2. CAG Report on The Fiscal Health of States

The Comptroller and Auditor General (CAG) has released a decadal analysis of the fiscal health of India's 28 states, highlighting a sharp rise in public debt over the last decade. Given that States collectively spend more than the Union Government on welfare and development, the findings hold major implications for federalism, welfare delivery, and sustainable growth.

Overview of the CAG Report on State Debt

Debt Growth Over a Decade - States' total public debt increased 3.39 times, from ₹17.57 lakh crore in 2013–14 to ₹59.60 lakh crore in 2022–23, reflecting a substantial rise in borrowing to meet expenditures.

Debt as Percentage of GSDP - The debt-to-GSDP ratio increased from 16.66% to 22.96%, showing that debt has grown faster than state economies.

Key Fiscal Terms -

GSDP - Value of all goods and services produced within a state.

Debt-to-GSDP Ratio - Measures debt burden relative to the size of a state's economy.

Debt-to-Revenue Ratio - Shows how much of a state's income is tied up in debt obligations.

Debt-to-Non-Debt Receipts Ratio - Indicates if routine state income can cover debt, excluding borrowings.

Divergent State Debt Profiles

Highest Debt-to-GSDP - Punjab (40.35%), Nagaland (37.15%), West Bengal (33.70%).

Lowest Debt-to-GSDP - Odisha (8.45%), Maharashtra (14.64%), Gujarat (16.37%).

Debt Distribution (March 2023) -

1. 8 states > 30% GSDP
2. 6 states < 20% GSDP
3. 14 states between 20–30% GSDP

Rising Debt Relative to Revenue

Debt-to-Revenue Trend - 128% in 2014–15 → 191% in 2020–21 (COVID-19 year). On average, states' debt has been ~150% of revenue receipts, highlighting sustainability concerns.

Non-Debt Receipts - Debt was 127–190% of total non-debt receipts.

Revenue Dependence - States differ widely in internal revenue generation -

1. Maharashtra - 70%
2. Uttar Pradesh - 42%
3. Arunachal Pradesh - 9%

Many states rely on volatile, unsustainable sources - lotteries (Kerala), mining royalties (Odisha), land sales (Telangana).

Reasons for High State Debt

Reduced Fiscal Autonomy Post-GST - GST (2017) centralized indirect taxes, reducing states' powers to raise revenue. Rising **cesses and surcharges** (from 10.4% in 2011–12 to 20% in 2021–22) further shrank the divisible pool.

Cess - A tax levied for a specific purpose, earmarked for particular use (Articles 270 & 277).

Surcharge - An additional levy on existing taxes (Articles 270 & 271).

Revenue-Expenditure Mismatch - States collect less than one-third of total revenues but manage nearly two-thirds of public expenditure. Structural deficit forces higher borrowings.

Populist Expenditure & Subsidies - Free power, farm loan waivers, and welfare schemes increase recurring costs. Borrowings often fund salaries, pensions, and subsidies rather than long-term infrastructure.

Pandemic Shock - Tax collections collapsed during COVID-19. Emergency health and welfare spending spiked, raising debt levels.

Market Borrowings (SDLs) - Now the largest component of state debt, carrying higher interest rates. Some states spend 20–25% of revenue just on interest payments.

Violation of the "Golden Rule of Borrowing" - Borrowing should fund capital expenditure, not current expenditure. 11 states, including Andhra Pradesh, Punjab, Bihar, Kerala, and Tamil Nadu, used borrowings mainly for current spending. In AP & Punjab, only **17–26%** of borrowings went to capital expenditure.
COVID-19 Effect on Debt-to-GSDP - Jumped from 21% (2019–20) → 25% (2020–21) due to economic contraction and emergency borrowing.
GST Compensation Shortfalls - Led to central loans and special assistance, deepening dependence on the Union.

Implications of Rising State Debt

Threat to Fiscal Federalism - Rising debt increases dependence on central transfers, weakening financial autonomy. Even surplus states like UP rely heavily on Union transfers (58% in some cases).
Risk of Fiscal Mirage - Token welfare schemes or off-budget borrowings may show surplus but do not indicate true financial health.
Centre-State Fiscal Balance - Centre's debt (~57% of GDP) + state debt (~23% of GDP) → general government debt ~80% of GDP, exceeding the 60% FRBM target.
Volatile Revenue Dependence - Revenue from lotteries, land sales, or mining is unpredictable, increasing risk of unsustainable debt.
Intergenerational Equity - Borrowing for current expenditure shifts the burden to future taxpayers without creating productive assets.

Way Forward - Managing State Debt

Broaden Revenue Base - Strengthen property taxes, improve GST compliance, diversify non-tax revenue streams.
Prioritise Productive Spending - Borrowings should focus on capital investments (infrastructure, health, schools), aligning with the "golden rule."
Debt Restructuring - Refinance high-cost debt, explore cheaper sources (NSSF, green bonds, infrastructure bonds). Maintain debt ceilings within FRBM limits.
Strengthen Social Safety Nets - Build targeted welfare systems that protect vulnerable populations without excessive budget pressure.
Innovate Financing - Use PPPs, municipal bonds, blended finance models to fund infrastructure sustainably.
Improve Public Financial Management - Adopt performance-based budgeting linked to outcomes. Use Fiscal Health Index (FHI) for benchmarking. Digitalize procurement and spending to curb leakages.

FRBM Act, 2003 and Its Relevance

Objective - Ensure fiscal discipline, reduce deficits, and promote long-term economic stability while protecting intergenerational equity.
Key Provisions -

1. Fiscal Responsibility - Regular reporting to Parliament.
2. Medium-Term Fiscal Policy (MTFP) - 3-year rolling framework for deficit and debt targets.
3. Oversight - CAG ensures compliance and transparency.

Debt & Fiscal Deficit Targets (2018 Amendment) -

1. General government debt - ≤ 60% of GDP
2. Central government debt - ≤ 40% of GDP by FY 2024–25
3. Fiscal deficit - ≤ 4.5% of GDP by FY 2025–26

States - Many breach the recommended debt-to-GSDP ceilings (20–25%), highlighting sustainability concerns.

Conclusion

Rising state debt, structural fiscal gaps, and dependence on central transfers threaten fiscal federalism and effective welfare delivery. Sustainable management requires -

1. Diversified and stable revenue sources
2. Borrowing focused on productive, capital investments

3. Transparent, accountable financial management
4. Adherence to the FRBM framework to ensure long-term fiscal health

Source - https - //www.thehindu.com/business/Economy/analysing-indian-states-macro-fiscal-health/article70105107.ece