



सत्यमेव परमो धर्मः

# Policy Brief

## **BUILDING RESILIENT STATE FINANCES FOR VIKSIT BHARAT**

A Discussion Hosted and Organised by the

**INSTITUTE OF ECONOMIC GROWTH**

May 4, 2026 | 3:00-4:30 pm | India Habitat Centre, New Delhi

# Introduction

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**Building** resilient state finances is central to realising the vision of Viksit Bharat. It calls for renewed focus on a critical yet often underexamined pillar of India's economy, the fiscal health of state governments.

Fiscal systems worldwide are under strain. While developing economies account for a smaller share of global public debt than advanced economies, their debt is rising much faster, heightening fiscal vulnerabilities and constraining policy space. Their fiscal position is therefore not peripheral but foundational to macroeconomic stability and long-term growth.

India's federal structure reinforces this reality. National fiscal sustainability cannot be achieved through Union action alone; it depends equally on the strength, discipline, and resilience of state finances. A sustainable fiscal framework for Viksit Bharat thus requires close Union–state coordination. Fiscal federalism is not merely a constitutional arrangement for sharing powers and resources; it is a functional instrument for ensuring macroeconomic stability, efficient public service delivery, and inclusive growth. In this context, the discussion emphasises how fiscal federalism operates in practice and how deeper coordination can strengthen India's long-term fiscal trajectory.

**Fiscal federalism is not merely a constitutional arrangement for sharing powers and resources; it is a functional instrument for ensuring macroeconomic stability, efficient public service delivery, and inclusive growth.**



# Keynote Address

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**The keynote** address underscored the need for sustained analytical scrutiny of state finances as a prerequisite for strengthening India's fiscal resilience and advancing its transition to a higher-income economy.

State finances are no longer merely a subnational concern; they are integral to macroeconomic stability, development outcomes, and the credibility of India's overall fiscal framework. The address also highlighted a challenging external environment, marked by geopolitical tensions, elevated commodity prices, particularly crude oil, and slowing global growth. While these pressures originate outside the country, their fiscal consequences are largely absorbed domestically, most directly by states. Rising input costs expand subsidy burdens, while economic uncertainty increases demand for welfare support and employment programmes. As a result, states are compelled to spend more even as their fiscal space tightens. As the country aspires to higher income levels, the quality of state-level fiscal management will be pivotal in determining both the pace and inclusiveness of growth.

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# Keynote Address

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A central theme of the address was the growing divergence in fiscal performance across states. Some states have sustained revenue surpluses while scaling up capital expenditure, particularly in infrastructure. With lower interest burdens, they can channel borrowing toward productive investment that yields long-term returns. Others, however, continue to run persistent fiscal deficits driven by high revenue expenditure, with limited capital outlay. In these cases, borrowing is increasingly used to finance current spending, such as salaries, pensions, and subsidies, rather than to finance asset creation, thereby undermining future growth potential.

This divergence reflects deeper incentive structures. Capital expenditure, despite its long-term benefits, offers limited immediate political returns, strengthening the preference for direct cash transfers. Unconditional transfers now amount to nearly ₹1.7 lakh crore (around 0.5 per cent of GDP) and are concentrated largely in revenue-deficit states. Unlike capital outlays, which generate compounding returns, such spending has relatively weak fiscal and productivity multipliers. The emerging divide between capital-led and consumption-led expenditure is thus becoming a defining feature of fiscal strength versus stagnation across states.



(Left to Right) Prof Pravakar Sahoo, Dr V. Anantha Nageswaran and Prof Sabyasachi Kar

# Fiscal Health Index

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**The Fiscal Health Index** was presented as a comprehensive tool to assess the financial performance of states.

Rather than relying on a single metric, it evaluates multiple dimensions, including the quality of expenditure, revenue mobilisation, fiscal discipline, debt sustainability, and growth. Its findings reinforce the pattern of divergence across states. Stronger performers are characterised by higher capital expenditure, controlled deficits, and prudent debt management. In contrast, weaker states exhibit lower investment spending, a higher share of committed expenditure such as salaries and pensions and weaker revenue mobilisation. A key takeaway is that fiscal stress is rarely cyclical; it is structural. Persistent imbalances typically reflect deeper issues, including limited tax capacity, rising committed liabilities, and underinvestment in growth-enhancing sectors. Addressing these challenges, therefore, requires sustained structural reforms rather than short-term fiscal adjustments.

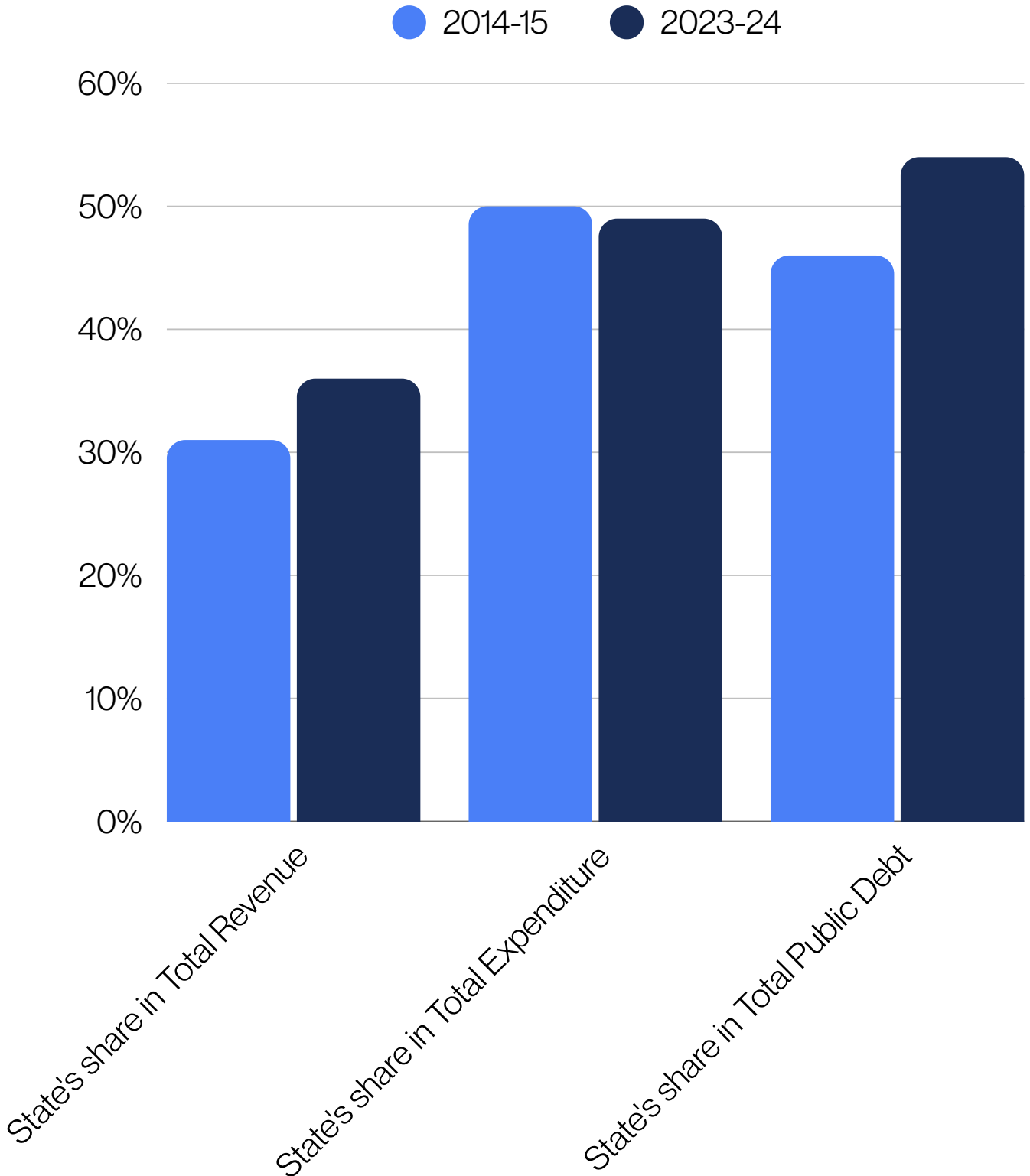
Importantly, fiscal stress at the subnational level is neither isolated nor contained. Investors increasingly evaluate India through the lens of general government finances, combining the fiscal positions of both the Centre and the states. Consequently, weaknesses in individual state finances can elevate national borrowing costs, affect macroeconomic stability, and erode the credibility of India's broader fiscal framework.



**Prof Pravakar Sahoo, Senior Lead,  
NITI Aayog & Faculty at IEG**

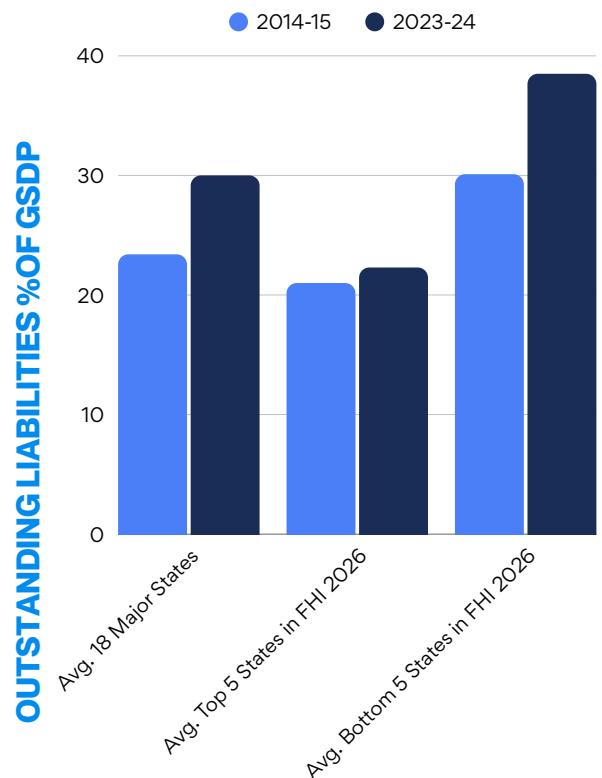
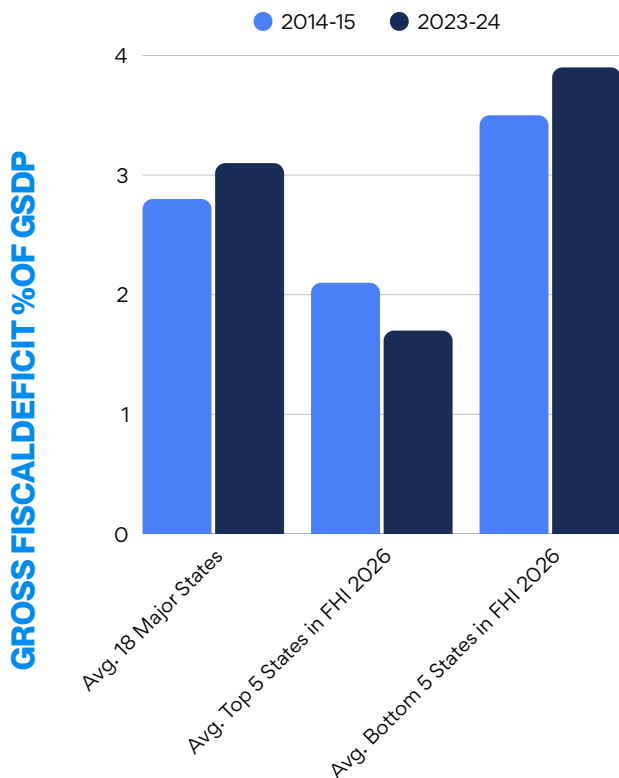
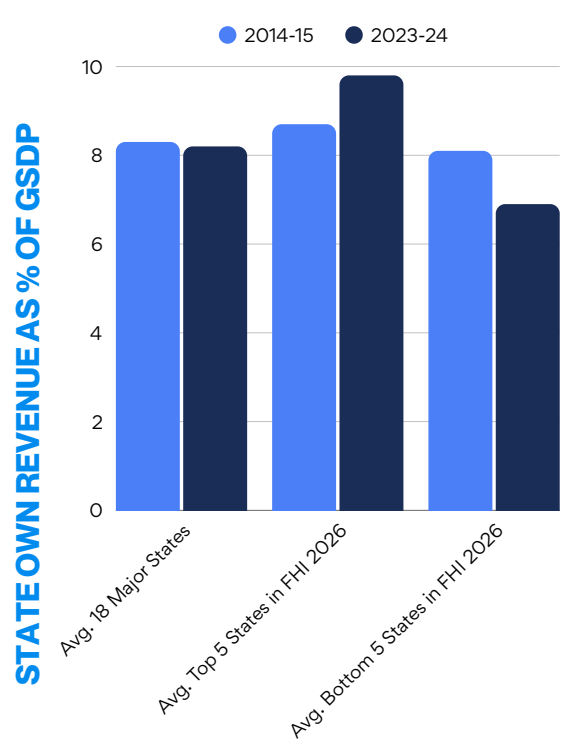
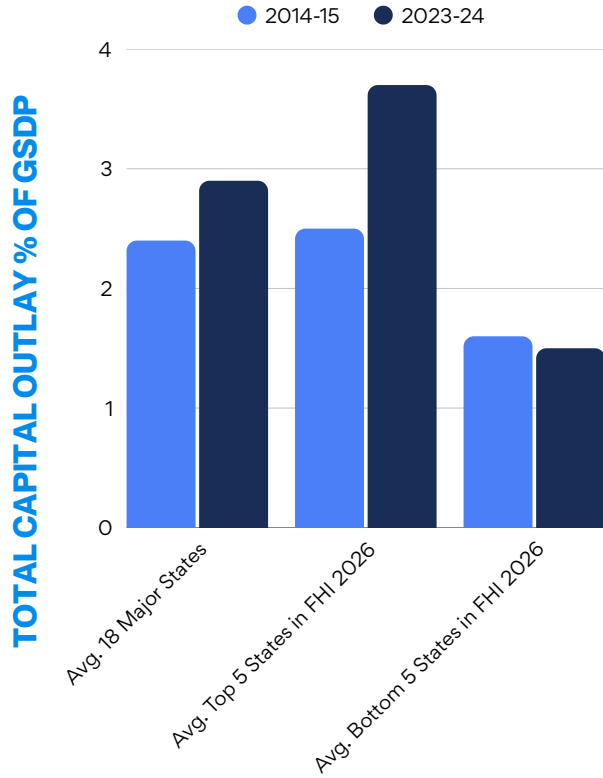
# State of State Finances

## SHARE OF STATES IN THE TOTAL GOVERNMENT FISCAL METRICS



# State of State Finances

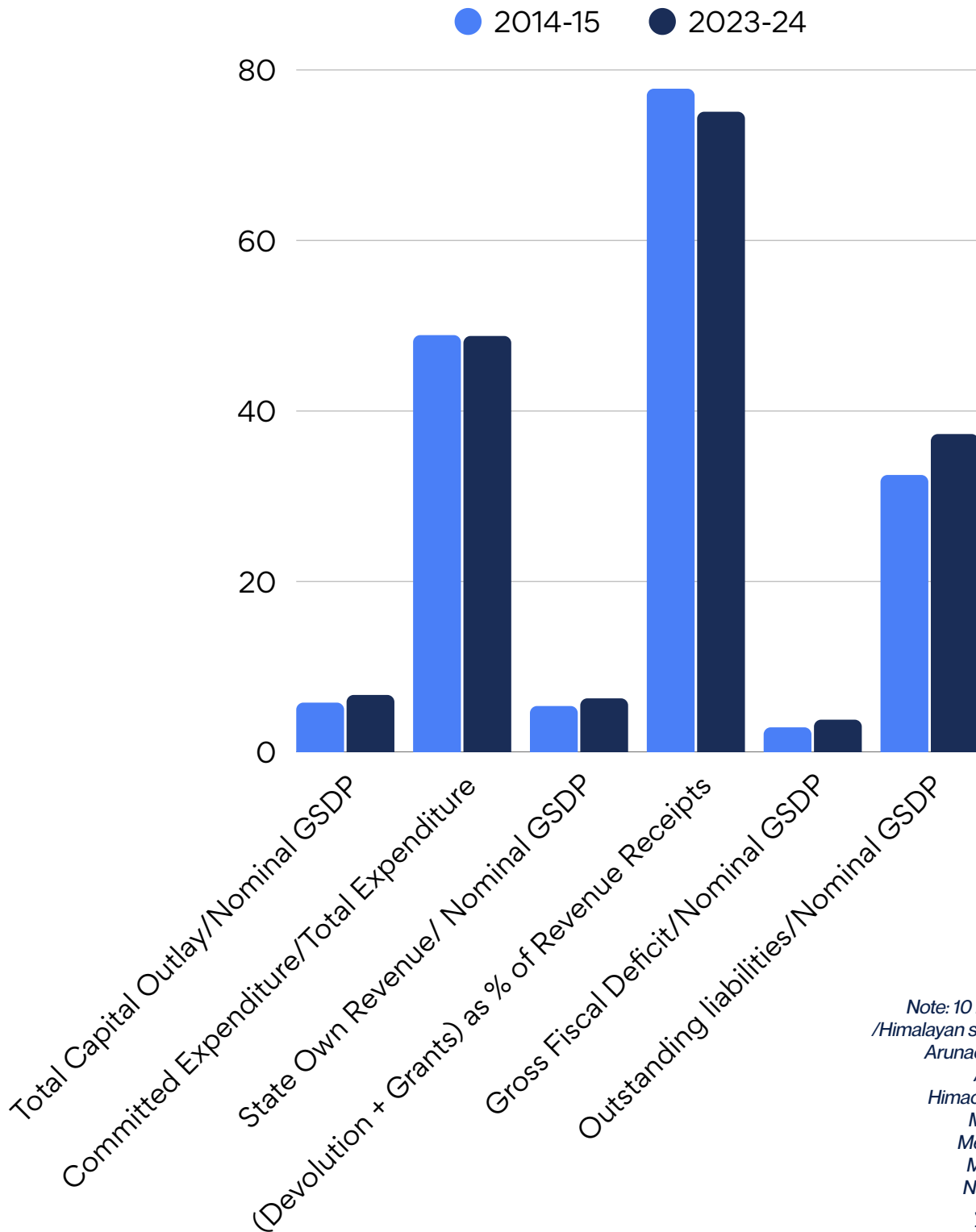
## PERFORMANCE OF MAJOR STATES ON A FEW FISCAL INDICATORS



(Note: 18 Major States, the top 5 and the bottom 5 states have been considered on the basis of the Fiscal Health Index (FHI 2026) of NITI AAYOG. The top 5 states include Odisha, Goa, Jharkhand, Gujarat and Maharashtra. The bottom 5 states include Rajasthan, Andhra Pradesh, West Bengal, Kerala, and Punjab. These states have been evaluated based on Quality of Expenditure, Revenue Mobilisation, Fiscal Prudence, Debt Index, and Debt Sustainability.)

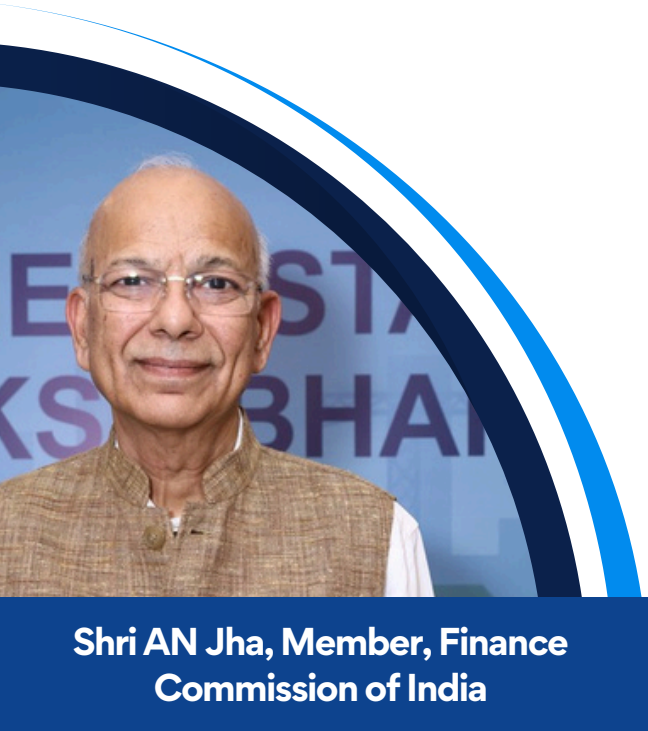
# State of State Finances

## INDICATOR LEVEL PERFORMANCE OF AVERAGE OF 10 NORTH-EASTERN / HIMALAYAN STATES ACCORDING TO FHI 2026



Note: 10 North-eastern/  
/Himalayan states included are:  
Arunachal Pradesh  
Assam  
Himachal Pradesh  
Manipur  
Meghalaya  
Mizoram  
Nagaland  
Sikkim  
Tripura  
Uttarakhand

# Panel Discussion



**Shri AN Jha, Member, Finance Commission of India**

**It highlighted** a fundamental imbalance in India's fiscal federal architecture: states bear substantial expenditure responsibilities but have limited autonomy to raise revenue. This asymmetry leaves them heavily reliant on Union transfers, particularly through Finance Commission devolution and centrally sponsored schemes. While such transfers are essential for maintaining fiscal balance, they do not fully address the underlying structural gap and can, over time, weaken incentives for states to strengthen their own revenue bases. At the same time, the discussion underscored that weak revenue performance cannot be attributed solely to policy choices. Many states operate under structural constraints, such as geographic limitations, lower levels of industrialisation, and a high dependence on agriculture, that inherently restrict revenue capacity.

These factors create genuine fiscal disadvantages that cannot be resolved through uniform policy prescriptions. The core challenge, therefore, lies in distinguishing structural constraints from policy inefficiencies and designing fiscal responses that account for both

A key shift in the discussion was the emphasis on revenue mobilisation as central to fiscal sustainability. Public discourse on state finances often overemphasises expenditure control, but long-term resilience depends equally on the ability to generate stable and sustainable revenues. India's tax-to-GDP ratio has remained broadly stagnant, with states contributing a relatively modest share, though performance varies significantly across them. In some states, weak revenue mobilisation reflects structural constraints such as a narrow tax base and high dependence on agriculture.



**Dr Shamika Ravi, Member, PM-EAC**

# Panel Discussion

In others, it stems from administrative inefficiencies, weak compliance, and policy choices that limit revenue effort. The implication is clear: improving fiscal health requires a balanced approach: rationalising expenditure, strengthening revenue systems, enhancing compliance, and expanding the tax base where feasible.

The discussion also highlighted the limited role of market discipline in shaping state fiscal behaviour. In theory, fiscally stronger states should benefit from lower borrowing costs, while weaker ones face higher rates. In practice, this differentiation is muted. State borrowing is widely perceived to carry an implicit sovereign backstop, and pooled borrowing arrangements further compress risk distinctions. As a result, financial markets exert little effective discipline. This underscores the need for stronger alternative mechanisms, i.e., fiscal rules, institutional oversight, and



**Shri Jayant Sinha, Advisor to CAG**

transfer design to promote fiscal prudence.

Data quality and fiscal transparency emerged as another critical theme. Weaknesses in fiscal reporting —such as off-budget borrowing, expenditure misclassification, and reporting delays can significantly distort states' true fiscal positions. Off-budget liabilities understate debt, while misclassifying routine spending as capital outlay inflates perceptions of productive investment. These practices weaken transparency, dilute accountability, and hinder sound policy assessment.

The discussion underscored the need to strengthen expenditure quality metrics and institutionalise accountability standards. Encouragingly, improvements are underway, including more frequent reporting, monthly fiscal updates, and greater standardisation in accounting practices. Enhancing data quality and transparency will be essential for



**Shri Jayant Sinha & Prof Sabyasachi Kar**

# Panel Discussion

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better fiscal oversight, more informed policymaking, and stronger accountability in state finances.

A clear way forward emerged from the discussion, centred on a balanced, long-term approach to strengthening state finances. Borrowing must be directed primarily toward productive investment rather than routine expenditure, and efforts must be made to contain committed spending. Equally important is strengthening revenue systems through better tax administration, improved compliance, and the expansion of viable revenue sources. Institutional reforms will be critical, particularly in the design of intergovernmental transfers and fiscal rules. These must incentivise prudent fiscal behaviour while accommodating genuine structural constraints across states. Improving data quality and transparency will further enhance accountability and build credibility with investors and the public.

Ultimately, India's transition to a developed economy hinges on the strength of its state finances. With states accounting for the bulk of public expenditure and development activity, their fiscal health is central to sustaining growth, ensuring efficient use of resources, and addressing regional disparities. The journey toward Viksit Bharat will depend as much on fiscal choices at the state level as on those taken by the Union.

**The journey toward Viksit Bharat will depend as much on fiscal choices at the state level as on those taken by the Union.**



**(Left to Right) Shri Jayant Sinha, Dr Shamika Ravi, Shri AN Jha and Prof Sabyasachi Kar**

# Key Takeaways



**Fiscal Federalism and Coordination**

Developing economies, including India, face rising debt and fiscal pressures, making subnational fiscal health increasingly important. India's fiscal sustainability depends on both the Union and state governments; effective fiscal federalism and coordination are critical.



**Challenging Global Backdrop**

External challenges such as geopolitical tensions, high commodity prices, or slow global growth will increase spending pressures at the subnational level while reducing fiscal space.



**Divergence in Fiscal Outcomes**

There is growing divergence across fiscal outcomes in states. Stronger states have higher capital expenditure, controlled deficits, and better debt management. Weaker states show high revenue expenditure, persistent deficits, and limited investment in growth. Borrowing in weaker states is often used for current spending (salaries, subsidies) rather than productive investment, harming long-term growth.



**Welfare Spending**

Incentive structures favour short-term welfare spending over capital investment, contributing to fiscal divergence.

# Key Takeaways



India's Fiscal Credibility

Rising unconditional transfers (cash transfers) yield weaker long-term economic returns than capital expenditure.

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Revenue Mobilisation

Fiscal stress in states is largely structural (e.g., weak tax capacity, high committed liabilities), requiring long-term reforms rather than short-term fixes.

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Market Discipline

Weak state finances can raise national borrowing costs and affect India's overall fiscal credibility.

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Data Quality and Transparency

Revenue mobilisation is as important as expenditure control for fiscal sustainability; states must improve tax systems, compliance, and broaden the tax base.

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Market discipline on state borrowing is weak due to perceived sovereign backing, necessitating stronger fiscal rules and institutional oversight.

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Poor data quality and transparency (off-budget borrowing, misclassification) distort fiscal assessments and weaken accountability.

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# Key Takeaways



Reforms



Roadmap

Improvements in fiscal reporting and transparency are underway, but need further strengthening.

Key reforms need to (i) Prioritise capital expenditure over routine spending, (ii) Contain committed expenditures, (iii) Strengthen revenue mobilisation, (iv) Reform fiscal rules and transfer mechanisms and (v) Improve data transparency and accountability.



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