IV The Way Forward

4.1 The improvement in State finances through 2021-22 and 2022-23 on the back of a reduction in the revenue deficit paved the way for a strong push to capital outlay and augured a favourable fiscal outlook for 2023-24. So far, buoyancy in revenues has supported consolidation and sustained a large increase in capital spending. Over the medium term, however, States need to address several challenges to fiscal sustainability.

4.2 To start with, the return to the Old Pension Scheme (OPS) by a few States and reports of some other States moving in the same direction would exert a huge burden on State finances and restrict their capacity to undertake growth-enhancing capital expenditures. Internal estimates suggest that if all the State governments revert to OPS from the National Pension System (NPS), the cumulative fiscal burden could be as high as 4.5 times that of NPS, with the additional burden reaching 0.9 per cent of GDP annually by 2060. This will add to the pension burden of older OPS retirees whose last batch is expected to retire by early 2040s and, therefore, draw pension under the OPS till the 2060s. Thus, any reversion to OPS by the States will be a major step backwards, undermining the benefits of past reforms and compromising the interest of future generations.

4.3 Second, some States have budgeted for fiscal deficits exceeding 4 per cent of GSDP in 2023-24 as against the all-India average of 3.1 per cent. They also have debt levels exceeding 35 per cent of GSDP as against the all-India average of 27.6 per cent. Any further provision of non-merit goods and services, subsidies, transfers and guarantees will render their fiscal situation precarious and disrupt the overall fiscal consolidation achieved in the last two years.

4.4 Going forward, there is a need for scaling up fiscal capacity for uninterrupted and efficient delivery of social, economic and general services to the people and for upgrading the quality of physical and human capital. GST implementation has led to greater formalisation of the economy which is important from the point of view of expanding the tax base, without unduly raising the tax burden. Improvement in tax administration, including data analytics to curb tax evasion, will likely augment fiscal capacity of the States. In addition, the institutional strength of States' revenue departments should be enhanced for effective implementation of policies and regulations. To incentivise such efforts, financial incentives to those States that initiate measures to boost tax revenue collections may be considered. For sustained fiscal consolidation, FC- XVI could examine reinstating some of the fiscal efficiency parameters.

4.5 States need to scale up their initiatives for asset monetisation in order to increase non-tax revenue. Monetisation of assets unlocks their value, eliminates their holding cost and enables scarce public funds to be deployed into new projects, thus fast-tracking new infrastructure creation. State governments need to tap into their sizeable infrastructure asset base, with significant potential in roads, transport and power sectors. A comprehensive review of unutilised land assets and their conversion into revenue generating industrial estates or monetising them by outright sale would also help to mobilise revenues. Similarly, in the case of non-operational public sector undertakings (PSUs), States may expedite their liquidation to curb losses.

4.6 Mining is an important source of non-tax revenue for the mineral-rich States. A robust mechanism to prevent, detect and curb illegal mining activities would shore up their revenues. The use of modern technologies such as, Geographic Information Systems (GIS) and Drone Surveys may be utilised by the States for identifying and curbing illegal mining activities.

4.7 There is also a need for review of the current system of grants from the Centre to the States. Currently, revenue deficit grants are disbursed to those States which are assessed to have high revenue deficits post tax-devolution. Such protected revenues could dis-incentivise the States from carrying out fiscal reforms. Going forward, the Finance Commissions could consider recommending an increased share of conditional transfers based on reforms, quality of expenditure and fiscal sustainability to harness healthy competition across States towards improving their economic performance.

4.8 India's diverse topography has led to varying climate vulnerabilities across States. According to a recent global study, nine Indian States are among the top 50 regions globally at risk of climate change-related damage to their environment (XDI, 2023). States play a pivotal role in customising climate actions to local needs. There is a growing need for States to focus on climate action, collaborate with the Central government, and adopt/ promote energy-efficient practices such as National Clean Air Programme (NCAP) and Lifestyle for the Environment (LiFE) movement. A few States have already initiated plans to bolster renewable energy capacity, while others have introduced mechanisms like climate budgets. States' coordination with the Centre and other stakeholders is crucial for adapting to climate related challenges and fostering sustainable development.

4.9 Integrating climate finance into the broader fiscal planning processes of the States is crucial. The Centre can introduce performance-based incentives for States that achieve significant progress towards climate goals. For instance, additional grants could be given to States that do well in reducing emissions or increasing renewable energy generation. Also, within the Scheme for Special Assistance to States for Capital Investment, a separate head for climate related investment projects can be considered.

4.10 In the medium term, States may improve their information dissemination platforms to enhance transparency and public awareness of their fiscal initiatives. Establishing their own platforms akin to a press information bureau (PIB) can serve to release policy-related notifications for public information. Furthermore, disclosure/ dissemination of sensitive information/data about guarantees, off-budget borrowings, total resource transfers to lower tiers, and States' expenditure on research and development, will increase transparency and underpin credibility and confidence in State finances.