STATE OF STATE FINANCES

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October 2016

States spend 30% more than centre

No change in spending on key sectors post Finance Commission

States spend 21% of receipts on servicing debt

This report analyses finances of the following 17 states based on their 2016-17 budget documents.

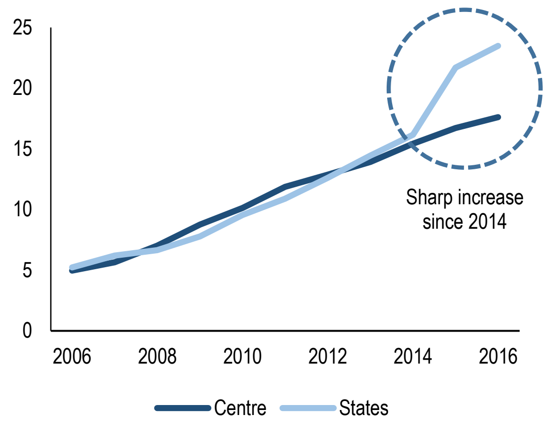
State	Abbreviation	State	Abbreviation	State	Abbreviation
Andhra Pradesh	AP	Jammu and Kashmir	JK	Punjab	PB
Bihar	BR	Karnataka	KA	Rajasthan	RJ
Chhattisgarh	CG	Kerala	KL	Telangana	TS
Delhi	DL	Madhya Pradesh	MP	Uttar Pradesh	UP
Gujarat	GJ	Maharashtra	MH	West Bengal	WB
Haryana	HR	Odisha	OD		

INSIGHTS

States spend 30% more than the central government

- In 2015-16, the centre budgeted to spend Rs 17.6 lakh crore. All states together budgeted to spend approximately Rs 23.4 lakh crore, which was 30% higher than that of the centre.
- Finances of states have been changing due to (i) increased devolution of central taxes, (ii) rationalisation of the Centrally Sponsored Schemes, (iii) the introduction of the UDAY scheme, and (iv) the proposed introduction of GST, among other reasons.
- This report analyses the financial position of 17 states (including one union territory with legislature), based on their annual budgets across the last few years.[1] These states account for over 80% of the total expenditure by all states.

Figure 1: States spend more than the centre

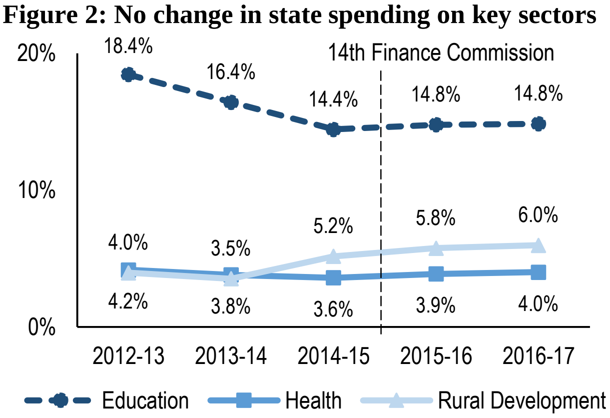


Note: Figures in lakh crore rupees. Centre's expenditure includes grants given to states.
Sources: Indian Public Finance Statistics, Ministry of Finance; PRS.

No significant change in spending on key sectors post 14th Finance Commission

- Following the increase in tax devolution to states, and rationalisation of central spending on schemes, the state expenditure on key social and economic sectors did not witness a substantial change.
- Expenditure on education grew from 14% in 2015 to 15% in 2016. Spending on health and rural development also witnessed marginal increases during this period.

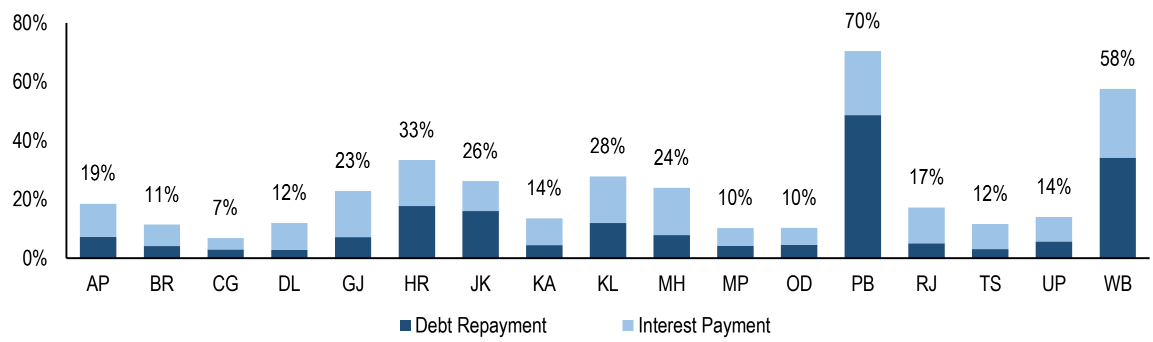
Figure 2: No change in state spending on key sectors



Note: Figures are as a percentage of total expenditure.
Sources: Respective State Budget Documents; PRS.

States spend 21% of their total receipts (excluding borrowings) on debt servicing

Figure 3: Punjab and West Bengal spend a large proportion of receipts on servicing debt (2013-17)



Sources: Respective State Budget Documents; PRS.

- States spend close to 21% of their total receipts (excluding borrowings) on servicing their debts (interest payment and principal repayment) between 2013 and 2017.

RECEIPTS

Receipts indicate the resources available with states to meet their spending priorities. Receipts may be broadly categorised under revenue or capital heads. Revenue receipts of states comprise of their own revenue receipts and funds transferred by the centre. Own revenue receipts of states comprise of, (i) tax revenue which includes various taxes levied by states such as sales tax, excise duty, and stamp duty, and (ii) non-tax revenue, which includes fees charged for providing services such as electricity, water, and forestry. Central transfers to states consist of, (i) share in taxes devolved from the central pool of taxes, and (ii) grants-in-aid for specific purposes and schemes.

Capital receipts result in a change in the assets or liabilities of a state, and include, (i) borrowings of the state, (ii) repayment received for loans advanced by the state, and (iii) proceeds from disinvestment of state public sector enterprises. The capital receipts of states, excluding borrowings, constitute less than 5% of the total receipts of states. For this section, we primarily focus on analysing revenue receipts of states.

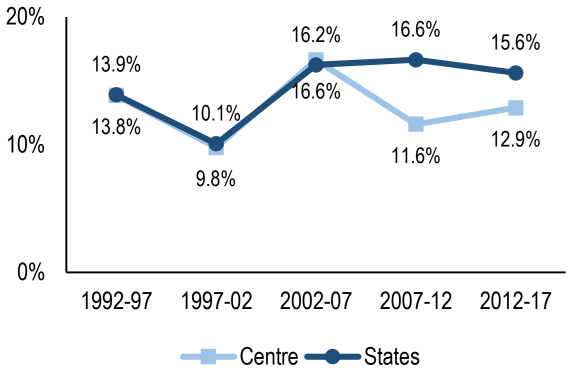
Growth in Revenue Receipts

Revenue receipts of states grew at a higher rate than the centre

Since the early 1990s, revenue receipts of the 17 states have witnessed an annual growth in the range of 10% to 15%, on an average. These receipts have expanded at a rate higher than the centre from 2002 onwards. Between 2012 and 2017, the average growth in revenue receipts for these states has been over 15% (Figure 4).

The revenue growth over the five-year period ranged from 13% in Maharashtra to 19% in Bihar. This growth was led by central transfers, followed by states own receipts. Growth rate for tax and non-tax revenue for all states can be found in Figure 6.

Figure 4: State revenues growing faster than the centre (1991-2016)



Sources: State Finances: A Study of Budgets, RBI; Respective State Budget Documents; PRS.

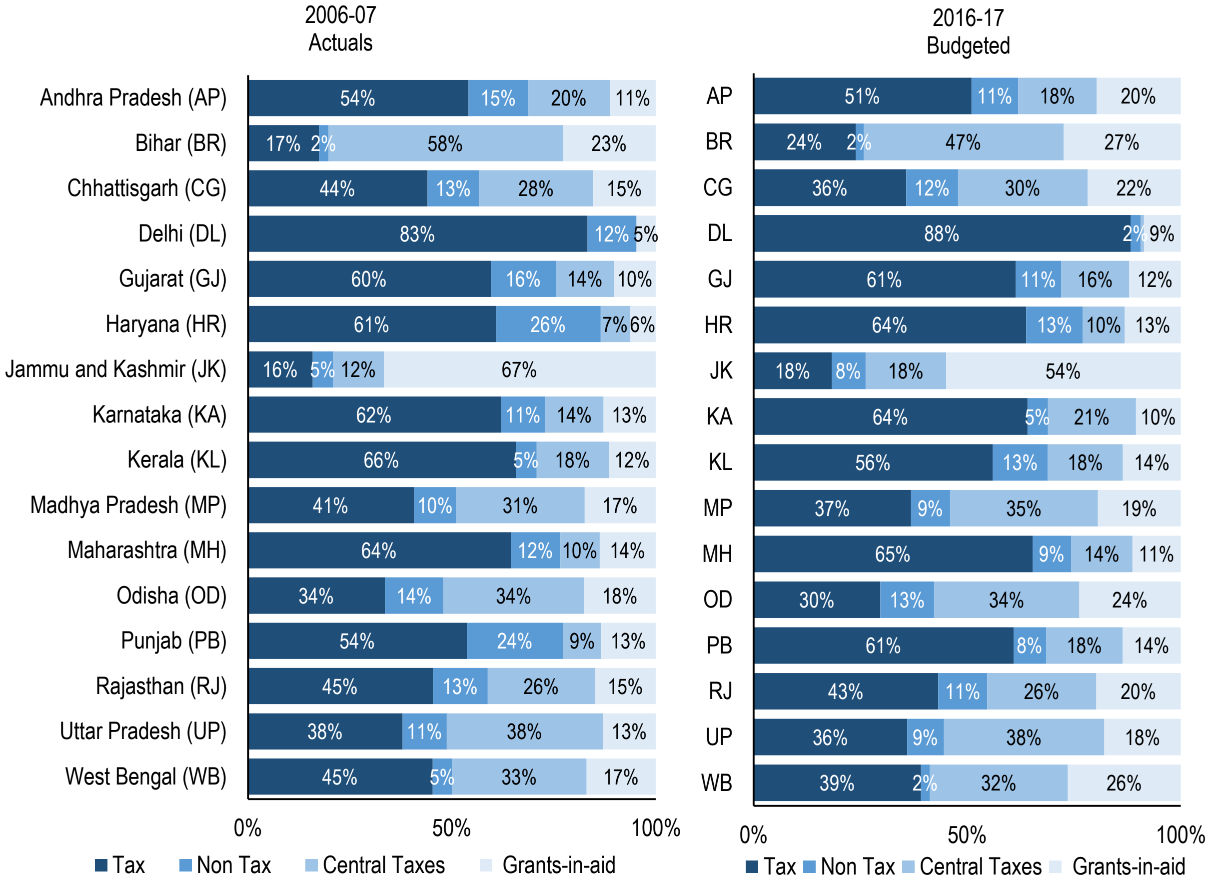
Revenue composition of states

High proportion of revenue earned by levying taxes

In 2016-17, taxes levied by the 17 states constitute 48% of their total revenue receipts, thereby being the largest revenue component for most states. However, in certain states with lower per-capita income such as Bihar, Jammu and Kashmir and Odisha, the revenue from taxes is less than 30% of their total revenue receipts. This may be due to the low per-capita income resulting in lesser sale and consumption of goods. The inadequacy of tax revenue collected by these states has been supplemented by transfers from centre in the form of grants, which constitute 20% of the total receipts and devolved central taxes, which constitute 23% of the total receipts.

Figure 5 presents the shift in revenue composition of states between 2006-07 and 2016-17. During the decade, most states saw an increase in the share of central transfers in their revenue composition. This was due to the central transfers growing at an average rate of 18%, which was higher when compared to the own revenue receipts of states growing at 15%. Among individual states, the share of tax revenue increased in some states such as Punjab and Bihar, while it reduced by close to 10% in others such as Kerala.

Figure 5: Own taxes constitute the largest proportion in revenue receipts (2007-17)



Note: Andhra Pradesh (AP) includes the states of Andhra Pradesh and Telangana.
Sources: Respective State Budget Documents; PRS.

Taxation powers in India

Taxation powers are broadly divided between the centre and states. In addition, state legislatures may devolve some of their taxation powers to local bodies (i.e. panchayats and municipalities). As a result, the taxes levied by these local bodies may vary from state to state. A break-up of taxes levied by the centre, states and local bodies can be found in the table below.

Taxes levied by the centre, state and local bodies

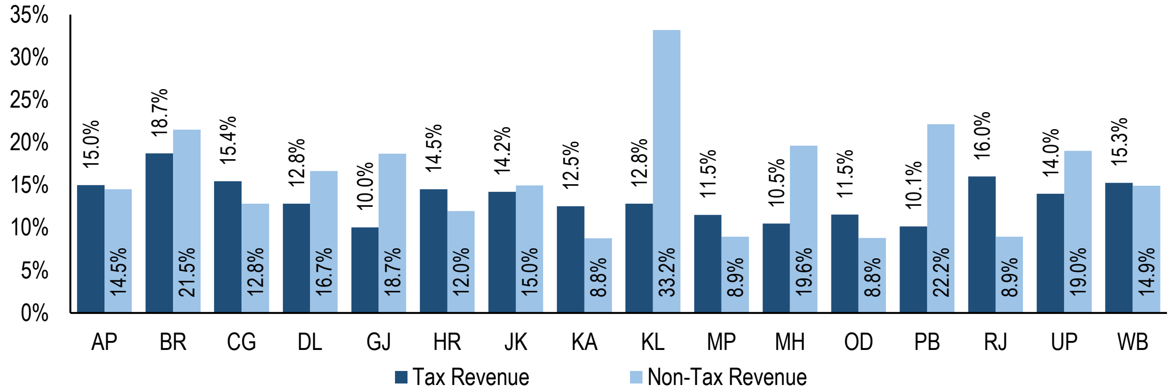
Centre	States	Local Bodies
Income Tax	Sales Tax	Tax on Land and Building
Corporation Tax	Tax on Electricity Consumption	Entry Tax on Goods
Customs (on Import) and Export Duty	Excise Duty on Alcohol	Vehicle Tax
Excise Duty on Manufacturing of Goods	Stamp Duty	Toll Tax
Service Tax	Agricultural Income	Entertainment Tax

While the centre levies taxes on items such as income and services, the revenue from these taxes is shared by the centre with states. The ratio of tax devolution from the centre to states is determined by the Finance Commission, which is constituted every five years. The 14th Finance Commission increased the share of central taxes devolved to states from 32% to 42%, in February 2015.

Own tax revenue of states grows at 13%; Non-tax revenue at 16%

In the five-year period between 2011-12 and 2016-17, the revenue generating sources of states-tax revenue and non-tax revenue witnessed varied rates of growth. The average growth in non-tax revenue (16%), was higher than the growth in tax revenue (13%). As seen in Figure 6, growth in taxes was led by Bihar (19%), which was followed by Rajasthan and West Bengal, while other states witnessing high growth in non-tax revenue included Kerala (33%), followed by Punjab, and Bihar. In states such as Kerala, the high growth in non-tax revenue was on account of increased revenue collections from state lotteries, among other reasons.

Figure 6: Own tax revenue of states grows at 13%; Non-tax revenue at 16% (2012-17)



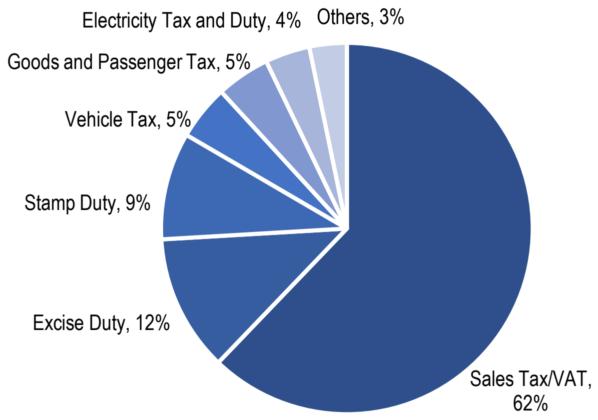
Note: Andhra Pradesh (AP) includes the states of Andhra Pradesh and Telangana.
Sources: State Finances: A Study of Budgets, RBI; Respective State Budget Documents; PRS.

Sales Tax constitutes the largest share in tax revenue of states

States levy Sales Tax or Value Added Tax (VAT) on the sale of all goods. As seen in Figure 7, this is the largest component of their tax revenue, with a share of over 60%. Most states do not provide a break-up of the amount of Sales Tax collected from each item. However, states such as Andhra Pradesh and Telangana are expected to receive 18% of the Sales Tax from the sale of excisable goods (such as alcohol) in 2016-17.

Other taxes for the 17 states, such as Excise Duty levied on the manufacture of alcohol constitutes 12% of the tax revenue, followed by Stamp Duty (9%) on land and building registration. The remaining tax revenue is generated by levying taxes on vehicles, goods and passengers entering a state, and supply of electricity, among others.

Figure 7: Sales Tax constitutes the largest share in tax revenue (2016-17)



Sources: Respective State Budget Documents; PRS.

Goods and Services Tax

The Goods and Services Tax (GST) will subsume several indirect taxes levied by the centre and states on goods and services. This includes taxes imposed by the centre such as Service Tax and Union Excise Duty, as well as those by states such as Sales Tax and Goods and Passenger tax.

Under the GST framework, these taxes will be subsumed under three taxes, (i) the Central GST, (ii) the State GST, and (iii) the Integrated GST (tax levied on inter-state trade). The tax rates for GST will be recommended by the GST Council, consisting of the Union Finance Minister and finance ministers from all states. Alcohol for human consumption will be kept outside the ambit of GST, while the GST Council will decide when petroleum products will be brought under the purview of the proposed tax. The receipts from the Central GST will be shared by the centre with all states.

Tax Revenue Collection

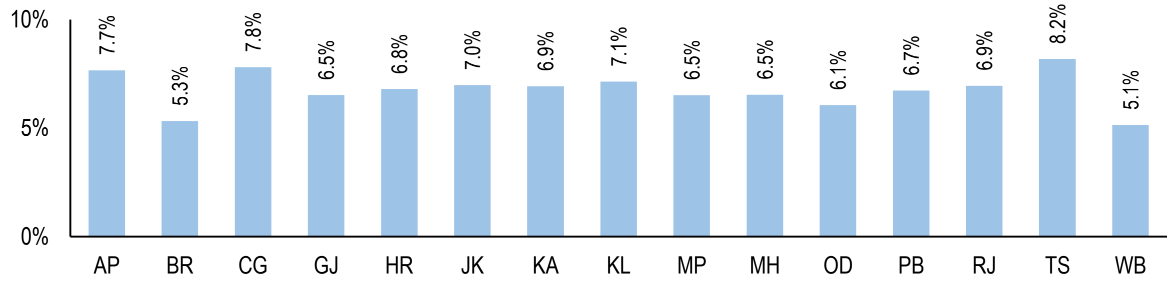
States estimated to maintain tax-GSDP ratio in the range of 5% to 8%

One of the ways to measure levels of tax collection is by using the tax to Gross State Domestic Product (GSDP) ratio. The ratio compares the tax collection of a state to its GSDP, indicating the proportion of economic activity which has translated into tax collection. A higher tax-GSDP ratio indicates that economic growth has translated into tax collection for the state. For example, a ratio of 7% indicates that for every 100 rupees of economic activity in the state, 7 rupees were collected as taxes by the state. Factors that impact the ratio include the efficiency of the tax administration, change in tax rates, and the number of taxpayers under the tax network.

As seen in Figure 8, in 2016-17, states are expected to have their tax-GSDP ratio ranging from 5% in West Bengal to 8% in Telangana. Note that the tax to Gross Domestic Product (GDP) ratio of the central government has been consistent, at around 7% for the last few years.

The implementation of GST is expected to improve tax compliance and hence positively impact collections. On the other hand, the removal of cascading effect of taxes (tax on tax) may result in a reduction in tax collection for the state.[2] It remains to be seen if the GST will eventually result in an improved or worsened tax-GSDP ratio. This would depend, among other factors, on the GST rate levied on various goods and services. For the first five years of the implementation of GST, the central government will cover any shortfall to the state's tax collection. The GST Council has set 2015-16 as the base year, and a benchmark 14% annual growth in revenues for this purpose.

Figure 8: Tax-GSDP ratio estimated to be in the range of 5% to 8% (2016-17)



Sources: Respective State Budget Documents; PRS.

Devolution of funds from the central government to states

Growth in funds devolved from the centre to states

The Constitution envisages that the centre should share a proportion of its taxes with states. The transfer of resources from the centre supports the expenditure of states, even if their own revenue receipts are not commensurate with their spending priorities. The central taxes devolved to states are untied funds, and states can spend them according to their discretion. The manner in which these taxes are to be shared by the centre with states is determined by the Finance Commission, which is set up every five years. In addition, the centre also provides grants to states, most of which are tied in nature, implying that they must be used for specified purposes.

The 14th Finance Commission, in February 2015, sought to increase the devolution of untied funds to states. Consequently, it recommended that the proportion of central pool of taxes devolved to states should be increased from 32% to 42%.[3] In Table 1, the first column indicates the share of states in funds devolved by the centre, and the second column indicates the funds received by states for every 100 rupees added to the divisible pool of taxes.

Distribution of taxes among states

The 14th Finance Commission revised the methodology used to determine the distribution of central taxes devolved by the centre across all states.[3]

Horizontal distribution criteria

Finance Commission	13th	14th
Population (1971)	25.0	17.5
Population (2011)	0	10.0
Income Distance	47.5	50.0
Area	10.0	15.0
Forest Cover	0	7.5
Fiscal Discipline	17.5	0
Total	**100**	**100**

Note: Income Distance is the difference between the per capita income of a state with the average per-capita income of all states. Fiscal Discipline evaluates capacity of a state to generate revenue.
Sources: Economic Survey 2014-15; PRS.

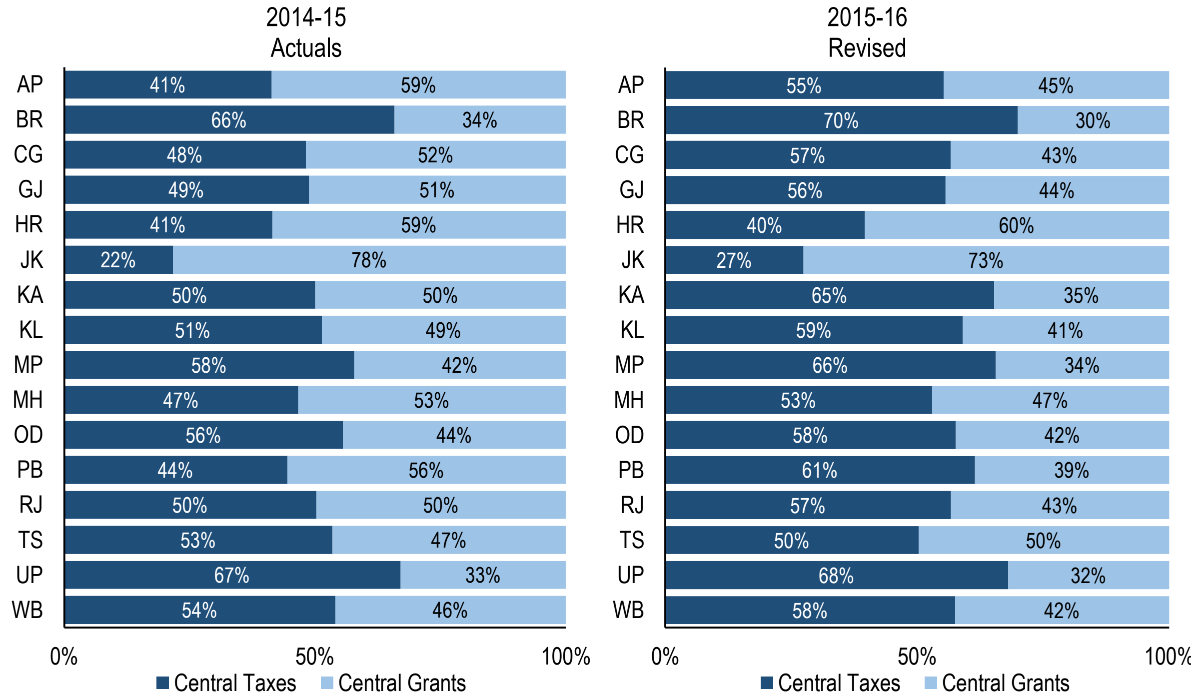
Table 1: Share of states in funds devolved by the centre

States	13th Finance Commission Share of States (%)	13th Finance Commission Share of States (Out of 32%)	14th Finance Commission Share of States (%)	14th Finance Commission Share of States (Out of 42%)
Andhra Pradesh	6.94	2.22	4.31	1.81
Bihar	10.92	3.49	9.67	4.06
Chhattisgarh	2.47	0.79	3.08	1.29
Gujarat	3.04	0.97	3.08	1.30
Haryana	1.05	0.34	1.08	0.46
Jammu & Kashmir	1.55	0.50	1.85	0.78
Karnataka	4.33	1.38	4.71	1.98
Kerala	2.34	0.75	2.50	1.05
Madhya Pradesh	7.12	2.28	7.55	3.17
Maharashtra	5.20	1.66	5.52	2.32
Odisha	4.78	1.53	4.64	1.95
Punjab	1.39	0.44	1.58	0.66
Rajasthan	5.85	1.87	5.50	2.31
Telangana	N.A.	N.A.	2.44	1.02
Uttar Pradesh	19.68	6.30	17.96	7.54
West Bengal	7.26	2.32	7.32	3.08
Other States	16.09	5.15	17.21	7.23
All States	**100**	**32**	**100**	**42**

Sources: Reports of the 13th and 14th Finance Commissions; PRS.

With an increase in the proportion of untied funds being devolved to states, the centre revised the resource-sharing pattern for schemes and other programmes. As part of the revision, several schemes for which tied grants were given to states were discontinued. In addition, the fund sharing pattern of some other schemes was altered to reduce the central government share. This was done to allow states the flexibility of deciding the schemes they would wish to continue implementing using the additional funds received by them. Figure 9 compares the composition of central transfers received by states in 2014-15 and 2015-16. Note that recommendations of the Finance Commission were implemented from 2015-16 onwards.

Figure 9: Share of taxes in central transfers increases after 14th Finance Commission



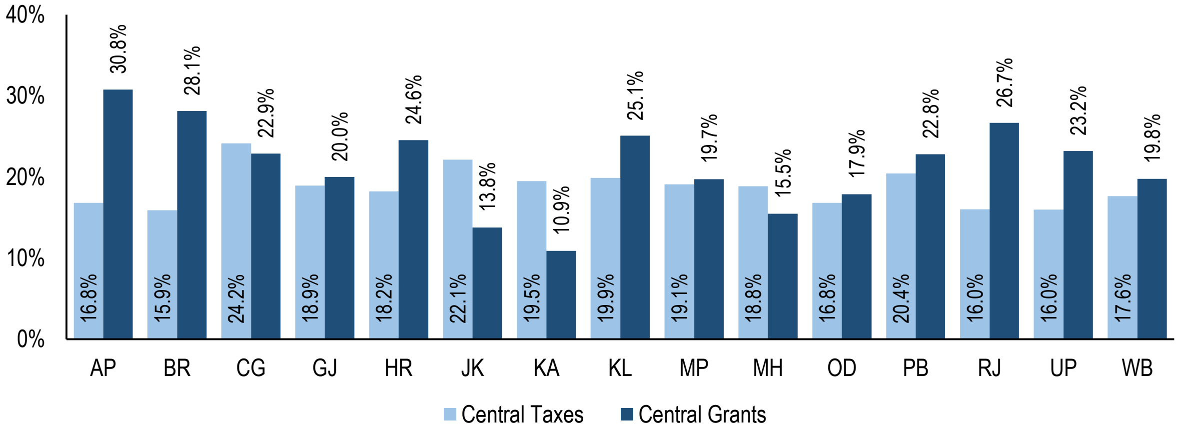
Sources: Respective State Budgets; PRS.

Barring Telangana and a marginal decrease of 1% in Haryana, states saw an increase in the share of taxes received from the centre, as a result of increased fund devolution. The highest increase was seen in Punjab, where the share of central taxes increased from 44% in 2014-15 to 61% in 2015-16.

Grants-in-aid from the centre increased by 20% between 2012 and 2017

The central government also provides tied grants to states for operating schemes, programmes, and for other specified purposes. For example, grants are provided to the state for running schemes such as Sarva Shiksha Abhiyan and the National Health Mission, among others. Between 2012 and 2017, states on an average witnessed a growth rate of 21% for grants-in-aid received from the centre. As seen in Figure 10, states with a growth rate of over 25% and above included Bihar (28%), Rajasthan (27%) and Kerala (25%).

Figure 10: Central grants devolved to states grow by 20% (2012-2017)



Note: Andhra Pradesh (AP) includes the states of Andhra Pradesh and Telangana.
Sources: State Finances: A Study of Budgets, RBI; Respective State Budget Documents; PRS.

EXPENDITURE

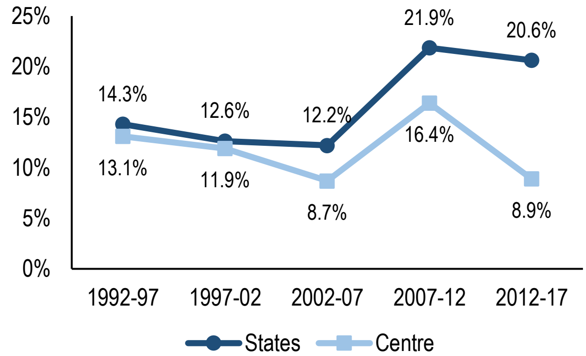
States largely spend funds on three key services provided by them: (i) economic services, such as agriculture, transport, and electricity, (ii) social services, such as education, health, and housing, and (iii) general services, which includes administration in the state.

State expenditure grew faster than central expenditure between 2012 and 2017

Expenditure of states is focused on providing essential services such as, creating infrastructure in the form of roads and schools, aiding growth of sectors such as agriculture and manufacturing, ensuring public safety, and providing subsidies to people in the state.

Between 2012 and 2017, expenditure of states grew at an average rate of 20.6% annually. This is higher than the growth of central government expenditure, which grew at an average of 8.9% annually.

Figure 11: State expenditure growing faster than the centre (1991-2016)



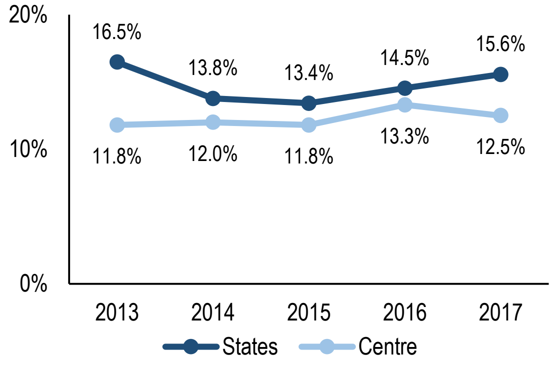
Sources: Respective State Budget Documents; PRS.

Revenue and Capital Expenditure

States spend 16% of their total expenditure on capital expenses, while the centre spends 13%

A large proportion of states' spending is on revenue expenditure. This includes expenses such as administration, implementation of schemes, and payment of salaries. While revenue expenditure meets annual spending requirements of certain government services, the rest is spent on capital expenses which creates infrastructure (such as road and buildings). The returns on infrastructure created may accrue over the long term. Capital expenditure also includes repayment of loans.

Figure 12: States spend a higher share of expenditure on capital expenses

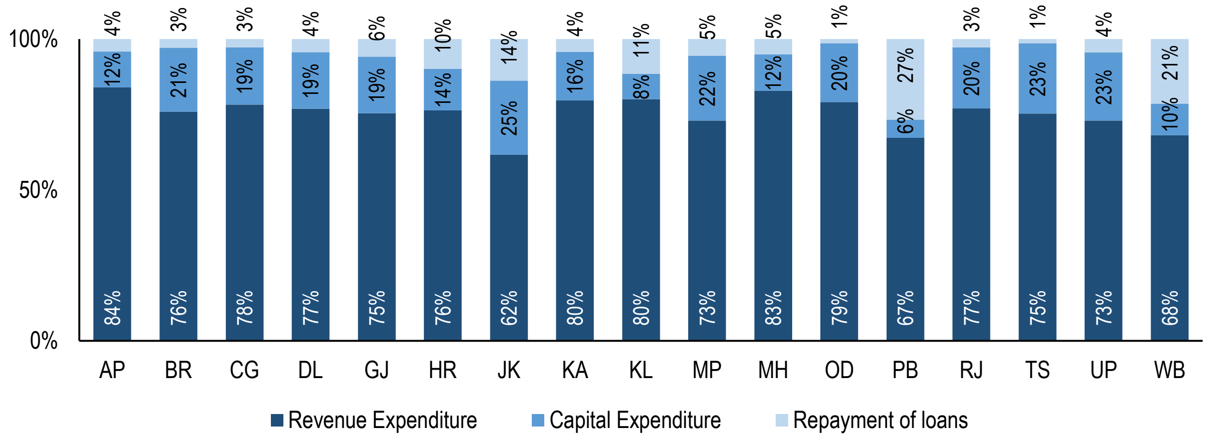


Note: Capital expenditure excludes repayment of loans.
Sources: Union and Respective State Budget Documents; PRS.

In 2016-17, the 17 states have budgeted to spend 16% of their total expenditure on capital expenses. This is higher than the central government expenditure of 13% on capital expenses. Note that central grants to states, which are reflected as revenue expenditure in the Union Budget, may also be used by states for the creation of assets (capital expenditure).

Figure 13 presents a comparison of 17 states based on revenue expenditure, capital expenditure and loan repayment. A higher proportion of a state's expenditure on the repayment of loans may indicate that lesser funds are being spent on creating infrastructure such as schools, hospitals, roads, and bridges. Among the 17 states, Punjab is expected to spend 27% of its total expenditure on loan repayment, while Odisha and Telangana are expected to spend 1%.

Figure 13: Over 70% of the expenditure of states is on revenue items (2016-17)



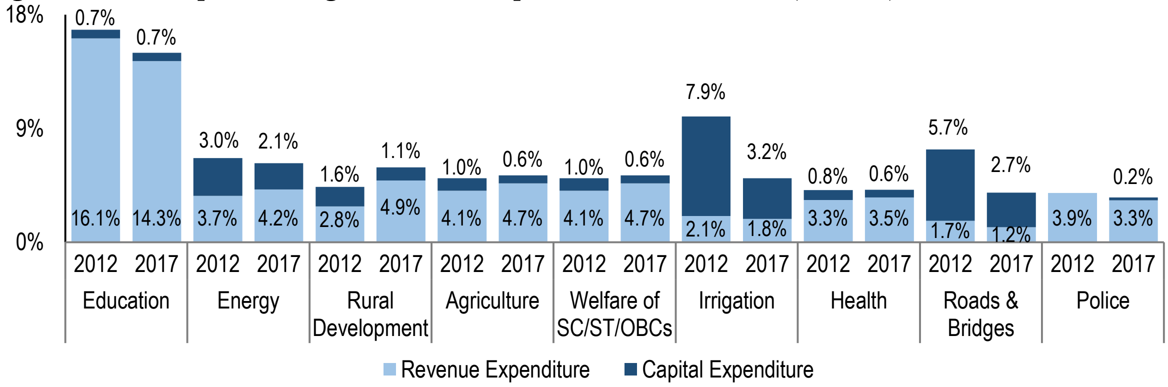
Note: Capital Expenditure excludes funds spent on repayment of loans.
Sources: Respective State Budget Documents; PRS.

Expenditure across sectors

Education is the top priority; Spending on rural development almost doubled in the last five years

Over the last five years, the 17 states spent the highest proportion of their budget on education, followed by energy, rural development, and agriculture. In 2016-17, states are expected to spend approximately 17% of their total expenditure on education, which is higher than their cumulative expenditure on energy and rural development sectors. Between 2012 and 2017, while spending on rural development witnessed the highest increase from 4.1% of the total expenditure of states to 6.2%, spending on irrigation, and roads and bridges saw a decline. Figure 14 compares the expenditure of states across major sectors, between 2012 and 2017.

Figure 14: States spend the highest share of expenditure on Education (2012-17)



Note: Figure for Police for 2012 includes both revenue and capital expenditure.
Sources: State Finances: A Study of Budgets, RBI; Respective State Budget Documents; PRS.

While all sectors require revenue and capital expenditure, the ratio between the two heads may depend on the nature of the sector. Thus, sectors with a large workforce (such as education and police) may require higher revenue expenditure to pay salaries, and a lower capital expenditure if the requisite infrastructure has already been created. Other sectors such as irrigation, roads and bridges may require a relatively higher proportion of capital expenditure for creating assets.

Ujwal Discom Assurance Yojana

In November 2015, the central government launched the Ujwal Discom Assurance Yojana (UDAY), to improve the financial situation of state-owned power distribution companies (discoms). The discoms have been accumulating losses due to various reasons, including low power tariffs. As a result, the debt of the discoms stood at over Rs 4 lakh crore as on March 2015.[4]

States signing up for the UDAY scheme were required to take over 75% of the discoms' debt over a period of two years. 50% of the debt was to be taken over in the first year (2015-16), and the remaining 25% in the second year (2016-17). To incentivise states to participate, the scheme provided that the debt taken over from discoms would not be included in the fiscal deficit for 2015-16 and 2016-17 for the purpose of the Fiscal Responsibility and Budget Management Act limits.

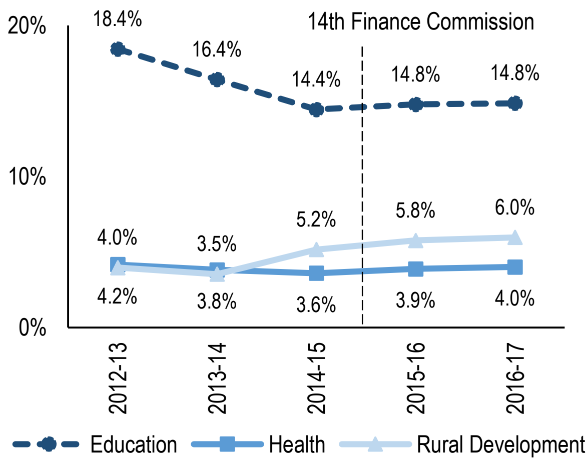
The RBI annual study on state budgets in 2016 noted that while UDAY is expected to improve the situation of discoms, it may adversely impact finances of states in the years to come. The absorption of debt may lead to increased liabilities for the state in the future. In addition, the interest payment burden on states is expected to go up immediately.[5]

Expenditure on key sectors after the change in tax devolution to states

Following the Finance Commission recommendations, the centre increased devolution of central taxes in 2015-16 to give greater autonomy regarding spending to states. Combined with the rationalisation of central spending on schemes, the impact on allocations for sectors such as education, health and rural development was uncertain.

As seen in Figure 15, between 2014-15 and 2016-17, expenditure of states on these sectors is expected to grow marginally. During this period, spending on education as a percentage of total expenditure is expected to increase from 14.2% to 14.6%. Similarly, expenditure on health and rural development is expected to witness marginal increases. A comparison of state expenditure on these sectors between 2014-15 and 2015-16 can be found in Table 2.

Figure 15: No change in spending on key sectors



Note: Data does not include Delhi.
Sources: Respective State Budget Documents; PRS.

Table 2: Expenditure on sectors as a % of total expenditure

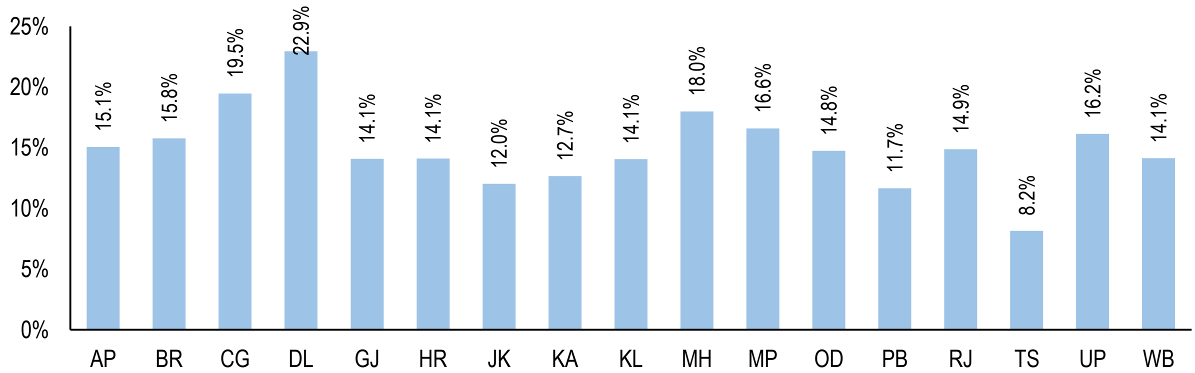
State	Education		Health		Rural Development	
	2014-15	2015-16	2014-15	2015-16	2014-15	2015-16
Andhra Pradesh	15.2%	15.0%	3.5%	3.5%	7.6%	7.6%
Bihar	15.8%	18.6%	5.2%	3.4%	11.7%	11.4%
Chhattisgarh	20.0%	19.2%	5.8%	5.2%	8.1%	8.6%
Gujarat	14.1%	15.5%	4.8%	4.9%	3.8%	3.5%
Haryana	15.6%	13.5%	4.2%	3.2%	3.2%	3.0%
Jammu and Kashmir	13.4%	13.4%	4.6%	5.5%	3.7%	3.4%
Karnataka	13.2%	14.7%	3.8%	4.3%	4.0%	3.7%
Kerala	16.5%	16.6%	5.1%	5.6%	3.9%	2.9%
Madhya Pradesh	17.6%	15.1%	4.3%	3.9%	7.2%	7.3%
Maharashtra	19.1%	19.4%	3.8%	4.7%	6.4%	3.3%
Odisha	14.7%	14.1%	4.7%	4.3%	8.7%	9.7%
Punjab	11.7%	11.9%	3.5%	3.7%	0.8%	0.9%
Rajasthan	14.9%	12.4%	4.1%	3.2%	8.6%	7.8%
Telangana	8.1%	10.4%	3.9%	3.2%	5.2%	5.9%
Uttar Pradesh	16.2%	14.4%	3.7%	3.0%	5.3%	4.6%
West Bengal	16.8%	14.8%	4.1%	4.7%	8.2%	11.2%

Sources: Respective State Budget Documents; PRS.

Education

In 2016-17, the 17 states are expected to spend 15% of their total expenditure on education on an average. Delhi is expected to spend the highest on education, accounting for 23% of its expenditure. This is followed by Chhattisgarh (20%) and Maharashtra (18%). On the other hand, Telangana has budgeted to spend the lowest on education (8%). Figure 16 compares expenditure of the 17 states on education in 2016-17.

Figure 16: Expenditure on Education in 2016-17 (as a % of total expenditure)

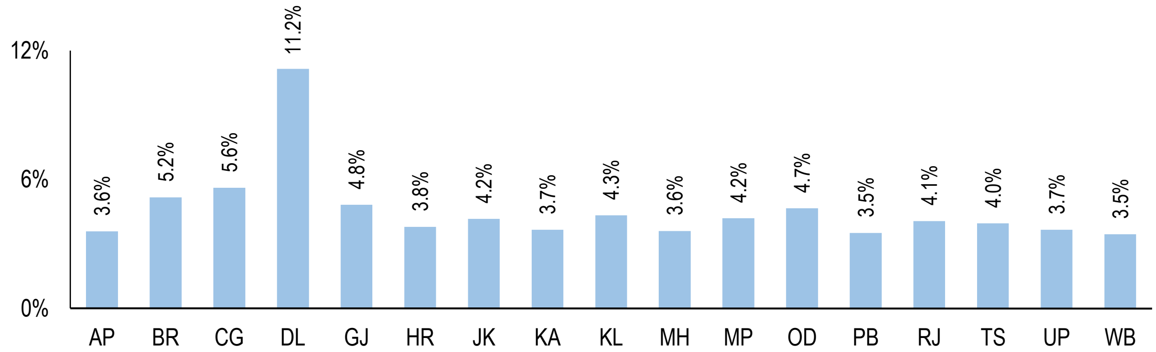


Sources: Respective State Budget Documents; PRS.

Health

In 2016-17, the 17 states are expected to spend 5% of their total expenditure on health. Delhi has budgeted to spend 11% on health, which was the highest among all 17 states. This is followed by Chhattisgarh (6%). Punjab (4%) and West Bengal (4%) are among the states with the lowest expenditure on health. Figure 17 compares expenditure of the 17 states on health in 2016-17.

Figure 17: Expenditure on Health in 2016-17 (as a % of total expenditure)

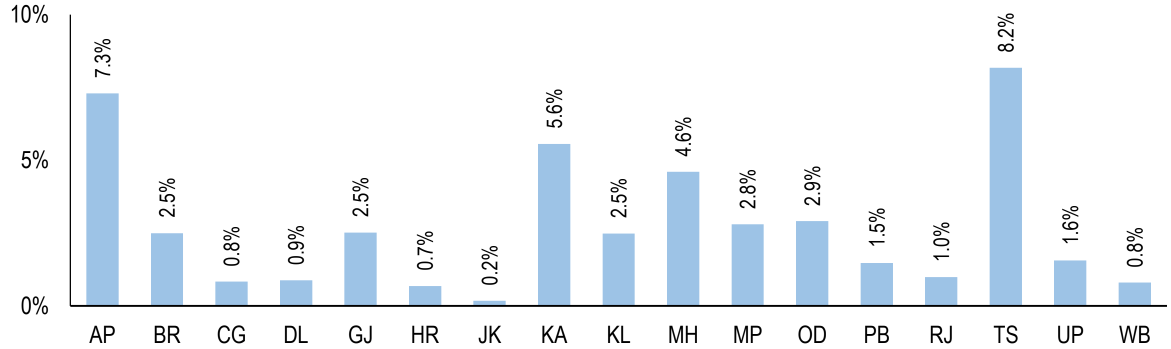


Sources: Respective State Budget Documents; PRS.

Welfare of SC, ST and OBCs

Welfare programs for SC, ST and OBCs include expenditure on scholarships, in addition to construction and maintanance of hostels for SC and ST students. Spending for these programs may vary depending on the SC and ST population in the state. In 2016-17, Telangana (8%) is expected to have the highest expenditure on SC, ST and OBCs. This is followed by Andhra Pradesh (7%) and Karnataka (6%). Figure 18 compares expenditure of the 17 states on welfare of SC, ST, and OBCs in 2016-17.

Figure 18: Expenditure on Welfare of SC, ST and OBCs in 2016-17 (as a % of total expenditure)

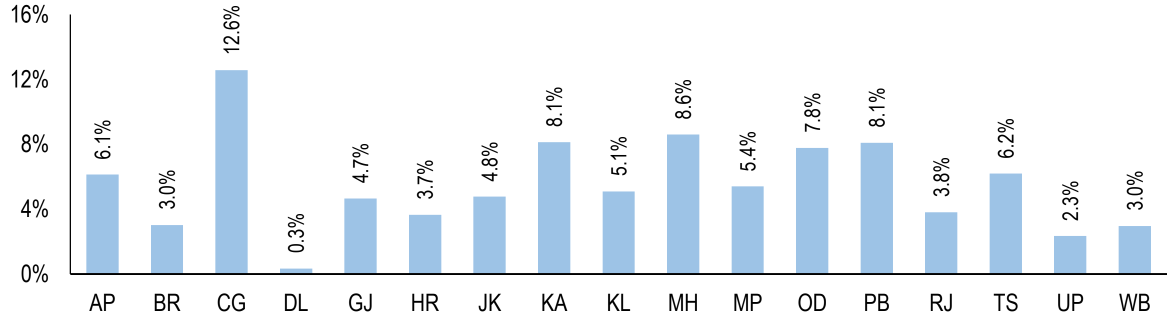


Sources: Respective State Budget Documents; PRS.

Agriculture

In 2016-17, the 17 states are expected to spend 6% of their total expenditure on agriculture, on an average. Chhattisgarh is expected to spend the highest proportion, accounting for 13% of its total expenditure. This is followed by Maharashtra (9%), Karnataka (8%) and Punjab (8%). Figure 19 compares expenditure of the 17 states on agriculture in 2016-17.

Figure 19: Expenditure on Agriculture in 2016-17 (as a % of total expenditure)

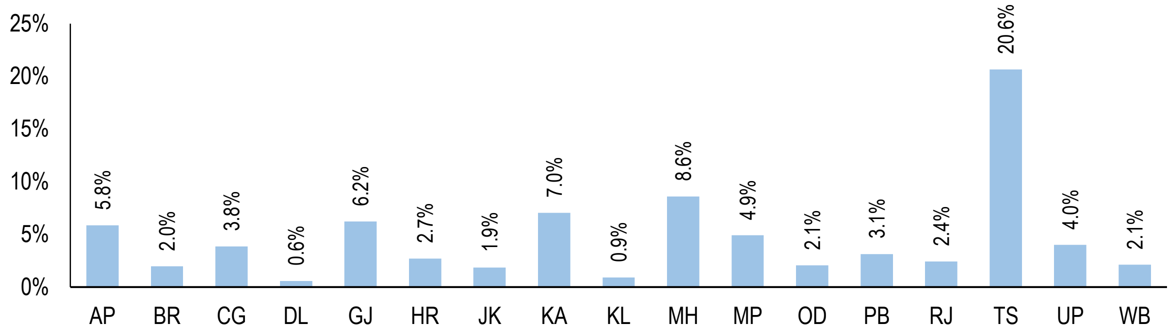


Sources: Respective State Budget Documents; PRS.

Irrigation

In 2016-17, the 17 states are expected to spend 5% of their total expenditure on irrigation. Expenditure under this head may depend on the topography and availability of water resources in the state, among other factors. Telangana is expected to spend 21% of its total expenditure on irrigation, which is the highest among all the 17 states. This is followed by Maharashtra (9%) and Karnataka (7%). Figure 20 compares expenditure of the 17 states on irrigation in 2016-17.

Figure 20: Expenditure on Irrigation in 2016-17 (as a % of total expenditure)

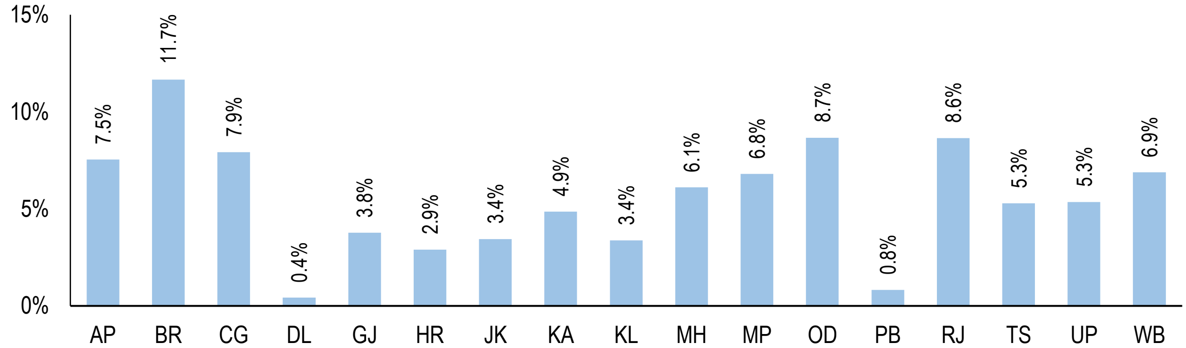


Sources: Respective State Budget Documents; PRS.

Rural Development

In 2016-17, the 17 states are expected to spend 6% of their total expenditure on rural development. Bihar has budgeted to spend 12% of its total expenditure on rural development, which is the highest among the 17 states. This is followed by Odisha (9%), and Rajasthan (9%). On the other hand, Punjab and Haryana are among the states with the lowest budgeted expenditure on the sector. Figure 21 compares expenditure of the 17 states on rural development in 2016-17.

Figure 21: Expenditure on Rural Development in 2016-17 (as a % of total expenditure)



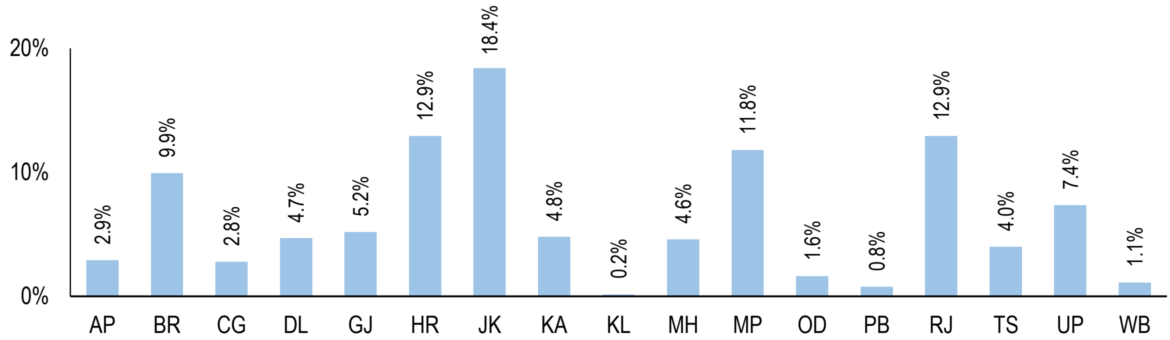
Sources: Respective State Budget Documents; PRS.

Energy

In 2016-17, the 17 states are expected to spend 6% of their total expenditure on energy. This includes expenditure on areas such as electricity generation, distribution and renewable energy sources. Jammu and Kashmir is expected to spend 18% of its total expenditure on energy, followed by Rajasthan (13%) and Haryana (13%). The spending on energy includes expenditure on the Ujwal Discom Assurance Yojana (UDAY) in case of states that have opted for the scheme.[1] Figure 22 compares expenditure of the 17 states on energy in 2016-17.

[1] As of October 2016, states which have opted to participate in the UDAY scheme are: Andhra Pradesh, Bihar, Chhattisgarh, Goa, Gujarat, Jammu and Kashmir, Jharkhand, Haryana, Karnataka, Madhya Pradesh, Manipur, Punjab, Puducherry, Rajasthan, Uttar Pradesh and Uttarakhand.

Figure 22: Expenditure on Energy in 2016-17 (as a % of total expenditure)

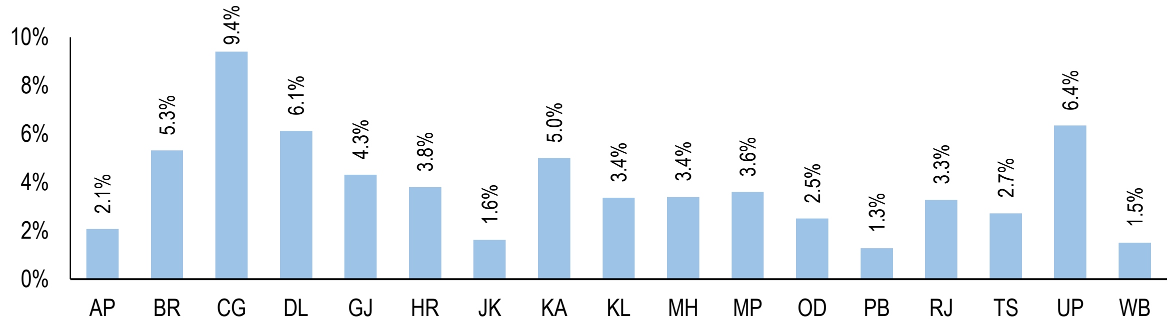


Sources: Respective State Budget Documents; PRS.

Roads and Bridges

On an average, the 17 states are expected to spend 4% of their expenditure on roads and bridges in 2016-17. Chhattisgarh has budgted to spend the most, which accounts for 9% of its total expenditure. This is followed by Uttar Pradesh and Delhi spending 6% of their respective expenditure. On the other hand, Punjab (1%), Jammu and Kashmir (2%) and Andhra Pradesh (2%) are expected to spend the lowest on roads and bridges. Figure 23 compares expenditure of states on roads and bridges in 2016-17.

Figure 23: Expenditure on Roads and Bridges in 2016-17 (as a % of total expenditure)



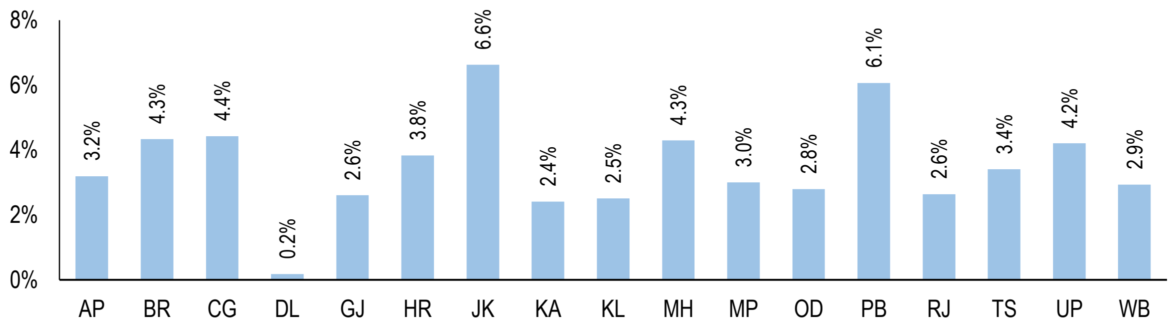
Sources: Respective State Budget Documents; PRS.

Police

In 2016-17, the 17 states are expected to spend 4% of their total expenditure on police. Jammu and Kashmir is expected to spend 7% of its total expenditure on police, which is the highest among all states. It is followed by Punjab budgeting to spend 6%. On the other hand, Karnataka has budgeted to spend 2% of its expenditure on Police, which is the among the lowest expenditure by states.

While the police in Delhi is under the central government, the state's spending on police is on a forensic laboratory. Figure 24 compares expenditure of states on police in 2016-17.

Figure 24: Expenditure on Police in 2016-17 (as a % of total expenditure)



Sources: Respective State Budget Documents; PRS.

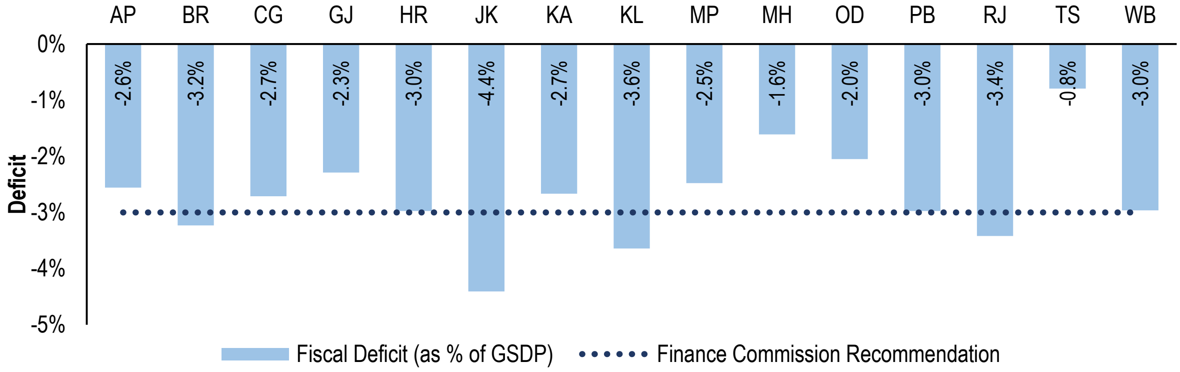
DEFICITS AND LIABILITIES

Fiscal deficit is the excess of government expenditure over its receipts. A high fiscal deficit of a government implies a higher borrowing requirement in a financial year. The borrowed funds may be spent by the state for various purposes, including on development activities and interest payments.

In 2003, Parliament passed the Fiscal Responsibility and Budget Management Act (FRBM Act) which prescribed limits for the fiscal deficit at 3%, and sought to eliminate revenue deficit. In the following years, several states passed their respective FRBM Acts, imposing similar limits on their borrowings. In 2015, the 14th Finance Commission recommended that states continue to maintain a fiscal deficit at 3% of their GSDP and eliminate revenue deficit. It suggested that the fiscal deficit limit be relaxed to a maximum of 3.5%, if states were able to contain their debt and interest payments to specified levels. The relaxation would be allowed in the following cases: (i) 0.25% if the debt-GSDP ratio of the state was under 25% in the preceding year, and (ii) 0.25% if interest payments of the state were less than or equal to 10% of its revenue receipts in the preceding year.[3]

While the spending of states has grown at an average rate of 18.8% annually since 2012-13, most states have managed to exercise fiscal discipline by keeping their fiscal deficit within the prescribed limits. Figure 25 presents the average fiscal deficit estimates of states for the 2013 to 2017 period.

Figure 25: Most states manage to keep fiscal deficit under 3% of their GSDP on an average (2013-17)

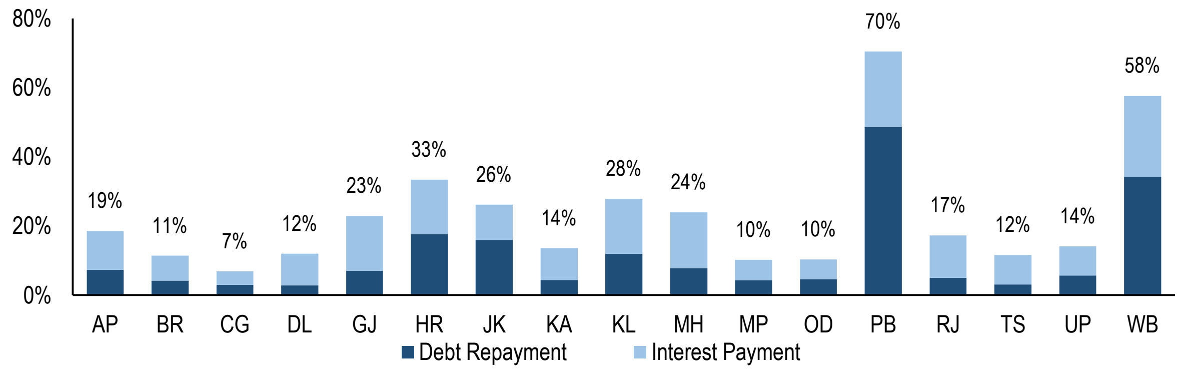


Note: Negative numbers imply deficit.
Sources: Respective State Budget Documents; PRS.

States spend 21% of their non-debt receipts on debt servicing

States borrow money in order to finance their fiscal deficit. They are required to service the borrowed debt by making periodic repayments of the principal amount along with the interest. In the five-year period between 2013 and 2017, the 17 states on an average spent over 21% of their total receipts (excluding borrowings) on debt servicing. This indicates that out of every Rs 100 of money received by a state, Rs 21 is spent on repaying borrowings taken previously, and the remaining amount is spent on development activities. In 2013-17, approximately 60% of this amount was for interest payment, and the remaining 40% for principal repayment. Across the 17 states, Punjab spent the highest proportion of its receipts on debt servicing at 70%, followed by West Bengal at 58% (Figure 26).

Figure 26: Punjab and West Bengal spend the highest share of their receipts on servicing debt (2013-17)



Sources: Respective State Budget Documents; PRS.

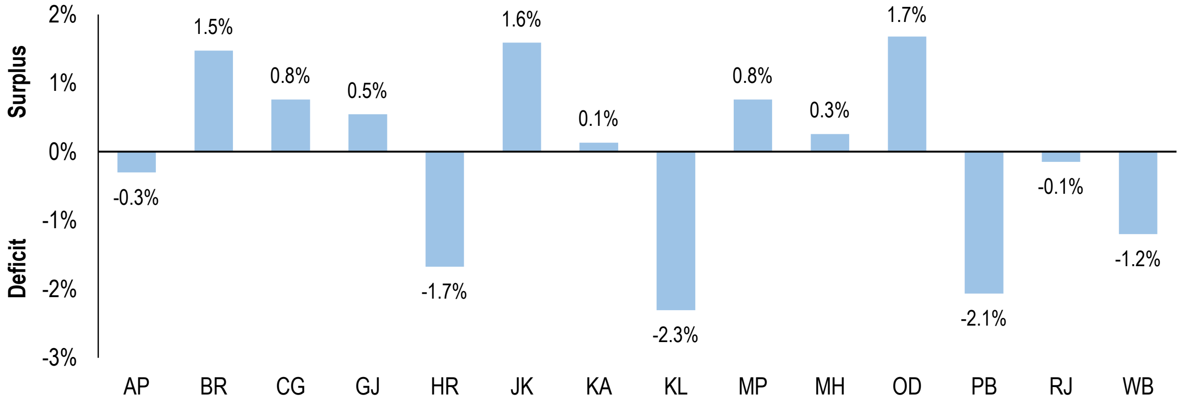
Most states have a revenue surplus in the period between 2013 and 2017

Revenue deficit is the excess of revenue expenditure (such as salary and interest payments) over revenue receipts (such as taxes and revenue received from providing services) of the government. A revenue deficit means that states need to borrow to meet expenses which do not create any assets.

Conversely, a revenue surplus indicates that the revenue sources of states are sufficient to meet their expenditure requirements in a given year. A high revenue surplus indicates: (i) the state can create capital assets; or (ii) it can pay off outstanding liabilities. While a high revenue surplus in the short term may allow for greater spending on asset creation, such a surplus for a longer term may indicate inadequate revenue expenditure by the state. The 14th Finance Commission recommended that states should aim to eliminate revenue deficits. The Commission also estimated the revenue deficit that states would incur post-devolution, and suggested that the centre compensate these states through revenue deficit grants.[3] Out of the 17 states, Andhra Pradesh and Jammu and Kashmir are expected to receive these grants for five years, Kerala for three years, and West Bengal for two years.

As seen in Figure 27, in the period between 2013 and 2017, five states posted a revenue deficit. Kerala on an average had a deficit of over two percent, followed by Punjab (2.1%), Haryana (1.7%) and West Bengal (1.2%).

Figure 27: Five states post a revenue deficit on an average (2013-17)



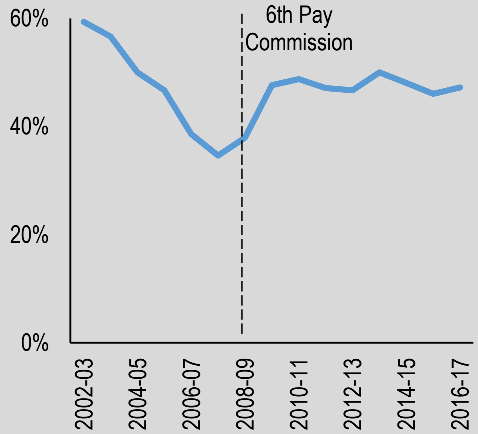
Note: Negative figures imply deficit and positive figures imply surplus.
Sources: Respective State Budget Documents; PRS.

Seventh Pay Commission may impact deficit of states – A case study of Maharashtra

A large share of any state's revenue receipts goes into expenses on the administration. This includes payments of salaries to current employees, and pensions to former employees. For example, in 2016-17, Maharashtra is expected to spend over one lakh crore rupees on salaries and pensions. This constitutes approximately 47% of its revenue.

As seen in the graph, the salaries and pensions in Maharashtra rose in 2008-09, after the recommendations of the Sixth Pay Commission were implemented. In 2015, the Seventh Central Pay Commission recommended an overall increase of over 23% in pay, allowances and pensions of central government employees. If states follow the centre's lead in implementing its recommendations, there could be a rise in their revenue and fiscal deficits.

Salaries and pensions as a % of revenue receipts in Maharashtra

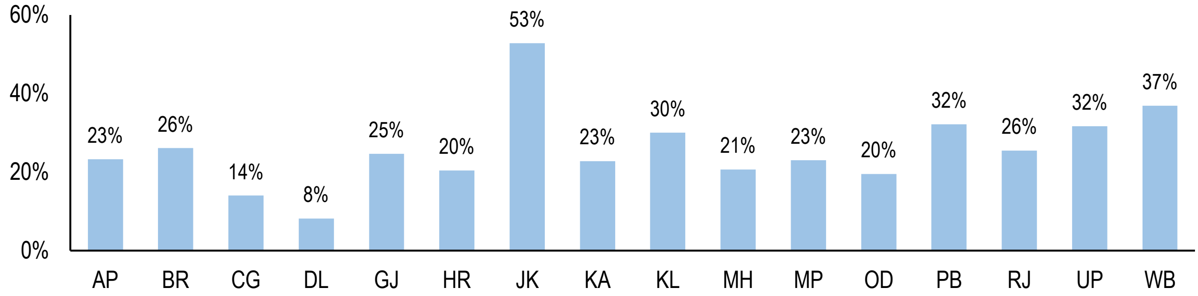


Sources: Maharashtra State Budget Documents; PRS.

Outstanding liabilities of states at 26% of GSDP

Outstanding liabilities refers to debt accumulated from financing the fiscal deficit in the past. Higher outstanding liabilities may indicate a higher obligation for the state to repay loans in the coming years. The FRBM Acts of states usually specify limits on the outstanding liabilities as a percentage of GSDP. Typically, these limits are set at 25% of GSDP in a year. During the five-year period between 2012 and 2016, states on an average had outstanding liabilities at 26% of GSDP. As seen in Figure 28, this varied from 53% of GSDP in Jammu and Kashmir to 8% in Delhi.

Figure 28: Outstanding Liabilities of states at 26% of GSDP on an average (2012-16)



Sources: State Finances: A Study of Budgets, RBI; PRS.

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1. The note compares states using budget documents such as Budget at a Glance, Annual Financial Statement, Department-wise Demand for Grants, Medium Term Fiscal Policy Statement.
2. Report on the Revenue Neutral Rate and Structure of Rates for the Goods and Services Tax (GST), Ministry of Finance, December, 2015, http://www.finmin.nic.in/the_ministry/dept_revenue/report_revenue_neutral_rate.pdf.
3. Report of the Fourteenth Finance Commission, February 2015, http://finmin.nic.in/14fincomm/14fcreng.pdf.
4. UDAY (Ujwal DISCOM Assurance Yojana) for financial turnaround of Power Distribution Companies, Press Information Bureau, Cabinet, November 5, 2015.
5. State Finances: A Study of Budgets of 2015-16, Reserve Bank of India, April 7, 2016, https://www.rbi.org.in/Scripts/AnnualPublications.aspx?head=State%20Finances%20:%20A%20Study%20of%20Budgets.