and focus of the states on the development of the human and physical capital, the states needs to trim down its establishments cost of which pension is a big pie.

The NPS was introduced after lots of deliberations and research and this study concluded that it incorporates all the desirable components of the reformist pension plan including reducing pension liabilities to sustainable levels, advanced fundings, portability of the pension funds. The only component it has limited success was of harmonising the compensation and attracting talents, since NPS replaced more than generous OPS.

The study un-ambiguously concluded that reverting back to OPS from NPS for the states would be counterproductive move and would entail an additional expenditure of 0.4-1.9% of GDP depending on the CAGR nominal growth rates. It was noted that for a decade or so the states reverting back to OPS may save 0.1-0.15% of GSDP but that would be short-lived and would be outweighed when the civil servants currently under NPS starts retiring in early to mid 2030s and by mid 2050s this may become full-blow fiscal crisis for states.

The research paper notes with caution that, the pension reform is difficult as the easy option for now may be disastrous in the future and the fiscally prudent option is difficult to sell politically especially in a competitive polity.

Further, it was noted with caution that there are limited study on the impact of NPS- OPS debates on the financial conditions of the civil servants when they retire.

The study found in no-ambiguous terms the financial prospects of the civil servants when they retire would be precarious. They on an average would be getting 20-30% replacement of their salary in the best case scenario possible and further the financial markets may hold surprises with downward risks outweighing the upward rewards for the civil servants at the verge of retirement.

The study concluded with policy recommendations of designing a Pension System with NPS architecture as a base and build-up a guaranteed pension product to safeguard the welfare of the civil servants when they retire and at the same time maintain the fiscal sustainability of the pension system.

Annexures

Annex-1 Pay matrix for the seventh pay commission

7th Pay Commission Pay Matrix Table for Central Government Employees w.e.f.1.1.2016																			
Level	1	2	3	4	5	6	7	8	9	IO	11	12	13	13A	14	15	16	17	18
1	18000	19900	21700	25500	29200	35400	44900	47600	53100	56100	67700	78800	118500	131100	144200	182200	205400	225000	250000
2	18500	20500	22400	26300	30100	36500	46200	49000	54700	57800	69700	81200	122100	135000	148500	187700	211600		
3	19100	21100	23100	27100	31000	37600	47600	50500	56300	59500	71800	83600	125800	139100	153000	193300	217900		
4	19700	21700	23800	27900	31900	38700	49000	52000	58000	61300	74000	86100	129600	143300	157600	199100	224400		
5	20300	22400	24500	28700	32900	39900	50500	53600	59700	63100	76200	88700	133500	147600	162300	205100			
6	20900	23100	25200	29600	33900	41100	52000	55200	61500	65000	78500	91400	137500	152000	167200	211300			
7	21500	23800	26000	30500	34900	42300	53600	56900	63300	67000	80900	94100	141600	156600	172200	217600			
8	22100	24500	26800	31400	35900	43600	55200	58600	65200	69000	83300	96900	145800	161300	177400	224100			
9	22800	25200	27600	32300	37000	44900	56900	60400	67200	71100	85800	99800	150200	166100	182700				
10	23500	26000	28400	33300	38100	46200	58600	62200	69200	73200	88400	102BOO	154700	171100	188200				
11	24200	26800	29300	34300	39200	47600	60400	64100	71300	75400	91100	105900	159300	176200	193800				
12	24900	27600	30200	35300	40400	49000	62200	66000	73400	77700	93800	109100	164100	181500	199600				
13	25600	23400	31100	36400	41600	50500	64100	68000	75600	80000	96600	112400	169000	186900	205600				
14	26400	29300	32000	37500	42800	52000	66000	70000	77900	82400	99500	115800	174100	192500	211800				
15	27200	30200	33000	38600	44100	53600	68000	72100	80200	84900	102500	119300	179300	198300	218200				
16	28000	31100	34000	39800	45400	55200	70000	74300	82600	87400	105600	122900	184700	204200					
17	28800	32000	35000	41000	46800	56900	72100	76500	85100	90000	108800	126600	190200	210300					
18	29700	33000	36100	42200	48200	58600	74300	78800	87700	92700	112100	130400	195900	216600					
19	30600	34000	37200	43500	49600	60400	76500	81200	90300	95500	115500	134300	201800						
20	31500	35000	38300	44800	51100	62200	78800	83600	93000	98400	119000	138300	207900						
21	32400	36100	39400	46100	52600	64100	81200	86100	95800	101400	122600	142400	214100						
22	33400	37200	40600	47500	54200	66000	83600	88700	98700	104400	126300	146700							
23	34400	38300	41800	48900	55800	68000	86100	91400	101700	107500	130100	151100							
24	35400	39400	43100	50400	57500	70000	88700	94100	104800	110700	134000	155600							
25	36500	40600	44400	51900	59200	72100	91400	96900	107900	114000	138000	160300							
26	37600	41800	45700	53500	61000	74300	94100	99800	111100	117400	142100	165100							
27	38700	43100	47100	55100	62800	76500	96900	102800	114400	120900	146400	170100							
28	39900	44400	48500	56800	64700	78800	99800	105900	117800	124500	150800	175200							
29	41100	45700	50000	58500	66600	81200	102800	109100	121300	128200	155300	180500							
30	42300	47100	51500	60300	68600	83600	105900	112400	124900	132000	160000	185900							
31	43600	48500	53000	62100	70700	86100	109100	115800	128600	136000	164800	191500							
32	44900	50000	54600	64000	72800	88700	112400	119300	132500	140100	169700	197200							
33	46200	51500	56200	65900	75000	91400	115800	122900	136500	144300	174800	203100							
34	47600	53000	57900	67900	77300	94100	119300	126600	140600	148600	180000	209200							
35	49000	54600	59600	69900	79600	96900	122900	130400	144800	153100	185400								
36	50500	56200	61400	72000	82000	99800	126600	134300	149100	157700	191000								
37	52000	57900	63200	74200	84500	102BOO	130400	138300	153600	162400	196700								
38	53600	59600	65100	76400	87000	105900	134300	142400	158200	167300	202600								

Annex-2 Assumptions for calculating replacement rate

	Fitment	Yearly growth	DA / inflation	Promotion Growth	Corpus growth*
2022-2031	12.50%	2.70%	4.00%	5.40%	6.00%
2032-2041	12.50%	2.50%	3.00%	5.00%	5.00%
2042-2051	12.50%	2.20%	3.00%	4.40%	5.00%
2052-2061	12.50%	2.00%	2.00%	4.00%	4.00%
2062-2071	12.50%	2.00%	2.00%	4.00%	4.00%
2072-2081	12.50%	2.00%	2.00%	4.00%	4.00%
2082-2091	12.50%	2.00%	2.00%	4.00%	4.00%
2092-2101	12.50%	2.00%	2.00%	4.00%	4.00%

***Real rate of return assumed to be 2% Explanations-**

1. Fitment factor is the multiplication factor given during the pay revision after subsuming the DA (Accumulated inflation).
2. Yearly increment / growth (7th pay-commission it is 2.7%)
3. DA / Inflation- government declares every six months. Since RBI is targeting 4% inflation, DA would hover around 4% as the economy matures
4. Promotion growth (every 6th year) is the pay increment

Annex-3 Assumptions for analysis of state of Andhra Pradesh

Assumptions

1. Pension fixed at 50% of last drawn pay for OPS
2. Earnings rate for corpus assumed at 4%*
3. State Owned revenues growing at 4% for various scenarios*
4. Number of recruitments at 50% of number of retirements in the same year
5. Contribution rate at 20%
6. Annual Salary growth including DA and fitment assumed to be 10%
7. Mortality rate as per Indian Assured Lives Mortality (used by pension firms)

*Calibrated model of pension and states owned revenue growth

Years Assumed	Rate
2023-25	7.50%
2026-30	7.00%
2031-35	6.50%
2036-40	6.00%
2041-45	5.50%
2046-50	5.00%
2051-55	4.50%
2056-60	4.00%
2061-65	3.50%
2066-70	3.00%
2071-80 2.50%	-2.5%
2081-2100 2.00	2.00%
2023-2100 (Effective rate)	4.00%

Annex-4 Assumptions for Life Insurance Cover

Assumptions

1. 7th pay matrix as Annexed in Annexure-1
2. Life Insurance premium- Representative quotes for individual covers taken from one of the insurer providers in the Indian market. The average annual premium cost per employee is approximately ₹ 650 per 10 Lakhs.

Bibliography

1. (Goswami 2001)- INDIAN PENSION SYSTEM: PROBLEMS AND PROGNOSIS
2. (B.K.Bhattacharya 2003) Report of the Group to Study the Pension Liabilities of the State Governments
3. (Robert Gillingham 2001)- Robert Gillingham and Daniel Kanada IMF working paper on Pension reforms in India
4. (OASIS 2001)- The project OASIS Report (Old Age Social and Income Security Project)
5. (Rachit Solanki 2023)- Fiscal Cost of Reverting to the Old Pension Scheme by the Indian States – An Assessment. https://rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=22058#:~:text=The%20NPS%20is%20a%20DC,from%20the%20State%20gover nment%204.
6. (Vaidyanathan, 2022). "OPS, NPS and the Alternative" https://www.thehindubusinessline.com/opinion/ops-nps-and-the-ap-alternative/ article65481198.ece.
7. State Finances: A Risk Analysis, Reserve Bank of India Bulletin, June 2022, https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/6STATEFINANCESARISKANALYSIS143105EB27A744E1B9C404CF7D96909A.PDF.

12

Innovations in State Finances: Odisha

Hrudaya Kamala Jena
Additional Secretary, Finance Department
Government of Odisha

1.0 Introduction

Odisha has emerged as a model state for fiscal prudence and economic resilience in recent years. The state has effectively leveraged its diverse economic base, strong revenue streams, and disciplined fiscal management to achieve sustainable economic growth. The fiscal policy adopted by the State Government during Covid-19 stands out as an example of sound public finance management. Odisha has made strides in improving its infrastructure, industrial capacity, and social welfare, balancing short-term fiscal needs with long-term growth aspirations. As the state continues to implement innovative reforms in public financial management, it stands poised to further enhance its economic stature and improve the quality of life for its citizens. This section gives an overview of the state's economy and fiscal position.

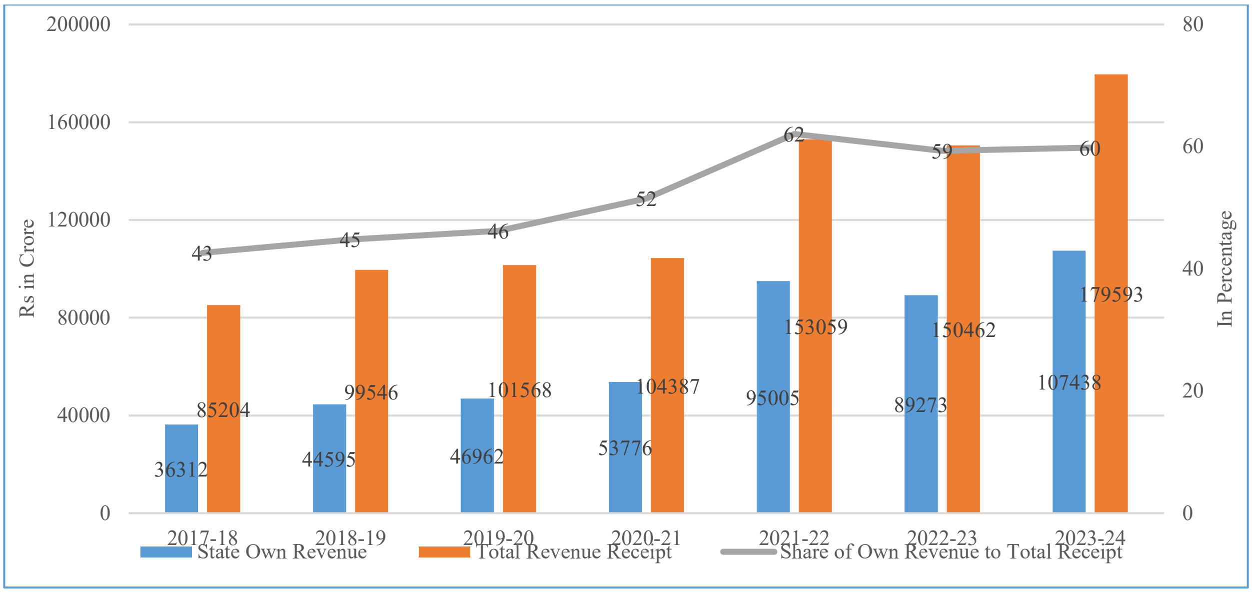
If we look at the key economic parameters, then we can see that the state has made continuous improvements. The state's gross domestic product (GSDP) in current prices was at Rs. 8.32 lakh crore in FY 2023-24 as per the advances estimate and is estimated to reach 9.26 lakhs crore in FY 2024-25 reflecting a growth of about 11%. Over the past 10 years, excluding the COVID-19 affected years of 2020-21 and 2021-22, Odisha's economy has grown at an average real growth rate of 7.3%, showcasing its resilience and sustained economic growth.

For the financial year 2024-25, budget size of Rs. 2.65 lakh crore has been proposed which represents 29% of its GSDP. Odisha continues to maintain fiscal prudence, with a projected revenue surplus of 3% of GSDP in FY 2024-25. Fiscal Deficit is estimated to be 3.5% of its GSDP, which is within the FRBM limit as per the recommendations of 15th Finance Commission. Capital outlay for 2024-25 is expected to be Rs. 58,195 crores, which is 6.3% of GSDP, emphasizing Odisha's focus on capital investments and infrastructure development.

2.0 Resource Position of Odisha

The share of own revenue in total revenue receipts of the state has increased from 43% in FY 2017-18 to 60% in FY 2023-24. During the same period, the contribution of own non-tax revenue to the total own revenue grew from 36% to around 50%. This growth in own non-tax revenue is mainly on account of increase in revenue realisation from mining sector. If we look at the share of central transfers to the state, it has decreased. Over the last decade, the dependency on central transfers to the state has reduced to some extent. However, the total central transfer which consists of "Share in Central Taxes" and "Grants-in-Aid from the Centre", is about 44% of the total revenue receipts. Besides mining revenue, GST is another major source of revenue for the state after implementation of GST in 2017. The GST revenue was initially supported by compensation received from the Central Government. The chart below shows the share of own revenue to the total revenue receipt of the state.

Chart-1



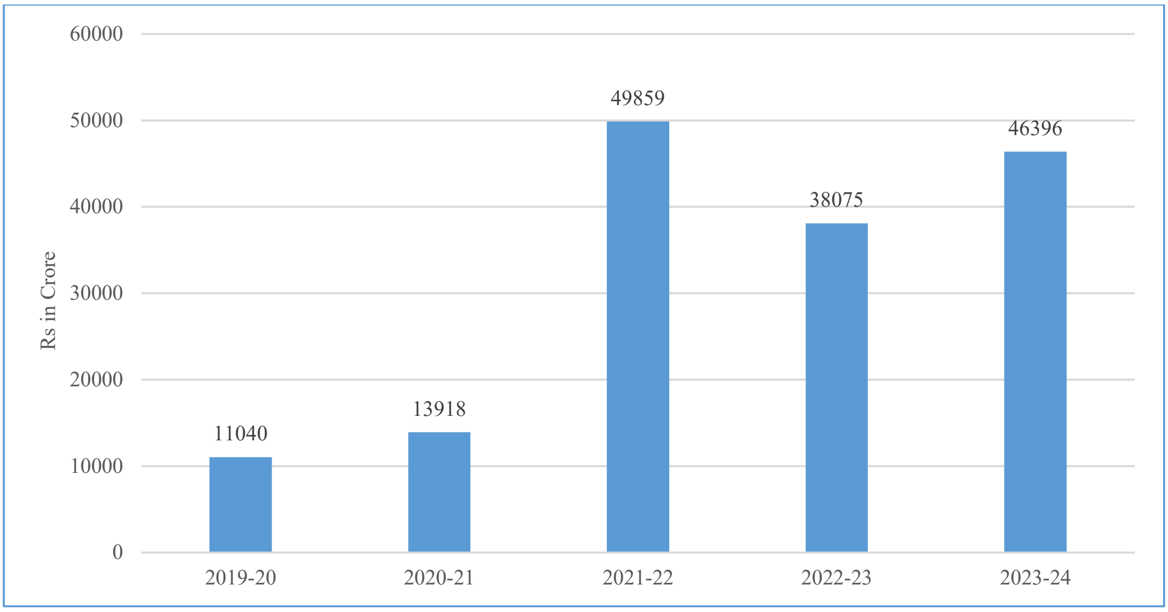
2.1 Revenue from Mining Sector & Its Associated Challenges

Odisha is endowed with vast resources of a variety of minerals and occupies a prominent place in the country as a mineral rich State. Abundant reserves of high-grade Iron ore, Bauxite, Chromite, Manganese ore along with other minerals such as Coal, Limestone, Dolomite, Tin, Nickel, Vanadium, Lead, Graphite, Gold, Gemstone, Diamond and Decorative Stone etc. are extensively available in the State. This has opened up immense possibilities for establishment of mineral based industries for manufacture of Steel, Ferroalloys, Cement, Alumina/ Aluminium, Refractories, Thermal Power etc., along with setting up other auxiliary and ancillary downstream industries.

Mining revenue is a crucial component of the state's finances, accounting for approximately 90% of the state's own non-tax revenue, 45% of total own revenue, and 26% of total revenue receipts. The rise in mining revenue is not a one-time windfall but is expected to persist throughout the 50-60 year lease period of the auctioned mines, providing a sustainable and reliable source of income for the state over the long term.

The contribution of non-tax revenue from mining sector has substantially gone up from 39% of own revenue in FY 2020-21 to 52% in FY 2021-22. The growth in mining revenue is about 258% due to new e-auction policy adopted by the Odisha Government. This trend is likely to continue in the medium term also. Chart-2 below shows the mining revenue over the last 5 years.

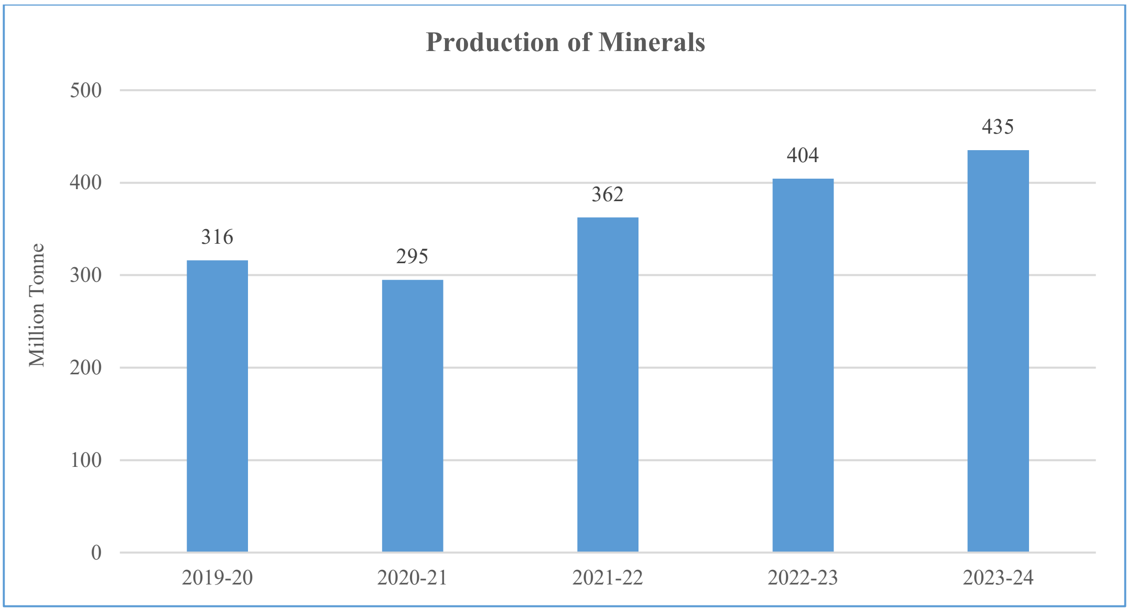
Chart-2 : Revenue from Mining



Due to the shift in the policy, some of the mines have been auctioned with premium payment up to 150% over and above the royalty payment of 15% (14% for coal). As a result, there has been a focus on the manufacturing in the state, rather than export to other states and countries. This change in policy has created a win-win situation for new miners who have their own industries inside the state or who intend to setup their industry inside the state. This has ensured value addition in the state economy as well as employment generation in mining and associated industrial sector. Chart-3 below shows production of minerals over the last 5 years.

This significant growth of revenue was not the result of greater amount of extraction, instead this upsurge has been witnessed due to a new e-auction policy adopted by the state government. In other words, The growth is not due to increase in production of minerals, rather due to transition to scientific mining and transparent auction policy.

Chart-3 : Production of Minerals

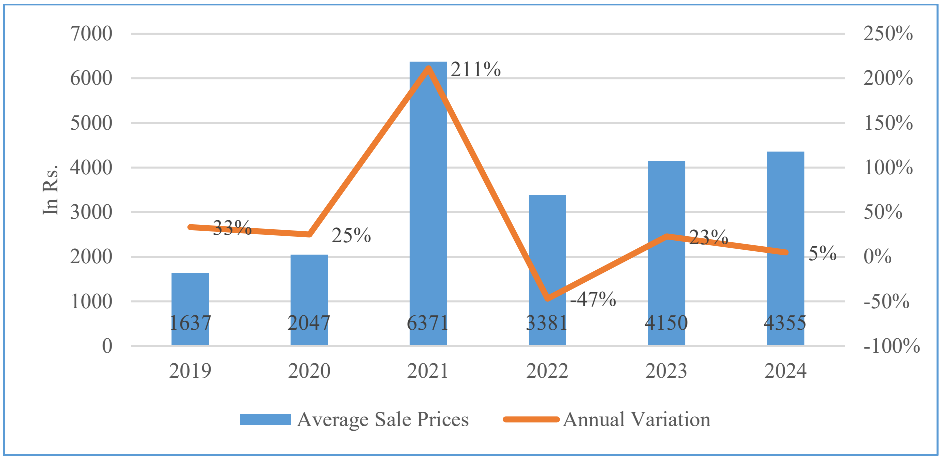


2.2 Fiscal risk associated with the mining revenue

Revenue from this sector is sensitive to price fluctuation and demand for metals in national and international markets. Also, it is subjected to variation in exchange rate between Indian Rupee and benchmarked currencies of the world.

Firstly, the Indian Bureau of Mines sets mineral prices based on market demand for metals. Price fluctuations of 30-40% annually may be a natural phenomenon based on certain environmental changes, which may create fiscal risks for the state. Secondly, these unpredictable price changes can affect the stability of mining revenue, making long-term fiscal planning more challenging. Finally, despite Odisha having 205 working mines, only 24 have been auctioned, further limiting the state's ability to fully capitalize on its mining resources. Chart-4 below shows variation in average sales price of Iron Ores (60% to 62% fine grade Iron Ores average sales prices).

Chart-3: Variation in average sales price of Iron Ores



2.3 Budget Stabilisation Fund:

Considering the financial risks associated with mining revenue, the State Government has decided to put in place a "Budget Stabilisation Fund" which will act as a buffer fund to ensure financial stability during the period of negative shocks from the mining sector. Potential revenue from the mining sector over the medium term has been worked out. In case of positive shocks i.e. higher than expected mining revenue, transfer of fund to BSF is effected and in case of negative shocks i.e. lower than expected mining revenue, drawdown from the fund will be done to maintain fiscal balance.

Rules and detailed accounting procedure have been formulated for such withdrawal and addition to the budget stabilisation fund in concurrence with the Accountant General, Odisha. Further, Special drawing facility is also available against the investment made in the fund. The rules also provide that The fund shall not be used for any purpose other than to supplement resources in exceptional circumstances when there is negative shock from mining revenue. State Government has transferred Rs.18700 crore to the fund till date.

3.0 Optimal use of resources:

Optimal use of resources involves balancing short-term fiscal needs with long-term developmental goals. Increase in mining revenue has resulted in increase in fiscal space for the state to undertake higher capital investment. For optimizing use of resources, State Government has taken a number of new initiatives some of which are explained in detail:

- **Strategic top down budgeting with advanced communication of budget ceiling**: The State Government has introduced top-down budgeting through advance communication of budget ceilings to line departments from FY 2020-21. To have predictability of budgetary outlay and aid in multi-year project planning, line departments have been indicated the broad expenditure ceilings in advance for the Budget Year i.e., Y along with Y+1 and Y+2. This will ensure that the line departments prioritize their expenditures, reducing gaps between budget proposals and actual allocations.

- **Medium Term Fiscal Framework (MTFF) for realistic estimation of revenue and expenditure**: MTFF is being used as a reference point for preparation of annual budget. The process has made things easy for the government to plan things in advance based on the forecasted revenue. Revenue receipt and GSDP growth scenarios are developed by projecting different economic conditions (optimistic, pessimistic, and moderate) to predict fiscal trends. These scenarios help in assessing future revenue performance and fiscal sustainability, linking revenue growth to GSDP growth with appropriate elasticity assumptions.
- **Publication of Fiscal Strategy Paper**: Fiscal Strategy Paper is a pre-budget disclosure document published annually as an outcome of the MTFF process. It facilitates stakeholders' engagement and serves as an early indication of the State government's strategic intent for the forthcoming budget and the medium-term fiscal outlook.
- **One supplementary budget in a year**: To improve budget credibility and transparency further, we have limited the practice of going for a supplementary budget to only once every financial year.

4.0 Money Savings lead to Wealth Creation:

4.1 Low Cost Borrowing

As a fiscally responsible and revenue-surplus state, Odisha has consistently maintained sound financial management practices. The composition of debt stock has transitioned from some of the high-cost borrowing sources such as National Small Saving Fund (NSSF), Open Market Borrowing (OMB) to low cost borrowing sources.

State Government has taken an innovative step to avail loans from Odisha Mineral Bearing Area Development Corporation (OMBADC) Fund and Compensatory Afforestation (CAMPA) Fund, where rate of interest is 1.5 to 2% lower than Open Market Borrowing (OMB). Up to 60% of the surplus fund available in these dedicated funds can be borrowed by the State Government. The tenure of lone from these funds is generally one year.

Odisha has maintained relatively low debt levels compared to other states, which gives it room to borrow for productive investments. Debt is being prudently managed, with borrowings used primarily for capital expenditures. The State Government has not opted for Open Market Borrowing in the last three financial years i.e. 2021-22, 2022-23 and 2023-24.

Odisha's average borrowing cost of 5.5% is among the lowest in the country, supported by a long debt maturity profile that allows for smoother repayments. With minimal foreign currency loan in the debt portfolio of the state, exposure to exchange rate fluctuations is reduced. Projections for the coming five years include assessments of debt stock, GSDP ratio, and interest payments, ensuring continued fiscal responsibility. Since the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act in 2005, Odisha has consistently remained compliant with its provisions. Chart-4 shows the debt to GSDP ratio over the last 5 years. Chart-5 shows the average rate of interest for the state government.

Chart-4: Debt to GSDP ratio

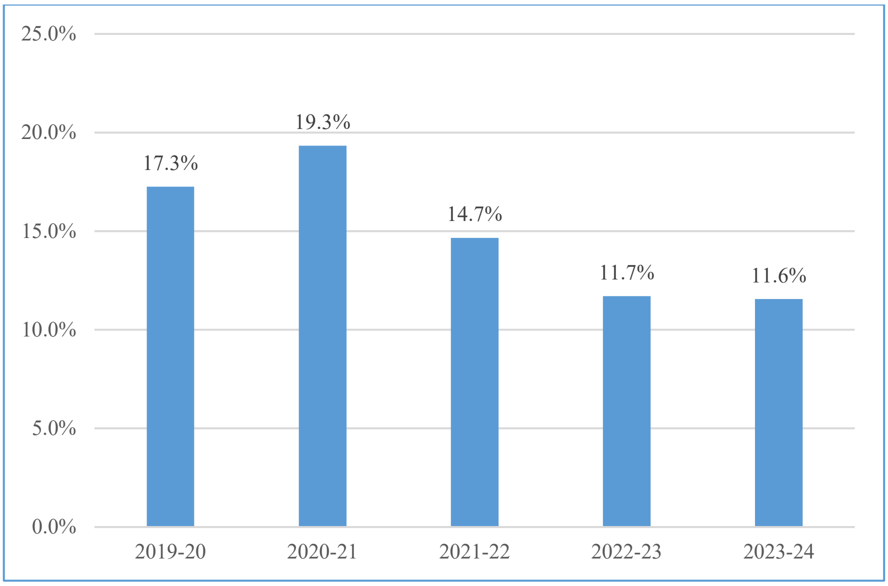
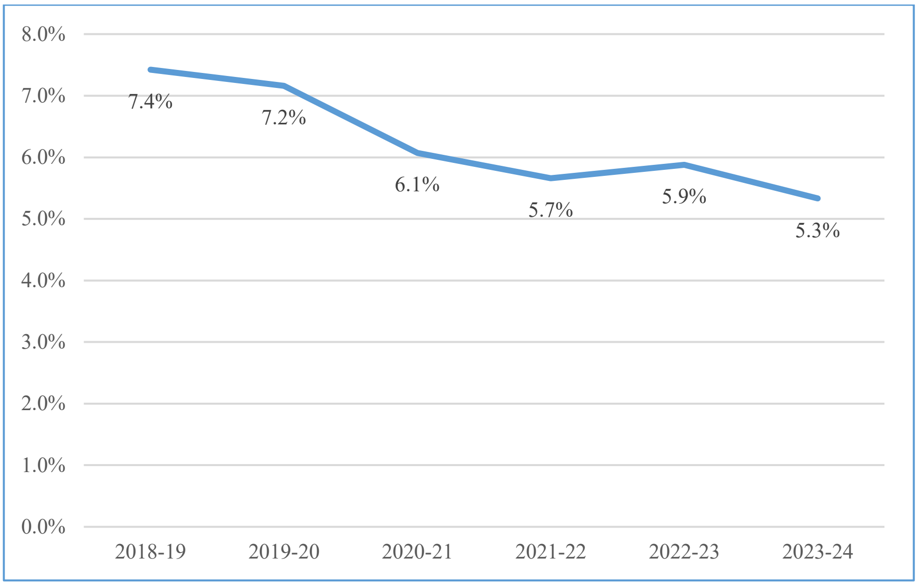


Chart-5: Average Rate of Interest



4.2 Just-In-Time Funding System

Earlier, funds were drawn prematurely from the Consolidated Fund of the State and parked in designated bank accounts before being fully utilised. This led to inefficiencies, as unutilised funds remained idle in the bank accounts of grantee institutions, causing cash mismatches and delays in submitting utilisation certificates (UCs). These issues disrupted liquidity management and created artificial shortages, impacting the state's fiscal discipline.

To address these concerns, Odisha introduced the "Just-in-Time Fund Release System (JITFS)" within its Integrated Financial Management System (IFMS). JITFS ensures that funds are released only when required, avoiding the practice of idle fund float. The system automates e-payments and is integrated with the Reserve Bank of India's e-Kuber platform for seamless and timely disbursement of funds. This system improves cash flow management by disbursing funds at the right time, reducing the mismatch between fund allocation and actual utilisation.

Furthermore, JITFS grants operational autonomy to Scheme Implementing Agencies (SIAs), ensuring that they can manage their funds efficiently while still adhering to fiscal discipline. By closely monitoring fund releases and linking them to actual needs, Odisha has significantly enhanced its cash management practices, minimising delays in UC submission and ensuring that public funds are utilised optimally. The introduction of JITFS marks a significant improvement in Odisha's financial governance, ensuring both efficiency and accountability in managing public resources.

➢ https://blog-pfm.imf.org/en/pfmblog/2024/08/smart-payments-making-fiscal-transfers-just-in-time

4.3 Short-term Cash Management

Odisha has made substantial progress in strengthening Public Financial Management (PFM) to ensure effective short-term cash management. Several mechanisms have been introduced to optimise the state's cash flow and improve fiscal discipline. One of the primary improvements is the coordination between the "Cash and Debt Management Units", which work together to manage cash flow forecasting and debt planning. This ensures that the state maintains an optimal balance between its available cash and its borrowing requirements.

To maintain liquidity and safeguard against cash shortages, the state also keeps a cash buffer. This buffer helps in managing unexpected fluctuations in cash flow and enables the efficient investment of any surplus cash. The introduction of an online Cash Management Module has further streamlined cash management by ensuring a more even distribution of expenditure throughout the fiscal year. This system helps reduce the traditional rush of spending towards the end of the fiscal year, promoting more prudent financial practices.

Odisha also uses an Excel-based Cash Forecasting and Analysis Tool (CFAT) to project its cash requirements monthly, quarterly, and annually. This tool provides accurate cash flow forecasts, allowing for better planning and management of the state's financial resources.

4.4 Getting ready for Fiscal Risks:

Odisha has undertaken financial risk analysis. Required institutional arrangement has been put in place for fiscal risk analysis. **Fiscal Risk and Debt Management Unit**, **PPP Directorate** and **Fiscal Risk Committee** have been constituted to oversee and to provide direction. PPP Directorate has been set up to compile all information related to total fiscal commitments, contingent liabilities concerning all PPP projects under implementation and in pipeline.

Fiscal Risk Analysis includes risk identification and quantification, risk classification, risk reporting in the form of disclosure statement and finally putting in place apposite risk mitigation measures. All possible sources of risk such as macroeconomic, institutional, risks emanating from SOEs, PPP, Natural Disasters, Government Guarantees etc, have been identified. Risks are also quantified as percentage of GSDP.

Risk Assessment is done based on its financial impact and likelihood of realization. Based on the assessment, risks are classified and put into a risk matrix. The **Fiscal Risk Matrix** is being updated regularly taking into account the recent developments.

Chart-6: Fiscal Risk Matrix

Fiscal impact				
	High (>0.5% of GSDP)	• Growth slowdown	• GST revenues • Central Transfer	• Natural disasters • Mining-related revenues • Electricity sector – Energy Sector PSUs
	Medium (0.1% - 0.5% of GSDP)	• Risks from Public sector undertakings	• Social security programs • Food Supply Department • Government Institutions • Investment scams of small-scale investors	• Inflation • Non-performing assets of public financial institutions
	Low (<0.1% of GSDP)	• PPPs • Tax refunds under litigation • Pension schemes • Foreign-currency debt	• Line departments	
		Low (<10%)	Medium (10%-50%)	High (>50%)
	Likelihood of realization			

State PSUs/SOEs receive budgetary support in the form of equity capital, loans and subsidies from the State Government. It is critical for the State Government to undertake strategic oversight, monitoring and fiscal analysis of high-risk PSUs. The SOE Risk Analysis Tool developed with technical inputs from the IMF-SARTTAC has helped in analysing the fiscal health of the SOEs.

We are also using the Fiscal Risk Assessment Tool (FRAT) of IMF for fiscal risk assessment in Odisha. In fact, **FRAT was piloted by IMF in Odisha**. Fiscal Risk Assessment Tool (FRAT), developed by IMF was piloted in Odisha: https://blog-pfm.imf.org/en/pfmblog/2021/06/the-frat-brings-order-to-the-fiscal-risk-party

Fiscal Risk Reporting is critical for ensuring transparency and accountability. Public disclosure about various risks and the risk mitigation measures adopted by Government will enhance the credibility. The State Government is bringing out a **Fiscal Risk Statement** along with the annual budget every year.

RBI in its 'State Finances: A Study of Budgets of 2020-21' report (page-34) has recognized Fiscal Risk Management in Odisha as a best practice in financial management in India. Principal Secretary, Finance presented Odisha's Fiscal Risk Management Practice as a case study in the IMF's Spring Meetings 2022.

5.0 Institutional Mechanism

Odisha has established a robust institutional mechanism to drive Public Financial Management (PFM) reforms. Key elements of this framework include:

- **Partnership with CEFT (Centre for Excellence in Fiscal Transparency)**: Odisha collaborates with CEFT for academic inputs, enhancing the effectiveness of PFM initiatives through expert guidance.

- **Directorate of PPP**: This dedicated directorate conducts comprehensive risk analyses of Public-Private Partnership (PPP) projects, ensuring that fiscal risks are well-identified and mitigated.
- **Fiscal Risk Management Committee and Cash Coordination Committee**: Both committees, chaired by the Secretary of Finance, oversee fiscal risk assessments and cash flow management. Their role is critical in ensuring systematic monitoring of fiscal risks and the efficient management of the state's liquidity.

These institutional arrangements have significantly improved fiscal governance, ensuring better financial management and transparency in Odisha's public finances.

13

Innovations by the Government of Karnataka

L.K Atheeq I.A.S Additional Chief Secretary to Govt. Finance Department

Government of Karnataka

Karnataka has consistently been at the forefront of India's development trajectory. Karnataka is renowned for its innovation, industrial growth, and a highly skilled talent pool that excels across multiple economic and developmental parameters.

Karnataka's growth has been anchored in its sound fiscal management. Over the last decade, the state has adhered to the fiscal prudence outlined in the Karnataka Fiscal Responsibility Act (KFRA), maintaining its fiscal deficit within permissible limits (2.95% in the 2024-25 Budget Estimates) and its debt-to-GSDP ratio at 23.2%, within the limits set by the framework.

The Government of Karnataka is committed to enhancing its fiscal management through innovative strategies that ensure sustainable development and efficient resource allocation. Two key themes driving this include:

1. **Public Private Partnerships (PPPs) to create good quality infrastructure with minimum government fund outlay**

PPPs enable state governments to deliver critical infrastructure with minimal upfront capital, reducing fiscal burden. By leveraging private sector expertise and efficiency, PPP projects often result in higher-quality outcomes, ensuring better service delivery and long-term value for public investment.

2. **Innovative Financial Instruments**

Identifying new, cost-effective sources of capital is critical for driving the state's economic development and enhancing financial resilience. Innovative financial instruments can support the state and para-statal bodies to access diverse funding sources for large-scale infrastructure projects as well as other capital requirements.

By adopting innovative financing strategies, the state can reduce reliance on traditional funding sources, alleviate fiscal pressure on the budget, and ensure more efficient capital allocation.

Below are the details of the initiatives undertaken by the state across the two themes.

PPPs to create good quality infrastructure with minimum government fund outlay

Exhibit #1: Bengaluru International Airport Limited (BIAL)

BIAL is the third-largest airport in India, serving as a key transportation hub and economic driver for the region. Established under a Public-Private Partnership (PPP) model, BIAL involves stakeholders from the Government of Karnataka (GoK), Airports Authority of India (AAI), and private sector entities such as Fairfax India and Siemens. Since its inception, the airport has played a pivotal role in connecting Bengaluru to global destinations and stimulating local economic growth.

- In 2023, BIAL handled 36.5 million passengers, and with the ongoing expansion of Terminal 2, this figure is projected to exceed 50 million by 2025.
- The long-term vision includes handling 100 million passengers annually by 2033-34, following the completion of Terminal 3 and further developments at Terminal 2.
- The airport currently facilitates approximately 750 flights per day, including 650 domestic and 90 international flights.

Stockholding Structure

BIAL operates under a well-defined PPP framework, with the following ownership distribution:

- The Government of Karnataka (GoK) retains a 13% equity stake since inception.
- Fairfax India holds the largest share at 54%, having acquired its stake from GVK in 2017.
- Siemens owns 20%.
- The Airports Authority of India (AAI) holds the remaining 13%.

This collaborative ownership structure ensures that both public and private interests are aligned toward the airport's long-term growth and development.

Government of Karnataka Investment and Returns

The Government of Karnataka made an initial equity infusion of INR 50 crore in BIAL in 2006, acquiring a 13% stake in the airport. As of the latest valuation, this stake is now worth INR 2,700 crore, reflecting a more than 50-fold increase in value. BIAL's current valuation stands at approximately USD 2.5 billion, showcasing the significant financial returns on the GoK's early investment.

Employment and Economic Impact

BIAL has been instrumental in generating employment both directly and indirectly. The airport currently provides over 38,000 direct jobs. In addition, it has generated significant indirect employment, which includes employment related to industry linkages such as the construction of the airport. Furthermore, the airport has created induced employment, which refers to employment due to increased consumption induced by the rise in direct and indirect employment. This broad employment spectrum encompasses not only aviation-related jobs but also jobs in infrastructure development, retail, and hospitality sectors, contributing substantially to the local and regional economy.

Revenue Streams for the Government of Karnataka

The Government of Karnataka benefits from several revenue streams linked to BIAL's operations. To date, BIAL has generated INR 184 crore in lease rentals, with a projected revenue of INR 3,500 crore over the next 44 years from ongoing lease agreements. The state also derives revenue from taxes, duties, and VAT associated with fuel uplift at the airport. Additionally, the airport's expansion has facilitated significant land registration revenue through land monetization in North Bengaluru, further boosting the state's financial returns from the project.

Conclusion

BIAL stands as a prime example of the success of a Public-Private Partnership, benefiting both the Government of Karnataka and private stakeholders. The airport's rapid growth, impressive valuation, employment generation, and substantial revenue streams underscore its importance to Karnataka's economy. The Government's initial equity infusion of INR 50 crore has not only yielded strong financial returns but has also contributed to the state's economic development, employment, and infrastructure expansion. Looking ahead, BIAL's continued growth, particularly with the upcoming expansions of Terminals 2 and 3, will further enhance its role as a key driver of both local and national growth.

Exhibit #2: Knowledge Wellbeing and Innovation (KWIN) City

The Knowledge Wellbeing and Innovation (KWIN) City is an ambitious project aimed at establishing a state-of-the-art innovation and research hub near Bengaluru, Karnataka. This project integrates healthcare, education, and research to redefine global standards and foster significant collaborative opportunities.

KWIN City will concentrate on five emerging themes in sunrise sectors to drive innovation and economic growth:

1. **Life Sciences** will be a major focus, encompassing medical devices, biotechnology, biosimilars, regenerative medicine, and personalized medicine. These areas promise significant advancements in healthcare and medical treatments, addressing critical health challenges and improving patient outcomes.
2. **Future Mobility** will also be a key sector, with an emphasis on electric vehicles, autonomous vehicles, Li-ion batteries, alternative energy storage solutions like fuel cells, and high-speed rail equipment. This sector aims to revolutionize transportation, making it more sustainable and efficient.
3. **Semiconductor and Advanced Materials** are crucial for modern technology, with focus areas including semiconductors, smart materials, nanotechnology, carbon nanotubes, and sustainable packaging. These technologies are foundational for various high-tech applications, driving innovation across multiple industries.
4. **Advanced Manufacturing** will focus on commercial and industrial robotics, IoT, RFID, sensors, augmented and virtual reality, smart devices, and additive manufacturing. This sector aims to enhance manufacturing processes, making them more intelligent, efficient, and adaptable to new demands.
5. Finally, **Aerospace, Defense, and Space Technology** will cover unmanned aerial vehicles (drones), nano and micro satellites, reusable launch vehicles, integrated defense platforms, and propulsion technology. This sector is poised to push the boundaries of space exploration and defense capabilities, fostering technological advancements that have far-reaching implications.

These focus sectors align with global trends and market demands, ensuring that KWIN City becomes a hub for cutting-edge research, innovation, and industrial growth.

Stakeholders

The stakeholders of the KWIN City project form a diverse and integral group, each contributing significantly to its success. The Government of Karnataka stands as a primary stakeholder, offering land as equity, facilitating regulatory frameworks, and providing both financial and non- financial incentives to attract investments. These incentives include subsidies, and streamlined processes to enhance ease of doing business, ensuring a supportive environment for all participants.

Industry players, including multinational corporations (MNCs), startups, and Indian corporates, are crucial for driving sector-specific advancements and innovations. These entities will establish Global Capability Centers (GCCs), R&D centers, and corporate offices within KWIN City, fostering a dynamic ecosystem of innovation and development. Their involvement will not only bring cutting-edge technology and practices but also create numerous job opportunities, boosting the local economy and talent pool.

Academic institutions are expected to set up satellite centers, enhancing education and research. Prestigious universities and research institutions will collaborate on advanced projects, contributing to groundbreaking discoveries and innovations. These institutions will offer specialized courses and training programs, aligning with the city's focus sectors, and ensuring a continuous supply of skilled professionals. Their presence will attract students and researchers from around the world, turning KWIN City into a global education hub.

Healthcare providers will play a key role in establishing state-of-the-art hospitals, creating a world-class healthcare infrastructure within the city. This will include advanced medical facilities, research hospitals, and specialty hospitals, providing high-quality healthcare services to residents and medical tourists. The integration of healthcare and research will lead to innovations in medical treatments and technologies, positioning KWIN City as a leader in global healthcare standards.

Master developers are also essential stakeholders, recognizing the project's potential for innovation and mutual growth. They will bring their expertise in large-scale infrastructure projects, ensuring the timely and high-quality development of the city's facilities. Their role will also involve maintaining the quality and sustainability of the infrastructure.

Local communities and residents will also play a vital role as stakeholders, contributing to and benefiting from the city's growth. Their participation in the planning and development processes will ensure that the city meets the needs and expectations of its inhabitants, fostering a vibrant and inclusive community.

Phased development: The development of KWIN City will be implemented in four strategic phases to ensure sustainable growth and market alignment. Each phase will incrementally expand the city's infrastructure and capabilities, starting with the initial phase of establishing foundational elements and progressively building towards a fully integrated and advanced ecosystem. This phased approach ensures that development is aligned with market demand and commercial feasibility while providing ample opportunity to attract and integrate diverse stakeholders.

KWIN City's development encompasses multiple revenue generators that significantly contribute to the government's financial health. The project spanning around ~2,000 acres is expected to generate significant economic benefits for Karnataka, with projected revenues of approximately INR 6,000-6,500 Cr from multiple sources incl. Stamp duty, SGST and other taxes.

Innovative financial instruments

Exhibit #3: Inter Corporate Deposits

Inter-Corporate Deposits (ICDs), as permitted under the provisions of the Companies Act, 2013, offers a mechanism for the state (Public Sector Undertakings) PSUs to lend and borrow funds amongst themselves.

For PSUs with surplus funds, ICDs present a strategic opportunity to achieve higher returns by deploying surplus capital at competitive interest rates, thereby improving returns compared to traditional bank deposits. Simultaneously, borrowing entities benefit from accessing funds at interest rates lower than those typically offered by commercial banks or other financial institutions.

The initiative fosters financial stability and resilience across Karnataka's PSUs, creating a mutually beneficial financial ecosystem that enhances the state's overall economic development. By utilizing ICDs, both lenders and borrowers can secure more favorable interest rates than those available through conventional market instruments, thereby promoting more efficient financial intermediation within Karnataka's public sector.

Eligibility for lenders per Companies Act, 2013:

The following are the eligibility criteria for companies to be able to lend via Inter Corporate Deposits:

- A company without any defaults in the repayment of any deposits or in payment of interest – as per Section 186 (8) of Companies Act, 2013.
- Further, prior approval of the public financial institution (where any term loan is subsisting) is required if:
  - Lender's aggregate total of investments, loans, guarantee or security so far provided and proposed to be made to other corporates exceeds the limit mentioned in the terms of transaction.
  - Lender has defaulted on loan repayments or interest payments to the public financial institution – as per Section 186 (5) of Companies Act,2013.

Terms of transaction per Companies Act, 2013:

A company can provide Inter Corporate Deposits at a maximum loan amount that is greater of the following two limits L1 and L2:

- L1: 60% of its paid-up capital + free reserves + securities premium account.
- L2: 100% of its free reserves + securities premium account.
- Above limit can be exceeded if authorized by a special resolution passed in the company's general meeting – as per Section 186 (2) of Companies Act, 2013.

Interest Rate norms per Companies Act, 2013: Loans must have an interest rate that is at least as high as the current yield of the government security closest to the loan's term. As of 2nd July 2024, Govt. of India's 10-year bond yield is 7% – as per Section 186 (7) of Companies Act, 2013.

Number of Investment Layers per Companies Act, 2013:

A company must make investments through no more than two layers of investment companies – as per Section 186 (1) of Companies Act, 2013.

Exemptions: Any loan made by the following companies are exempt from the above rules:

- Company established with the objective of and engaged in the business of financing industrial enterprises (or) of providing infrastructural facilities.
- Government company engaged in defense production.
- If the government company obtains approval from the relevant government authority (state/ center) before making any loan.

- Banking / insurance / housing finance company.

NBFC – as per Section 186 (11) of Companies Act,2013

Potential interest rate savings have been identified for PSUs via Inter Corporate Deposits by evaluating two primary components:

- Incremental interest rate value for a PSU by lending liquid assets through ICDs instead of Fixed Deposits (FDs). The interest rate differential for the lender ranges from 0.5% to 1.2% depending on the tenure of the ICD.
- Interest rate savings for borrowing PSU by opting for ICDs over conventional debt instruments. The interest rate differential for the borrower ranges from 0.5% to 1.2% depending on the tenure of ICD.

ILLUSTRATIVE EXAMPLE: Interest rate savings for borrowing and lending entities

Company A currently holds INR 4,000 crore in reserves and surplus, distributed across various term deposits at 7.9% annual interest rate. Assume that Company A invests half of its reserves (INR 2,000 crore) in ICDs to fellow PSUs.

Borrowers currently secure loans from the market at a high interest rate. For example, Company B's loan book's weighted average interest rate is 9.3%.

By facilitating an inter-corporate transaction between the two at an assumed interest rate of 8.7%, Company A would realize an additional interest benefit of 0.8%, resulting in an annual gain of INR 16 crore. Simultaneously, Company B would benefit from an interest saving of 0.6%, yielding savings of INR 12 crore annually.

This would generate a **combined financial benefit of INR 28 crore per annum for the system** from 1 transaction.

Implementation of Inter Corporate Deposits in Karnataka

11 organizations have been identified as potential lenders based on their financial strength and 9 borrowers across Road Transport Corporations and Energy Supply Companies. A government circular is being issued to enable the shortlisted undertakings to implement Inter Corporate Deposits amongst each other in order to ensure effective fund management. The following aspects of the circular are important to ensure effective implementation:

- All concerned entities with reserves and surplus exceeding INR 100 crore shall be required to invest no less than 50% of their total reserves and surplus in Inter-Corporate Deposits (ICDs) as a mandatory compliance measure. In circumstances where adherence to the directive is deemed infeasible, the respective entities must submit a formal justification, duly approved by the Board of Directors.
- The lending corporation to ensure that the interest rate for the inter corporate transactions is at least 50 bps higher than the weighted average annual term deposit rate of interest as on sanction date for the lending organization. In cases where the offered interest rate is lower, the corporation may lend if it is justified.
- The borrowing corporation to provide full disclosure on the intended usage of proceeds. The proceeds to be utilized in the following order of priority: 1) capital expenditure, 2) operations and maintenance. Further, ICD lending may be avoided to the extent possible for company liabilities like PF, salaries, and pensions.
- The borrowing corporation to maintain an updated borrower profile including its financial position, existing and past long/ short term debt, outstanding liabilities, and cash positions.

- The repayment to be facilitated via an escrow account to operationalize an automatic clearance house mechanism by pooling in a share of collected revenue into the escrow account. The borrower to ensure that at least 50% of the remittance is credited in the escrow account at least 15 days prior to the due date.
- In case of default by the borrower, the cost of funds for the transaction shall increase as follows:
    - By 50 bps over and above the agreed upon rate of interest in case of 15 days of default
    - By 100 bps over and above the agreed upon rate of interest in case of 30 days of default
    - In case of further defaults beyond 30 days, the Finance Department shall intervene and remit the outstanding funds from the upcoming subsidy of the borrowing entity, or departmental budget heads, as applicable.
- Standardized operational procedures to be implemented:
    - All transactions to be formalized through legally binding agreements between lending and borrowing corporations.
    - The agreement to be vetted by legal and financial experts from both parties and reviewed timely on a case-by-case basis.
    - The betted proposals to be submitted to the respective boards for approval and further processing.

By adhering to these guidelines, the ICD initiative can be implemented effectively, ensuring mutual benefit and regulatory compliance. This initiative is estimated to generate total benefit of INR 150 – 200 crore per annum across the shortlisted borrowers and lenders thus making it overall beneficial for Karnataka's Public Sector Undertakings (PSUs).

ISBN: 978-81-985527-3-0

National Institute of Public
Finance and Policy, New Delhi
18/2, Satsang Vihar Marg, Special Institutional Area
(Near JNU), New Delhi 110067
Phone: 011-26569303, 26569780, 26569784 ,
Email.: policy.communications@nipfp.org.in .
Web.: www.nipfp.org.in