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Fiscal Stress, Revenue Deficit Grants and Development Finance in Himachal Pradesh

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ABSTRACT

Himachal Pradesh has experienced increasing fiscal stress due to persistent revenue deficits, rising public liabilities and high committed expenditure on salaries, pensions and interest payments. The state's mountainous geography also raises the cost of infrastructure and public-service delivery, creating a structural mismatch between revenue capacity and expenditure requirements. This study examines the fiscal condition of Himachal Pradesh and assesses the role of Revenue Deficit Grants (RDGs) in maintaining fiscal stability and protecting development expenditure. The study uses secondary data from the Government of Himachal Pradesh, Finance Commission reports, the Comptroller and Auditor General of India (CAG) and PRS Legislative Research. Descriptive trend analysis is combined with a proposed econometric framework linking RDGs, fiscal stress, debt, committed expenditure and capital expenditure. The revised estimate for 2025–26 places the revenue deficit at ₹9,812 crore, equivalent to 3.9% of GSDP, while the fiscal deficit is estimated at ₹16,708 crore, or 6.6% of GSDP. Outstanding liabilities are estimated at approximately 41% of GSDP. Under the Fifteenth Finance Commission, Himachal Pradesh was recommended ₹37,199 crore in Revenue Deficit Grants during 2021–22 to 2025–26. The discontinuation of RDGs from 2026–27 increases the pressure on the state's finances. The study argues that RDGs have functioned as an important short-term fiscal stabilizer, but long-term sustainability requires stronger own-source revenue mobilization, expenditure rationalization and protection of productive capital expenditure.

Keywords: Himachal Pradesh, Revenue Deficit Grants, fiscal stress, public debt, capital expenditure, fiscal federalism, mountain economy.

INTRODUCTION

Himachal Pradesh faces a structural mismatch between limited revenue capacity and high expenditure requirements. Its mountainous terrain, dispersed settlements and vulnerability to natural disasters increase the cost of providing infrastructure and public services. At the same time, expenditure on salaries, pensions and interest payments has created substantial rigidity in the state's budget. The result is persistent pressure on the revenue and fiscal balances of the state. The latest budget data show that the revenue deficit increased from ₹6,390 crore in the 2025–26 Budget Estimate to ₹9,812 crore in the Revised Estimate, while the fiscal deficit increased from ₹10,337 crore to ₹16,708 crore. The revised fiscal deficit was equivalent to 6.6% of GSDP. [2,3,7] The state's fiscal position is particularly important because fiscal stress can affect the composition of public expenditure. When a large proportion of revenue is committed to salaries, pensions, interest and other recurring obligations, the government has less flexibility to allocate resources to capital formation. In 2026–27, Himachal Pradesh has budgeted ₹35,641 crore for salaries, pensions and interest payments, equivalent to approximately 88% of estimated revenue receipts. Capital outlay, meanwhile, is budgeted at only ₹3,090 crore, 70% lower than the 2025–26 Revised Estimate of ₹10,229 crore. [3,7]

Revenue Deficit Grants have historically played an important role in this context. The Fifteenth Finance Commission recommended ₹37,199 crore in Revenue Deficit Grants for Himachal Pradesh for the period 2021–22 to 2025–26. The annual amount declined from ₹10,249 crore in 2021–22 to ₹3,257 crore in 2025–26. [4,6] These grants reduced the immediate revenue financing gap, but the state continued to experience revenue deficits during the later years of the award period. PRS notes that Himachal Pradesh recorded revenue deficits from 2022–23 onward despite receiving RDGs. [7] The discontinuation of RDGs from 2026–27 therefore represents an important change in the state's fiscal environment. The Sixteenth Finance Commission did not recommend Revenue Deficit Grants for any state during its award period. [5,7] This development raises an important policy question: whether the withdrawal of RDGs will result in higher borrowing, greater expenditure compression or a reduction in development-oriented expenditure. The present study addresses this issue by examining the relationship between fiscal stress, RDGs, debt, committed expenditure and capital expenditure in Himachal Pradesh.

Objectives

The main objective of the study is to examine the fiscal condition of Himachal Pradesh and assess the role of Revenue Deficit Grants in maintaining fiscal stability. The study specifically examines the trends in revenue deficit, fiscal deficit and outstanding liabilities; analyses the magnitude and pattern of Revenue Deficit Grants received by the state; evaluates the possible relationship between RDGs and capital expenditure; examines the effect of committed expenditure and debt on fiscal space; and suggests policy measures for sustainable fiscal consolidation while protecting productive public investment.

DATA AND METHODOLOGY

The study is based entirely on secondary data. Information has been collected from the Economic Survey of Himachal Pradesh, state budget documents, reports of the Fifteenth and Sixteenth Finance Commissions, CAG State Finances Audit Reports, PRS Legislative Research and Reserve Bank of India publications. The descriptive analysis covers the recent budget period and selected historical observations, while the analysis of Revenue Deficit Grants focuses on 2021–22 to 2025–26, corresponding to the Fifteenth Finance Commission award period. [1–9]

The study employs trend analysis to examine changes in revenue deficit, fiscal deficit, debt, committed expenditure and capital expenditure. Fiscal indicators are expressed both in absolute terms and, wherever appropriate, as percentages of GSDP. This permits comparison across years despite changes in the size of the state economy.

For the proposed econometric analysis, capital expenditure is specified as a function of Revenue Deficit Grants, committed expenditure, outstanding liabilities and economic growth. The model is expressed as:

$$\mathbf{CAPEX_t = \beta_0 + \beta_1 RDG_t + \beta_2 COMEXP_t + \beta_3 DEBT_t + \beta_4 GROWTH_t + \varepsilon_t}$$

Where CAPEX represents capital expenditure as a percentage of GSDP, RDG represents Revenue Deficit Grants as a percentage of GSDP, COMEXP represents committed expenditure as a percentage of GSDP, DEBT represents outstanding liabilities as a percentage of GSDP, and GROWTH represents real GSDP growth.

The expected coefficients are $\beta_1 > 0$, $\beta_2 < 0$, $\beta_3 < 0$ and $\beta_4 > 0$. A positive coefficient for RDG would suggest that grants increase the fiscal space available for capital expenditure, while negative coefficients for committed expenditure and debt would indicate that expenditure rigidity and debt obligations constrain development spending. A second model examines the determinants of fiscal stress:

$$\mathbf{REVDEF_t = \alpha_0 + \alpha_1 RDG_t + \alpha_2 COMEXP_t + \alpha_3 DEBT_t + \alpha_4 GROWTH_t + \varepsilon_t}$$

The expected signs are $\alpha_1 < 0$, $\alpha_2 > 0$, $\alpha_3 > 0$ and $\alpha_4 < 0$. The model assumes that RDGs reduce the revenue financing gap, while committed expenditure and debt increase fiscal stress. Economic growth is expected to improve revenue capacity and therefore reduce the revenue deficit. However, annual observations for Himachal Pradesh alone are insufficient for a statistically reliable regression with several explanatory variables. Therefore, the final econometric analysis should preferably employ a balanced panel of Indian states, including Himachal Pradesh, over a sufficiently long period. State fixed effects and year fixed effects can then be incorporated to control for unobserved state-specific characteristics and common macroeconomic shocks. The Himachal Pradesh-only analysis should consequently be treated primarily as descriptive and exploratory rather than as definitive causal evidence.

FISCAL CONDITION OF HIMACHAL PRADESH

Himachal Pradesh's recent fiscal indicators demonstrate considerable fiscal pressure. The state recorded a revenue deficit of ₹6,805 crore in 2024–25, while the 2025–26 Budget Estimate projected a deficit of ₹6,390 crore. The Revised Estimate for 2025–26, however, increased the revenue deficit substantially to ₹9,812 crore, equivalent to 3.9% of GSDP. The 2026–27 Budget Estimate projects a revenue deficit of ₹6,577 crore, or 2.4% of GSDP. PRS also notes that Himachal Pradesh has experienced a revenue deficit in every year since 2022–23. [2,3,7]

Table 1. Revenue Deficit of Himachal Pradesh

Year	Status	Revenue Deficit (₹ crore)	Revenue Deficit (% of GSDP)
2024–25	Actual	6,805	3.0%
2025–26	Budget Estimate	6,390	2.5%
2025–26	Revised Estimate	9,812	3.9%
2026–27	Budget Estimate	6,577	2.4%

Source: Government of Himachal Pradesh, Budget Documents [2,3]; PRS Legislative Research [7].

The fiscal deficit provides a broader measure of the state's financing requirement because it represents the gap between total expenditure and total receipts excluding borrowings. The fiscal deficit increased sharply from the 2025–26 Budget

Estimate of ₹10,337 crore to ₹16,708 crore in the Revised Estimate, representing an increase of 62%. The revised fiscal deficit was equivalent to 6.6% of GSDP, substantially above the budgeted 4.0%. For 2026–27, the state has targeted a fiscal deficit of ₹9,698 crore, equivalent to 3.5% of GSDP. [3,7]

Table 2. Fiscal Deficit of Himachal Pradesh

Year	Status	Fiscal Deficit (₹ crore)	Fiscal Deficit (% of GSDP)
2024–25	Actual	12,611	5.5%
2025–26	Budget Estimate	10,337	4.0%
2025–26	Revised Estimate	16,708	6.6%
2026–27	Budget Estimate	9,698	3.5%

Source: Government of Himachal Pradesh, Budget Documents [2,3]; PRS Legislative Research [7].

Debt is another major component of fiscal stress. Outstanding liabilities were estimated at approximately 41% of GSDP at the end of 2025–26 and are projected at 40.5% of GSDP at the end of 2026–27. High debt increases the future burden of interest payments and reduces the flexibility of the government to allocate resources to productive expenditure. [3,7] The fiscal transmission mechanism can therefore be represented as:

Fiscal Deficit ↑ → Borrowing ↑ → Debt ↑ → Interest Payments ↑ → Fiscal Space ↓ → Capital Expenditure Pressure ↑

The expenditure structure further intensifies this problem. In 2026–27, committed expenditure on salaries, pensions and interest is budgeted at ₹35,641 crore, comprising ₹16,603 crore on salaries, ₹11,766 crore on pensions and ₹7,272 crore on interest payments. This represents approximately 88% of estimated revenue receipts. [3,7]

Table 3. Committed Expenditure in Himachal Pradesh, 2026–27

Component	Amount (₹ crore)	Share of Revenue Receipts
Salaries	16,603	41%
Pensions	11,766	29%
Interest payments	7,272	18%
Total committed expenditure	**35,641**	**88%**

Source: Himachal Pradesh Budget Documents 2026–27; PRS Legislative Research [3,7].

The high level of committed expenditure has important implications for development finance. Revenue expenditure for 2026–27 is budgeted at ₹46,938 crore, while capital outlay is only ₹3,090 crore. The latter represents a 70% decline from the Revised Estimate of ₹10,229 crore for 2025–26. This sharp reduction suggests that capital expenditure may become an important adjustment variable when the state's recurring expenditure obligations are high. [3,7]

Table 4. Revenue Expenditure and Capital Outlay

Year	Revenue Expenditure (₹ crore)	Capital Outlay (₹ crore)
2024–25 Actual	47,677	5,957
2025–26 BE	48,733	3,941
2025–26 RE	54,349	10,229
2026–27 BE	46,938	3,090

Source: Himachal Pradesh Budget Documents 2026–27; PRS Legislative Research [3,7].

REVENUE DEFICIT GRANTS

Revenue Deficit Grants are transfers recommended by the Finance Commission to states that have a post-devolution revenue deficit. Their purpose is to provide additional resources to states whose revenue capacity, even after tax devolution, is insufficient to meet assessed revenue expenditure. In the case of Himachal Pradesh, the Fifteenth Finance Commission recommended a total of ₹37,199 crore for 2021–22 to 2025–26. [4,6]

Table 5. Revenue Deficit Grants to Himachal Pradesh under the Fifteenth Finance Commission

Year	RDG (₹ crore)	RDG as % of GSDP

2021–22	10,249	6.0%
2022–23	9,377	4.9%
2023–24	8,058	3.8%
2024–25	6,258	2.7%
2025–26	3,257	1.3%
Total	**37,199**	—

Source: Fifteenth Finance Commission [4]; Sixteenth Finance Commission, *Evaluation of State Finances of Himachal Pradesh* [6]; PRS Legislative Research [7].

The pattern of RDGs shows a substantial decline over the award period. The annual grant fell from ₹10,249 crore in 2021–22 to ₹3,257 crore in 2025–26. This declining trajectory was consistent with the Finance Commission's assessment of the state's post-devolution revenue position. Nevertheless, the state continued to record revenue deficits during the later years of the award period. PRS reports that Himachal Pradesh experienced revenue deficits from 2022–23 through 2025–26 despite receiving RDGs. [7] RDGs can reduce the immediate revenue financing gap and thereby potentially reduce the need to borrow for recurring expenditure. Their fiscal mechanism can therefore be represented as:

RDG ↑ → Revenue Gap ↓ → Borrowing Pressure ↓ → Debt-Service Pressure ↓ → Fiscal Space ↑

This does not mean that RDGs directly finance capital expenditure. Rather, their potential contribution to development finance is indirect. If a revenue gap is financed through grants rather than borrowing or cuts to other expenditure, the government may have greater flexibility to maintain capital expenditure. The magnitude of this indirect effect, however, must be tested empirically rather than assumed.

The withdrawal of RDGs after 2025–26 is consequently significant. The Sixteenth Finance Commission did not recommend Revenue Deficit Grants for any state during its award period. At the same time, Himachal Pradesh's 2026–27 budget continues to project a revenue deficit of ₹6,577 crore. [5,7] The discontinuation of RDGs therefore creates an adjustment requirement for the state, particularly because committed expenditure remains high.

ECONOMETRIC FRAMEWORK

The central empirical question of this study is whether Revenue Deficit Grants create fiscal space that can help protect capital expenditure. The proposed capital-expenditure model is:

$$\mathbf{CAPEX_t = \beta_0 + \beta_1 RDG_t + \beta_2 COMEXP_t + \beta_3 DEBT_t + \beta_4 GROWTH_t + \varepsilon_t}$$

The dependent variable, CAPEX, represents capital expenditure as a percentage of GSDP. RDG is measured as Revenue Deficit Grants relative to GSDP. COMEXP represents committed expenditure as a percentage of GSDP, while DEBT represents outstanding liabilities relative to GSDP. GROWTH represents the real growth rate of GSDP.The expected coefficient for RDG is positive because grants may reduce the revenue financing gap and thereby preserve fiscal space. The coefficient on committed expenditure is expected to be negative because higher recurring obligations reduce flexibility for capital spending. The coefficient on debt is expected to be negative because higher debt and associated interest obligations constrain fiscal space. Economic growth is expected to have a positive effect because stronger economic activity can increase revenue capacity and support public investment.

A second model is proposed to examine the determinants of revenue deficit:

$$\mathbf{REVDEF_t = \alpha_0 + \alpha_1 RDG_t + \alpha_2 COMEXP_t + \alpha_3 DEBT_t + \alpha_4 GROWTH_t + \varepsilon_t}$$

Here, REVDEF represents revenue deficit as a percentage of GSDP. RDG is expected to have a negative coefficient because additional grant resources should reduce the financing gap. Committed expenditure and debt are expected to have positive coefficients, while economic growth is expected to have a negative coefficient.The principal hypotheses of the study are that Revenue Deficit Grants have a positive association with capital expenditure, higher committed expenditure reduces capital expenditure, and higher debt reduces the fiscal space available for development expenditure. These hypotheses should be tested using a wider state-level panel rather than a simple time-series regression for Himachal Pradesh alone. The panel specification can take the form:

$$\mathbf{CAPEX_{it} = \beta_0 + \beta_1 RDG_{it} + \beta_2 COMEXP_{it} + \beta_3 DEBT_{it} + \beta_4 GROWTH_{it} + \mu_i + \lambda_t + \varepsilon_{it}}$$

where μ_i represents state-specific fixed effects and λ_t represents year-specific effects. Such a specification would provide a stronger empirical basis for assessing whether the relationship observed in Himachal Pradesh is part of a broader pattern among Indian states.

FINDINGS

The descriptive evidence indicates that fiscal stress in Himachal Pradesh is structural rather than purely cyclical. The state has continued to record revenue deficits since 2022–23, despite substantial Revenue Deficit Grants during the Fifteenth Finance Commission period. The persistence of the revenue deficit indicates that RDGs have helped finance the gap but have not eliminated the underlying mismatch between recurring revenue and expenditure. [7] The fiscal deficit also remains a major concern. The revised fiscal deficit for 2025–26 of ₹16,708 crore, equivalent to 6.6% of GSDP, was substantially above the original budget estimate of ₹10,337 crore. Although the 2026–27 Budget Estimate targets a lower fiscal deficit of ₹9,698 crore, or 3.5% of GSDP, the state continues to face a revenue deficit. [3,7]

Debt and expenditure rigidity further constrain fiscal space. Outstanding liabilities of approximately 41% of GSDP and committed expenditure of ₹35,641 crore in 2026–27 indicate that a large proportion of available resources is already tied to existing obligations. [3,7] This creates a risk that capital expenditure will become an adjustment variable during periods of fiscal stress. The most important evidence in this regard is the sharp decline in budgeted capital outlay. Capital outlay is projected at ₹3,090 crore in 2026–27 compared with ₹10,229 crore in the 2025–26 Revised Estimate. [3,7] Although budget estimates can change during implementation, the scale of the reduction highlights the vulnerability of development expenditure to fiscal pressures.The RDG data suggest that grants provided meaningful fiscal support, particularly during the initial years of the Fifteenth Finance Commission period. However, the declining annual grant and its eventual discontinuation indicate that the state cannot rely on RDGs as a permanent solution. The central fiscal challenge is therefore to use the period of grant support to undertake structural reforms in revenue mobilization and expenditure management.

POLICY RECOMMENDATIONS

Himachal Pradesh should strengthen its own-source revenue capacity. The state's own tax revenue is budgeted at ₹15,290 crore in 2026–27, equivalent to approximately 5.5% of GSDP. [7] Improvements in tax compliance, digitization of tax administration, rationalization of user charges, better collection of non-tax revenue and more effective monetization of appropriate public assets can strengthen the revenue base without placing excessive pressure on vulnerable households. Tourism-related economic activity can also be linked more effectively with local revenue generation through transparent and rational user fees.

Expenditure management should focus on the structural growth of salaries, pensions, interest payments, subsidies and losses of public enterprises. Since committed expenditure accounts for approximately 88% of revenue receipts, even moderate improvements in expenditure efficiency could create significant fiscal space. [7] Expenditure reforms should, however, distinguish between productive social expenditure and genuinely unproductive recurring expenditure. Essential spending on health, education, social protection and disaster response should be protected while efficiency improvements are pursued elsewhere.

Capital expenditure should be protected during fiscal consolidation. Roads, bridges, disaster-resilient infrastructure, health facilities, educational infrastructure, water systems and climate-adaptive infrastructure have long-term economic and social returns. A reduction in low-priority recurring expenditure is preferable to across-the-board cuts in capital investment. The state could also adopt a medium-term capital expenditure protection rule under which a minimum proportion of available fiscal space is reserved for high-return infrastructure projects. The Union government may also consider a targeted **Mountain State Fiscal Resilience Grant** for states facing exceptional geographical and ecological constraints. Such a mechanism could recognize the higher cost of service delivery, ecological conservation, disaster vulnerability and climate-related risks in Himalayan states. However, unlike an unconditional revenue-support mechanism, such assistance should incorporate measurable fiscal-performance conditions, including improvements in own-source revenue, reduction of expenditure rigidity, improved public-enterprise performance and protection of capital expenditure .Himachal Pradesh should also improve the quality of fiscal planning through medium-term expenditure frameworks. Annual budgets should be accompanied by realistic revenue forecasts, explicit debt-management strategies and clear estimates of the fiscal impact of subsidies and guarantees. This would reduce the likelihood of large revisions between Budget Estimates and Revised Estimates, such as those observed in 2025–26.

CONCLUSION

Himachal Pradesh's fiscal condition reflects a structural mismatch between revenue capacity and expenditure obligations. Persistent revenue deficits, high outstanding liabilities and substantial committed expenditure have significantly reduced the state's fiscal flexibility. The revised estimate for 2025–26 illustrates the severity of the problem, with a revenue deficit of ₹9,812 crore and a fiscal deficit of ₹16,708 crore. [3,7] Revenue Deficit Grants have acted as an important fiscal stabilizer. The ₹37,199 crore recommended by the Fifteenth Finance Commission between 2021–22 and 2025–26 provided substantial resources to bridge the state's post-devolution revenue gap. [4,6] However, the continuation of revenue deficits despite these transfers demonstrates that grants cannot substitute for structural fiscal reform.The discontinuation of RDGs from 2026–27 therefore represents a significant fiscal adjustment challenge. The state's 2026–27 budget continues to project a revenue deficit of ₹6,577 crore, while capital outlay is budgeted at only ₹3,090 crore. [3,7] The key policy challenge is consequently not simply to reduce expenditure, but to improve the composition of expenditure by reducing unproductive recurring obligations while protecting productive public investment. For Himachal Pradesh, sustainable fiscal consolidation should combine stronger own-source revenue mobilization, expenditure rationalization, improved debt management and protection of development-oriented capital expenditure. The proposed econometric framework can provide further evidence on whether RDGs have helped preserve capital expenditure. However, a reliable causal assessment requires a multi-state panel dataset rather than a short Himachal Pradesh-only time series. The broader lesson is that intergovernmental transfers can provide essential short-term fiscal stabilization, but long-term fiscal sustainability depends on strengthening the state's own revenue base and improving the quality and composition of public expenditure.

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Note: I have corrected the paper's 2026–27 figures using the latest available budget analysis: revenue deficit ₹6,577 crore (2.4% of GSDP), fiscal deficit ₹9,698 crore (3.5% of GSDP), outstanding liabilities 40.5% of GSDP at the end of 2026–27, committed expenditure ₹35,641 crore, and capital outlay ₹3,090 crore. The 2025–26 Revised Estimate figures remain ₹9,812 crore revenue deficit and ₹16,708 crore fiscal deficit.

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