CHAPTER 1

INTRODUCTION

1.1 Introduction

Growth of public debt has been a widely discussed topic of Public Finance especially since the 1980's. The mismatch between government expenditure and revenue has resulted in a persistent and seemingly unsustainable gap in resources. The consequent fiscal stress has made financial management an increasingly difficult task. Several research projects have examined the origin, implications and options in respect of the resource gap of the governments. However, it was the Central Government finances, that have been the focus of research in India. The resource gap of State Governments, manifested in the form of growing public debt of these governments, has not received adequate attention. In the present situation of large fiscal imbalance, there is need to measure and analyse the public debt of State Governments in a comprehensive and systematic manner.
1.2 Borrowing Powers of the Central and the State Governments under the Indian Constitution

The Constitution of India confers the power of borrowing on both the Centre and the States though the two are not placed on equal footing. The Central Government has unrestricted powers of borrowing in India and from abroad subject only to such limits as may be fixed by the Parliament by law (Article 292). On the contrary, the borrowing powers of the States are both territorially and otherwise limited (Article 293). They have no power to raise loans outside India. Within India, a State may raise loans from the Government of India or float public loans. However, a State cannot raise a public loan without the consent of the Government of India if there is still outstanding any part of a loan which has been advanced to it by the Government of India or in respect of which a guarantee has been given by the Government of India. The borrowing powers to the States had also been defined in the Government of India Act 1919 and Government of India Act, 1935.

Borrowing powers, in fact, have been one of the most contentious issues between the States and the Centre in the Indian federation. The States have no independent borrowing powers and as such depend on Central Government permission with many conditions laid down in the process to borrow either
from the public or from financial institutions or from the Centre. On the other hand, the Central Government has unlimited borrowing powers. An asymmetry has developed in that while there is no control over the Centre because it can run up deficits by borrowing from the Reserve Bank of India (RBI), the States have to stick to the overdraft limit laid down by the RBI. Moreover, the external credits sanctioned for State projects are not entirely allocated to the States on the same terms and conditions.

1.2.1 Public Debt of State Governments

In India, public borrowing has been a significant element of the financing of government expenditure at the Central and State levels. Consequently, public debt has increased considerably in recent years. Considering the magnitude of the problem, it is not surprising that the issues surrounding public debt in India have received considerable attention. However, public debt of the Central Government has been the focal point in all these discussions, even though more than one third of the currently outstanding combined public debt is owed by the State Governments in India.

In the context of huge expenditure responsibilities, revenues of the State Governments consisting of non-debt Central transfers and States' own
resources have become increasingly insufficient and the resultant resource gap of a State is met through borrowing. Public borrowing has become the mechanism often resorted to cover the gap between the expenditure needs and available resources of State Governments. The growth of States' public debt and servicing of these debts pose serious strain on the State's budget. In this analysis, the problem of States' indebtedness and its implications are examined, with special reference to the public debt of Kerala.

1.2.2 Burden of Debt

Public borrowing may at times be preferred to tax financing to meet governmental expenditure. Apart from the adverse political fallout, heavy taxation adversely affects the incentive to work and invest. Public borrowing, given its voluntary character, is free from these limitations. But unlike tax revenue, funds raised through borrowing have to be repaid along with interest. This is referred to as the burden of public debt. The problem of debt servicing becomes a serious issue when the ratio of interest payment to revenue expenditure rises continuously leading to diversion of resources on account of interest payment. This will set limits on the governments' ability to incur other expenditure. This hampers economic growth and in turn adversely affects the growth of government revenue mobilization. So a sort of vicious
circle develops, whereby the ratio of the interest payments to revenue receipts becomes larger. Governments are thus compelled to borrow more just to meet their debt servicing obligations. Nowadays, this is manifested in the form of revenue account deficits of State and Central Governments, which are financed by borrowings. Debt servicing capacity can improve only if the amount borrowed by a government is used for investment purposes which yield returns high enough to meet the interest and repayment obligations. A detailed discussion of theoretical issues in public debt, is attempted in the second chapter.

In a country like India, the quantum of resource of State Governments are influenced by federal fiscal transfers from the Centre to the States. Even when States' own revenue resources expand sufficiently, but the share of non-debt resource transfer from the Centre declines, the growth in the total revenue receipts of the State Governments may be far less than desired. Similarly, increase in the share of Loans and Advances from the Central Government (LACG) in total transfers, leads to growing debt servicing burden on the States. The revenue and capital resource mobilization of State Governments in India are not totally within States' own control. So the public debt situation of a State can be meaningfully analysed only in the backdrop fiscal transfers to the State and its composition.
The burden of debt in terms of gross interest payments overstate the burden of debt. The net interest burden which takes into account the interest receipts on debt financed investment provides a better measure of the burden of debt. Debt relief recommended by the various Finance Commissions also influences the debt position of State Governments in India.

1.2.3 Public Debt of Kerala

In this study, the various aspects of the public debt of Kerala are examined in detail. An attempt is made to trace the genesis of Kerala’s fiscal crisis and the debt problem. Though all State Governments in India are experiencing the budgetary problem of revenue account deficit, Kerala’s fiscal problems are unique for more than one reason. The frequency and magnitude of the crisis are much more for Kerala than for other States. The fiscal crisis of Kerala surfaced in the Seventies itself, much ahead of other States. For long by keeping total capital disbursements at a low level, surpluses in the capital account were generated by Kerala to finance revenue deficits. All other States, on the other hand, had been utilizing their revenue surpluses to meet capital deficits till recently. Thus Kerala’s mounting and recurrent revenue deficits have become a charge on the State’s capital receipts including loans from the Centre, market borrowings and negotiated loans. The public
debt problem of Kerala and the fiscal crisis of the State are closely linked. So in the present context of large fiscal imbalance, there is need to measure and analyse the public debt of Kerala State in a comprehensive and systematic manner.

1.3 Objectives of the Study

The following are the broad objectives of the study:

1. To analyse the growth and composition of the public debt of Kerala, in the context of the growing debt burden of the Central and State Governments in India.

2. To examine the growth and composition of the debt receipts and their utilization by the Government of Kerala.

3. To study the problem of servicing of the public debt of Kerala.

4. To study debt relief recommended by various Finance Commissions to Kerala.

1.4 Methodology

The present study is essentially explorative and makes a statistical analysis of data on the public debt of Kerala. Necessary comparisons have
been made with All States’ and Central Government’s public debt. The secondary data are collected from sources like the Reserve Bank of India Bulletins, RBI Report on Currency & Finance, Finance Commission Reports, Five Year Plan documents of the Central and State Governments, Economic Reviews published by the Government of Kerala, Finance Accounts of Kerala published by the Comptroller and Auditor General of India, Papers of the Kerala State Planning Board and Budget documents of the Government of Kerala. Data collected from the above sources have been tabulated and interpreted in accordance with the chapter scheme.

1.5 Limitation

The study is explorative in nature and no hypothesis has been used in the analysis of the public debt of Kerala. The study covers only the period between 1974-75 to 1996-97. State finances data are not comparable with those published prior to 1974-75, due to changes in budgetary classification. However, to provide the public debt scenario of the country, data from 1950-51 onwards have been used in the presentation of Indian public debt and public debt of the State Governments in India.
1.6 Chapter Scheme

There are eight chapters in the study. They are:

Chapter - I Introduction

Chapter - II Theoretical Issues in Public Debt and Review of Empirical Literature

Chapter-III Public Debt of India

Chapter-IV Public Debt of State Governments in India


Chapter-VII Debt Servicing Burden and Debt Relief

Chapter-VIII Conclusions and recommendations.