

Evaluation Report of Compliance to Provisions of the Sikkim FRBM Act: Fiscal Years 2021-22 & 2022-23

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Chapter 1: Assessing Compliance to the Fiscal Rules: A Background

Objectives and Scope of the Evaluation Report

1.1 The objective of this assessment is to present the results of an independent review of state finances and compliance to the State Fiscal Responsibility and Budget Management Act (FRBM Act) of Sikkim for the fiscal years 2021-22 and 2022-23. The state FRBM Act stipulates an independent review, which must be presented to the state legislature to support the legislative scrutiny of the process of fiscal management.

1.2 This report follows the review process outlined in the FRBM Act and pertains to a period of two fiscal years – 2021-22 and 2022-23. These two fiscal years were significant in the fiscal management process, as the Union and the state government were in the process of recovering from the adverse impact of Covid-19 pandemic. The governments at both levels faced significant challenges to comply with provisions of fiscal rules and had to reshape them to facilitate gradual adherence to the fiscal consolidation process.

1.3 The focus of the evaluation is to assess the state's compliance with the targets of the fiscal responsibility act and present an analysis of emerging fiscal management process. It examines revenue and expenditure trends, resultant fiscal outcomes, compliance to key FRBM Act provisions, and an analysis of budget to assess the government's ability to implement the budgetary plans. The assessment also analyse the efforts of the government to raise resources from own sources, transfers from the Union government, the spending plans under social, economic, and general services, within the broad division of revenue and capital expenditure. The assessment highlights the efforts of the state government to return to the fiscal consolidation process.

1.4 The report covers literature review, background analytical work and examines the state's finances in recent years. It provides a summary of the key conclusions and lessons learned from fiscal management for the fiscal years 2021-22 and 2022-23. Key features of assessment, pertaining to management of state finances and fiscal responsibility legislation, are outlined in the report.

- a. Assessment of macroeconomic outlook that includes broad composition of gross state domestic product, contribution of various sectors to the state income, and growth perspective. As per the provisions of the FRBM Act, a macroeconomic outlook statement is prepared along with the medium-term fiscal plan (MTFP).
- b. Analysis of revenue effort, central transfers, and spending pattern in the budget and fiscal outcomes in terms of deficit and debt stock are included in the assessment of state finances. It also examines the response of the state government to the requirements of Fiscal Responsibility Act during the challenging times of recovery following the pandemic induced slowdown.
- c. Compliance of the State Government to the provisions of FRBM Act in the fiscal years of 2021-22 and 2022-23 is examined. These include an assessment of fiscal targets relating to deficit, debt, and other fiscal variables as specified in the Act.
- d. Evaluation of budget reliability in terms of budget projections and outturns both on revenue and spending side is carried out.
- e. In assessing the compliance of the state to the FRBM Act provisions, the report reviews its adherence to fiscal management principles and transparency requirements enunciated in the Act.

1.5 The State Government entrusted the responsibility of reviewing the compliance of the Act for the fiscal years 2021-22 and 2022-23 to the National Institute of Public Finance and Policy (NIPFP), New Delhi, a Centre for research in public economics. Founded in 1976, the institute undertakes research, policy advocacy and capacity building in areas related to public economics. NIPFP assists the Central, State and Local governments in formulating and reforming public policies by providing an analytical base. The institute was set up as an autonomous society, at the joint initiative of the Ministry of Finance, Planning Commission, several state governments and distinguished academicians.

Reviewing Compliance to FRBM Act: The Context and Background

1.6 The state government amended the FRBM Act in response to the recommendation of Thirteenth Finance Commission (FC-XIII) incorporating an independent review process for the compliance to the provisions of the Act. The recommendation of the Commission aimed at enhancing the credibility and transparency of the fiscal management process by the state

governments in implementing fiscal responsibility legislation. Independent review has remained a crucial feature of establishing a sound public financial management process.

1.7 FC-XIII recommended to institutionalize the process of independent review of compliance of FRBM Act at both Union and state level. According to the Commission, the independent review mechanism should evolve into a fiscal council with legislative backing over time¹. Fourteenth Finance Commission (FC-XIV) and other expert bodies also favored creating fiscal council at the Union level². Fifteenth Finance Commission (FC-XV) as part of their reform recommendations relating to fiscal architecture and building fiscal institutions strongly favored fiscal council at both Union and state levels.

1.8 While international experiences shows that independent fiscal councils improve the accuracy of fiscal projections and adherence to fiscal rules³ by functioning as an advisory body, it has not taken root in India. The Union Government has entrusted the responsibility of independent evaluation of the FRBM Act to the Comptroller and Auditor General of India (CAG). Several states, including Sikkim, have amended their FRBM Acts to include periodic independent reviews, which appear to be a more feasible approach to enhance accountability and transparency.

1.9 Independent review of the fiscal management in the context of fiscal rules leads to establishing transparency and accountability⁴.

- a. Assessing fiscal policy objectives, programs to implement the policies, outcomes and deviations from plans helps taking corrective measures.
- b. It enhances legislative control over financial management as the reports are laid in the legislature and subject to legislative debates.

¹ Report of the Thirteenth Finance commission, para 13.56, pp.395

² The 13th and 14th Finance Commissions advocated for establishing independent fiscal agencies to review the government's adherence to fiscal rules, and to provide independent assessments of budget proposals. The N.K. Singh committee, (2017) on the review of fiscal rules suggested the creation of an independent fiscal council that would provide forecasts and advise the government on whether conditions exist for deviation from the mandated fiscal rules. In 2018, the D.K. Srivastava committee on Fiscal Statistics suggested the establishment of a fiscal council that could co-ordinate with all levels of government to provide harmonized fiscal statistics and provide an annual assessment of overall public sector borrowing requirements.

Report of the Fifteenth Finance commission, para 9.66, pp.137

³ Roel M. W. J. Beetsma ; Xavier Debrun ; Xiangming Fang ; Young Kim ; Victor Duarte Lledo ; Samba Mbaye ; Xiaoxiao Zhang (2018), Independent Fiscal Councils: Recent Trends and Performance, Working Paper No. 18/68, International Monetary Fund

⁴ IMF Code of Good Practices on Fiscal Transparency.

- c. Assessment of compliance to fiscal rules and disclosure of fiscal information as stipulated in the Acts helps increasing transparency in public financial management.
- d. Issues relating to comprehensiveness of the state budget, accessibility of budget documents comprising all the key fiscal information, level of coordination with central government as reflected in flow of funds in central schemes⁵ can also be assessed in the review process.
- e. The review report can be used to assess the budget credibility and examine the ability of the government to implement the planned activities⁶.

Sikkim FRBM Act

1.10 Government of Sikkim adopted the FRBM Act in 2010 with the aim of establishing a rule-based fiscal management system and ensure fiscal stability and sustainability. The state FRBM Act sets quantitative targets for deficit measures and debt levels as percent of GSDP. As stipulated by the Act, the government prepares Medium-Term Fiscal Plan (MTFP) providing a medium-term perspective to the macro-fiscal management. The State Government made necessary changes in the FRBM Act by bringing amendments following the recommendations of Central Finance Commissions. The Act provides fiscal management principles emphasizing prudence, and transparency in fiscal management and predictability in funding arrangements.

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

⁵ PEFA: Framework for Assessing Public Financial Management, (2016), PEFA secretariat, Washington DC

⁶ Jena Pratap Ranjan and Abhishek Singh, "Sub-national Budget Credibility: Institutional Perspective and Reform Agenda in India", Working Paper No. 338, July-2021, National Institute of Public Finance and Policy.

indicative debt-GSDP ratio. In the amendment to the FRBM Act in 2021-22, the fiscal deficit target was fixed at 4 percent of GSDP for 2021-22, 3.5 percent for 2022-23 and 3 percent thereafter. The debt-GSDP ratio was fixed at 27.5 percent and 28.1 percent respectively in these two years

1.12 After the adoption of the fiscal rules the state government was successful in reducing fiscal deficit and generate revenue surplus to adhere to the fiscal targets. The fiscal management under fiscal rules also has experienced improvement in quality of expenditure with rise in share of capital expenditure. The impact of growth in GDP and transfers from union government played crucial role in the fiscal consolidation process. While states in India managed to navigate through the financial crisis of 2008-09 and consequent decline in national growth rate and reduced central transfers, the Covid-19 Pandemic induced fiscal stress has brought about large disruptions. The revival of growth process in the country was instrumental in coming back to fiscal consolidating path in the post-pandemic period.

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

1.14 The ability to develop and implement clear fiscal strategy leads to achieving fiscal goals. As the state has a limited base to generate resources internally and the provision of public services in a difficult hilly terrain is costly, the Government needs to calibrate its fiscal policy and spending pattern with a restraint provided by the fiscal rules. The FRBM Act emphasizing fiscal discipline, becomes an enabling factor to take sound decisions on resource allocation and achieve operational efficiency.

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

compliance with other budget management requirements outlined in the Act, such as transparency and adherence to desirable fiscal management principles.

Data and Information for the Evaluation Report

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

Organization of the Report

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

Chapter 2: Overview of the State Economy

Recovery from the Impact of Covid-19 Pandemic

The Indian economy recovered in 2021-22 and achieved to 8.7 percent growth after the opening up of the economy and the revival of economic activities. By 2022-23, the impact of pandemic had largely dissipated, positioning India for rapid growth and a return to its pre-pandemic growth path. India's recovery from the pandemic was relatively quick, with growth in the upcoming year was driven by solid domestic demand and increased in capital investment. The growth rate of the national economy in 2022-23 was 7.6 percent at constant prices. India continued to face the challenge of reining in inflation that the European strife accentuated. Resilience of the Indian economy was evident in the improvement of private consumption, which gave a boost to production activity. According to the Economic Survey of 2022-23, India's economic growth in FY23 has been principally led by private consumption and capital formation.

The recovery process across the states has varied in pace. One major policy instrument utilized at both the Union and states level to combat the growth erosion during the pandemic phase was fiscal stimulus. Improvement in key sectors like manufacturing, services, and infrastructure development driven by high capital investment from the government, helped the growth process in the recovery phase.

The economy of Sikkim demonstrated a robust recovery following the COVID-19 pandemic, with a favorable macroeconomic outlook. In 2021-22, the state's GSDP grew by approximately 6 percent at constant prices and 13.75 percent at current prices. This growth further accelerated in 2022-23, reaching 6.83 percent at constant prices and 13.84 percent at current prices. The size of Sikkim's economy was ₹37.64 thousand crore in 2021-22 and expanded to ₹42.67 thousand crore in 2022-23. GSDP growth rate during these two years, at both constant and current prices, reflects stable economic progress in the state. A stable economic situation in the long run will help the state government building sound fiscal forecasting to support development oriented fiscal policy.

The FRBM Act stipulates that the state government should provide a macro-economic framework statement along with the FRBM related documents. The objective of this statement

is to provide analysis of growth and sectoral composition of GSDP. The growth rate of GSDP is an important factor in the context of revenue generation effort of the State Government. The state economy's overall growth rate and the contribution from different sectors helps in determining potential budgetary revenue outcomes. The GSDP reflects the state's revenue base, even though the macroeconomic outlook at the national level is a key element in fiscal policy at both the Union and state levels. The tax buoyancy, which is utilized to examine the internal revenue effort of the state government, is derived by assuming the GSDP as proxy for tax base.

The Trend of GSDP Growth in Sikkim

The trend of economic growth and contribution of various sectors to the state economy assumes significance in formulating fiscal strategy for the budget year, primarily for assessing the possible revenue implication. The growth rate of GSDP becomes a crucial factor in the context of budget making as it is the denominator in all targets fiscal ratios, and it is also the determining factor for borrowing limit of the State. The fixation of the borrowing limits as percent to the GSDP is based on the assumptions regarding the growth rate usually made by the Central Finance Commission. The medium term fiscal plan (MTFP) presented along with the budget elaborates on state government's fiscal strategy adopted in the budget and the macroeconomic trends.

The GSDP of Sikkim at constant prices was ₹22,94,796 lakh in 2022-23, which grew by 8.04 percent from the last financial year 2021-22 (₹ 21,24,027 lakh). The growth rate of GSDP at constant prices in recent years has remained volatile due to COVID-19, with a growth of just 0.3 percent in 2020-21. Higher growth of 8.6 percent in 2021-22 in Sikkim reflects the revival of growth process in the country after the disruptions faced during the pandemic. The GSDP growth in the state more or less was aligned with trend of the national economy during 2015-16 to 2022-23, leaving only 2017-18 and 2020-21 (Fig 2.1). A comparison of state GSDP growth at constant prices with India's GDP growth shows that the growth rate of the state economy is higher in 2022-23, but slower in 2021-22. The fiscal management and achievement of the consolidation process, as per the amended FRBM Act, are expected to be positively influenced by the recovery process.

Figure 2.1: Sikkim's Economic Growth: GDP-GSDP Growth rates (at constant prices)

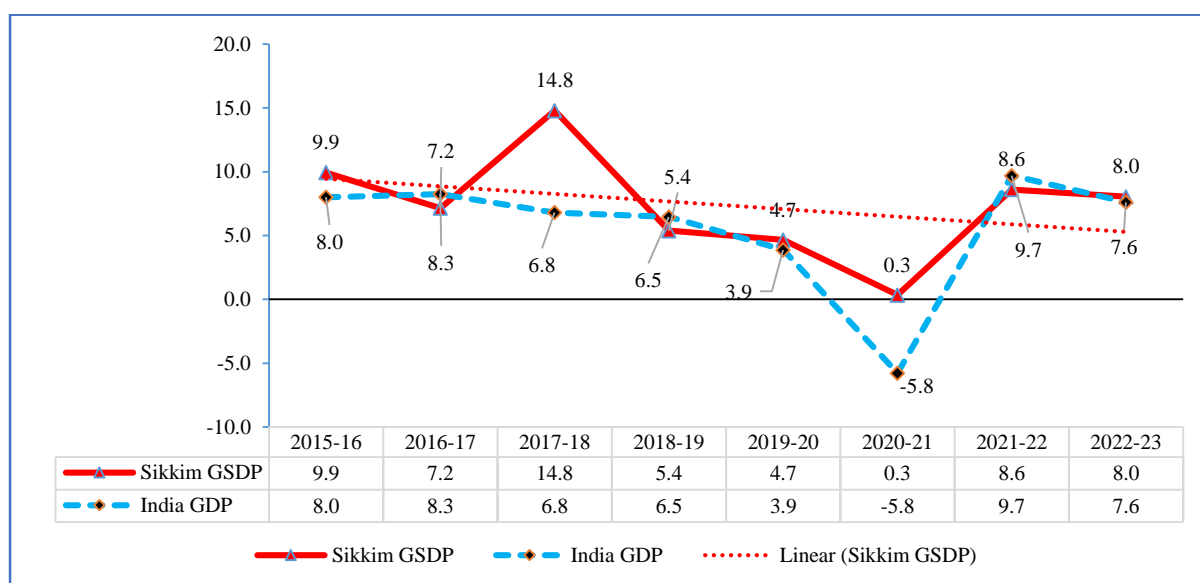


Table 2.1
Key Aggregates of State Domestic Product (Constant Prices)

Item	Growth over previous year (in %)								
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Gross State Value Added	9.09	6.16	11.94	8.26	5.06	0.79	8.61	8.04	8.52
Taxes on Products	20.65	21.37	56.22	28.04	-2.71	-3.75	8.61	8.04	8.52
Less Subsidies on Products	19.17	-20.19	30.99	3.89	-0.05	70.19	8.61	8.04	8.52
Gross State Domestic Product	9.93	7.15	14.78	5.38	4.66	0.33	8.61	8.04	8.52
Consumption of Fixed Capital	15.36	5.10	24.61	10.81	6.16	23.70	8.53	7.98	10.98
Net State Value Added	8.15	6.33	9.95	7.81	4.86	-3.45	8.62	8.05	7.93
Net State Domestic Product	9.16	7.46	13.33	4.50	4.40	-3.76	8.62	8.05	7.96
<i>GSDP at Current Prices</i>	<i>17.05</i>	<i>14.71</i>	<i>25.54</i>	<i>9.36</i>	<i>10.70</i>	<i>5.0</i>	<i>14.0</i>	<i>13.4</i>	<i>14.7</i>

Source: Central Statistical Office, GoI

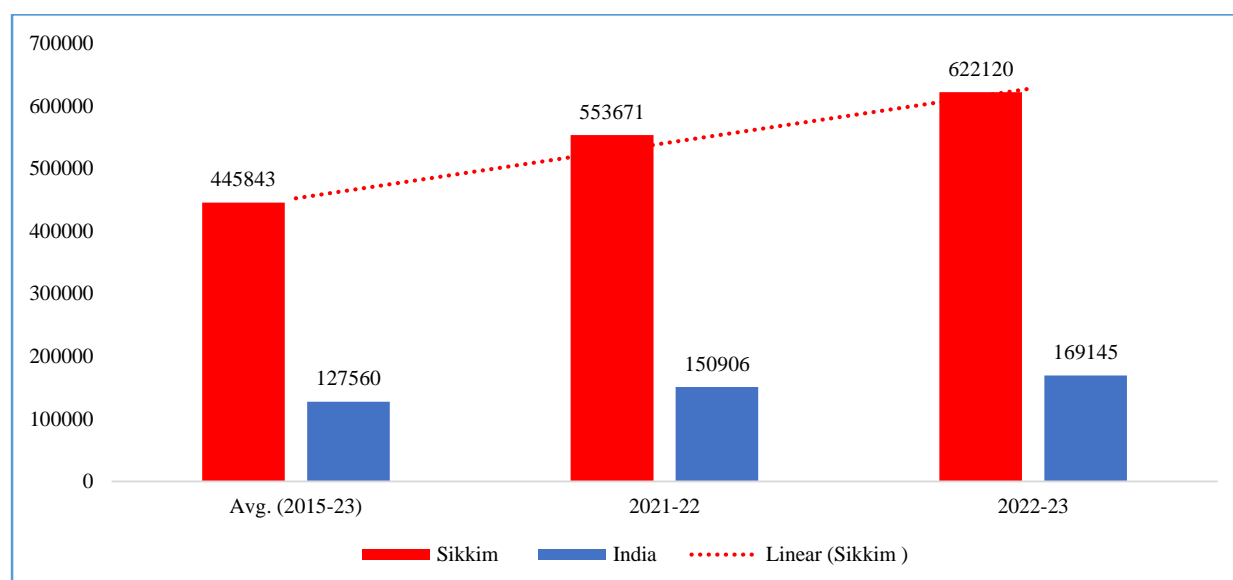
A comparison of the state GSDP growth with the projections made by the projected by the Central Finance Commissions (CFCs) at current prices shows a mixed picture. The Fourteenth Finance Commission (FC-XIV) had projected Sikkim's GSDP growth at current prices to be

24.32 percent for the award period 2015-16 to 2019-20, whereas the actual average annual growth during this period was significantly lower at 15.03 percent. The Fifteenth Finance Commission (FC-XV) projected an annual GSDP growth at current prices of 11.5 percent for 2021-22 and 12.0 percent for 2022-23. However, the state exceeded these projections, recording higher growth rates of 14.0 percent and 13.4 percent, respectively, in these years.

Per-Capita Income of Sikkim

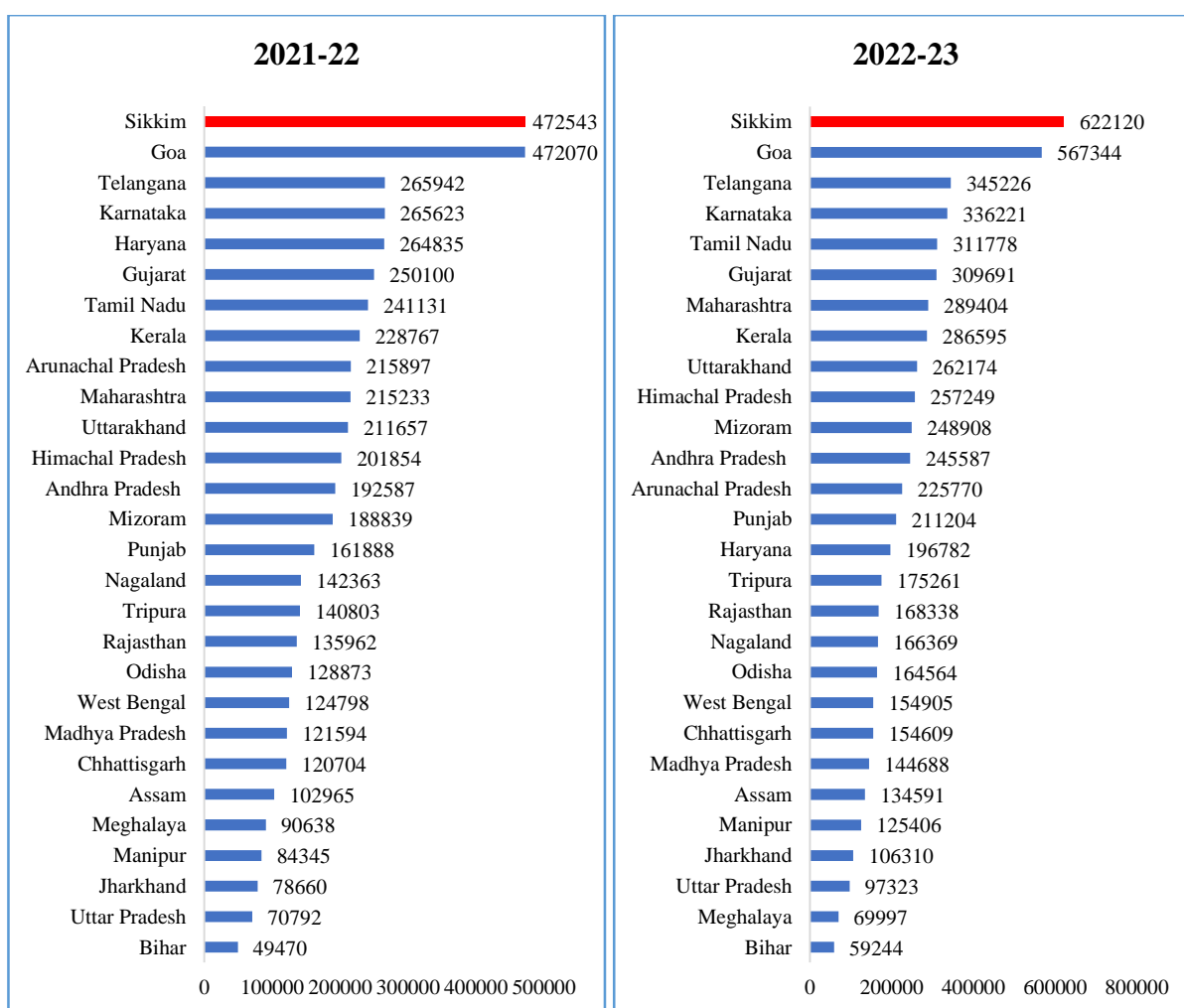
The per capita income of Sikkim at current prices was ₹5,53,671 in 2021-22, rising to ₹6,22,120 in 2022-23, reflecting a growth rate of 12.36 percent (Fig 2.2). This growth outpaced the national average of 12.1 percent in 2022-23. The gap between Sikkim's per capita income and the national average has been widening significantly over time.

Figure 2.2: Per-Capita Income, Sikkim and India (in ₹)



The past growth performance propelled Sikkim to a very high in the per capita income ladder across Indian states. The per capita income of the State shows an annual average growth rate of 12.58 percent during this period (2015-16 to 2020-21). While the average growth rate was about 14 percent during 2015-16 to 2019-20, the low growth of just 4.07 percent in 2020-21 has affected growth of per capita income of the state. The revival of growth process in the state after the Covid-19 pandemic will facilitate overall development process and help in achieving improved socio-economic indicators.

Figure 2.3: Per- Capita Income of all States in 2021-22 and 2022-23 (in ₹)



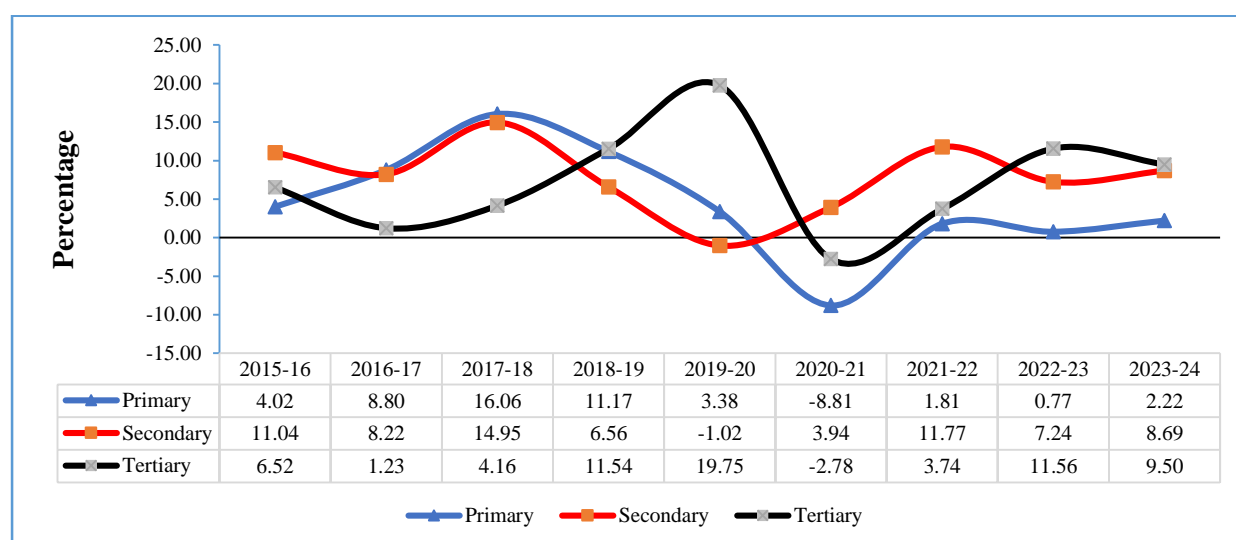
The Sectoral Composition and Growth

Contribution of various sectors is crucial to assess the trend of state GSDP. At the national level, the agriculture sector sustained the growth rate of 4.8 percent and 5.9 percent in 2021-22 and 2022-23 respectively. The industrial sector, which had faced a significant setback with a contraction of 1.3 percent in 2019-20 and marginal growth of 0.2 percent in 2020-21, showed signs of recovery, expanding by 12.7 percent in 2021-22 and 2.4 percent in 2022-23. Similarly, the services sector, which had contracted by 8.4 percent in 2020-21 due to a decline in economic and social activities, rebounded with growth rates of 9.2 percent in 2021-22 and 10.3 percent in 2022-23.

In Sikkim, the primary (agriculture and allied), secondary (industry) and tertiary (service) sectors, have shown varied performance over the years (Fig 2.4). After the dismal performance in pandemic year, all sectors showed improved growth performance. The agriculture sector,

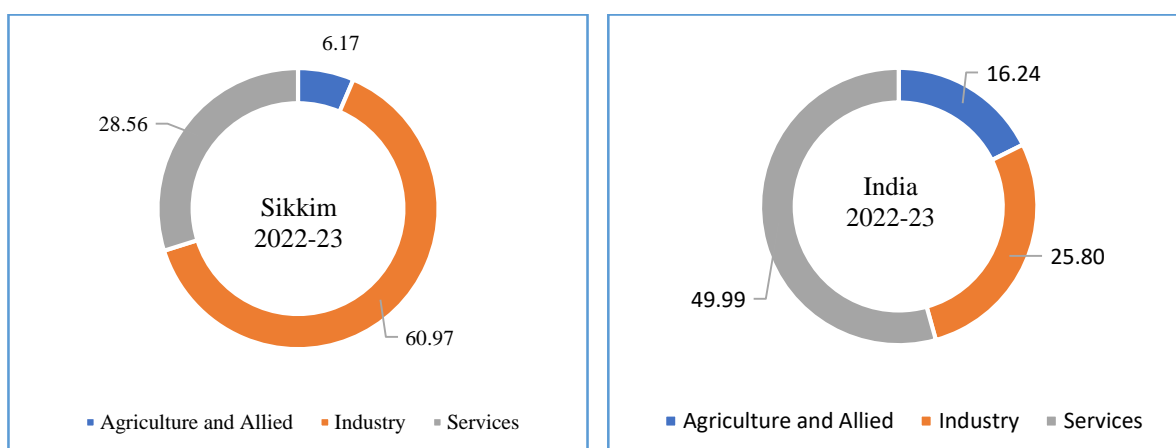
which contracted considerably in 2020-21, started showing some positive growth in 2021-22 and 2022-23. The industry sector has remained a crucial component of the state's economy due to its preeminent share. Despite low growth experienced in 2020-21, the industry sector showed sign of recovery from a negative growth experienced in the previous year. This growth in this sector continued to rise from 3.94 percent in 2020-21 to healthy rate of 11.77 percent in 2021-22 and 7.24 percent in 2022-23. The services sector, which plays a dominant role in the state's economy, achieved its highest growth rate of 19.75 percent in 2019-20. However, it faced a sharp decline in 2020-21, contracting to 2.78 percent due to pandemic. The sector bounced back in 2022-23, registering a growth rate of 11.56 percent.

Figure2.4: Year-on-Year Growth of Sectors at constant prices (2011-12)



The sectoral composition of Sikkim and India in 2022-23 is presented in Figure 2.5. In Sikkim, the Agriculture and Allied sector contributed approximately 6.17 percent to the state's GSDP in 2022-23. Industry sector holds a prominent position in the economy of Sikkim, contributing ₹11,67,271 crore, which accounts for around 61 percent of the GSDP. The services sector, meanwhile, constituted 28.5 percent of the state's GSDP in the same year. In contrast, at the national level, the services sector holds a significantly larger share in India's GDP, accounting for approximately 50 percent in 2022-23.

Figure 2.5: Sectoral composition at constant (2011-12) prices, Sikkim and India, 2022-23



The composition of GSDP of Sikkim shows that industry sector, which includes manufacturing, Electricity, Gas, Water Supply & Others and construction has remained the largest contributor to the economy (Table 2.2). The share of this sector has remained constant at around 60 percent during 2015-16 to 2022-23. Given the small size of the economy, the investments in hydroelectricity and pharmaceuticals have strengthened the secondary sector. Due to the economic slowdown in 2019-20, the industry sector's relative share declined to 57.6 percent. It rebounded in subsequent years, reaching 61.43 percent in 2021-22. Within the industrial sector, manufacturing accounted for the highest share of 34.62 percent of GSDP, followed by electricity and other utilities at 21.86 percent in 2022-23.

The relative share of the service sector, which includes trade, hotel, transport, real estate, and financial services, has more or less remained stagnant for more number of year in recent past. The other services of this sector which includes education, healthcare services among others are the major contributors in services sector with a share of around 8.3 percent in 2021-22 and 2022-23 in the overall GSDP of the State. This is followed by trade, repair, hotels and restaurants contributed 7.05 percent in 2022-23, public administration (6.41 percent), real estate, ownership of dwelling & professional services (3.08 percent), transport, storage, communication & services related to broadcasting (2.53 per cent).

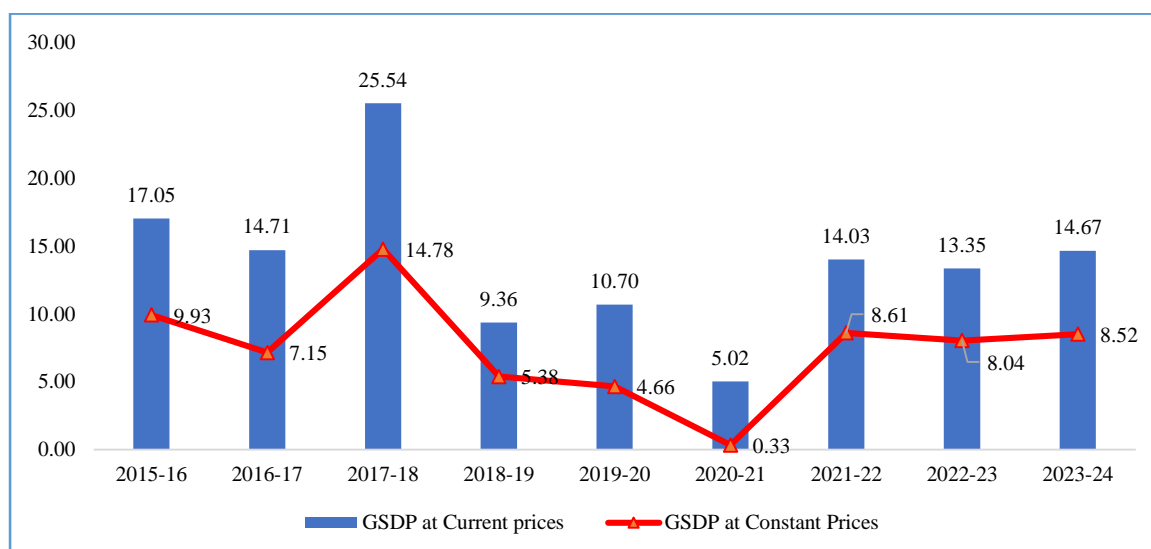
Table 2.2 Composition of GSDP (Constant Prices)

Economic Activity	Percentage Share								
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Agriculture, Forestry and Fishing	7.17	7.29	7.38	7.81	7.72	7.03	6.58	6.12	5.76
Mining and Quarrying	0.09	0.08	0.07	0.06	0.05	0.03	0.04	0.05	0.05
Primary	7.26	7.37	7.46	7.87	7.77	7.06	6.62	6.17	5.82
Manufacturing	41.62	43.85	44.30	44.08	40.27	37.96	37.64	36.20	34.62
Electricity, Gas, Water Supply & Others	12.90	12.08	12.00	12.97	13.16	18.03	19.70	20.21	21.86
Construction	5.05	4.24	3.94	3.87	4.19	3.69	4.08	4.56	4.59
Secondary	59.57	60.16	60.24	60.92	57.61	59.69	61.43	60.97	61.07
Trade, Repair, Hotels and Restaurants	4.31	4.31	4.31	4.72	5.07	5.42	5.58	6.65	7.05
Transport, Storage, Communication	3.00	3.16	2.82	2.78	2.89	2.71	2.62	2.64	2.53
Financial Services	2.59	1.57	1.36	1.38	1.66	1.78	1.33	1.46	1.46
Real estate	4.38	4.22	3.78	3.72	3.78	3.68	3.38	3.27	3.08
Public Administration	6.27	5.87	5.20	6.43	7.51	6.96	6.46	6.30	6.41
Other Services	8.23	8.06	7.21	7.09	8.97	8.41	8.28	8.24	8.30
Tertiary	28.78	27.19	24.68	26.12	29.89	28.96	27.66	28.56	28.82
TOTAL GSVA at Basic Prices	95.61	94.73	92.38	94.90	95.27	95.71	95.71	95.71	95.71

Source: Central Statistical Office, GoI

Revival of the growth process in Sikkim in 2021-22 and 2022-23 is in sync with national growth process and is expected to further enhance development process of the state. The state's GSDP shows the highest growth of 25.54 percent and 14.78 percent at current and constant prices, respectively, in 2017-18 (Fig 2.6). The lowest growth rates were recorded during the pandemic 2020-21, when the state's economy grew by only 5.02 percent at current prices and 0.33 percent at constant prices. Economic conditions improved significantly in 2021-22 and 2022-23 with GSDP growth rebounding to 8.61 percent at constant prices and 14.03 percent at current prices in 2021-22, followed by 8.04 percent and 13.35 percent, respectively, in 2022-23. A sectoral decomposition of growth at constant prices reveals that overall growth was driven by an expansion of 11.77 percent in the secondary sector in 2021-22 and 7.24 percent in 2022-23, alongside a robust 11.56 percent growth in the services sector in 2022-23. The sustained improvement in both the industrial and services sectors bodes well for revenue generation and overall economic stability in the state.

Figure 2.6: GSDP Growth at Current and Constant Prices



Growth perspective is crucial from budget management point of view, as the state economy is usually assumed to provide base for the revenue. Thus, movement of the economy and contribution of different sectors are tracked through an unbiased macroeconomic and fiscal projections is essential to formulating accurate revenue projections. In the case of Sikkim, a large part of the GSDP is derived from manufacturing and power generation. The service sector also shown improvement in terms of it share in both 2021-22 and 2022-23. These sectors are expected to drive consumption demand, which, in turn, will contribute to higher revenue generation.

Chapter 3: Fiscal Overview of Sikkim

Process of Fiscal Consolidation in States during the Recovery from Covid-19

3.1 The Fiscal Responsibility Legislations (FRLs), adopted by the State governments in the early 2000s, played a key role in the fiscal consolidation process. According to the RBI report on State Finances 2024, the consolidated gross fiscal deficit (GFD) of the Indian States fell from an average of 4.3 per cent of GDP during the period 1998-99 to 2003-04 to 2.7 per cent of GDP during 2004-05 to 2023-24. Due to this reduction in fiscal deficit, there has been a moderation in the debt burden of the states, which declined from 31.8 per cent of GDP in 2004 to 28.5 per cent of GDP in 2024. The Fiscal Responsibility and Budget Management (FRBM) Review Committee (2017), however recommended that the state debt-GDP ratio should be limited to 20 percent.

3.2 The state governments implemented several initiatives to simplify tax system and made concerted efforts to prioritize spending pattern to improve quality of expenditure. Introduction of GST was key tax reforms adopted by the states in coordinated manner, which improved tax base and revenue receipts. On the expenditure side, states shifted from the Old Pension Scheme (OPS) to the National Pension System (NPS), moved to Direct Benefit Transfers (DBT), and implemented a Single Nodal Agency (SNA) for the centrally sponsored schemes. Market-based financing became a measure source of borrowing, with the share of market borrowings in financing the GFD increasing from 17.0 per cent in 2005-06 to 79.0 per cent in 2024-25 (BE) (RBI state Finance report, 2024).

3.3 The states in India have successfully managed to maintain the gross fiscal deficit within the limits specified under FRBM Act at 3 percent of GDP since 2005-06⁷. There have been some exceptions to this achievement, such as 2009-10, 2015-16 and 2016-17, where factors beyond the control of the States have resulted in gross fiscal deficit to cross the threshold set by the FRBM Act. For instance, the global financial crisis of 2008-09 had adverse impact on

⁷ State Finances A Study of Budgets 2020-21

the national economy of India in 2009-10. Similarly, the process of fiscal consolidation was derailed due to the adverse impact of pandemic during 2020-21.

3.4 The fiscal health of the States improved considerably in 2021-22, recovering from the sharp pandemic-induced deterioration in the preceding year. Consolidated gross fiscal deficit of the states declined from 4.1 per cent of GDP in 2020-21 to 2.8 per cent in 2021-22. This improvement was driven by expenditure restructuring, particularly a reduction in revenue expenditure, coupled with an increase in revenue receipts. The fiscal year 2022-23 witnessed sustained improvement in fiscal health of the states, as the consolidated fiscal deficit declined to 2.7 percent of GDP. States managed to reduce their revenue deficit, which helped them to limit the fiscal deficit. To achieve fiscal consolidation, states in India readjusted their spending pattern, mainly on curbing revenue expenditure, while capital expenditure remained strong.

3.5 As the economy started recovering after relaxation in lockdown, the revenue receipts of states increased in 2021-22. Increase in own revenue receipts compensated reduced grants from the Centre. States managed to reduce revenue expenditure (as a per cent of GDP) declined in 2021-22 from the pandemic peak of 2020-21, as pandemic related spending declined, which helped the fiscal consolidation process. In the fiscal year 2022-23, while own revenue of the states continued to rise, tax devolution and grants declined resulting a marginal decline in total revenue receipts as percent to GDP. The fiscal management process witnessed reduction in revenue expenditure in 2022-23 by the states. States' capital expenditure (per cent of GDP) increased marginally in 2022-23, primarily due to higher loans and advances.

3.6 State governments have put up a prudent fiscal management process during the recovery period to achieve fiscal consolidation by restraining fiscal deficit below 3 per cent of GDP in both 2021-22 and 2022-23 (Table 3.1). The revenue deficit in these two years remained at 0.4 and 0.2 percent respectively. This has allowed the States to increase their capital spending, which improved the quality of expenditure. High debt-GDP ratio, outstanding guarantees, and the increasing subsidy burden, however, continues to be areas of concern.

3.7 Expenditure undertaken by states influences the development of human capital and physical infrastructure. It is, however, crucial for the state governments to balance developmental aspirations and sustainability commitments. To achieve this, augmenting

resource base through raising additional resources should be encouraged at the sub-national level.

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

(Rs in Lakh Crores)						
Item	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Gross Fiscal Deficit	4.1	4.6	5.3	8.1	6.6	7.2
(% of GDP)	(2.4)	(2.4)	(2.6)	(4.1)	(2.8)	(2.7)
Revenue Deficit	0.19	0.2	1.2	3.7	1.0	0.6
(% of GDP)	(0.1)	(0.1)	(0.6)	(1.9)	(0.4)	(0.2)
Primary Deficit	1.17	1.4	1.7	4.2	2.3	2.6
(% of GDP)	(0.7)	(0.8)	(0.9)	(2.1)	(1.0)	(1.0)

Source: State Finances: A Study of Budgets, 2024-25

Central Finance Commission Recommendations relating to Fiscal Consolidation

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

3.9 The FC-XV, while revising the fiscal consolidation path in the light of the fiscal distress faced by the state, prescribed for a fiscal deficit of 4.5 percent of GSDP in 2020-21 and tapering off to 3 percent in 2025-26 (Table 3.2). The Commission suggested that the ratio of public debt to GDP should continue to serve as the medium-term anchor for fiscal policy in India, with fiscal deficit as the operational target. Once the estimated revenue deficit adjusted with matching provision for revenue deficit grant, the whole borrowing space under fiscal deficit is

available for capital spending. Based on this approach, the Commission determined the net borrowing limit (gross borrowing minus repayment) of the state governments.

Table 3.2
FC-XV: Indicative Deficit and Debt Path

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

Source: Report XV Finance Commission

Fiscal Developments in Sikkim in 2021-22 and 2022-23

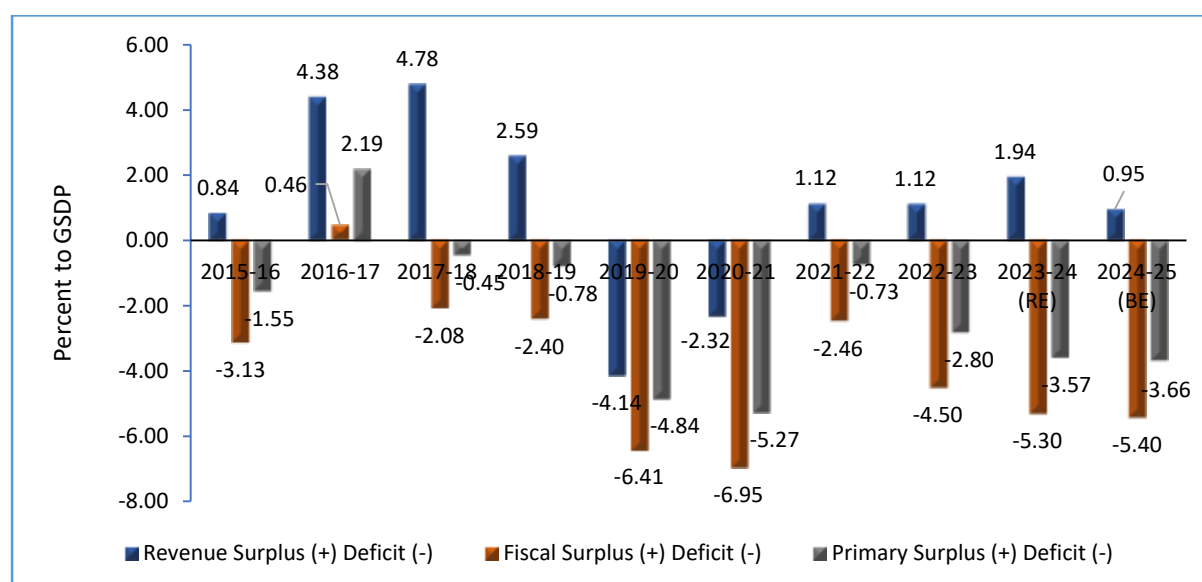
3.10 Fiscal Responsibility and Budget Management (FRBM) Act adopted in 2010 continues to anchor the fiscal management in Sikkim. Since the adoption of fiscal rules, the state showed improved fiscal performance. In this process higher transfers from the Union government and better own revenue effort played key roles. State government also rationalized the spending plan to generate surplus in the revenue account and improve quality of expenditure. Flexibility provided in borrowing facility and assistance to enhance capital investment played useful role.

3.11 The state's fiscal performance shows that after emerging from pandemic it was able to generate revenue surplus and keep the fiscal deficit within the target of 3 percent in 2021-22 (fig 3.1). In the revenue account, there was considerable improvement from a deficit of 2.32 percent in 2020-21 to a surplus of 1.12 percent of GSDP in 2021-22. The fiscal deficit declined from a peak of 6.95 percent of GSDP in 2020-21 to 2.46 percent in 2022-23. In 2022-23, the state continued to maintain a revenue surplus of 1.12 percent of GSDP, the fiscal deficit increased to 4.50 percent, well above the limit stipulated by the FRBM Act. This increase was primarily due to additional borrowing allowed to the state government for capital investment and power sector reforms.

3.12 The additional borrowing facilities were provided to the states to facilitate them for capital investment, aiding their recovery from the impact of Covid-19 pandemic. The availability of these additional sources of revenue was expected to help in the development of states. As per the amendment to the FRBM Act, the state was expected to achieve fiscal deficit

to the tune of 3.5 percent of GSDP in 2022-23. However, an annual additional borrowing space of 0.5 percent of GSDP was allowed for the period 2021-22 to 2024-25, based on the meeting of certain performance criteria in the power sector. The fiscal deficit, however exceeded the 4 percent target in 2022-23 due to availing additional borrowing frailties.

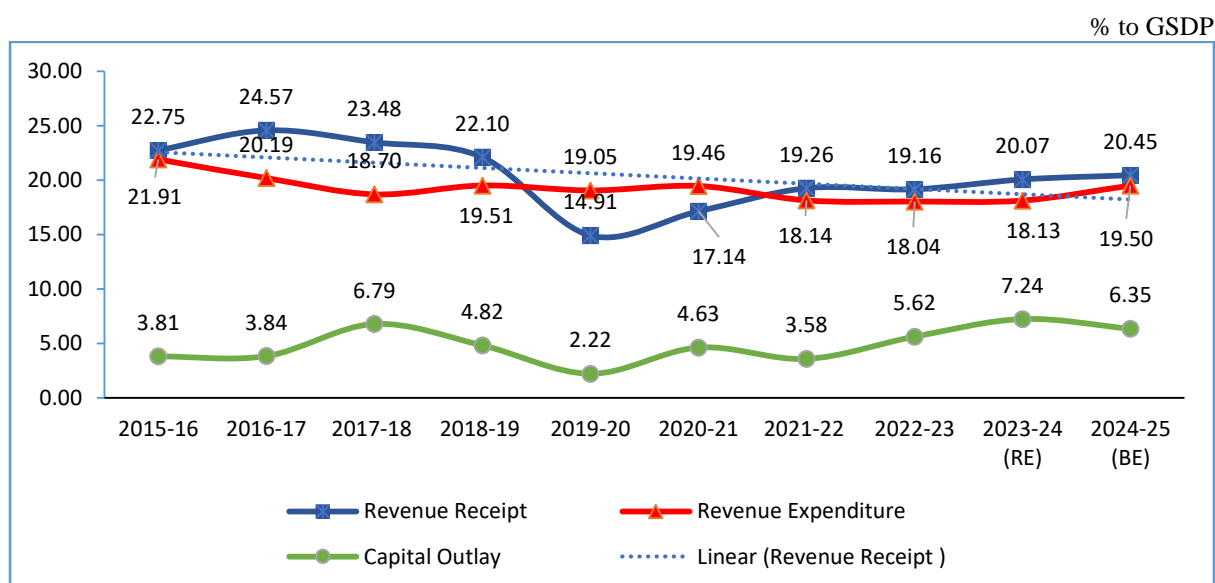
Figure 3.1
Key Fiscal Variables



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

3.14 The aggregate revenue and expenditure trend in the state for the years 2021-22 and 2022-23 show a favorable picture, enabling improved fiscal outcome. The aggregate revenue, as a percent of GSDP, in the state showed large improvement in these two years compared to the pandemic affected fiscal year of 2020-21 (Fig 3.2). Revenue receipt as a percent of GSDP increased from 17.14 percent in 2020-21 to 18.14 percent in 2021-22 and slightly declined to 18.04 percent in 2022-23. This improvement in total revenue receipts as percent to GSDP was driven by mostly higher transfers from Central government.

Figure 3.2
Revenue Receipt and Aggregate Spending Categories

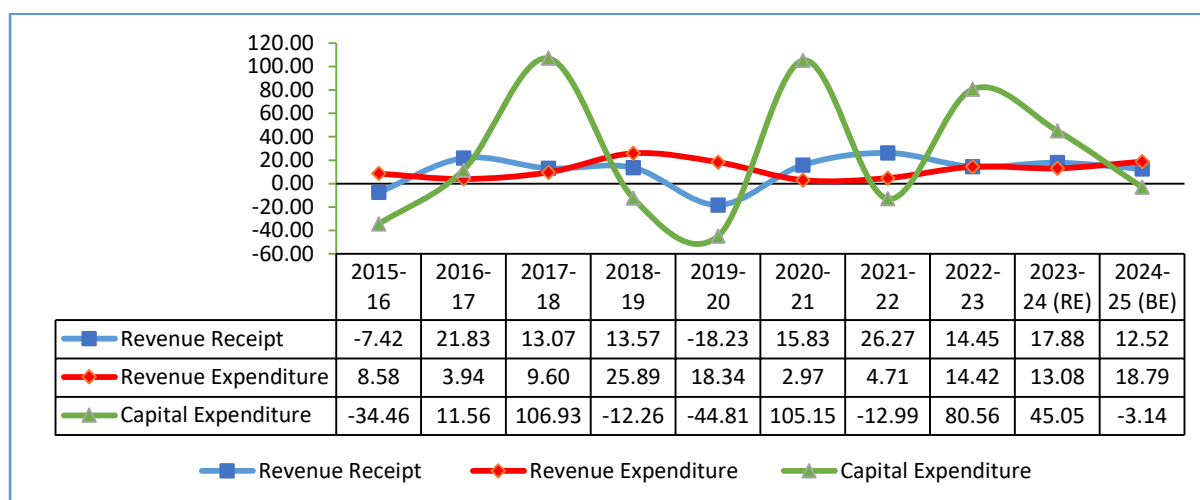


3.15 The spending pattern in 2021-22 and 2022-23 reveals that the revenue expenditure has moderated in these two years as percent to GSDP. The revenue expenditure declined as percent to GSDP from 19.46 percent in 2020-21 to 18.14 percent in 2021-22 and further to 18.4 percent in 2022-23. The revenue expenditure in the pandemic year 2020-21 was higher due to management of pandemic related expenses. This downward trend of revenue expenditure reflects the government's efforts to exercise fiscal restraint and maintain fiscal consolidation.

3.16 Capital expenditure as percent to GSDP declined in 2021-22 as compared to the previous year but significant improvement from 3.58 percent in 2021-22 to 5.62 percent in 2022-23. The increase was driven by the proactive push of state government and the availability of additional borrowing facility extended by the Union government, which positively influenced capital expenditure.

3.17 While the total revenue receipts in nominal terms increased from ₹5607.823 crores in 2020-21 to ₹7080.72 crores in 2021-22 and further to Rs.81.03.80 crores in 2022-23. The revenue receipt exhibited very high growth of 26.27 percent in 2021-22, which moderated to 14.45 percent in 2022-23. Both own revenues and central transfers showed high growth during these two years.

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



Source: Finance Accounts and State Budget, relevant years.

3.18 The growth rate of revenue expenditure, which was showing a declining trend since 2018-19, reduced to 2.97 percent in 2020-21. In 2021-22, the growth rate improved to 4.71 percent and further increased to 14.45 percent in 2022-23. In nominal terms, the revenue expenditure rose from ₹6368.63 crores in 2020-21 to ₹6668.84 crores in 2021-22 and further to Rs.7630.58 crores in 2022-23. While the average annual growth rate of revenue expenditure was 15.73 percent during 2018-19 to 2020-21, it declined to 9.57 percent in 2021-22 and 2022-23. Overall trend of revenue expenditure indicates that the government has exercised fiscal restraint.

3.19 The growth rate of capital expenditure in the state remained significantly volatile, with noticeable spikes in 2017-18 and 2020-21, and with negative growth rates in 2015-16, 2018-19 and 2019-20. The fluctuating trend continued in 2021-22. While the capital expenditure contracted by about 13 percent in 2021-22, the growth rate on the weak base increased to 80.56 percent in 2022-23. The capital expenditure, in nominal terms, declined from ₹1512.71 crore in 2020-21 to Rs.1316.18 crore in 2021-22. It increased to ₹2376.53 crore in 2022-23, largely driven by additional borrowing facilities allowed to the state. Capital expenditure has remained a residual in the system depending on central transfers and revenue expenditure commitments.

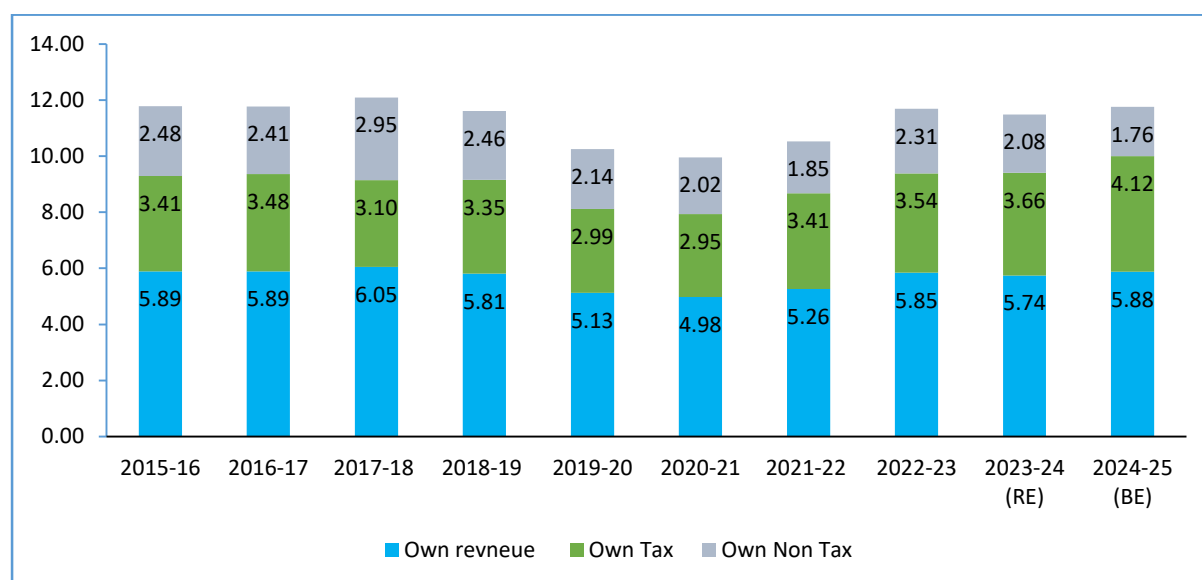
Own Revenue Receipts of the State

3.20 Own revenue receipts of the state on an average constituted about 27.89 percent of total revenue receipts during 2015-16 to 2022-23 out of which own tax revenue was 16.37 percent

and own non-tax revenue was 11.45 percent. The relative share of own revenue receipts as compared to central transfers has increased in the state. It has increased from 25.89 percent in 2015-16 to 30.52 percent in 2022-23. The share of central transfer has shown a declining trend, from 74.11 percent in 2015-16 to 69.48 percent in 2022-23. The rise in own revenues indicates a reduced dependency of the state on central transfers.

3.21 The own revenue including its components own tax and own non-tax receipts, as percent to GSDP showed a subdued trend from 2015-16 to 2020-21. Own revenue receipts as percent to GSDP declined from 5.89 percent in 2015-16 to 4.98 percent in the pandemic year 2020-21. . As the economy started recovering after the pandemic, the own revenue receipts of Sikkim has started to increase. It has increased to 5.26 percent in 2021-22 and further to 5.85 percent in 2022-23 (Fig 3.4), reaching pre-Covid-19 levels. Both the components of own revenue i.e., own tax and non-tax receipts as percentage of GSDP showed an increasing trend in 2021-22 and 2022-23.

Figure 3.4
Own Revenue as Percent to GSDP



3.22 The own revenue growth, particularly in its components - own tax and non-tax revenue receipts, shows large improvement after the pandemic (Fig 3.5). The growth rate of own tax revenue surged to 29.76 percent in 2021-22 compared to a negative growth in the previous year. The growth rate was significantly high partly due to both a weak base and increased economic activities after the lockdown was relaxed. Own non-tax revenue also shows higher

growth during 2021-22 and 2022-23. In nominal terms, the own tax revenue of the state was ₹966.70 crores in 2020-21, which increased to ₹1497.26 crores in 2022-23.

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

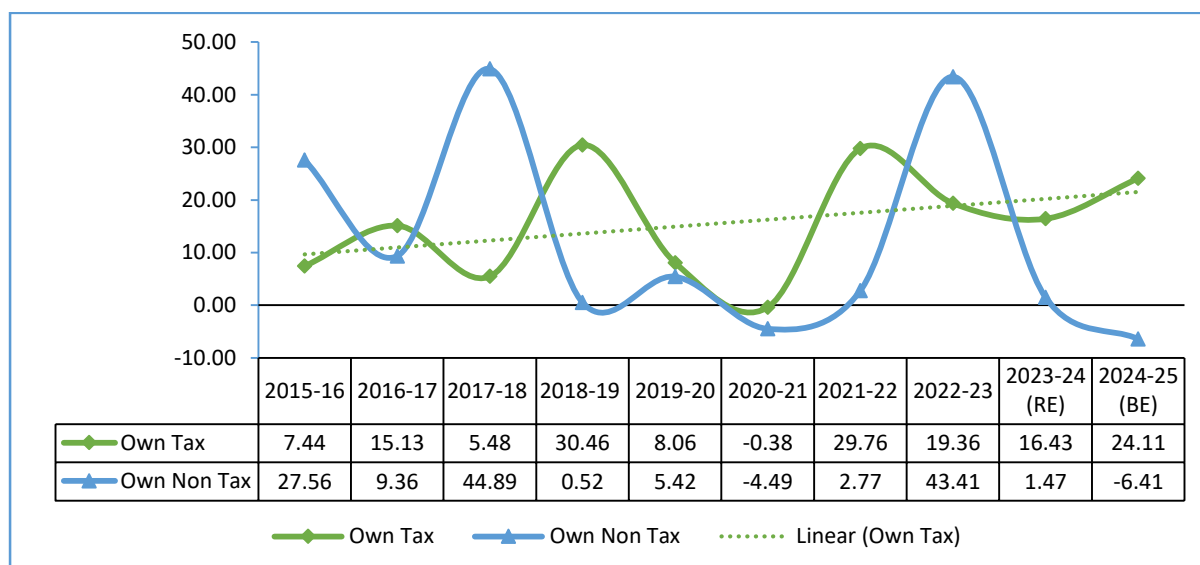
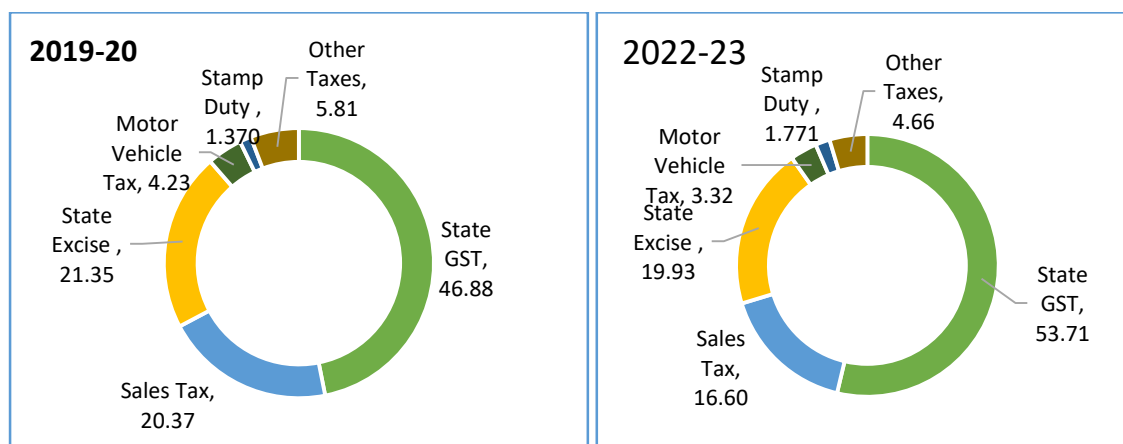


Figure 3.6
Composition of Own Tax Revenue



3.23 Sales Tax, including VAT and SGST constitutes a major portion of the state taxes. The share of sales tax & VAT during 2015-16 was 56.46 percent, which increased to 70.32 percent including the GST in 2022-23. The improvement in the relative share of GST in own tax revenue is clearly visible. Between 2019-20 and 2022-23, it increased from 46.88 percent. The GST compensation provided by the Union government was accounted for under grants-in-aid. State excise is another important source of own tax revenue for Sikkim; however, its share has

declined from 21.35 percent in 2019-20 to 19.93 percent in 2022-23. Relative share of motor vehicle tax and stamp duty remains low over the years.

Tax Buoyancy

3.24 Tax buoyancy⁸ for the period 2015-16 to 2022-23 remained below 1 signifying growth of own tax revenue fell short of growth of GSDP. Looking at the components of own tax revenue, the buoyancy coefficient of sales tax and SGST taken together during this period was more than one. Sales tax and SGST constitute about 67 percent of own tax revenue during 2017-18 and 2022-23. Tax buoyancy of other individual taxes remained less than one during 2015-16 to 2022-23.

3.25 Annual tax buoyancy has improved considerably after the pandemic affected fiscal year of 2020-21. Buoyancy coefficient of aggregate own tax receipts exceeded 2 percent in 2021-22 and was estimated to be 1.29 in 2022-23. Sales tax and SGST taken together, state excise duty and motor vehicle tax all showed buoyancy coefficients more than one in 2021-22 and 2022-23. Higher buoyancy coefficient in post-Covid-19 period indicates a higher growth of tax revenue compared to the growth of GSDP.

Table 3.3
Buoyancy Coefficient of State Taxes

	2018-19	2019-20	2020-21	2021-22	2022-23	2015-16 to 2022- 23
Own Tax Receipts	1.48	0.38	-0.47	2.41	1.29	0.975
Sales tax + SGST	1.99	0.47	1.08	2.76	1.28	1.237
State Excise	1.05	0.62	1.84	1.50	1.31	0.749
Motor Vehicle Tax	0.62	1.14	-36.07	2.84	1.80	0.733
Stamp Duty	0.49	-0.52	-1.56	6.31	0.90	0.912
Other Taxes	-0.06	-1.07	-0.66	0.58	-0.77	-0.459

⁸ Buoyancy coefficients of state taxes provide indicators to assess the performance of taxes as compared to growth of state income. Tax buoyancy measures responsiveness of revenue mobilization efforts in response to growth of the GSDP. A tax is said to be buoyant if the tax revenue increases more than proportionately in response to a rise in GSDP.

Non-tax revenue

3.26 The growth rate of own non-tax revenue, which had turned negative during pandemic, improved in 2021-22 and 2022-23. Composition on own non-tax revenue shows that the income from economic services has remained the largest contributor. The average relative share of economic services of own non-tax revenue, which includes forestry and wildlife, major and minor irrigation, and other economic services accounted for about 59.4 percent from 2017-18 to 2022-23 (Table 3.4). In nominal terms, income from the non-tax revenue increased from ₹654.38 crore in 2017-18 to ₹976.11 crore in 2022-23. State non-tax revenue contains income from forestry and wildlife, interest receipts, dividends and user fees for services provided by the State Government. Income from forestry and wildlife constituted the largest source of revenue in terms of non-tax revenue of the state.

Table 3.4
Composition of Non-Tax Revenue

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Interest Receipts	17.5	19.1	20.7	19.2	7.3	6.8
Dividends and Profits	0.4	0.7	0.5	0.4	0.2	0.4
General Services	20.5	23.9	26.3	13.2	27.8	20.5
Social Services	2.0	2.6	2.4	4.2	3.9	2.8
Economic Services	59.5	53.8	50.0	63.0	60.8	69.5

Source: Finance Account Data, Sikkim

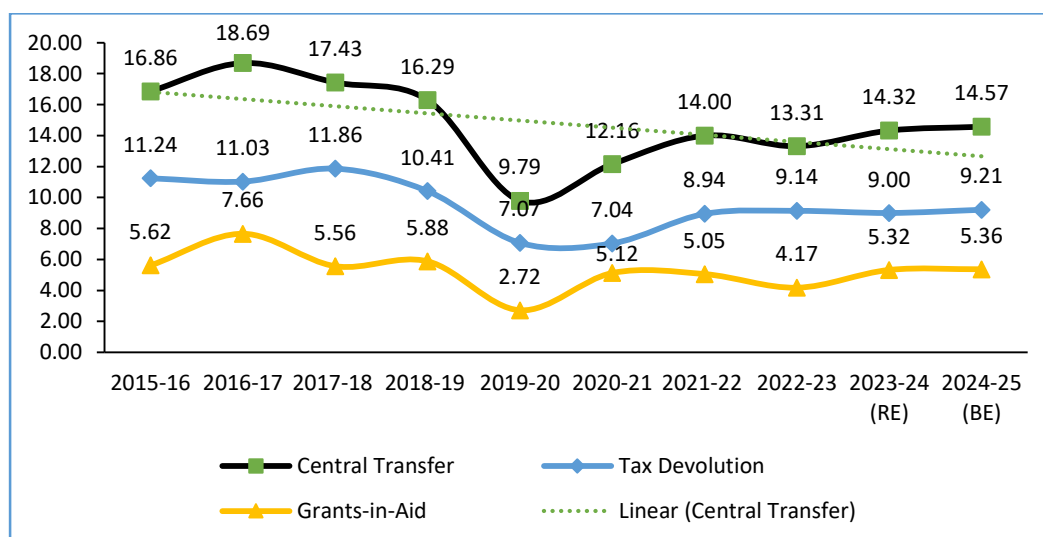
Central Transfers

3.27 FC-XV kept the recommendations for Tax devolution similar to those made by FC-XIV. However, FC-XV changed the criteria and weightage while determining the inter-se share of states in the divisible pool by including demographic performance, reducing the income distance weight, and including tax effort as a criterion. The inter se share of Sikkim in the divisible pool has experienced a minor increase from 0.367 percent under FC-XIV to 0.388 in the recommendation of FC-XV for the period 2021-22 to 2025-26. The State received revenue deficit grant for first three years of the award period, from 2021-22 to 2023-24.

3.28 The central transfers to the state of Sikkim show the linear downward trend since 2015-16 (Fig 3.7). The annual average transfers from the center during FC-XIV was 15.81 percent of GSDP from 2015-16 to 2019-20. During the next three years, from 2020-21 to 2022-23, the

annual average transfers as percentage to GSDP was 13.16 percent. Central transfers experienced considerable decline in 2019-20 due to subdued economic growth in the country. It declined from 16.11 percent in 2018-19 to 9.79 percent of GSDP in 2019-20. However, aggregate central transfers improved in 2020-21 to 12.16 percent, further increased to 14 percent in 2022-22 before marginally declined to 13.31 percent in 2022-23. The major driving force behind the increase in central transfers in 2020-21 compared to the previous year was the grants component recommended by the FC-XV. The improvement in central transfers in 2021-22 and 2022-23 was mainly due to rise in tax devolution.

Figure 3.7
Trend of Central Transfers (% to GSDP)



3.29 Higher annual growth rate of central transfers in 2020-21, at 25 percent, must be viewed in the context of extremely weak base in 2019-20, when the growth rate had declined by 27 percent. The growth rate of central transfers in 2021-22 compared to the previous year surged to 29.33 percent. The fiscal year 2022-23 witnessed a growth of 9.42 percent over the previous year. This improvement in central transfers has helped overall increase in revenue receipts of the state in these two years.

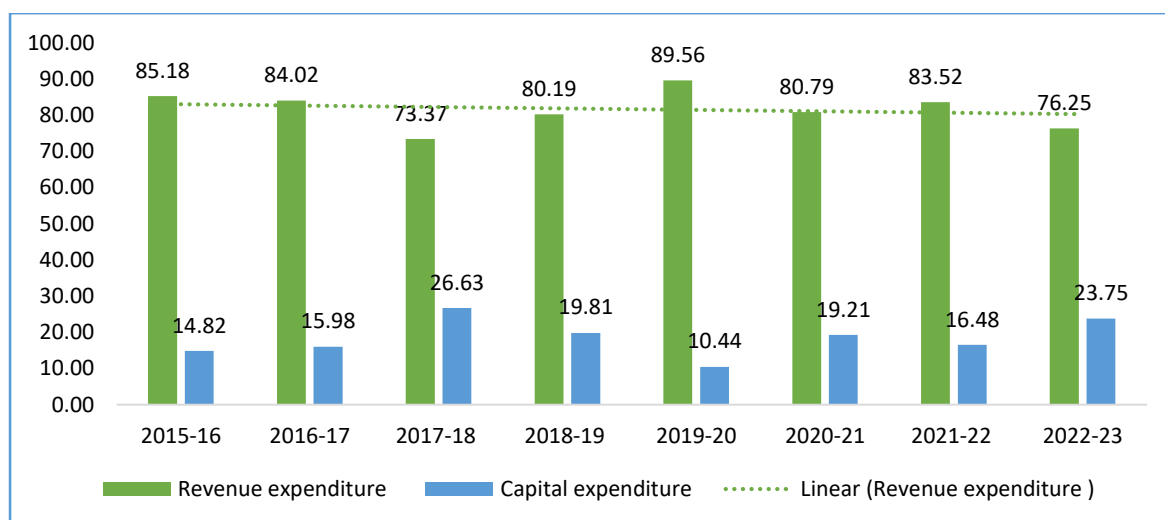
The Expenditure Trends

Broad Composition of Government Expenditure

3.30 The revenue expenditure as percentage to GSDP has witnessed a decline over the years. It declined from 21.91 percent in 2015-16 to 18.04 percent in 2022-23. The government has made efforts to generate revenue surplus, which can be utilized for capital expenditure. Consequently, the state government managed to increase capital expenditure as a percentage to GSDP from 3.96 percent to 5.62 percent during the same period. The need to remain on the fiscal consolidation path and improve capital investment remained major objectives of the fiscal policy.

3.31 Composition of government expenditure in terms of revenue and capital expenditure since 2015-16 given in figure 3.7 shows that the state government managed to restrain the growth of revenue expenditure despite the pressure from committed spending. The relative share of revenue expenditure in the state was 85.18 percent of total expenditure in 2015-16, while the capital expenditure stood at 14.82 percent. A declining trend in the relative share of revenue expenditure was witnessed as it came down to 76.25 percent in 2022-23.

Figure 3.8
Relative Share of Revenue and Capital Expenditure (%)



3.32 While a secular decline in revenue expenditure is visible, though fluctuations were observed in 2021-22 and 2022-23. The relative share of revenue expenditure was low in 2020-

21, but it increased in 2021-22. However, aligning with general fiscal management policy, revenue expenditure was restrained in 2022-23, leading to a rise in the relative share of capital expenditure.

Sector Outlays and Priorities: Revenue and Capital Expenditure

3.33 The composition of revenue expenditure in Sikkim shows that the state government spent on an average 38.40 percent on general services, 37.63 percent on social services, 22.56 percent on economic services, and about 1.41 percent on compensation to local bodies during 2015-16 to 2022-23.

- In general services, interest payment and pension payment are two major items of spending. Relative share of interest payment and pension has continued to increase over the years, from 2018-19 to 2022-23 (Table 3.5).
- The composition of the social services indicates that spending on education, health, water supply and sanitation, welfare, and nutrition have been the prime focus areas. The relative share of education stood at 19.26 percent and 18.01 percent in 2021-22 and 2022-23 respectively remained the largest spending item. The expenditure on health has been steadily increasing from 5.72 percent in 2018-19 to 7.49 percent in 2022-23. The relative share of expenditure on social welfare and nutrition has increased in 2022-23 as compared to the previous years.
- In economic services, the relative share of agriculture in revenue expenditure was an average of 7.63 percent from 2018-19 to 2022-23, and shows a declining trend over the years. The share of expenditure on energy has increased from 3.93 percent in 2018-19 to 5.30 percent in 2022-23.
- The expenditures on wages and salary, pension payments, and interest payment taken together constitute a major portion of revenue expenditure. These spending items, being committed in nature, cannot be avoided or postponed during the year. The committed expenditure averaged 67.71 percent of total revenue expenditure from 2018-19 to 2022-23. While the share of aggregate committed expenditure has shown an increasing trend from 2018-19 to 2021-22, it declined in 2022-23 to 63.45 percent from 70.23 percent in 2021-22 (Table 3.6). The relative share of components of committed spending shows that the interest payment increased considerably from 43.38 percent in 2018-19 to 48.21

percent in 2022-23, and contributed to rise in committed expenditure. While the relative share of pension payment increased, share of salary and wages showed a marginal decline in 2022-23.

Table 3.5
Relative Share of Major Items: Revenue Expenditure

	2018-19	2019-20	2020-21	2021-22	2022-23	Average
Interest Payment	8.29	8.24	8.61	9.52	9.41	8.81
Pension	14.11	14.72	14.26	14.74	15.07	14.58
Education	18.41	20.62	18.75	19.26	18.01	19.01
Health	5.72	5.83	6.83	7.98	7.49	6.77
Water Supply, Sanitation, Housing & Urban	1.15	1.04	0.99	0.98	0.91	1.01
Social Welfare & Nutrition	2.17	2.18	2.39	2.22	2.83	2.36
Agriculture & Allied Activities	8.18	7.91	7.34	7.40	7.33	7.63
Rural Development	2.69	2.93	3.06	3.47	2.93	3.02
Energy	3.93	4.61	4.91	4.30	5.30	4.61
Compensation to LBs	1.27	1.36	1.47	1.64	1.29	1.41

Table 3.6
Share of Committed Spending in Revenue Expenditure (%)

	2018-19	2019-20	2020-21	2021-22	2022-23
Interest Payment	43.38	51.98	41.31	48.21	38.96
Pension	8.29	8.24	8.61	8.40	9.41
Salaries and wages	14.11	14.72	14.26	13.62	15.09
Committed Expenditure	65.77	74.94	64.18	70.23	63.45

3.34 Despite rise in share of capital expenditure in recent years, it shows a volatile trend, implying its residual nature. Capital expenditure as percent to GSDP declined from about 5 percent in 2018-19 to 2.77 percent in 2019-20 due to decline in revenue receipts, which was more pronounced in decline in central transfers. High revenue and fiscal deficit in 2019-20 characterized the fiscal outcomes. In the pandemic affected year of 2020-21, capital expenditure witnessed significant improvement to 4.62 percent due to the flexibility provided by additional borrowing under fiscal stimulus package. In 2021-22, despite a surplus in revenue

account, the capital expenditure as percent to GSDP declined to 3.58 percent, which resulted in a low fiscal deficit of 2.42 percent. However, the capital expenditure sharply increased again 5.62 percent in 2022-23. Higher capital expenditure in 2022-23 was made possible due to surplus in revenue account and higher interest free loan provided by the Central government.

3.35 Broad composition of capital expenditure shows that the state government accorded priority to the productive economic services, as its share was highest at 53.19 percent averaged during the period from 2018-19 to 2022-23 (Table 3.7). During the same period, the average share of social services was 34.10 percent, while the share of general services was 11.59 percent. During this period, the relative share of social services was showing improvement, it got massive boost in 2022-23. It increased considerably from 29.25 in 2021-22 to 44.52 percent. As a result, relative economic services declined from 64 percent in 2018-19 to 53.30 percent in 2021-22 and nosedived to 44 percent 2022-23. The relative share of general services has witnessed improvement from 5.44 percent to 11.48 percent during the same period.

3.36 The composition of capital expenditure given in table 3.7 shows that the sectors like transport, energy and the general economic services are the priority sectors for capital investment in the state. In the case of social services, water supply, sanitation and urban development, welfare services, health and education are the important sectors where government has invested to create infrastructure. The share of water supply, sanitation and urban development taken together, which declined from 13.85 percent in 2018-19 to 12.58 percent in 2021-22, increased considerably to 33.45 percent in 2022-23. Spending on this head pushed the share of social services massively in 2022-23. While share of capital spending on public health shows a declining trend, the share of education, public works under general services, and energy under economic services witnessed measure improvement. It is important to note here that the net lending (disbursement of loans and advances minus recoveries of loans and advances) has almost disappeared in 2022-23.

Table 3.7
Composition of Capital Expenditure

Heads	2018-19	2019-20	2020-21	2021-22	2022-23
General Services	5.44	17.47	6.16	17.42	11.48
Police	0.11	0.00	0.12	0.09	0.32
Public works	5.11	17.47	5.94	20.63	11.66
Social Services	27.20	36.04	33.46	29.25	44.52
Education	5.24	5.63	9.98	11.91	9.03
Public Health	6.79	5.30	11.86	3.10	1.55
Water Supply Sanitation Housing & Urban Dev	13.85	23.62	10.63	12.58	33.45
Welfare of SC/ST/OBC	0.77	0.71	0.41	0.01	0.00
Other Social Services	0.56	0.78	0.58	1.66	0.49
Economic Services	64.00	44.21	60.46	53.30	44.00
Agriculture and Allied Services	1.01	0.68	0.80	0.59	0.33
Rural Development	0.40	0.06	0.61	0.41	1.43
Irrigation and Flood Control	3.88	0.11	2.73	2.11	4.20
Energy	4.76	2.77	10.70	7.80	9.49
Industry and Minerals	0.05	1.01	0.03	0.00	2.92
Transport	47.04	32.59	35.36	26.06	14.04
Science and Environment	0.00	0.00	0.00	0.00	0.00
General Economic Services	4.09	4.04	6.45	13.02	8.88
Other Economic Services	2.77	2.95	3.77	3.31	2.71
Net Lending	3.35	2.27	-0.08	0.03	0.00

Composition of Aggregate Expenditure

3.37 State government expenditure can be categorized into three broad heads, expenditure on government programs, which includes both revenue and capital outlay, debt repayment and loans and advances. The interest payment on outstanding liabilities is part of revenue expenditure, while loans and advances are included in capital expenditure. For the purpose of this study, we have kept it as separate category to keep revenue and capital spending on various sector together. The total expenditure, net of debt repayment which includes total of revenue and capital expenditure (excluding public debt and loans and advances) shows an increasing trend from 93.91 percent in 2018-19 to 98.35 percent in 2022-23 (Table 3.8). The share of repayment of public debt of the state has declined considerably from 5.42 percent to 1.65 percent during this period. Loans and advances by the state government has become negligible.

Table 3.8
Composition of Aggregate Expenditure (%)

Heads	2018-19	2019-20	2020-21	2021-22	2022-23
Total Expenditure net of debt repayment	93.91	94.13	99.00	98.52	98.35
Public Debt	5.42	5.64	1.00	1.47	1.65
Loans and Advances	0.67	0.23	0.00	0.01	0.00

Debt Stock and its Management

3.38 The debt-GSDP ratio of Sikkim has shown an increasing trend during the post-Covid19 period, surpassing the limits set under the FRBM Act. The upward revision of fiscal deficit above the earlier stipulated 3 percent of GSDP and flexibility to borrow above the FRBM Act limits contributed to this rise. The FRBM Review Committee (N.K. Singh Committee, 2017) recommended a debt-to-GDP ratio of 60% for the general government (combined) by 2023, with a 40% limit for the Central Government and 20% for the State Governments. Given the fiscal development during the pandemic year and post-pandemic period, the debt-GSDP ratio has remained much higher than this limit.

3.39 For all the states in India, the debt to GDP ratio increased sharply in 2020-21 to meet spending requirements in the pandemic affected year. The state governments were given flexibility by the Union government to increase the fiscal deficit beyond the FRBM Act requirements. This was done to compensate decline in revenue receipts and flow of central funds in a pandemic year and second, to encourage capital investment to give boost to economic recovery. The aggregate debt-GSDP ratio for states increased from 26.7 percent in 2019-20 to 31.1 percent in 2020-21 (RBI State Finances, 2022). It has shown a declining trend since then, reaching 28.2 percent in 2022-23 (RBI State Finances, 2024).

3.40 Sikkim maintained its debt-GSDP ratio within the limit of 25 percent of GSDP during 2015-16 to 2019-20⁹. In the pandemic affected fiscal year of 2020-21, the ratio increased beyond this limit to 27.7 percent of GSDP (Fig 3.9). The upward trend continued in the post-pandemic years, reaching 29.55% in 2021-22 and further increasing to 30% in 2022-23. In

⁹ The FC-XIV in their fiscal roadmap for the States recommended anchoring the fiscal deficit at 3 percent of the GSDP. The States can avail the flexibility to increase this limit by 0.5 percentage points, 0.25 percent separately depending upon conditions prescribed. One of the major conditions was to limit the debt-GSDP ratio to 25 percent in the previous year. Thus, for all effective purposes the benchmark of debt-GSDP ratio was 25 percent.

nominal terms, the outstanding liabilities (including internal borrowing, loans from Central government, small savings and provident fund, reserve fund and deposits) increased from Rs.9059.58 crores in 2020-21 to Rs.12696.89 crores in 2022-23.

Fig 3.9
Debt Stock (₹Lakh) and Debt GSDP Ratio (%)

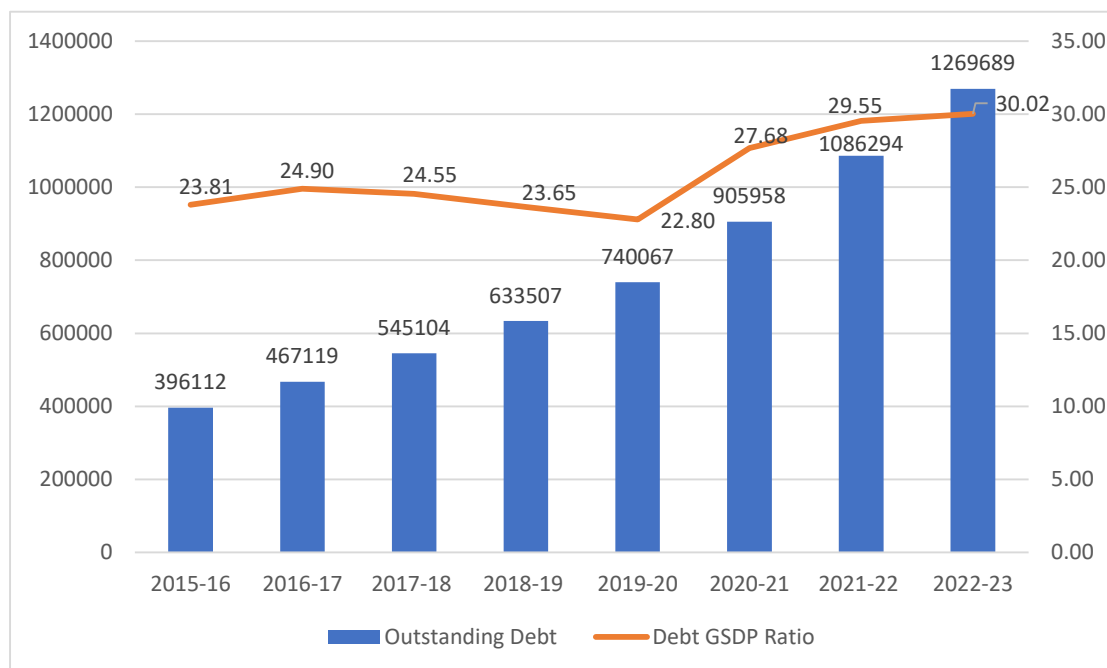
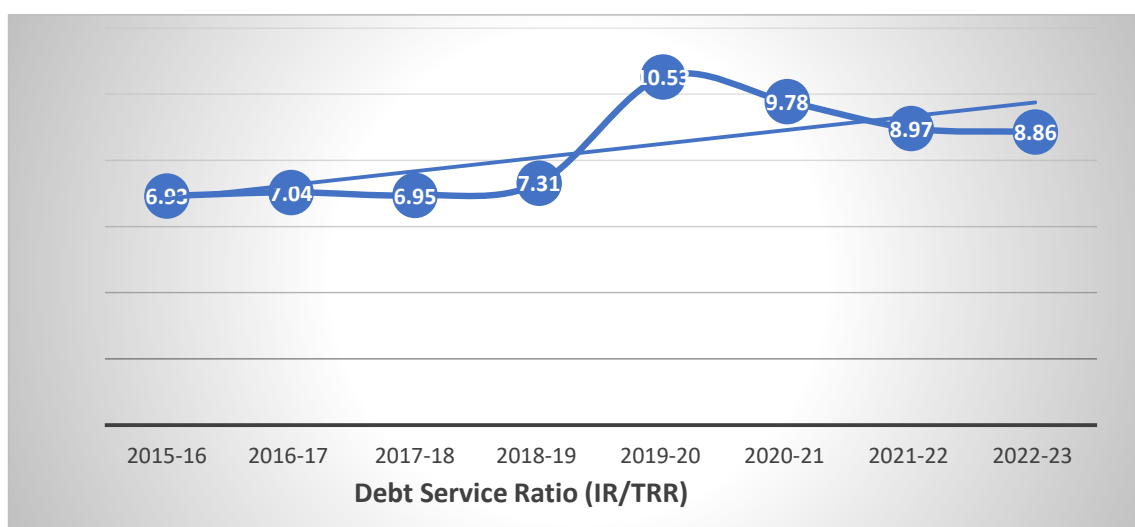


Table 3.10
Debt Service Ratio – Interest Payment/Revenue Receipts (%)



3.41 The impact of debt burden, in term of interest payment as percent to revenue receipt, increased moderately from 6.93 percent in 2015-16 to 7.31 percent in 2018-19. However, there was a sharp rise to 10.53 percent in 2019-20 (Fig 3.10). The debt service ratio declined to 9.78 percent in 2020-21 and further to 8.86 percent in 2022-23. This decline in debt service ratio provides flexibility to the government for developmental work.

3.42 Government of India stepped up the borrowing limits of states from 3 percent to 5 percent in terms of increased fiscal deficit limit in 2020-21, to provide flexibility to ease the unusual fiscal pressures. FC-XV in their report assessed that states being revenue-stressed might avail this additional borrowing facility offered to them and worked out indicative debt-GSDP path for the states. Indicative debt-GSDP ratio for Sikkim was estimated at 27.4 percent for the year 2020-21.

3.43 The state government amended the FRBM Act in 2021-22 by including annual debt-GSDP ratio following the indicative debt-GSDP path given by the FC-XV. The target were set at 27.5 percent for 2021-22 and 28.1 percent for 2022-23. However, the debt-GSDP ratio for these two years exceeded these targets.

3.44 The composition of public debt given in Table 3.9, reveals that the major source for state borrowing has been the market loans. The relative share of internal debt which includes market loans, special securities and NSSF, and loans from financial institutions increased from 72.83 percent in 2020-21 to 74 percent in 2022-23. The share of loans from Central government also increased from 3.24 percent to 8.9 percent during the same period. The Union government assistance for capital expenditure in terms of central loan has played a role in this increment for the year 2020-21. The relative share of other liabilities from the public accounts like small savings and provident fund, reserve fund and deposits declined from 23.93 percent in 2020-21 to 17.1 percent in 2022-23.

Table 3.9
Outstanding Liabilities

(₹In Lakh)

	2018-19	2019-20	2020-21	2021-22	2022-23
Public Debt	498629	540572	689143	865413	1052328
Internal Debt	488877	530500	659809	806839	939595
Central Govt. Loans	9752	10072	29334	58574	112733
Other Liabilities	134877	199494	216815	220881	217361
Small savings Provident Fund	100565	116286	131829	141632	145336
Reserve Fund	6331	47058	48751	41551	35713
Deposits	27981	36150	36234	37698	36312
Total Liabilities	633506	740066	905958	1086294	1269689
Debt-GSDP Ratio (%)	23.6	22.8	27.7	29.4	29.7
Composition of Debt					
Public Debt	78.71	73.04	76.07	79.7	82.9
Internal Debt	77.17	71.68	72.83	74.3	74.0
Loans from Central Government	1.54	1.36	3.24	5.4	8.9
Other Liabilities	21.29	26.96	23.93	20.3	17.1
Small savings Provident Fund	15.87	15.71	14.55	13.0	11.4
Reserve Fund	1.00	6.36	5.38	3.8	2.8
Deposits	4.42	4.88	4.00	3.5	2.9

Source: Finance Accounts, various issues

3.45 The maturity profile of the repayment liabilities pertaining to the internal debt shows that up to 2022-23, the debt stock getting matured is small at ₹284.75 crores, which accounts for only 3.03 percent of all the internal debt (Table 3.10). Thus, the debt repayment liabilities in the short run was not much and their impact on fiscal management would be manageable. During the next five years, i.e., from 2023-24 to 2027-28, about 30.90 percent of the existing debt will be matured and the amount for this period would be about ₹2903.07 crore. In the following five years (2028-29 to 2032-33), an amount of ₹6191.15 crore (65.89 % of the debt stock) will be matured. Thus, beyond 2023-24, the repayment liabilities will increase as large portion of loans, maturing by 2032-33.

Table 3.10
Maturity Profile of Internal Debt

Financial Year	Total - 6003 Internal Debt (₹Crore)
Maturing in and prior to 2022-23	284.75
Maturing in 2023-24 to 2027-28	2903.07
Maturing in 2028-29 to 2032-33	6191.15
Maturing in 2033-34 to 2037-38	16.08
Maturing in 2037-38 to 2038-39	1.06
Total	9396.11
Composition (%)	
Maturing in and prior to 2021-22	3.03
Maturing in 2022-23 to 2026-27	30.90
Maturing in 2027-28 to 2031-32	65.89
Maturing in 2032-33 to 2036-37	0.17
Maturing in 2037-38 to 2038-39	0.01

Source: Finance Accounts, 2022-23

Guarantees given by the State Government

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

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

3.48 Government of Sikkim constituted Guarantee Redemption Fund in the year 2005 for meeting payment obligations arising out of the guarantees issued by the Government in respect of bonds issued and borrowings by the State Undertakings or other bodies, in case the same are revoked. The Government is required to contribute an amount equal to at least one-fifth of the outstanding invoked guarantees plus an amount likely to be invoked as a result of the incremental guarantees issued during the year. However, it is open to the Government to increase contribution to the fund at its discretion. During 2022-23, the State Government transferred Rs.3.00 crore to the Guarantee Redemption Fund. No guarantees were invoked during the year. The fund had a corpus of Rs.71457 crore at the end of the year out of which Rs.68 crore has been invested. (Finance Accounts, 2022-23).

3.49 Sikkim Ceiling on Government Guarantees Act, 2000 controls the process of giving guarantees. As per the total outstanding Government Guarantees as on the first of April of any year shall not exceed thrice the State's tax revenue receipts of the second preceding year as in the books of the Accountant General of Sikkim. The FRBM Act stipulates that total outstanding guarantees of the government should follow the Government Guarantees Act, 2000. The total outstanding guarantees in 2021-22 were Rs.4107.03 crores in 2021-22 and Rs.4878.29 crores in 2022-23. The outstanding guarantee at beginning of the year exceeds the limit set by the guarantees Act.

Table 3.11
Guarantees given by the State Government

	₹crore	
	2021-22	2022-23
Maximum amount Guaranteed	4,668.47	5,043.47
Ceiling applicable to the outstanding amount of guarantees including interest (Criteria)	2,911.23	2,900.10
Outstanding amount of guarantees including interest at the beginning of the year	4,107.03	4,878.29

Source: Finance accounts

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

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

4.1 Rule based budget management by the countries across the World facilitates establishing numerical constraints in terms of agreed upon fiscal targets, reducing discretionary elements in policy choices, committing to debt sustainability, addressing political pressure to reduce deficit bias¹⁰. Fiscal rules are designed to improve transparency in budget management through better flow of information and enhance accountability. These rules become helpful in macroeconomic stabilization process by reducing the risk of excessive deficits and debt. Fiscal responsibility legislation contains provisions to limit size of deficit and debt stock, puts cap on expenditure in specific areas, and ensures regular reporting to enhance transparency in fiscal management. The need for maintaining long-run fiscal sustainability and preventing rise in future indebtedness remained overarching objective of fiscal rules. The experience of implementing a rules based fiscal management, however, shows that economic condition generally determines its adherence.

4.2 Fiscal rules in the forms of FRBM Act has remained the corner stone for fiscal management for the Union and state government in India. FRBM Act was adopted by the Union Government in 2003 and by most of the states in 2005 to address persistent fiscal imbalance existing during late nineties and early 2000s. Sikkim adopted the FRBM Act in 2010 and was successful in reducing fiscal deficit within a range and stabilize the debt ratio at

¹⁰ Schick, Allen (2003), "The Role of Fiscal Rules in Budgeting", OECD Journal of Budgeting, vol3, no.3

prescribed level. The Act contained provisions to reduce the fiscal deficit to GDP ratio to 3 percent by 2013-14 and balance the current account. The Act aimed at reaching a sustainable fiscal stance which was supposed to be carried on beyond the target year. The FRBM act stipulated to providing information on policy decisions through a fiscal policy statement and forecasting fiscal variables for three years.

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

4.4 The government at both the levels have amended the FRBM Act several times responding to emerging economic situations. Sikkim amended the FRBM Acts following the recommendations of Central Finance Commissions and responding to specific requirements as allowed by the Union government. While the FRBM Act adopted by Sikkim in 2010 contained the gradual reduction of deficit and debt conforming to FC-XII fiscal consolidation path, the government brought amendments to include the recommendations of FC-XIV regarding the flexibility in fiscal deficit and associated prudency conditions. FRBM Act was amended in 2020 to reflect the additional borrowing allowed by the union government. The government amended the Act following the recommendations of the FC-XV relating to fiscal deficit and debt-GSDP targets in 2021-22 to make it more relevant in the post-Covid19 period.

4.5 This assessment report covers fiscal years 2021-22 and 2022-23 and evaluates performance of Sikkim in complying with the FRBM Act provisions. It covers mandatory fiscal targets, accountability clauses, transparency measures and guiding principles for fiscal management. The assessment assumes significance when the state is emerging from the

disruptive impact of the Covid-19 pandemic and making efforts to stay on the fiscal consolidation path.

Medium Term Fiscal Plan

4.6 The Medium-Term Fiscal Policy (MTFP) is central to the documents associated with the FRBM Act. It provides a two-year forward projection of fiscal indicators, such as the revenue deficit, fiscal deficit, and outstanding liabilities as a percentage of the GSDP. Additionally, it includes revised estimates for the current year and budget estimates for the upcoming year. The statement outlines assumptions regarding fiscal trends, which form the basis for projecting key fiscal outcomes. The MTFP assesses the equilibrium between revenue receipts and expenditure, as well as the use of capital receipts to create productive assets. Consequently, the MTFP presents the state's fiscal plan for the upcoming budget year and the following two years. The Act mandates that the MTFP should include specific statements.

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

Fiscal Management Principles

4.7 The integration of fiscal management principles into the FRBM Act aims to guide policymaking towards achieving set objectives while ensuring compliance with established fiscal strategies. These principles highlight the need for strengthening institutional frameworks and public financial management (PFM) systems. The Act outlines key fiscal management principles to support these goals.

- (a) to maintain State Government debt at prudent and sustainable level;
- (b) to manage guarantees and other contingent liabilities prudently, with particular reference to quality and level of such liabilities;
- (c) to ensure that borrowings are used for productive purposes and Fiscal Management Principles accumulation of capital assets, and are not applied to finance current expenditure;
- (d) to ensure that the policy decisions of the Government have due regard to the financial implications on the future generations;
- (e) to maintain the integrity of the tax system by minimizing special incentives, concessions and exemptions;
- (f) to pursue tax policies with due regard to economic efficiency and compliance costs;
- (g) to pursue non-tax policies with due regard to cost recovery and equity;
- (h) to pursue expenditure policies that would provide impetus to economic growth, poverty, reduction and improvement in human welfare;
- (i) to build up a revenue surplus for use in capital formation and productive expenditure;
- (j) to ensure maintenance of the physical assets of the Government;
- (k) to maintain transparency by disclosing sufficient information to allow public to scrutinize the state of the public finances;
- (l) to minimize the fiscal risk associated with management of public sector undertakings and the utilities providing public goods and services;
- (m) to ensure discharge of current liabilities in a timely manner;
- (n) to formulate a realistic budget with due regard to the general economic outlook and revenue prospects and minimize deviations during the course of the year.

The Fiscal Policy Strategy Statement:

4.8 The fiscal policy strategy statement contains the fiscal stance of the state government with respect to fiscal targets for the ensuing year, revenue generation efforts, expenditure plan

and consequent borrowing requirements. The other important elements of fiscal policy strategy statement are as follows;

- a) The strategic priorities of the government;
- b) The reasons for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administered pricing and borrowings;
- c) An evaluation of the current policies of the Government based on fiscal objectives and fiscal principles enunciated in the Act.

Fiscal Targets

4.9 Government of Sikkim amended its FRBM Act in 2021 reflecting the recommendation of FC-XV and the emerging fiscal situation in the post-Covid19 period. The fiscal targets for the Government of Sikkim, as per the FRBM Act, are the following;

- Maintain revenue account balance;
- The State Government shall adhere to a maximum fiscal deficit of 4% of Gross State Domestic Product (GSDP) in 2021-22, 3.5% of Gross State Domestic Product (GSDP) in 2022-23 and maintain it at 3% of Gross State Domestic Product (GSDP) in 2023-24 and thereafter;
- An annual additional borrowing space of 0.5% of Gross State Domestic Product (GSDP) would be allowed for the period 2021-22 to 2024-25 based on certain performance criteria in the power sector;
- Cap the total outstanding guarantees within the specified limit under the Sikkim Ceiling on Government Guarantees Act, 2000 (21 of 2000);
- If the State Government is not able to fully utilize its sanctioned borrowing limit, as specified above, in any particular year during the years from 2021-22 to 2024-25, it will have the option of availing this unutilized borrowing amount in any of the subsequent years within 2021-22 to 2025-26.
- The State Government shall maintain a declining trend of Debt to Gross State Domestic Product (GSDP) ratio after the financial year 2022-23. The indicative debt path shall be as under;

Table 4.1
Indicative Debt Path for the Debt-to-GSDP ratio

Financial Year	Debt to GSDP
2021-22	27.5
2022-23	28.1
2023-24	28.1
2024-25	28
2025-26	27.9

Box 1
Debt-GSDP Ratio

The Fiscal Responsibility and Budget Management (FRBM) Review Committee, which submitted its report in 2017, recommended a debt to GDP ratio of 60 percent for the general (combined) government by 2023, comprising 40 percent for the central government and 20 percent for the state governments. Given deterioration in public finances faced by the government in 2020-21, it was not possible to adhere to this recommendation.

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

Measures for Fiscal Transparency

4.10 The FRBM Act mandates that governments disclose data and information on fiscal variables and the outcomes of fiscal transactions. These disclosures, referred to as disclosure statements, are required to follow specific formats outlined in the Act's rules. The information provided under the Act aims to improve transparency within the system and assist policymakers in making well-informed decisions. The disclosure statements include the following components.

- Key fiscal indicators depicting fiscal management;

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

Measures to Enforce Compliance

4.11 The FRBM Act of the state requires the Minister of Finance to present a half-yearly review statement to the State Legislature. This statement must detail trends in receipts and expenditure against the budget estimates. It should also highlight any deviations from the fiscal variables projected in the budget and the Fiscal Policy Strategy Statement. The Minister is expected to outline corrective measures taken by the government to address these deviations and ensure adherence to the fiscal targets set in the Act. Additionally, the review should discuss the impact of unforeseen events on fiscal management and the measures implemented by the government to manage such situations.

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

Other Legal Issues

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

4.14 The FRBM Act-related documents, particularly the MTFP and fiscal policy strategy statements, are intended to provide insights into the medium-term impact of the policies outlined in the budget. The MTFP serves as a platform to define fiscal policy objectives and constraints in both quantitative and qualitative terms, forming the foundation for evaluating the fiscal implications of budget provisions. There is significant potential to further develop the MTFP into a comprehensive budgeting tool that not only conveys the government's fiscal policy stance but also aids in the decision-making process.

Compliance of the State Government to the FRBM Act Targets: 2021-22 & 2022-23

4.15 The review report assesses fiscal targets, requirement of disclosure of data and information, and overarching fiscal policy objectives and principles that the state needs to follow. The compliance record of the state government to the FRBM targets is given in tables 4.2, 4.3, and 4.4.

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

4.16 Table 4.2 provides the FRBM documents presented by the government for the fiscal years 2021-22 and 2022-23.

Table 4.2
Presentation of FRBM Documents Along With Budget

FRBM Documents	Compliance
Assessment Period	2020-21 and 2022-23
Mid-year review by the Finance Minister	The mid-year review of fiscal situation keeping the FRBM Act targets in consideration was presented by the Finance Minister in the assembly.
Medium Term Fiscal Plan	
MTFP Rolling Targets	The Medium Term Fiscal Plan, as required under sub-section (1) of section 3, of the Act shall include in Form F-2 three years rolling targets in respect of the following fiscal indicators are presented along with the budget (a) Revenue deficit as a percentage of GSDP; (b) Fiscal deficit as a percentage of GSDP; (c) Total outstanding debt as a percentage of GSDP; (d) Primary deficit / surplus as a percentage of GSDP.
Assumptions underlying the projections	The assumptions made to project the fiscal variables reflecting the fiscal policy choices with realistic assumptions relating to the likely behaviour of fiscal variables presented.
The Macro-economic Framework Statement	The growth perspective as required under MTFP was presented contained following points: a) Overview of the State economy b) GSDP Growth c) Overview of State Government Finances and prospects
Fiscal Policy Overview in Form F-1, (See Rule 3), Medium Term Fiscal Plan	The MTFP presented along with budget contained the following fiscal management processes 5 Tax Policy 6 Expenditure Policy 7 Debt management 8 Strategic priorities for the ensuing year 9 Fiscal management practices and evaluation

4.17 The state government met the requirements of disclosing information in specified formats. The government placed MTFP containing fiscal management details for the ensuing year, growth perspective, fiscal strategy and disclosers in specified formats along with the budget.

4.18 Among all the documents indicated in table 4.1, Medium Term Fiscal Policy (MTFP) document is most crucial. It provides projected fiscal outcomes for 2 outward years beyond the budget year. The projection in the MTFP is usually carried out in a rolling manner taking into consideration the emerging economic situation. The MTFP for the year 2020-21, which provided the projection for 2021-22, was prepared on the back drop ongoing Covid19 pandemic. However, the achievements of the state government was reasonably closure to the projections (Table 4.3). The comparison of MTFP projections for the year 2022-23 (provided in the MTFP of 2021-22) with fiscal outcomes shows larger gap in fiscal deficit. The variation in flexibility provided each year for additional borrowing and availability of interest free loans from Union government seems to have impacted on the projections and outcomes.

Table 4.3
MTFP Projections and Outcomes

	projections for 2021-22	Actuals	Projections for 2022-23	Actuals
Revenue deficit as percentage of GSDP	1.50	1.12	0.50	1.12
Fiscal deficit as percentage to GSDP	-3.00	-2.46	-3.50	-4.50
Total Debt Stock as Percentage of GSDP	25.20	29.55	28.86	30.02

Fiscal Targets and Achievements in 2021-22 and 2022-23

4.19 FRBM Act provisions and achievements given in table 4.4 shows that for the year 2021-22, the state government was successful in achieving revenue and fiscal deficit targets as the state was able to generate revenue surplus and limited the fiscal deficit below the FRBM target. However, it fell short of debt-GSDP targets. Rise in revenue receipts and control over expenditure resulted in lower fiscal deficit as compared to FRBM Act targets. The debt-GSDP ratio exceeded the targets set under the Act due to the flexibility provided for additional

borrowing and availability of capital investment assistance from the Central Government, which are booked under the borrowings.

4.20 In 2022-23, while the revenue account was in surplus satisfying the FRBM act target, the targets for fiscal deficit and debt-GSDP were not met. Fiscal deficit, taking actual expenditure and revenue receipts of the state government, works out to be 4.5 percent of GSDP, which exceeded fiscal deficit target of 3.5 percent by 1 percentage points. Despite healthy growth of revenues and control over revenue expenditure, the fiscal deficit increased due to higher capital outlay facilitated by additional borrowing. Consequently, the debt GSDP ratio exceeded the FRBM Act target.

Table 4.4
FRBM Act Provisions and Compliance

2021-22			
	Target	Achievement	Assessment
Revenue deficit(-) /surplus(+) % of GSDP	Surplus	1.12	✓
Fiscal deficit % of GSDP	-4	-2.46	✓
Total debt stock % of GSDP	27.5	29.55	✗
Outstanding Government Guarantees as on the first of April of any year shall not exceed thrice the State's tax revenue receipts of the second preceding year	2911.23	4107.03	✗
2022-23			
Revenue deficit(-) /surplus(+) % of GSDP	Surplus	1.12	✓
Fiscal deficit % of GSDP	-3.5	-4.5	✗
Total debt stock % of GSDP	28.1	30	✗
Outstanding Government Guarantees as on the first of April of any year shall not exceed thrice the State's tax revenue receipts of the second preceding year*	2900.10	4533.50	✗

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

* State's tax revenue receipts of the second preceding year (2018-19) includes own tax revenue following CAG Audit reports.

4.21 Outstanding Government Guarantees, according to the government guarantee Act adopted in 2000, as on the first of April of any year should not exceed thrice the State's tax revenue receipts of the second preceding year. The outstanding guarantee given by the state government to various entities in both 2021-22 and 2022-23 exceeded the limits stipulated by

the Guarantee Act. The state taxes (as required under the Guarantee Act) here includes own tax revenue of the state following the CAG Audit report.

4.22 The state government maintains that for the purpose of guarantees, as stipulated in the Act, state taxes should include own tax revenue of the state and share in Central taxes. However, the limit maintained by the state government, three times of the own tax plus share in Central taxes, works out to be quite a large number as compared to the size of the state budget. As the guarantees given by the state remained small in recent years, the rule position should be clarified¹¹.

Disclosure Statements in the FRBM Documents

4.23 The disclosure statements provided by the state government along with the FRBM related documents are listed in table 4.5.

Table 4.5
Disclosure of Information and Compliance – 2020-21

Disclosure Statements	Compliance
1. A statement of select indicators of fiscal situation in Form D-1	<p>Following select fiscal indicators were presented in the MTFP following the FRBM Rules in Form D1</p> <ol style="list-style-type: none"> 1. Gross Fiscal Deficit as Percentage to GSDP 2. Revenue Deficit as Percentage of GSDP 3. Revenue Deficit as Percentage of Gross Fiscal Deficit 4. Revenue deficit as Percentage of TRR 5. Debt Stock as Percentage of GSDP 6. Total Liabilities as Percentage to GSDP 7. Capital Outlay as Percentage of Gross Fiscal Deficit 8. Interest Payment as Percentage of TRR 9. Salary Expenditure as Percentage of TRR 10. Pension Exp. As Percentage of TRR 11. Non-development Expenditure as Percentage of Aggregate Disbursements 12. Non-tax Revenue as Percentage of TRR
2. Components of State Government Liabilities in Form D-2	<p>Components of state government liabilities were presented in the MTFP following the FRBM Rules in Form D2.</p> <ol style="list-style-type: none"> 1. Internal Debt 2. Loan from Centre 3. State Provident Funds 4. Reserve Funds 5. Deposits 6. Other Liabilities

¹¹ In the review report for the FY21, the stand taken by state government regarding state taxes was accepted. However, in this report own tax revenue of the state is taken as state taxes, for guarantee purpose, as reported in the CAG Audit report.

3. Guarantees Given by the Government in Form D-3	Details of Guarantees given by the state government were presented in MRFP following FRBM Rules in Form D3.
4. Number of Employees in PSUs & Aided Institutions and Expenditure of State Government in Form D-4	Details of number of employees in Public Sector Undertakings & Aided Institutions and Expenditure of State Government were given in MTFP following FRBM Rules in Form D4.

Observing Fiscal Management Principles

4.24 The fiscal management principles outlined in the State FRBM Act are advisory and do not establish specific targets or indicators for evaluation, unlike mandatory fiscal targets. Their purpose is to guide policymaking toward achieving desired objectives and making sound public financial management decisions. These principles embody the overarching goals of economic policies applicable to governments at all levels. In the context of Sikkim, they hold particular importance due to challenges such as a limited resource base, significant committed expenditures, and the high costs associated with delivering public services in a geographically challenging terrain.

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

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

Prudence in Debt Management

4.26 The FRBM Act requires the state government to sustain debt at manageable levels while prudently handling guarantees and other contingent liabilities. It emphasizes that borrowings should be allocated to productive purposes rather than financing current expenditures. The core aim is to ensure that the government's policy decisions consider their financial impact on future generations. A government's debt management policy focuses on fulfilling financing requirements at the lowest possible long-term borrowing costs while keeping total debt within sustainable limits.

4.27 The borrowing limit for State governments is set annually by the Ministry of Finance, Government of India, as states require the Centre's consent to borrow if they owe the Centre for a previous loan (as per Article 293(3)). Since the Reserve Bank of India (RBI) manages the public debt of state governments and oversees the investment of their surplus cash balances, states are not directly subjected to market evaluation based on their fiscal capacity and economic conditions. This central determination of borrowing limits serves as an external control within rule-based fiscal management. Following the recommendations of the 13th Finance Commission (FC-XIII), the central government establishes a state's borrowing limit in line with the fiscal deficit target specified in the FRBM Act. Additionally, state governments can use their cash balances to finance deficits, thereby lowering their borrowing needs.

4.28 The Union government has been providing interest free loan for capital investment to the state over and above the FRBM Act limit. This has resulted in resorting to higher borrowing allowed by the Union government. The debt stock as percentage of GSDP at 29.55 and 30 percent in 2021-22 and 2022-23 respectively exceeded the debt path charted out in the amended FRBM Act. The state government also exceeded guarantees allowed set under the Guarantees Act of 2000 by taking into consideration CAG audit report.

4.29 In 2021-22 and 2022-23, the state government managed to generate surplus in the revenue account. Thus the borrowed funds are utilized for creating capital assets.

Simplifying Tax Policy and Administration

4.30 The FRBM Act requires the State Government to maintain integrity of the tax system by minimizing discretionary policies like special incentives, concessions and exemptions. It also emphasizes on pursuing the tax policy with due regard to economic efficiency and compliance cost. Taxes collected internally by the state does not constitute a major portion of total revenue receipts. It constituted 17.72 and 18.48 percent of total revenue receipts in 2021-22 and 2022-23 respectively.

4.31 One of the important features of a good tax system is to maintain stability and predictability in the level of tax burden. There have not been many changes in tax rate of individual State taxes. While, the VAT regime, introduced in 2005 had stabilized in terms of

rate and base structure in the State, the GST has emerged as an important source of revenue for the government.

Expenditure Policy and Institutional Measures to Improve Quality of Expenditure

Expenditure Policies

4.32 The FRBM Act emphasizes the necessity for the state government to prioritize economic growth, poverty alleviation, and advancements in human development while allocating resources. It further mandates adherence to fiscal management principles, including enhancing the institutional framework for the upkeep of physical assets, promoting transparency, mitigating fiscal risks tied to public sector undertakings (PSUs), and ensuring the formulation of realistic budgets to minimize deviations during the fiscal year. The evaluation of these objectives requires a long-term perspective.

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

4.34 The relative share of capital expenditure has increased over the years signifying improving quality of expenditure. The state government managed to improve the capital expenditure as percentage to GSDP from 3.58 percent in 2021-22 to 5.62 percent in 2022-23. Special assistance provided by the Union government played a key role in addition to expenditure restructuring carried out by the state government in improving capital expenditure.

4.35 The achievement of socio-economic development in Sikkim has been significant. The State economy has experienced substantial growth in recent years and the per capita income of the state has increased from Rs.4, 72,543 in 2021-22 to Rs. 6, 22, 120 in 2022-23 at current prices. The major socio-economic indicators for the State show commendable improvement.

The poverty ratio has declined to 8.19 per cent as compared to all India average of 21.92 per cent in 2011-12. The literacy rate at 81.40 per cent in 2011-12 is significant achievement. The IMR has gone down to 5 per 1000 in 2020 as compared to the all India average of 28.

Table 4.6
Socio Economic Indicators

Socio Economics Indicators	Sikkim	All India Status	Other States	
Decadal Growth Rate% (census- 2011)	12.89	17.7	8.2 (Goa)	25.42 (Bihar)
Rural-Urban ratio of Population (census-2011)	74.8: 25.1	69:31:00	52 : 47 (Kerela)	89:11 (Bihar)
Sex Ratio Females/1000 Males [NFHS 05- 2019-20]	890	1020	1121 (Kerala)	926 (Haryana)
Literacy Rates (%) (census- 2011)	81.42	73%	93.91% (Kerala)	61.80% (Bihar)
Male Literacy Rate (%) (census-2011)	86.55	82.14	96.10 % (Kerala)	71% (Bihar)
Female Literacy Rate (%) (census-2011)	75.61	64.46	92.10% (Kerala)	51.50% (Bihar)
IMR [SRS- 2020] (per 1000 birth)	5	28	6 (Kerala)	38 (2nd highest in U.P., C.G.)
Malnourished Children (% of underweight children under < 5 years [NFHS 5]-2020-21	7.2	32.1	12.3 (Mizoram)	39.4 % (Jharkhand)
Human Development Index (HDI 2021-22)	0.702	0.633	0.72 (Kerala)	0.5 (Bihar)
Percentage of Forest Area to Geographical Area (2021)	47.1	21.71	(84.53) Mizoram	3.63 (Haryana)
Percentage of Total Population Below Poverty Line (2011-12)- [RBI handbook-2022]	8.2	21.9	5.1% (Goa)	39.9% (Chhattisgarh)
Replacement Rate of Population (2020)	1.1	2	lowest in Sikkim (1.1)	3.0 (Bihar)
State-Wise Gross Enrolment Ratio- (2021-22) Primary (1 to 5)	106.2	103.4	112.5 (Telengana)	86.9 (Madhya Pradesh)
Upper Primary(6 to 8)	77.7	94.9	106 (Telengana)	86.0 (Bihar)
Elementary(1 to 8)	92.9	100.1	110 (Telengana)	88.7 (Madhya Pradesh)
Secondary (9 to 10)	89.1	79	97.9 (Kerala)	64.9 (Bihar)
Higher Secondary (11 to 12)	64.2	57.6	85 (Kerala)	35.9(Bihar)

Transparency in Fiscal Management

4.36 Fiscal transparency measures enunciated in the FRBM Act requires the state government to minimize the secrecy and disclose data and information relating to the fiscal operations. The rules to the Act specify the data and information to be disclosed along with the

budget documents. However, these disclosure statements containing data and information do not cover all aspects of budget management.

4.37 Transparency in public finances fosters the consistent preparation of comprehensive budgeting and financial data, ensuring accessibility for users. Key attributes of transparency in financial management include: a detailed budget classification system; budget documents encompassing all government financial transactions; limited revenue sources and expenditure responsibilities outside the budget framework; reduced discretionary elements in resource transfers to states; and timely dissemination of information on these transfers. To assess the level of transparency in the fiscal management process, an evaluation adhering to established standards, such as PEFA, should be conducted.

Budget Realism and Predictability

4.38 The state FRBM Act mandates the government to craft a realistic budget that considers the broader economic outlook and revenue projections, while striving to minimize deviations during the fiscal year. Unpredictable fund flows, which create gaps between objectives and outcomes, jeopardize the management of both current and future programs. A realistic budget ensures programs are executed as intended, reflecting the government's capacity to deliver public services aligned with its policies. Deviations from the planned budget can lead to altered spending priorities, surpassing deficit targets, and failing to meet critical service delivery commitments.

4.39 Sikkim is heavily dependent on central transfers, including its share of central taxes and grants. The timing and pattern of fund flows from the central government are crucial in determining spending activities. Budgeted expenditures are often disrupted due to delays or non-receipt of funds, with grants occasionally arriving only at the end of the financial year. Access to timely and reliable information on central allocations for the upcoming year is essential for sub-national governments to make informed decisions on resource allocation, while the actual receipt of funds directly impacts spending patterns. Furthermore, issues such as limited government capacity for policy execution, structural inefficiencies, and legal or environmental obstacles also contribute to deviations from planned expenditures.

4.40 Accurate and impartial revenue projections are essential to the budget preparation process, as they underpin the spending plan and the government's capacity to deliver services. Overestimating revenues can result in excessively large resource allocations, necessitating either abrupt reductions during the year or unplanned borrowing to sustain the spending plan. Conversely, overly conservative revenue forecasts can lead to surplus funds being directed toward projects and schemes that have not undergone rigorous budgetary scrutiny.

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

4.42 Comparison of actual revenue generated and expenditure incurred with the original approved budget and the extent of deviation from the projections gives the measure of budget credibility. The deviations as percent to the budget projections in 2021-22 and 2022-23 as performance indicator are given table 4.6 to measure budget credibility.

Table 4.7
Budget Estimates and Outturns for the year 2021-22 & 2022-23

(Rs. Lakh)

	2021-22	2021-22 (BE)	Percentage Variation	2022-23	2022-23 (BE)	Percentage Variation
Total Revenue Receipts	708072.21	774269.86	-8.55	810379.9	842059.51	-3.76
Own Tax Revenues	125442.53	119547.81	4.93	149726	133642	12.04
Own Non-Tax Revenues	68062.71	77521.86	-12.20	97611	99008.62	-1.41
Central Transfers	514566.97	577200.19	-10.85	563042.9	609408.89	-7.61
Tax Devolution	328754	258239	27.31	386475	316859	21.97
Grants	185812.97	318961.19	-41.74	176567.9	292549.89	-39.65
Revenue Expenditure	666883.85	739092.89	-9.77	763058	822643.64	-7.24
Interest Payment	63503.93	68913.07	-7.85	71817.9	73245.15	-1.95
Pension	98323.86	96616.98	1.77	115024.5	111996.53	2.70
Capital Expenditure	131618.16	207676.97	-36.62	237653.43	159355.58	49.13
Capital Outlay	131577.88	207549.7	-36.60	237659.7	159228.31	49.26
Net Lending	40.28	127.27	-68.35	-6.27	127.27	-104.93
Deviation (Rs. Lakh)						
Revenue Deficit/Surplus	41188.36	35176.97	6011.39	47321.90	6627.78	40694.12
Fiscal Deficit	-90429.8	-172500	82070.2	-190331.5	-152727.8	-37603.73
Outstanding Debt	1086294	1073295	-476776.5	1269689	1241111	28577.21

Source: Basic data – Finance Accounts and Budget Document for the relevant years

Note: Negative sign for revenue deficit indicates surplus

4.43 Budget credibility analysis taking into consideration, the deviations of budget outturns from budget estimates given in table 4.7 reveals the following result.

- In the fiscal year 2021-22, the total revenue of the state considerably fell short of the budget projections, by 8.55 percent. At the same time in 2022-23, this deviation was reasonably small at 3.76 percent. Own tax revenue in both these years exceeded the budget targets, by 4.93 percent in 2021-22 and 12.04 percent in 2022-23. While generating more revenue as compared to the targets may be perceived favorably, the large deviation in 2022-23 implies underestimation of tax potential. Underestimating revenue projections results unexpected gains, which are usually utilized without serious spending plans.
- Looking at the components of total revenue, Central transfers and own non-tax receipts fell short of budget targets. As the central transfers constituted on an average 71 percent of total revenue receipts in these two years, large deviations (10.85 in 2021-22 and 7.61 in 2022-23) are matter of concern. While tax devolution exceeded the budget projections by 27.31 percent and 21.97 percent respectively, the grants component was less by 41.74 and 39.65 percent. This level of deviation in actual receipts as compared to the budget projections do not support sound budgeting practice and has adverse impact on meeting spending targets. It seems, during the post-Covid-19 period (FY22 and FY23), the budget projections could not adequately assess the impact of the recovery process on economy and likely flow of resources from the Union government.
 - Total grants budgeted for 2021-22 amounted to ₹3,189.61 crore. The actual grants provided by the central government during the same year were ₹1,858.12 crore. The largest portion of the budget was allocated to CSS, with ₹2,005.76 crore earmarked. The second-largest allocation was under Non-Plan grants, which amounted to ₹1,178.85 crore. However, only ₹748.9 crore was received under CSS, and ₹787 crore under Finance Commission grants.
 - Total grants budgeted for 2022-23 amounted to ₹2925.49 crore. The actual grants provided by the central government during the same year were ₹1,765.67 crore. While the portion allocated to CSS in this year was ₹1756.17 crore, only ₹1,118.21 was received. The deviation in total grants

was mainly due to CSS grants and other grants (Allocated ₹ 591.02 crore and received only ₹ 86.90 crore).

- Revenue expenditure fell short of budget estimates by 9.77 percent in 2021-22 and 7.24 percent in 2022-23. While the Government made efforts to restrain the growth of revenue expenditure to generate revenue surplus, missing the budget targets by wide margin is a concern as it will derail the sector spending plans. The impact of revenue shortfall seems to have affected implementation of revenue expenditure plans.
- The deviation in capital expenditure as compared to the budget estimates in both these years have been very large. While it fell short of the budget estimates by 36.62 percent in 2021-22, it exceeded the budget estimates by 49.13 percent in 2022-23. The actual capital expenditure seems to have been affected by not adequately integrating the capital investment assistance by the Union government.
- The state government ended up with a higher revenue surplus of Rs. 60.11 crores as compared to the budget estimates in 2021-22. At the same time the fiscal deficit in 2021-22 was less by Rs.820.70 crores as compared to the budget estimates. A lower fiscal deficit became possible as there was higher revenue surplus and the actual capital expenditure fell short of the budget estimates by about Rs.760.85 crores.
- In 2022-23, the revenue surplus increased considerably by about Rs.406.92 crores as compared to the budget estimates mostly due to compression of revenue expenditure. Despite expanding the revenue surplus, the Government ended up with larger fiscal deficit of Rs.376.03 crores as compared to the budget estimates. A large variance in capital expenditure, as the capital expenditure exceeded the budget estimates by Rs.782.98 (49%), was the primary reason for incurring higher fiscal deficit.
- The outstanding debt increased by Rs.129.99 crores in 2021-22 as compared to the budget estimates. In 2022-23 the outstanding debt exceeded the target by Rs.285.77 crores.

Chapter-5: Concluding Remarks

5.1 The Indian economy rebounded strongly from the pandemic, recording an 8.7% growth rate in 2021-22 as economic activities resumed. By 2022-23, the country regained its pre-pandemic growth path, fueled by robust domestic demand and enhanced capital investments. Despite challenges such as inflation, worsened by conflicts in Europe, the economy registered a growth rate of 7.6 percent (constant prices) in 2022-23. Sikkim also demonstrated significant recovery in the post-pandemic period, with its GSDP increasing by 6 percent at constant prices and 13.75 percent at current prices during 2021-22. This upward momentum continued into 2022-23, with the GSDP growth rate rising to 6.83 percent at constant prices and 13.84 percent at current prices. The state's economy grew steadily from ₹37.64 thousand crore in 2021-22 to ₹42.67 thousand crore in 2022-23, reflecting consistent progress.

5.2 The composition of Sikkim's GSDP shows that in 2021-22 and 2022-23 all the sectors showed improved growth performance as compared to the pandemic year of 2020-21. The industry sector showed higher growth rate as it increased from 3.94 percent in 2020-21 to healthy rate of 11.77 percent in 2021-22 and 7.24 percent in 2022-23. The tertiary sector bounced back from a negative growth rate in 2020-21 to 3.74 percent in 2021-22 and in 2022-23 it registered a growth rate of 11.56 percent. Higher growth enabled the state government to improve its revenue performance.

5.3 The state's aggregate revenue as a percentage of GSDP significantly improved in 2021-22 and 2022-23 compared to the pandemic-affected year of 2020-21. Revenue receipts as a percentage of GSDP rose from 17.14percent in 2020-21 to 18.14percent in 2021-22, with a slight decrease to 18.04percent in 2022-23. This improvement was primarily driven by higher transfers from the Central government. The revenue expenditure as a percentage of GSDP moderated in 2021-22 and 2022-23, reflecting fiscal restraint and consolidation efforts. It decreased from 19.46percent in 2020-21 (elevated due to pandemic-related expenses) to 18.14percent in 2021-22, and further to 18.04percent in 2022-23. This trend highlights the government's focus on maintaining fiscal discipline post-pandemic period. Capital expenditure as percent to GSDP improved considerably from 3.58 percent in 2021-22 to 5.62 percent in 2022-23. The push given by state government and the availability of additional borrowing facility became crucial factors.

3.50 Improvement in central transfers helped the state government to increase its total revenue receipts. Aggregate central transfers improved from 12.16 percent in 2020-21 to 14 percent in 2021-22 and marginally declined to 13.31 percent in 2022-23. The improvement in central transfers in 2021-22 and 2022-23 was mainly due rise in tax devolution. In addition to rising Central transfers the availability of interest free loans for capital investment also straitened the capacity of the state government to undertake infrastructure building.

5.4 Own revenue receipts accounting for more than a quarter of aggregate revenue receipts, showed improved performance in 2021-22 and 2022-23. Own revenue receipts provide considerable flexibility to the government to take spending decisions. Sikkim's own revenue receipts showed an increasing trend as the economy recovered post-pandemic, rising to 5.26percent of GSDP in 2021-22 and further to 5.85percent in 2022-23, reaching pre-COVID-19 levels. Both components—own tax and non-tax receipts—also demonstrated growth during this period. Annual tax buoyancy improved considerably after pandemic affected fiscal year of 2020-21. Buoyancy coefficient of aggregate own tax receipts exceeded 2 percent in 2021-22 and was estimated to be 1.29 in 2022-23.

5.5 Broad trend of expenditure shows that the state government made efforts to remain on the fiscal consolidation path and improve capital investment. Composition of revenue expenditure in the state points to the fact that, in addition to committed spending like interest payment and pensions, spending on education, health, water supply and sanitation, welfare, and nutrition have been the prime areas of focus. Composition of capital expenditure shows that the state government accorded priority to the productive economic services like transport and energy. The rise in relative share of capital expenditure is considered to have improve the quality of expenditure. The push given by the Union government and flexibility provided to states for additional borrowing for capital expenditure seems to have positively influenced capital expenditure.

5.6 The state government amended the FRBM Act reflecting the recommendation of the FC-XV and emerging fiscal situation post-pandemic. While the state government was successful in achieving revenue and fiscal deficit targets as the state was able to generate revenue surplus and limited the fiscal deficit below the FRBM target in 2021-22, it exceeded

the fiscal deficit target in 2022-23. The debt-GSDP ratio, however, remained higher than the targets set in the amended FRBM Act. The debt-GSDP ratio exceeded the targets set under the Act due to the flexibility provided for additional borrowing and availability of capital investment assistance from the Central Government, which are booked under the borrowings.

5.7 Outstanding Government Guarantees is another target in the FRBM Act that is to be determined based on the guarantee Act adopted in 2000. The outstanding guarantee given by the state government to various entities in both 2021-22 and 2022-23 exceeded the limits stipulated by the Guarantee Act if the determining limit is estimated based on own tax revenue of the state as assessed by the CAG in their Audit report. However, the state government maintains that for the purpose of guarantees, state taxes should include own tax revenue of the state and share in Central taxes. There is a need to clarify the concept of state tax in the FRBM act.

5.8 Observing fiscal management principles is important feature of the FRBM Act. These principles include prudence in debt management, utilization of borrowed funds for productive purpose, establishing medium term perspective in expenditure management, running an efficient tax system, fiscal policy supporting economic growth, generating surplus in revenue account, good asset management, transparency in fiscal management, and risk management in fiscal policy. Judged from these principles, the state government has been successful in integrating these fiscal management principles in many areas. Sikkim has emerged as a high per capita income state with significant achievements in socio-economic indicators. Nevertheless, there are many in areas in which scope for improvement exists. The state needs to establish an effective medium term perspective, performance management system for service delivery, and transparency in public finances.

5.9 FRBM Act requires that the budget should be realistic to limit deviations from budget estimates and improve predictability in fund flows to reduce discrepancies between planning and achievements. A realistic budget enhances ability of the government to implement planned schemes and projects. Comparison of actual revenue generated and expenditure incurred with the original approved budget for the fiscal years 2021-22 and 2022-23 reveals that deviation from budget forecasts were large. The revenue receipts, despite a good performance of own revenues, fell short of the budget estimates considerably due to deviations in Central transfers. The government expenditure both in terms of revenue and capital expenditure show large

variances from the budget estimates. The variance in capital expenditure in these two years has been large, falling short of budget estimates by about 37 percent in 2021-22 and exceeding the budget estimates by 49 percent in 2022-23. There is a need to improve budget forecasting taking into account existing economic situation and capacity of the government to raise revenue and utilize them according to the fiscal strategy and plan.

5.10 Fiscal consolidation process gained strength post-pandemic with decline in fiscal deficit and debt burden across the states. Sikkim has also made progress after recovering from the distorting effects of the pandemic. The support received from the Centre in the form of 50-year interest free capex loans has helped improving the quality of expenditure and stabilizing interest burden. Composition of aggregate expenditure shows that aggregate expenditure net of debt repayment has exceeded 98 percent. Higher fiscal deficit in 2022-23 and higher debt-GSDP ratio as compared to the FRBM Act limits continues to be the areas of concern. With economy gaining strength, the State government needs to improve its own revenues and rationalize the spending plans to remain on the fiscal consolidation path as charted out in the FRBM Act.