Q11

Explain how the Fiscal Health Index (FHI) can be used as a tool for assessing the fiscal performance of states in India. In what way would it encourage the states to adopt prudent and sustainable fiscal policies?

UPSC Civil Services Mains 2025 · GS III · 15 marks · Government Budgeting

Government Budgeting.

Core demand of the question

- Define FHI as a NITI composite of State fiscal quality
- **Show the pillars:** revenue, spending quality, deficit, debt
- Show how ranks and dashboards can nudge prudence without replacing the Finance Commission

Revision summary

NITI Aayog's Fiscal Health Index, 2025 scores major States on revenue, spending quality, deficit and debt.

Odisha led the first public ranking; rich States were not automatically healthy.

The index is a dashboard for comparison, not a substitute for the Finance Commission.

Sunshine, markets and carefully designed extra borrowing room can reward prudence.

It must not punish poverty or hide off-budget debt if it is to stay honest.

Introduction

- **A State's budget can look large and still be** unhealthy**:** borrowed money spent on salaries, own tax left uncollected, capital works starved. NITI Aayog's **Fiscal Health Index** tries to put that story into **one comparable score** for major States. It is a **dashboard**, not a punishment. Used well, it can shame waste and praise States that tax fairly and invest.

Body

What the index measures

The **Fiscal Health Index, 2025** (NITI Aayog, released in early 2025) scores **eighteen large States** on pillars that typically include **quality of expenditure** (how much goes to capital and development rather than only interest and wages), **revenue mobilisation** (own tax and non-tax, GST effort), **fiscal prudence** (deficit relative to GSDP), and **debt index / sustainability** (debt-GSDP, interest burden). **Odisha** ranked at the top in that first public edition; several high-income States did less well than their fame, which is the point of a composite: **size of GSDP is not health**.

A student should treat the exact rank as a **snapshot**. The method matters more. An index that rewards **own-revenue** stops a State from living only on Union transfers. An index that rewards **capital outlay** stops a State from calling every loan "development". An index that flags **guarantees and off-budget** borrowing (if the method is honest) stops creative accounting.

How it can push prudence

Sunshine is the first nudge. A chief minister dislikes a public red mark beside a neighbour. **Markets** and rating agencies already watch State bonds; an official index can **align** that gaze. The Union can **link** some challenge funds or extra borrowing room (within FRBM) to improvement, though the **Finance Commission** remains the constitutional distributor and should not be replaced by a NITI league table. **Legislatures** can use the pillars in budget debates instead of only the size of a farm-loan waiver.

- **Limits:** States differ in **mineral luck and GST base**. A coal State can look "prudent" while a poor hill State looks "weak". The index must **normalise** and must not become a stick against welfare that is actually investment in people. Used as a **learning tool** - peer review of property tax, power-subsidy reform, capital-budget execution - it encourages **sustainable** policy: deficits that buy assets, debt that a future tax base can service.

The encouragement works when the score is **transparent, yearly, and hard to game**.

Flow diagram

> Fiscal Health Index -> Own revenue
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> Fiscal Health Index -> Quality of spend
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> Fiscal Health Index -> Deficit and debt
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> Fiscal Health Index -> Nudge: sunshine peer review

Conclusion

The Fiscal Health Index compares States on revenue effort, spending quality, deficits and debt. Public ranks can push prudence if they reward own tax and capital works, not if they only punish poor States or replace the Finance Commission.

Facts & figures

> **FHI 2025**
> NITI Aayog's first widely discussed Fiscal Health Index covering eighteen major States, released in January 2025.

> **Odisha lead**
> Odisha topped that edition, showing that mineral-revenue management and fiscal ratios can outrank a larger coastal economy.

> **Debt-GSDP**
> A core sustainability ratio: how large a State's debt is compared with its economy, and how much of the budget is eaten by interest.

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