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Sub-national Budget Credibility: Institutional Perspective and Reform Agenda in India

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Abstract

The fiscal management principles enshrined in fiscal responsibility acts of states emphasize on formulating budget in a realistic manner with due regard to general economic outlook and realistic revenue prospects and minimizing deviations during a year. Failure to implement the budgets as planned may result in shifting spending priorities, exceeding deficit targets, and compromising on critical service delivery promises. This budgetary tenet assumes significance as the states have to respond to disruption in revenues, rising expenditure burdens and changes in priorities in the wake of Covid-19 pandemic and face challenges to restore fiscal consolidation process. The paper assesses the budget credibility of states in India to explain their ability to implement planned activities and respond to fiscal stress. It also focuses on strengthening institutional framework to utilize fiscal instruments optimally for better service delivery and development.

JEL Classification: H61, H68, E62

Keywords: PEFA, Budgeting System, Multi-year Expenditure Framework, Fiscal Rules, Performance Budgeting,

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1. Introduction

A credible budget, which refers to a budget that is implemented as intended is considered as key element of a sound public financial management system (PFM) and helps in achieving planned results. A credible budget reflects the ability of the government to deliver public services as enunciated in government policies (PEFA 2016). Respecting the sanctity of the budgetary provisions establishes discipline in the fiscal system that leads to taking crucial decisions relating to priorities of the government. While achieving a hundred percent accuracy is not feasible, reasonable consistency as compared to established standards relating to expenditure and revenue targets forms the basis of credibility assessment.

An efficient budgeting system supports the accepted theory that decentralized planning and budgeting helps in improving efficiency and accountability (Oates 1972, 2005). In a federal country like India, where the state governments bear major functional responsibilities following constitutional provisions spanning over social and economic sectors, a credible budget is crucial to reduce uncertainty and risks in fiscal management (Rao 2009, Rao and Sen, 2011). The paper assesses the budget credibility at sub-national level in India and argues that there is need to focus on the institutional framework to utilize fiscal instruments optimally for better service delivery and development.

State finances in India suffered severe body blow due to the adverse impact of Covid-19 pandemic, particularly in fiscal year 2020-21. The states faced loss of internal revenue, reduction in central transfers, rise in spending to address the health sector exigencies and loss of livelihood of the people. The states had traversed a long way from late nineties and early 2000s when fiscal reforms were undertaken to stave off the imbalance and mounting debt burden (Rao and Jena 2009). While, the states had shown their capacity to adopt fiscal reforms and political willingness to own the reform process, the decline in national growth rate and lack of buoyancy in revenue generation in recent years led to rise in fiscal stress. As the country is staring at major deceleration in growth rate and slow recovery process during post-pandemic period, it will be challenging for the states to come back to the fiscal consolidation path[1]. Restoring fiscal consolidation will depend upon revival of growth process and increased flow of funds. A sound public financial management process will be necessary at the sub-national level to take informed decisions regarding resource allocation and implementation of policies.

A realistic budget, projecting available resources and allocations to various sectors without prejudice and bias, will be key to fiscal consolidation process. The states need to adhere to the fiscal management principles contained in their fiscal responsibility legislations, which call upon the states to formulate the budget in a realistic and objective manner with due regard to the general economic outlook and realistic revenue prospects while minimizing deviations during the course of the year. Failure to implement the budgets as planned may result in shifting the spending priorities, exceeding the deficit targets, and compromising on critical service delivery promises.

The States in India have adopted Sustainable Development Goals (SDGs) in their overarching economic policies and in sector policies. Indeed, targeted economic planning of this kind for the states require enhanced level of funding from their own efforts as well as with active support of the Central government, and strengthening of public financial management (PFM) systems. While states have put trust on their existing programs to deliver the results, the question of enhanced level of funding remains open. Improvement in institutional capacity will be intrinsic to sector goals and resource allocation given the trade-offs and fiscal pressure faced by the states.

The paper assess the performance of the states in India in terms of their ability to achieve the revenue and spending targets projected in the budgets. The performance indicators of Public Expenditure and Financial Accountability (PEFA) framework are utilized to assess the credibility of budget of sub-national governments at the aggregate and at individual state level during 2012-13 to 2018-19. The paper examines cross cutting issues involved in the process of utilization of resources and reasons for deviation by assessment of data and interview of spending departments in three states – Madhya Pradesh, Odisha and Sikkim.

[1] The FC-XV anchored the fiscal consolidation process of states around net borrowing, which finances the fiscal deficit, to protect capital spending. The Commission recommended that the normal limit for net borrowing may be fixed at 4 percent of GSDP in 2021-22, 3.5 percent in 2022-23 and be maintained at 3 percent of GSDP from 2023-24 to 2025-26.

The paper is structured as follows. After the introductory section, section 2 discusses issues relating to and relevance of budget credibility in the context of a sound public finance management system (PFM). In section 3 planned fiscal outcomes and achievements have been analyzed. The methodology of assessment is discussed in section 4. In section 5, budget credibility results for all states with scoring of performance indicators are given for aggregate revenue, aggregate expenditure, and for expenditure components. In section 6, the assessment of budget credibility for individual states has been discussed taking into account broad fiscal variables. Cross cutting issues relating to budget deviation are provided in section 7. In section 8, the institutional strengthening measures have been discussed to improve budget credibility. The concluding remarks are contained in section 9.

2. Significance of Credible Budget at Sub-national Level

According to standard fiscal federalism framework, public expenditure functions at sub-national level enhances efficiency by capturing correspondence between economic costs and benefits of delivering public services (Musgrave 1989, Oates 1972, 1999). The performance of sub-national governments, in terms of service delivery and achieving policy goals, depend upon the performance of their budget. Control over public money and the authority to allocate the resources to various sectors makes the budget as the most crucial instrument in the process of governance. In a democratic process the budget establishes relationship between politicians and bureaucrats in a complex process of programs, activities, and resource allocations to provide public service (Wildavsky, 1984; Schick, 2011). The ability of the government to provide quality public services, to meet the entitlements of citizens, and to make the information accessible depends upon the implementation of the budget as planned.

The budget credibility is about intents and outcomes of annual budgetary activities and taking stock of deviations that have impacts on program management and achievement of results. State governments in India follow accepted procedures and methods to prepare the budget as prescribed in the law or the Constitution. Budget preparation and execution processes contain principles that help accounting for all the government revenue and expenditure comprehensively, recording and reporting transactions, and providing authority to take decisions (Schick 2003). After the budget is voted in legislature, controlling and monitoring of financial transactions is carried out following prescribed accountability framework.

Unbiased projection is the most important feature of a credible budget. Revenue forecasting error due to weaknesses in technical capacity is considered as the foremost reason for deviations from planned budget (Simson and Welham, 2014). It is not uncommon for states to either overestimate or fail to ascertain the full potential of revenue receipt for various reasons. Overestimation leads to unsustainable allocation of resources, which does not materialize. It results in either unplanned borrowing to maintain spending plan or unnecessary time and cost overrun for projects. On the other hand conservatism in revenue forecasts results in surplus resources at hand that could be put to use in projects and schemes without going through regular planning process or results in cash reserves.

Although, states in India differ in fiscal capacity, there are other exogenous factors that affect efficiency of their budgeting system. Individual states do not have the ability to influence macroeconomic situation in the country, for which the revenue projection and spending plan get affected due to cyclical problems or disturbances caused by external shocks. For instance, the decline in national growth rate in India from about 9 percent to 6 percent in 2008-09 due to financial crisis reduced the internal revenue receipts and fund flows from Central government causing distortions in state budgets. Similarly, the current Covid-19 pandemic was a shock that destabilized public finance in the country. The fiscal rules and stipulated budget targets become the casualty during downturns (Schick, 2010).

There are provisions for amending the budget, which should not be construed as impinging on sanctity of the budget. The Constitution of India through Article 115 provides for "supplementary, additional or excess grants" during the year. The state governments unusually table supplementary demands during the year to allocate resources to various programs. These adjustments of budget are administrative necessities that arise from time to time for smooth execution of programs. Often the budget adjustments are carried out in response to crises or economic exigencies. Governments employ any surplus fund arising from programs or additional revenue generation through these supplementary demands. The provision for budget adjustment, however, should not be misused, as in the instance of repeated adjustment, to disregard the original budget planning. If the quantum of adjustments through supplementary demands exceeds considerably, then the original budget is drowned out.

The quality of budget forecast also depends on availability of complete information in a timely manner. Incomplete information leads to presenting inflated revenue forecasts for approval to support generous spending plan, which may not materialize. Excessive demand for public spending by the beneficiary groups leads to such budgeting practices and results in higher deficit, if such spending plans are executed (von Hagen and Harden, 1995). The challenges due to conflicting interests between the people and their elected representatives at various levels of the government involving several layers of stakeholders can also influence the budgetary decision making and its credibility (Laffont and Martimort, 2009; Campos, Ed and Sanjay Pradhan, 1999).

The budget outcomes of the state governments gets affected by the uncertainties and discretions in the fund-flow from the central government. Past studies on fiscal marksmanship at union level shows that shortfall in the central budget affected spending plan of states adversely due to reduction in budgeted transfers (Jena, 2006). The PEFA study showed that tax devolution to states being formulaic exhibits reasonable level of transparency, while other form of transfers show discretionary tendencies and creates uncertainties in budget management at state level (Jena, 2010 – PEFA India). The constraining feature of the fiscal rules jeopardizes public investment when faced with adverse intergovernmental transfers (Chakraborty, 2017). While the budgeting system is considered to be in harmony with accounting, audit, and legislative control systems (Swarup, 1990), enhancing efficiency and effectiveness in intergovernmental transfers remained as concerns.

Adoption of fiscal rules with achievable targets of deficit and debt proved to be a strong anchor for budget making and public policy at state level. This was expected to usher in institutional changes such as fiscal planning in the medium term, improved transparency and budget credibility. The fiscal prudence requires political commitment without which it becomes difficult to adhere to fiscal rules for a long period (Hallerberg, R Strauch, and J Von Hagen, 2007). The fiscal management under fiscal rules, however, revolved around achieving the targets within the resource constraints, changing conditions and targets fixed by the central finance commissions and making choices in spending pattern. The stipulations relating to required fiscal principles, providing better information, and other institutional changes continued as routine activities not having much influence on fiscal management.

Removal of distinction of plan and non-plan in expenditure classification in 2017, which existed due to long standing development planning process was another development in budgeting system. This aspect of the budget weighed heavily in the context of examining credibility as defined here due to concerns relating to comprehensive resource availability to the departments. The plan budget link was not organic and because of differences in time, scale, and participation of different economic agents budget as a financial instrument gave rise to complexity and opaqueness (Premchand 1983). The distinction between plan and non-plan expenditures, which was an accounting development that led to expanding the plans beyond the resource limits and resulted in neglect of existing assets both at Central and sub-national levels (Ministry of Finance 2008).

In an established accountability structure, flow of funds outside the budget is considered to be distortionary. Extra budgetary funds defeat the cause of budget credibility and assessment of budget credibility becomes less useful. If the extra budgetary fund is small and limited to certain organizations like hospitals keeping part of user fees for their own use, it will not be problematic. However, large transactions outside the budget and parastatals usurping government revenue affect the budget credibility. The states opting extra budgetary borrowing through various public enterprises to meet legitimate functions, creates problems like contingent liabilities. While the practice of extra budgetary borrowing is acknowledged, there is not much information to assess the extent of the problem.

3. Planned and Achievements of Fiscal Outcomes at State Level

States in India have traversed a long way from the situation of fiscal imbalance and mounting debt burden of late nineties and early 2000s after adopting fiscal rules in 2005. Most states remained within FRBM Act target of fiscal deficit (3% of GSDP) and eliminated revenue deficit. The incentives provided by the Union Government, increased central transfers and acceleration of GDP growth contributed to fiscal consolidation process (GoI, Economic Survey 2016). Restraint shown by states in their spending pattern and tax reforms in the form of adopting value added tax (VAT) played crucial role (Rao and Jena 2009). The compliance to the targets of fiscal rules to contain fiscal deficit and stabilizing debt overhang underpinned a broad spectrum of political commitment to the fiscal rules.

While states remained on fiscal consolidation path, the data shows that there has been a plateauing of revenue growth despite larger devolution of central taxes (Table 1). State governments also managed to remain within FRBM Act limits during financial crisis and resultant reduction in national growth during 2008-09. The pressure on state finances have been mounting in recent years because of the pay commission recommendations, slowing growth, and rising payments due to several states opting for UDAY schemes[2]. This has made the states to rationalize the spending decisions by reducing both revenue and capital expenditure. It will be a testing time for the states to meet emerging spending demands and maintain fiscal discipline in times of Covid-19 pandemic.

There was a concern relating to outstanding liabilities, which have been showing an increasing trend as percent of GSDP. The debt-GSDP ratio remained below 25 percent until 2015-16, the benchmark stipulated by FC XIV to avail flexibility in fiscal deficit. Implementation of UDAY programme increased the debt burden of several states, which pushed up growth of overall debt stock in 2016-17 and 2017-18. Although, the growth of outstanding debt stock has declined since then, more number of states have exceeded the 25 percent benchmark and debt-GSDP ratio aggregated across states has stood at 25.56 percent in the BE of 2020-21

Table 1: Trends in State Finances (% of GSDP)

		2015-16	2016-17	2017-18	2018-19	2019-20 (RE)	2020-21 (BE)
1	**Total Revenue Receipt (2+3)**	**13.97**	**13.80**	**13.71**	**13.84**	**13.93**	**14.27**
2	**Own Revenue Receipt (a+b)**	**7.69**	**7.37**	**7.31**	**7.41**	**7.40**	**7.51**
a	Own Tax Revenue	6.53	6.23	6.24	6.24	6.25	6.33
b	Own Non-Tax Revenue	1.16	1.14	1.07	1.17	1.15	1.18
3	**Central Transfers (i+ii)**	**6.28**	**6.43**	**6.40**	**6.43**	**6.53**	**6.76**
i	Share in Central Taxes	3.87	4.12	4.07	4.18	3.53	3.73
ii	Grants-in-aid	2.40	2.31	2.33	2.24	3.00	3.03
4	Revenue Expenditure	14.01	14.10	13.90	13.96	14.70	14.43
5	Capital Expenditure	2.53	2.64	2.34	2.35	2.50	2.49
6	**Total Expenditure (4+5)**	**16.54**	**16.74**	**16.24**	**16.31**	**17.20**	**16.91**
7	Revenue Deficit	-0.04	-0.29	-0.19	-0.12	-0.78	-0.16
8	Fiscal Deficit	-3.21	-3.64	-2.51	-2.50	-3.19	-2.76
9	Primary Deficit	-1.57	-1.94	-0.75	-0.79	-1.49	-1.06
10	Outstanding Liabilities	23.80	25.13	25.12	24.89	25.11	25.56

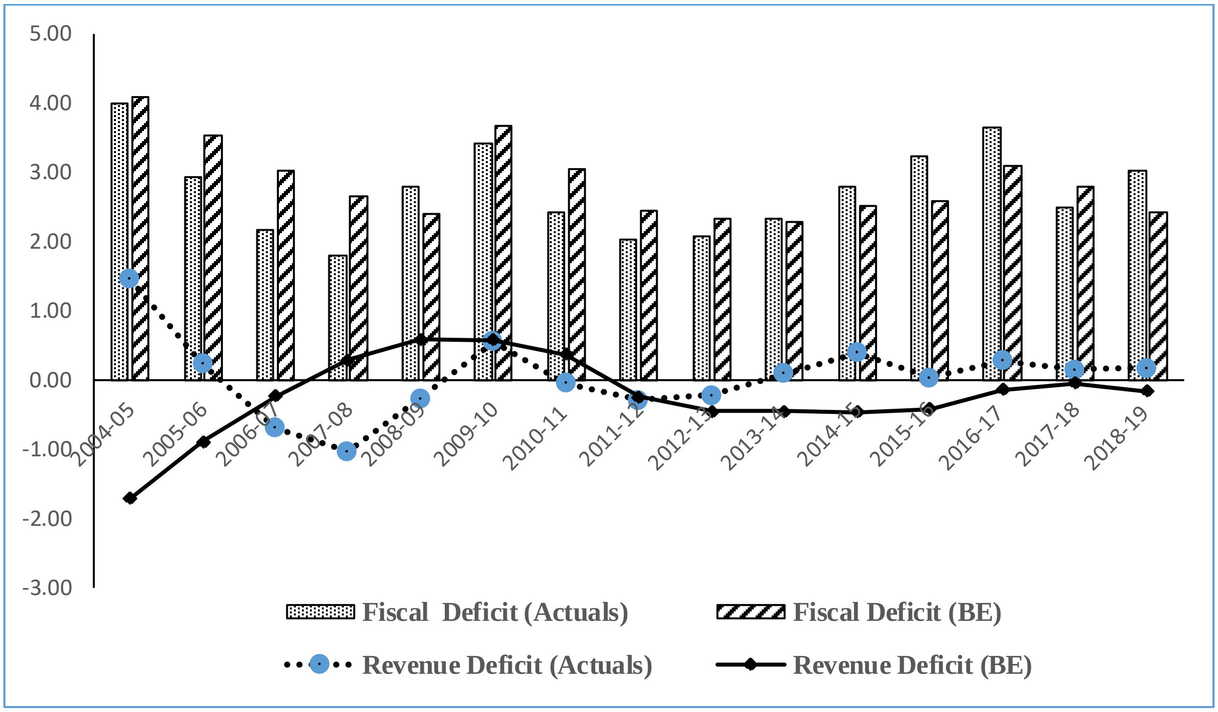
Notes: Data is for 28 states; does not include J&K; Deficit (-)/Surplus (+)
Source: 2020-21 Budget of 28 state governments & Finance Accounts; GSDP data for 2015-16 to 2019-20 from MoSPI and for 2020-21 from State Budgets.

[2] The slippage in state finances in 2015-16 and 2016-17 was mainly due to Ujjawal DISCOM Assurance (UDAY) Scheme, under which states were to take over certain part of DISCOM debt stock on their own balance sheet.

While aggregate data usually does not reflect the extent of variation between budget and actual numbers at individual state level, it presents an overarching picture that has significant value for general government in a federation. The FRBM Acts of state governments mostly conformed to the fiscal consolidation path proposed by the Central Finance commissions. Thus for all practical purposes, the FRBM Act revolved around the target of 3% fiscal deficit and elimination of revenue deficit. The FC-XIV provided some flexibility to increase the fiscal deficit by 0.5 percent based on satisfying conditions relating to fiscal prudence. Thus, budget projections of states were bound by agreed upon deficit limits and the Central Government could enforce this by fixing the borrowing limit based on the fiscal deficit limit.

Planned and achieved fiscal outcomes in terms of deficits of all states since 2004-05 shows that there have been variances, while remaining within the targets of fiscal rules (Figure 1). Aggregated deficit and surpluses in revenue account show that initial volatility in differences between budget and actual numbers have come down in recent years. What is important to note here is since 2013-14 against budget projection of revenue deficit, aggregate accounts show surplus in revenue account. The comparison of budget and actual fiscal deficit since 2004-05 shows that, in recent years, fiscal stress has been rising as actual numbers have been exceeding the budget projections since 2014-15. Fiscal deficit and surpluses/deficit in revenue account are product of several underlying fiscal variables, implications of which vary in the fiscal management. To get a reasonable idea of the implications of other variables it is necessary to look into the revenue and expenditure trends.

Figure 1: Budgeted and Actual Deficit



4. Budget Credibility Assessment Methodology

Revenue Side

The credibility of the budget is assessed from both revenue and expenditure side. On the revenue side change in revenue between the original approved budget and end of the year outturn is compared following the PEFA methodology to score them. The revenue outturn is usually assessed to give an ordinal scoring on a scale of A to D taking into account at least two of the last three years. All states aggregate data and individual states have been scored based on two blocks of three years from 2012-13 to 2014-15, and from 2016-17 to 2018-19. The first block of three years pertains to last three years of award of FC-XIII and second block of three years pertains to award period FC-XIV. As per this methodology, for aggregate revenue good performance with score of 'A' is given if the actual revenue remains within 97% to 106% of budgeted revenue (Table 2). Score 'B' is given if it remains between 94% to 112% and 'C' is given if it is within 92% and 116% and a performance less than this gets a score of 'D' (PEFA, 2016).

The revenue receipts of states mainly constitute of own tax and non-tax revenue and tax devolution and grants from union government. For these major components of revenue, the methodology utilized for aggregate revenue was adopted to assess the deviation and for scoring. For the individual taxes, the PEFA methodology prescribes a different scoring pattern. A score of 'A' is given if the variation is less than 5%, 'B', if the variation is less than 10% and, a 'C', when variation is less than 15%. The score of 'D' is given when the performance is less than what is required for 'C'.

As discussed earlier, forecasting revenue accurately forms the foundation of any budgeting system as the intricately designed expenditure plan depends upon it. Overestimation, being biased to support large spending plan or due to lack of enough information on economic variables to project revenue, becomes disruptive. Underestimating the potential, on the other hand results in higher realization of revenue which are deployed without proper planning in the budgeting process. It also has been discussed earlier that governments do amend their budget projection mid-year due to several reasons. But midyear correction by the governments are usually not large enough to affect the program implementation. Despite having best of abilities, macroeconomic shocks can derail the accuracy of the projection. To address such problems the scoring methodology described above considers three years and selects any two years to exclude the outlier year.

Table 2: Dimensions and Scoring for Revenue outturns

Score	Dimension	Data Range
Aggregate Revenue Outturn		
A	Actual value lies between 97 percent and 106 percent of budgeted amount	1. 2012-13 to 2014-15 2. 2016-17 to 2018-19 (in at least two of these three years)
B	Actual value lies between 94 percent and 112 percent of budgeted amount	
C	Actual value lies between 92 percent and 116 percent of budgeted amount	
D	Performance is less than C score	
Revenue Composition Outturn		
A	Variance in revenue composition less than 5%	1. 2012-13 to 2014-15 2. 2016-17 to 2018-19 (in at least two of these three years)
B	Variance in revenue composition less than 10%	
C	Variance in revenue composition less than 15%	
D	Performance is less than required for a C score	

Expenditure Side

Composition of government expenditure, which reflects distribution of expenditure across sectors and priorities, to a certain extent influences predictability of fund flows depending on availability of aggregate revenue as projected in the budget. Following the common classification of revenue and capital expenditure, the former constitutes about 85 percent of total expenditure (Table 3). The types of spending, which are committed in nature like interest payment, pension, and salary and wages constitute a large portion of revenue expenditure and are most likely to be met from the consolidated fund. For all the general category states, these three types pf spending constitute about half of the revenue expenditure and for some states, it can rise up to 60 percent. The capital outlay could be a residual in the system depending on availability of revenue.

The comparison of aggregate expenditure with the budgeted expenditure shows the ability of the government to implement expenditures voted by the legislature and deliver public services based on government policies. The government accounts in India are kept on a cash basis. Only actual receipts and payments during the financial year, from April1 to March 31, are taken into account with no outstanding liabilities or accrued income included. All cash appropriations lapse at the close of the financial year with no provision of rolling over of unspent amount to the next fiscal year. A variance of 5 percent from the budget estimates gives score of 'A' and a 10 percent variance gives a score of 'B'. A 15 percent variance from budget gives a lower score of C and variance above that gets a score of D (Table 4). For data of all states, we have applied this methodology of scoring to revenue and capital expenditure along with total expenditure. Debt repayment is not included in capital expenditure as this is sovereign commitment.

Table 3 Composition of Total Expenditure

Percent

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Revenue Expenditure	84.92	85.14	85.28	85.02	83.50	82.50	85.73	85.48
Capital Expenditure	15.08	14.86	14.72	14.98	16.50	17.50	14.27	14.52

As the aggregate expenditure is the sum total of myriad spending items, the budget credibility test for spending items by decomposing the total expenditure will be important. Decomposed level of expenditure provides idea as to how the allocation of spending across budget categories explain the variance. While the expenditure categories are affected by variance of aggregate expenditure from budget projections, there could be reasons unrelated to accuracy of forecast that affects the actual spending. There is a need to assess the variances arising out of structural and other budget management problems in spending categories besides the general issue relating to availability projected revenue in the budget. To measure the variance occurring between achieved and planned spending amounts in various spending categories, an adjustment is made to remove the effects of changes in aggregate expenditure. This is achieved by adjusting the budget outturn for each category used by the proportional difference between the total original, approved budget expenditure and the total expenditure outturn. This leaves the deviation in each category that occurs due to the changes in the spending categories during the budget implementation phase not related to the shifts in aggregate spending.

The interest payment on debt stock was excluded as it is too much of a committed spending, which government adheres to every fiscal year. The scope for making errors in forecasting the likely interest payment is less. Instead of taking all the components of spending to find variation, we have selected few important categories spending to assess the variance and score them. The scoring pattern is similar to the aggregate expenditure assessment (Table 4).

Table 4: Dimensions and Scoring for Expenditure

Score	Dimension	Data Range
	Expenditure Outturn	
A	Actual value lies between 95 percent and 105 percent of budgeted amount	1. 2012-13 to 2014-15 2. 2016-17 to 2018-19 (in at least two of these three years)
B	Actual value lies between 90 percent and 110 percent of budgeted amount	
C	Actual value lies between 85 percent and 115 percent of budgeted amount	
D	Performance is less than C score	

Source: PEFA, 2016

Budget credibility assessment was carried out here both at aggregate level as well as the level of individual state. To probe further the issues related to sector priorities and expenditure pattern and utilization of budgeted amount under revenue and capital heads, data analysis and interviews were conducted across spending departments of three states, Madhya Pradesh, Odisha and Sikkim. While Madhya Pradesh and Odisha are general category states, Sikkim is special category state in Indian union. However, the dependence of all three states on central transfers is quite high.

5. Assessment of Budget Credibility: All States

Revenue Receipts

Total revenue receipts of states show large deviation from budget estimates in both the blocks of three years (Table 5). While the actual receipts fell short of projections by 10 and 14 percent in 2013-14 and 2014-15, the deviation was 11.30 percent in 2016-17. The deviation of actual receipts as percentage to budget estimates for last two years in the second block was more than 8 percent. The score, based on the methodology discussed earlier, is lowest at 'D' for the first block and 'C' for the second block. Looking at the components of total revenue receipts, while states fared better in their own tax effort by staying closer to projections, it was the central transfers, particularly the grants, which deviated considerably.

The relative share of own tax revenue constitutes about half of the total revenue receipts; its share has declined from 52 percent in 2011-12 to 46 percent in 2016-19. This is due to rise in relative share of transfers, which constituted about 46 percent of total revenue during 2015-16 to 2018-19. The deviation of own tax revenue from projections was relatively less in both the block of three years, leaving aside the fiscal year 2016-17 for which it received a score of 'B'. Score of own non-tax revenue varied from a solid 'A' to 'C' in these two time periods. The non-tax revenue has remained a smaller component of total revenue receipts of the state as its share has been on an average 9 percent during this period. The Central transfers, received a low score of 'D' in booth the blocks due to shortfall in grants as compared to the budget projections.

Table 5 Revenue Receipts of All States (Deviation as percentage to BE)

	2012-13	2013-14	2014-15	Score	2016-17	2017-18	2018-19	Score
Total Revenue Receipts	-5.97	-10.22	-14.17	D	-11.30	-8.37	-8.26	C
Own Tax Revenue	1.99	-6.35	-7.54	B	-14.05	-1.96	-5.32	B
Own Non-Tax Revenue	-2.56	4.22	-5.63	A	-16.40	-8.48	-3.28	C
Central Transfers	-15.75	-17.78	-22.16	D	-7.43	-14.87	-11.81	D
Tax Devolution	-4.64	-7.89	-15.06	C	4.40	-9.22	-1.51	A
Grants	-28.48	-28.98	-28.19	D	-22.99	-23.11	-25.97	D

The first block of three years from 2012-13 to 2014-15, was the last three years of the award period FC-XIII. This period marked the continuation of the fiscal consolidation process based on the recommendation of the Commission. States tried to improve their tax effort by raising taxes on tobacco and liquor and simplifying tax procedures and for improving tax compliance within the existing VAT mechanism. During this phase central government restructured centrally sponsored schemes (CSS), and started routing all CSS related transfers through state Government budgets in 2014. The FC-XIII recommended several conditions for states to avail grants, which proved to be challenging. Enthusiastic budget projections of states relating to grants proved to be in considerable variation with actual receipts.

The years from 2016-17 to 2018-19 was the award period of FC-XIV, which witnessed major changes in central transfers to the sub-national governments. While the recommendations of FC-XIV to increase the tax devolution to a high of 42 percent resulted in larger flow of tax devolution, central government restructured the assistance to state plans by subsuming plan grants in FC-XIV transfers and de-linking several grants, which reduced overall plan grants. These changes had their impact on policy responses and fiscal management practices of the states. Thus, the increment in tax devolution signifies a change in composition of central transfers, as the plan grants to the state budget have been removed leaving mostly the CSS funds. The Central

Government also restructured the CSS based on the recommendations of the subgroup of chief ministers in 2016-17.

States in the second block of three years managed to hold on to their own tax revenue projections despite several challenges. The introduction of GST was landmark tax reform that subsumed several state and central direct taxes. Despite having improved tax administration and coordination across states, the revenue impact of GST was not very encouraging in the initial years. The tax devolution, which increased after the recommendations of the FC-XIV remained closer to the projections for which it received a high score of 'A'. The uncertainties and unpredictability of grants from central government continued unabated for which it received a very low score due to large deviations.

Performance of individual taxes provides major lead to the conduct of total own tax revenue as compared to the budget projections. Sales tax in the form of VAT and GST form major chunk of states taxes since 2017-18 (Table 6). While on an average the sales tax in VAT constituted about 63 percent of all states taxes between 2011-12 to 2016-17, with GST component, it has gone up to about 70 percent. State excise duty and stamps and registration fees are two other major state taxes that account for on an average 12 and 11 percent respectively during 2011-12 to 2018-19. Motor vehicle tax and taxes on goods and passengers taken together constitute about 7 percent own tax revenue. While own tax revenue at state level remained less buoyant in recent years, the adherence to projection would reflect a sense of stability and certainty in terms of resource generation.

Table 6 Composition of Own Tax Receipts

Percent

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
SGST	0.00	0.00	0.00	0.00	0.00	0.00	32.65	42.65
Electricity Duty	3.08	3.36	3.12	3.31	3.67	3.17	3.37	3.49
Sales Tax	61.43	61.29	63.27	62.74	62.27	64.24	37.43	28.40
State Excise Duties	12.84	12.61	11.40	11.64	11.95	11.37	11.73	14.11
Motor Vehicle Tax	5.15	5.20	5.03	5.09	5.34	5.68	6.07	5.75
Taxes on Goods and Passengers	2.02	2.27	2.66	2.49	2.70	2.79	1.25	0.22
Stamp Duty and Registration Fees	11.54	11.55	10.85	10.93	10.99	9.75	10.28	9.28
Other Taxes	3.96	3.72	3.67	3.79	3.09	3.00	-2.79	-3.90

The changes in relative share of tax receipts would not reflect their performance as compared to the targets set under budget projections. The composition, however, shows the relative importance of individual taxes and their role in influencing the behavior of aggregate tax. The changes in tax rates or any other economic situation arising during the course of year, however, can change the revenue realization. The variance in revenue composition where the actual revenue by category is compared with the approved budget can explain the behavior of individual tax receipts. This is intended to capture the extent of accuracy of forecasts of the revenue composition and the ability of the agencies to meet the budget targets.

The state taxes over both the periods show varying level of deviation from budget projections (Table 7). As shown in the methodology, the assessment for scoring here is more liberal as compared to the aggregate revenue. The sales tax in the first block of three years was VAT and in the second block GST implemented in 2017-18 contained most of the products leaving petroleum product and alcohol under VAT for states to levy. The GST data for states (SGST) is available only for one year in our data set to compare the projections and actual receipt for which we have not scored it. The sales tax (VAT and without GST in 2017-18 and 2018-19)) received a score of 'B' in both the periods although large deviations have been witnessed in 2014-15 and 2017-18. The performance of other two major taxes state excise duty and stamps and registration fees has remained poor in terms of remaining close to the budget estimates. Two smaller components of own tax revenue, i.e., electricity duty and motor vehicle tax performed well in both the periods.

Table 7 Composition of State Taxes (Deviation as percentage to BE)

	2012-13	2013-14	2014-15	Score	2016-17	2017-18	2018-19	Score
SGST							21.82	
Electricity Duty	18.78	5.89	6.9	**B**	-16.97	-3.61	-1.03	**A**
Sales Tax	0.11	-5.61	-14.68	**B**	-9.06	-42.9	6.47	**B**
State Excise Duties	-0.11	-13.58	-11.08	**C**	-13.7	-4.84	14.04	**C**
Motor Vehicle Tax	3.97	-7.38	-12.46	**B**	-1.7	3.62	-4.51	**A**
Taxes on Goods and Passengers	4.38	19.84	-6.36	**B**	-14.53	-20.02	5.51	**D**
Stamp Duty and Registration Fees	3.49	-10.41	-14.22	**C**	-19.22	2.48	-8.22	**C**
Other Taxes	22.9	-5.17	-242.19	**D**	-60.57	-188.2	-50.29	**D**

Record of Adhering to Aggregate Expenditure Projections

Expenditure outturn at aggregate level shows clear trend over two blocks of three years for all states. The deviation from budget projections was relatively low for total expenditure excluding debt repayments except for the fiscal year 2014-15 (Table 7). The deviation of aggregate expenditure outturns in both the blocks of three years reviewed here remained within 10 percent leaving the year 2014-15, where the deviation was large at 13.91 percent. The credibility score was B taking performance of best two years in each block, which reveals consistency for both the periods. The deviation of revenue receipts from the budget projections as was discussed in the earlier section seems to have been reflected in the shortfall of aggregate expenditure. One of the reasons for which the state expenditure revealed restraint in recent years was that actual spending fell short of what was projected in the budget.

Following the broad classification of expenditure into revenue and capital expenditures, it is evident that the performance of actual revenue expenditure was better. The revenue expenditure, which constitutes about 85 percent of total expenditure shows low variation, with a score of 'A' during 2012-13 to 2014-15 indicating the that the deviation was less than 5 percent at least for two years and 'B' during more recent 2016-17 to 2018-19. Given high incidence of committed spending in revenue expenditure of states, it remains close to the budget estimates. The performance of capital outlay in terms of conforming to budget projections has been dismal over the years with large variations and low score of 'D' in both the blocks of three years. The residual nature of capital expenditure has spread from allocation to budget execution level. The push for higher public investment to improve growth performance may not get enough backing from states given the uncertainties involved in their capital spending.

Table 8 Expenditure Outturns: Deviations from Budget Estimates

Percent

	Total expenditure		Revenue Expenditure		Capital Expenditure	
2012-13	-2.91	B	-1.01	A	-18.05	D
2013-14	-8.74		-4.82		-15.92	
2014-15	-13.91		-10.39		-16.8	
2016-17	-7.39	B	-6.32	B	-22.56	D
2017-18	-9.18		-8.25		-16.02	
2018-19	-7.93		-7.1		-16.36	

Results from Composition of Expenditure

Composition of government spending given in table 9 shows that on an average state governments spend about 42 percent of total expenditure on social services, which includes education health, water supply and sanitation, and social welfare activities. In the functional division of responsibilities between following the constitutional provisions, states have more responsibilities in social sector. The economic services that include productive sectors like agriculture, energy, and transport accounts for about 34 percent of total spending. The general services, which include administrative services, pensions and spending fiscal services account for about 21 percent of total spending of states. The general services exclude interest payment and debt repayment has been removed from total spending in this data set. While, states have been on the forefront in spending in the area of social sector, they also have the responsibility to build productive infrastructure.

The spending priorities of the state government and the emerging focus areas ascertained from aggregate sector expenditure indicate that pension, aggregate administrative services, education, water supply, sanitation and urban development, electricity, agriculture, power, and transport have been the priorities. Health in social series and irrigation in economic series are other important source of government spending. The composition of total expenditure in recent years indicate that it was economic services, relative share of which has seen an increasing trend due to higher allocation given to agriculture, rural development, and power sector. While there has been some deceleration in the case of general services, the relative share of social services in terms of resource allocation has remained stagnant. However, it remains the most important spending item for the Government.

The variance of expenditure from budget projections for selected expenditure categories aggregated over all the states is shown in Table 10. We have chosen expenditure categories, relative share of which are high to assess the budget variation. As discussed earlier, the classification of expenditure in terms of general services, social service economic services is adopted here. The spending on social services has been the largest as the state governments bear major responsibilities in this area.

Table 9 Composition of Government Expenditure

Percent

Heads	2012-13	2013-14	2014-15	2016-17	2017-18	2018-19
General Services (Rev exp.)*	**21.75**	**21.84**	**20.53**	**19.00**	**20.40**	**20.86**
Organs of States	0.95	0.99	1.05	0.83	0.89	1.02
Fiscal Services	1.39	1.45	1.30	1.13	1.14	1.07
Pension	7.62	7.56	7.02	6.53	6.69	6.75
Administrative Services	11.47	11.49	10.71	10.15	11.37	11.56
Other General Services	0.32	0.35	0.46	0.36	0.32	0.46
General Services (Cap exp.)	0.70	0.90	0.90	0.85	0.79	0.79
Social Services (Total Exp.)	**41.90**	**42.28**	**40.72**	**41.24**	**41.54**	**41.59**
Education Sports Art & culture	19.91	19.78	18.96	17.88	18.08	17.68
Medical and Public Health	4.50	4.51	4.74	4.80	5.18	5.19
Water Supply Sanitation Housing & Urban Dev	5.89	5.71	5.90	7.24	7.54	7.16
Welfare of SC/ST/OBC Classes	3.27	3.30	2.80	2.94	3.14	2.91
Social Welfare and Nutrition	5.87	6.16	5.56	5.56	1.07	5.94
Other Social Services	2.47	2.82	2.75	2.82	6.53	2.71
Economic Service (Total Exp.)	**32.82**	**31.92**	**35.13**	**36.43**	**34.44**	**33.83**
Agriculture and Allied Services	6.35	6.19	6.70	6.23	7.77	7.89
Rural Development	4.31	4.14	6.64	7.02	6.54	6.04
Irrigation and Flood Control	6.26	5.76	5.05	5.45	4.61	4.47
Energy	6.49	6.15	7.40	8.06	6.78	6.39
Industry and Minerals	1.23	1.12	1.16	1.09	1.04	1.17
Transport	6.12	6.56	6.40	6.27	5.95	6.07
Science Technology & Environ.	0.08	0.08	0.07	0.08	0.07	0.06
General Economic Services	1.55	1.42	1.30	1.84	1.37	1.42
Other Economic Services	0.45	0.50	0.42	0.39	0.32	0.33
Assignments to Local Bodies	**2.83**	**3.07**	**2.73**	**2.49**	**2.82**	**2.93**

Note: General Service excludes interest payment and servicing of debt.
Social and Economic services include both revenue and capital expenditure.
The fiscal year 2015-16 is not part of this data set as the year was not used for credibility scoring.

While the aggregate spending shows a clear performance pattern when decomposed into revenue and capital expenditure, the results from expenditure categories in different sectors vary over the years. The expenditure categories included in this exercise contain both capital and revenue components. The general service, social service, and economic service aggregated over their components and grants to local bodies get high score of 'A' over the two blocks of three years during 2012-13 to 2018-19. The good score for aggregate spending categories compliments the results in the case of total spending of all the states.

In the case of general services, while pension and fiscal services show low deviations from budget estimates, the administrative service, which is the largest component and capital component of general service show large variations. In the case of social services, priority sectors like education, health, and social welfare and nutrition performed well as the variation from the budget estimates were low. Water supply and sanitation and urban development, however, show relatively higher deviation. In the case of productive economic sectors, results are more varied. Agriculture and allied services, which is the largest component of economic services, rural development and industry & minerals show low deviation from budget estimates and scored higher ranks. However, other major categories of spending like irrigation and transport show relatively higher deviation from budget estimates. In the case of transport, the actual expenditure exceeded the budget estimates considerably in almost all the years.

The results obtained after removing the impact of deviation of aggregate expenditure on individual expenditure categories shows several issues relating the practice of public expenditure management in a complex government budgetary system. The varying deviations over the years imply several implementation issues across the departments. Deviation below 5 percent gives best results, but a deviation increasing to 10 percent or beyond poses serious challenges to executing the government programs. The issues ranging from environmental regulation to hindrances in executing infrastructure projects or lack of effective planning before taking up the programs to changes in policies in the middle of the fiscal year become relevant. Further the role of an effective internal control system, existence of an orderly and predictable program management, and exercise of control and stewardship in the use of public funds are crucial issues in successfully utilizing the voted amounts for programs.

Table 10: Variance of Expenditure Categories (%) and Budget Credibility Scores

	2012-13	2013-14	2014-15	Score	2016-17	2017-18	2018-19	Score
General Services	**1.47**	**4.62**	**4.85**	**A**	**-3.86**	**3.78**	**3.44**	**A**
Organs of States	-6.62	-1.10	0.41	**A**	-7.79	0.32	9.85	**B**
Fiscal Services	-0.94	10.05	5.62	**B**	0.37	2.95	-3.28	**A**
Pension	-7.23	-1.84	-1.83	**A**	-5.00	0.80	-3.35	**A**
Administrative Services	10.65	10.48	10.64	**C**	-0.99	8.46	10.57	**B**
Other General Services	-26.72	-23.06	-4.53	**D**	-41.24	-42.23	-33.67	**D**
General Serv. (Cap Exp.)	-44.76	-40.66	-31.49	**D**	-29.00	-30.02	-32.99	**D**
Social Services (Total Exp.)	**-0.84**	**0.09**	**-2.79**	**A**	**-2.18**	**-0.25**	**-1.24**	**A**
Education Sports Art & culture	-0.07	0.20	-1.19	**A**	-2.81	2.84	1.24	**A**
Medical and Public Health	-1.29	-1.95	-0.32	**A**	-2.69	9.73	6.13	**B**
Water Supply Sanitation Housing & Urban Dev	-9.08	-10.65	-12.43	**C**	1.47	-6.64	-13.82	**B**
Welfare of SC/ST/OBC	4.63	-3.75	-16.66	**A**	-13.68	-8.41	-16.62	**D**
Social Welfare and Nutrition	0.65	7.16	2.83	**A**	1.68	-80.15	6.47	**B**
Other Social Serv. Exp.)	5.26	20.77	13.15	**C**	-0.05	166.7	13.86	**C**
Economic Serv. (Total Exp.)	**2.08**	**-1.28**	**1.88**	**A**	**5.87**	**-1.27**	**0.19**	**A**
Agriculture & Allied Services	9.67	-2.63	-4.34	**A**	0.30	4.50	8.16	**A**
Rural Development	-7.60	-9.85	-11.46	**B**	-2.67	-6.01	-12.52	**B**
Irrigation	-12.28	-12.98	-2.11	**C**	7.50	-15.36	-12.51	**C**
Energy	26.55	10.41	29.74	**D**	19.65	10.69	9.73	**C**
Industry and Minerals	15.17	-3.78	-0.72	**A**	-14.03	-7.62	-6.17	**B**
Transport	5.82	20.59	13.07	**C**	8.83	6.76	13.09	**B**
Science and Environment	-13.56	-12.77	-7.33	**C**	25.75	-30.76	-40.60	**D**
General Economic Services	-17.48	-26.37	-21.98	**D**	4.13	-22.21	-9.81	**B**
Other Economic Services	-28.34	-12.30	-24.58	**D**	21.59	-12.70	-6.40	**C**
Grants to Local Bodies	-2.26	0.86	-0.62	**A**	0.38	5.33	5.53	**A**

6. Assessment of Budget Credibility: Individual State Results

The assessment of budget credibility at individual state level for broad categories of revenue receipts and expenditure more or less reflect the results derived for data of all states. The individual state assessment included data for 17 major states in India. Two sets of three-year data, first for 2012-23 to 2014-15 and second, 2016-17 to 2018-19, was compiled on actual and budget estimates to derive the deviation of actual receipts from budget estimates (Tables 10 & 11). On the revenue side the variables included in this exercise were total revenue receipts, own tax revenue, tax devolution, and grants. On the expenditure side the data included are revenue expenditure and capital outlay.

More number of states, 14 in first block and 12 in second block, receive a score 'D' in aggregate revenue receipt, implying a large variation from the budget estimates. In the case of own tax revenue, while the number of states show variation in terms of level of deviation in the first block, there has been a deterioration in the second block. The own tax revenue effort seems to have gone down. The second period experienced the teething problem of tax reforms in terms of adopting GST, which to some extent affected the behaviors of own taxes vis-a-vis budget projection. But what is clear across these two blocks is the poor performance of central transfer categories, particularly the grants component. In both the blocks all most all the states get a score of 'D' in the case of grants and a large number of states score 'C' in the first block. The performance of tax devolution has improved in the second block after the recommendation of FC-XIV for an enhancement of the tax devolution to states.

The two broad categories of expenditure, revenue expenditure and capital expenditure more or less reflect the results obtained in the case of all states data. Large number of states managed to receive good scoring in the case of revenue expenditure implying a low deviation from budget estimates. As the revenue expenditure includes committed spending heads, meeting them becomes a priority for the states. The capital expenditure remained residual in the system in the budget implementation process deviation from budget estimates becomes high. More number of states in this exercise received a score of 'D' in both the blocks, implying a deviation more than 15 percent from the budget estimates.

Table 10: Budget Credibility 2012-13 to 2014-15

Score	Total Revenue	Own-tax Revenue
A	MH	GJ, MH, KR
B	KR, RJ	AP, CG, MP, OD, RJ
C	GJ, MP, OD, TN, UP	BH, GA, JH, UP, WB
D	AP, BH, CG, GA, HR, JH, KL, PN, WB	HR, KL, PN, TN
	Tax Devolution	**Grants-in-Aid**
A		
B	HR, JH, MP, OD	
C	BH, CG, GA, GJ, KR, KL, MH, PN, RJ, TN, UP, WB	
D	AP	AP, BH, CG, GA, GJ, HR, JH, KR, KL, MP, MH, OD, PN, RJ, TN, UP, WB
	Revenue Expenditure	**Capital Outlay**
A	KL, MH, PN, RJ, TN, WB	KR, UP
B	CG, GJ, HR, KR, OD, UP	GJ
C	AP, GA, MP	BH, MP, RJ
D	BH, JH	AP, CG, GA, HR, JH, KL, MH, OD, PN, TN, WB

Source: Authors' Computations using Budget Documents and Finance Accounts (various years)

Central transfers are crucial components of budget management of states in India and the uncertainty in actual transfer increases vulnerability, which is usually termed as poor fiscal marksmanship (Jena 2006). While dependency of relatively high income states on central government is less, at about quarter of their total revenues, relatively poorer states 'dependence is about one half of their total revenues. The fluctuations in central revenue directly affects the tax devolution as well as grants at the time of fiscal stress.

The uncertainty in central grants, particularly in CSS, however, has been an existing issue that state governments continue to face (Garg, 2006,). The states have to address several factors relating to design of the schemes, conditions attached with it, and guidelines to execute the schemes, which sometimes becomes challenging. Actual performance in terms of utilization of fund released is a major indicator for release of second tranche of grants. The failure of states to raise matching grants given by the central government in the decided ratio hampers full release of grants. The CSS operate in a framework of stretched performance chain starting from central ministries to the grassroots level through implementing agencies that encumbers flow of funds.

Table 11: Budget Credibility 2016-17 to 2018-19

Score	Aggregate Revenue	Own-tax Revenue
A	GA, KR, MP, MH	KR
B	GJ, OD	MP, MH, OD, TN
C	RJ, TN, UP, WB	GA, GJ, RJ,
D	AP, BH, CG, HR, JH, KL, PN, TL	AP, BH, CG, HR, JH, KL, PB, TL, UP, WB
	Tax Devolution	**Grants-in-Aid**
A	AP, BH, CH, GA, GJ, JH, KR, KL, MP, MH, PN, RJ, TN, UP	
B	OD, TL, WB	
C		MP, RJ
D	HR	AP, BH, CH, GA, GJ, HR, JH, KR, KL, MH, OD, PN, TN, TL, UP, WB
	Revenue Expenditure	**Capital Outlay**
A	AP, GJ, KR, KL, MP, MH, RJ, TN, WB	KR, KL, MP, OD,
B	CH, GA, HR, UP	GJ, WB
C	JH, OD, PN	JH
D	BH, TL	AP, BH, CH, GA, HR, MH, PN, RJ, TN, TL, UP

Source: Authors' Calculation using Budget Documents and Finance Accounts (various years)

7. Experiences from Three States

The state governments, despite their best efforts, may still end up with variations in their actual spending as compared to what they had budgeted. The pattern and timing of fund flow from the central government also influences the spending. Timeliness of reliable information on the allocation from the central government for the coming year helps the sub-national Government to take resource allocation decision and the actual flow determines the spending pattern. The capacity of the Government to implement the policies, structural bottlenecks, and hurdles posed due to legal and environmental factors are other reasons for derailment of spending plans. Some of the important factors affecting utilization of budget amounts in three states, Madhya Pradesh, Odisha, and Sikkim are discussed here.

- **Non-receipt of Central grants:** Non-receipt of central grants was cited by many departments as one of the major problems in meeting the budget estimates. Comparison of budget proposals and fund flows under central schemes in these three states show considerable variation. While capacity of the government to implement the policies, and hurdles posed due to legal and environmental factors could be considered as the reasons for derailment of spending plans, in many cases, central transfers were reduced or delayed despite being budgeted that adversely affected the implementation of programs.

- **Projecting in anticipation**: States, particularly those receiving several central schemes like north-eastern states, tend to project the grants in anticipation based on their own project costing. The central transfers under these schemes may not match their projections, and actual flow falls short of anticipation.
- **Matching Grants**: The matching grants to CSS has always remained an issue that affected the priorities of the states. Lack of provision of matching grants, in some case resulted in denial of subsequent release of central grants resulting in shortfall in actual spending. It needs to be kept mind that the matching component has increased after restructuring of CSS based on the recommendations of the subgroup of chief ministers in 2016-17 for general category states.
- **Structural Issues:** Several structural issues hindered many departments in utilizing the available resources. There have been capacity issues in conceptualizing and executing modern infrastructure projects. Legal and environmental issues also affected executing infrastructure projects like irrigations projects.
- **Power sector subsidy**: The subsidy given by the state Government to various sections of the society on power tariff plays a crucial role in budget management process. If the revision of power tariff is not issued before the budget preparation, with the increase in tariff the subsidy amount increases. As the state government does not revise the subsidy aligning with the power tariff, actual spending rises beyond the budget estimates.
- **Policy changes after presentation of budget**: Policy changes during the fiscal year cause large swing in the actual spending exceeding the budget estimates. For instance, introduction of crop insurance scheme in agriculture sector, expanding capital spending in irrigation, and rise in spending in right-based schemes in education, and so on increase actual spending beyond the budget estimates.
- **Not filling of vacancies**: In the case of spending department like education, where salary is the largest component, if vacancies were not filled in during the year, actual spending falls short of budget estimates. The budget estimates usually takes into account all the sanctioned posts.
- **Program management and Utilization Certificate**: Providing utilization certificate in timely manner, minimizing the layers of authorities involved in clearing the project

proposals, and effectively utilizing the contractors at various levels are crucial factors in implementing projects. Issues like delay in clearance for acquiring forestland, delay in starting of the work, delay in utilization of previous instalment are other factors. Land acquisition continues to bedevil the departments building infrastructure projects.

- **Efficient Investment Management**: Overarching principles involving investment management system that includes selection of projects, estimating cost, planning and budgeting, monitoring and control system have been found wanting that hindered utilization of public resources and achievement of the stated objectives.
- **Delay in receipt of central funds**: The funds received during the last quarter of the fiscal year could not be put to use and large part of it remains as unspent amount.

8. Dealing with Budget Credibility

While an unbiased revenue projection mechanism becomes important to improve the sanctity of the budget, it cannot always be explained mechanically. Looking at the results at aggregate and at individual state level, it becomes clear that central transfers affect the ability of the states to achieve the projected revenue. While a solid macro-fiscal projection is necessary to give early indication of revenue availability, the performance of national economy is more relevant as compared to the state GSDP. Exuberance shown in projection in revenue collection expecting increase in economic activities, may not be realized with national growth slowing down. What is important in this context is the notion of sanctity of the budget, which needs to be valued in budget management system.

Given the emergence of GST as the major source of tax revenue for states, strengthening revenue administration has become essential to improve tax performance. Revenue administration involves several features, the major objective of which is to reduce discretionary elements and establish clear understanding about rights and obligations. Adequate tax dispute resolution reduces time consuming legal tussles, which results in large arrears in tax receipts. The tax collecting agencies at sub-national level, should increasingly adopt efficient risk management process to minimize tax evasion and cost of collection and emphasize on reducing compliance cost in the system. Improvement in audit and fraud investigations helps in this context.

Appropriately designing the institutions that govern the decisions over public finances would improve the environment of budgeting system. Establishing a medium term perspective, bringing performance orientation in the budgeting, improving fiscal transparency and provision for independent review of fiscal stance of the governments are relevant reforms that would strengthen budget management system and program implementation. Ensuring value for money and effective utilization of public resources to achieve desired results remained as the problem areas. Weakening of state finances due to Covid-19 pandemic and consequent resource problem and increasing debt burden requires a robust PFM system.

Establishing a medium term perspective linking policy making to budget through medium term expenditure framework (MTEF) has emerged as one of the key PFM reforms to strengthen budgeting system (World Bank, 1998). This innovation has received acceptability both in developed and developing world due to positive experiences (Brumby and Hemming, 2013). The MTEF tends to reduce the tendency of ambitious annual spending plans based on blown up revenue projections to improve budget realism. The MTEF will provide opportunities to the state governments to emphasize on sector priorities based on their objectives and will help in resource allocation decisions to reduce fiscal strain coming from politically induced tradeoff. The MTEF helps the spending departments to become proactive while designing and costing their programs due to increase in predictability of flow of resource in a multi-year mode. Adoption of MTEF by Union Government in 2012 continues to remain a work in progress and states have not pursued it earnestly (Jena 2018).

The state governments should make efforts to infuse better performance orientation in budgeting system by utilizing their outcome budgets. Outcome budget was adopted at Union level in 2005 and later by states, after a dismal run of performance budget adopted long back in 1968. Despite changing the nomenclature, the central outcome budget has not been proved useful to influence the budgetary decisions in both program formulation and resource allocation (Jena 2016). The practice of performance budget across the world shows that establishing explicit links between allocations and result indicators, and improving decision making by using better quality information of performance of agencies and programs are crucial features (Robinson, 2007, OECD, Allen Schick, 2014). State Governments are better placed to utilize outcome budgets by formulating appropriate and acceptable performance indicators and cost estimates to achieving them. The medium term approach alluded above also needs output/outcome type budget to be effective.

Independent review of fiscal policy can be a potential instrument to bring in efficiency to public spending and improve credibility. Some of the state governments have included the provision of independent review of their fiscal management in their fiscal responsibility legislations. In this context establishing fiscal council is advocated with key functions like advising on fiscal policies and plans and auditing fiscal plans and performance (Hemming and Joyce, 2013, Debrun et al., 2013)). The research shows that independent fiscal council tends to boost accuracy of fiscal projections even as it helps countries stick to fiscal rules better (Roel Beetsma et al., 2018). While establishing fiscal council for all the states looks as a humongous effort, periodical independent review should be initiated by states to enhance accountability[3].

Improved fiscal transparency enables states to produce fiscal information in a timely manner and makes it accessible and contributes to public accountability (Kopits, G., & Craig, J. 1998). The requirement of transparency is overarching, in almost all aspects of policy making and executing the policies. The state governments need to make their budgets comprehensive, make the budget documents accessible comprising all the key fiscal information, and coordinate with central government in transparent manner relating to central schemes. While accounting and reporting the fiscal information is crucial, the state governments also should prepare performance indicators and output expectations from the programs and include them in the budget documents along with information relating to policy objectives and goals.

The state governments have accepted technological solutions to improve efficiency in governance. The computerization of treasury management system is one of the innovations that helped states improving payment system and reduce irregularities (Ghosh and Jena, 2008). Some states also have linked to the web based public financial management system (PFMS) of the Union Government, which provides financial management platform for all plan schemes, a database of

[3] 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.

all recipient agencies, and integration with core banking solution of banks handling plan funds. State governments need to utilize the technological innovations effectively to get adequate information on fund utilization in various schemes leading to improved monitoring, review and decision support system. Informed decision making is key requirement for implementing a realistic budget.

9. Concluding Remarks

The budget credibility assessment using PEFA methodology for state governments brings out several important features of PFM system at sub-national level in India. The importance of strengthening budgeting system at state level is linked to their large functional responsibilities and the expansion of public spending. The ability of states to achieve improved level of public service delivery through implementation of planned budget hinges considerably on the quality of transfer of resources from central government in addition to their own revenue effort and expenditure management. The dependence of states on central transfers for resources has emerged as a key determinant of quality of budget implementation. Addressing local economic factors and institutional environment also influences the policy decisions and the budget credibility.

The contemporary PFM challenges faced by states include allocative efficiency in resources and operational efficiency in putting the public resources to the best use. With a slow moving resource envelope, states could hardly become innovative in taking decisions to strengthen institutions across the sectors. There has always been resource trade-offs to maintain existing programs, assisting public sector units, providing power and transport at subsidized rates, providing education and health services and myriad such services in social and economic sectors. Promises for new services regularly appear along with the budget speeches that have the potential to spread the resources thinly. Uncertainties in flow of funds, late arrival of central funds, and issues relating to utilization of available resources continue to haunt the implementation of programs.

The fiscal prudence and political willingness to function under fiscal rules shown by the state governments was affected by slowdown in the economy in recent years. The Covid-19 pandemic dealt a body blow to the public finances in the country resulting in reduced level of fund flows to states and higher debt burden. While the FC-XV has worked out a gliding path for fiscal consolidation for the states, the achievement will depend upon the revival of the economy and better resource availability. The states need fiscal discipline, which will provide opportunities to strengthen institutional framework to improve efficiency and effectiveness of budgeting system. While the diagnostic assessment in this paper has acknowledged the role of economic situation affecting the budgetary decisions, the accuracy of macroeconomic assumptions across large number of states contained in their fiscal responsibility legislations have not been considered due to lack of objectivity and consistency.

Strengthening revenue administration plays crucial role in establishing a credible budgeting system by enhancing accountability and transparency. Reduction in uncertainties in flow of funds can improve accountability in spending programs and guard against fiscal mismanagement. State governments need to improve their tax administration to reduce discretionary elements, manage the risk involved in achieving planned targets, and reduce compliance cost for tax payers. Strengthening revenue administration will help reducing both overestimating and underestimating the revenue receipts.

Overarching PFM reforms to strengthen institutional efficiency is more needed for states given their functional responsibilities. While states have adopted several innovations and improved transparency through better availability of information, they remained slow in changing PFM institutions. Innovations like adopting a medium term expenditure framework to link plans to budget, establishing independent review process, improving fiscal transparency, bringing performance orientation in the budgeting process are advocated to improve the overall budget management process and reduce the uncertainty surrounding resource availability for the programs and utilization of the resources voted in the budget.

In the budget forecasting and PFM institutional reforms, only technical or mechanical type solutions will not be adequate to bring in desired changes in the government system. In the context of improving budget credibility, the spending departments need to develop internal capacity, actively manage the changes in a transparent manner, and plan their activities keeping performance indicators in consideration. In the budget implementation process, the spending departments should change the entrenched practice to bring innovations in program management, improve accountability structure, and make informed choices.

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