Chapter-7

SUMMARY AND CONCLUSIONS
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The present summary proceeds chapter wise, and being a summary does not trace out the full extent of argument. Only the gist of the findings, conclusions and suggestions, as the case may be, is laid down. The basic theme of this thesis is to analyse the role of public debt (internal and external) in India’s economic development. The study contains public debt of central government of India. The debt of states and local authorities are not included in this study. The focus is on interest payments, the largest single item in revenue expenditure of the government.

Historical Background of Public Debt

The burden controversy is one of the oldest subjects of academic discussion. Whether public debt is a net economic burden has been a subject of great debate since the days of mercantalists. The early classical economists opposed public debt creation on the ground that the government spending is wasteful and does not provide any benefit to the community. The classical theory of public debt came to be formulated in the last decades of the nineteenth century. H.C. Adams, C. F. Bastable, who may be taken to be the best representatives of the classical theory of public debt, refuted the idea that the burden of public debt cannot be shifted on to the future generation. C.F Bastable clearly stated that by creation of debt rather than by taxing, the burden is carried forward in time and that analogy between private debt and public debt is quite right and there is no significant difference between internal public
debts and external public debts. In both cases, burden of debt can be shifted on the future generation.

The modern theory of public debt on “the new orthodoxy” as Buchanan puts it, is an offshoot of the economic of depression or the Keynesian economics. The economic anomaly created by Great Depression of 1930’s gave way to the development of the new theory of public debt. According to J.M. Buchanan, the modern theory of public debt is based on three propositions:

1. The creation of public debt does not transfer the primary real burden to future generation.
2. The analogy between private debt and public debt is fallacious.
3. There is sharp and important distinction between an internal and external debt.

Theory of Public Debt

In recent years there has been an abnormal expansion in the functions of the government and this has increased its revenue and capital expenditures. Modern wars and growth of defence expenditure have also led to increase in public expenditure. In fact, increased public expenditure has been responsible for vast increase in public debt everywhere. The main reason to justify the growth of public debt are war finance, Development finance, Financing current expenditure and Government market power.

Developing countries have very limited scope so they try to tap domestic savings through the sale of bonds in the domestic market. Only few developing
countries have managed to finance a large proportion of their expenditure through increase in domestic debt because of the following reasons-

(a) Small size of the domestic capital market and limited role of financial intermediaries.

(b) The interest rate policies often pursued by these countries have constrained the free market determination of the rates, sometimes resulting in negative real rates of return and, therefore, lack attractiveness for domestic financial investments.

(c) The desire to limit the crowding out of the private sector from an already small financial market.

(d) The high default and political risk perceived by potential bond buyers.

In developing countries, foreign financing acquires an important place. Foreign financing can come through grants, concessionary loans, project loans, supplier's credit and commercial borrowing.

The important sources of internal public debt are borrowing from individuals, borrowing from non-banking financial institutions, borrowing from commercial banks and borrowing from central bank. It may be noted that the borrowing from individuals and financial institutions is simply transfer of funds from private to government use and therefore, will not be expansionary in its effect on the economy. Borrowing from commercial banking system and the central bank will have an expansionary effect.

Borrowing from external sources includes international financial institutions like the I.M.F, IBRD and its affiliates, the I.D.A and I.F.C and
government assistance generally to assist specific developmental projects. In an expansionary economy when borrowing from internal sources does not serve the purpose, the government borrows from external sources.

In a developing country like India, it is difficult to stimulate the growth of the economy with stability. It is difficult to consider any single factor as the prime mover in the process of economic development. Fiscal policy in a developing economy is concerned with government’s taxing, borrowing and spending policies to achieve rapid economic development with reasonable monetary stability. It has to serve both the objective of capital accumulation and maintenance of stability. In a developing economy taxation should go beyond financing normal expenditure and supply a considerable amount of funds for investment in development projects. It is, however, difficult to determine the relative share of taxation and borrowing in financing economic development.

Significant changes have taken place in the financing pattern of deficits in India since 1980’s. Government deficits have increased considerably. The major part of deficits was financed by government’s domestic borrowing and resultant increase in public debt. The fiscal deficit of the centre, initially declined from 6.6 percent of GDP in 1990-91 to 4.1 percent in 1996-97. It started rising from 1997-98 and reached a level of 6.2 percent of GDP in 2001-02. After that, there was a fall in centre’s fiscal deficits relative to GDP, when the FRBMA rule was enacted in 2003 which reduced fiscal deficit to 3.4
percent in 2006-07. The total public debt increased from Rs.3,14,558 crore in 1990-91 to Rs. 19,68,062 crore in 2006-07 (B.E)

**Growth and Composition of Internal Public Debt**

Internal debt comprises loans raised in the open market, special securities issued to Reserve Bank, compensation and other bonds etc. It also includes borrowings through treasury bills including 14 days treasury bills issued to state government, commercial banks and other parties, as well as non-negotiable, non-interest bearing rupee securities issued to international financial institutions viz: The International Monetary Fund, International Bank for Reconstruction and Development, International Development Association, International Fund for Agriculture Development and Asian Development Bank. Government of India launched Market Stabilisation Scheme (MSS) in consultation with Reserve Bank of India on April, 2004. Market loans are raised in the open market by the sale of securities. It was estimated at Rs. 1,84,100.96 crore in 1996-97 which increased to Rs. 9,84,645.35 crore in 2006-07 (B.E)

The amount of treasury bills increased from Rs. 6,953.30 crore in 1990-91 to Rs.35,402.23 crore in 2006-07(B.E). The amount of national small savings fund increased from Rs. 50,100.18 crore in 1990-91 to Rs. 3,29,759.50 crore in 2004-05. The amount of state provident fund increased from Rs.10,156.97 crore in 1990-91 to Rs.72,217.01 crore in 2006-07 (B.E). The amount of public provident fund was estimated at Rs. 2,798.68 crore in 1990-91 which increased to Rs 11,824.89 crore in 1995-96.
Debt financing is viable so long as debt servicing, repayment of debt with interest payment does not distort fiscal balance and the debt-GDP ratio does not move to a self-sustained growth path, i.e., growing on its own momentum. The burden of debt servicing depends not only on the amount of debt and interest but also on maturity and mode of interest payment. The burden is relatively higher on shorter maturing of debt.

Interest payment is a committed expenditure, which cannot be altered in the budget. Interest payment is a non-plan current expenditure which should be paid out of government’s current revenue. More than one-fifth of government of India tax-revenue now is spent on interest payment on past debt and less than four-fifth is available for all non-plan expenditure—defence, civilian administration; subsidy, etc. What is worse is that as interest burden increases the government is forced to resort to deficit financing in current account, which in turn raises the debt and future interest payment.

So, internal public debt is now rising much faster than GDP, and the bulk of public debt in India is incurred by government of India from domestic private sector. A better step would be to raise tax-GDP ratio which has been relatively stagnant during the last decade against a rising public expenditure-GDP ratio. The interest on public debt of government of India, which has risen in the recent years would also be reduced. Finally a curb on growth of non-productive public expenditure is necessary to contain debt-GDP ratio with in a critical level.
External Debt in India

A developing country like India needs foreign aid in the early stages of economic development to sustain a high level of investment, purchase capital equipment and machinery from abroad, and to cover balance of payment gap. External debt is usually raised in foreign currency and a substantial part of it is also repayable in foreign currency. The government of India has raised foreign loans from a number of countries like USA, U.K, France, USSR, West Germany, Japan etc. and international institutions like IMF, IBRD, IDA, ADB, IFAD etc.

The external debt increased from Rs.31525 crore in 1990-91 to Rs.71546 crore 2001-02. The burden of external debt increased tremendously during this period. The burden of external debt should not be considered only by taking into account the interest burden charges. Much depends on how the funds mobilised through external debt are used. If external debt is wasted on unproductive activities, it becomes a dead weight debt. On the other hand, if the resources raised by the government through borrowings are spent on developmental activities, they raise the productive capacity of the country, and thus are not burdensome. In India, a considerable amount of external loans has been used for general and maintenance imports. As a result, our productive capacity has not increased as much as was possible with the appropriate utilisation of external resources. The burden of servicing has become quite heavy, and at times one feels that it would have been better had the country not gone for foreign loans.
The problem of amortisation and payment of interest is compounded by the fact that the developing countries are still in the midst of the developmental process. The ability of the economy to proceed with the developmental effort is diluted when a large part of the government revenue is devoted to external public debt servicing. Debt service is a charge on the meagre export earnings devoting a sizeable fraction of the scarce foreign exchange earnings to debt servicing. This implies a diversion of such resources for purposes other than imports of equipments, goods and the building up of foreign exchange reserves. Our study shows burden of external debt with respect to interest payment. So, interest payment have to be made on external debt which India borrowed from different countries and international agencies like IBRD, IDA, IFAD, ADB etc. The interest payment given by the government of India to IBRD was Rs.1,022.7 crores in 1990-91 which subsequently increased to Rs. 2,124.19 crore in 1995-96. The interest given to IDA was Rs.174.99 crores in 1990-91, which increased to Rs. 866.43 crore in 2004-05. The interest payment paid to ADB was Rs.14.91 crore in 1990-91 which subsequently increased to Rs.830.18 crore in 2002-03. Presently the government has no other option except to effect reduction in the existing stock of debt.

**Role of Public Debt in Development Finance**

In a developing country like India, it is difficult to stimulate the growth of the economy with stability. It is difficult to consider any single factor as a prime mover in the process of economic development. There are other liabilities upon the government of India, which have contributed in financing
the development plans, such as contribution of public in small savings schemes, provident funds, reserve funds and deposits. The amount under these heads in utilised for financing development expenditure. These are to be repaid by the government of India. They increased from Rs.1,29,029 crore in 1990-91 to Rs.2,47,115 crore in 1995-96. These liabilities were estimated at Rs.657572 crore in 2004-05 which further increased to Rs.8,74,815 crores in 2006-07 (B.E). The total liabilities of government of India increased from Rs. 4,43,587 crore in 1990-91 to Rs.28,42,877 crore in 2006-07 (B.E).

The resources raised through borrowings are directed for development and creation of assets of various services which are useful for the economic and social development of the country. These are –

(a) General services

(b) Social and community services

(c) Economic services

(d) Loans advanced by the Central government.

The investment expenditure on general services increased from Rs.31,022.66 crore in 1990-91 to Rs. 2,81,420.26 crore in 2006-07 (B.E) whereas the investment expenditure on social services estimated at Rs.3,749.24 crore in 1990-91 subsequently increased to Rs.11,753.77 crore in 2006-07 (B.E). The expenditure on economic services was Rs. 2,72,552.81 crore for 2004-05 and Rs. 3,11,609.24 crore in 2006-07 (B.E) respectively. The amount of loans advanced by the central government for investment expenditure on Public sector enterprises, foreign governments, government servants taken together
increased from Rs.1,14,724.66 crore in 1990-91 to Rs.7,02,068.83 crore in 2006-07(B.E).

So, public debt plays an important role in development finance of India. If borrowings are used for investment expenditure and for creation of assets, this sort of expenditure is developmental in nature. The burden of public debt cannot have adverse effects upon the economy but will have positive effects. Interest payments which contributed most to the fiscal imbalance have continued to rise. According to Raja J. Chelliah, “the net interest payments by the government can be reduced by bringing down the gross interest payments or by increasing the income from the government’s investment. It does not seem feasible to increase the latter. It is therefore, necessary to find ways of reducing the gross interest payments by the government.” The interest payments on external borrowings of the central government rose from Rs.21498.25 crore in 1990-91 to Rs.139822.60 crore in 2006-07 (B.E).

Interest payments are committed liabilities of the government, an increase of which may force reduction in primary expenditures, that is expenditure after excluding interest payments. Interest payments rise both on account of rise in debt as well as rise in interest rate. Interest rate may rise due to large government borrowings.

Centre’s debt at the beginning of planning i.e. 1950-51 was only about 28 percent of GDP. In those days Central government was the primary borrower. Over time, Centre’s debt increased steadily especially during the last two decades or so and was around 50 to 55 percent of GDP. The debt GDP
ratio was lowest i.e. 49 percent in 1996-97 which subsequently increased to 56.3 percent in 2002-03. But when the FRBM rule was enacted in 2003, debt-GDP ratio came down to 47.4 percent in 2006-07 (B.E). If GDP itself grows, a corresponding growth in the amount of debt will leave the debt-GDP ratio unchanged. If debt grows faster than GDP then it becomes a cause for concern. A rising debt GDP ratio gives rise to growing interest payments relative to GDP.

If we analyse interest as percentage of GDP, it was highest at 4.8 percent in 2002-03. It was around 4 to 5 percent in all the financial years under consideration because as interest payment increased, GDP at market prices also went up, leaving the ratios almost unchanged. Interest as percentage of revenue receipts was 39 percent in 1990-91 which subsequently increased to 53.3 percent in 2001-02, with more than half of revenue receipts being utilised for interest payments. A relatively smaller amount was available to meet all other revenue expenditure including development expenditure. Non-development expenditure in India was high over the years. An important factor that contributed to this was the huge interest payments on public debts which were made by the government.

As percentage of revenue expenditure (development and non-developmental) interest payments accounted for more than 33 percent for most of the years. Although it reduced subsequently due to the passage of FRBM Act standing at 28.6 percent in 2006-07 (B.E), it was still rather high. Thus we conclude that government expenditure increased due to increased liabilities of
the government. This was financed either by tax or by public debt. Government borrowing for developmental expenditure is not a burden but if borrowing is for non-developmental expenditure then it is burdensome. As elaborated in this thesis, public debt is not burdensome if it is used for developmental projects. But government spending was more non-developmental primarily due to the huge interest payments.

Suggestions

A few important points may however be mentioned in the light of above conclusions, so as to make public debt more viable and effective

1. When government incurs debt for meeting its current expenditure in this respect, each and every expenditure (developmental and non-developmental) should be subjected to the criterion of cost and benefit.

2. There is much scope for further cuts in non-developmental expenditure, especially with regard to emoluments and size of the bureaucracy and subsidies to public sector.

3. Reduction of the interest burden through quick retirement of a part of the public debt.

4. The share of interest payment must be brought down by keeping public debt with limits.

5. The Central government should cut down the size of Ministries and Departments dealing with subjects which are mainly the responsibilities of the States.
6. It is difficult to prescribe a particular size of the public debt but it is possible to set up a monitoring unit with strong recommendatory powers for the containment of public debt.

7. To cover deficits in budget from year to year greater use should be made of taxation as an instrument of fiscal policy to maximize revenue by expanding the tax base.