

# Debt Composition and Fiscal Adjustment Across Indian States: Evidence from Decadal Growth of Public Liabilities

Surjit Basantaray<sup>1\*</sup>, Sanjay Thakur<sup>2</sup>, and Sanjeet Singh<sup>3</sup>

<sup>1</sup> PhD Scholar, Department of Commerce and Management Studies, Career Point University, Hamirpur, Himachal Pradesh.

<sup>2</sup> Professor, Department of Commerce and Management Studies, Career Point University, Hamirpur, Himachal Pradesh

<sup>3</sup> Professor & Head, Department of Economics, Central University of Himachal Pradesh

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## Abstract

*This paper examines the evolution and composition of state government liabilities in India through a comparative analysis of selected high, medium, and low debt states. Using secondary data on state finances, the study analyses the decadal compound annual growth rates of major components of total liabilities over the periods 1990–1999, 2000–2009, and 2010–2019, capturing pre-reform, transition, and post-FRBM phases. The results reveal a common shift away from loans and advances from the central government towards market-based borrowing across states; however, the nature and intensity of this transition vary significantly. Low debt states exhibit relatively stable and disciplined debt profiles, while medium and high debt states show persistent growth in internal debt, reflecting borrowing-led fiscal adjustment under structural constraints. The findings suggest that fiscal rules have altered the composition of state debt rather than uniformly reducing debt accumulation. The study highlights the need for a differentiated, composition-sensitive approach to subnational debt management in India.*

**Keywords:** State Government Debt; Debt Composition; Fiscal Federalism; Market Borrowing; FRBM; India

**JEL Classification:** H63, H72, H74

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## I. Introduction

The sustainability and composition of public debt at the subnational level have emerged as a critical concern in federal economies, particularly in developing countries where states play an increasingly important role in public expenditure and service delivery. In India, state governments account for a substantial share of total public spending, especially in sectors such as agriculture, health, education, power, and infrastructure. Consequently, the evolution of state government liabilities has important implications not only for fiscal stability but also for long-term economic growth and intergenerational equity (RBI, 2019; Mohanty, 2020).

Historically, state government borrowing in India was largely characterised by dependence on loans and advances from the central government. However, the post-1991 economic reforms and subsequent fiscal consolidation efforts fundamentally altered the structure of subnational public debt. The introduction of market-oriented reforms, followed by the enactment of Fiscal Responsibility and Budget Management (FRBM) legislation across states in the mid-2000s, encouraged a gradual shift from central loans towards market-based instruments such as State Development Loans (SDLs), market loans, and National Small Savings Fund (NSSF) liabilities (Ahluwalia, 2002; RBI, 2017). While these reforms aimed to enhance fiscal discipline and transparency, their impact on the borrowing behaviour of states has been far from uniform.

Existing literature on India's public debt largely focuses on aggregate debt indicators such as debt-to-GSDP ratios, fiscal deficits, and interest payment burdens (Buitier & Patel, 2010; RBI, 2021). Although these indicators are useful for assessing overall fiscal stress, they often mask significant heterogeneity in the *composition* of state liabilities. The structure of debt—whether dominated by market loans, central government advances, reserve funds, or other instruments—has important implications for debt servicing costs, rollover risks, and fiscal flexibility. Yet, comparative evidence on how different states have restructured their liabilities over time remains relatively limited.

This gap becomes particularly relevant when states are viewed through the lens of debt intensity. Indian states exhibit sharp contrasts in their fiscal capacity, revenue mobilisation, and expenditure commitments, resulting in divergent debt trajectories. High debt states such as Rajasthan and West Bengal have historically faced persistent fiscal stress, driven by structural revenue constraints, high committed expenditures, and periodic reliance on special borrowing instruments. In contrast, relatively fiscally prudent states like Gujarat and Maharashtra have demonstrated better debt management, supported by stronger own-tax revenues and economic

diversification. States such as Tamil Nadu and Uttar Pradesh, meanwhile, occupy an intermediate position, reflecting mixed fiscal outcomes and transitional borrowing strategies.

Against this background, analysing debt merely in aggregate terms risks overlooking important structural dynamics. For instance, a rise in market loans may indicate improved access to financial markets, but it may also increase exposure to interest rate volatility. Similarly, declining dependence on central loans may enhance fiscal autonomy, yet it can simultaneously intensify repayment pressures if not supported by adequate revenue growth. Therefore, a component-wise and temporal examination of state liabilities is essential to understand the true nature of fiscal adjustment at the subnational level.

The present study contributes to the literature by undertaking a comparative analysis of the growth and composition of state government liabilities across selected Indian states categorised as high, medium, and low debt states. Using decadal compound annual growth rates (CAGR) for major components of total liabilities over the periods 1990–1999, 2000–2009, and 2010–2019, the study captures long-term structural shifts in borrowing patterns. This periodisation is particularly relevant as it encompasses the pre-reform era, the transition towards market-oriented borrowing, and the post-FRBM phase marked by tighter fiscal rules and changing centre–state fiscal relations.

By focusing on disaggregated liability components—such as market loans, NSSF, loans from banks and financial institutions, reserve funds, and loans and advances from the centre—the study moves beyond conventional debt indicators to highlight qualitative differences in fiscal strategies across states. The comparative framework adopted here allows for a nuanced understanding of how states with varying debt burdens respond to common institutional constraints, macroeconomic shocks, and policy reforms.

The findings of this study are expected to have important policy relevance. As India continues to rely on states for implementing growth-oriented and welfare-enhancing programmes, understanding the evolving nature of state debt becomes crucial for designing effective fiscal rules and debt management strategies. Rather than adopting a one-size-fits-all approach, the evidence underscores the need for state-specific fiscal frameworks that account for heterogeneity in debt composition, revenue capacity, and economic structure. In doing so, the study seeks to inform ongoing debates on subnational debt sustainability and cooperative federalism in India.

## **Review of Literature**

The literature on public debt in India has extensively examined the evolution, sustainability, and macroeconomic implications of government borrowing, with a significant focus on fiscal consolidation and institutional reforms. Early studies on India's public debt primarily analysed aggregate fiscal indicators, highlighting the rising debt burden and its implications for macroeconomic stability (Rangarajan & Srivastava, 2005). These studies underscored the need for fiscal discipline, particularly in the context of mounting revenue deficits and growing interest payment obligations at both central and state levels.

With the initiation of economic reforms in the early 1990s, scholarly attention shifted towards understanding the changing nature of centre–state fiscal relations and their implications for subnational debt. Ahluwalia (2002) noted that fiscal stress among Indian states was largely driven by structural imbalances, including low own-tax revenue capacity and high committed expenditures. The increasing reliance of states on borrowing to finance revenue deficits was identified as a key source of fiscal vulnerability. Subsequent studies reinforced this view, arguing that debt accumulation at the state level was not merely cyclical but reflected deeper institutional and structural constraints (Rao & Singh, 2005).

The introduction of the Fiscal Responsibility and Budget Management (FRBM) framework marked a turning point in the literature on state finances. Several studies assessed the effectiveness of FRBM legislation in improving fiscal outcomes across states. While some authors found evidence of reduced fiscal deficits and improved transparency in the post-FRBM period (Kaur & Mukherjee, 2012), others pointed out that the adjustment often occurred through changes in the *composition* of debt rather than a fundamental reduction in borrowing (RBI, 2017). This shift was characterised by declining loans from the central government and a growing dependence on market-based instruments such as State Development Loans (SDLs) and market loans.

A growing strand of literature has therefore emphasised the importance of examining debt composition rather than relying solely on aggregate debt indicators. Buiter and Patel (2010) argued that market borrowings, while enhancing fiscal autonomy, expose states to higher rollover and interest rate risks. Similarly, Mohanty (2020) highlighted that increasing reliance on internal debt components—particularly market loans and NSSF—has raised concerns about long-term debt sustainability, especially for fiscally weaker states. These studies suggest that identical fiscal rules can yield heterogeneous outcomes across states depending on their economic structure and revenue-generating capacity.

Inter-state comparative analyses further reveal substantial heterogeneity in debt trajectories. Studies by the Reserve Bank of India consistently document that high debt states tend to exhibit faster growth in internal debt and greater dependence on non-transparent or contingent liabilities, while fiscally stronger states demonstrate relatively stable debt profiles supported by higher own revenues and diversified economic bases (RBI, 2019; RBI,

2021). However, much of this evidence remains descriptive, with limited emphasis on long-term growth patterns of individual debt components.

Despite these contributions, notable gaps remain in the existing literature. First, most studies rely on debt-to-GSDP ratios or fiscal deficit indicators, offering limited insight into the structural transformation of state liabilities over time. Second, there is a lack of systematic, decadal analysis capturing pre-reform, transition, and post-FRBM phases simultaneously. Third, comparative studies explicitly classifying states into high, medium, and low debt categories and analysing their debt composition remain scarce. As a result, the differential fiscal strategies adopted by states under similar institutional constraints are not adequately understood.

The present study addresses these gaps by providing a component-wise, decadal comparison of state government liabilities across selected Indian states. By focusing on the growth dynamics of individual liability components, the study contributes to a more nuanced understanding of subnational debt management and fiscal adjustment in India.

## II. Data and Methodology

### Data Sources

The study is based on secondary data on state government finances compiled from official publications of the Reserve Bank of India, primarily the *State Finances: A Study of Budgets* and related RBI reports. These sources provide consistent, long-term information on the stock of state government liabilities and their disaggregated components. The analysis covers six major Indian states—Rajasthan, West Bengal, Tamil Nadu, Uttar Pradesh, Gujarat, and Maharashtra—selected to represent varying levels of public debt intensity.

The time period spans three decades, from 1990–91 to 2019–20, which is further divided into three sub-periods: 1990–1999, 2000–2009, and 2010–2019. This temporal division is analytically meaningful as it captures (i) the pre-reform phase characterised by high dependence on central government loans, (ii) the transition phase marked by fiscal adjustment and the introduction of market-based borrowing, and (iii) the post-FRBM phase characterised by tighter fiscal rules and evolving centre–state fiscal relations.

### Variables and Debt Components

The core variable of interest is Total Liabilities of state governments, disaggregated into major components to capture structural changes in borrowing patterns. These components include market loans, State Development Loans (SDLs), loans from banks and financial institutions, National Small Savings Fund (NSSF), loans and advances from the central government, provident and reserve funds, deposits and advances, contingency funds, and other special instruments such as power bonds and compensation bonds where applicable. This disaggregation allows for a nuanced assessment of how states finance their fiscal requirements and manage debt over time.

### Classification of States

For analytical clarity, the selected states are classified into three categories based on their overall debt burden and historical fiscal performance:

- **High debt states:** Rajasthan and West Bengal
- **Medium debt states:** Tamil Nadu and Uttar Pradesh
- **Low debt states:** Gujarat and Maharashtra

This classification facilitates a structured comparison of borrowing behaviour and debt composition across fiscally heterogeneous states operating under a common institutional framework.

## III. Methodology

The study employs decadal Compound Annual Growth Rate (CAGR) as the principal analytical tool to examine the growth dynamics of total liabilities and their individual components. CAGR is computed for each debt component across the three decadal periods using the standard formula:

$$\text{CAGR} = \left( \frac{V_t}{V_0} \right)^{\frac{1}{n}} - 1$$

where  $V_t$  represents the terminal value of a given liability component,  $V_0$  is its initial value, and  $n$  denotes the number of years in the respective decade.

The use of CAGR offers two key advantages. First, it smooths short-term fluctuations and highlights long-run trends in debt accumulation. Second, it enables meaningful inter-state comparisons by standardising growth rates across different time periods and fiscal environments. Rather than focusing solely on the magnitude of debt, this approach captures shifts in the *structure* of liabilities, which is crucial for assessing fiscal sustainability and risk exposure.

## Analytical Approach

The analysis proceeds in three stages. First, state-specific trends in the growth of total liabilities and individual debt components are examined to identify intra-state structural shifts over time. Second, comparisons are drawn across high, medium, and low debt states to assess how fiscal stress, revenue capacity, and institutional constraints shape borrowing behaviour. Finally, the results are interpreted in the context of broader fiscal reforms, including the FRBM framework and the growing reliance on market-based borrowing instruments.

By combining component-wise analysis with a comparative state-level framework, the methodology provides a comprehensive assessment of evolving debt dynamics in Indian states and offers insights into the differentiated fiscal strategies adopted across the federal structure.

## IV. Results and Discussion

### Overview of Trends in State Government Liabilities

The decadal growth patterns of state government liabilities reveal substantial heterogeneity across Indian states, despite a common macro-fiscal and institutional framework. Across all selected states, a gradual shift away from loans and advances from the central government towards market-based borrowing instruments is evident, particularly after the 2000s. However, the pace, composition, and intensity of this transition differ sharply across high, medium, and low debt states, reflecting variations in fiscal capacity, expenditure pressures, and debt management strategies.

A common feature across states is the declining growth of central government loans during the 2000–2009 and 2010–2019 periods, coinciding with fiscal decentralisation reforms and the implementation of Fiscal Responsibility and Budget Management (FRBM) legislation. At the same time, internal debt components—especially market loans and loans from banks and financial institutions—have emerged as dominant sources of state borrowing.

### Debt Dynamics in Low Debt States: Gujarat and Maharashtra

Low debt states such as Gujarat and Maharashtra exhibit relatively stable and disciplined debt trajectories over the three decades. In both states, the growth of total internal debt remains moderate in the post-2010 period compared to earlier decades, suggesting improved fiscal consolidation and prudent borrowing behaviour.

The liability structure of Gujarat, categorised as a low debt state, reflects a relatively disciplined and stable borrowing pattern across decades. During the 1990–1999 period, Gujarat's total internal debt recorded a high CAGR of 0.27, driven primarily by loans from banks and financial institutions (0.28) and moderate growth in market loans (0.19). This phase corresponds to the pre-reform period, marked by expanding development expenditure and limited fiscal restraint at the subnational level.

Table 1: Gujarat State's Decadal CAGR of Various Components in Total Liabilities.

Variables	1990-1999	2000-2009	2010-2019
SDLs			0.18
Power Bonds			
Market Loans	0.19		
Compensation and other bonds	0.00	0.08	
NSSF		0.25	-0.04
WMA from RBI			
Loans from Banks and FIs	0.28	0.14	0.11
Total Internal Debt	0.27	0.24	0.11
Loans and Advances from Centre	0.14	-0.06	-0.03
Provident Funds etc.	0.17	0.09	0.05
Reserve Funds	0.00	0.33	0.09
Deposit and Advances	0.23	0.04	0.09
Contingency Funds	0.18	0.06	0.00

Source: Computed by the authors from the State Finances Reports, RBI

In the subsequent decade (2000–2009), the growth of total internal debt moderated to 0.24, indicating early fiscal consolidation efforts. The sharp decline in loans and advances from the central government (–0.06) suggests a structural shift away from intergovernmental borrowing. At the same time, reserve funds exhibited a

strong growth of 0.33, reflecting improved cash management and internal resource mobilisation rather than fiscal stress.

During 2010–2019, Gujarat’s debt profile shows further stabilisation. The CAGR of total internal debt declined significantly to 0.11, while loans from banks and financial institutions also moderated to 0.11. The low and stable growth of deposits and advances (0.09) and reserve funds (0.09) suggests that market borrowing in Gujarat was increasingly aligned with fiscal capacity. Overall, Gujarat’s experience highlights a transition from rapid debt accumulation to a more sustainable and growth-consistent borrowing strategy.

The liability dynamics of Maharashtra reveal a similar but slightly more expansive borrowing pattern compared to Gujarat. In the 1990s, Maharashtra recorded a high CAGR of 0.28 in total internal debt, supported by strong growth in market loans (0.22) and deposits and advances (0.22). This reflects the state’s capacity to access market finance during a period of infrastructure expansion.

Table 2: Maharashtra State’s Decadal CAGR of Various Components in Total Liabilities

Variables	1990-1999	2000-2009	2010-2019
SDLs			0.17
Power Bonds			0.29
Market Loans	0.22		
Compensation and other bonds	-0.11	0.13	
NSSF		0.27	-0.04
WMA from RBI			
Loans from Banks and FIs	0.16	0.21	0.11
Total Internal Debt	0.28	0.28	0.10
Loans and Advances from Centre	0.15	-0.12	-0.04
Provident Funds etc.	0.19	0.08	0.07
Reserve Funds	0.21	0.07	-0.06
Deposit and Advances	0.22	0.10	0.11
Contingency Funds	0.27	-0.12	0.02

Source: Computed by the authors from the State Finances Reports, RBI

In the 2000–2009 period, Maharashtra’s total internal debt growth remained unchanged at 0.28, indicating continued borrowing intensity despite fiscal reform efforts. However, the sharp decline in loans from the centre (–0.12) points to a decisive shift in borrowing sources. Growth in loans from banks and financial institutions increased to 0.21, suggesting greater reliance on institutional finance. The post-2010 decade shows a clear moderation in borrowing, with total internal debt growth declining to 0.10. Reserve funds turned negative (–0.06), while the growth of central loans further declined (–0.04), indicating improved fiscal adjustment. The moderation of debt growth in the most recent decade suggests that Maharashtra successfully combined market access with fiscal discipline, reinforcing its classification as a low debt state.

### Medium Debt States: Tamil Nadu and Uttar Pradesh

The medium debt states—Tamil Nadu and Uttar Pradesh—present a more complex picture. These states exhibit persistent growth in total internal debt across all decades, with no clear evidence of sustained deceleration in the post-2010 period.

Tamil Nadu shows a relatively balanced yet persistent debt accumulation pattern. During the 1990s, total internal debt grew at 0.19, supported by high growth in NSSF (0.30) and loans from banks (0.25).

Table 5: Tamil Nadu State’s Decadal CAGR of Various Components in Total Liabilities

Variables	1990-1999	2000-2009	2010-2019
SDLs			0.22
Power Bonds			
Market Loans	0.17		
Compensation and other bonds			
NSSF		0.30	-0.04

WMA from RBI	0.07		
Loans from Banks and Fls	0.25	0.09	0.08
Total Internal Debt	0.19	0.23	0.18
Loans and Advances from Centre	0.16	-0.05	0.07
Provident Funds etc.	0.23	0.05	0.11
Reserve Funds	0.08	0.16	0.11
Deposit and Advances	0.18	0.10	0.22
Contingency Funds	0.09	0.00	0.03

Source: Computed by the authors from the State Finances Reports, RBI

In the 2000–2009 period, internal debt growth increased to 0.23, despite declining central loans (–0.05). Reserve funds expanded significantly (0.16), reflecting internal fiscal adjustments. The post-2010 decade shows sustained internal debt growth at 0.18, with deposits and advances rising sharply (0.22), indicating continued expenditure pressures. Tamil Nadu’s experience suggests a structural dependence on internal borrowing to finance developmental and welfare commitments, placing it firmly in the medium debt category.

The liability structure of Uttar Pradesh reflects persistent fiscal rigidity. During the 1990s, total internal debt grew at 0.21, with loans from banks and financial institutions expanding at 0.18. The state also relied significantly on ways and means advances (0.25), indicating short-term liquidity stress.

In the 2000–2009-decade, total internal debt growth remained nearly unchanged at 0.20, despite declining loans from the centre (–0.06). Compensation and other bonds grew sharply (0.33), reflecting off-budget financing practices. Reserve funds expanded at 0.13, suggesting limited fiscal space.

**Table 4: Uttar Pradesh State’s Decadal CAGR of Various Components in Total Liabilities**

Variables	1990-1999	2000-2009	2010-2019
SDLs			0.18
Power Bonds			0.33
Market Loans	0.18		
Compensation and other bonds		0.33	0.84
NSSF		0.24	-0.01
WMA from RBI	0.25		
Loans from Banks and Fls	0.18	0.20	0.23
Total Internal Debt	0.21	0.20	0.15
Loans and Advances from Centre	0.15	-0.06	-0.05
Provident Funds etc.	0.18	0.14	0.06
Reserve Funds	0.21	0.13	-0.18
Deposit and Advances	0.13	0.06	0.03
Contingency Funds	0.06	-0.04	0.01

Source: Computed by the authors from the State Finances Reports, RBI

In the post-2010 period, internal debt growth slowed marginally to 0.15, but loans from banks and financial institutions rose further to 0.23, the highest among medium debt states. Negative growth in reserve funds (–0.18) signals fiscal strain. Overall, Uttar Pradesh exhibits borrowing persistence with limited structural adjustment.

### High Debt States and Structural Fiscal Stress

The high debt states—Rajasthan and West Bengal—exhibit the most pronounced growth in total liabilities and internal debt components. The debt trajectory of Rajasthan presents a contrasting picture, characterised by persistent and accelerating internal debt growth. During the 1990s, total internal debt grew at a CAGR of 0.25, driven largely by loans from banks and financial institutions (0.30) and steady growth in provident funds (0.21).

**Table 5: Rajasthan State's Decadal CAGR of Various Components in Total Liabilities**

<b>Variables</b>	<b>1990-1999</b>	<b>2000-2009</b>	<b>2010-2019</b>
SDLs			0.19
Power Bonds			1.02
Market Loans	0.19		
Compensation and other bonds			
NSSF		0.23	-0.05
WMA from RBI			
Loans from Banks and FIs	0.30	0.10	0.11
Total Internal Debt	0.25	0.19	0.16
Loans and Advances from Centre	0.15	-0.06	0.10
Provident Funds etc.	0.21	0.11	0.10
Reserve Funds	0.18	0.10	0.58
Deposit and Advances	0.20	0.11	0.17
Contingency Funds	0.00	0.21	0.11

Source: Computed by the authors from the State Finances Reports, RBI

In the 2000–2009 period, although total internal debt growth declined slightly to 0.19, the emergence of power bonds with an exceptionally high CAGR of 1.02 indicates the use of special instruments to manage fiscal stress. Reserve funds and deposits also expanded steadily, suggesting borrowing-led adjustment rather than revenue consolidation.

The most striking pattern emerges in the 2010–2019 period, where total internal debt growth accelerated to 0.16, accompanied by an extraordinary rise in reserve funds (0.58). Growth in loans from the centre turned positive again (0.10), highlighting continued fiscal dependence. These trends point to mounting fiscal pressure and limited adjustment capacity, reinforcing Rajasthan's classification as a high debt state.

The debt dynamics of West Bengal highlight long-standing fiscal stress. In the 1990s, total internal debt grew rapidly at 0.29, driven by loans from banks (0.26) and deposits (0.25). During 2000–2009, internal debt growth remained high at 0.23, while reserve funds surged dramatically (0.61), indicating non-transparent fiscal adjustments. Although loans from the centre declined (–0.06), market borrowing continued to expand.

**Table 6: West Bengal State's Decadal CAGR of Various Components in Total Liabilities**

<b>Variables</b>	<b>1990-1999</b>	<b>2000-2009</b>	<b>2010-2019</b>
SDLs			0.18
Power Bonds			
Market Loans	0.19		
Compensation and other bonds	-0.07	0.00	
NSSF		0.25	-0.02
WMA from RBI			
Loans from Banks and FIs	0.26	0.08	-0.01
Total Internal Debt	0.29	0.23	0.10
Loans and Advances from Centre	0.16	-0.06	0.02
Provident Funds etc.	0.19	0.07	0.09
Reserve Funds	0.14	0.61	0.11
Deposit and Advances	0.25	0.08	0.14
Contingency Funds	0.00	-0.02	

Source: Computed by the authors from the State Finances Reports, RBI

In the 2010–2019 period, internal debt growth moderated to 0.10, but this deceleration coincided with declining bank loans (–0.01), reflecting constrained borrowing capacity rather than fiscal consolidation. The continued reliance on internal debt components underscores persistent fiscal vulnerability.

### **Comparative Assessment Across Debt Categories**

A comparative reading of the results highlights three key insights. First, the transition from central loans to market-based borrowing is common across all states but is most pronounced in high debt states, where market instruments substitute for declining intergovernmental transfers. Second, low debt states exhibit a more balanced liability structure, with moderate growth across components and limited volatility, indicating stronger fiscal fundamentals. Third, medium and high debt states show signs of borrowing-led fiscal adjustment, characterised by persistent internal debt growth and greater exposure to interest rate and rollover risks.

These findings underscore those fiscal rules such as the FRBM Act, while effective in reducing overt fiscal deficits, have not eliminated inter-state disparities in debt outcomes. Instead, they have reshaped the composition of debt in ways that reflect underlying structural and institutional differences across states.

### **V. Conclusion and Policy Implications**

This study examined the evolution and composition of state government liabilities in India through a comparative analysis of selected high, medium, and low debt states over three distinct decades. By focusing on the decadal growth of individual debt components rather than aggregate debt indicators alone, the study provides a nuanced understanding of how subnational fiscal strategies have evolved in response to economic reforms, fiscal rules, and changing centre–state fiscal relations.

The findings reveal that while all states have experienced a structural shift away from loans and advances from the central government towards market-based borrowing instruments, the nature and intensity of this transition vary significantly across states. Low debt states such as Gujarat and Maharashtra demonstrate relatively stable and disciplined debt profiles, characterised by moderated growth in total liabilities and a balanced composition of internal debt. In these states, market borrowing appears to function as a strategic financing mechanism, supported by stronger revenue bases and diversified economic structures. In contrast, medium debt states—Tamil Nadu and Uttar Pradesh—exhibit persistent growth in internal debt components across decades, indicating structural rigidities in revenue mobilisation and expenditure commitments. Although these states have successfully reduced their dependence on central government loans, the increasing reliance on market instruments and institutional borrowings suggests that fiscal adjustment has been partial and uneven. The situation is most pronounced in high debt states such as Rajasthan and West Bengal, where rapid expansion of internal debt, reserve funds, and special borrowing instruments reflects borrowing-led fiscal adjustment under persistent fiscal stress. The continued growth of liabilities in these states, even in the post-FRBM period, indicates that fiscal rules have reshaped the composition of debt rather than fundamentally curbing debt accumulation. This raises important concerns regarding debt sustainability, fiscal transparency, and future fiscal space.

From a policy perspective, the results underscore the limitations of a uniform, rule-based fiscal framework in a fiscally heterogeneous federation. While the FRBM framework has contributed to greater fiscal discipline and transparency, it has not adequately accounted for inter-state differences in revenue capacity, expenditure needs, and debt management capabilities. The evidence suggests that debt sustainability at the state level cannot be effectively assessed through aggregate indicators alone; instead, close attention must be paid to the composition, growth, and maturity structure of liabilities. A key policy implication is the need to strengthen state-level debt management institutions. High and medium debt states, in particular, must adopt more active debt management strategies that align borrowing decisions with medium-term revenue projections and expenditure priorities. Improving maturity structures, managing interest rate risks, and reducing reliance on short-term or non-transparent borrowing instruments are essential to mitigate fiscal vulnerabilities.

Equally important is the need to enhance own-source revenue mobilisation. Persistent internal debt growth in fiscally weaker states reflects limited revenue elasticity and high committed expenditures. Targeted reforms aimed at broadening the tax base, improving compliance, and rationalising subsidies can reduce dependence on debt-financed expenditure and create fiscal space for productive investment. In this context, greater emphasis on debt-financed capital expenditure—rather than revenue expenditure—can improve the growth dividend of public borrowing. The findings also highlight the importance of improving fiscal transparency and accountability, particularly with respect to reserve funds, deposits, and other off-budget or quasi-fiscal liabilities. Integrating such liabilities into formal fiscal reporting frameworks and strengthening legislative oversight would help ensure that short-term fiscal adjustments do not translate into long-term sustainability risks.

Overall, the study emphasises that the challenge facing Indian states is not merely one of reducing the size of public debt, but of improving its quality and composition. A differentiated and composition-sensitive fiscal framework—one that recognises inter-state heterogeneity while promoting prudent borrowing and sustainable fiscal practices—is essential for ensuring long-term fiscal stability and balanced regional development in India. Future research may extend this analysis by linking debt composition with economic growth, social sector outcomes, and investment efficiency at the state level.



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