IV The Way Forward

4.1 The fiscal health of States has rebounded from pandemic induced stress, aided by buoyant revenue collections and prudent expenditure management. The undershooting of budgetary targets for key deficit indicators has enabled States to reduce their outstanding liabilities.

4.2 These developments have extended into 2022-23 so far. A coincident indicator of this sustained improvement is that market borrowings are much lower than in the indicative calendar due to comfortable cash flow positions of the States, boosted by timely payment of GST compensation by the Centre (May and November 2022) and release of two advance instalments of tax devolution (August and November 2022). The States need to take advantage of this 'sweet spot' by building up fiscal buffers and stepping up capex.

4.3 The recognition of off-budget borrowings of States in their debt positions and within annual borrowing ceilings is a welcome step towards achieving transparency.

4.4 A major risk looming large on the sub-national fiscal horizon is the likely reversion to the old pension scheme by some States. The annual saving in fiscal resources that this move entails is short-lived. By postponing the current expenses to the future, States risk the accumulation of unfunded pension liabilities in the coming years.

4.5 Going forward, increased allocations of capital expenditure for sectors like health, education, infrastructure and green energy transition can help expand productive capacities and create a broad-based developmental agenda for the States. Outlays on social services and physical infrastructure can enhance productivity; hence, States must mainstream capital planning rather than treating them as residuals and first stops for cutbacks in order to meet budgetary targets. In this context, it is worthwhile to consider creating a capex buffer fund during good times when revenue flows are strong so as to smoothen and maintain expenditure quality and flows through the economic cycle.

4.6 States also need to step up their expenditure on research and development (R&D) from the current lows compared to global peers[1] so as to spur innovation and progress.

4.7 Climate change is another area that deserves special attention in the coming years. There is a growing recognition of the need for responsible climate change policies at the State-level in areas such as clean energy, energy efficiency, clean transport, and sustainable land use, among others. Capacity building on access to finance and climate governance would help States meet their potential and realise the committed national target of net zero emissions by 2070. In this regard, climate-incentivised borrowing ceilings may encourage States to issue green bonds in order to finance green projects. Also, within the Scheme for Special Assistance to States for Capital Investment, a separate head

[1] As per the latest data available from World Bank (World Development Indicator Database) till 2020, most of the OECD countries spend more than 2 per cent of their GDP on R&D. Among the BRICS countries, expenditure on R&D amounts to 1.2 per cent of GDP in Brazil; 2.4 per cent in China; 1.1 per cent in Russia; and 0.6 per cent in South Africa as against 0.7 per cent in India. Among others, Israel and South Korea spend 5.4 per cent and 4.8 per cent of GDP, respectively, on R&D.

for climate-related investment projects can be created.

4.8 The COVID-19 pandemic, geopolitical events and global spillovers from synchronised aggressive monetary policy tightening have stalled the progress on Sustainable Development Goals (SDGs). India has in fact, slipped (Sachs *et al.,* 2022). Going ahead, India's commitment to achieve the SDG goals by 2030 is heavily conditioned by policies and actions adopted by the States. With the Centre's recent thrust towards 'SDG Localisation'[2], States are now better equipped to orient their spending and investment patterns towards areas requiring attention. Capital expenditure by States in critical areas, *viz.*, health, education, infrastructure, R&D and green energy transition holds the key to India achieving the SDGs.

4.9 As a part of institutional reforms, State governments need to set up Finance Commissions (SFC) in a regular and timely manner to decide on the assignment of taxes, fees and other revenues to local governments. Institutionalisation of a well-defined and timely devolution mechanism to local governments can improve the provision of quality services for the greater public good.

[2] As part of the 'Indian Model of SDG Localisation', the NITI *Aayog* has already instituted progress monitoring systems at the national, state and local levels. The *SDG India Index and Dashboard*, the *North Eastern Region District SDG Index* and *Dashboard* and the *SDG Urban Index and Dashboard* have enabled the monitoring of progress in respect of numerous SDG indicators at the sub-national level (NITI *Aayog,* 2022).