

**Fiscal Consolidation through Devolution and Transfers:
A Study on State Finance of Himachal Pradesh**

by

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1. Introduction

Himachal Pradesh is largely a mountainous State having a deeply dissected topography and complex geological structure. It has an area of 55,673 square kilometers. Five major river systems of north and north-western India flow through it. It is also the most rural State in the country with about 90 per cent of its population living in the villages. Most of the towns are like large villages in the country elsewhere. The State is administratively divided into twelve districts. It has over 18,000 villages and 59 urban settlements. Himachal's social indicators are among the best in the country. Its per capita income is above the national average.

At the time of formation of State, the fledgling State had a very poor resource base and the principal revenue resource was its forests. This, as one could appreciate, would change as we move on in the time line in overall national interest and environmental considerations. In terms of connectivity, the State's integration with the mainstream remains almost at the same level of evolution as in the beginning and the only significant development over time has been that it has developed a fairly good internal network of roads to connect its innumerable habitations with the centers of administration and possibly the markets which led to diversification of its subsistence level agriculture. It was inherent in the design of creation of this State that it would, like other mountainous States, bank upon central resource flows for not only dealing with the enormous backlog of development and rampant poverty, but also towards charting its own typical path of development. It was accordingly included in the comity of the "Special Category States" from the beginning of the Fifth Five Year Plan (1974-79). By design, the Special Category States would suffer from the problem of chronic revenue account deficits as their revenue receipts would fall way short of the revenue expenditure commitments for regulatory as well as developmental administration.

The revenue expenditure commitments would generally be much higher than in the plains States due to easily understood logic that the sparse population density, long distances, difficult topography, severity of climatic conditions and variations in climate, would all add up to push the per capita cost of developmental and regulatory services to a level far higher than the States located in the plains. On the receipts side, considerations like low population density, poor industrialization, distance from the markets and subsistence level agrarian economy would render the State to have poor revenue base.

2. Review of Literature

Budget Document, Government of Himachal Pradesh (2020-21), According to the budget estimates for the year 2021-22 the total revenue receipts were estimated at ₹ 37,028 crore as against ₹ 35,588 crore in 2020-21 revised estimates. For the financial year 2020-21 the State Excise and Taxation Department collected ₹ 7044.24 crore taxes under different heads against a target of ₹ 6886.13 crore which is 2.30 percent more than the target. During the current financial year 2021-22, (up to December 2021) the department has collected ₹ 6,232.24 crore taxes under different heads against the annual target of ₹ 6,964.84 crore.

P.K. Chaubey (2016), in his book review on *Special Category States Of India authored by Govind Bhattacharjee*, has made a analysis on Special Category Status. Recommendation made in the Draft Outline of the First Five Year Plan, the National Development Council was set up by a Cabinet Resolution on 6 August 1952. Based on the views expressed in meetings of the National Development Council in December 1967, September 1968 and April 1969, two broad formulations were made. One was Gadgil formula for block plan assistance for all states and the other was special treatment of Assam, Jammu & Kashmir, and Nagaland through ad hoc lump sum assignment of plan assistance. Thus, both ‘Special Category States’ and ‘Gadgil Formula’ had the same historical genesis. It may not be out of place that it is Assam which gets special mention in the Article 275 that pertains to Grants from the Union to certain States insofar as the welfare of the Scheduled Tribes and administration of Scheduled Areas in Assam are concerned.

15th Finance Commission Report (2019), It said that Himachal may enhance its gross state domestic product (GSDP) by boosting tourism with measures such as improving the air and road connectivity, developing new offbeat hill-stations, starting heli-taxi services to remote hill-stations, encouraging eco-tourism and adventure sports and promoting home stays as a viable alternate source of income for the people. Suggesting reforms, the Commission said that the state has a high debt to GSDP ratio which needs to be consolidated

in line with the new Fiscal Responsibility and Budget Management (FRBM) Act and other recommendations made by the Commission. The state has not done well in terms of GST collections. It needs to find innovative ways to increase both its own tax revenue (OTR) and own non-tax revenue (ONTR) and needs to take measures to restructure and rationalize its spends by reducing the burden of committed expenditure.

V.P.Tripathi, Saumya Nagar and Arun Bhaduria (2003), in their article '*Devolution of Resources: An Alternative Mechanism*', addressed the problem related to lack of participation of States. The first and foremost the step towards improving financial relations between the Union and the States was to enhance the level of participation of states in the determination of the share of Centre and various states.

Jagannath Lenka (2003), suggested about the devolution criteria in his paper entitled '*Devolution Criteria for Federal Transfer to States: An Exercise in Searching for Implicit Weights*'. More criteria should be included to capture the disparities that really exist among the states. And appropriate weights should be assigned to the selected criteria so that the resource distribution was just and at the same time didn't tell upon the fiscal efficiency of the states.

P.K.Chaubey (2003), in his article '*Federalism in India: An Introduction*', has elaborated the relationship between Union and States. It is observed that the Union is found to collect much more resources than the tasks assigned to it require and the states fall short of funds for executing their responsibilities. Naturally the jurisdiction of the Union over taxation is disproportionate to its responsibilities.

Economic Survey of Himachal Pradesh (2020-21), stated that Roads are a very vital infrastructure for rapid economic growth of the State. The development of important sectors of economy such as Agriculture, Horticulture, Industry, Mining and Forestry depends upon efficient road network. In the absence of any other suitable and viable modes of transportation like railways and waterways, roads play a vital role in boosting the economy of the hilly State like Himachal Pradesh. Starting almost from a scratch the State Government has constructed 40,020 kms. of motorable roads (inclusive of jeepable and track) till December, 2021. The State Government has been assigning a very high priority to road sector.

3. Objectives of the Study

- 1) To analyse the Fiscal indicators of Himachal Pradesh State
- 2) Analysis of State's Tax and Non-Tax revenue
- 3) Review the fiscal road map of the State
- 4) Estimating revenue sources and measures to improve the source base

4. Methodology of the Study

The methodology followed for the conduct of the study is outlined as follows. Data was collected from the relevant sources to meet the basic objectives. In this context, it is important to mention that the study has been limited to the secondary sources from publications of Government of Himachal Pradesh and Reserve Bank of India. Data was tabulated for the study in a time series of 11 years i.e. 2010-11 to 2020-21. Some statistical techniques were used to get outcomes relevant to the objectives of the study. The present work took into account a view of the growth of the fiscal capacity of the State overtime.

Data Source

- Annual Financial statements for the respective years.
- Hand book of state Finances on Indian Economy
- Reports on the FRBM Act
- Economic survey reports of State of various years
- State statistical year book
- Report on Evaluation of Himachal Pradesh State Finance by State Finance Department

5. Analysis and Interpretation

Indian Economy: An Overview

The Indian economy, to some extent has resisted the economic slowdown despite continued fall in the global economic indicators. This stability was marked by good governance through major domestic as well as foreign policies catering to the development of the economy. The initiation of various reforms have stimulated Indian economy that registered a steady pace of economic growth. Hence, growth of real GDP has been high with average growth rate of 6.4 per cent in the last 4 years.

Himachal Pradesh : An Overview

The State Government mobilizes financial resources through direct and indirect taxes, non-tax revenue, share of central taxes and grants-in-aid from Central Government to meet the expenditure for administrative and developmental activities. For the financial year 2020-21 the State Excise and Taxation Department collected ₹ 7044.24 crore taxes under different heads against a target of ₹ 6886.13 crore. During the current financial year 2021-22, (up to

December 2021) the department has collected ₹ 6,232.24 crore of taxes under different heads against the annual target of ₹ 6,964.84 crore.

The state has depended upon the central transfers for meeting a large part of its expenditure commitments because it has a poor financial resource base and its geography acts as a disadvantage in attracting big investments in various sectors. Unlike in the plain areas or in General Category states, the administrative units like districts, Tehsils & Patwars tends to be much smaller in hills. So that the cost of administrative function in hilly regions bound to be much higher per unit of population and Area.

5.1 Fiscal Roadmap for States set by the Finance Commission

The Finance Commission (FC) is a constitutional body, that determines the method and formula for distributing the tax proceeds between the Centre and states, and among the states as per the constitutional arrangement and present requirements. Under Article 280 of the Constitution, the President of India is required to constitute a Finance Commission at an interval of five years or earlier. The 15 Finance Commission was constituted by the President of India in November 2017, under the chairmanship of NK Singh. Its recommendations will cover a period of five years from the year 2021-22 to 2025-26. The government accepted the 15 Finance Commission's recommendation to maintain the States' share in the divisible pool of taxes to 41% for the five-year period starting 2021-22.

Target for the states-Fiscal deficit as % of Gross State Domestic Product (GSDP)

- 4% in 2021-22
- 3.5 % in 2022-23
- 3.0% in 2023-26

The Table-1 and Chart -1 clearly showed that the Gross Fiscal Deficit as per cent of GSDP was 2.6 in 2010-11 and it was high in 2019-20 as 6.5%. Still it was 4.6 in 2020-21 which alarm the State to fulfill the Fiscal target set by the 15th Finance Commission. In Revenue deficit also the state is lag behind to have surplus revenue which is shown in the above table.

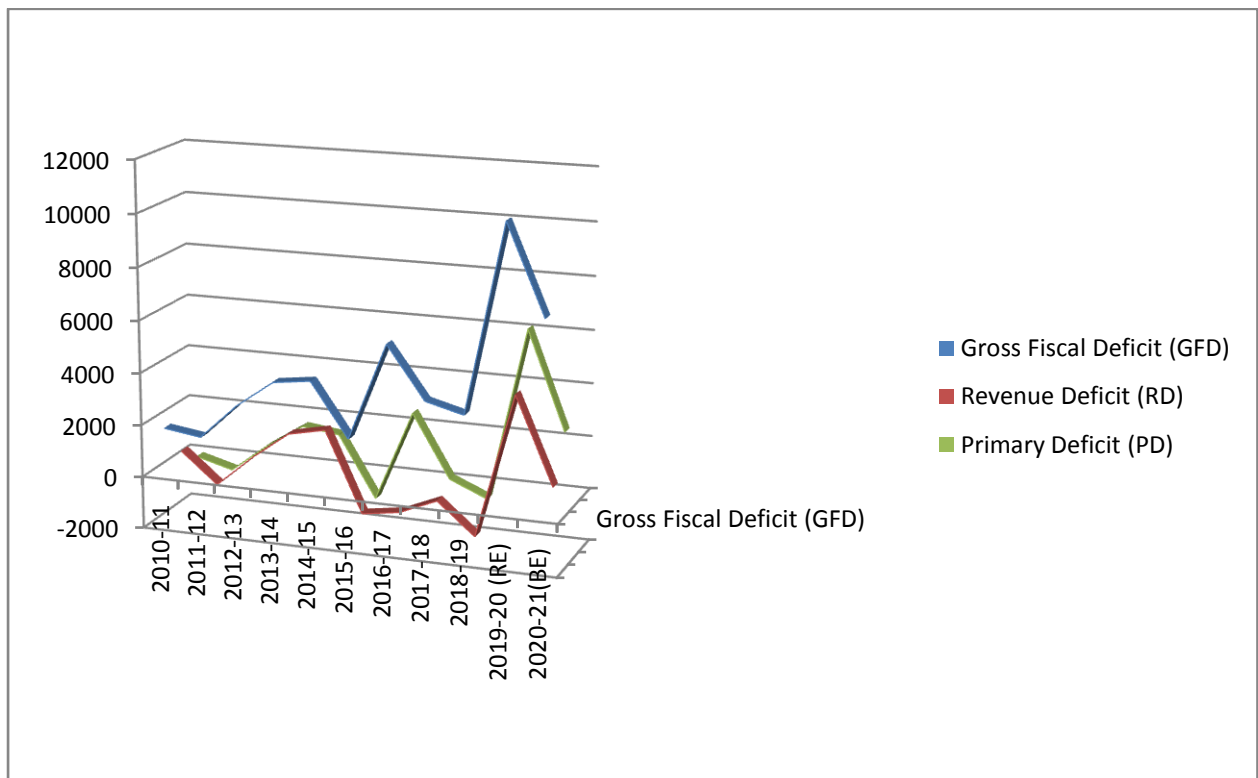
Table -1
Fiscal Indicators of Himachal Pradesh

(Rs in Crore)

Years	Gross Fiscal Deficit (GFD)	Revenue Deficit (RD)	RD as % of GFD	Primary Deficit (PD)	PD as % of GFD	GFD as % GSDP
2010-11	1833	535	29	-117	-6	2.6
2011-12	1633	-645	-39	-497	-30	2.2
2012-13	2978	576	19	609	20	3.6
2013-14	4012	1641	41	1531	38	4.2
2014-15	4200	1944	46	1351	32	4.0
2015-16	2164	-1138	-53	-991	-46	1.9
2016-17	5839	-920	-16	2480	42	4.6
2017-18	3870	-314	-8	82	2	2.8
2018-19	3500	-1522	-43	-522	-15	2.3
2019-20 (RE)	10626	4007	38	6076	57	6.5
2020-21(BE)	7272	684	9	2340	32	4.6

Source: Hand book of Statistics on Indian Economy, RBI, 2020-21

Chart -1
Fiscal Indicators of Himachal Pradesh



5.2 Fiscal Federal transfers to States

The data in Table-2 indicates that the over-dependence of the State of Himachal Pradesh on central transfers for meeting its expenditure commitments has continued to deepen further even after the implementation of the recommendations of the Fourteenth Finance Commission. As a trend, it does not bode well for the State. Instead of gaining fiscal strength to fend for itself, it has continued to lean further on the central transfers to meet its committed revenue expenditure because its capacity to raise revenues has continued to shrink

Table-2
Gross Devolution and Transfers (GDT) to Himachal Pradesh
(Rs in Crore)

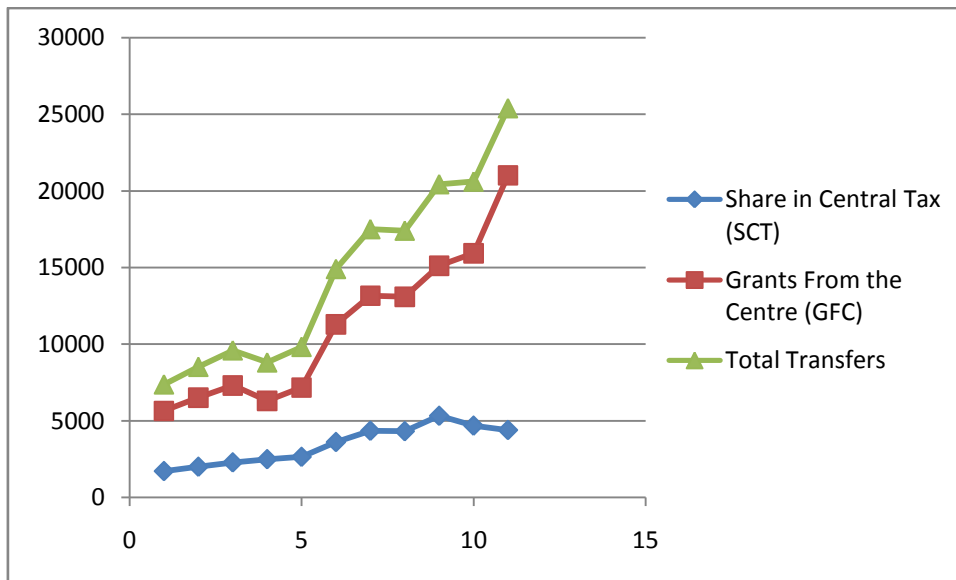
Years	Share in Central Tax (SCT)	SCT as % of Total transfers	Grants From the Centre (GFC)	GFC as % of Total transfers	Total Transfers	Total transfers as % Total Revenue Receipts
2010-11	1715	23	5658	77	7373	58
2011-12	1998	23	6521	77	8519	59
2012-13	2282	24	7313	76	9595	62
2013-14	2492	28	6314	72	8806	56
2014-15	2644	27	7178	73	9822	55
2015-16	3611	24	11296	76	14907	64
2016-17	4344	25	13164	75	17508	67
2017-18	4316	25	13094	75	17410	64
2018-19	5323	26	15118	74	20441	66
2019-20 (RE)	4678	23	15935	77	20613	67
2020-21(BE)	4394	17	21009	83	25403	69

Source: Budget Document of Various years, RBI
Statistical year book of Himachal Pradesh (2020-21)

Since the above data includes certain transfers from the Central Government which are in the nature of State's share in central taxes, a better appreciation will emerge if one looks at the transfers from Centre by way of grants of different shades and nomenclature. The data from 2010-11 to 2020-21 has been included in the table more for historic purposes. The data from 2015-16 onwards represents the current reality. It becomes clear that after the implementation of the award of the Fourteenth Finance Commission, the grants through the award of the Finance Commission account for two-third of all the grants from Centre, the remaining one-third being the grants from the Centre through the centrally sponsored

schemes. Also, the other grants from the Finance Commission are a minute fraction of the total grants.

Chart-2
Gross Devolution and Transfers (GDT) to Himachal Pradesh



Tax devolution for Himachal Pradesh, as per the recommendation of 15th Finance Commission, is 81,977 crore for the next 5 years that is from 2021-26 . 0.83 of total tax devolution out of 42.2 lakh crore i.e. 37,199 crore is as revenue deficit grant.

5.3 Revenue Deficit status of Himachal Pradesh

Almost all the grants from the Finance Commission are by way of the revenue deficit grants. It is safe to presume that even in future, the tax share of Himachal Pradesh will remain a small devolution, and the larger part of transfers will have to be through the revenue deficit grants. It seems imperative that the mechanism of revenue deficit grants needs to be strengthened and institutionalized for the fiscally weak mountain States in the philosophy of the Finance Commissions for future.

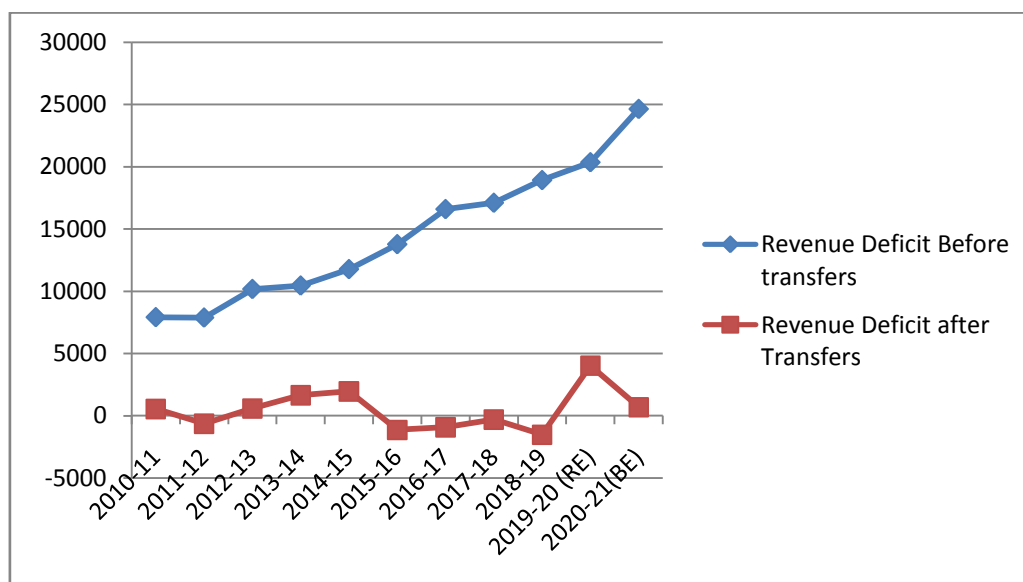
Table-3 and Chart-3 shows that the revenue deficit still exists even after the transfers from Centre except 3-4 years. So the revenue generation of Himachal Pradesh is weak to get revenue surplus rather than revenue deficit.

Table-3
Revenue Deficit Before transfers and After Transfers (Himachal Pradesh)
(Rs in Crore)

Years	Total Revenue	Total Transfers from the Centre	State's Own Revenue	Revenue Deficit Before transfers	Revenue Deficit after Transfers
2010-11	12710	7373	5337	7909	535
2011-12	14542	8519	6023	7875	-645
2012-13	15598	9595	6003	10171	576
2013-14	15712	8806	6906	10446	1641
2014-15	17843	9822	8021	11766	1944
2015-16	23440	14907	8533	13770	-1138
2016-17	26264	17508	8756	16588	-920
2017-18	27367	17410	9957	17096	-314
2018-19	30951	20441	10510	18919	-1522
2019-20 (RE)	30990	20613	10377	20353	4007
2020-21(BE)	36903	25403	11500	24634	684

Source: Study on State Finances, RBI bulletin of different years
 Statistical Year book of Himachal Pradesh (2020-21)

Chart-3
Revenue Deficit Before transfers and After Transfers



5.4 Revenue Receipts of the State

Government receipts can broadly be divided into non-debt and debt receipts. The non-debt receipts consist of tax revenue, non-tax revenue, grants-in-aid, recovery of loans and disinvestment receipts. Debt receipts mostly consist of market borrowings and other liabilities, which the government is obliged to repay in the future.

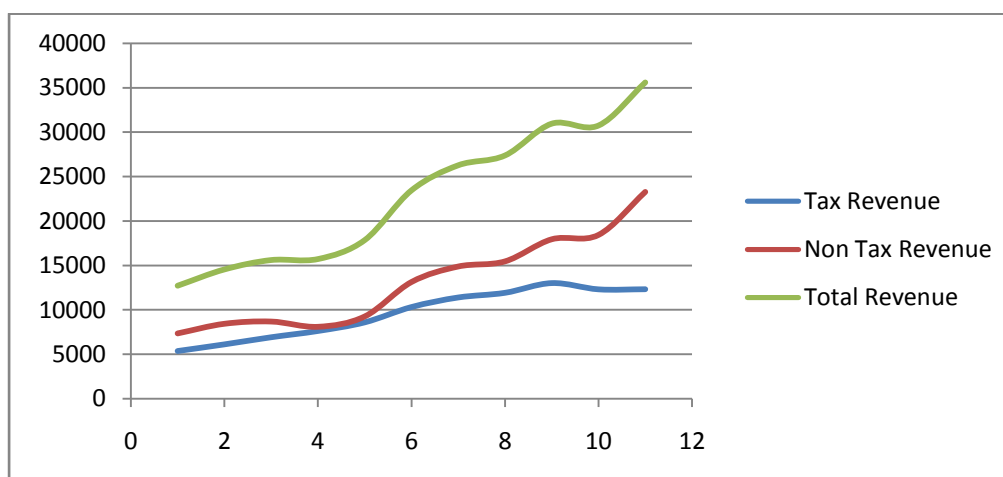
Table-4
Revenue Receipts of Himachal Pradesh

(Rs in Crore)

Year	Tax Revenue	% to Total Revenue	Non Tax Revenue	% to Total Revenue	Total Revenue
2010-11	5358	42	7353	58	12711
2011-12	6106	42	8437	58	14543
2012-13	6908	44	8690	56	15598
2013-14	7612	48	8099	52	15711
2014-15	8584	48	9259	52	17843
2015-16	10307	44	13134	56	23440
2016-17	11383	43	14882	57	26264
2017-18	11909	44	15458	56	27367
2018-19	13003	42	17948	58	30950
2019-20 (RE)	12301	40	18437	60	30738
2020-21(BE)	12312	35	23277	65	35588

Source: Annual Financial Statement (Budget), Government of Himachal Pradesh

Chart-4
Revenue Receipts of Himachal Pradesh



The above data and Chart reveals that the relative shares of the tax and non-tax revenues of the State have shown extremely erratic trend over the study period. For the year 2010-11, the tax revenues accounted for 42 per cent of the total revenues of the State and the non-tax revenues constituted 58 per cent of the total. For the year 2020-21, the corresponding shares were of the order of 35 per cent and 65 per cent, respectively. The component analysis subsequently will reveal that the villain of the piece is the non-tax revenue from the power sector. It is, therefore, difficult to perceive any trend in the shares of the tax and non-tax

revenues at an overall level and use such trend for future forecasting. the quantum increases in the non-tax revenues witnessed over the study period is undoubtedly attributable to the introduction of tax reform by enlarging the tax base. Whether such a significant and sustained increase would materialize after the implementation of the goods and services tax, is a big question which is difficult to be answered at this stage.

5.4.1 Tax Revenue

According to Budget Estimates of 2020-21, the tax revenue (including central taxes) was estimated at 35588 Crore. Major point to be noted that the State' Own Tax Revenue has been decreased in the study period whereas Share in Central Tax is very high.

Table-5
Categories of Tax Revenue (Himachal Pradesh)

(Rs in Crore)

Year	State's Own Tax Revenue (SOTR)	SOTR % to Total Tax Revenue	Share in Central Tax	SCT % to Total Tax Revenue	Total Tax Revenue	GSDP	Tax GSDP Ratio
2010-11	5358	42	7353	58	12711	69432	8
2011-12	6106	42	8437	58	14543	72720	8
2012-13	6908	44	8690	56	15598	82820	8
2013-14	7612	48	8099	52	15711	94764	8
2014-15	8584	48	9259	52	17843	103772	8
2015-16	10307	44	13134	56	23440	114239	9
2016-17	11383	43	14882	57	26264	125634	9
2017-18	11909	44	15458	56	27367	138551	9
2018-19	13003	42	17948	58	30950	149442	9
2019-20 (RE)	12301	40	18437	60	30738	162816	8
2020-21(BE)	12312	35	23277	65	35588	156522	8
CAGR	9.5		12.3		11.2		

Source: Excise and Taxation Department, Government of Himachal Pradesh
Annual Financial Statement (Budget), Government of Himachal Pradesh.

Note : CAGR-Compound Annual Growth Rate

In the year 2010-11, State's Own Tax Revenue was 42 per cent of the total tax revenue gradually it was lowered to 35 per cent of total revenue except two years i.e.2013-14 and 2014-15. The data reveals that the share of Central tax has been continuously increased from 58 per cent of total tax to 65 per cent of total tax revenue which is estimated for the year 2020-21. So the proportion of transfers in case of tax is also high for the State of Himachal Pradesh.

Tax: GSDP Ratio

The tax to GSDP ratio for the study period has ranged between 5.5 % to 6.5 %. The normative expectation of the 14th Finance Commission of attaining an 8% ratio has been achieved. Another thing is, 14 per cent growth rate in tax revenue of the State was suggested but it was able to reach only at 11 per cent.

5.4.2. Non-Tax Revenue

Non-Tax Revenue consists mainly of Own Tax Revenue and Grants From the Centre and sub components such as interest receipts on loans, receipts from sale of power, dividends and profits from public sector undertakings and receipts from services provided by the Government like general services such as those provided by the Public Service Commission,

Table-6
Major Components of Non-Tax Revenue (Himachal Pradesh)

(Rs in Crore)

Year	State's Own NonTax Revenue (SONTR)	SONTR % to Total Non-Tax Revenue	Grants from the Centre	GFC % to Total Non-Tax Revenue	Total Non-Tax Revenue	NTR as % of GSDP
2010-11	5358	42	7353	58	12711	8
2011-12	6106	42	8437	58	14543	8
2012-13	6908	44	8690	56	15598	8
2013-14	7612	48	8099	52	15711	8
2014-15	8584	48	9259	52	17843	8
2015-16	10307	44	13134	56	23440	9
2016-17	11383	43	14882	57	26264	9
2017-18	11909	44	15458	56	27367	9
2018-19	13003	42	17948	58	30950	9
2019-20 (RE)	12301	40	18437	60	30738	8
2020-21(BE)	12312	35	23277	65	35588	8
CAGR	9.5		12.3		11.2	

Source: Source: Excise and Taxation Department, Government of Himachal Pradesh
Annual Financial Statement (Budget), Government of Himachal Pradesh.

Note : CAGR-Compound Annual Growth Rate

social services such as health and education, economic services such as irrigation etc. The non-tax revenue is likely to increase to ₹ 12,312 crore in 2021-22 Budget estimates. This is estimated to be 8.0 per cent of State GSDP. It is revealed from the above table that in case of Non-Tax Revenue also, Grants from the Centre has lion share. In the year 2020-21, State's Own Non Tax Revenue share in the total NTR was 35 Per cent which is for behind the contribution of Grants from the Centre about 65 per cent in the Total Non Tax Revenue. And

the Non-tax GSDP ratio of Own NTR was 8%. Again the State has to generate the Non-Tax Base also to make tax effort efficiently.

5.4.3 Revenue Expenditure Scenario

The below table explains the Per Capita Revenue, Expenditure and Revenue-Expenditure ratio of Himachal Pradesh. It's a unhealthy scenario for the State regarding contribution of the Own revenue in State's Total Expenditure which is proved from the Table-7. In the year 2010-11 the Ratio of Own Revenue to Total Expenditure was 40% which was gradually move downward to 32 % in 2020-21. So this is the indication for the State to consolidate the Fiscal parameters as early as possible.

Table-7
Per Capita Revenue and Per Capita Expenditure (Himachal Pradesh)
(in Rs)

Years	Per capita Revenue Receipts Before transfers	Per Capita Revenue Receipts After Transfers	Per Capita Revenue Expenditure	Own Revenue to Total Expenditure Ratio (in %)
2010-11	7783	18,537	19,318	40
2011-12	8675	20,946	20,017	43
2012-13	8536	22,178	22,998	37
2013-14	9695	22,057	24,361	40
2014-15	11100	24,693	27,383	41
2015-16	11659	32,027	30,472	38
2016-17	11812	35,430	34,189	35
2017-18	13258	36,441	36,023	37
2018-19	14397	42,398	40,313	36
2019-20 (RE)	16700	44,001	49,455	34
2020-21(BE)	16837	51,978	52,903	32

Source: Hand book of Statistics on Indian Economy, RBI, 2020-21

6. Suggestions for enlarging revenue base

Processing facilities: Some of the crops such as Maize and Peas are in abundance. These are generally sold informally to traders who take it to the market and sell it at higher prices. One of the options can be to set up a food processing plant because the raw materials (Pea and Maize) are available very easily and the processing plant will get it at a lower price.

Abundant water: Though the water is found in abundance, there are no processing plants situated in the area. One of the options could be to set up a 'Bottling plant' which can be supplied to a different part of the country by setting up a proper distribution channel.

Tourism can be one of the revolutionary moves for the region. Chamba is still not known for its tourism, but a dedicated effort can make it become a hub for the tourists.

Processing of fallen apples: The fallen apples can be processed easily to make *Jam* and *Jelly*. The cost of setting processing plant for *Jam* and *Jelly* is very low and can be done at the household level.

Maize processing: As maize is found in abundance, this can be used for making cornflakes, which has a very high market value. However, the cost of the machine is high, but the government can take steps to attract private investments to set up the plant.

Non-tax revenues of the State will be expected to rise in tandem with the additional capacity installation of hydro-electric installations which are in pipe line as the State will get free power in a progressive manner.

7. Conclusion

Reforms in the Indian Economy are a continuing process. Various Ministries and Departments are implementing Government's strategic programs and policies to enhance economic growth. Government is using a bottom-up approach in the process of preparation of an economic policy that best meets the needs of our society. The COVID-19 pandemic engendered a once-in-a-century global crisis in 2020. Faced with unprecedented uncertainty at the onset of the pandemic.

Government of Himachal Pradesh has initiated several measures for speedy progress in the quality of life for people of the State through efficient policies and cooperation with Central Government. Himachal has a vibrant economy due to steady efforts of the hardworking people of the State and by the implementation of progressive policies and programmes of the Central and State Government. Himachal has become a fast growing economy. In order to maximize the own revenue base the State has to take care of the above said issues and challenges.

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