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Overview

1.1 Since the release of the Report titled ‘State Finances: A Study of Budgets of 2020-21’ in October last year - with the spatial dimensions of the COVID-19 pandemic as its theme - the world has suffered from the emergence of newer variants of the virus, renewed waves of the pandemic and further lockdowns/ containment measures. In India, the second wave of the pandemic resulted in a sharp rise in infections and mortalities within a very short period of time. Localised and regional restrictions imposed by State and local governments (LGs) slowed down economic activity *albeit* to a lesser extent than during the nation-wide lockdown at the time of the first wave. As the second wave ebbs and normalcy is gradually restored, the speed and scale of vaccination will shape the path of economic recovery (RBI, 2021)¹.

1.2 While all tiers of governments joined hands in the fight against COVID-19, the LGs took up additional responsibilities, *viz.*, setting up make-shift hospitals and quarantine centres; contact-tracing; ramping up testing facilities; distribution of free food to the poor; information dissemination; implementing travel restrictions; fostering COVID-appropriate behaviour among the public; maintaining the supply of essential goods and services; and organising vaccination camps while simultaneously addressing vaccine hesitancy issues. Accordingly, this year’s report on State finances is dedicated to that effort and chooses the theme “Coping with the Pandemic: A

Third-Tier Dimension.” It explores the role played by LGs, especially, municipal corporations (MCs) across various States in India in response to the pandemic.

1.3 The choice of the theme is motivated by three factors. First, LGs are by design suited to undertake effective and timely intervention as they are better informed about local needs, can mobilise local people and monitor progress at the grass-root level (Agarwal, 2009). They can also perform certain functions effectively, like encouraging cooperation with public health recommendations, especially during a pandemic-like crisis (Faguet, 2014; Quinn *et al.*, 2013). LGs have also been found to be more successful than other tiers of the government in ensuring compliance with regulations, encouraging community-wide participation, and responding to the immediate needs of the public (Manor, 1999; Dutta and Fischer, 2020). The responsibilities assigned by the Constitution of India to the local governments, *viz.*, public health, sanitation, registration of births and deaths, and maintenance of burial grounds and cremations² became the focus of the response to the COVID-19 crisis.

1.4 Second, as densely populated cities and districts again emerged as ‘hotspots’ in the second wave, local governments and district administration authorities were at the forefront, enforcing localised restrictions and other measures which helped minimise the loss of output and livelihood relative to the first wave.

¹ RBI Bulletin, State of the Economy, June 2021.

² This is in accordance with the principle of subsidiarity that the level of government closest to the community should be entrusted with all public functions it can handle (Conlan, 2006).

1.5 Third, coping with the pandemic necessitated not only emergency policy responses but also recovery and restoration measures all of which became dependent on the level of preparedness, fiscal strength, quality of crisis management as well as accessibility of health care facilities and essential equipment that varied across local governments. Several success stories of effective and innovative interventions at the grass-root level about containment, treatment and vaccination have created opportunities for peer learning and exchanging knowledge and experience (RBI, 2021a).

1.6 Historically, pandemics have been the portals of structural and even societal change. The second wave has shed light on India's third tier of government, the weakest link in India's federal structure. Strengthening local governments in terms of resources, health infrastructure and capacity building can enable them to build resilience to future shocks and support the rapid pace of urbanisation and social change in a sustainable manner. The 15th Finance Commission's recommendation of higher transfers to local bodies (₹4.36 lakh crore for the period 2021-26) is a step in this direction.

1.7 As per tradition, Chapter II of this Report undertakes an in-depth analysis of the fiscal position of States in terms of actual outcomes for 2019-20, revised estimates and provisional accounts for 2020-21, and budget estimates for 2021-22. The chapter also discusses recovery

plans of State governments in 2021-22 as reflected in their budget documents. Additionally, in view of the 15th Finance Commission's report submitted to the Parliament in February 2021, the chapter examines the evolving role of finance commission transfers in shaping State finances. It also assesses the indebtedness of State governments in terms of their market borrowings and outstanding liabilities.

1.8 In line with this year's theme, Chapter III delves into the local dimensions of the pandemic and the role played by the third-tier governments in coping with the crisis. The chapter analyses the severity and the spread of the second wave *vis-à-vis* the first wave across localities and the efforts of third tier governments in containment, treatment and vaccination. The challenges faced by India's third-tier governments in terms of resource constraints and infrastructure bottlenecks as well as post-pandemic strategies to build resilience are also addressed in this Chapter.

1.9 Chapter IV concludes by envisaging the way forward for State finances, keeping in view the positive impact of increased pace of vaccination coverage, the strengthening economic recovery and the likely consequences of a possible third wave of COVID-19.

1.10 Data on various budgetary components and fiscal indicators of all the States and Union Territories with legislature are presented in appendices and statements.