IV The Way Forward

The elevated level of State government debt necessitates a clear, transparent and time-bound glide path for consolidation with transparent and uniform reporting of outstanding liabilities, including off-budget borrowings and guarantees, and expenditure efficiency with outcome and climate budgets. Strengthening of State Finance Commissions is critical for ensuring adequate and timely fund transfers to local bodies.

4.1 While the progress in improving post-pandemic State finances is commendable, a durable fiscal consolidation must mark the way forward.

4.2 First, an area of incipient stress is the sharp rise in expenditure on subsidies, driven by farm loan waivers, free/subsidised services (like electricity to agriculture and households, transport, gas cylinder) and cash transfers to farmers, youth and women. States need to contain and rationalise their subsidy outgoes, so that such spending does not crowd out more productive expenditure.

4.3 Second, too many Central government schemes reduce flexibility of State government spending and dilute the spirit of cooperative fiscal federalism. Rationalisation of centrally sponsored schemes (CSS) can free up budgetary space to meet State-specific expenditure needs and reduce the fiscal burden of both the Union and the State governments.

4.4 Third, the persistent high level of sub-national debt calls for a credible roadmap for debt consolidation. Following the Centre's strategy outlined in the Union Budget 2024-25, States with elevated debt levels may establish a clear, transparent and time-bound glide path for debt consolidation, that is aligned with macroeconomic objectives such as debt sustainability, economic resilience, and fiscal flexibility.

4.5 Fourth, timely availability of reliable and comprehensive data is crucial for fiscal risk assessment of States. There are significant spatial variations in definitions, coverage and methodologies. Moreover, certain definitions in States' FRLs are often inconsistent with those of the Finance Commissions, the Union Ministry of Finance, and the Reserve Bank, leading to ambiguities in reporting, differential treatments of public account items, non-uniform nomenclature, and underreporting of debt liabilities. A time-bound effort by States to provide data on outstanding liabilities in a uniform format (Annex IV.1) in their budget documents would improve the quality of subnational finances and aid both analysts and State governments in assessing fiscal health of States.

4.6 Fifth, uniform reporting of contingent liabilities and off-budget borrowings by States is important. Consistent reporting of off-budget borrowings would enhance fiscal transparency and discipline with potential benefits like lower borrowing costs.[1]

[1] Although the CAG provides information pertaining to off budget borrowings by State governments in its publications, these are not in uniform format across States.

4.7 Sixth, improving public expenditure efficiency by implementing outcome budgeting, *i.e.*, linking spending to measurable outcomes, to foster accountability and targeted resource use is crucial to generate maximum developmental impact. Such an approach would prioritise allocations for sectors with meaningful economic and social benefits. Additionally, outcome-based reports provide citizens an insight of how their tax money is being utilised, fostering public trust, encouraging civic engagement and enhancing the quality of spending.

4.8 Seventh, the adoption of climate budgeting to integrate climate action into fiscal planning should be a priority. Going forward, it is essential for States to strengthen data systems, build technical capacity, and promote inter-state knowledge sharing to standardise and enhance climate budgeting practices. This could aid the States in entrenching climate change action within the development frontier and contribute to strong, sustainable growth.

4.9 Eighth, a timely availability of quarterly fiscal data of States assumes relevance in the context of the G20 data gaps intiative-2 (DGI-2) which advises member nations to disseminate quarterly general government data consistent with the GFSM 2014[2] standards. The CAG may improve the depth and granularity of States' monthly accounts and consider releasing a consolidated position at least on a quarterly basis.

4.10 Ninth, State departments engaged in delivering public services such as education, health and internal security generate vast amount of micro-data that remain underutilised. With the rapid digitalisation of tax collection machinery, taxation authorities generate large volumes of big data. States' public finance management systems also produce extensive data corresponding to fiscal transactions of the government. States could harness capabilities, either within their Finance Departments or Directorates of Economics and Statistics, or through partnerships with technical institutions to leverage this data for improved public policy and better governance.

4.11 Finally, the role of State Finance Commissions (SFCs) is crucial for evolving principles that can be applied towards the devolution of funds to local governments. Timely and adequate transfers to local bodies by States are vital for strengthening decentralised governance, enabling *panchayats* and urban local bodies to fulfil their functions in service delivery and in provision of infrastructure. A multi-pronged approach of refining the process of appointment of SFCs, data collection and dissemination and improving the quality of the SFC reports is called for.

4.12 Overall, while the State governments have made progress in fiscal consolidation, there is scope for further improvement in expenditure efficiency, outcome and climate/green budget, uniform and more transparent data reporting and use of modern techniques like artificial intelligence and machine learning. Concerted efforts by States in these areas will pave the way for higher economic growth with macroeconomic stability.

[2] Government Finance Statistics Manual (GFSM), 2014.

Annex IV.1: Statement on Total Outstanding Liabilities

(in ₹Crore)

Component	2023-24 (Accounts)	2024-25 (Revised Estimates)	2025-26 (Budget Estimates)
I. Internal Debt (a to d)			
a. Market Borrowing			
b. NSSF			
c. WMA from RBI			
d. Loans from Banks and FIs (i to vi)			
i. Loans from LIC			
ii. Loans from GIC			
iii. Loans from NABARD			
iv. Loans from SBI and other Banks			
v. Loans from NCDC			
vi. Loans from Other Institutions			
II. Loans from the Centre			
of which: External Assistance			
III. Provident Funds			
IV. Reserve Funds			
V. Deposit and Advances			
VI. Contingency Funds			
VII. Outstanding Liabilities (I to VI)			
of which: Public Debt (I+II)			
VIII. GSDP (In current prices)			