

## **Fiscal Prudence and States' Development: Which way now?**

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### **Abstract**

*This paper examines the Fiscal Health Index 2025 published by the NITI Aayog and attempts to connect the fiscal health of the states with their overall development. If the Indian states consider fiscal prudence as an end in itself and follow the best practices of the achievers to be fiscally prudent then Vikasit Bharat is likely to remain as a distant dream. An integrated index that combines fiscal health and development indicators is crucial for addressing broader development goals of the State and the country.*

When India is aspiring to become a developed economy by 2047, the NITI Aayog has come up with a Fiscal Health Index (FHI) 2025 of Indian States for the financial year 2023 with a view to promote best practices among the States. The index, however, breeds a paradox. The States with relatively higher development outcomes are ranked low in fiscal indicators, while less developed States are the top performers in terms of fiscal prudence. The key issue is; whether India will be developed economy in 2047 if the States are to take the FHI seriously and follow the best practises that it highlight. A deeper examination of the relevance of the analytical foundations of FHI for a developing country like India and a more nuanced understanding of the interplay between fiscal health and development outcomes is called for.

## The pillars and performance

The FHI stands on five pillars; quality of expenditure, revenue mobilization, fiscal prudence, debt and debt sustainability. The quality of expenditure is measured using the ratio of total developmental expenditure to total expenditure and the ratio of total capital outlay to Gross State Domestic Product (GSDP). While the revenue mobilisation is measured using the ratio of States own revenue to GSDP and ratio of States own revenue to total expenditure, the ratios of gross fiscal deficit to GSDP and revenue deficit to GSDP are the indicators used for fiscal prudence. The debt index is estimated using the ratio of interest payments to revenue receipts and the ratio of outstanding liabilities to GSDP. The difference between the growth rate of GSDP and interest payments is the indicator used for debt sustainability.

FHI divided the 18 major States into four cohorts based on their rank in terms of fiscal performance; achievers, front runners, performers and inspirational States. States such as Odisha, Chhattisgarh, Goa, Jharkhand and Gujarat, holding top ranks, are achievers. Maharashtra, Uttar Pradesh, Telangana, Madhya Pradesh and Karnataka are the front runners. While, Tamil Nadu, Rajasthan, Bihar and Haryana are ranked as performing States, the bottom four States Kerala, West Bengal, Andhra Pradesh and Punjab are diplomatically denoted as inspirational States. With a close look at the rank and the grouping one wonders whether the grouping of States itself has been arbitrary. Maharashtra with an index score of 50.3 has been included in the group with lower than 45.9 instead of including in the group of achievers along with Gujarat with an index score for 50.5. Similarly, Kerala with an index score of 25.4 has been included among inspirational States with index score lower than 21.8 instead of including in the group with Haryana having an index of 27.4. Each of these States performed differently in these five the pillars. For example, Chhattisgarh has high rank in quality of expenditure and fiscal prudence, but it lags in the debt index. Similarly, Uttar Pradesh rank high in debt index and debt sustainability but its performance is poor in revenue mobilisation.

The report also presents a picture of State level performance over time by comparing their average rank during 2014-15 to 2021-22 and 2022-23. During both time points Orissa retained the top position and the States like Chhattisgarh, Jharkhand and Rajasthan have improved their rank at least by two positions. Hence these four States may be termed as sustained performers of which all the States, except Rajasthan, belong to the group of achievers.

### **Fiscal health versus development**

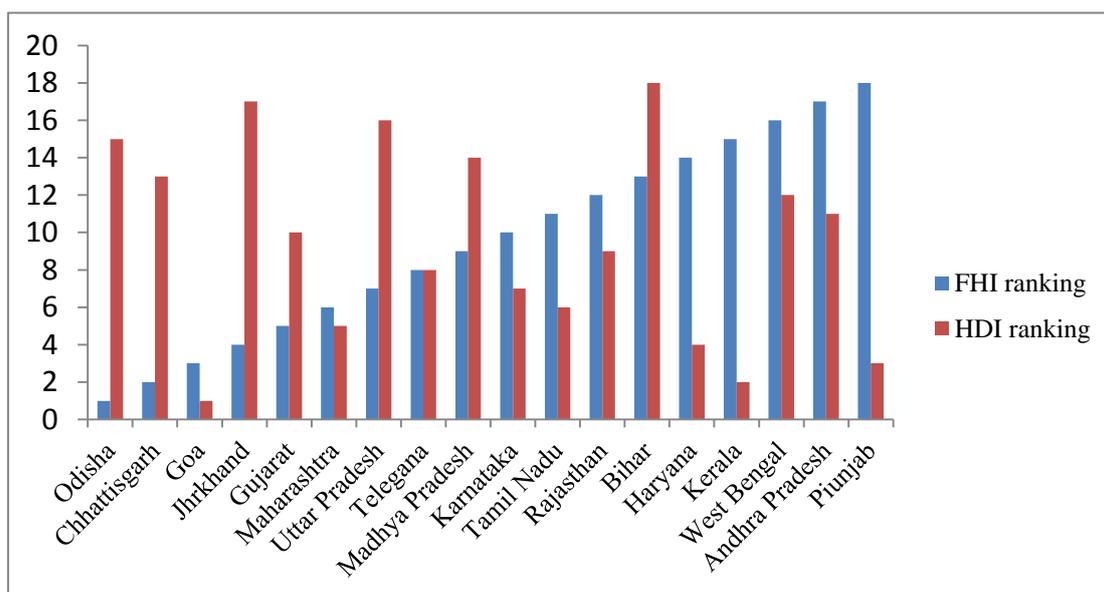
A key concern in the context of aspirational India is the clear mismatch among the States in terms of fiscal prudence and developmental outcomes. It is evident except Goa all the four achievers have displayed a poor show with respect to their accomplishments in terms of Human Development Index (Fig 1). At the same time among the bottom five, termed as inspirational States, three of them turns out to be truly inspirational on account of their outstanding human development performance. This paradox raises the question as to why the States with higher human development have higher deficits and debt, while the fiscally prudent ones display poor development performance. Evidently, the present fiscal stress of the inspirational States cannot be delinked from their past investment in human development leading to higher committed expenditure at present. They need to adopt strategies to strengthen their productive sectors by harnessing their human development and improve their tax base while rationalising expenditure where ever possible. Experience of achievers indicates that fiscal prudence need not necessarily translate into development outcomes. Instead of taking pride in revenue surplus and maintaining fiscal deficit even lower than the FRBM level, while people go hungry, homeless and remain illiterate, these States must embark on higher public expenditure and improve their spending capacity to ensure that they contribute to the national vision of a Vikasit Bharat. Economic history teaches us that development went hand in hand with higher public expenditure. In the OECD countries, for example presently the general government expenditure is as high as 59% of the Gross Domestic Product (GDP) in France and the lowest being 24.4% in Ireland.

### **Fiscal health of states: Means or an end?**

Within the fiscal federal context of India where the States shoulder about two-third of the general government expenditure and collect only about one-third of the revenue, the expenditure by the States is contingent on the devolution from the Union government. It is to be noted that in 2022-23 the central transfers accounted for 40.7%, 48.5%, and 52.7% of the total revenue receipts respectively of the achievers like Odisha, Chhattisgarh and Jharkhand indicating the role of devolution in their fiscal performance. When it comes to poor fiscal performers like Kerala and Haryana, their share in devolution was at a lower level of 34.4% and 19.6% respectively. The fiscal stress of Punjab cannot be delinked from their specialisation in non-taxable agriculture that brought food security to the country. Kerala specialised in non-taxable human resources by which the country benefitted *inter alia*

through remittances. On the whole, if the Indian States consider fiscal prudence as an end in itself and follow the best practices of the achievers to be fiscally prudent Vikasit Bharat is likely to remain as a distant dream. An integrated index that combines fiscal health and development indicators is crucial for addressing broader development goals of the State and the country.

**Figure 1:** Plot on Fiscal Health Index ranking and Human Development Index ranking



Source: Authors construction using Fiscal Health Index report 2025 and Human Development Index report 2022

**(This article is the reproduction of the article titled ‘Should fiscal prudence be an end in itself?’ published in Businessline on 20 March 2025).**

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