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# For Four New State Governments, Same Old Problem — Mounting Debt and Fiscal Strain

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7 May 2026

**ECONOMY****POLITY****GS3****GS2**

CURATED &amp; WRITTEN BY

**Bharat Choudhary**

UPSC Educator &amp; Content Creator

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# For Four New State Governments, Same Old Problem — Mounting Debt and Fiscal Strain

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GS3

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The Indian Express

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## INTERVIEW ANGLE



*"Many newly elected state governments are inheriting significant debt burdens, partly of their own making through pre-election welfare promises. How should states balance populist demands with fiscal responsibility? What is the Centre's role?"*

## WHY IN NEWS

Four states that went to polls in 2024–25 — **Jharkhand, Maharashtra, Delhi, and Bihar** — are grappling with deteriorating fiscal positions as new governments take charge. The combination of **pre-election welfare announcements (freebies), off-balance sheet borrowings (state-owned enterprises), rising pension liabilities, and interest payments eating into revenue** has created a structural debt trap. The **15th Finance Commission** and RBI data show median state debt-to-GSDP is now ~31% — dangerously close to the FRBM outer limit.

## INDIA'S STATE FISCAL ARCHITECTURE

### Constitutional Framework

FEATURE	DETAIL
<b>Article 293</b>	State governments can borrow only from the Centre or capital markets (with Centre's consent if prior debt outstanding)
<b>Article 280</b>	Finance Commission recommends Centre-state revenue sharing
<b>FRBM Act</b>	Fiscal Responsibility and Budget Management Act, 2003; states have own FRBM laws
<b>FRBM limits</b>	Fiscal deficit $\leq$ 3% of GSDP; debt $\leq$ 25% of GSDP (breached by most states)
<b>RBI guidelines</b>	Publish annual State Finances Report — key monitoring tool

### Finance Commission Framework (15th FC: 2021–26)

FEATURE	DETAIL
<b>Vertical devolution</b>	States get <b>41%</b> of divisible pool
<b>Criteria</b>	Population (15%), Area (15%), Income distance (45%), Forest cover (10%), Tax effort (2.5%), Demographic performance (12.5%)
<b>Grants-in-aid</b>	Sector-specific + local body grants
<b>16th Finance Commission</b>	Constituted; submitting report for 2026–31 period

## THE DEBT CRISIS: KEY NUMBERS

### State Debt Position

METRIC	DATA
Median state debt-to-GSDP (2024–25)	~ <b>31%</b>
FRBM recommended ceiling	<b>25% of GSDP</b>
Punjab	~48% (most stressed)
Rajasthan	~38%
Bengal	~36%
Maharashtra	~28% (post-COVID recovery)
Bihar	~38%
Jharkhand	~34%

### Interest Payment Burden

STATE	INTEREST AS % OF REVENUE RECEIPTS
Punjab	<b>25%+</b>
Rajasthan	<b>18%+</b>
All India average	~ <b>14–15%</b>

When interest payments consume >15% of revenue receipts, little room remains for capex or social spending.

## WHY DEBT IS RISING: STRUCTURAL DRIVERS

### 1. The Freebie Dynamic

- Pre-election: free electricity, free bus travel, cash transfers (Ladli Behna, Mukhyamantri Mahila Samman, etc.)
- These are **revenue expenditure** — no asset creation; recurrent annual cost
- Delhi example: Free electricity (200 units) costs ~₹3,500 crore/year; free DTC buses ~₹1,500 crore/year

## 2. Off-Balance Sheet Borrowings

- State DISCOMs, State Road Transport Corporations borrow separately — **not captured in fiscal deficit figures**
- DISCOM debt: ~₹6.5 lakh crore nationwide (as of 2024)
- UDAY scheme (2015–19) transferred DISCOM debt to state balance sheets — increasing reported debt

## 3. Pension Liabilities

- **Old Pension Scheme (OPS) revival:** 5+ states reverting from NPS to OPS
- **Actuarial cost of OPS revival:** 4.5–6x higher than NPS in long run
- RBI has flagged OPS revival as a major **fiscal risk**

## 4. GST Compensation Cliff

- GST compensation guarantee (14% revenue growth assured) ended in **2022**
- States reliant on compensation now face shortfall without structural tax base growth
- Revenue buoyancy varies widely by state

## 5. Revenue vs. Capital Expenditure Mix

YEAR	REVENUE EXPENDITURE	CAPITAL EXPENDITURE
2019–20	80%	20%
2024–25	82–84%	16–18%

Capex — the productive multiplier — is being crowded out by committed revenue expenditures.

## POLICY SOLUTIONS

### Short-Term

- ➊ **Rationalize subsidy targeting:** Move from universal to targeted (DBT-based) freebie delivery
- ➋ **Asset monetisation:** Lease idle state assets — land, PSU stakes — to raise revenue without new borrowing
- ➌ **DISCOM reforms:** Privatisation/separation of distribution (Rajasthan model); smart metering

## Medium-Term

- 1 **OPS reversal:** Return to NPS — phase it in without disrupting current beneficiaries
- 2 **Own tax revenue improvement:** Property tax reform (huge untapped revenue); state GST audit efficiency
- 3 **Centre-state fiscal compact:** RBI/Finance Commission enforcement of FRBM limits

## Long-Term

- 1 **Intergovernmental fiscal council:** A formal body (like GST Council) for fiscal discipline coordination
- 2 **Expenditure quality metrics:** Measure capex-to-total-expenditure ratio in Finance Commission grants criteria

## UPSC RELEVANCE

PAPER	ANGLE
GS3 — Economy	State fiscal deficits, FRBM, debt-to-GSDP, freebies, DISCOM debt, OPS vs NPS
GS2 — Polity	Finance Commission, Article 293, Centre-state fiscal relations, 15th/16th FC
GS3 — Economy	Revenue vs capex trade-off, GST compensation, fiscal federalism

**Mains Keywords:** State debt, FRBM, fiscal deficit 3% GSDP, Article 293, 15th Finance Commission, 16th Finance Commission, DISCOM debt, UDAY scheme, OPS revival, freebie debate, revenue expenditure vs capex, Punjab fiscal stress, GST compensation cliff, DBT, intergovernmental fiscal council

### Prelims Facts Corner

ITEM	FACT
States' share of divisible pool (15th FC)	<b>41%</b>
FRBM fiscal deficit limit (states)	<b>3% of GSDP</b>
FRBM debt ceiling (states)	<b>25% of GSDP</b>
Median state debt-to-GSDP (2024–25)	<b>~31%</b>
Punjab debt-to-GSDP	<b>~48%</b> (most stressed)
DISCOM debt (nationwide, 2024)	<b>~₹6.5 lakh crore</b>
UDAY scheme	<b>2015–19</b> — transferred DISCOM debt to states
GST compensation guarantee ended	<b>June 2022</b>
Article 293	<b>State borrowing</b> — requires Centre's consent if prior debt outstanding
16th Finance Commission	Constituted; covers <b>2026–31</b>

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CURATED &amp; WRITTEN BY

## Bharat Choudhary

UPSC Educator &amp; Content Creator

[linkedin.com/in/epicbharat](https://www.linkedin.com/in/epicbharat)[Read Full Article on Ujiyari →](#)<https://ujiyari.com/editorials/2026/05/ie-state-debt-burden-four-new-governments/>

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