Fiscal Health Index (FHI)

Highlights:

- ***The NITI Aayog has introduced a Fiscal Health Index (FHI) to asses the fiscal performance of India's general category states.***
- ***The Index will help in assessing the alignment of the regional economic trends with national objectives and will be instrumental in evaluating fiscal discipline and management with a focus on key parameters such as fiscal prudence.***
- ***The FHI Covers 18 major states that drive the Indian Economy. Himalayan and North-Eastern States have not been considered.***

The NITI Aayog, in January 2025, has released the Fiscal Health Index (FHI) for general category States which ranks the states on the basis of fiscal indicators and public finance ratio and tries to assess the fiscal performance of sub-national governments. This is done in order to bring greater alignment of regional economic performance to national objectives. The debate on credit rating of states has been a long standing one with no fruitful resolution in sight. The Fiscal health index might not provide a full solution to the pricing of credit risk for States but will at least provide a clearer picture of the fiscal health of the states. We present a brief summary and the methodology and the nuances of the Fiscal Health Index.

Fiscal Federalism: India follows fiscal federalism**,** which implies that sub-national governments have significant autonomy in deciding the various aspects of public finances. The federalism over the years has morphed into competitive and also co-operative federalism, within the center and the states and amongst states too. Since the adoption of the rule based fiscal policy i.e. the Fiscal Responsibility and Budget Management Act (FRBM -2003) by the Central government, and subsequent adoption of the Fiscal Responsibility Legislation by the States, fiscal indicators have assumed a greater role in guiding public finances. Adopting fiscal rules effectively also requires clear and consistent fiscal indicators. In that light, this is a welcome initiative by the NITI Aayog.

There have been various studies on State Finances in recent years with RBI publishing annual reports covering various aspects of regional finance in detail. Also, as the international credit rating agencies view public debt as a combined entity comprising national and sub-national debt, tracking the fiscal health becomes all the more vital for the economy to attract foreign capital, as the aspirations of the economy are projected to a Viksit Bharat 2047.

The report also includes state-specific insights highlighting the issues and challenges pertaining to each state, also analyzing the economic and fiscal trends over the past decade.

Index Methodology: The Fiscal Health Index bases its index construction taking help from earlier studies done on the State Finances by public as well as private institutions. The composite fiscal health index for 18 major states has been calculated using the data from the Comptroller and Auditor General of India (CAG). The period of the analysis is Financial Year 2022-23. Five major sub-Indices are aggregated to form the Fiscal Health Index. The Sub-Indices are as below:

MAJOR SUB-INDICES	MINOR SUB-INDICES
1. Quality of Expenditure	1.1 Total Developmental Expenditure/Total Expenditure
	1.2 Total Capital Outlay/ GSDP*
2. Revenue Mobilization	2.1 State Own Revenue/ GSDP*
	2.2 State Own Revenue/ Total Expenditure
3. Fiscal Prudence	3.1 Gross Fiscal Deficit/ GSDP*
	3.2 Revenue Deficit/ GSDP*
4. Debt Index	4.1 Interest Payments/Revenue Receipts
	4.2 Outstanding Liabilities/ GSDP*
5. Debt Sustainability	5.1 Growth Rate of GSDP* – Growth Rate of Interest Payments

GSDP at current prices for the year 2022-23

Source: Fiscal Health Index -2025 NITI Aayog

A detailed, step-by-step explanation of each state's FHI score calculation is given as follows:

Apart from the Five major Sub-Indices, there are nine minor sub-indices which are based on based on specific fiscal metrics, that reflect key aspects of fiscal performance. These minor sub-indices are categorized under the five major sub-indices mentioned above. Four major sub-indices have two fiscal indicators, except the Debt Sustainability index, which has only one fiscal indicator.

The values obtained from these minor sub-indices are then standardized through normalization. The minor sub-indices are classified into one of two categories-The Improvement Index or the Deprivation Index, as defined below:

Improvement index: Improvement Index is a favorable index where higher values of the variable are rewarded. The Improvement Index is constructed in such a way that the higher the ratio for a state, greater the index value assigned to it. The minor sub-indices under Quality of expenditure, Revenue Mobilization, and Debt Sustainability are considered as improvement indices.

Deprivation Index: A Deprivation Index is a deteriorating index where lower values of the variable are rewarded. The index is constructed in such a way that the lower the ratio for a state, greater the index value assigned to it. The minor sub-indices under Fiscal Prudence and Debt Index are considered as Deprivation Indices.[1]

The major sub-indices are then computed by taking arithmetic mean of the normalized values of the corresponding minor sub-indices for each state. For example, the value for the major sub-index "Quality of Expenditure" is the arithmetic mean of the normalized values of its associated minor sub-indices, viz Total Developmental Expenditure/Total Expenditure & Total Capital Outlay/GSDP.

The final composite FHI score is computed by taking the arithmetic mean of the five major sub-indices computed in the above step. For instance, the FHI score for Gujarat is the arithmetic mean of the values for its five major sub-indices.
Finally, states are ranked based on their computed FHI scores, with the top performing state receiving the first rank.

Final Ranking of the States for 2022-23: States are classified into four categories as per their ranking achieved on the above given methodology. These four categories are Achiever, Front Runner, Performer and Aspirational. The analysis clearly highlights that strong revenue mobilization, effective expenditure management, and prudent fiscal practices are critical determinants of success. The top five high-performing states are Odisha, Chhattisgarh, Goa, Jharkhand, and Gujarat, while the aspirational five are Haryana, Kerala, West Bengal, Andhra Pradesh, and Punjab.

However, the states' performance varies across the five subcategories. For instance, Uttar Pradesh and Bihar have a good score under Quality of Expenditure, but they rank lower with regard to Revenue Mobilization. Karnataka performs well across most indices but it ranks amongst the three aspirational states in Debt Sustainability. Odisha and Chhattisgarh have performed well under Revenue Mobilization, with their Own Non-Tax Revenue growing significantly due to high revenue collection from mining. However, regarding Debt Sustainability, Chhattisgarh ranks lower compared to some other states.

[1] The calculation of the improvement and deprivation index is given in the appendix.

States	FHI Score	Rank 2022-23	Quality of Expenditure	Revenue Mobilization	Fiscal Prudence	Debt Index	Debt Sustainability
Odisha	67.8	1	52.0	69.9	54.0	99.0	64.0
Chhattisgarh	55.2	2	55.1	56.5	56.0	79.6	29.0
Goa	53.6	3	45.5	87.1	59.4	51.0	25.2
Jharkhand	51.6	4	47.3	45.7	62.4	66.9	35.7
Gujarat	50.5	5	40.0	48.7	52.7	69.0	42.0
Maharashtra	50.3	6	37.1	59.1	41.8	76.4	36.8
Uttar Pradesh	45.9	7	45.8	34.6	44.7	59.9	44.5
Telangana	43.6	8	36.9	75.2	40.8	53.3	11.7
Madhya Pradesh	42.2	9	59.7	27.6	35.6	61.0	27.2
Karnataka	40.8	10	47.4	43.9	43.9	62.2	6.7
Tamil Nadu	29.2	11	32.0	41.2	25.8	36.0	11.1
Rajasthan	28.6	12	38.3	35.4	19.9	32.3	16.8
Bihar	27.8	13	56.1	5.3	11.5	47.2	18.8
Haryana	27.4	14	24.8	47.8	26.1	24.1	14.3
Kerala	25.4	15	4.2	54.2	34.0	23.1	11.3
West Bengal	21.8	16	32.3	12.4	25.4	18.3	20.6
Andhra Pradesh	20.9	17	31.4	22.1	13.3	37.8	0.0
Punjab	10.7	18	4.7	28.1	5.6	0.0	15.2

Source: Fiscal Health Index -2025 NITI Aayog

The fiscal landscape across states reveals a picture where progress and challenges coexist. As states navigate their unique fiscal challenges, the path forward hinges on a commitment to transparency, enhanced tax compliance, and targeted investments in social and economic infrastructure. By fostering a culture of fiscal prudence and accountability, states can stabilize their economies and elevate the quality of life for their citizens, ensuring a resilient and prosperous future. High persistent deficits and varying fiscal performances among states underscore the urgency for reform and targeted interventions. The journey toward fiscal sustainability is complex, but with concerted efforts, it can lead to transformative outcomes that benefit all.

Appendix 1: Computation of Improvement and Deprivation Indices

Improvement index: Improvement Index is a favorable index where higher values of the variable are rewarded. The Improvement Index is constructed in such a way that the higher the ratio for a state, greater the index value assigned to it. The minor sub-indices under Quality of expenditure, Revenue Mobilization, and Debt Sustainability are considered as improvement indices.

Improvement Index for a State i = $\frac{X_i - Min(X)}{Target(X) - Min(X)} * 100$

Xi is the value for the particular minor sub-index under Quality of Expenditure, Revenue Mobilization and Debt Sustainability.

Min(X) is the minimum value for the particular minor sub-index across all states in the specified period.

The target value (Target(X)) is the highest value (of the maximum of all the states in each year) observed over the past 9 years.

Deprivation Index: A Deprivation Index is a deteriorating index where lower values of the variable are rewarded. The index is constructed in such a way that the lower the ratio for a state, greater the index value assigned to it. The minor sub-indices under Fiscal Prudence and Debt Index are considered as Deprivation Indices.

Deprivation Index for a State I = $\frac{Max(X) - Xi}{Max(X) - Target\ (X)} * 100$

Where,

Xi is the value for the particular minor sub-index under Fiscal Prudence and Debt Index Max(X) is the maximum value for the particular minor sub-index across all states in the specified period.

The target value (Target(X)) is the lowest value (of the minimum of all the States in each year) observed over the past 9 years.

Reference:

- https://www.niti.gov.in/sites/default/files/2025-01/Fiscal_Health_Index_24012025_Final.pdf

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