Fiscal performance of the Central government and the States of India

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Abstract

The paper analyses the fiscal performance of the Central Government and the States of India. It addresses the question of whether the central and state governments have fully recovered from the mega fiscal shock of the Covid 19 pandemic of 2020-22 by examining their fiscal performance today (i.e., 2023-24, 2024-25) as compared to a baseline before the pandemic shock (2019-20). With state governments accounting for about two-thirds of public spending and a third of total revenue, the fiscal performance of states has always been an important component of India's overall fiscal performance. It turns out that of late there are signs of lax fiscal discipline at the state level. The paper develops a particular developmental taxonomy of States as a lens through which to assess their fiscal performance. This lens is used to compare the intra-group and inter-group fiscal performance of States to assess whether their fiscal performance is related to their development orientation as also how the fiscal behavior of individual States in the different groups has evolved over time.

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1. Introduction

In his celebrated volume *Asian Drama*, Gunnar Myrdal first defined the concept of the 'soft state' (Myrdal 1968). Though the volume purported to be about Asia, it was really mostly about India. The Indian state was a classic case of what he described as a soft state, one which is buffeted between many competing special interests. Decision making and implementation gets gridlocked in attempting to accommodate all these interests despite the limited capacity and resources of a weak state. These challenges are made more complex by India's federal structure, where the State governments are competing for resources with the central government and with one another. The state falls short in delivery of pure public goods such as security or law & order and merit goods such as basic education or public health, while at the same time delivering many private goods at subsidized rates that are unwarranted (Mundle & Sikdar 2020). Chronic fiscal stress is therefore a typical feature of the soft state. This paper analyses the fiscal performance of the Central Government and the States of India under these complex conditions.

Section 2 of the paper reviews India's recent fiscal performance at the level of the Central Government and all the State governments combined. In particular, this section addresses the question of whether the central and state governments have fully recovered from the mega fiscal shock of the Covid 19 pandemic of 2020-22, their fiscal performance today (2023-24, 2024-25) as compared to a baseline before the pandemic shock (2019-20). With state governments accounting for about two-thirds of public spending and a third of total revenue, the fiscal performance of states has always been an important component of India's overall fiscal performance. It turns out that of late there are signs of lax fiscal discipline at the state level. This is particularly concerning in view of the political outcome of the recent elections.

With the ruling BJP falling well short of an absolute majority, it needs its alliance with some key regional parties for ensuring a majority of the National Democratic Alliance in Parliament. Meanwhile, other regional parties have combined with the Indian National Congress to constitute the INDIA alliance which also commands a large number of seats in Parliament, in addition to being in power in several State governments. With this realignment of political power in favor of the States, the fiscal performance of States will be all the more important for the overall fiscal health of the economy.

Hence the subsequent sections of the paper deal with the fiscal performance of States. Section 3 develops a particular developmental taxonomy of States as a lens through which to assess their fiscal performance. This lens is then used in section 4 to compare the intra-group and inter-group fiscal performance of States to assess whether their fiscal performance is related to their development orientation. Section 5 presents a longitudinal analysis of how the fiscal behavior of individual States in the different groups has evolved over time. Section 6 concludes

2. Fiscal performance since the Pandemic shock

Three features stand out as the defining features of the Central Government's fiscal performance during the period since the pandemic: fiscal consolidation, a commitment to high capital expenditure (capex) and buoyant revenues, especially tax revenue.

Following convention, we use the fiscal deficit: GDP ratio (henceforth FD or the 'deficit') as the principal indicator of fiscal consolidation. Much of the action on the ground in coping with the pandemic was undertaken in the States: public and private hospitals, health care workers, etc., but the fiscal burden was mainly borne by the Central Government. There was much criticism at the time that the government was doing little to address the pandemic shock, which led to a 6.6 percent per cent contraction of GDP. Indeed, much of the Rs 20 trillion stimulus package announced at the time was in the form of various schemes for subsidized credit. The government's own stimulus package and its deficit spending was not at all comparable to the stimulus provided by some of the advanced country governments.

Nevertheless, the deficit of the Central Government nearly doubled from 4.7 percent in 2019-20 to 9.2 percent in 2020-21. Social safety net spending jumped from 9 percent of total expenditure to nearly 22 percent in 2020-21 and this was largely financed by increased deficit spending. The central government also managed to compress its 'committed expenditure' (wages & salaries, pensions, interest payments, etc.) that year, presumably through reduced hiring. There was only a mild half per cent compression each in the shares of capex and social expenditure during that year (Table 1).

Subsequently the central government very quickly reined in deficit spending, reducing it in one shot from 9.2 percent in 2020-21 to 6.7 percent in 2021-22. Thereafter, it has continued to reduce the deficit at an average rate of 0.5 percent of GDP per year to get to a target rate of 4.5 percent of GDP by 2025-26. There is a view that this is a very timid pace of fiscal consolidation. But there are others, including one of us, who felt that the initial sharp contraction by 250 basis points in the very first year after the pandemic was premature. A more gradual fiscal consolidation would have led to a faster recovery from the contraction of 2020-21. But that is history. What matters now is that the economy has grown at a sustained pace of 7-8 percent since the contraction of 2020-21, much higher than the average growth of 6.6 per cent during the period of 8 years leading up to the pandemic, not to mention the 3.7 percent growth recorded in 2019-20 just prior to the pandemic (Bhattacharya, Gupta, Mundle & Pandey 2024).

Such robust growth, the highest among all major economies, is probably attributable in large measure to a sustained thrust to public sector capex by the Central Government. As noted above, the share of capex was only marginally reduced from 12.5 percent in 2019-20 to 12.1 percent in the pandemic year 2020-21. Since then, the capex share of total Central Government expenditure has risen monotonically each year to a peak of over 23 percent in the budget for 2024-25 (Table 1).

There is a striking contrast between the Central Government's focus on capex and its spending on social services and the social safety net. The share of social services spending in total expenditure rose sharply in 2021-22, following its mild compression during the pandemic in 2020-21. But since then, it has remained stationary at around 5 -5.5 per cent. The same is true of the share of social safety net spending, mainly consisting of the food subsidy, income support and the MNREGA relief employment scheme. After the sharp spike to 22 percent in 2020-21, it has been tapered down to less than 8 percent in the vote-on-account budget estimate for 2024-25. It would appear that growth promoting capex was prioritized over social spending by the previous NDA government[1].

However, restrained social spending alone would not have enabled the massive push to capex while at the same time reining in the deficit. This combination of fiscal consolidation along with the push to capex was possible primarily thanks to buoyant revenues, especially tax revenue. Gross tax revenue grew at 13.5 percent in 2023-24 on top of 12 percent in 2022-23. Barring revenues from excise duties, which declined due to a reduction in rates, and customs duties which have only grown moderately due to the slow growth of imports, all other direct and indirect taxes have been very buoyant. Revenues from corporation tax grew at 13.5 percent and 17.3 percent respectively during 2022-23 and 2023-24, personal income tax grew even more impressively at 19.1 percent and 25.8 percent and CGST by 24.5 percent and 13.7 percent (Bhattacharya, Gupta, Mundle & Pandey 2024). How these dynamics of revenue and expenditure might change with a new coalition government in power at the Centre remains to be seen.

Turning to the States, the overall picture of fiscal performance from the year of the pandemic (2020-21) and onwards, setting aside for now the large inter-State variations, reveals some similarities but more contrasts compared to the Central Government. One important similarity is the buoyancy of revenues, especially tax revenue. There also seems to be a strong commitment to capex, but nowhere near comparable to the commitment of the Central Government, and this too with some qualifications which are discussed below. A striking contrast is the relatively muted impact of the pandemic on state finances as compared to finances of the Central Government discussed earlier. A second important difference is the much larger share of expenditure on social services. A third difference, which is particularly concerning, is the apparent weakening of the commitment to fiscal consolidation.

For all States combined, their own revenue receipts (ORR) declined mildly to 6.5 percent of GDP during the pandemic compared to 7.1 percent during the pre-pandemic baseline in 2019-20. It has since exceeded the baseline at 7.8 percent in 2023-24 and is budgeted to rise further in 2024-25 (Table 1). States' own revenue receipts (ORR) accounts for around two-thirds of total revenue of the States and States' own tax revenue accounts for close to 90 percent of their ORR. This component has grown at around 11 percent during the last couple of years and is budgeted to grow by a further 14 percent during 2024-25, implying a buoyancy of well over 1 relative to nominal GDP growth. In contrast central transfers, the other component of states' revenues, grew by only 0.7 percent in 2023-24. Though devolution increased by 20 percent on average, reflecting the buoyant growth of

[1] This remark is subject to the caveat that social services such as health are primarily subjects under the State list in the 7th schedule of the constitution.

the shareable pool of tax revenues, it was mostly off-set by a 26 percent decline in grants (Bhattacharya, Gupta, Mundle and Pandey 2024).

Table 1: Key Fiscal Indictors (Centre and States) (%)

		2019-20	2020-21	2021-22	2022-23	2023-24RE	2024-25BE
A	**Centre**						
1	NRR/GDP	8.4	8.2	9.2	8.8	9.2	9.2
2	Capex/Totex	12.5	12.1	15.6	17.6	21.4	23.3
3	Social Services expenditure/Totex	5.3	4.9	7.1	5.3	5.6	5.0
4	Committed expenditure/Totex	45.8	39.8	42.1	NA	NA	NA
5	Social safety net expenditure/Totex	8.85	21.54	12.19	10.29	8.19	7.57
6	FD/GDP	-4.7	-9.2	-6.7	-6.4	-5.6	-5.1
7	Outstanding Liabilities/GDP	50.8	60.8	57.4	56.5	57.1	56.0
B	**States (26 States)**						
1	ORR/GDP	7.1	6.5	6.9	7.3	7.8	7.9
2	Capex/Totex	13.0	12.1	13.7	13.7	16.2	16.2
3	Social Services expenditure/Totex	37.1	37.8	38.2	38.4	39.3	39.5
4	Committed expenditure/Totex	39.4	39.5	38.5	37.3	NA	NA
5	FD/GDP	-2.6	-4.0	-2.7	-2.7	-3.3	-4.0
6	Outstanding Liabilities/GDP	25.2	29.6	27.7	26.8	27.3	27.4
C	**Net Liabilities of Centre & States (% of GDP)**	75.1	88.9	83.1	81.2	82.0	80.5

Note: 1) For Centre data for the fiscal indicators NRR/GDP, Capex/Totex and FD/GDP for 2023-24 pertains to 2023-24 provisional actuals (PA).
2) NRR (Net Revenue Receipt) of Centre is defined as Total Revenue Receipt net of devolution.
3) RE: Revised Estimate; BE: Budget Estimate; Capex: Capital expenditure; Totex: Total expenditure; GDP: Gross Domestic Product; FD: Fiscal Deficit; ORR: Own Revenue Receipts; NA: Not available.
4) Social safety net expenditure includes expenditure on food subsidy, Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), National Social Assistance program (NSAP) and Pradhan Mantri Kisan Samman Nidhi (PM-Kissan).
5) States' data does not include data for Sikkim and Arunachal Pradesh.
6) Committed expenditure comprises expenditure on salaries and wages, pension payments and interest payments.
7) Net liabilities of Centre & states is the addition of outstanding liabilities of Centre and all states (here 26 states) net of central loans to states.
Source: Finance Accounts and Budget documents of States; Budget documents of Union Government; Controller General of Accounts (CGA); Salaries data of Central government from Lok Sabha Unstarred Question No 4269 (27 March 2023); GDP from Ministry of Statistics and Programme Implementation (MoSPI).

A second feature of combined State finances in recent years is their continuing strong focus on provision of social services. The share of social spending in total expenditure rose to 37.8 percent in the pandemic year 2020-21, up from 37.1 percent in 2019-20, presumably due to the additional public health spending that year to cope with the pandemic. But the share of social spending has continued to rise even after the pandemic, rising to 39.3 percent in 2023-24. The provision for social services in 2024-25 is even higher at 39.5 percent in the combined budget of all the States (Table 1). The other large item of expenditure is committed expenditure, e.g., interest payments, wages and salaries, pensions, etc. It was somewhat lower than the corresponding component of Central Government expenditure at just over 37 percent compared to 42 percent for the central government. Unfortunately, data on this major component of public spending is not available in the public domain for the period after 2022-23 (Table 1).

As noted above, the spending pattern of State governments also reveal a commitment to capex, though this is not nearly as pronounced as in the case of the Central Government. The share of combined capital expenditure of all States was stationary at around 13-14 percent until 2022-23, then it jumped to over 16 percent in 2023-24, an increase of 36 percent in a single year (Table 1). However, there was no commensurate jump in revenues or cuts in spending elsewhere. The sharp increase in capex was largely financed through additional borrowing. In particular, it was financed by the Union Government scheme for Special Assistance to States for Capital Investment wherein it provided 50-years interest free capital expenditure loans to states. The provision for loans under this scheme was Rs 1 trillion in 2022-23, which was increased to Rs. 1.3 trillion in 2023-24. For 2024-25, the allocation under this scheme has been maintained at Rs. 1.3 trillion. Despite this, the combined capex of all States is budgeted to increase by only 9 percent in 2024-25, with an actual decline in Capex in several states. Evidently, the States are now mostly using their revenues to meet revenue expenditure and largely relying on loans to finance their capital expenditure (Bhattacharya, Gupta, Mundle & Pandey, 2024).

The very generous terms of the new capex assistance scheme notwithstanding, it is important to note that it is a loan not a grant. It adds to the annual fiscal deficit of the States and further increases their indebtedness. After peaking at 4 percent during the pandemic year 2020-21, the combined fiscal deficit of all the States came down during the next two years. But it rose again to 3.3 percent in 2023-24 and is budgeted to rise further to 4 percent in 2024-25 (Table 1). This is the same level as in the pandemic year and well above deficit targets recommended by the 15th Finance Commission. Fiscal consolidation seems to have fallen by the wayside.

A possible reason for the recent fiscal laxity of the States is the fact that their level of debt or outstanding liabilities, relative to GSDP, at just over 27 percent is well below the indebtedness target set by the 15h Finance Commission (Finance Commission 2020). However, when added to central government debt, the level of total public debt (net of central loans to the States) remains very high. From a base level of 75.1 percent of GDP in 2019-20 public debt spiked to 89 percent in the pandemic year 2019-20. It has gradually come down since then, but still remains elevated at over 80 percent as budgeted for 2024-25. This is well above the fiscal consolidation debt path recommended by the 15th Finance Commission. More important, the interest on this high level of debt is the single largest item of expenditure in the Central Government budget and in most state government budgets, a committed expenditure amounting to about a quarter of total public expenditure on average, which crowds out other more productive and socially desirable spending on education, health and infrastructure.

3. A development taxonomy of states

In section 2 above we have discussed the fiscal performance of the Central Government and that of all the States combined. However, there are vast differences across States both in terms of their level of economic and social development as well as their fiscal performance. These differences in performance are important not only because of their impact on overall development and fiscal performance, among other things, but also because of their political economic implications (Mundle 2023). These political economic differences have become all the more important following the recent national elections, which marks a distinct shift in the balance of political power in favour of the States vis-à-vis the Central Government. Sections 4 and 5 of the paper analyses these inter-State variations in fiscal performance. This is done through the lens of development distances among States to assess if there is any distinct relationship between fiscal performance and development outcomes. In this section we develop that lens, a development taxonomy of states.

Per capita income is a standard measure of economic performance. But is does not measure social development which is an equally important attribute of development if by development we mean, following Amartya Sen (1999), the capability and freedom to live fulfilling lives. Other attributes of a jurisdiction such as the level of education attained by its constituents, their health, longevity, etc. have to be included in our measure of development. The Human Development Index (HDI) is clearly a candidate for such a measure, but it is a complex index, sensitive to the weights of its constituent indicators which are themselves evolving over time. Instead of squeezing all the attributes of development into a single, complex index; in this paper we have adopted a bivariate lens. We have taken per capita income as an indicator of economic development and longevity as an indicator of social development. A principal architect of the HDI concept in 1990, Sen argued later that if any single indicator is chosen to measure social well-being, then life expectancy is the best candidate (Sen 1998). Though per capita income accounts for about a third of the variation in longevity across States, the latter is also a function of a whole host of other indicators (Mundle 2023).

Using this bi-variate classification of per capita income (GSDP) and life expectancy, we have classified the twenty States for which the required data was available into four different groups:

Balanced development States:- States with higher than median value of per capita income and also higher than median life expectancy: Andhra Pradesh, Kerala, Tamil Nadu, Gujarat, Himachal Pradesh , Maharashtra, Uttarakhand

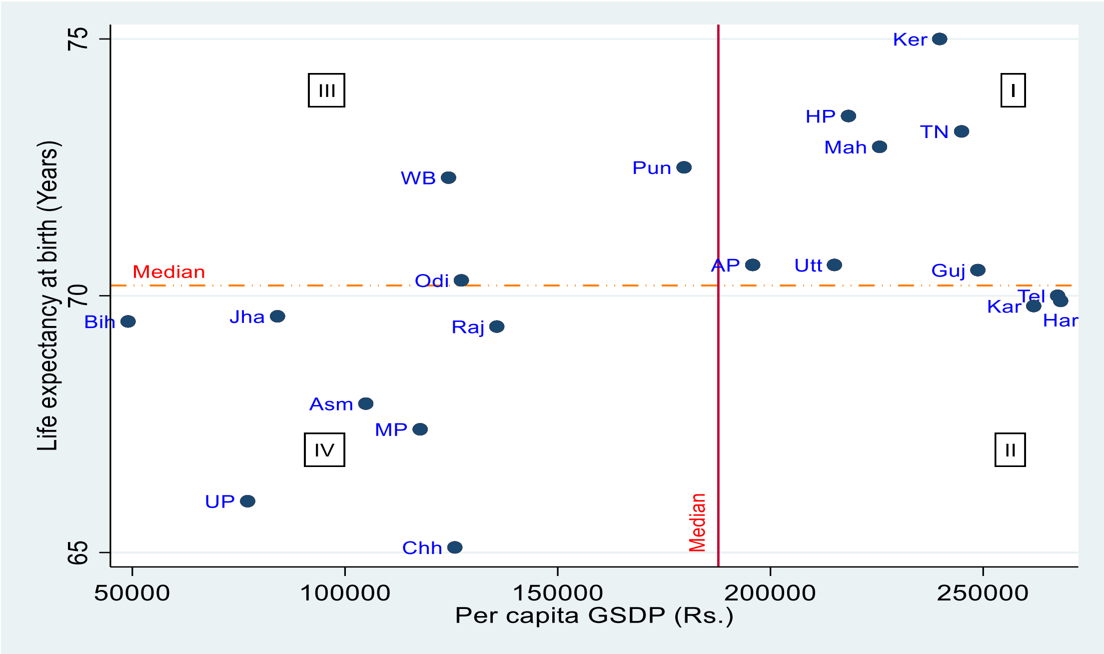
High economic development States:- States with higher than median per capita income but below median life expectancy: Haryana Telengana, Karnataka

High social development States:- States with below median per capita income but higher than median life expectancy: Punjab, West Bengal, Odisha

Lagged development States:- States with below median per capita income and also below median life expectancy: Rajasthan, Madhya Pradesh, Assam, Chhattisgarh, Jharkhand, Uttar Pradesh, Bihar

The distribution of States by this bi-variate classification is presented in Figure 1.

Fig-1: Classification of states based on Socio-economic development



Note: 1) For economic development we have considered 3 year average Per capita GSDP (PCGSDP) (average of years 2019-20, 2020-21 and 2021-22). The vertical line represents the median average PCGSDP. States on the right and left of it are states with respectively higher and lower than median income.

2) For social development we have considered 2016-20 life expectancy at birth. The horizontal line represents the median life expectancy at birth. States above and below the horizontal line are states with, respectively, higher and lower than median life expectancy

3) These two median lines divide the graph into 4 quadrants. *Balanced development States* are in quadrant I; *High economic development States* are in quadrant II; Quadrant III includes *High social development States* and quadrant IV has the *Lagged development States*

Source: PCGSDP from Ministry of Statistics and Programme Implementation (MoSPI); Life expectancy from SRS based abridged life tables 2016-20, Office of the Registrar General & Census Commissioner, Ministry of Home Affairs, Government of India.

4. The fiscal performance of States: 2022-23

We now turn to a comparison of fiscal performance of the States in these different development groups to assess whether there is any distinct relationship between fiscal performance and development outcomes. The indicators being used for this assessment include the ratio of own revenue receipts to total revenue receipts (ORR/TRR), the share of capital expenditure in total government expenditure (Capex/Totex), the share of social service expenditure in total government expenditure (Social Service Expnd/Totex), and, most importantly, the fiscal deficit (FD/GSDP) and the outstanding public debt ratio (Debt/GSDP). High values of the first three indicators and low values of the last two would be indicative of sound fiscal performance. The data pertaining to 2022-23, the most recent year for which all the relevant data are available for twenty States, is presented in Table 2. These twenty States together account for 98.5 percent of total population and 98.6 percent of total GSDP. A measure of the huge fiscal distance between the States of India is the difference in their per capita public expenditure. It varies from only Rs 17,104 for

Bihar to as much as Rs 67,696 in the case of Himachal. Had some small States with high economic development like Goa or Delhi been included in the database, the distance may have been even more.

On the receipts side of the budget, there is a distinct variation across groups in their capacity for own revenue mobilization to finance public spending. The High Economic Development group of states, essentially states with high per capita income, raise about 75 percent of their revenues from their own resources, going up to 80 percent in the case of States like Haryana. States in the Balanced Development group, which also have above median per capita income, also raise two-thirds of their revenues from their own resources whereas the High Social Development States, with below median per capita income, are able to raise only half their revenues from their own resources. The lagging states, with the lowest per capita incomes, manage to raise only 44 percent of total revenue from their own resources.

The picture is less clear when we turn to the expenditure side. The share of Capex in total State government expenditure (Capex/Totex) varies very widely across individual States, from a low of 3.5 percent (Andhra Pradesh) to a high of 21 percent (Karnataka). But there seems to be no discernable relationship between the Capex ratio and the development status of a State. The average capex ratio is 11.7 percent for the Balanced Development States and the High Social Development States. It is higher at 15.5 percent for High Economic Development States but even higher at 15.7 percent for the Lagged Development States which have the lowest per capita income. There are also significant intra-group variations in the capex share of individual States within the groups.

There is similar ambiguity with social expenditure. Its share in total expenditure ranges from 27.3 percent in Punjab to 51.3 percent in West Bengal, though curiously both States belong to the High Social Development group. The average share of social expenditure in the High Economic Development States is 35.8 percent. It rises to 37.1 percent for the Balanced Development group, further to 39.8 percent for the Lagged Development states and finally 41.4 percent for the High Social development group. This last is despite the very low share of social expenditure in Punjab, which is more than offset by the very high share in West Bengal. Barring such outliers, the share of social expenditure in most states lies in a narrow range of around 35-40 percent, hence it is difficult to draw any clear relationship between the social expenditure share in government spending and the development status of a State.

Table 2: Fiscal Performance Indictors of States (2022-23) (%)

		Per capita Totex	ORR/ TRR	Capex /Totex	Social Service expd/ Totex	FD/ GSDP	Debt/ GSDP
A	**Balanced development states**						
1	Andhra Pradesh	39281	52.9	3.5	42.6	-4.0	32.0
2	Gujarat	30224	71.8	16.5	40.9	-0.8	18.5
3	Himachal Pradesh	67696	35.4	11.9	38.4	-6.5	45.2
4	Kerala	44091	65.6	9.0	34.2	-2.4	36.8
5	Maharashtra	37165	72.5	13.1	36.8	-1.9	18.7
6	Tamil Nadu	41620	68.6	12.4	32.3	-3.5	29.2
7	Uttarakhand	44850	43.7	15.8	38.8	-1.0	25.8
	Total (7 states)	**38533**	**66.1**	**11.7**	**37.1**	**-2.4**	**24.9**
B	**High economic development states**						
8	Haryana	39568	80.4	9.9	40.2	-3.2	31.0
9	Karnataka	40425	68.8	21.0	34.3	-2.1	23.5
10	Telangana	45077	79.4	10.4	35.2	-2.5	26.9
	Total (3 states)	**41542**	**74.5**	**15.5**	**35.8**	**-2.4**	**26.1**
C	**High social development states**						
11	Odisha	35609	59.3	20.3	37.2	-2.0	14.9
12	Punjab	37304	55.3	5.5	27.3	-5.0	46.5
13	West Bengal	24761	43.9	9.0	51.3	-3.3	38.2
	Total (3 states)	**29867**	**51.6**	**11.7**	**41.4**	**-3.3**	**34.2**
D	**Lagged development states**						
14	Assam	33118	33.7	13.6	46.3	-5.8	25.3
15	Bihar	17104	27.9	14.6	43.8	-6.0	39.0
16	Chhattisgarh	32828	51.5	13.5	37.3	-1.0	21.9
17	Jharkhand	20555	47.3	17.4	40.7	-1.2	30.1
18	Madhya Pradesh	28362	45.4	18.2	39.6	-3.3	29.2
19	Rajasthan	30532	55.3	8.0	40.2	-3.7	37.0
20	Uttar Pradesh	20154	45.0	19.7	36.8	-2.9	28.9
	Total (7 states)	**23345**	**44.1**	**15.7**	**39.8**	**-3.4**	**31.0**

Note: The definition of abbreviations in the table are as follows: Totex: Total expenditure; ORR: Own revenue receipt; TRR: Total revenue receipt; GSDP: Gross state domestic product; Capex: Capital expenditure; FD: Fiscal deficit. Debt means outstanding liabilities.
Source: Budget documents of States; GSDP from Ministry of Statistics and Programme Implementation (MoSPI).

Finally, we look at the two most important indicators of fiscal performance, namely, the fiscal deficit and the level of public debt in a State. The level of fiscal deficit ranges from a low of 0.8 percent (Gujarat) to a high of 6.5 percent (Himachal). However, high and low fiscal deficit States co-exist in the same development group. In fact, Gujarat and Himachal both belong to the Balanced Development group. Gujarat is the least indebted state (18.5 percent) and Punjab the most indebted (46.5 percent). In terms of group averages, the level of indebtedness rises from 24.9 percent for the Balanced Development group to 26.1 percent for the High Economic Development group, 31 percent for the Lagged

Development group and 34.2 percent for the High Social Development group. It would appear from the foregoing that the Balanced Development group of States are also fiscally the most prudent, followed by the High Economic Development group and the Lagged development group. The High Social Development group seems to be the most lax, fiscally. However, this is at best a weak inference since, as has been pointed out, States with high and low levels of deficit and indebtedness co-exist within the same development groups.[2]

The lack of a clear relationship between development outcomes and fiscal performance, except on the revenue receipt side, is perhaps surprising if not somewhat underwhelming. But it leads to an important conclusion, namely, that a state's fiscal performance has not been an important driver of its development outcomes. Other factors have determined those outcomes, which lie beyond the scope of this paper. However, this is the past. Going forward, it is arguable that capex and social expenditure need to have a much larger share of public spending to make an impact on development outcomes. Also, the fiscal performance of a state is intrinsically important since sound fiscal descipline is a part of good governance. As explained in section 2 above, the interest burden of the public debt is now the single largest item of expenditure in most States as well as the Centre, pre-empting a quarter or more of total expenditure and crowding out other items of priority spending.

5. Fiscal performance of States: A longitudinal view

Against that background, in this section we take a longitudinal view of fiscal performance in the States, tracking the movement of the performance indicators from 1991-91 onwards, to identify which aspects of fiscal performance are improving or deteriorating in the different States. This dynamic picture has been summarized in a single but complex table, table 3. The detailed supporting data is presented in Appendix tables A2.1 to A2.3. The period since 1991-92 has been divided into three sub-periods: 1991-92 to 2001-02, 2001-02 to 2011-12, and 2011-12 to 2022-23. For each indicator for each sub-period data in the Appendix tables shows whether it improved, deteriorated or stayed the same during the sub-period. Each indicator in Table 3 has a column of three letters for each state, corresponding to the three sub-periods. The letter I indicates improvement during the sub-period, D indicates deterioration and S indicates no significant change. Thus DIS, for instance, would indicate deterioration during the period 1991-92 to 2001-02, improvement during the period 2001-02 and no change during the period 2011-12 to 2022-23.

[2] The lack of any clear relationship between fiscal performance and development outcomes, seen through our bivariate lens, has been verified through regression analysis. It confirms the absence of any statistically significant relationship between the capex ratio and the economic development indicator (per capita income), the social expenditure ratio and the social development indicator (life expectancy) and per capita income and the fiscal deficit. However, consistent with the bivariate picture on the receipts side described above, per capita income is significant at the 1% level of confidence when regressed against per capita own revenue receipts, with an R- square value of 0.82 (Appendix table A1).

Table 3: Changes in States' fiscal performance over three periods: 1991-92 to 2001-02, 2001-2 to 2011-12 and 2011-2 to 2022-23

		ORR/ TRR	Capex/ Totex	Soc. Ser /Totex	FD/ GSDP	Debt/ GSDP
A	**Balanced development states**					
1	Andhra Pradesh	IID	IID	DII	DID	DID
2	Gujarat	IDD	DID	III	DII	DII
3	Himachal Pradesh	IID	DDS	DII	DID	DID
4	Kerala	IID	DII	DSI	III	DID
5	Maharashtra	IDD	DII	IID	DID	DII
6	Tamil Nadu	IDD	IID	IID	IID	DID
7	Uttarakhand	ID	II	ID	II	ID
	7 states	**IDD**	**SID**	**SID**	**DID**	**DID**
B	**High economic development states**					
8	Haryana	IDD	ISD	DII	DID	DID
9	Karnataka	DID	DII	DIS	DIS	DID
10	Telangana	-	-	-	-	-
	3 states	**IDD**	**SID**	**DIS**	**DIS**	**DID**
C	**High social development states**					
11	Odisha	III	DII	DID	DID	DII
12	Punjab	IDD	IDI	DIS	DID	DID
13	West Bengal	DDD	DDI	DII	DIS	DII
	3 states	**DDD**	**DDI**	**DII**	**DID**	**DID**
D	**Lagged development states**					
14	Assam	IID	DII	DII	DID	IID
15	Bihar	DSI	DID	DII	DID	DID
16	Chhattisgarh	DD	ID	ID	ID	ID
17	Jharkhand	DI	SI	DI	IS	ID
18	Madhya Pradesh	DDD	DII	DII	DID	DID
19	Rajasthan	IID	DID	ISI	DID	DID
20	Uttar Pradesh	SID	III	DII	DID	DII
	7 states	**IDD**	**DII**	**DII**	**DID**	**DID**

Note: 1. The definition of abbreviations in the table are as follows: Totex: Total expenditure; ORR: Own revenue receipt; TRR: Total revenue receipt; GSDP: Gross state domestic product; Capex: Capital expenditure; FD: Fiscal deficit. Debt means outstanding liabilities.

2. The table summarises changes in States' fiscal performance over three periods: 1991-92 to 2001-02, 2001-02 to 2011-12 and 2011-12 to 2022-23. In each column the three letters refer to changes in the first period, the second period and the third period respectively. However, for the three States Uttarakhand, Chhattisgarh and Jharkhand there are only two letters in each column, referring to the second and third periods respectively, since these States were created only in 2000-01. Consequently, the geographical coverage of Uttar Pradesh, Madhya Pradesh and Bihar in the second and third periods are different from that in the first period. The detailed data underlying the letter grading in these columns is provided in the Appendix tables A2.1-A2.3.

3. The letters indicate improvement in performance (I), deterioration (D) or similarity (S). In case of FD/GSDP, and Debt/GSDP the letter 'I' would imply improvement or a reduction in the ratio, the letter 'D' would indicate a deterioration or rise in the ratio and the letter 'S' would indicate similarity or no significant change during the relevant period. For all the other fiscal performance indicators 'I' indicates a rise in the ratio while 'D' indicates a fall in the ratio.

Source: Summary of Appendix table, which is based on Finance Accounts, budget documents of states and GSDP data from Ministry of Statistics and Programme Implementation (MoSPI).

On the resource mobilization side, recent performance is disappointing in the Balanced Development group of States. The share of own revenue receipts in total revenue (ORR/TRR) has been deteriorating during the recent period (2011-12 to 2022-23) in all these States though it had been improving during the first period (1991-92 to 2001-02) and continued to improve during the second period is some States (Andhra, Himachal, Kerala and Uttarakhand). The own resource mobilization share has also been declining during the recent period in the High Economic Development states Haryana and Karnataka. There is no longitudinal track record for Telangana, which was created only recently. Among the High Social Development group of States, Odisha has consistently improved its own share of total revenue throughout the reference period while there is a sustained decline of that share in Punjab and West Bengal. The picture for the Lagged Development States is mixed. The own revenue share has been rising in Bihar and Jharkhand in the recent period. It has been falling in all the other States in the group, though it had been rising earlier in Assam, Rajasthan and Uttar Pradesh.

Turning to capex on the expenditure side, there are intra-state variations in trends even within the individual group of States but the aggregate group-wise picture is more coherent. For the group of Balanced Development States, the Capex share of total expenditure was stable during the first period then improved during the second period, but it has unfortunately declined during the third period. The same pattern is seen for the High Economic Development States, a stable ratio in the first period followed by improvement in the second period and deterioration in the third period. For the High Social development group and also the Lagged Development group, the trend is more encouraging. The capex share declined during the first period, but has been improving since then.

The share of social expenditure in total spending in the Balanced Development group, ignoring intra-group differences, was stable during the first period, improved during the second period and deteriorated in the third period. In the High Economic Development group of States, it was deteriorating in the first period, then improved in the second period and remained stable during the third period. For the High Social Development group as well as the Lagged Development States the inter-temporal pattern is more encouraging. It deteriorated in the initial period, then improved during the second phase and continued to improve in the third sub-period.

We turn finally to our two key indicators of fiscal performance, namely, the fiscal deficit and public debt. Setting aside intra-State differences, for the High Economic Development group, deterioration in the initial period was followed by improvement in the second period and a fairly stable FD in the third period. All the other three groups of states reveal a very similar inter-temporal pattern of initial deterioration followed by strong improvement in the second period and again deterioration in the third period. Though the levels of indebtedness vary, the inter-temporal pattern is again similar for all the four groups of states: deterioration in the first period, followed by improvement in the second period and again deterioration, sometimes quite sharp, in the third period.

6. Conclusion: Observed patterns and concerns going forward

The dominant feature of fiscal performance of the Central Government has been its sustained commitment to high Capex, combined with a commitment to fiscal consolidation. Its fiscal deficit level remains above the path recommended by the 15th Finance Commission. However, following the sharp spike in the deficit during the pandemic, the Central Government has made a concerted effort to cut down the deficit every year to reach a target deficit level of 4.5 percent by 2025-26. This combination of high capex with deficit reduction has been made possible by very buoyant tax revenues, along with restraint in revenue expenditure. The main concern in central government finances today is the high level of public debt. The consolidated public debt of the Centre plus States is around 80 percent, well above the target level recommended by the 15th Finance Commission, and most of it is Central Government debt.

There are very large variations in the fiscal performance of the State governments and it is more tractable to analyze their performance by groups of States. We have classified the States according to their levels of economic and social development, represented respectively by per capita income and longevity: Balanced Development States with per capita income and longevity both above the median, High Economic Development States with per capita income above the median but longevity below the median, High Social Development States with per capita income below the median but longevity above the median and Lagged Development States with per capita income and longevity both below the median. Fiscal performance of the States has been analyzed through this bivariate lens of socio-economic development.

One important conclusion is that in the past the shares of capex and social spending have had little impact on development outcomes, at least no impact that is statistically significant. It is arguable that the shares of Capex and social spending need to be higher going forward to significantly impact development outcomes. Certainly, the modest allocation for Capex in the States is in sharp contrast to the very high allocation by the Central government. Indeed, there was temporarily a boost to capex allocation by the States, incentivized by the fifty-year interest free loan from the central government. But these loans are now being used to substitute for the States' own revenues, which are being diverted to revenue expenditure, such that total capex allocation in the States remains modest.

In contrast to the expenditure side of States' finances, on the receipts side there is indeed a strong, statistically significant, correlation between the level of economic development (per capita income) and the share of own revenue receipts in total revenue receipts. States with higher than median per capita income have a much higher share of own revenue receipts compared to States with lower than median per capita income. As a consequence, the former are less dependent on borrowed resources. The level of indebtedness is higher and rising for the States with below median per capita income.

Thus, the Central Government's main focus going forward should be on reducing its level of debt, while the economically more developed States (above median per capita income) need to focus on raising the allocation of expenditure on capex and social spending. The economically less developed states (below median per capita income) also need to raise the share of spending on capex and social services, but in addition they also need to focus on reversing the declining share of their own revenue receipts and their rising levels of public debt.

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2024-25 Budget documents of 26 State governments.

Appendix Tables

Table A1: Regression Results

	PCGSDP	PCGSDP	Life Expectancy	Life Expectancy	Per capita ORR	Fiscal Deficit
	(1)	(2)	(3)	(4)	(5)	(6)
capex/Totex	-4027.95					
per capita capex		16.63				
soc.ser expd/Totex			-0.106			
per capita soc.ser expd				0.0003*		
PCGSDP					0.073***	-1.522
Constant	271184.4***	142727.6***	74.41***	66.77***	787.66	-3210282***
Adj R-square	0.048	0.136	0.048	0.182	0.82	0.004
No. of Observations	20	20	20	20	20	20

Note: 1) t-statistics in parentheses; ***, **, and * denote significance at 1%, 5%, and 10% levels, respectively.
2) The definition of abbreviations in the table are as follows: Totex: Total expenditure; ORR: Own revenue receipt; GSDP: Gross state domestic product; Capex: Capital expenditure; FD: Fiscal deficit; soc.ser expd: Social services expenditure.

Table A2.1: States' fiscal performance: 1991-91 to 2022-23 (%)

		ORR/GSDP				ORR/TRR			
		1991 -92	**2001 -02**	**2011 -12**	**2022 -23**	**1991 -92**	**2001 -02**	**2011 -12**	**2022 -23**
A	**Balanced development states**								
1	Andhra Pradesh	9.9	9.2	8.8	6.4	64.2	66.2	69.5	52.9
2	Gujarat	13.1	10.5	8.0	6.4	80.3	81.3	78.7	71.8
3	Himachal Pradesh	8.1	6.5	8.3	7.0	26.9	30.0	41.4	35.4
4	Kerala	10.9	8.3	7.8	8.3	66.9	71.4	74.5	65.6
5	Maharashtra	10.5	9.5	7.5	8.3	79.2	86.2	79.0	72.5
6	Tamil Nadu	13.1	9.8	8.7	7.1	71.6	77.4	76.5	68.6
7	Uttarakhand	NA	7.2	5.9	7.1	NA	43.4	49.3	43.7
	7 states	**11.3**	**9.4**	**8.0**	**7.4**	**72.0**	**75.1**	**73.8**	**66.1**
B	**High economic development states**								
8	Haryana	11.3	10.1	8.4	7.3	82.4	87.3	82.2	80.4
9	Karnataka	11.7	9.7	8.3	6.9	73.7	71.4	72.4	68.8
10	Telangana	NA	NA	NA	9.7	NA	NA	NA	79.4
	3 states	**11.6**	**9.9**	**8.4**	**7.8**	**76.5**	**76.7**	**75.4**	**74.5**
C	**High social development states**								
11	Odisha	6.7	6.8	8.6	11.9	38.1	44.8	49.4	59.3
12	Punjab	14.0	9.8	7.6	7.2	85.8	87.1	77.1	55.3
13	West Bengal	6.7	4.7	5.0	5.6	57.6	50.3	44.7	43.9
	3 states	**8.8**	**6.4**	**6.5**	**7.5**	**62.9**	**59.8**	**53.0**	**51.6**
D	**Lagged development states**								
14	Assam	6.5	5.5	7.3	6.1	32.0	35.0	38.3	33.7
15	Bihar	5.7	4.5	5.5	6.4	36.2	26.5	26.3	27.9
16	Chhattisgarh	NA	9.2	9.3	10.4	NA	62.1	57.1	51.5
17	Jharkhand	NA	7.0	6.6	9.6	NA	54.2	44.6	47.3
18	Madhya Pradesh	9.7	7.2	10.9	7.4	58.7	56.0	55.0	45.4
19	Rajasthan	9.9	7.8	7.9	7.9	55.2	59.1	60.6	55.3
20	Uttar Pradesh	7.1	6.4	8.7	8.3	47.3	47.3	48.0	45.0
	7 states	**7.7**	**6.7**	**8.3**	**7.9**	**47.5**	**48.1**	**47.8**	**44.1**

Note: 1. The definition of abbreviations in the table are as follows: ORR: Own revenue receipt; TRR: Total revenue receipt; GSDP: Gross state domestic product; NA: Not available.
Source: Finance Accounts and budget documents of states; GSDP from Ministry of Statistics and Programme Implementation (MoSPI).

Table A2.2: States' fiscal performance: 1991-91 to 2022-23 (%)

		Soc. Ser/Totex				Capex/Totex			
		1991 -92	**2001 -02**	**2011 -12**	**2022 -23**	**1991 -92**	**2001 -02**	**2011 -12**	**2022 -23**
A	**Balanced development states**								
1	Andhra Pradesh	35.2	31.3	37.3	42.6	6.1	11.1	13.2	3.5
2	Gujarat	32.2	35.1	37.9	40.9	15.2	7.2	18.8	16.5
3	Himachal Pradesh	38.4	34.7	35.1	38.4	16.1	12.4	11.5	11.9
4	Kerala	39.5	33.8	33.7	34.2	8.2	4.6	7.7	9.0
5	Maharashtra	32.5	34.6	40.2	36.8	8.8	7.1	12.6	13.1
6	Tamil Nadu	33.1	35.8	38.0	32.3	3.1	7.6	16.3	12.4
7	Uttarakhand	NA	36.5	41.8	38.8	NA	6.6	15.2	15.8
	7 states	**33.9**	**34.2**	**38.1**	**37.1**	**8.2**	**8.0**	**13.9**	**11.7**
B	**High economic development states**								
8	Haryana	30.6	28.8	37.5	40.2	6.0	14.5	14.4	9.9
9	Karnataka	33.5	32.1	34.6	34.3	13.7	10.2	19.2	21.0
10	Telangana	NA	NA	NA	35.2	NA	NA	NA	10.4
	3 states	**32.7**	**31.0**	**35.5**	**35.8**	**11.4**	**11.6**	**17.7**	**15.5**
C	**High social development states**								
11	Odisha	33.2	31.6	38.3	37.2	19.9	8.2	11.5	20.3
12	Punjab	23.6	23.1	27.8	27.3	6.5	7.2	4.6	5.5
13	West Bengal	40.7	34.3	42.5	51.3	5.6	5.1	3.6	9.0
	3 states	**33.1**	**30.6**	**38.0**	**41.4**	**9.4**	**6.4**	**5.9**	**11.7**
D	**Lagged development states**								
14	Assam	40.1	37.2	40.0	46.3	11.7	7.0	8.6	13.6
15	Bihar	35.8	30.0	35.3	43.8	7.1	6.2	16.0	14.6
16	Chhattisgarh	NA	37.3	43.0	37.3	NA	8.8	15.2	13.5
17	Jharkhand	NA	36.5	33.8	40.7	NA	13.2	13.1	17.4
18	Madhya Pradesh	35.4	30.0	35.5	39.6	12.4	9.3	14.7	18.2
19	Rajasthan	34.2	39.8	39.4	40.2	22.9	10.2	11.7	8.0
20	Uttar Pradesh	32.4	27.0	36.1	36.8	6.4	10.1	14.8	19.7
	7 states	**34.6**	**32.0**	**37.0**	**39.8**	**11.0**	**9.4**	**14.0**	**15.7**

Note: 1. The definition of abbreviations in the table are as follows: Capex: Capital Expenditure; Totex: Total expenditure; Soc. Ser: Social services expenditure; NA: Not available.
Source: Finance Accounts and budget documents of states.

Table A2.3: States' fiscal performance: 1991-91 to 2022-23 (%)

		FD/GSDP				Debt/GSDP			
		1991-92	**2001-02**	**2011-12**	**2022-23**	**1991-92**	**2001-02**	**2011-12**	**2022-23**
A	**Balanced development states**								
1	Andhra Pradesh	-2.8	-4.3	-2.1	-4.0	23.1	30.3	20.4	32.0
2	Gujarat	-4.7	-5.3	-1.8	-0.8	30.4	36.7	24.5	18.5
3	Himachal Pradesh	-6.7	-8.8	-2.2	-6.5	45.0	59.6	38.8	45.2
4	Kerala	-4.6	-4.2	-3.5	-2.4	33.0	37.2	25.6	36.8
5	Maharashtra	-2.3	-4.0	-1.6	-1.9	20.0	27.0	19.2	18.7
6	Tamil Nadu	-3.5	-3.2	-2.3	-3.5	22.1	25.5	16.9	29.2
7	Uttarakhand	NA	-3.9	-1.5	-1.0	NA	29.3	20.5	25.8
	7 states	**-3.2**	**-4.2**	**-2.0**	**-2.4**	**24.1**	**30.5**	**20.8**	**24.9**
B	**High economic development states**								
8	Haryana	-2.3	-4.2	-2.4	-3.2	21.0	26.0	18.3	31.0
9	Karnataka	-3.0	-5.2	-2.0	-2.1	21.8	28.9	17.0	23.5
10	Telangana	NA	NA	NA	-2.5	NA	NA	NA	26.9
	3 states	**-2.8**	**-4.8**	**-2.2**	**-2.4**	**21.5**	**27.8**	**17.4**	**26.1**
C	**High social development states**								
11	Odisha	-6.5	-8.5	0.3	-2.0	42.4	59.6	18.4	14.9
12	Punjab	-5.0	-6.2	-3.2	-5.0	35.6	42.6	31.2	46.5
13	West Bengal	-2.8	-7.5	-3.4	-3.3	25.3	41.8	39.9	38.2
	3 states	**-4.2**	**-7.3**	**-2.5**	**-3.3**	**31.4**	**44.9**	**32.7**	**34.2**
D	**Lagged development states**								
14	Assam	-2.1	-3.8	-1.1	-5.8	41.0	32.8	22.0	25.3
15	Bihar	-3.9	-4.5	-2.4	-6.0	41.5	55.3	27.4	39.0
16	Chhattisgarh	NA	-3.7	-0.5	-1.0	NA	25.1	10.8	21.9
17	Jharkhand	NA	-3.9	-1.3	-1.2	NA	22.3	20.3	30.1
18	Madhya Pradesh	-3.0	-4.2	-1.8	-3.3	27.0	28.3	25.9	29.2
19	Rajasthan	-3.4	-6.3	-0.8	-3.7	33.1	43.6	24.5	37.0
20	Uttar Pradesh	-4.4	-5.2	-2.1	-2.9	35.1	39.6	31.7	28.9
	7 states	**-3.7**	**-4.9**	**-1.6**	**-3.4**	**34.8**	**37.7**	**26.0**	**31.0**

Note: 1. The definition of abbreviations in the table are as follows: GSDP: Gross state domestic product; FD: Fiscal deficit; NA: Not available. Debt means outstanding liabilities.
Source: Finance Accounts and budget documents of states; GSDP from Ministry of Statistics and Programme Implementation (MoSPI).

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