CHAPTER VI

SUMMARY OF FINDINGS, SUGGESTIONS AND CONCLUSION

The main findings of the study are summarised in this chapter by bringing into focus some ‘clues’ for the future policy makers. As the analysis was based on the data that was available for a short period and also due to the fact that even the available information was limited, the ‘clues’ may not be as strong as one would like them to be; yet, they do throw up some ‘indications’ and to the extent that continuous monitoring would enable a change towards objective policy changes, they do serve a very important purpose.

Study of public debt and its determinants has assumed prominence in view of the fact that the public debt plays a very significant role in mobilizing financial resources. Public debt has played an important contribution in the planned economic growth of India. Public debt assumes two forms, viz., (i) internal debt and (ii) external debt. The internal debt comprises market borrowing, treasury bills, special securities issued to the RBI and other internal liabilities. External debt comprises multilateral and bilateral loans, IMF, commercial borrowings, trade credit, NRI &FC (B&O) deposits and Rupee debt. Public debt in India is incurred to cover budget deficit, to fight depression, to finance public expenditure, to carry out welfare programmes and to create infrastructure.
Scholars have already made some studies on public debt. The present study has taken twenty-six years of public debt in India from 1981-82 to 2006-07 for analysis. The data needed for this study have been compiled from the various issues of Reserve Bank of India Bulletin, RBI-Report on Currency and Finance; Economic Survey and Articles published in Economic and Political weekly, Southern Economists and Indian Economic Journal, Third Concept and Public Opinion.

For an analysis of data, regression equations have been estimated using the principle of least squares. To estimate the average annual growth rate, compound growth rate of public debt, simple time series trend and semi-log model have been used. To find out the determinants of public debt, a multiple linear regression model has been adopted.

This study has covered a period of 26 years from 1981-82 to 2006-07. For the source of analysis, this period has been divided into two-sub periods on the basis of New Economic Policy.

**FINDINGS**

Before New Economic Policy, the trend analysis for internal debt for the years from 1981-82 to 1990-91 had revealed that there was an increasing
trend. The average annual growth rate of internal debt during pre-reform period was 12883.11. The compound growth rate was 17.31.

After New Economic Policy for the years from 1991-92 to 2006-07, it shows continuous growth rate. It increased more than seven times during the study period. From the year 1991–92 to 2006-07, the average annual growth rate of internal debt was 93852.23. The calculated compound growth rate of internal debt was 16.64. It is clear that Centre is not able to contain its current expenditure within its current revenues. Instead, it was meeting a portion of its expenses through borrowings.

During 1981-82 to 2006-07, the average annual growth rate of internal debt was 55960.37. Regression co-efficient was significant at both levels 84 percentage variation found in internal debt had been explained. The compound growth rate was 16.47.

The ‘t’ test was carried out to examine whether the growth rates for market loans differed between the two sub-periods has shown that there was a significant difference between the two periods for internal debt.

The increasing trend in the internal liabilities was a matter of serious concern. This had raised not only the interest burden, but also the concern about the sustainability of the growing internal debt. The net borrowings from
the market had financed about 70 per cent of the gross fiscal deficit in the year 2002-03.

Before New Economic Policy, the total external debt of India continuously increased. There was no decline in external debt in any one of the years. The trend analysis of external debt for the years from 1981-82 to 1990-91 shows, that the average annual growth rate was 2123.84. The calculated compound growth rate was 11.06.

From the year 1991-92 to 2006-07, there was a continuous growth in the India’s external debt. The value of slope co-efficient was 1793.86. This shows that the average annual growth rate of external debt was 3.30.

The annual growth rate was 2503.72 during 1981-82 to 2006-07. Regression estimates were statistically significant. The calculated compound growth rate was 7.29. The important reason for the increased trend in the total external debt is that the Government of India found herself in a position of being a dependent on substantive foreign assistance when she decided upon a policy of planned economic development. Foreign help was required to cover the investment gap and the balance of payments gap and the Government of India had to borrow on a large scale from various external sources.
Regarding currency composition of external debt, US dollars, as in the past, was the most important currency in the currency composition of external debt. However, the importance of US dollar is gradually waning. Its share declined from 54.3 percent at the end of March 2002 to 48.6 percent as at the end of March 2007. Other important currencies were Special Drawing Rights (SDR), Rupees, Japanese Yen, Euro and Pound Sterling, which together accounted for 55.9 percent of the total debt.

There has been a perceptible improvement in external debt indicators. The ratio of external debt to GDP showed a steady improvement, dropping to 16.6 percent as at the end of March 2007 from 38.7 percent as at the end of March 1992. India improved its rank among the top fifteen debtor countries from third in 1991 to eighth in 2002, according to the latest available information from the World Bank (Global Development Finance, 2004). In terms of maturity-wise composition of external debt, there has been a distinct shift towards long-term debt in the line with the policy stance of restricting short-term debt to prudent limits. Among the top 15 debtor countries, India’s short-term debt to total debt ratio and short-term debt to foreign exchange reserve ratio are the lowest.

The cover for external debt provided by India’s foreign exchange reserves has steadily increased from 6.9 per cent in March 1991 to 106.1 per cent as on June 30, 2004.
Concessional debt as a proportion of total external debt exhibited a decline from 45.6 percent at the end of March 1991 to 35.5 percent at the end of March 2001 but moved in a narrow range thereafter. At 35.4 percent at the end of June, it continued to be a significant proportion of total external debt.

India was the eighth largest debtor country in 2003; however, among the top 20 debtor countries, India had the lowest debt-GDP ratio, next to China. The ratio of the short-debt to total external debt was also among the lowest for India and was placed at 6.1 per cent at end March 2005 as against an average of 15.7 per cent for the developing countries as a group. The increase in short-term debt in the year 2004 was due to increase in trade credit.

Proportion of India’s short-term debt to total external debt at 4.2 per cent in 2003 was the lowest as compared to that of other countries. Similarly, the proportion of short-term debt to forex reserves was the lowest for India at 4.6 per cent followed by Mexico at 15.5 per cent.

The outcome of the deliberate policy efforts on the part of the Government has seen the decline in the short-term debt as a ratio of the debt. It is impressive to note that short-term debt as per cent of total debt has shirked from 9.9 per cent in 1989-90 to 2.8 per cent in the year 2001-02, but increased to 7.6 in the year 2006-07. To a large extent, this is indicative of heightened import activity including of course dollar dominated petroleum imports.
Fifteen years ago, India passed through one of the worst foreign exchange crisis, with external reserves at as low as 7 per cent of aggregate debt. Since, then there has been a spectacular turn around. At the end of March 31, 2005 forex reserves exceeded external debt by $18.2 billion providing a cover of nearly 115 per cent. At the end of March 2005, India held the fifth largest stock of reserves in the world. In 2004, the forex reserves exceeded debt for the first time. That placed India in a position to retire all its debt from its reserves.

External debt stock expanded at a lower rate than the growth rate of GDP in the post-reform period. As a result, external debt to GDP ratio, after rising sharply from 28.7 per cent in 1990-91 to 38.7 per cent in 1991-92, dropped over time to 16.4 per cent during 2006-07.

To facilitate international comparison, the Present Value of external debt is computed which reflects essentially the element of concessionality in external debt portfolio. Present Value (PV) concept is considered as a useful measure of indebtedness which is arrived at by discounting the future stream of debt service payments for individual loans by appropriate discount rates and aggregating such PVs for all loans. PV of external debt of India worked out to US $113.5 billion in the year 2003.
India’s debt service ratio has improved progressively over the years owing to the combined effect of moderation in debt service payments and redemption of RBIs. Debt service ratio worked out to 12.4 per cent in 2002-03, 8.5 per cent in 2003-04 and 4.8 per cent in March 2007.

The ratio of foreign exchange reserves to external debt works out the vulnerability of the Indian economy to the hazards of external debt.

The ratio of reserves to external debt which was nearly 6.7 per cent in 1990-91, dramatically increased. It rose to manifold tunes 117 per cent in 2005.

An important aspect of recent jump in external reserves has been due to non-debt creating inflows. After 24 years, there was a current account surplus in 2001-02. In fact, India has recently become a creditor to the I.M.F.

At the close of March 31, 2005, forex reserves exceeded external debt by $18.2 billion providing a cover of 117 per cent. In 2004, the reserves exceeded debt for the first time. That placed India in the select company of developing countries along with China to be in a position to retire all its debt from its reserves.

At around US $141 billion March 31, 2005 India held the fourth largest stock of international reserve assets among emerging economies and ranked sixth in the world.
Adequacy of reserves has emerged as an important parameter in gauging its ability to cushion its external shortages. In terms of trade related reserve adequacy indicators, Indian foreign exchange reserves are more than 15 months imports and higher than several other emerging economies in Asia.

India’s share of concessional debt continues to be high by international standards. India’s share of concessional debt to total debt at 37.8 per cent at the end of 2003 was the highest among the top ten debtor countries followed by Indonesia at 27.4 per cent.

The variable multilateral IMF, commercial borrowings, NRI and FC deposit, rupee debt, total long-term debt, short-term debt and gross total are statistically significant at 5 per cent level. The variables bilateral and trade credit are not statistically significant.

Before implementation of New Economic Policy, public debt increased more than four times over ten years. The value of slope co-efficient was 15006.95. The compound growth rate of public debt was 15.99 during the year 1981-82 to 1990-91. The burden of public debt was increasing in the subsequent years due to the rising budgetary deficits and the inflationary pressure due to the increasing non-development expenditure in India.
After the introduction of New Economic Policy, it shows continuous growth rate. From the year 1991-92 to 2006-07, the average annual growth rate of public debt was 95646.08. The calculated compound growth rate of public debt was 15.29. In the post-reform period, the debt service had increased at an alarming rate, which had led to huge fiscal deficits with adverse effects on the total public debt of India.

The average annual growth rate was 58463.43 during 1981-82 to 2006-07. Regression estimates were statistically significant; 83-percentage variation found in public debt had been explained. The calculated compound rate was 15.33. The ‘t’ test, which was carried out to examine whether the growth rates for public debt differed between the two sub-periods, had shown that there was a significant difference between the two periods of public debt.

The determinants of public debt shows, that the variables, fiscal deficit, exports and expenditure are positively related to public debt, whereas the population imports and GDP are negatively related to public debt.
SUGGESTIONS

A higher fiscal deficit leads to an increase in the ratio of domestic debt to real GDP. Normally, by reducing the quantum of fiscal deficit, it is believed that domestic public debt could be brought down. But it has been found that the government income and expenditure pattern keeps on changing and hence the effects of reduction in the fiscal deficit on domestic public debt get nullified. Unless the government has a long-term stable revenue expenditure policy, reduction fiscal deficit cannot have any impact on domestic borrowing.

Development requires mobilization of resources. Short cut through deficit financing is not desirable. Resort to printing press may prove inflationary. Solution may prove worse than the malady.

The government can augment its revenue mobilization by increasing the rate of tax particularly for upper income declines. Taxing of rural rich is also a positive step to improve the financial position of the country. The government can ensure better enforcement of the collection from existing taxes. The black money can be brought into light through effective enforcement of tax laws. The black money is an important source to boost up government revenue.
The government can resort to comprehensive import curtailment unless they are connected with mass consumption goods and they are essential for productive and improving facilities.

Wasteful expenditure by the government should be drastically cut. Without doubt, there is a large scope for reducing its administrative expenses. The government can undertake an in-depth analysis of subsidies to find out the beneficiaries and it can rationalize the subsidies.

Certain measures have to be adopted to effect the reduction in the existing stock of debt in order to cut down on the burden of interest payments. For this specific purpose, following measures can be suggested.

(a) The amount of annual dividend payable to the RBI by the Government of India should be stepped up; the amount thus realized should be used to retire market debt owned by the government.

(b) The government confiscates contraband that has come in through smuggling. All that is confiscated in future should be sold in action to the public at a price not less than the ruling internal market price and the net proceeds can be given to the retirement of debt.
In 1990, the debt crisis, primarily external debt crisis, necessitated the immediate economic reform. Debt service ratio, which measures repayment abilities, has higher than one-third of exports and this ratio had an increasing trend. There are two ways by which this increasing ratio can be brought down effectively. One way is to bring down considerably the total foreign borrowings, cutting down non-development expenditures. Secondly the capital has to be linked to export oriented industries. This will help to bring down the debt-servicing ratio to exports.

As there is a high correlation between population and public debt it is obvious that by controlling the growth of population and extend of borrowing can be effectively controlled.

There is a vast scope for further research in this area of study. Most of the studies are based on macro variables. The various deficits in the budget on internal and external borrowing can be analyzed on a time scale. This may help to know the influence of the deficit on the borrowing of different periods of time. Further, an analysis of debt servicing would help us to know the extent of drain on our revenue. It has been observed that political instability results in more borrowings, particularly from abroad. However, borrowings need not lead to economic crisis. The crisis is only because misuse of the borrowings for purposes other than economic growth. Hence an analysis of
utilization of borrowings for productive purpose can be made. This would be useful for knowing the extent to which borrowings are utilized for development purposes.

The nation is still confronted with a staggering amount of foreign debt. It is about $100 per head. Given the fact that the economy fails to generate adequate level of domestic savings to finance the required investment, the country needs to tap foreign sources of savings in order to fill this gap. However, we need to bear in mind that in the ultimate analysis, India must raise its own capability in this direction and increase incentives for the households, and corporate sectors to increase their savings. The government must make sure that it sets its own capability in this direction and increase incentives for the households, and corporate sectors to increase their savings. The government must make sure that it sets its own house in order and make net positive and not negative contribution to national saving.

Since the population is the most important variable influencing external debt the Government should take proper and adequate measures to check the growth of population.

In the context of growing trade deficit, efforts are needed to ensure that the growth momentum in merchandise export is maintained. For this, there is a need to remove the existing trade restrictions within the country and strengthen the
small and medium scale enterprises through policy support. Also, import tariffs must go down further in keeping with the trend in other Asian countries.

Then there is a question of inflow of hot money on capital account. FII inflows and NRI remittances are far in excess of FDI inflows. The country needs more FDI inflows to sustain the strength of the external sector and provide foreign exchange resources for the growing trend of overseas acquisitions by Indian companies in their effort to become global companies.

A dynamic private sector is essential, as it will enhance the country’s ability to thrive amid global competition.

The government must put its fiscal house in order to open up its economy to more trade and investment. India’s exports still account for less than one percent of total world exports and average trade tariffs remain high at 22 per cent, but in the ASEAN countries, it is around 8 per cent only.

Some domestic sectors also need restructuring to attract investors. The country’s huge and latent pool of enterprise can play a vital role, but creativity, risk taking and enterprise must be rewarded.

In recent year, the time has come to revisit the arrangements for managing public debt in India. Debt and monetary management should be separated in India. The separation of debt management from monetary policy
will help the central bank to focus exclusively on price stability, which will provide transparency in its operations and thereby enhance its credibility. The assignment of the function of debt management to a separate office would help to establish specific accountability and responsibility on the debt manager. This could lead to an integrated and more professional management of all government liabilities, currently dispersed among different offices, with a mandate to operate on sound economic and commercial principles. The development of a focused and transparent debt management strategy also could ensure that funds are available to the Government at competitive rates of interest that will lead to expenditure prioritization and to fiscal discipline in budget making.

**CONCLUSION**

The empirical evidence for India shows that the burden of total debt is mounting. An important implication of this finding is evident from the foregoing discussion. The main problem of India is that the growth rate of national income is very low as against the rapid increase of public debt. Therefore, it is absolutely necessary to speed up the rate of growth of Indian economy so as to make the burden of debt service less onerous.

The balance of payment situation in recent years remained comfortable. The situation will however need close monitoring in the successive years.
External sector will crucially depend upon the sustainable growth of export. So highest export growth in future ensures import financing without replaying on external debt. Policy measures are necessary to provide appropriate incentives for exports to get strengthened in the light of the emerging global environment.

The foreign exchange is much more required for external debt repayment. The conversion of rupee currency imposes heavy strain on the balance of payments because a major part of export surplus is absorbed in servicing the debt only. Further, when a large slice of government’s revenue is utilized towards external debt servicing the government has to curtail its investment on developmental programme, which will ultimately affect economic growth. The government can cut down its non-developmental expenditure without affecting the interest of the poor.

The main problem of India is the low growth rate of national income as against the rapid increase of external debt. Therefore, it is absolutely necessary to speed up the rate of growth of Indian economy so as to make the burden of debt service less onerous.

Foreign debt servicing capacity may be strengthened by export promotion and also by import substitution. External sector will crucially depend upon the sustainable growth of exports. So high export growth in future ensures import
financing without relying on external debt. The government should adopt suitable policy measures to provide appropriate incentives for exports to get strengthened in light of emerging global environment.

India has come a long way from the days of crisis of the early 1990’s. Its pragmatic and gradual approach to reform seemed to have paid reasonably well. It has emerged almost unscathed from various crises like East Asian Crisis, drought or sanction like situation. There are strong reasons to believe that India would be on a higher growth trajectory in the coming decades. At the same time, a lot of needs are to be done to improve the quality of life. While the proportion of the poor in total population has come down, the absolute number of poor people remains high. India’s rank in terms of human development index and gender development index continues to be low compared to many developing countries. There is a need for linking growth with development and fill the gap between macro economic performance and social sector development.