The Review of Compliance to Sikkim FRBM Act – 2012-13

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1. Introduction

The Sikkim Fiscal Responsibility and Budget Management Act (FRBM), 2010 provides for an independent review/monitoring of compliance of the implementation of the FRBM Act. The FRBM Act of the State stipulates fiscal targets in terms of deficit and debt stock relative to the State GSDP as the benchmarks for a rule based fiscal management system to attain fiscal stability and sustainability. The Act is in line with the fiscal adjustment path recommended by the Thirteenth Finance Commission (TFC) for Sikkim limiting the fiscal deficit at the targeted level to ensure sustainable level of debt. The Act also calls upon the Government to improve transparency, and follow the desirable fiscal management principles. The fiscal management principles enshrined in the Act aimed at maintaining debt stock at a sustainable level, using borrowed funds for productive use, pursuing tax policies with due regard to economic efficiency, pursuing expenditure policies to provide impetus to economic growth, and to formulating a realistic budget to minimize deviations during the course of the year.

As the State has a limited resource base and high dependence on central fund for provision of public services in a difficult hilly terrain, a prudent fiscal management is necessary. The FRBM Act with its stated objective to set up a sustainable fiscal policy over a long-run can improve the predictability of resource flow for the provision of physical and social infrastructure. This will also help the State Government to establish an enabling environment for investments and creation of employment. Thus assessing the progress of the State Government in achieving the provisions enshrined in the FRBM Act is essential for the fiscal management of the State.

An independent review has remained as an important element of public financial management requirements for effective fiscal responsibility legislation. The FRBM Act, through the provision of independent review and monitoring, provides an institutional process to assess the fiscal management of the State Government keeping in view the statutory fiscal targets and fiscal management principles. This is a desirable feature of the Act, which improves the credibility and transparency of the fiscal management of the Government. An independent review of fiscal policy and fiscal rule achievements also improves the integrity of the outcome of the fiscal policy. It helps in providing an unbiased assessment of Government's compliance with the provisions of the fiscal rules and reasons for deviations.

The State Government entrusted the responsibility of reviewing the compliance of the Act for the year 2012-13 to the National Institute of Public Finance and Policy (NIPFP), New Delhi. This review report evaluates the fiscal trends achieved during the year 2012-13 as against the budget projections contained in the rolling fiscal targets worked out in the Medium Term Fiscal Policy (MTFP) presented along with the budget. The report also assesses the desired fiscal management principles contained in the FRBM Act of the State to achieve the fiscal targets and transparency measures.

The report has analyzed the macroeconomic outlook and recent trends of public finance including revenue generation, expenditure framework, and the debt burden to assess the compliance of the State Government to the provision made in the FRBM Act. The fiscal targets and achievements for the year 2012-13 are reviewed and an assessment has been made regarding the desired fiscal management principles. The reports also assess the spending pattern of the State Government for the year 2012-13 under revenue and capital heads. Senior officials of the Department of Finance provided overall perspective on the State fiscal management including revenue mobilization efforts and the rationale behind resource allocations to different sectors. While Commercial Tax department provided inputs on tax realization during the year, the spending departments shared their views on expenditure trends and priorities.

The report is organized as follows. Section 2 provides an overall assessment of macroeconomic outlook and sectoral composition of GSDP. The section 3 contains analysis on state finances in recent years. Compliance of the State Government to the fiscal targets and fiscal management principles under the Sikkim FRBM Act are covered in section 4. Issues related to revenue mobilization and expenditure pattern for the year 2012-13 as compared to the budget provisions are analyzed in Section 5. Concluding observations are contained in Section 6.

2. Macroeconomic Outlook

The State has achieved significant growth of the economy in recent years. The per capita income of the state, which was Rs.30727 in 2004-05, has increased substantially to Rs.168112 in 2012-13 at current prices.The State GSDP at constant prices grew at the rate of 7.62 percent in 2012-13, after registering a higher growth of 10.76 percent in the previous year (Table 1). The State economy, however, showed very high growth during 2008-09 and 2009-10. The average annual growth rate over the period 2005-06 to 2012-13 at current prices was staggering 26 percent. The spurt in growth of the State GSDP was driven by manufacturing, construction, and power sectors. The relative share of service sector, which was the dominant contributor to the growth of GSDP since 2004-05, declined in the recent years. The relative share of primary sector has been declining over the years and the share of mining and quarrying activities remained very small. The agriculture however, has shown improvement during 2011-12 and 2012-13.

Table 1

Composition of GSDP (Constant Prices)

(Percent)

Sector	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
Primary Sector	**18.71**	**17.74**	**16.76**	**16.18**	**14.56**	**8.74**	**8.44**	**10.56**	**10.09**
Agriculture	18.59	17.63	16.65	16.07	14.40	8.65	8.34	10.42	9.89
Mining	0.12	0.11	0.11	0.11	0.15	0.10	0.10	0.14	0.20
Secondary Sector	**28.72**	**29.25**	**29.54**	**30.18**	**34.94**	**55.03**	**59.12**	**59.06**	**59.57**
Manufacturing	3.86	3.60	3.66	3.90	3.65	28.44	37.15	37.98	35.37
Construction	19.23	19.86	19.44	18.69	15.52	9.91	9.36	10.79	13.85
Electricity, gas and Water supply	5.62	5.78	6.44	7.59	15.76	16.69	12.61	10.28	10.35
Tertiary Sector	**52.58**	**53.01**	**53.70**	**53.64**	**50.51**	**36.22**	**32.44**	**30.39**	**30.34**
Transport	4.12	4.18	4.38	4.55	4.46	2.94	2.82	2.89	3.05
Trade, hotels and restaurants	5.19	4.84	4.62	4.51	4.07	2.43	2.35	2.74	2.64
Banking, Insurance	2.58	2.95	3.59	4.04	3.64	2.60	2.94	2.87	3.00
Real estate	9.99	9.38	9.19	9.94	9.49	5.60	5.36	5.16	4.99
Public Admin	14.60	15.14	15.52	14.79	14.15	11.72	9.85	8.87	9.16
Other services	16.09	16.52	16.41	15.81	14.70	10.93	9.13	7.86	7.49
Growth Rate									
Constant Prices		9.79	5.99	7.63	16.38	73.61	8.71	10.76	7.62
Current Prices		14.59	8.45	15.96	28.85	89.92	20.85	20.17	17.58

Source: CSO, GoI

The growth of the economy and its relative composition is an important factor to assess the revenue generation effort of the State Government. The manufacturing, construction, and power sectors contributed significantly to the growth of the State economy. The commissioning of hydropower projects, strengthening of small-scale industries and pharmaceutical industries helped the growth process. While agriculture sector is usually out of the tax net, the growing manufacturing sector should positively help in improving the tax effort. The sectors growing rapidly and contributing to growth process should have contributed to the revenue collection of the State Government. Some of the sectors included in the service sector like transport and transactions in real estate provide a tax base to the Government. However, collection of service tax is in the hand of the Central government, out of which the State gets a share.

3. Overview of the State Finances

State finances in Sikkim have remained healthy since the adoption of FRBM Act in 2010-11 with revenue account surpluses and fiscal deficits remaining below the permissible level prescribed in the Act (Figure 1). The introduction of FRBM Act provided the rule based fiscal management with defined deficit and debt targets. The fiscal deficit has declined from 4.27 percent relative to GSDP in 2010-11 to2.02 percent in 2011-12 and further to **0.63 percent in 2012-13**. The surplus in the revenue account, which declined from 8.42 percent relative to the GSDP in 2009-10 to 1.89 percent in 2010-11, has increased to **7.46 per cent in 2012-13**. The high revenue surplus in 2012-13 helped in reducing the fiscal deficit considerably.

The fiscal outcomes for the State reveal that the overall fiscal balances should not cause any worry for the Government of Sikkim.The fiscal consolidation, by creating fiscal space for the Government, provides flexibility to pursue the resource allocation decisions to priority areas. The surpluses/deficits, resulting in a variety of ways, needs to be analyzed keeping the underlying fiscal variables in consideration. Particularly the expenditure and revenue trends both at broad and decomposed levels need to be looked into to get a realistic idea of the implications of the observed fiscal stance of the Government.

Figure 1
Fiscal Outcomes in Sikkim

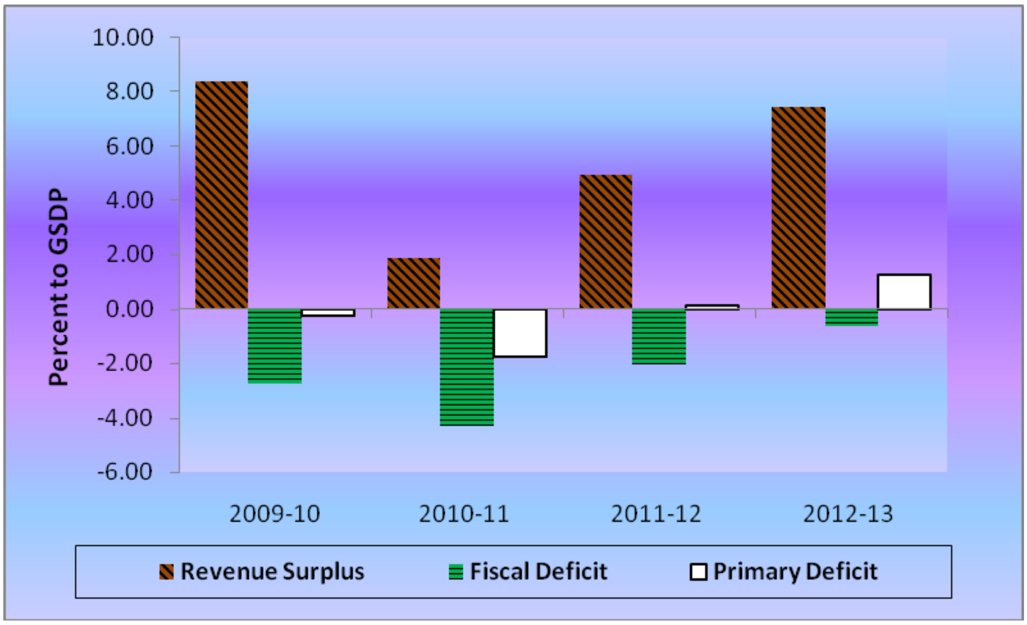
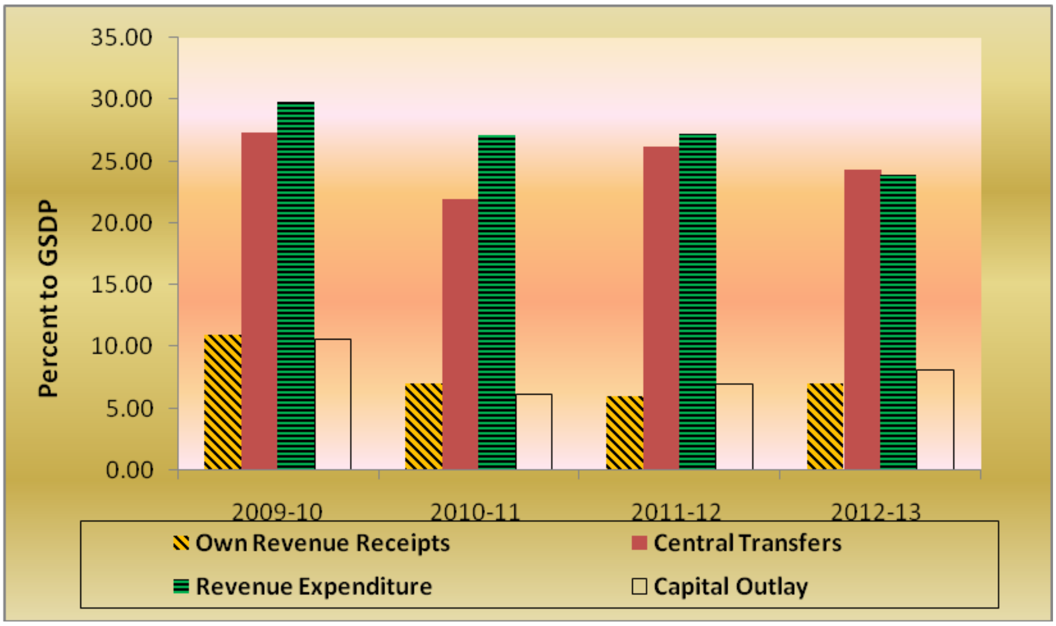


Figure 2 depicts the trends in own revenue receipts, central transfers, revenue expenditures and capital outlay (on general, social and economic services together). It shows that the own revenue of the State, both tax and non-tax receipts taken together declined from 11 percent of GSDP in 2009-10 to about 6 percent in 2011-12 and **increased to 7 percent in 2012-13**. The Central transfer that includes both the share in Central taxes and grants, to the State shows a declining trend during this period. The **aggregate Central transfers declined from 27.3 percent in 2009-10 to 24.4 percent in 2012-13** as percentage of GSDP. Given this resource position, the State Government seems to have tightly controlled the revenue expenditure. **The revenue expenditure declined from 29.8 percent in 2009-10 to 23.9 percent in 2012-13 relative to the GSDP**. Similarly, the **capital outlay also suffered a decline during this period**. The capital outlay as percentage of GSDP came down from 10.57 percent in 2009-10 to 6.91 percent in 2011-12 before **increasing to 8.04 percent in 2012-13**. The deteriorating resource position led the State government to control the revenue expenditure and reduce the budget provision for capital outlay. The rise in revenue receipts in 2012-13 and strict control over revenue expenditure helped the state Government to improve the revenue surplus. This has facilitated increasing the capital outlay in 2012-13 by 1.13 percentage points as compared to the previous year.

Figure 2
Broad Fiscal trends in Sikkim



While during the post FRBM Act period, the State continued with fiscal consolidation, the own revenue as percent of GSDP declined until 2011-12 before rising by about one percentage point in 2012-13 (Table 2). The trend of revenue receipt figures reveal that own tax receipt of the State has increased as percent of GSDP. It has increased from 3.6 percent in 2009-10 to 4.2 percent in 2012-13. It was the declining non-tax revenue that contributed to the slide in own revenue receipts.The nontax revenue in Sikkim contains large contributions from lottery operations and sale of electricity as the State Government manages the power sector through a department. These sources have become volatile in recent years. Particularly, the income from lottery operations has declined due to adverse market conditions and unfavorable policies by other State Governments.

While, the sales tax collections have remained more or less static at around 2 percent of GSDP for the year 2009-10 to 2010-11, it plunged to 1.4 percent in 2011-12 before **rising to 2.2 percent in 2012-13**. State excise duty and motor vehicle tax show improvement as percentage to the GSDP. The collection from stamps and registration fees remained static at 0.1 percent of the GSDP and other tax show an increase in 2012-13. **What is important in the context of Sikkim is the low buoyancy of the State taxes. The State taxes have not kept pace with the growing economy over the years**.

The Statements of Medium term Fiscal Policy (MTFP) of the State of the past years presented along with the budget acknowledge that the buoyancy coefficients for the State taxes remained low suggesting that the growth of taxes has fallen behind the growth of the GSDP. Probably the pattern of growth in the State has not helped expanding the tax base. **The sectors, electricity, and manufacturing, growing rapidly and contributing to growth process have not contributed to tax revenues**. **Although the value of the electricity generated by the newly commissioned hydroelectric units contributes to the growth numbers, it does not enlarge the tax base. Similarly, the improved production by the pharmaceuticals in the manufacturing sector, though adds to the growth, most of it goes out of the State in the form of consignments attracting no VAT. However, the expanded economic activity due to the construction and higher employment in these sectors, and rise in business should have resulted in higher tax collection beyond the normal growth. It is necessary for the State to look into these issues to improve the tax mobilization.**

Table 2
Revenue Receipts in Sikkim

Percent of GSDP

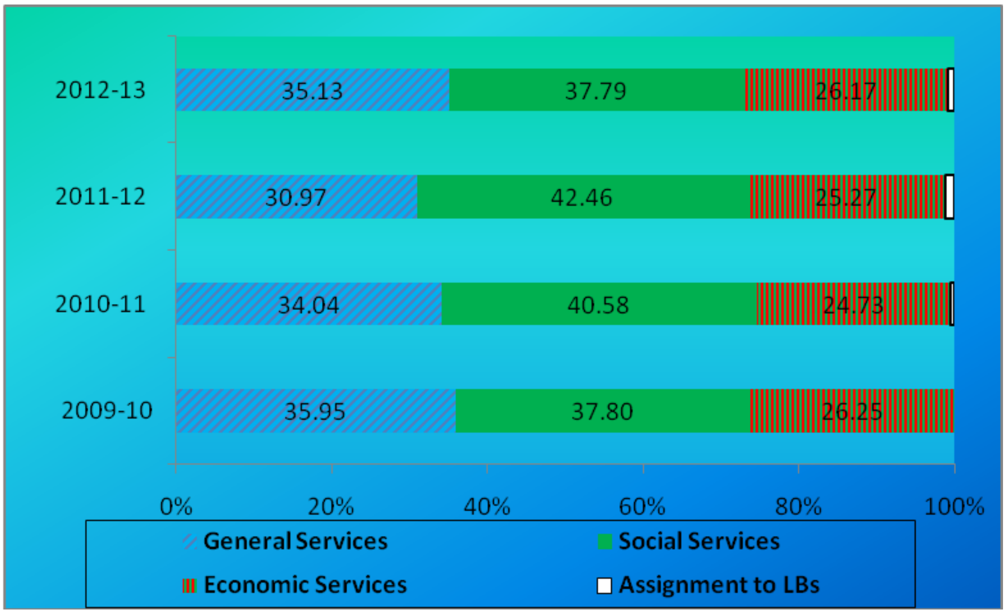
	2009-10	2010-11	2011-12	2012-13
Total Revenue Receipts	**38.2**	**29.0**	**32.2**	**31.4**
Own Revenue Receipts	**10.94**	**7.04**	**6.04**	**7.04**
Own Tax Revenues	**3.6**	**3.8**	**3.3**	**4.2**
Sales Tax	2.0	1.9	1.4	2.2
State Excise Duties	0.9	1.0	1.1	1.1
Motor Vehicle Tax	0.1	0.1	0.2	0.2
Stamp Duty and Registration Fees	0.1	0.1	0.1	0.1
Other Taxes	0.5	0.7	0.5	0.7
Own Non-Tax Revenues	**7.3**	**3.3**	**2.7**	**2.9**
Central Transfers	**27.3**	**22.0**	**26.2**	**24.4**
Tax Devolution	6.1	7.1	6.9	6.7
Grants	21.2	14.9	19.3	17.7

Source (Basic Data): Finance Accounts, State Budget 2014-15, and CSO

On an average the central transfers constitutes little more than three fourths of the total State revenues. High dependency of the State on Central funds implies severe distortions in the resource allocation in case there is any deviation from the budget estimates. Although the central transfer has increased from Rs.1674.30 crore in 2009-10 to Rs.2550.88 crore in 2012-13 in nominal terms, it has remained a volatile source of revenue for the State. As percentage of GSDP, the Central transfer has declined from 27.3 percent to 24.4 percent during this period. While the share in Central taxes has increased relative to the GSDP, the grants from Centre have declined considerably. Despite the decline in Central transfer as percentage of GSDP, the transfer dependency of the State has not declined due to the subdued revenue effort over the years.

As the public expenditure is dominated by the revenue expenditure, which has declined in recent years, its composition needs to be analyzed to examine the resource allocation to different sectors. The composition of revenue expenditure, given in Figure 3, shows that the relative shares of directly productive social and economic sectors increased until 2011-12. While the share of economic sector continued to rise in 2012-13, the share of social sector shrunk. The share of general service, however, increased in 2012-13 as compared to the previous years. **It is important for the Government of Sikkim to focus on directly productive social and economic sectors so that the overall composition of revenue expenditure adds value to the public expenditure.**

Figure 3
Composition of Revenue Expenditure in Sikkim



Composition of revenue expenditures can also be examined from the point of view expenditures that are contractual, committed, and pre-determined in nature. Higher share of committed expenditure in total revenue expenditure reduces the discretionary expenditure on providing public services and limits the degree of flexibility available to the government in determining allocation of public expenditures. The committed expenditure in Sikkim, while declining in 2011-12 over 2010-11, increased in 2012-13 due to higher salary and pension payments.

Table 3
Committed Revenue Expenditure in Total Revenue Expenditure

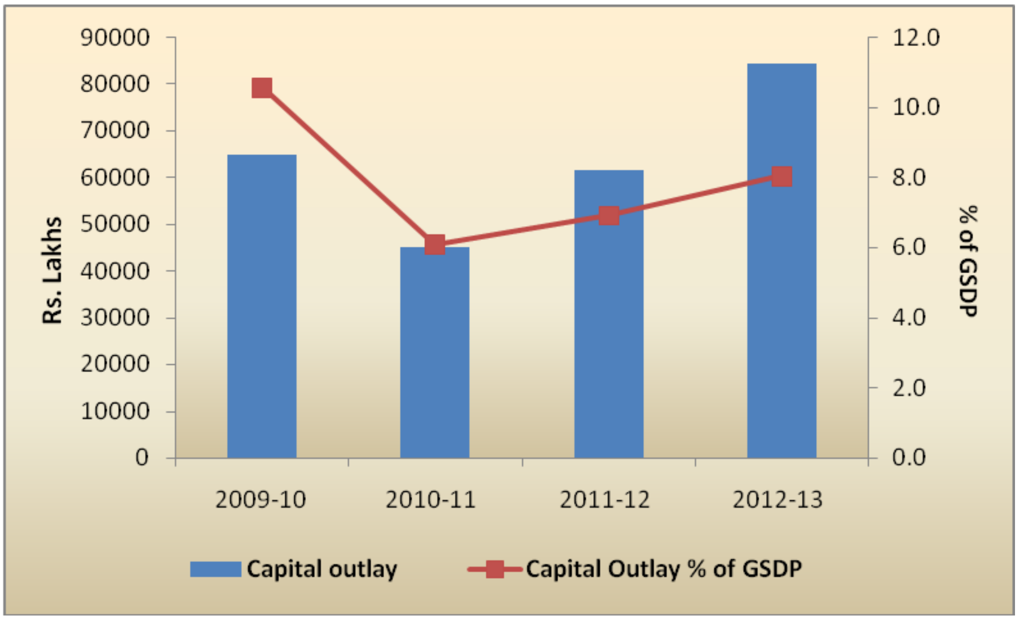
(Percent)

	2009-10	2010-11	2011-12	2012-13
Salaries	54.05	55.55	44.08	47.29
Interest payment	8.44	9.28	7.85	7.93
Pension	6.88	7.96	7.15	8.98
Total	69.37	72.79	59.08	64.21

Source (Basic Data): Finance Accounts and State Budget 2014-15

The Capital outlay on various services (general, social, and economic) in the State has remained reasonably high (Figure 4). Although as percentage of GSDP, it came down from 10.6 percent in 2009-10 to 6.1 percent in 2010-11, it continued to increase after that and reached at 8 percent in 2012-13. In nominal terms, the capital outlay has almost doubled during 2010-11 to 2012-13. Public capital expenditures of the right kind have a major role to play in stimulating the rate of growth of the state economy. It contributes to growth more directly and it is a somewhat positive development that the share of capital outlay has registered an increase in recent years. There was scope for pushing this up, as the fiscal deficit in 2012-13 was very low as compared to the FRBM Act targets. The State government should finance identified public investments with high social returns.

Figure 4
Capital outlay in Sikkim



The indebtedness of the Government of Sikkim has declined significantly over the years (Table 4).Taking all types of liabilities, the **total stock decreased from 37.4 percent of GSDP in 2009-10 to 26.34 percent in 2012-13**, with indebtedness falling consistently every year throughout the period. FRBM Act of the state stipulates to maintain the outstanding debt at prudent and sustainable level. The decline in the average cost of debt of the state because of the debt restructuring formula of the Twelfth Finance Commission has helped to lowering the debt burden. As the State Government managed to adhere to the FRBM Act targets for the fiscal deficit and reducing the fiscal deficit to 0.6 percent of GSDP in 2012-13, the debt burden has reduced significantly. The aggregate level of indebtedness in 2012-13 indicates that the State Government complied with the TFC recommendations and its own FRBM targets.

Table 4
Liabilities of the Government of Sikkim

(Percent of GSDP)

	2009-10	2010-11	2011-12	2012-13
A.Public Debt	**29.21**	**24.47**	**20.80**	**18.89**
Internal Debt of the State Government	24.62	20.96	19.03	17.46
Loans and Advances from the Central Government	4.59	3.51	1.76	1.42
B.Other Liabilities	**8.17**	**8.32**	**7.87**	**7.45**
Small Savings, Provident Fund etc	6.71	6.88	6.50	5.96
Reserve Fund	0.39	0.28	0.21	0.13
Deposits	1.07	1.15	1.16	1.36
Total Public Debt & Other Liabilities	**37.39**	**32.78**	**28.66**	**26.34**

Source (Basic Data): Finance Accounts, Relevant Years

4. Compliance to the FRBM Act Targets: 2012-13

4.1 FRBM Targets and Fiscal Achievements of the State Government

The objective of this review report is to assess fiscal achievement of the State Government for the year 2012-13 while complying with the statutory fiscal targets made in the FRBM Act and review the fiscal management principles enshrined in the Act. The FRBM Act calls upon the State to ensure fiscal stability and sustainability through maintaining balance in revenue account and planned reduction of fiscal deficit and prudent debt management. The major provisions of the Sikkim FRBM Act are as follows;

- Present a Medium Term Fiscal Plan (MTFP)

- Undertake appropriate fiscal management principles indicated in the Act to achieve the targets
- Achieve fiscal targets relating to deficit, stock of debt, and outstanding guarantees.
- Take suitable measures to ensure greater transparency in the fiscal operation.

Presenting the medium term fiscal plan (MTFP) in the State legislature along with the budget and achieving the fiscal targets stipulated in the FRBM Act are statutory provisions.The rules to the FRBM Act details the fiscal transparency measures, which are disclosures on fiscal operations and data and information to be given along with the budget to ensure greater transparency. Fiscal management principles enshrined in the FRBM Act are guiding principles to conduct the fiscal policy in the State to facilitate achievement of the required fiscal targets.

The medium term fiscal plan statement presents the fiscal stance of the State Government with respect to fiscal targets for the ensuing year, revenue generation efforts, expenditure plan, and consequent borrowing requirements. The objective of MTFP is to provide the fiscal plan of the Government to raise the revenues, resource allocation priorities, and borrowing plan for the ensuing year in a transparent way. This statement contains three-year rolling targets for revenue deficit, fiscal deficit, and the debt-GSDP ratio – for the ensuing year, and for two subsequent years synchronizing with the Act provisions. It also contains medium-term fiscal objectives, perspective on the growth of the State economy, the strategic priorities for revenues and expenditures, and the conformity of the fiscal outlook of the Government with the fiscal principles enshrined in the Act. The MTFP was presented in the assembly along with the budget documents. The first year of the MTFP projections is the budget estimates for the year 2012-13.

The Government of Sikkim, as per the FRBM Act, is required to achieve the following mandatory fiscal targets;

1. **Maintain revenue account balance beginning from the year 2011-12 ;**
2. **Reduce the fiscal deficit to 3.5 percent of the estimated Gross State DomesticProduct in each of the financial year starting from 2011-12 and reduce the fiscal deficit to not more than three percent of the estimated Gross State DomesticProduct at the end of 31st March 2014 and adhere to it thereafter;**

3. **Cap the total outstanding guarantees within the specified limit under the SikkimCeiling on Government Guarantees Act, 2000 (21 of 2000);**
4. **Ensure that the outstanding debt-GSDP ratio follows a sustainable path emanating from the above targets of the deficit as specified by the Government beginning from the fiscal year 2011-12. The level of debt-GSDP is fixed based on the recommendations of the Central Finance Commission. For Sikkim, the debt-GSDP ratio recommended by the 13^{th} Finance Commission for the year 2012-13 was 62.1 percent.**

In the fiscal year 2012-13, the State experienced slide in aggregate revenue receipts due to decline in Central transfers as percentage of GSDP. The aggregate revenue receipt declined to 31.4 percent of GSDP as compared to 32.2 percent achieved in the previous year. However, strict control over revenue expenditure, reducing it from 27.3 percent in 2011-12 to 23.9 percent in 2012-13 relative to GSDP, the State managed to improve the capital outlay and achieve the fiscal targets stipulated in the FRBM Act.

The fiscal targets specified in the FRBM Act and the outcomes for the year 2012-13 are shown in Table 5. Against the Act requirement of maintaining balance in the revenue account, and limiting the fiscal deficit to 3.5 percent of the GSDP, the State Government achieved a revenue surplus of 7.46 and fiscal deficit of 0.6 percent respectively. In nominal terms, the revenue surplus has increased from Rs.442.49 crores in 2011-12 to Rs.780.97 crores in 2012-13. On the other hand, the fiscal deficit has reduced from Rs.180.16 crores to Rs.65.59 crores during the same period.As the Act requires the deficit to be expressed as a ratio to the GSDP, the revenue and fiscal deficit of the State in 2012-13 remained within the limit imposed by the Act. Outstanding debt burden, an outcome of the fiscal management of the State at 26.30 percent relative to the GSDP, remains much lower than the target of 62.1 percent. The other fiscal target, outstanding guarantee, remained within the specified limit of Sikkim Ceiling on Government Guarantee Act 2000. Thus, the fiscal outcomes for the year 2012-13 show that the State Government was able to achieve the fiscal targets stipulated in the FRBM Act.

The State government managed to generate substantial revenue surplus, limit the fiscal deficit and debt burden relative to GSDP,and achieve the FRBM Act targets. The fiscal performance in 2012-13 continues the trend of fiscal achievements of earlier years. The substantial reduction in fiscal deficit and debt burden raises the question regarding the necessity of the adjustment to such a magnitude. Although the capital outlay has improved in 2012-13, the revenue expenditure relative to the GSDP has been compressed significantly. This has affected the spending for social sector in general and priority sectors like health and education in particular.

Table 5

FRBM Act Targets and Fiscal Achievements during 2012-13

Percent

	Targets	**Achievements**
Revenue Deficit % of GSDP	0	-7.46
Fiscal Deficit % of GSDP	3.5	0.6
Total Debt Stock % of GSDP (TFC Target)	62.1	23.3
Outstanding Guarantee	Restricted to the limit under the Sikkim Ceiling on Government Guarantees Act, 2000	

Note: Negative sign for deficit figures indicate surplus

4.2 Fiscal Management Principles

The FRBM Act of the State enunciates a set of guiding fiscal management principles to zxazmaintain prudent debt level, manage guarantees, ensure borrowings to be used for productive purposes, and pursue revenue expenditure policies to provide impetus to economic growth. The objective of giving a set of fiscal management principles is to help the State Government to achieve the statutory targets. These principles are usually common to the economic policies pursued by the Governments at any level and can be properly assessed only over a reasonably long period with continuous monitoring of relevant fiscal data. The recent fiscal policies and budget management practices need to be assessed keeping the stated principles of the Act under consideration.

Debt Management

The debt management principles of the FRBM Act require the State Government to maintain debt at a prudent level, manage guarantees and other contingent liabilities prudently, and use borrowed funds for productive purposes and create capital assets. The borrowed resources should not be used to finance current expenditure. Indeed, the debt management policy of any Government aims at meeting the financing needs at the lowest possible long-term borrowing costs and to keep the total debt within sustainable levels. The debt stock as percentage of GSDP has declined substantially to 26.3 percent in 2012-13 and ceased to be concern for the State.

As the fiscal deficit has been contained at very low level in 2012-13, the net addition to the debt stock to finance the fiscal deficit accordingly remained low. Borrowings and repayments for the year 2012-13 shown in Table 6 reveals that actual public debt that includes internal debt (market and institutional borrowing) and loans from Central Government was less than the budget estimates. The State Government can borrow up to the limit fixed by the Central Government. Given a comfortable cash balance situation the borrowing limit fixed by the Central government usually remains below the permissible level of fiscal deficit. Thus due to substantial revenue surplus and the limit put by the Central Government on borrowing, the debt stock has come down in Sikkim.

Table 6

Borrowings and Repayments: 2012-13

(Rs.Lakh)

	Budget Estimates	Actual	Difference
Public Debt Receipts			
Internal Debt	23226.22	19522.33	-3703.89
Loans Advances from Central Government	1450.00	159.04	-1290.96
Public Debt	24676.22	19681.37	-4994.85
Small Savings and Provident Fund	21010.51	21991.84	981.33
Total	45686.73	41673.21	-4013.52
Debt Repayments			
Internal Debt	6230.86	6157.60	-73.26
Loans Advances from Central Government	1045.36	954.15	-91.21
Public Debt	7276.22	7111.75	-164.47
Small Savings and Provident Fund	12235.50	17456.60	5221.10
Total	19511.72	24568.35	5056.63

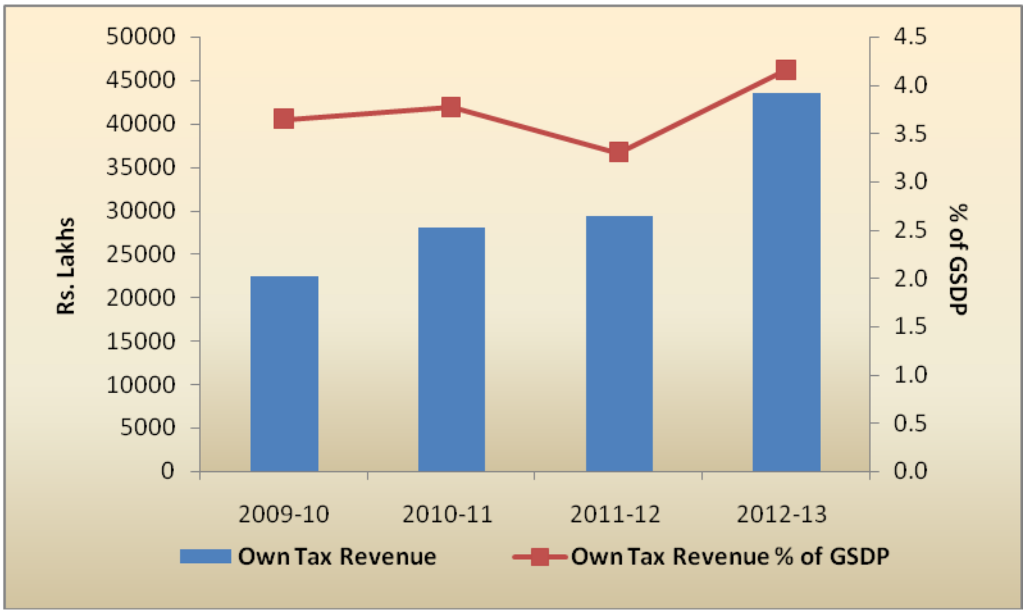
Source: Finance Accounts and Budget Document for the year 2012

Although the statutory requirement of using borrowed funds exclusively for creating capital assets is satisfied as generating revenue surplus consistently over the years helped to limit the borrowing for capital outlay only, the low-borrowing regime raises concerns in the context of a fiscal policy enabling growth and development. Indeed, borrowing is carried out to finance the deficit arising due to capital outlay and any deficit in the revenue account. A revenue surplus provides greater fiscal space to the Government to increase the capital outlay and keep the debt burden sustainable. Between the years 2010-11 and 2012-13, the capital outlay as percentage of GSDP has increased from 6.9 percent to 8.0 percent. Given the fiscal space available to the State Government, both the revenue and capital expenditure could have been scaled up. Resorting to higher level of borrowing to finance the fiscal deficit is unlikely to create fiscal imbalance for the State government.

Tax Policy and Administration

The FRBM Act requires the State Government to maintain integrity of the tax system by minimizing special incentives, concessions and exemptions. It also calls upon the Government to pursue the tax policy with due regard to economic efficiency and compliance cost. Although, the own tax revenue in nominal terms shows a rising trend, as percentage of GSDP it does not show a smooth rising curve since 2009-10 (Figure 5). One of the important features of a good tax system is to maintain stability and predictability in the level of tax burden. The own tax revenue as percent of GSDP declined in 2011-12 due to low level of sales tax collection. However, in 2012-13, it has increased to 4.2 percent of GSDP from 3.3 percent realized in the previous year. There have not been many changes in tax rate of individual State taxes. The VAT regime, introduced in 2005, has stabilized in terms of rate and base structure in the State. The introduction of GST, which has remained uncertain, will bring in changes in the tax system as some of the State taxes like entertainment tax, luxury tax, and entry tax will be subsumed in it along with the VAT.

Figure 5
Own Tax Revenue as Percentage of GSDP



Collecting sufficient revenues to carry out functional responsibilities without distorting economic decisions of people relative to saving and consumption and market behavior imparts economic efficiency to the tax system. The introduction of VAT and stabilization of the rate structure in the State has reduced any discretionary changes in the tax policy. The State Government has made efforts to modernize the tax administration and introduced electronic payment taxes, e-filing of returns and generation of Waybills and statutory forms on electronic mode. This has improved the tax collection in the fiscal year 2012-13.

The FRBM Act also calls upon the Government to raise non-tax revenue with due regard to cost recovery and equity. The non-tax revenue of the State contributes significantly to the own revenue of the State. Although as percentage of GSDP, it has shown marginal increase in 2012-13, its relative share in total own revenue of the State declined from 45.36 percent in 2011-12 to about 41 percent. The major share of non-tax revenue of the State comes from provision of electricity and transport and lottery operation. In addition to these sources, the non-tax revenue includes income from interest earnings, police, and forestry. These sources, particularly the lottery income, have not proved to be stable sources of income. The scope for reducing subsidy and improving cost recovery from other services provided by the Government in the social and economic sectors seems to be limited. However, the Government should make efforts to improve cost recovery in economic sectors by improving the quality of the service provided.

Expenditure Policy and Institutional Measures to Improve Quality of Expenditure

The FRBM Act of Sikkim calls upon the Government to pursue expenditure policies that would provide impetus to economic growth, poverty reduction, and improvement in human development. The fiscal management principles also requires the Government to improve institutional framework to maintain physical assets, increase transparency, minimize fiscal risks associated with public sector undertakings (PSUs), and formulate realistic budget formulation to minimize the deviations during the course of the year. The achievement of these goals needs to be assessed over a long period.

The achievement of socio-economic development in Sikkim has been significant. The State economy has experienced substantial growth in recent years and the per capita income of the state has increased from Rs.30727 in 2004-05 to Rs.168112 in 2012-13 at current prices. The major socio-economic indicators for the State show commendable improvement. The poverty ratio has declined to 8.19 per cent as compared to all India average of 21.92 per cent in 2011-12. The literacy rate at 81.40 per cent in 2011-12 is significant achievement. The IMR has gone down to 24 per 1000 in 2011 as compared to the all India average of 44. The rebuilding and reconstruction activities required after the devastating earthquake of 2011 has been continuously funded by both the Central and the State Government.

The expenditure trends for the State shows that the Government has focused on the productive social and economic sectors. However, spending on general service, which is relatively less productive for the State, continues to be high. The capital outlay, which was traditionally high in Sikkim, has shown a downward trend in recent years leaving aside the fiscal year of 2012-13. Given the availability of fiscal space, the Government should take determined steps to further improve the spending in priority sectors and strengthen the infrastructure building.

The Act requires the Government to improve budget credibility and preserve the sanctity of the budget voted in the State Legislature. The detailed account of comparison of budget estimates and actual outcome relating to revenue and expenditure has been given in later sections. However, the budget management practice in the State shows several discrepancies. The State is heavily dependent on Central transfers that includes share in central taxes and Central grants. The State, in addition to centrally sponsored schemes, also receives funding from agencies like DONER and NEC for infrastructure projects. The State budget suffers during the implementation phase due to lack of predictability of these funds. Many a times the expenditures planned in the budget go awry due to non-receipts of components of these funds and late receipt of grants towards fag end of the financial year. It is important for the State Government to step up coordination with the Central agencies to improve the fund-flow to planned projects and programmes.

Fiscal transparency measures enunciated in the FRBM Act requires the State Government to minimize the secrecy and disclose data and information relating to the fiscal operations. The rules to the Act specify the data and information to be disclosed along with the budget documents.

5. Budget Credibility: Projections and Outturns

The fiscal management principles require that budget should be formulated in a realistic manner to minimize the deviations from the projected revenues and expenditures. In this section, a comparison between budget estimates and fiscal outturns for the year 2012-13 is provided. The budget year being the first year of the MTFP projection, the realized budget outturn shows the achievement of the Government in adhering to the basic fiscal rule principles. The ability to raise the projected revenue and implement the budgeted expenditure is an important factor that shows the capacity of the Government to deliver the public services as enunciated in the Government policies. Table 7 shows the fiscal variables as projected in the budget for the year 2012-13 and the achievements for the year. The fiscal indicators for both the budget estimates and budget outturns are shown as percentages of the GSDP at current prices.

Table 7

Budget Estimates and Outturns for the year 2012-13

(Percentage of GSDP)

	2012-13 (BE)	2012-13 (Actual)	Difference (Actual to BE)
Revenues	**38.8**	**31.4**	**-7.39**
Own Tax Revenues	**3.4**	**4.2**	**0.78**
Own Non-Tax Revenues	**2.8**	**2.9**	**0.07**
Central Transfers	**32.6**	**24.4**	**-8.24**
Tax Devolution	6.9	6.7	-0.24
Grants	25.7	17.7	-8.01
Revenue Expenditure	**27.1**	**23.9**	**-3.17**
General Services	8.9	8.4	-0.48
Social Services	10.0	9.0	-1.00
Economic Services	7.7	6.3	-1.44
Compensation and Assignment to LBs	0.5	0.2	-0.26
Capital Expenditure	**14.0**	**8.1**	**-5.92**
Capital Outlay	14.0	8.0	-5.92
Net Lending	0.04	0.04	0.00
Revenue Surplus	**11.7**	**7.5**	**-4.22**
Fiscal Deficit	**-2.3**	**-0.6**	**1.70**
Primary Deficit	**-0.4**	**1.3**	**1.68**
Outstanding Debt	**27.3**	**26.3**	**-1.00**

Source: Basic data – Finance Accounts and Budget Document for the year 2014-15, GoS
GSDP data used are of 2004-05 series

The budget estimates for the fiscal year 2012-13 shows an ambitious agenda, which was not realized. The planned revenue receipts of the order of 38.8 percent of GSDP fell short by 7.39 percentage points. While own revenue receipts, including own tax and own non-tax receipts improved by 0.85 percentage points as compared to the budget estimates, the central transfers declined by a whopping 8.24 percentage points dragging down the aggregate revenues. In the Central transfers, the grant component shows a major decline of about 8 percentage points; the share in central tax declining marginally by 0.24 percentage points as compared to the budget estimates. Given this shortfall in revenue receipts, the State Government compressed the revenue expenditure from 27.1 percent of GSDP to 23.9 percent, a 3.17 percentage point decline. This has brought down the revenue surplus to 7.5 percent of GSDP against the budget estimate of 11.7 percent, 4.22 percentage points decline.

In the case of capital expenditure, there was a shortfall of 5.92 percentage points relative to the GSDP. It has come down from planned level of 14 percent of GSDP to about 8.1 percent. Thus with the decline in capital outlay and the level of revenue surplus achieved, the State government managed to achieve a fiscal deficit of 0.6 percent of GSDP as against budget projection of 2.3 percent, an improvement of 1.7 percentage points. The outcome of the budget management during the fiscal year 2012-13 was the decline in debt stock from 27.3 percent of GSDP to 26.3 percent.

Although the State Government could not meet the ambitious revenue surplus target, realization of a 7.5 percent revenue surplus relative to GSDP is significant. With this level of revenue surplus, there was no reason to shrink the planned capital outlay and achieve a fiscal deficit of 0.6 percent of GSDP, while the permissible level is as high as 3.5 percent. The fiscal management principle enunciated in the FRBM Act calls upon the State to respond appropriately to eliminate the revenue deficit and contain the fiscal deficit at a sustainable level. The fiscal deficit of the order of 0.6 percent of GSDP seems too low as compared to the FRBM Act target, which was achieved by reducing the capital outlay by 5.92 percentage points.

The reduction of fiscal deficit as compared to the budgeted level may not be all by design. This budget management points to the fact that the State Government may have to address several issues including capacity constraint to undertake infrastructure building in a large scale. The capacity constraint to conceptualize projects and implement them properly and ground level bottlenecks in the implementation process have proved to be formidable problems needing serious attention. Some of the spending departments, which were interviewed for this study, pointed out that the disputes in acquiring land and non-receipts of central funds in time created problem to implement several infrastructure projects. The Finance department indicated that there was delay in fund flow under many centrally sponsored schemes, for which spending could not be undertaken during the year and this is one of major reasons for getting large revenue surplus. The State Government also fails to provide allocated state share for the CSS in time and puts the availability of Central funds in jeopardy. It is important that the State Government should improve its budget management practice and coordinate with the central Government for better fund flow system to enable better implementation of projects and utilization of voted funds.

5.1 Disaggregated Analysis of Revenue Receipts

Table 8 shows the detailed sources of actual and budgeted revenue receipts. The realized own tax revenue has exceeded the budget estimates by Rs.82.13 crores, which forms about 23 percent of budget estimates. Leaving the stamps and registration fees, all other taxes surpassed the budget estimates. The increase in own tax collection was mostly driven by sales tax, excise duty and other taxes. The other taxes, which includes cess on sale of petrol and diesel going to transport infrastructural development fund and a cess collected from all non-biodegradable goods at a rate of one percent, which once again goes to a ecology and environment fund, shows a significant increase over the budget estimates.

The official explanation for the surge in collection of sales tax revenue during 2012-13 was the starting of online tax filing system and putting the waybill online, which improved the efficiency of tax collection and transparency. Indeed online filling of sales tax strengthens the tax administration and helps the collection of tax. However, the increase in tax revenue as against the budget estimate cannot be entirely attributed to improvement in tax administration alone. The online filling of tax has started in 2012-13 and it is unlikely to cause a rise in tax collection the first year itself. The target of Rs.187.14 crore in 2012-13 as budget estimates was quite high, about 51 percent, as compared to the previous year. The actual collection of Rs.227.08 crore was higher by about Rs.40 crores as compared to the budget estimates. It looks like there was a huge collection of tax arrears in 2012-13 that increased the actual collection.

The cess on petroleum yielded higher revenue due to higher number of vehicles plying in Sikkim due to rise in economic activities. The rise in cess on VAT is caused by the higher collection of sales tax/Vat during the fiscal year 2012-13.

Table 8
Revenue Realization: 2012-13

Rs.lakh

	2011-12	2012-13 (BE)	2012-13 Actuals	Difference (Actual to BE)	Difference as % to BE
Own Tax Revenues	**29392**	**35335**	**43548**	**8213**	**23**
Sales Tax	12419	18714	22708	3994	21
State Excise Duties	9626	9500	11112	1612	17
Motor Vehicle Tax	1656	1500	1638	138	9
Stamp Duty and Registration Fees	827	747	535	-212	-28
Other Taxes	4863	4873	7521	2648	54
Own Non-Tax Revenue	**24404**	**29451**	**30200**	**749**	**3**
Interest Receipts	2939	2115	4600	2485	117
Dividends and Profits	0	25	153	128	513
Police	1289	4488	4923	434	10
Public Works	538	456	470	14	3
Administrative Services	668	303	964	661	219
Net Lottery Income	4362	5000	4143	-857	-17
Education, Sports, Art & Culture	135	140	137	-3	-2
Medical and Public Health	127	127	150	23	18
Water Supply and Sanitation	290	340	274	-67	-20
Urban Development	167	175	97	-78	-45
Forestry and Wildlife	1253	1348	1228	-120	-9
Plantations	259	320	398	78	24
Other Rural Development Programme	125	232	146	-86	-37
Power	7970	10005	8290	-1715	-17
Road Transport	3089	2905	2901	-4	0
Tourism	184	500	213	-287	-57
Others	1008	971	1113	142	15
Central Transfers	**233415**	**341406**	**255088**	**-86318**	**-25**
Tax Devolution	61165	72314	69848	-2466	-3
Grants	172250	269092	185240	-83852	-31

The collection of own non-tax revenue surpassed the budget estimates by Rs.7.49 crores. Thus, the non-tax revenue realization during the year 2012-13 was very close to the budget estimates. The pattern of non-tax revenue in Sikkim suggests that income from interest receipts, power sector, transport, lottery operations, and police are the major components. The interest receipts exceeded the budget estimates by Rs.24.85 crores, which forms a huge 56.50 percent of the budgeted amount. The higher interest receipts were due to increase in investment of cash balances. This rise in cash balance is related with the inability of the State Government to spend the funds received for centrally sponsored schemes in time. Among the major sources of non-tax revenue, lottery income and income from power sector fell short of the budget estimates. The lottery income proved to be a volatile source of revenue depending upon the market situation. The shortfall in power sector income seems to be due to overestimating in the budget for the year 2012-13 as compared to the previous year.

In the case of Central transfers, the tax devolution to the State was rather close to the budget estimates as it deviated only by three percent. However, the grants both plan and non-plan taken together, was less by Rs.838.52 crores, which is about 31 percent of the budget estimates. The factors like overestimation for the year and non-receipts of funds under several centrally sponsored schemes have caused this shortfall in 2012-13. The projected fund flow under centrally sponsored schemes like JNNURM, AIBP and EAP did not materialize in 2012-13. There were also issues regarding NEC component of plan grants in which the projections based on agreed projects were not realized. The combined effect of all these factors reduced the actual grants from Centre as compared to the budget estimates.

5.2 Disaggregated Analysis of Expenditure Pattern

The decomposed revenue expenditure profile for the year 2012-13 given in Table 9 shows that the revenue expenditure fell short of the budget estimates by Rs.331.64 crores. This amount forms 12 percent of budget estimates in nominal terms and 3.17 percent relative to GSDP. The gap in actual spending as compared to the budget estimates was due to shortfall of 5 percent in general services, 10 percent in social service, and 19 percent in economic service. Thus, the contraction in revenue expenditure was more due to shortfall in spending in productive social and economic services.

Looking at various components of revenue expenditure it is clear that the savings, unutilized portion of the voted amount, was rather spread across many departments. For instance, savings of Rs.14.5 crores in pension payment was due non-payment of retirement benefits. In the social sector, lower actual spending as compared to the budget estimates was found in the case of education, housing, welfare of SC/STs, and social welfare and nutrition. The concerned departments pointed out various reasons like non-payment of scholarships, cost reduction due to direct payment to beneficiaries' accounts, non-submission of bills, etc. In some cases, non-receipt of funds from the Central Government reduced the planned spending.

Table 9
Revenue Expenditure Profile

Rs.Lakh

	2011-12	2012-13 (BE)	2012-13	Difference (Actual to BE)	Difference as % to BE
Revenue Expenditure	**242961**	**283903**	**250739**	**-33164**	**-12**
General Services	**75243**	**93069**	**88088**	**-4981**	**-5**
Interest Payment	19083	20138	19892	-246	-1
Pension	17376	23966	22517	-1448	-6
Other General Services Excluding Salary	38784	48965	45678	-3287	-7
Social Services	**103169**	**105184**	**94747**	**-10437**	**-10**
Education	47433	52522	51416	-1106	-2
Medical and Public Health	11397	12422	12567	145	1
Water Supply & Sanitation	2066	1651	1903	252	15
Housing	2919	16627	10635	-5992	-36
Urban Development	2623	2155	2043	-112	-5
Information & Broadcasting	533	1137	1149	12	1
Welfare of SCs, STs & OBCs	1912	4161	1999	-2162	-52
Labour	364	655	420	-234	-36
Social Welfare & Nutrition	29286	8772	7747	-1026	-12
Other Social Services	4636	5082	4869	-212	-4
Economic Services	**61402**	**80662**	**65611**	**-15052**	**-19**
Agriculture and Allied	22296	28385	21311	-7075	-25
Rural Development	8098	11143	10929	-214	-2
Irrigation and Flood Control	4012	14785	5518	-9267	-63
Energy	9798	9688	10730	1042	11
Industry and Minerals	4660	2486	2528	42	2
Transport	9779	10382	10723	341	3
General Economic Services	2427	3410	3600	191	6
Other Economic Services	331	383	271	-112	-29
Compensation and Assignment to LBs	**3147**	**4988**	**2294**	**-2694**	**-54**

In the economic service, two sectors where the utilization was discernibly low were the forestry and irrigation. In the case of forestry, non-receipt of state share and the desired funding from JICA for the biodiversity project was the major reason for deviating from the budget estimation. The department also failed utilizing the funds under forest management capacity building recommended by the 13th FC in 2012-13. The cess collected for ecological fund was also not coordinated properly with the forest department hindering its utilization. In the case of irrigation as the planned infrastructure building was not carried out, the revenue expenditure was reduced.

The shortfall in capital expenditure in 2012-13 has been sharp. The actual expenditure was less by Rs.619.94 crores, which was about 42 percent of the budget amount. This is quite large given the size of the State budget. The capital outlay fell short of the budget estimates by large amount in all sectors – general, social, and economic services. In the case of general services, where a shortfall of Rs.96.87 crore was found as compared to the budget estimates which was mainly due to non-receipt of central funds under the Prime Minister's package for earthquake related infrastructure building. Besides this, the sectors where major shortfall was witnessed were education, water supply and sanitation, energy, and tourism. In other sectors like health, agriculture, transport, and rural development also shortfalls were witnessed during the year.

The decline in capital expenditure vis-à-vis the budget estimates, however, may not be all by design to achieve fiscal targets. The inability to spend the available funds, non-receipt of the entire central funds as budgeted, and late receipt of central fund in some CSS programmes are the major reasons for this shortfall. Some of the budget heads under capital expenditure indicate that budget estimates were based on several Central grants, NEC projects, and NLCPR components of DONER. Under many of these projects, funds were not received during the year for which the actual expenditure fell short of the budget estimates. The predictability of availability of fund has remained low. Further, the budget management system in the State has not been very efficient. Many spending departments also pointed out the fact that the State Government failed to provide the State's share in several CSS projects because of which, the next installments of Central funds were not released. Given the requirement of infrastructure building in hilly State like Sikkim, forgoing large amount of Central funds due to non-provision of State share is a serious lapse in the budget management process.

Table 10

Capital Expenditure Profile

	2011-12	2012-13 (BE)	2012-13	Difference (Actual to BE)	Difference as % to BE
Capital Outlay	61576	146229	84235	-61994	-42
General services	2529	18017	8331	-9687	-54
Social services	27711	60033	29122	-30911	-51
Education, sports, art & culture	6294	9643	6219	-3424	-36
Medical and Public Health	9756	11290	10138	-1153	-10
Water supply and sanitation	11386	37941	12622	-25319	-67
Information, Publicity etc	125	95	74	-21	-22
Welfare of SC/ST/OBC	130	745	70	-675	-91
Social security nutrition	20	50	0	-50	-100
Economic services	31336	68178	46782	-21396	-31
Agricultural and allied services	1747	2471	938	-1533	-62
Rural development	3577	2840	2004	-836	-29
Special areas	1787	1900	1740	-160	-8
Irrigation and flood control	291	1083	712	-372	-34
Energy	3759	10438	4366	-6072	-58
Industries and minerals	213	428	419	-8	-2
Transport	14228	33508	31589	-1919	-6
Tourism	5700	15381	4964	-10418	-68

The spending departments, particularly those who have the responsibility of building infrastructure in the State have also not been able to coordinate their activities efficiently to even spend the available funds. For instance, while the irrigation and flood control department was hit hard by non-receipt of funds under AIBP and FMP, the failure to provide utilization certificate in timely manner, layers of authorities involved in clearing the project proposals, and inefficiency of contractors (cooperative societies at grassroots level) have proved to be setbacks in implementing the projects. The power sector provided several reasons for decline in capital expenditure as compared to the budget projection. These include delay in clearance for acquiring forestland, delay in starting of the work, delay in utilization of previous installment, non-receipt of State share and non-receipts of Central and NEC grants. Land acquisition has remained very complicated issue for water supply and sanitation sector, in addition to non-provision of State share. These reasons for non-spending raise pertinent questions regarding project selection, budgeting, predictability of fund flow, and project execution.

6. Concluding Remarks

During the fiscal year 2012-13, the Government of Sikkim has managed the State finances quite conservatively and achieved the FRBM Act targets with ease. Despite a decline in aggregate revenue receipts as percentage of GSDP as compared to the previous year, the State generated considerable level of revenue surplus by restricting the revenue expenditure. The revenue surplus helped the State to finance the capital outlay and incur a very low level of fiscal deficit. While the permissible level of fiscal deficit was 3.5 percent of GSDP, the State achieved a fiscal deficit of 0.6 percent in 2012-13. Consequently, the outstanding debt burden was reduced to 26.39 per cent relative to the GSDP, which was well below the 62.1 percent level recommended as prudent by the 13thFinance Commission. Compared to the fiscal targets specified for the year in the FRBM Act, the State Government has met all the targets.

While the State Government adhered to the FRBM Act targets in 2012-13, the low level of fiscal deficit and the overall budgetary practice raises concern.The scale of adjustment relating to the fiscal deficit and debt burden riding high on a substantial revenue surplus raises the question regarding the necessity of the adjustment to such a magnitude. While there was an improvement in the capital outlay in 2012-13, the revenue expenditure relative to the GSDP has been compressed significantly. This has affected the spending for social sector in general and priority sectors like health and education in particular. The statutory targets of the FRBM acts are only guideposts; the overarching objective of any government is to provide good governance and improve the quality of life of its citizens.

The deviations from the budget estimates for the year 2012-13, which was quite ambitious, reveals that the State failed to meet the planned revenue targets, which caused the compression in both the revenue and capital expenditure as compared to the budget estimates. The large deviation between budgeted and actual capital expenditure raises important questions regarding the programme formulation and execution in the State. Undertaking infrastructure building in a large scale in the difficult terrain of Sikkim requires huge improvement in capacity to conceptualize projects and implement them properly. The ground level bottlenecks in the implementation process like disputes in acquiring land, legal provisions relating to clearances for environment and forest, utilization of previous installment to facilitate further funding, and providing State share of funding in time and coordination among the implementing departments are issues that need to be addressed. Further, the State Government needs to improve its budget management practice and coordinate with the Central Government to streamline the fund flow process. The delay in release of the Central funds under various schemes is one of the major reasons for lower utilization of budgeted funds and emergence of large revenue surplus.