

# STATE GOVERNMENT FINANCES

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**Higher devolution, upward revision  
in capex loans and extension of  
reform-linked borrowing to states in  
FY2026 to boost capex growth**

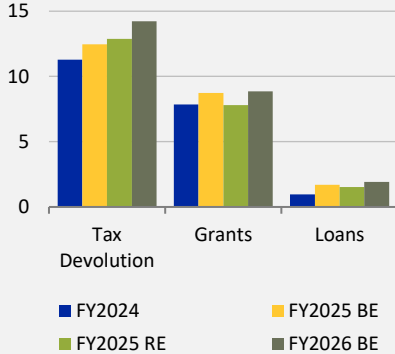
**FEBRUARY 2025**





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**EXHIBIT: Trends in grants and tax devolution to all states (Rs. Trillion)**



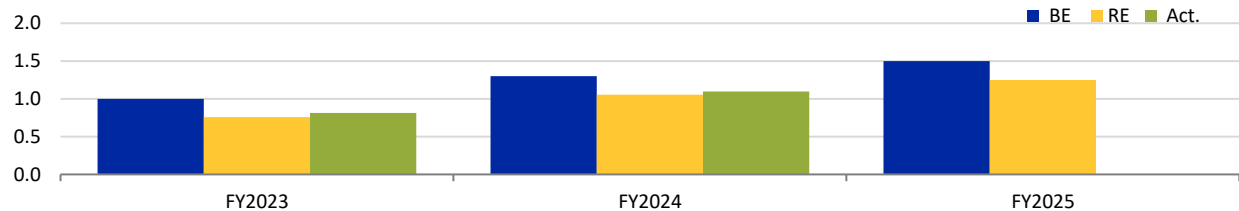
Source: Union Budgets; Press Information Bureau (PIB) Releases; Lok Sabha website; ICRA Research

Tax devolution, grants and loans are the main forms of transfer of resources by the Government of India (GoI) to the states. The GoI has estimated tax devolution to rise by 10.5% in year-on-year (YoY) terms to Rs. 14.2 trillion in the FY2026 budget estimates (BE) from Rs. 12.9 trillion in the revised estimates (RE) for FY2025. The latter has been revised upwards from Rs. 12.5 trillion in FY2025 BE on account of adjustment of past period dues and an uptick in the states’ share in income tax revenues in FY2025 RE relative to the BE. However, the increase in tax devolution by Rs. 397 billion during FY2025 RE from the BE, is more than offset by the downward revision in grants by Rs. 929 billion during that period (led by dip in the grants for Centrally Sponsored Schemes or CSS). For FY2026 BE, the GoI has pegged the total grants at Rs. 8.9 trillion, nearly 14% higher on a YoY basis.

To boost the resources of the states, the allocation for “Special Assistance as Loan to States for Capital Expenditure” scheme (herein referred to as the capex loan scheme) has been enhanced to Rs. 1.5 trillion for FY2026 BE from Rs. 1.3 trillion in FY2025 RE. Till end-January, the actual offtake by states under this scheme was Rs. 1.1 trillion, leaving a modest loan of Rs. 190 billion for meeting the target in RE. With states borrowing a sizeable amount under this scheme in the February-March during the last two fiscals, it will not be surprising to see the actual off-take of capex loan in FY2025 exceeding the RE levels.

Further, to incentivise reforms in the power sector, the GoI has extended the conditional borrowing (linked to completion of power sector reforms) of 0.5% of gross state domestic product (GSDP) to the states to FY2026, which was hitherto set to end in FY2025. An improvement in the off-take of capex loans and additional borrowing by states in FY2026 would provide an impetus to capex and overall economic growth.

**EXHIBIT: Trends in capex loan scheme to all states (Rs. Trillion)**





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