# Fiscal Prudence And State-Level Fiscal Performance In India: A Comparative Analysis Of How Different States In India Implement Fiscal Prudence And Its Effects On Their Economic Health.

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# I. Abstract

The Indian states after the liberalization needed fiscal discipline to ensure sustainability and economic stability. The study of the FRBM Act explores its scope and scale of applicability to ensure fiscal discipline. The complete legal framework of the FRBM Act was discussed while discussing the state-level fiscal performance by keeping it parallel to the guidelines of the FRBM limits and recommendations. The interdependent relationship of the Centre and the State have been analysed. The Pandemic's impact on the fiscal indicators has been observed with its impact on the economic health of the government. A comparison of states has been done by case studies of fiscal policy implementation between Maharashtra and Punjab underscoring the challenges of populist policies and rational decision-making. Based on these studies, several recommendations have been provided to improve fiscal prudence in the country.

# II. Literature Review

The study 'Understanding the Evolution of Fiscal Performance of Indian States' sheds light on the fiscal performance of 21 Indian states from 1980 to 2018. It provides an explanation of fiscal indicators and how it evolved over the years. The study fails to provide the fiscal performance of all the states and doesn't give a detailed explanation of data and events.

The paper 'State Finances in India: Managing Fiscal Risks and Sustaining Recovery' talks about the fiscal correction by states post-pandemic. It talks about how the recovery of the economy led to the underutilisation of funds and also talks about the failure of DISCOMs and how the UDAY yojana has increased the fiscal deficit. Despite this, the study fails to look at the fiscal performance during the pandemic.

The paper 'The Indian Fiscal Responsibility Laws' examines India's adoption of the FRBM Framework to maintain fiscal discipline. This also emphasises the ways to maintain stability in the economy. The other papers talk about the details of India's fiscal health during the Pandemic, the fiscal relationship between the centre and state and the fiscal indicators of Maharashtra and Punjab. The aim of these is to recognise the state-level fiscal performance and fiscal prudence in India.

# III. Introduction

Fiscal Prudence is defined as the responsibility of management of public resources and finance to ensure economic growth and stability. In India, the states enjoy a small amount of fiscal autonomy with a stronger dependence on the centre leading to states leading to different outcomes for different states. The centre and the state after 1991's liberalisation, have been working towards a more disciplined fiscal balance to ensure the stability of growth and minimise unwanted risks. The governments started to manage funds but to bring a nationwide framework to manage central and state balances, the Government Of India introduced the Fiscal Responsibility and Budget Management Act. The government has introduced several policies like loan swaps, etc to reduce the fiscal deficit in several Indian states. The Indian states were still suffering from many factors like poverty, resource mismanagement, terrorism and trying to play populist ideas.

The Indian Government in 2015 introduced the **UDAY scheme** which increased the fiscal deficit of the states and in 2016, GST was introduced which tried to consolidate the confusing and multiple taxing structure present before. These policy moves changed the fiscal situation of the states and how taxes and revenue structure were perceived. In 2019, the pandemic starkly widened the fiscal deficit due to increased expenditure and economic shutdown across the country. These events have played a strong role in the implementation of the fiscal rules and impacted the economic health of the states. This paper thus delves into the states' fiscal prudence, its relationship with the centre and the strong impact of the pandemic. The paper also analyses the economies of Maharashtra and Punjab to understand the fiscal strategies determining their fiscal health, further discussing ideas to solve the arising problems.

## IV. Understanding Fiscal Prudence - Legal Framework

The **Fiscal Responsibility and Budget Management (FRBM) Act** introduced by the Government of India in 2003 is aimed at achieving economic stabilisation and sustainable growth in fiscal balance. Fiscal control helps enable control of fiscal expenditure, improving fiscal position and therefore bringing down deficits and uplifting surpluses. The FRBM Act adopts a macroprudential approach using both numerical as well as procedural rules and guidelines. The powers of the Act come from Article 292 of the Constitution of India, which states that "Borrowing by the Government of India: The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed."

The parliament can authorise the Auditor and Comptroller General of India to review the reports by using the power granted under Article 148 of the Constitution and Section 7A of the FRBM Act. The annual financial statements, demand for grants, and disclosure of other significant details are all on the floor of both the Parliament Houses.

The FRBM Act of 2003 mentions that the total liabilities of the Central Government's assets are limited to 50 per cent of GDP. The Act ensures a year-to-year ceiling instead of a medium-term ceiling. The scope of the FRBM Act expands to any finance covering the subject of expenditure and revenue considering it as a subject under fiscal deficit. With the crash of the economy in 2008, the GOI invoked the 'escape clause' i.e., non-performance towards the act by not following the said rule and provision laid under the act. This special clause gives the government power to raise the bar of fiscal deficit from 3 per cent of GDP to 6.85 per cent. This clause can be used in case of unforeseeable circumstances or internal disturbance with the main purpose of reducing gross revenue deficit and gross fiscal deficit.

In the year 2000, the Ministry of Finance issued guidelines to the Sub-National Governments to implement Medium Fiscal Reform Programmes to help the SNGs reduce expenditure and improve tax collections. The Eleventh Finance Commission endorsed an incentive called the Fiscal Reform Facility for fiscal adjustment. The reform facility emphasised at least a 5 per cent improvement per year in revenue balance. Due to the small grants and only considerable amounts of improvement in revenue balance, the scheme failed to move towards fiscal consolidation.

Owing to the implementation of FRBMA, the fiscal deficit was reduced from 5.1 per cent to 3.2 per cent from 2012-13 to 2017-18 respectively. Though the fiscal deficit remained high due to the government's fiscal expansion plan, the government had planned to achieve a 3.2 per cent target. In FY 2023-24, India targeted 4.9 per cent of GDP with a tax revenue growth rate of 10.8 per cent [1]. The SNGs were incentivised by the Finance Commissions and the central government to adopt and effectively implement the fiscal policy regulations. Some states, being proactive, enacted their own FRBM laws before the FRBM 2003 laws like Karnataka, Tamil Nadu and Kerala.

**The NK Committee in 2016 said that the government should target the debt-to-GDP ratio of 60 per cent with a 40 per cent limit for the centre and 20 per cent for the states.** The committee proposed an autonomous fiscal council with a chairperson and two members with a non-renewable tenure. The committee also recommended the revenue deficit to be brought down by 0.2 per cent to reach 0.8 per cent by 2023. **To ensure that the escape clause added in the Act isn't misused, several guidelines were specified like setting a deviation limit up to 2.5 per cent of the GDP.** They also made it necessary to prepare a roadmap to return to the original deficit targets.

## V. State-Level Fiscal Performance

While both the states and the centre have independent powers to raise revenue and spend, the fiscal imbalances of both are significantly dependent. While agreeing to the idea of more autonomy to the states in the case of fiscal revenue and spending, the relationship is interdependent with funds allocation for the states made by the central government. The centre retains the entire tax collection while the states are left with few options like a tax on alcohol to earn independent revenue. **The central government in India still shares up to 43 per cent of the total government revenue[2].**

**Table 1. Relatives tax shares of central and state governments in the combined tax revenue**

| Category | 1990-91 | 2000-01 | 2005-06 | 2009-10 | 2013-14 |
|---|---|---|---|---|---|
| Central Government Share (after devolution of state share) | 49.06 | 44.8 | 45.98 | 48.3 | 43.08 |
| State Government Share | 50.94 | 55.2 | 54.02 | 51.7 | 56.92 |

Source: Indian Public Financial Statistics, various years, Ministry of Finance.

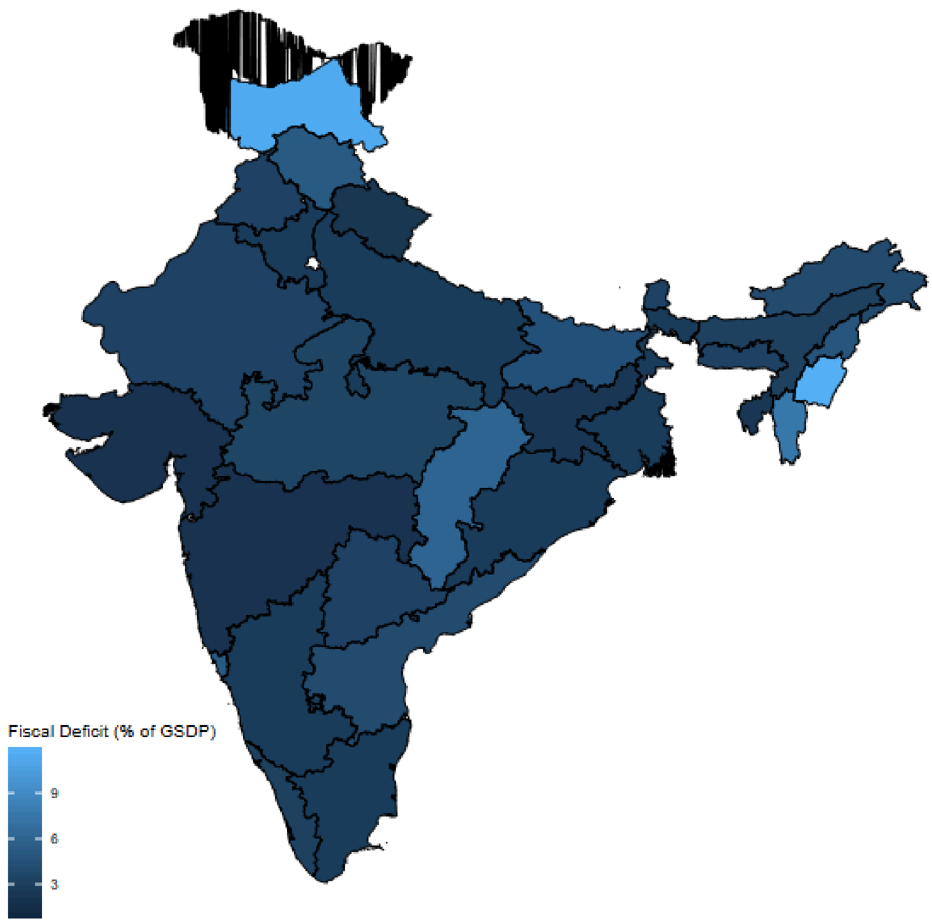
Despite the support from the central government, the fiscal health of the states shows variations due to the variations in revenue mobilisation capability and expenditures. Between 2003 to 2010, 28 states had passed the FRBM Act to manage and reduce revenue and fiscal deficit. After the FRBM Act was passed, an improvement

[1] "Budget 2024: Fiscal Prudence and Strategic Investments." Drishti IAS. Last modified July 24, 2024. https://www.drishtiias.com/daily-updates/daily-news-editorials/budget-2024-fiscal-prudence-and-strategic-investments.

[2] Sinha, Ram Pratap (2017) : Fiscal Performance Benchmarking Of Indian States-A Robust Frontier Approach, The Central European Review of Economics and Management (CEREM), ISSN 2544-0365, WSB University in Wrocław, Wrocław, Vol. 1, Iss. 4, pp. 225-249, https://doi.org/10.29015/cerem.527

in the fiscal indicators can be seen for the states. Even in the early 1980s, the Indian states had a revenue surplus but it all vanished by 1987-88[3]. The fiscal adjustment helped the government reduce the deficit but later the deficit kept growing. This imbalance of deficit coincided with the government's decision of pay revisions for state government employees. **The deficit in many states has increased due to excessive borrowing leading to a total of 10 states in 1999-2000 already breaching the 3 per cent limit of revenue deficits with some states reaching 4.5 per cent.** By large, a trend can be seen where poorer states have smaller issues with fiscal imbalance than richer states. This deterioration of revenue and fiscal imbalances can be seen in states like West Bengal, which was the worst with the revenue and fiscal deficit both worsening by 5 points as a percentage of NSDP (Net State Domestic Product). The deterioration could also be seen in states like Punjab, Rajasthan and Maharashtra. The expenditure in the states increased faster than revenues by 2.2 percentage points. Simultaneously the slowest growing component was the increase in transfers from the centre. This led the states to fend for themselves by growing their state revenue to manage the fiscal imbalance.

Figure 5: State-level Debt (% of GSDP) FY 2018-19.



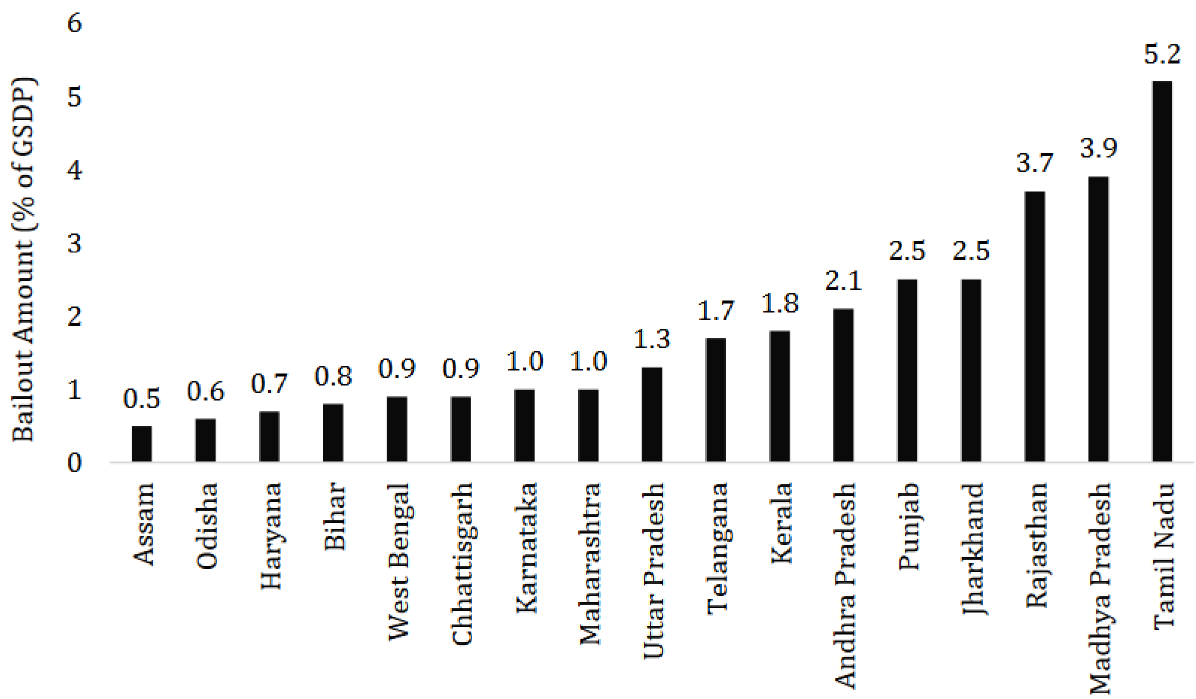

Notes: The heat map shows the total outstanding liabilities of each state as a percentage of their respective GSDP for FY 2018-19.

[3] Govinda Marapalli Rao, Economic and Political Weekly. (2022, January). State Finances in India: Issues and Challenges. Retrieved from https://www.researchgate.net/publication/262122520_State_Finances_in_India_Issues_and_Challenges

According to the 2022-23 data, 7 major states namely, Maharashtra, Haryana, Gujarat, Karnataka, Telangana, Tamil Nadu and Kerala contribute more than 50 per cent to India's GDP. The amount of union transfer to the states has been high at 46.6 per cent, according to 2021-22 fiscal year data. The poor states in India don't generate enough revenue and are dependent on union transfers with Bihar being the highest, reaching 75.4 per cent. **An RBI Report on state finances mentioned that some states have budgeted for fiscal deficits of over 4 per cent with their debt levels exceeding 35 per cent of GSDP as against an All-India average of 27.6 per cent.** The report also sheds light on the positive changes in the fiscal performances of the states like the decline in the states' consolidated fiscal deficits from 4.1 per cent in 2020-21 to 2.8 per cent in 2021-22. The states have also been enjoying more funds as the share of SGST has been increased in GST collection and the support from the centre with 50-year interest-free capex loans. This helps reduce the interest burden and improve the fiscal strength of the states.

The central government in 2021, according to the recommendations of the 15th Finance Commission, has allowed the states to borrow an additional 1 per cent of GSDP by relaxing the target under the FRBM Act[4]. The government also allowed an additional borrowing of 0.5 per cent to the states conditional and linked to power sector reforms. This additional support from the government though remains underutilised due to strong fiscal prudence and the emergence of the economy after covid which allowed the revenue to increase. In the pre-COVID era, the state-to-GSDP ratio in 2019-20 was at 27.3 per cent.

**Figure 6: Bailout of DISCOMs in Major States: 2020-21**




***Source:*** State Finances: A Risk Analysis, RBI, Jun 16, 2022.

[4] Pinaki Chakraborty and Kausik K. Bhadra. (2024). State Finances in India: Managing Fiscal Risks and Sustaining Recovery (Working Paper .413). Retrieved from National Institute of Public Finance and Policy website: https://nipfp.org.in/media/medialibrary/2024/07/WP_413_2024.pdf

A major risk affecting the fiscal deficit is the power sector reforms which involve increased bailouts and governmental interventions. This comes with the introduction of the **Ujwal DISCOM Assurance Yojana (UDAY)** by the Ministry of Power & New and Renewable Energy which required the state governments to take over the debt of electricity distribution companies to improve their financial health. The RBI Study on State Finances 2023-24 stated that **"Power distribution has strained State finances due to persistent operational inefficiencies and significant under-recoveries. Receipts from the power sector constitute less than a tenth of the corresponding revenue expenditure incurred by the States."** The implementation of the plan led to a sharp increase in fiscal deficit due to operational inefficiencies, high procurement costs and low productivity of the organisations[5]. A study "*Indian Electricity Distribution Companies amidst Churn: Understanding Present Challenges and Shaping Future Opportunities*[6]" said that the aggregate losses of state-owned DISCOMs are approx 35 per cent of the aggregate revenue deficit in 2021-22. The support to all the state-owned DISCOMs amounted to ₹1.4 lakh crores. **The subsidies amounted to 18 per cent of revenue generated by the DISCOMs going as high as 40-50 per cent in states like Madhya Pradesh and Karnataka.** This increased fiscal deficit due to this policy puts a heavy burden on the governments. The fiscal deficit can be judged by the revenues of the states which also keep fluctuating. According to state finance reports by the RBI, states like Manipur receive more union transfers due to low revenue. In terms of own revenue, states like Andhra Pradesh, Gujarat and Goa are high as compared to Himachal Pradesh and Tripura[7]. Overall, a wide range of disparities can be observed as with high revenue the fiscal deficit can also be seen increasing in the states.

## VI. Impact of Centre-State Fiscal Relations

### A. Overview

Between the Centre and State in terms of fiscal relations, the relationship lies in favour of the Centre. The centre holds a stronger control and autonomy in the management of funds which includes the setting of regulations and funds transfer to manage funds. The strong mark of the relation lies in the Fiscal Responsibility and Budget Management Act which highlights the targets and limits to achieving fiscal balance and increasing fiscal responsibility.

The Commission on Centre and State Relations examines and reviews the existing relationship between the centre and the state. The constitution lays down the relationship and grants the states and centre power of taxation. Article 275 and Article 282 under the constitution lay down the rules and guidelines for grants and transfers from the centre to the states. The centre transfers funds through three channels namely, the Finance Commission, the Planning Commission and the Central Ministries. The dependence of the states on central transfers can be analysed in terms of shares of transfers in the state's total revenue receipts. The

[5] Misra, S., Gupta, K., & Trivedi, P. (2021). Sub-national government debt sustainability in India: An empirical analysis. Macroeconomics and Finance in Emerging Market Economies, 16(1), 57-79. doi:10.1080/17520843.2021.1948171

[6] Ann Josey, Shantanu Dixit, Sreekumar Nhalur, and Manasi Jog. (2024, February 12). Indian Electricity Distribution Companies amidst Churn: Understanding Present Challenges and Shaping Future Opportunities. Retrieved from https://forumforstatestudies.in/wp-content/uploads/2024/03/DISCOM-Finance-Article_Prayas_120224.pdfhttps://forumforstatestudies.in/wp-content/uploads/2024/03/DISCOM-Finance-Article_Prayas_120224.pdf

[7] Akram, V., & Rath, B. N. (2021). Understanding the evolution of fiscal performance of Indian states. Growth and Change, 52(4), 2172-2193. doi:10.1111/grow.12544

dependence varies across states with the high-income states depending up to one-fourth to one-sixth of their revenue receipts. This number for the middle-income states is at one-third to one-fifth except for Chhattisgarh and West Bengal for whom the ratio increases up to 50 per cent. The dependence of the low-income states also lies within 42 to 80 per cent.

**B. The Imbalance between the relationship**

The states have been of the opinion that they deserve a greater share in the resource transfers and the current shares aren't commensurate with their growth. The states during the thirteenth Finance Commission demanded the increase of their share in central taxes up to 50 per cent from 29.5 per cent. The Finance Commission has also observed the states' need for a larger share of the resources when the Sixth Finance Commission[8] Observed, "*When the emphasis is on social justice, there is no escape from realignment of resources in favour of States, because services and programmes which are at the core of a more equitable social order come within the purview of the States under the Constitution.*" A report by the Commission on Centre and State Relations[9] observed that the 'one-size fits all' approach of the FRBM limitations and rules has limited the strong states to raise more resources. **The Commission recommended that the government should introduce state-specific targets to raise resources and the fiscal discipline path should factor in the variations of the states with their initial fiscal situation.** With a tendency to reduce capital expenditure to maintain the fiscal balance, the government might compress productive expenditure to adhere to the targets, thus defeating the purpose of the legislation of fiscal discipline and growth.

With the introduction of the **Goods and Services Tax** in 2016, the financial autonomy of the states has been affected as the states have lost the capability of independent taxation. The states are left with only liquor and Fuel as significant independent revenues without the Union's approval. This increased the state's dependence on the Centre. GST was brought in to replace the many taxes levied differently by the state and the centre. This problem was solved by the consolidation of taxes under the new regime. Another problem is the signing of the agreements between the Centre and other countries which can be a disadvantage for states in India. As there is no framework to compensate the losers for any agreement, the states are left to bear the cost and fend for themselves. The Thirteenth Finance Commission increased the share of states to 42 per cent but the total flow of resources from the centre to the states as a percentage of the GDP has declined in totality. These imbalances resonate with **Marx's idea of 'primitive accumulation of capital'** where the central domestic and foreign corporations are strengthened at the cost of petty production and trade. This comes at the expense of the state finances when the government wishes to accelerate the process of 'centralisation of capital'[10].

[8] Finance Commission India. (n.d.). Report of Sixth Finance Commission. Retrieved from https://fincomindia.nic.in/commission-reports-sixth

[9] Justice Madan Mohan Punchhi, Dhirendra Singh, Vinod Kumar Duggal, Dr. N.R. Madhava Menon and Vijay Shanker. (2010). VOLUME III, CENTRE-STATE FINANCIAL RELATIONS AND PLANNING. Retrieved from COMMISSION ON CENTRE-STATE RELATIONS website: https://interstatecouncil.gov.in/wp-content/uploads/2015/06/volume3.pdf

[10] Patnaik, P. (2018). Trends of centre–state relations in India under the Neo-liberal regime. Studies in People's History, 5(1), 83-91. doi:10.1177/2348448918759872

## VII. Fiscal Performance and Prudence during the Pandemic

The pandemic was a difficult time for the time when the country came to a stop. The production and companies came to a stop which adversely affected the fiscal strength of the states and the centre. With much of the action taken to cope with the pandemic in the states, in public and private hospitals, food supply, and tight lockdowns, the fiscal burden was mainly borne by the Centre. Though there was much criticism that the government was doing very little to address the shock, the economy suffered a 6.6 per cent contraction of the GDP. The government introduced a stimulus package which was majorly in the form of subsidized credit to revive the economy and stimulate production and value addition. The package and its deficit spending weren't comparable to the advanced economies.

**The deficit of the Government Of India nearly doubled to 9.2 per cent in 2020-21 from 4.7 per cent in 2019-20.** The government managed to reduce its 'committed expenditure' presumably by reducing hiring. The Central government managed to reduce the deficit spending from 9.2 per cent to 6.7 per cent in 2021-22. The deficit reduced 0.5 per cent on average of GDP per year to achieve a target of 4.5 per cent of GDP by 2025-26[11]. The combined revenue receipts of the states declined mildly to 6.5 per cent compared to 7.1 per cent during the Pre-Pandemic in 2019-20. The States' own revenue receipts account for two-thirds of total states' revenue. The level of revenue has since exceeded the baseline at 7.8 per cent in 2023-24. In contrast, the revenue by transfer only grew by 0.7 per cent in 2023-24. Consequently, both domestic and total liabilities of the government increased as a percentage of GDP. The ratio of outstanding liabilities to GDP also increased by almost three percentage points, while it increased by 1 percentage point annually from 2015-16 to 2018-19[12]. The ratio between interest payment and revenue receipts is considered tolerable when the ratio remains at one-fifth but India has a serious problem with debt servicing to maintain stability. Due to the high interest load arising out of high borrowings, the government is forced to borrow more to fulfill the payments which can eventually push the government into a debt trap. The finances of the government weren't healthy even before the Pandemic and the crisis just aggravated the situation. A new framework is needed as the setting of limits doesn't seem to solve the fiscal parameters such as fiscal deficit, revenue deficit and public debt.

[11] Sudipto Mundle and Manish Gupta. (2024). Fiscal performance of the Central government and the States of India (412). Retrieved from National Institute of Public Finance and Policy, New Delhi website: https://nipfp.org.in/media/medialibrary/2024/06/WP_412_2024.pdf

[12] Kaur, A., & Kaur, P. (2023). Revisiting public debt sustainability during the COVID-19 pandemic in India. Indian Journal of Finance, 17(12), 26. doi:10.17010/ijf/2023/v17i12/171265

**Table 3.** ***Indicators Depicting Spending Pattern***

| Year | RR | RE | CR | CE | IP | IP/RR | IP/CR |
|---|---|---|---|---|---|---|---|
| 1983–84 | 17.37 | 18.34 | 8.41 | 8.31 | 2.46 | 14.14 | 29.23 |
| 1985–86 | 19.00 | 20.84 | 7.36 | 6.79 | 3.03 | 15.95 | 41.20 |
| 1990–91 | 18.36 | 22.50 | 8.07 | 5.88 | 4.34 | 23.63 | 53.77 |
| 1995–96 | 18.04 | 21.19 | 6.56 | 3.99 | 4.90 | 27.16 | 74.68 |
| 2000–01 | 17.70 | 24.19 | 10.30 | 3.64 | 5.83 | 32.95 | 56.65 |
| 2005–06 | 19.47 | 22.20 | 8.47 | 4.23 | 5.62 | 28.85 | 66.30 |
| 2010–11 | 20.68 | 23.94 | 7.53 | 4.15 | 4.57 | 22.08 | 60.65 |
| 2015–16 | 19.96 | 22.48 | 7.48 | 4.82 | 4.71 | 23.58 | 62.94 |
| 2016–17 | 20.35 | 22.67 | 7.51 | 5.05 | 4.71 | 23.13 | 62.66 |
| 2017–18 | 19.76 | 22.46 | 6.74 | 3.96 | 4.77 | 24.13 | 70.73 |
| 2018–19 | 20.11 | 22.61 | 6.49 | 4.08 | 4.74 | 23.55 | 72.98 |
| 2019–20 | 21.32 | 24.44 | 7.08 | 4.43 | 4.76 | 22.34 | 67.26 |
| 2020–21 | 24.45 | 27.54 | 8.59 | 5.23 | 5.53 | 22.61 | 64.35 |

***Note.*** RR, RE, CR, CE, and IP represent revenue receipts, revenue expenditure, capital receipts, capital expenditure, and interest payments as a percentage of GDP, respectively. IP/RR is the ratio of interest payments to revenue receipts, IP/CR is the ratio of interest payments to capital receipts.

The overall expenditure on social security and health has increased during the pandemic. **The share of social spending as a component of total expenditure rose to 37.8 per cent in 2020-21 from 37.1 in 2019-20.** This share kept on increasing even after the pandemic rising to 39.3 per cent in 2023-24, presumably due to the spillover effect. The provision made by states for social spending is even larger at 39.5 per cent in a consolidated budget of the states. The level of debt for the states was below the recommendations by the Fifteenth Finance Commission which is a possible reason for the recent fiscal laxity of the states. Its share in total expenditure ranges from 27.3 per cent in Punjab to West Bengal's 51.3 per cent. The average share in high economic development states is 35.8 per cent rising up to 37.1 per cent for the Balanced Development group. Further to 35.8 per cent for lagged development states and finally to 41.4 per cent for the High Social Development group. The range of social expenditure lies within the range of 35-40 per cent.

## VIII. Impact of Fiscal Prudence on Economic Health

Managing debt levels over time is a very important indicator of computing fiscal health. A country with a medium level of debt with a good budget is better positioned than a low-debt economy with a rapidly increasing public deficit. The fiscal governance in the country influences how the budgetary policy is developed. Fiscal rules limit the government's ability to spend maintain social order and consolidate fiscal responsibility. Good fiscal health helps the government increase expenditure on social welfare and help in making economic growth more sustainable. It frees up the resources for investment in infrastructure, education and healthcare. Unchecked fiscal deficit can often lead to borrowing from central banks leading to high inflation. A controlled and strong fiscal discipline helps in inflation control and also brings investor confidence in the economy. In 1991, the reforms which adopted fiscal discipline helped in stabilizing the economy by reducing subsidies and privatising public enterprises. The government also relaxed fiscal rules during the Pandemic thus increasing spending on healthcare and later shifting to fiscal consolidation to avoid debt levels to increase. This signifies the importance of fiscal rules in ensuring economic resilience and boosting growth.

# IX. Case Study

## A. Punjab's Disastrous Fiscal Situation

Punjab had been under financial stress since 1984-85 being the state with the highest fiscal deficit. The minor consolidation in the mid-1990s again deteriorated in the late 1990s. The government followed the populist path allowing subsidies to farm sectors and removing house tax and octroi. **The state continuously incurred losses from the electricity board, low irrigation charges with a low revenue productivity agricultural dependent economy.**

**Table 1.** Major Fiscal Indicators of Punjab in the Pre-FRBMA Period (Percentage to GSDP)

| Year | | 1997–1998 | 1998–1999 | 1999–2000 | 2000–2001 | 2001–2002 | 2002–2003 |
|---|---|---|---|---|---|---|---|
| Gross fiscal deficit (GFD) | | 5.09 | 6.78 | 4.76 | 5.23 | 6.22 | 5.35 |
| Revenue deficit (RD) | | 3.05 | 4.72 | 4.06 | 3.13 | 4.74 | 4.56 |
| Primary deficit (PD) | | 1.29 | 2.62 | 0.83 | 2.09 | 2.23 | 1.18 |
| Outstanding liabilities (OL) | | 36.76 | 39.15 | 39.62 | 41.17 | 44.83 | 48.78 |
| Outstanding guarantees | | 10.29 | 6.08 | 14.82 | 12.03 | 13.28 | 16.70 |
| Interest payments (IP) | | 3.80 | 4.16 | 3.93 | 3.14 | 3.99 | 4.18 |
| Interest Burden | IP/RR (percentage) | 29.11 | 40.25 | 35.31 | 24.99 | 35.59 | 31.02 |
| | IP/RE (percentage) | 23.60 | 27.64 | 25.87 | 20.00 | 25.00 | 23.16 |

**Source:** RBI state finances: A study of state budget (RBI, 2010).
**Note:** Revenue receipts (RR); revenue expenditure (RE)).

In 1997-98, the gross fiscal deficit was 5.09 per cent which increased to 6.78 per cent in 1998-99. The reason behind this was the implementation of the fifth pay commission. The deficit reduced in 2002-03 but still remained high at 5.35 per cent of GSDP. the revenue deficit was also at an alarming 4.56 per cent of GSDP. The interest payment ratio to revenue receipts had increased and became a major part of the revenue receipts of the state. The ratio varied from 24.99 per cent to 40.25 per cent during the period up to one-fourth of revenue receipts[13]. The increasing burden and bad fiscal situation make the economy highly unsustainable. The report of the Twelfth Finance Commission also stated that, "*Debt Relief often underwrites lack of fiscal discipline of the past so it is clear that any debt relief will have to be linked to a desired path of fiscal adjustment including targets for revenue and fiscal deficit.*" The state government of Punjab framed the Punjab Fiscal Responsibility and Budget Management (PFRBM) which laid its sole responsibility to reduce the fiscal deficit to bring it down to 3 per cent of GSDP. The Act provisioned that the revenue deficit should decline and become a surplus by the end of 2010. **The government failed to comply with any of the targets and the revenue deficit never decreased.** Instead, the deficit continued to increase during the period. Later with amendment, the government managed to meet the limit of 2.9 per cent but later the deficit again increased higher than mandated. The revenue receipts kept on reducing continuously and the government

[13] Sawhney, U. (2018). An analysis of fiscal policy in an emerging economy: Innovative and sustainable fiscal rules in India. Millennial Asia, 9(3), 295-317. doi:10.1177/0976399618805629

reduced the capital expenditure to reduce the fiscal burden to meet the target. This reduction could lead to the deterioration of the economy as capital expenditure is important for the economy's growth.

**Table 5.** Deficit Reduction: Expenditure Contraction or Revenue Augmentation (as Percentage to GSDP)

| Year | Revenue Expenditure | Capital Outlay | GFD | RD | Revenue Receipts |
|---|---|---|---|---|---|
| **1997–1998** | 16.09 | 1.99 | 5.09 | 3.05 | 13.04 |
| **1998–1999** | 15.04 | 2.05 | 6.78 | 4.72 | 10.33 |
| **1999–2000** | 15.18 | 0.65 | 4.76 | 4.06 | 11.12 |
| **2000–2001** | 15.68 | 1.86 | 5.23 | 3.13 | 12.55 |
| **2001–2002** | 15.95 | 1.24 | 6.22 | 4.74 | 11.20 |
| **2002–2003** | 18.02 | 0.50 | 5.35 | 4.56 | 13.46 |
| | | **Post-FRBMA Period** | | | |
| **2003–2004** | 17.43 | 0.74 | 5.42 | 3.95 | 13.47 |
| **2004–2005** | 17.76 | 0.70 | 4.17 | 3.50 | 14.26 |
| **2005–2006** | 16.76 | 1.40 | 2.44 | 1.14 | 15.62 |
| **2006–2007** | 14.63 | 2.04 | 3.46 | 1.38 | 13.25 |
| **2007–2008** | 15.09 | 1.43 | 3.01 | 2.50 | 12.59 |
| **2008–2009** | 14.12 | 1.64 | 3.84 | 2.22 | 11.90 |
| **2009–2010** | 13.88 | 1.10 | 3.12 | 2.66 | 11.22 |
| **2010–2011** | 14.50 | 1.05 | 3.15 | 2.33 | 12.17 |
| **2011–2012** | 12.75 | 0.62 | 3.28 | 2.63 | 10.12 |
| **2012–2013** | 13.43 | 0.65 | 3.18 | 2.52 | 10.91 |
| **2013–2014** | 13.11 | 0.69 | 2.77 | 2.06 | 11.05 |

**Source:** RBI State Finances: A Study of State Budgets; Budget Documents, Government of Punjab.

**Punjab's debts as a proportion of their state GDP have increased by an average of 12 percentage points since 2014-15 and exceeded 40 per cent at the end of 2020-21. Debt levels are also likely to increase by nearly 48 per cent of state GDP to 55 per cent in 2027-28[14].**

The Union Government of India and the state government signed a Memorandum of Understanding (MOU) in 1999 and recommended that the state government implement a plan to improve the fiscal situation. Punjab's fiscal policy was criticized for not setting targets for investments and reduction in wastage of government expenditure. Several programmes lead to the deterioration of Punjab's fiscal strength including the huge losses in the 'procurement of food grains, losses on account of damaged wheat stock; interest on delayed payment by the Food Corporation of India (FCI); penal interest: carry-over charges on stock in hand; along with non-reimbursement of handling and transporting charges.'[15]

[14] Barry Eichengreen and Poonam Gupta. (2023, July 31). Incentivising fiscal prudence for states. Retrieved from https://www.ncaer.org/news/incentivising-fiscal-prudence-for-states

[15] Basanta K Pradhan and Anjali Prashad, INSTITUTE OF ECONOMIC GROWTH DELHI UNIVERSITY ENCLAVE DELHI-110007. (2018). Fiscal Scenario in Punjab: Past Trends, Future Prospects and Challenges. Retrieved from INSTITUTE OF ECONOMIC GROWTH DELHI website: https://www.niti.gov.in/sites/default/files/2023-03/Fiscal%20Scenario%20in%20Punjab%20Past%20Trends%2C%20Future%20Prospects%20and%20Challenges.pdf

## B. Maharashtra's improving fiscal strength

In 2003, the Maharashtra Government enacted the FRBM Act and the Fiscal Responsibilities Act on the recommendation of the Twelfth Finance Commission. The revenue deficit of the government was 0.4 per cent in 1991-92 but it increased after liberalization. The revenue deficit was observed to be 3.1 per cent in 2000-01, 0.8 per cent in 2005-06 and 0.2 per cent in 2013-14. The fiscal deficit was observed as 3.3 per cent in 1991-92 and 4.8 per cent in 2002-03. The high fiscal deficit became a strong concern when in 2003-04, it increased to 5.3 per cent. The state has reduced the fiscal deficit after the enactment of the FRBM Act with a fiscal deficit result of -0.4 per cent in 2006-07 and 2008-09. Since then the fiscal deficit has continuously grown driven strongly by non-plan and non-productive expenditures.

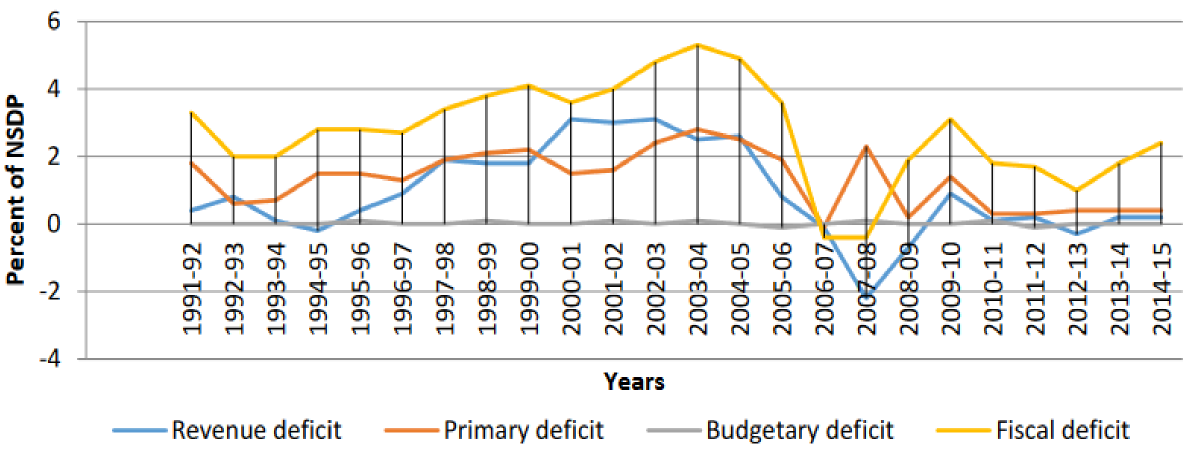



**Figure 2.** Revenue, primary, budgetary and fiscal deficits from liberalization era

**In the post-FRBM era, the CAGR increased to 14.38 per cent from 10.89 per cent in the pre-FRBM era.** Similarly the tax revenue receipts had also increased due to states own tax revenue as the taxes on property and capital transactions increased. The deficit increased because expenditure is more than revenue. **The expenditure in the state was reduced post-FRBM as it fell to 4.88 per cent from 12.5 per cent but developmental expenditure increased from 10.28 per cent to 14.93 per cent.** The expenditure on administrative services also increased due to migration and an increase in population. The interest payment and services of debt also fell 14.92 per cent to 9.71 per cent post-FRBM[16].

The revenue receipts for the government increased by 31.64 per cent from ₹2,04,693.14 crores in 2016-17 to ₹2,69,467.91 crores in 2020-21. The CAGR during the period was observed as 7.12 per cent though the revenue receipts declined by 4.85 per cent due to pandemic and lockdown restrictions. The revenue receipts accounted for 67 per cent of states's resources with Union transfers and Grants-in-Aid contributing 33 per cent. The tax revenue from all sources like sales tax, SGST, stamp duty, land revenue, etc. declined due to the pandemic and positive growth is projected in the future. Maharashtra's share in the divisible pool as per the Fourteenth Finance Commission was 5.551 per cent and has increased to 6.135 per cent in the Fifteenth

[16] Rode, S. (2018). Widening fiscal deficit in Maharashtra state: Causes and concerns. Public and Municipal Finance, 7(2), 48-65. doi:10.21511/pmf.07(2).2018.05

Finance Commission. Capital expenditure being the most important for infrastructure creation constituted 8.66 per cent of total expenditure in 2020-21[17].

## X. Recommendations

1. Banks should be mandated to use **AI and blockchain** in predicting behaviour and defaults using prior data to reduce defaults and increase Non-Performing Assets. This use will also help the banks increase profit as ICT can help raise profitability (*Thakur, Swapnilsingh, Shailesh Rastogi, Neha Parashar, Pracheta Tejasmayee, and Jyoti Mehndiratta Kappal. 2023. "The Impact of ICT on the Profitability of Indian Banks: The Moderating Role of NPA" Journal of Risk and Financial Management 16, no. 4: 211*).

2. The **takeover process** of the National Asset Reconstruction Company Limited should be sped up to resolve high amounts of NPAs as the complete capacity has not yet been fulfilled. The government should **focus on making frameworks** because Bad Banks can reduce NPAs but can't stop them. (*Nathan Menon, & Uden de Silva. (2024, March 27). India's bad bank, two years on.... Reed Smith*).

3. The cooperative banks can be shifted from the **state list to the concurrent list** so that a central law can be made governing all banks all over India. The legal framework also needs to be clarified as reports suggest a **lack of clarity in understanding and implementation of regulations** under the Banking Regulation Act. (*Shehnaz Ahmed, & Debanshu Mukherjee. (2019). Reforming the Governance of Co-operative Banks | A Study of State & District Central Co-operative Banks in 10 States. Vidhi Centre for Legal Policy.*)

4. The state and central governments should make provisions and allocate sufficient funds to **provide grants to PSUs.** The government should also set up a separate board to revive failing PSUs and do risk analysis to monitor and advise spending. Horizontal mergers can be made to reduce double spending of funds.

5. To improve fiscal responsibility, the government should establish an **incentive programme** where states meeting FRBM targets get the set incentives. Incentives like extended borrowing limits and grants can be provided.

6. The state and central governments need to reduce their investments in Non-Performing Assets (NPA), thus **reducing wasteful expenditure.**

7. The government needs to incorporate stronger and flexible fiscal responsibility rules with **state-specific fiscal limits** keeping in mind the current fiscal strength and the state's position for fiscal deficit management.

8. States need to raise mobilisation of revenue through achieving higher digitization as well as greater administrative simplification, widening tax base, enhancement in property tax, introduction of new taxes,

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[17] State Finances Audit Report for the year ended 31 March 2021, Chapter II: Finances of the State. (n.d.). Retrieved from https://cag.gov.in/uploads/download_audit_report/2021/7.%20Chapter%202.%20Finances%20of%20the%20State-0630c9449578a85.38622758.pdf

and increasing privatization receipts to **absorb the fiscal deficit**.

9. The government may implement a new way of enforcing fiscal regulations where strict **regulations are imposed and formulated to the end of the year performance.** This will help enhance the fiscal implementation as ex-post regulations are reactive and implemented to reduce deficit, prevent market failure and correct past mistakes. (Kopits, M., & Symansky, M. A. (1998). III Economic Effects. *In Fiscal policy rules* (pp. 12-16)).

10. The **need for transparency** is important for the durability of the fiscal rule in the long run. While the FRBM Act provides transparency, certain activities like off-budget financing can impact the fiscal balance in the state thus demanding strong transparency in the rules. With transparency, also comes **enforceability** and **flexibility** to adopt different sections. (Kopits, M., & Symansky, M. A. (1998). IV Evaluation of Fiscal Rules. *In Fiscal policy rules* (pp. 17-21)).

## XI. Conclusion

The Journey of fiscal Discipline in the states is multifaceted with the FRBM Act being the first legislation by the parliament. The FRBM Act aims to bring states towards fiscal management trying to bring down the deficit and the debt borrowing of the state and central government. The states and the centre being intertwined with fiscal discipline affect the country's economic health as a whole. The fiscal health of the states and the centre dropped during the Pandemic affecting the long-term goals. There also have been states like Maharashtra with best fiscal management and Punjab with disastrous fiscal management simultaneously in the same time period.

To cope with the problem, we try to look at the different rules of fiscal implementation, better expenditure management with disinvestment in NPAs, improving transparency and ways to increase revenue. A successful and long-term sustainable state can only be established by proper implementation of the rules and financial stability using rational decisions.

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