Opinion

# States slow-walking into a fiscal trap

*An old audit report of West Bengal's finances tabled recently shows ballooning debt despite impressive growth. The phenomenon, made worse by hidden debt in the form of guarantees, is quite common among states. Blaming only subsidies and cash transfers distorts the picture*

The West Bengal episode is as much about fiscal architecture as it is about political point-scoring(Photo | PTI)

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Late last month, West Bengal's new government tabled in the Assembly 28 Comptroller and Auditor General reports that had been pending since 2020-21. The state's finance minister termed the delay a "constitutional lapse". Among the revelations in the reports was Bengal's debt standing at over ₹8 lakh crore despite recording an almost 9.6 percent compounded annual growth over a decade.

Growth and rising debt moving together is not unique to Bengal. Delhi has seen its own version of this fight, with lieutenant-governors pressing chief ministers to table overdue audits. What has changed is the scale of what these audits are now uncovering at a moment when every state—irrespective of who governs it—is quietly renegotiating how much of its own budget it actually controls.

States, which cannot print money or run their own monetary policy, can only borrow within limits set largely by the Centre. Once salaries, pensions, interest and subsidies are paid, little room is left for anything new. What gets sacrificed in the process is capital expenditure. States allocated only 16.59 percent of their total spendings to capital assets like roads, hospitals and educational institutions in 2024-25. This is a significantly low proportion that has continued to linger between 13 percent and 20 percent over the past decade. For every rupee spent, barely a sixth builds the roads, hospitals and classrooms meant to drive future growth.

High interest payments seem to be the primary reason for reduced capital expenditures. Interest payments by all states have skyrocketed manifold, increasing by 160 percent over the last decade.

In 2024-25, 11 states—Punjab, Haryana, Kerala, West Bengal, Tamil Nadu, Andhra Pradesh, Rajasthan, Telangana, Himachal Pradesh, Karnataka and Gujarat—allocated more than 10 percent of their total budgets to pay for interest. Only Mizoram, Arunachal Pradesh and Odisha allotted less than five percent of their state budget to pay off their liabilities. Karnataka has the largest share of 14 percent allocated for subsidies, signifying that a single category cannot be solely held responsible for fiscal stress.

A less visible liability has grown just as quickly. Guarantees extended to power utilities and state corporations convert into real debt the moment they are invoked, yet sit outside headline deficit figures until then. As of March 2025, outstanding guarantees crossed ₹13 lakh crore or 4 percent of gross state domestic products (GSDP)—more than three times than a decade ago. It varies between over 14 percent of the GSDP in Telangana and less than 0.5 percent in Gujarat, Odisha and Uttarakhand.

State governments are also increasingly dependent on market borrowings to fund their deficits. As per the Reserve Bank of India, they accounted for 76.3 percent of the combined gross fiscal deficit in the 2025-26 budget estimates. This compares to 71.8 per cent in the previous fiscal. Over 1,000 separate loans were issued to state governments in 2025-26.

Every additional rupee raised this way locks in a future interest bill, feeding directly back into the committed expenditure trap described above, regardless of whether the underlying spending funded a hospital or a subsidy.

The trend of states recording a revenue surplus has reversed sharply, as the number of such states came down strikingly between 2018-19 and 2024-25, as the Economic Survey 2025-26 states. The overall revenue deficit of all states put together widened from 0.1 percent of GDP in 2019 to 0.7 percent. It worsened by another 40 basis points in the last fiscal year alone. States' own tax revenue did rise as a share of total revenue receipts, from 46 percent in 2022 to close to 50 percent by 2025, but this improvement has been concentrated in states with diversified, GST-friendly manufacturing and service sectors.

The sharper divide runs between states that can tax their own growth and those that cannot, not between generous spenders and austere ones.

A related finding in the same survey deserves more attention. Drawing on state-level data going back to 1980-81, it found that the size of Central transfers does not reliably predict faster growth in poorer states; what does correlate is the share of a state's own spending that goes into capital formation. Higher fiscal deficits are linked to weaker growth down the line, and social spending pays off more reliably when paired with actual investment rather than delivered alone.

The West Bengal episode is as much about fiscal architecture as it is about political point-scoring. A state that delays tabling its own audit reports for years denies its Legislature and citizens the chance to debate the trade-offs laid out: how much goes to interest, how much sits in contingent guarantees and how much is left for capital spending. Timely, transparent reporting is a precondition for credible fiscal correction.

Beyond that, it means that the instinctive reflex to blame subsidies and cash transfers oversimplifies a problem rooted in tax capacity, legacy debt and a national borrowing architecture that offers states few tools beyond the annual budget. A state with a narrow tax base and rising interest costs will struggle to fund capital investment, however it redesigns its welfare basket.

Until India's federal fiscal architecture confronts these path-dependent constraints directly, the weight of old baggage will keep increasing in new state budgets.

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*(Views are personal)*