Research Article

The Fiscal Health Index: A New Paradigm for Evaluating State Finances in India

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Abstract

With the release of the inaugural "Fiscal Health Index (FHI) 2025" report by NITI Aayog, the conclusions were presented by Arvind Panagariya, Chairman of the 16th Finance Commission. This study article aims to provide a comprehensive analysis of the state's financial situation by categorising them according to their fiscal performance and improving the knowledge of the major indicators used in the FHI. Secondary data, mostly from the FHI report and other newly obtained material, which has been carefully reviewed and evaluated, forms the basis of the analysis. The FHI 2025 evaluates the financial well-being of eighteen notable Indian states. This paper concludes that governments can achieve fiscal discipline, increase revenue generation, and guarantee debt sustainability by 2047. By doing so, they can strengthen their financial positions and back the Atma Nirbhar Bharat and Viksit Bharat goals.

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1. INTRODUCTION

NITI AAYOG (National Institution for Transforming India)

Established in 2015, NITI Aayog represented a pivotal transformation in India's governance and development planning framework.

Understanding of Difference Between the Planning Commission and Niti Aayog

Particulars	Planning Commission	Niti Aayog
Established	1950	2015
Purpose	Centralized economic planning and allocation of resources	Promote cooperative federalism and innovative policymaking
Approach	Top-down, centralized planning	Bottom-up, decentralized, participatory planning
State Involvement	Limited, imposed decisions on states	Strong focus on state participation and autonomy
Organizational Structure	Bureaucratic with fixed targets and five-year plans	Flexible, dynamic, with a focus on innovation and data-driven governance
Focus Areas	Traditional development sectors (agriculture, industry)	Innovation, technology, cooperative governance, data analytics
Funding Role	Allocated resources to states based on Five-Year Plans	Provides policy support and monitoring; does not allocate funds

FISCAL HEALTH INDEX

A comprehensive framework developed to evaluate the fiscal performance of Indian states, the Fiscal Health Index (FHI) provides a clearer view of their financial stability, sustainability, and governance. By analysing key fiscal indicators, we may learn about the financial well-being of states, which is crucial for long-term policymaking and planning. As a composite metric, the budgetary Health Index (FHI) was built using data from the Comptroller and Auditor General (CAG) of India, which provides the Indian states with trustworthy and transparent budgetary statistics. To evaluate the fiscal wellness of states, the Fiscal Health Index (FHI) relies on the information provided by the CAG, which is crucial since it provides reliable, transparent, and consistent financial data. State administrations and national agencies rely on the FHI as a vital resource when developing fiscal policies since it is a data-centric, quantitative tool for improving fiscal management and accountability across Indian states.

2. REVIEW OF LITERATURE

When discussing dangerous levels of debt, Blanchard (2022) suggested that the debt service-to-GDP ratio be utilised rather than the debt-to-GDP ratio. According to a recent study by Bansal and Verma (2022), the Fiscal Health Index would benefit from including social factors such as poverty rates, employment rates, and educational expenditure in order to provide a more complete picture. It advocates for a comprehensive plan that links fiscal health with SDGs (Sustainable Development Goals). Changes in per capita revenue are similar to variations in per capita gross state domestic product, according to Akram and Rath (2020), because states have different capacities for creating income. This means that with strong fiscal management, nations can attain both rapid growth and macroeconomic stability.

The capacity to increase taxes and other demographic and geographical factors cause states to differ in their income production, spending habits, debt levels, and deficit occurrences (Reddy and Reddy, 2019). In this case, differences or imbalances between states occur horizontally. State governments with lower per capita incomes usually get larger contributions from the federal government to help with these kinds of problems. Because more wealthy governments distribute a bigger amount of their income, these transfers cannot fully compensate less fortunate states for the challenges they confront. Thus, states compete with each other to increase their share of federal transfers. With an eye towards incorporating fiscal deficits and debt viability into a fiscal wellness metric, this study by Reddy, Y. V. (2014) examines the effect of public liabilities on the fiscal health of Indian states. It provides a helpful framework for understanding how fiscal responsibility and debt oversight are related.

3. RESEARCH OBJECTIVES

a) To analyse the concept of the Fiscal Health Index and its key indicators.
b) To analyse the status of 18 Indian states under the scanner of FHI.
c) To understand and interpret the four categories based on FHI performance, namely, Achievers, Front Runners, Performers, and Aspirational States.

4. RESEARCH METHODOLOGY

This study is based on secondary data and is exploratory in nature.

5. LIMITATION OF STUDY

a) The Study is based on secondary data only, hence relying on available data
b) This research paper studies only 18 states across the whole of India, ignoring other states.
c) The Fiscal Health Index has been focused on a few indicators only, like the quality of expenditure, revenue mobilisation, fiscal prudence, debt index, and debt sustainability.

6. DATA INTERPRETATION AND ANALYSIS

Fiscal Health Index and Key Indicators

A) Quality Of Expenditures

Development Expenditures - When it comes to ensuring sustainable prosperity, governments often prioritise increasing development expenditures, which are seen as investments in the future of the nation. It often includes spending on things like infrastructure, social services, and other things that help the economy flourish in the long run. In the long run, investing in development is a smart move that will benefit the nation's economy and social status, according to most people.

Examples of development expenditures – Construction of roads, railways, health insurance, etc.

Non-Development Expenditure - The term "non-development expenditure" describes funds that are required to maintain the government functioning and fund day-to-day operations but do not have a direct purpose to promote development. Spending on things other than development is essential for maintaining public services, national security, and fiscal stability, but it has a reputation for being more consumer-focused and less effective at encouraging growth in the long run.

Examples of Nondevelopment expenditures – Government pays interest, expenditure on defence equipment, salaries, and pensions for civil servants, etc.

Ratios For Analysing Quality Expenditures

Total Developmental Expenditure/Total Expenditure ratio

The ratio is an important indicator of how much of the government's budget goes towards programs that help build things like roads, schools, hospitals, and economies.

To help policymakers and economists make informed decisions, this ratio shows how much of a government's budget goes towards developmental goals compared to other types of spending.

Significance of Total Development Expenditure/ Total Expenditure
An increased ratio signifies that a greater portion of the government's budget is being directed towards initiatives that foster long-term economic advancement and enhancement of social metrics.
Analyzing this ratio enables analysts and policymakers to evaluate the alignment of government expenditure priorities with the objectives of national development.
This ratio also indicates the success of budgetary policies in directing resources towards sectors that will significantly influence the nation's long-term development.
E.g. if the total expenditure of a government is ₹72 trillion and the development expenditure is ₹120 trillion, the Developmental Expenditure/Total Expenditure ratio would be: **(72/120) = 0.6 or 60%** This suggests that 60% of the government's overall expenditure is allocated to developmental initiatives, which may be interpreted as a significant dedication to promoting sustainable economic growth.

B) Revenue Mobilisation

State Own Revenue/GSDP	**State Own Revenue/ Total Expenditure**
The term "state own revenue" refers to the money that a state government obtains from its own resources rather than from the federal government or outside sources. Taxes, fees, fines, and other revenue sources that are under the direct control of the state government are all included in this revenue category.	This includes the money a state receives from taxes (such as sales tax, state excise taxes, and property taxes), non-tax revenue (including penalties, fees, and interest income), and other sources.
The total value of all goods and services produced within a state's economy over a specific period of time, usually one year, is referred to as the gross state domestic product.	This is the total amount of money spent by the state government, including capital expenditures (for infrastructure and development projects) and revenue expenditures (for regular government operations, subsidies, salaries, and so forth).
FORMULA (State Own Revenue/GSDP) ×100	**FORMULA (State Own Revenue / Total Expenditure) x100**
Importance of the State Own Revenue/GSDP Ratio- Fiscal Independence: A higher ratio means that the state depends more on its own economic activity to generate revenue and less on grants and loans from the federal government. This ratio assists policymakers and economists in assessing the economic vitality of a state. Investors, credit rating agencies, and international organizations frequently examine this ratio to evaluate a government's capacity to meet its debt obligations.	**Importance of the State Own Revenue/Total Expenditure Ratio-** States that rely significantly on borrowing or external transfers to fulfil their expenditure requirements frequently face the danger of increasing debt levels. A higher ratio suggests that the state is effective in collecting revenue and managing its finances.
Example State P has a State Own Revenue of ₹ 50,000 crore and a GSDP of ₹2,00,000 crore: This means State P generates 25% of its GSDP from its own revenue. State Q has a State Own Revenue of ₹20,000 crore and a GSDP of ₹1,00,000 crore: This means State Q generates 20% of its GSDP from its own revenue. This means State Q generates 20% of its GSDP from its own revenue, indicating slightly weaker fiscal independence compared to State P.	**Example** State Y has a State Own Revenue of ₹1,00,000 crore and Total Expenditure of ₹1,20,000 crore: State C funds 83.33% of its overall expenditures through its own resources, indicating robust fiscal health and reduced reliance on external financing.

C) **Fiscal Prudence**

Fiscal Deficit - When a government spends more than it takes in, it has a fiscal deficit, which shows the difference between total income and total spending. This discrepancy shows how much the government must borrow to make up the difference.

Revenue Deficit - A revenue deficit occurs when the government’s income is inadequate to meet its regular operating expenses, leading to the need for borrowing to cover the shortfall in funding its operations.

D) Debt Index

This ratio shows how much debt the government has relative to its economic output. A higher Debt Index indicates more debt relative to the economy, which may raise concerns about the government's ability to pay off that debt.

Outstanding Liabilities/GSDP Ratio

Let's say **State A** has outstanding liabilities of ₹2 lakh crore, and the GSDP of the state is ₹10 lakh crore. The Outstanding Liabilities/GSDP ratio would be:

=Outstanding Liabilities/GSDP ratio

= (2,00,000/10,00,000) ×100 = 20%

This suggests that the liabilities of State A constitute 20% of its economic output, indicating that the state maintains relatively manageable levels of debt and may possess additional fiscal capacity for development and other expenditures.

E) Debt Sustainability

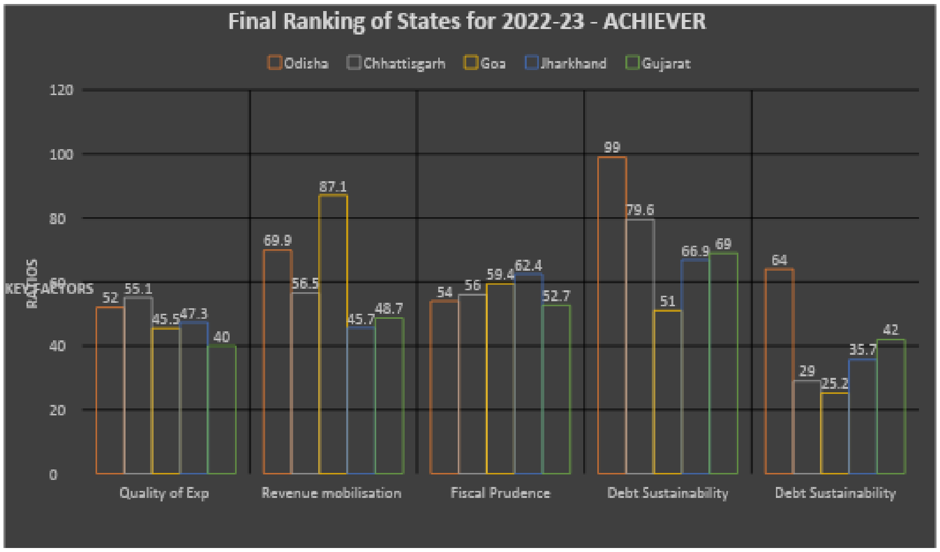
Debt sustainability pertains to the capacity of a government, individual, corporation, or state to effectively manage its debt over time, thereby avoiding financial distress or the possibility of default. Essentially, it involves the capability to meet both current and future debt obligations without resorting to excessive borrowing, significantly reducing essential public expenditures, or inducing inflationary pressures.

Growth Rate of GSDP - Growth Rate of Interest Payments

- A favourable difference indicates robust economic health, characterized by growth that exceeds debt obligations, thereby creating fiscal capacity for additional development.
- An unfavourable difference suggests possible fiscal challenges, where the burden of debt servicing could hinder the overall financial stability of the state.

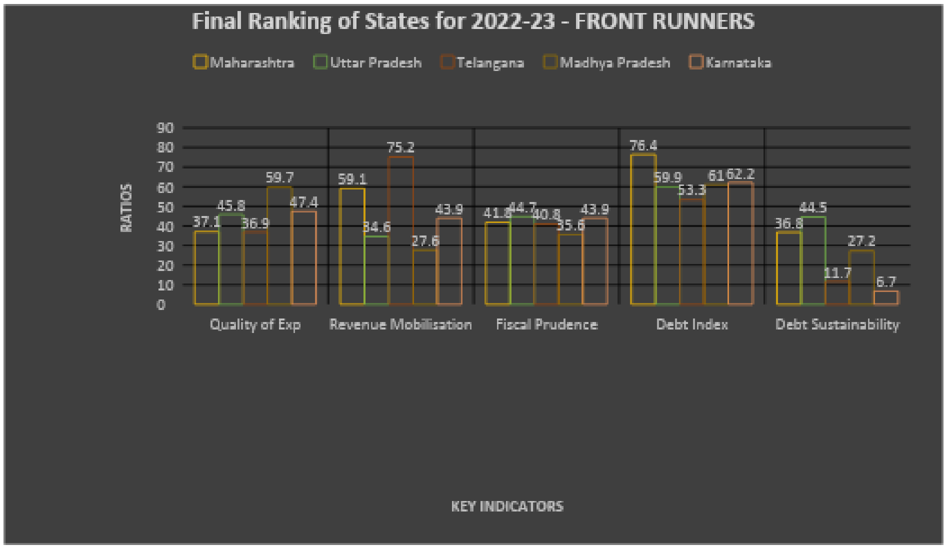
3) Analysis of 18 States and Performers
Final Ranking of States for 2022-23

Category 1: Achievers



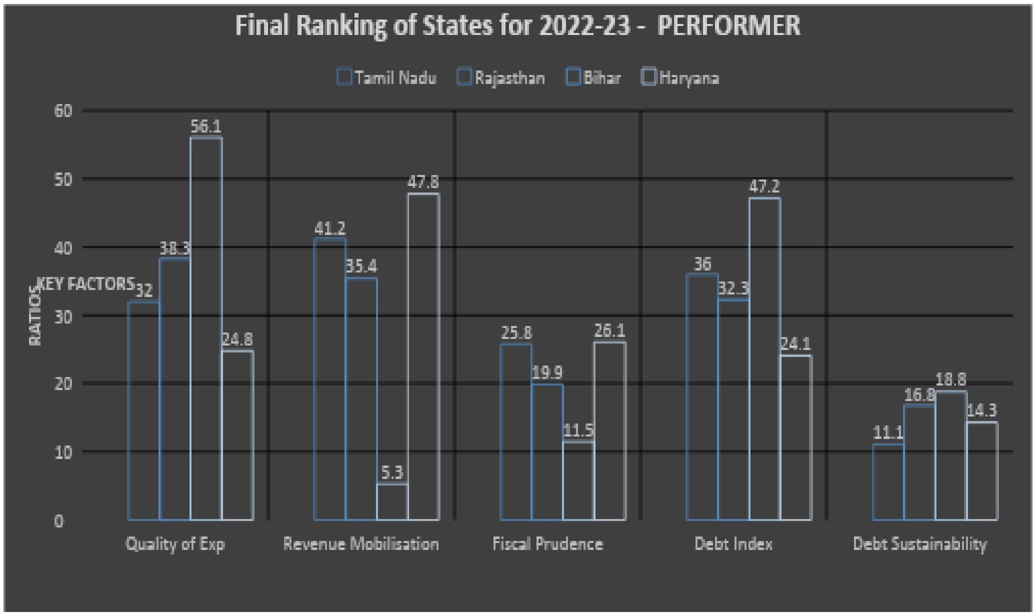
Achievers: NITI Aayog has indicated that the top five performing States exhibit a capital outlay reaching as much as 4% of their Gross State Domestic Product (GSDP). These States demonstrate effective mobilization of non-tax revenue, maintain a revenue surplus, and incur low interest payments, which amount to no more than 7% of their revenue receipts.

Category 2: Front Runners



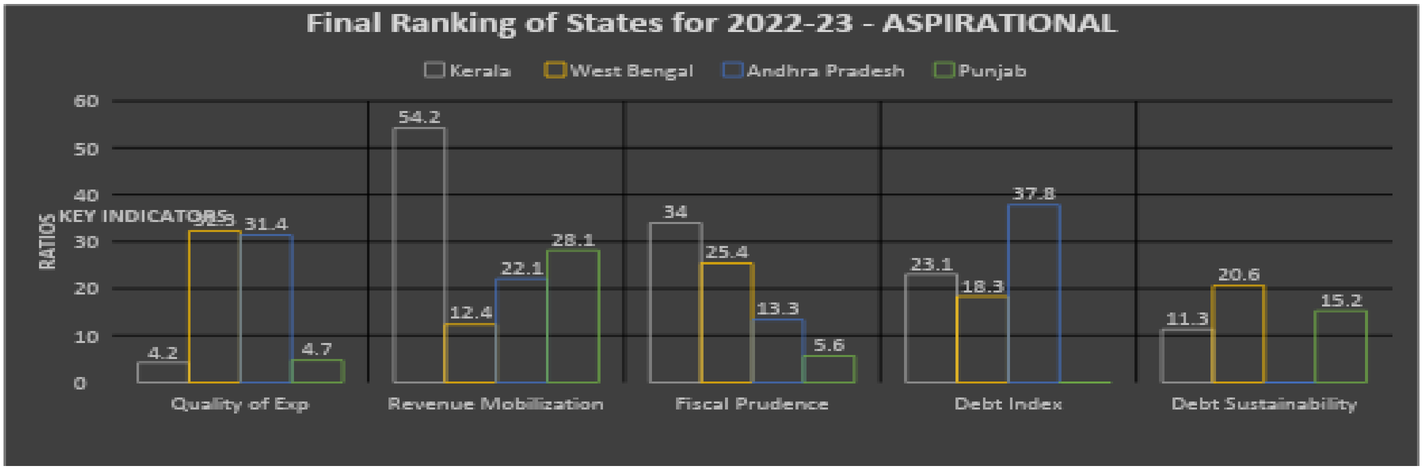
Front Runners: These states allocate as much as 73% of their revenue towards development initiatives. They exhibit consistent growth in their tax revenues. With a debt-to-GDP ratio of 24%, they reflect improved debt sustainability and effective fiscal management.

Category 3: Performer



Performers: The Fiscal Health Index categorizes a "performer" as a state exhibiting moderate fiscal health. This indicates that while the state is effectively managing its financial resources, there remain opportunities for enhancement in areas such as revenue generation or debt management. Typically, these states rank higher than those classified as "aspirational," yet fall short of the "front-runners" or "achievers" within the index.

Category 4: Aspirational



Aspirational: Several Indian states are grappling with serious budgetary issues due to high levels of debt, large interest payments, insufficient income, and wasteful spending on capital projects. These states include Punjab, Andhra Pradesh, Haryana, Kerala, and West Bengal.

A number of states are ranked quite low on the fiscal health index, suggesting that there is room for improvement on all fronts. According to the data, the states of Andhra Pradesh, Punjab, Kerala, and West Bengal are dealing with heavy debt loads, huge interest payments, insufficient tax collections, and wasteful spending on capital projects. Their fiscal health index score takes a hit because they rely on non-tax revenue sources.

7. CONCLUSION

- An essential tool for gauging state performance and pinpointing areas in need of fiscal improvement is the Fiscal Health Index.
- Based on their level of financial stability, the states are grouped into four separate categories: Achievers, Front-Runners, Performers, and Aspirational.
- Along with patterns shown from 2014–15 to 2021–22, the study includes statistics from the Comptroller and Auditor General of India (CAG) for the fiscal year 2022–23.
- Odisha has the best fiscal health in the 2022–23 timeframe, with a score of 67.8. With a score of 64.0 for sustainable debt levels and a score of 99.0 for outstanding debt management, it also does an excellent job with income collection and expenditure quality. Goa and Chhattisgarh come in at 53.6 and 55.2, respectively, after Odisha. Goa excels at revenue collection, while Chhattisgarh is great at managing debt.
- The states of Odisha, Goa, and Telangana are well-known for their efficient taxation and fiscal management. On the other hand, Kerala, West Bengal, Punjab, and Andhra Pradesh are all in deep financial trouble. West Bengal faces problems with tax collection and its debt load, whilst poor spending quality and high debt levels disproportionately impact Punjab and Kerala. Andhra Pradesh is likewise grappling with massive budget shortfalls, while Haryana is precariously positioned due to its mounting debt.

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