

India's silent defaults

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Stylized facts - I

Debt levels (Union + States)

Year (End-March)	Centre			States	Combined
	Domestic	External	Total		
1999-00	47.58	9.23	56.81	25.19	70.47
2004-05	59.64	5.90	65.53	31.28	82.13
2009-10	52.42	3.85	56.27	25.45	70.60
2014-15	48.48	2.94	51.42	21.69	66.58
2019-20	49.80	2.71	52.51	26.62	75.12
2024-25 (BE)	54.33	2.49	56.82	28.78	81.92

RBI - Handbook of Statistics on Indian Economy (Table 239: Select Debt Indicators of Central and State Governments (As Percentage to GDP))

Stylized facts - II

State defaults

- ▶ Nearly 3.5 lakh govt staff wait for salary in Kerala; Reports say govt mulls salary cap, Onmanorama, March 3, 2024
 - Supreme Court says Kerala responsible for its own financial misery, rejects state's plea to borrow more, The Economic Times, April 2, 2024
 - State debt and the constitution, by Alok Prasanna Kumar, Economic and Political Weekly, Vol. 59, Issue No. 25, 22 Jun, 2024
- ▶ Himachal Pradesh CM Sukhu and ministers defer salaries for 2 months over financial crisis, by Saurabh Parashar, The Indian Express, August 30, 2024
- ▶ Political furore in Punjab after Mann govt seeks enhancement in borrowing limit, hikes taxes, by Chitleen K Sethi, The Print, 11 September, 2024

Finance theory

Debt and default

- ▶ Debt $\uparrow \rightarrow$ Credit risk (default risk) $\uparrow \rightarrow$ Probability of default $\uparrow$
 1. $\Rightarrow$ Cost of debt $\uparrow$
 2. $\Rightarrow$ Credit rating $\downarrow$

Stylized fact - III

Cost of government debt

Table: Interest rates of securities, across time

	2000	2005	2010	2015	2020	2025
<i>Union government</i>						
New issue	11.77	6.11	7.23	8.51	6.85	6.96
Outstanding		8.79	7.89	8.09	7.71	7.29* (2023-24)
<i>State governments</i>						
New issue	11.89	6.45	8.11	8.58	7.24	7.20
Outstanding						

Sources: 1. Status paper on government debt, Ministry of Finance; 2. RBI - Handbook of Statistics on Indian Economy (Table 106 : Interest Rates on Central and State Government Dated Securities)

Stylized fact - IV

Long-term foreign currency credit rating

Year	Moody's	S&P	Fitch	Outlook	Event/Context
2003	Ba1	BB+	BB+	Stable	Below investment grade for all three agencies
2004	Baa3	BB+	BB+	Stable	Moody's upgrades to investment grade (Baa3)
2006	Baa3	BB+	BBB-	Stable	Fitch upgrades to investment grade (BBB-)
2007	Baa3	BBB-	BBB-	Stable	S&P upgrades to investment grade (BBB-)
2008–11	Baa3	BBB-	BBB-	Stable	Post-GFC: no change despite stimulus expansion
2012	Baa3	BBB-	BBB-	Negative	S&P negative outlook; fiscal slippage concerns
2013–16	Baa3	BBB-	BBB-	Stable	Outlook restored; no rating change
2017	Baa2	BBB-	BBB-	Stable	Moody's upgrades one notch to Baa2
2020	Baa3	BBB-	BBB-	Negative	Moody's reverts to Baa3; pandemic shock
2021–24	Baa3	BBB-	BBB-	Stable	No change
Aug 2025	Baa3	BBB	BBB-	Stable	S&P first upgrade in 18 years; fiscal consolidation cited

To summarize

- ▶ Fiscal situation of Union and states quite fragile;
- ▶ Some states have already defaulted, while others are struggling to keep up;
- ▶ But, the **cost of borrowing** for Union and states remain **stable**.
- ▶ Country **credit rating** at the **margin** (one notch above junk bonds).

Finance in Public Finance is broken.

The Liz Truss lesson

How functioning finance looks like?

- ▶ September 2022: Mini-budget announced
 - £45 billion unfunded tax cut - fiscal rules suspended
- ▶ Gilt market revolts
 - 10Y yields spike 100 bps in days; pension funds face margin calls
- ▶ BoE emergency interventions
 - £65 billion bond-buying to prevent systemic collapse
- ▶ Chancellor sacked; PM resigns (out in 44 days - the shortest tenure)

Why Public Finance?

Because fiscal failure cascades

- ▶ Salary defaults: Government functioning stalls;
- ▶ Pension delays: Social justice issue;
 - $\approx 8\%$ of Indian households live on pensions.
- ▶ PFM issues (both procurement & contracting);
 - Low quality suppliers crowd-in (poor low-quality equilibrium);
 - Poor quality public infrastructure.
- ▶ Capex collapses $\rightarrow$ Freebies replace investment;
 - Borrowing to consume, not to invest.
- ▶ Transfers breed patronage; patronage breeds populism; populism hurts citizen mobility
 - The common market breaks down.

India's fiscal architecture

Checks and balances

1. Fiscal Responsibility Legislations;
2. Competitive Federalism;
3. Debt Sustainability Assessments (IMF + WB).

Gains won: The reform era (1993-2007)

- ▶ 1993: Agreement between RBI and Ministry of Finance to stop direct monetization of debt
 - 1997: Complete cessation of automatic monetization
- ▶ 2003: FRBM Act (2004-07: State level FRLs)
 - Fiscal responsibility legislations ($\text{Debt/GDP} < 40/20\%$ (Union/States); Fiscal (Revenue) deficits $< 3\%$ ($\approx 0\%$))
 - Market borrowing reforms
 - ▶ RBI prohibited from participating in primary government securities auctions;
 - ▶ States must borrow directly from the market (no more direct borrowing from the Union).
- ▶ Continuous effort to make balance sheets more transparent
 - 2004 Pension reform: Old Pension Scheme (OPS) $\rightarrow$ New Pension Scheme (NPS);
 - Declare all Union/state guarantees (also limit on guarantees)

Where we failed?

- ▶ Failure on both counts: Fiscal rules vs. market discipline (with Swayamshree Barik)
 - No penalty for non-compliance with fiscal rules (soft-budget constraint problem)
 - Complete absence of credible enforcement mechanisms or sanctions
 - Aspirational (non-binding) from day 0
- ▶ How cost of borrowing is managed for the Union/states?¹
 1. Limit foreign currency borrowings; (Stylized fact I)
 2. Above 85% - Borrowing from Captive FIs as lenders; (government ownership of banks, insurance companies, and pension funds)
 3. Prudential regulations forcing FIs to hold Gov securities; (both micro & macro)
 4. Restricted foreign participation in government debt markets;
 5. In the waterfall, provide G-sec holders highest priority.

¹Who lends to the Indian state?, Aneesha Chitgupi, Ajay Shah, Manish K. Singh, Susan Thomas, Harsh Vardhan, XKDR Forum Working Paper 34, August 2024.

- ▶ Not even debt could do us part (with Swayamshree Barik)
 - Built a small theoretical model;
 - Show that the fiscal–monetary interdependence shapes debt sustainability in India;
 - Fiscal profligacy shows up in exchange rate market (higher debt leads to higher depreciation of Indian rupee).
- ▶ Monetary policy transmission in GoI debt markets²
 - Key findings:
 - ▶ Primary market yields adjust to equilibrium approximately twice as fast as long-term secondary yields;
 - ▶ Long-run pass-through becomes economically and statistically marginally significant for 10-year secondary yields but remains substantial for primary auction yields.
 - Evidence in favour of fiscal-monetary coordination and preferred-habitat behaviour in segmented bond markets.

²Monetary Policy Transmission in Primary and Secondary Markets: Evidence from Indian Government Securities (2026), Swayamshree Barik, Manish K. Singh, and Harsh Vardhan, Work in progress

My learnings

1. Rules are non-binding for sovereigns but costs are binding;
2. Public in Public Finance is a political economy problem (very limited knowledge),
BUT,
Finance in Public Finance **can** be non-political.
3. Governments resist accountability; (will try to dismantle all checks and balances)
4. Even when intentions and actions are right, things may not evolve in your favour

Period	Avg. nominal GDP growth rate
2005-10	15.89%
2008-13	16.24%
2013-18	11.98%
2018-23	9.58%

Theory of change

Theory of change

The idea

Most public policy thinkers are forwards.

They chase the goal. New ideas, new angles, slight spaces to score.

But, a 90-minute match is not settled with **1–2 minutes of scoring moments**.

What gives a team **consistency, quality, and confidence** is not the striker—it is the **midfielder**.

The midfielder:

- ▶ Keeps the ball moving on both flanks
- ▶ Pushes forwards, drops back to help defenders
- ▶ Re-strategises, rotates, rebuilds
- ▶ Attacks when needed; defends when needed

Theory of change

My claim

We need more strength in our midfield.

Not because scoring goals is unimportant—but because **goals scored without midfield control are fragile**. They get equalised.

In public policy, we score goals (reforms), lose the midfield (enforcement, markets, accountability), and then **concede the same goal again**, twenty years later.

We are fighting the same battle, losing the same ground.

Theory of change

The long game

1. Fix the midfield
 - Free the bond market; let fiscal excess have a price.
2. Build independent accountability frameworks
 - Generate signals that markets (and citizens) can use.
3. Shrink the arena (the size of the state)
 - Focus the state on genuine public goods.

The end. Comments!