Recent Trends in Fiscal Health Index, 2025

Why in news?

State governments in India faced worsening debt and fiscal issues during the COVID-19 pandemic. Their debt-to-GDP ratio increased from 25.3% in 2019 to 31% in 2021.

What is Fiscal health index?

- ***NITI Aayog*** has introduced a Fiscal Health Index, which evaluates the fiscal positions of 18 major states using ***five sub-indices:***
  - Fiscal Prudence
  - Debt Index and Sustainability
  - Revenue Mobilization
  - Quality of Spending
  - Stabilization of State Finances
- This framework not only ***identifies high-performing states*** but also pinpoints areas for improvement.

What are the Findings from the Index?

- **Top Performers -** ***Odisha, Chhattisgarh, Goa, Jharkhand, and Gujarat***.
- States like ***Odisha and Gujarat*** have low debt-to-GSDP ratios of 16.3% and 17.9%, respectively.
- **Bottom Performers -** Punjab, Andhra Pradesh, West Bengal, Kerala, and Haryana.
- Punjab has a high debt-to-GSDP ratio of 46.6%.

What are the Reasons for worsening debt-to-GDP Ratio:

- **Rising Debt-to-GDP Ratios** - States like Punjab and West Bengal have alarmingly high debt levels, raising concerns about debt sustainability and fiscal health.
- **Dependence on Borrowings** - Many states rely heavily on borrowings to meet fiscal deficits, which leads to higher interest liabilities, reducing funds for developmental expenditure.
- **Unproductive Expenditures -** Spending on "freebies" or populist schemes, without clear economic returns, burdens state finances. Guarantees for loans to poorly performing sectors further worsen fiscal stress.
- **Revenue Mobilisation Issues -** States struggle to generate adequate revenue due to inefficiencies in tax collection, limited resource mobilisation, and weak administration in sectors like GST compliance.
- **Loss-Making Power Distribution** - Power subsidies and inefficiencies in state-owned DISCOMs continue to drain resources, despite reforms like ***UDAY (Ujwal DISCOM Assurance Yojana).***
- **High Dependence on Central Transfers -** States heavily depend on central devolution and grants for their revenue needs. Any reduction in central assistance, like during economic crises, adversely impacts fiscal stability.

What are the Growing Disparities between States?

- The increasing economic and developmental disparity among Indian states is a critical issue.
- States like Gujarat, Maharashtra, and Tamil Nadu perform exceptionally well.
- States like Bihar, Uttar Pradesh, and Jharkhand lag in economic growth, fiscal health, and social development.

What are the Causes of Disparities between States?

- **Geographical Differences -** Coastal states benefit from trade and industrialization, while landlocked and disaster-prone states face challenges.
- **Historical Factors** - Colonial policies favored some regions, leaving others underdeveloped.
- **Unequal Resource Allocation -** Central funds and investments are often skewed towards developed states.
- **Governance Issues -** Poor administration and corruption in some states hinder development.
- **Economic Dependence -** Backward states rely heavily on agriculture, which is vulnerable to climate risks.
- **Lack of Industrialization -** Industrial growth is concentrated in a few states, creating regional gaps.
- **Low Human Capital -** Poor education and health systems result in unskilled labor in lagging states.

What Lies ahead?

- Strengthen revenue generation by improving GST compliance and reforming property taxes. Encourage fiscal responsibility by adhering to ***FRBM targets and avoiding off-budget borrowings***.
- Reform subsidy management to target deserving beneficiaries with Direct Benefit Transfers.
- Focus on capital expenditure in infrastructure, healthcare, and education, using Public-Private Partnerships.
- Address DISCOM issues with tariff management and loss reduction reforms**.**

Reference

The Indian Express | Fiscal Health Index