Conclusions and Suggestions

This chapter aims to sum up the work that has been done in the preceding chapters and present main findings obtained from the empirical analysis. Accordingly, section I presents the main findings of the study. Section II elicits suitable policy implications of the present study.

Analysis of public debt in developing countries like India has traditionally focused on external debt. However, in recent years, India adopted aggressive policies aimed at retiring public external debt and substituting it with domestically issued debt. The issue of public debt and debt sustainability in India has long been a concern for policy makers of both fiscal and monetary authority. High public debt stems from persistent fiscal deficit and has a significant negative effect on economic activity. It leads to high taxes and puts upward pressure on real interest rates, which may crowd out private investment. When a government is no longer able to finance its deficit, it is forced to cut spending or raise revenues, often at times when fiscal policy is needed to help stabilize the economy.

It is in this context that present study entitled “Trends, Structure and Effect of Public Debt on Fiscal Management in India” has analysed public debt both external public debt and internal public debt by using
time series data for the period 1980-81 to 2006-07. For analytical convenience this period has been divided into two sub periods, namely, 1980/81 to 1990/91 (pre reform period i.e. before nineties) and 1991/92 to 2006/07 (post reform period i.e. after nineties). More specifically, the objectives of the study are:

1. To analyse the trends and structure of public debt in India.
2. To examine the effects of public debt on Indian economy in terms of gross domestic product.
3. To analyse the causes of the increasing trends of public debt in India.
4. To devise and formulate the polices so that public debt can be minimized and used productively.
5. To evaluate the role of the public debt in the developing economy like India.

The study is based on data collected from various secondary sources and the main findings of this work are presented in section I.
SECTION I: CONCLUSIONS

The main conclusions drawn from the present study are as follows:

Growing public debt has become a common feature of the fiscal sectors of most of the economies. Contemporary economic wisdom does not consider public debt a major problem per se; rather problem is the mismanagement and unsustainability of the public debt. The modern theory for public debt sustainability discerns a fundamental relationship between economic stability and debt sustainability in a country. The inadequate debt management and a permanent and unlimited growth of debt to GDP ratio may result in some negative tendencies and changes in main macroeconomic indicators, like crowding out of investment, financial system instability, inflationary pressures, exchange rate fluctuations etc. There are also certain social and political implications of unsustainable debt burden. Persistent and high public debt calls for a large piece of budgetary resources for debt servicing. Consequently, the government is forced to cut allocations for other public services and it faces serious difficulties in executing its electoral manifesto, if it has. Still more serious implications of high and unsustainable public debt are possibilities of widespread bankruptcies like in Mexico and Latin American countries during 1980s. According to Richard Musgrave and Peggy Musgrave, "(Public) borrowing involves a withdrawal made in
return for the government's promise to repay at a future date and to pay interest at the interim”.

In the past decade, public debt has triggered several of the financial crises in large emerging markets. In the case of India, the traditional concerns have been with fiscal deficits (both central and states) and with the size and maturity of the country's external debt. The high order of borrowings by the centre and state governments continues raising concerns about the sustainability of the public debt. The combined debt-GDP ratio increased from 71 per cent in 2000-01 to 77 per cent in 2006-07. The Twelfth Finance Commission recommends that, with the estimated overall debt-GDP ratio of 81 per cent at the end of 2004-05, it should be brought down to 75 per cent by the end of 2009-10 and, as the interest payments constitute the major part of the public debt, the combined interest payments relative to revenue receipts to be reduced from 34 per cent in 2004-05 to 22 per cent in 2009-10 and eventually to about 17 per cent.

It is obvious that there is an urgent need to control the external debt in India. In the coming periods, attention should be given to avoid both the internal and external debt. Instead, the government should generate income inter alia by undertaking various business ventures to fulfill its
financial requirements. It is possible for a country to attain economic
development without getting any assistance from the foreign countries.
For instance, the former USSR attained the economic development only
by using its domestic finance.

In India, the population has been growing enormously every year, but
not the domestic savings. In the absence of domestic savings, there is a
need for external assistance in the country to meet out the expenses
incurred for building social and economic infrastructure, which is
required to satisfy the increasing demands of the increasing population.
The increasing population and public expenditure are considered the
important factors for the expansion of external debt in India. It is
observed that the external debt in India was positively correlated with the
population and public expenditure during the period 1991-92 to 2006-07.

According to World Bank, India has been placed under the category of
less indebted country. India improved its position to elevate its rank from
third position after Brazil and Mexico in 1991 to eighth in 2004 after
Brazil, China, Russian Federation, Argentina, Indonesia and Turkey. In
2004, Argentina ranked first in the debt to GNP ratio. In the same year,
India was placed second lowest after China at, 20.7 per cent as against
third in 1991 after Korea Republic and China. Among the SAARC
countries. India's debt-GNP ratio was lowest in 1991, which continued to be lowest in the year 2004 as well. Other SAARC countries, namely, Nepal, Sri Lanka and Maldives have maintained their less indebted benchmark from 1995 to 2004.

The total external debt in India has increased from Rs. 32.03 crores in 1950-51 to Rs. 31,524.97 crores in 1990-91, that is more than 550 times. During the period 1950-51 to 1990-91, the compound growth rate of external debt in India is recorded at 18.34 per cent. However, it has come down to 10.24 per cent during the period 1980-81 to 1990-91. Hence, it can be stated that even though there is a secular expansion of external debt in the country, the growth rate of external debt in India is in a declining pace.

Among the top 15 debtor countries of the world, India improved its rank from third debtor after Brazil and Mexico in 1991 to ninth in 2000. The external debt to GDP ratio showed a steady improvement, dropping to 17.8 per cent in 2006-07 from 38.7 per cent in 1991-92. The main reason for the decrease in external debt-GDP ratio was the increase in the GDP growth and active debt management policy followed by the government. The debt service ratio also rapid declined from a peak of 35.3 per cent in 1991 to 5 per cent in 2006-07.
A large part of India's external debt is owed to bilateral and multilateral creditors; its share that was hovering around 50 per cent in the later half of 1990s has gradually declined to around 40 per cent. The external assistance (Multilateral + Bilateral) accounted for about 41.1 per cent of total debt burden in 2006-07 - Rs. 3,61,390 crores. Out of this multilateral assistance was of the order of 26.3 per cent and bilateral assistance of the order of 14.8 per cent. The share of commercial borrowing increased in absolute terms from Rs. 35,711 crore in 1991-92 to Rs. 1,81,602 crore in 2006-07, and in relative terms, it went up from 12.1 per cent to 20.9 per cent. It had reached a peak in 2001, before declining modestly in the subsequent period.

The increasing population and public expenditure are considered the important factors for the expansion of internal debt in India. It is observed that the internal debt in India was highly positively correlated with the population and public expenditure during the period 1991-92 to 2006-07.

The total internal debt of India has grown at about 17.48 per cent per annum over the period 1980-81 to 1990-91. Total internal debt in India has increased from Rs. 30,864 crores in 1980-81 to Rs. 1,54,004 crores in 1990-91, that is more than five times. During the period 1980-81
to 1990-91, the compound annual growth rate of internal debt in India is recorded at around eighteen per cent per annum.

During the period 1991-92 to 2006-07, the compound growth rate of internal debt in India has been estimated at 16.74 per cent per annum, which is slightly lower than that of pre-liberalization era. In the post-liberalization period, there is a remarkable improvement in internal debt announced by market loans and small savings. So the World Bank has categorized India as a less indebted country since 1999.

The share of market loans in total internal liabilities is found highest followed by small savings, deposits & provident funds and other account. The results indicate that the CAGR of internal liabilities during the study period was highest in 182/364-day Treasury bill at 23 per cent per annum followed by market loans, other accounts, small savings and reserve fund & deposits. The short term Treasury bill is declined at a negative rate. So we can say that the internal debt is shifted to long term recourses.

The internal debt to GDP ratio showed a significant improvement, increasing to 40.76 per cent in 2006-07 from 29.07 per cent in 1991-92. The main reason for the increase in internal debt-GDP ratio was the increase in government expenditure and decline in external debt in recent
years. The compound growth rate of internal debt in India is recorded slightly lower in the post-liberalization era when compared with pre-liberalization period. It shows that the liberalization process has a positive impact on the problem of internal debt in India.

Continuous and sharp rise in budgetary deficits and consequently internal public debt. The size of the Central Government's debt was Rs. 2,865 crores at the end of 1950-51, Rs. 1,021,029 crores in 1999-2000 and Rs. 25,38,586 crores in 2006-07. Adding State government borrowings, the total debt exceeds the GDP.

The debt servicing bill of the Centre in 2006-07 was Rs. 340,599 crores and out of this, interest payments will take away around 50 per cent of the revenues.

The outstanding combined liabilities of the central and state governments increased from 68% of the GDP to 77% of the GDP in the case domestic debt between 1990-91 and 2006-07.

The issue of public debt management is critical for economic growth. While the classical economists believed in balanced budget, the Keynesian perspective advocates the deficit financing for economic growth. Under the rational expectations framework, the public debt debate has initiated new perspectives. Under the
crowding out hypothesis, extensive use of deficit financing through newly issued debt competes with the private sector borrowings, and thus crowds out private sector investment thereby reducing economic growth. Under Ricardian Equivalence hypothesis, expectations of the future taxes associated with government debt induce the private sector to increase its saving with newly issued government debt and hence absorbs the debt without any crowding out effects.

This study has examined the evidence for these alternative hypotheses in India. We have also examined these aspects from the perspectives of economic reforms. The results from the analyses uniformly reject both the hypotheses. Moreover, for many of the specifications the estimated coefficients on the deficit-income ratio were positive suggesting the crowding in perspective of deficit financing.

This result has further been strengthened by the positive effects of government spending, on the premise that a larger proposition of public expenditure is in fact induces private investment. As long as government expenditure increases economic and social infrastructure and builds necessary overheads, private investment is attracted. Thus, though gross fiscal deficit is an indicator of poor economic
performance, public debt need not be. At the current levels of public
debt and economic growth, there is less scope of debt trap. However,
caution must be exercised when a larger part of the public debt is
used to service interest payments and unproductive government
expenditure.

SECTION II: POLICY SUGGESTIONS

In the light of above stated empirical results, the following suggestions
have been put forward on the basis of derived policy implications:

In India, the external debt has almost become a severe problem and
hinders the economic development. Hence, India should take efforts to
reduce its external debt and sustain further development from its own
capital. For that, the following measures are suggested:

- India should take efforts to increase its exports and efforts to
  reduce its imports to control and minimise the external debt in
  the country in the coming period.

- To reduce the burden of external debt, government should
  borrow money with those nations and agencies which charge
  lower rates of interest.

- To minimize the burden of external debt, India should utilize
  the external debt only for the productive purpose. External debt
shall not cause any anxiety if it helps to create assets, which
provide the means of servicing the external debt.

The increase in domestic debt was mainly due to new borrowing
and that of external debt was due to accumulation of arrears. This
suggests that if emerging market countries had not been shut down from
the international capital market, they would have probably accumulated
more external and less domestic debt.

There is an urgent need for greater coordination between monetary
and fiscal policies for improving the primary deficit along with stable
inflation, exchange rate and GDP growth to reach a long term sustainable
path of debt dynamics.

If public debt is to be amortized completely in the medium term, there
will be no doubt severe pressure on the primary balance. One way out
could be, if disinvestment in public enterprises progresses with some
success, the proceeds could be utilized to amortize public debt.

The performance of individual States in terms of their fiscal deficit to
GDP ratios has not changed much over the past decade, with poor
performers remaining below the better performers. This indicates that the
Centre's revenue sharing and redistribution across states have not
necessarily encouraged States to improve their performance.
The RBI's approach to fiscal reforms is that while we agree on the need to eliminate the revenue deficit, and agree on a nominal limit for fiscal deficit, what is even more important is the mode of financing the fiscal deficit and the use that the resources so raised are put to. In addition, we focus on fiscal empowerment which was clearly articulated around 2000 in the Annual Report of the Board of Directors of the RBI. Exclusive focus on fiscal deficit may tend to reduce the role of the Government, and consequently, it will not be in a position to aid the process of growth, in particular, inclusive growth. Re-prioritisation of expenditure may be achieved through reduction or elimination of subsidies and deployment of resources thus released to the more needy sectors. Higher level of resources may also be available through reduction in tax exemption.

This study suggests that the traditional dichotomy between external and domestic debt does not make much sense in a world characterized by open capital accounts and that, although the recent switch to domestic borrowing has important positive implications for debt management, policymakers should not be too complacent.

The choice of the optimal debt structure involves important trade-
offs and, as weakness with the current system are often identified after a financial crisis starts to unravel (Krugman, 2006), policymakers should be aware of possible new vulnerabilities. Hence, crisis prevention requires detailed and prompt information on debt structure. Yet, most research and analysis focuses on external borrowing and prompt and detailed information on the level and composition of domestic public debt is often not available to policymakers and analysts.