Chapter-1

INTRODUCTION AND REVIEW OF LITERATURE
Introduction

On gaining independence India adopted planning for economic development of the nation. The budgetary policy plays a very vital role in the process of economic development in a mixed economy where public sector constitutes a major part of the whole economy. The Government needed enormous funds to start development project and to promote better standard of living of the people. Government has been directly participating in the production and supply of economic goods on the one hand and has been providing necessary infrastructure to the economy. There have been financial constraints on the government due to its greater involvement in the economy. The main thrust has been upon alleviation of unemployment and poverty in the country.

There are three major items in Government receipts in the budget-tax receipts, non tax receipts and borrowing. Whenever there is excess of expenditure over receipts the government resorts to the policy of borrowing. Due to this fact the gross fiscal deficit GFD that reflects the gap between total revenue and total expenditure of the Government has increased steadily, standing at 9 percent of GDP in 1986-87. However, since 1991 the fiscal deficit has been declining continuously and it accounted for 4.1 percent of the GDP in 1996-97. The fiscal deficit that is the broadest indicator of fiscal discipline has been closely monitored by I.M.F and World Bank agencies for several years. In 2001-02, the fiscal deficit again increased and reached a figure of 6.2 percent of GDP. But after the enactment of FRBM Act in 2003
the fiscal deficit continuously declined and was 3.2 percent of GDP in 2007-08 (B.E). The Government of India remained very much dependent on loans—internal and external for financing of the development programmes in the nation, especially since 1970. The total public debt of the central government stood at Rs. 4979 crore in 1960-61 comprising internal debt and external debt of Rs. 3,978 crore and Rs. 1,001 crore respectively. This amount increased to Rs. 16,931 crore including Rs. 11,107 crore as internal debt and Rs. 5824 crore of external debt in 1973-74, which reached Rs 314,558 crore in 1990-91 comprising internal debt and external debt of Rs 283,033 crore and Rs 31,525 crore respectively. The amount subsequently increased to Rs. 11,13,921 crore, internal debt at Rs 10,47,976 crore and external debt at Rs 65,945 crore in 2001-01. which further increased to Rs 19,68,062 crore with internal debt at Rs 18,91,346 crore and external debt at Rs 76,716 crore in 2006-07 (BE) .

Unproductive expenditure, tax distortions and high deficits are considered to have constrained the economy from realizing its full growth potential. The medium term fiscal policy stance of Government, therefore, has been to reduce deficits; prioritise expenditure and ensure that these result in intended outcomes; and augment resources by widening the tax base and improving the compliance while maintaining moderate rates. At the beginning of the fiscal reforms in 1991, the fiscal imbalance was identified as the root cause of the twin problems of inflation and the difficult balance of payment position. The fiscal consolidation, which followed in response, in the absence of a defined mandate, however, failed to sustain it self. For medium-term management of
the fiscal deficit, and to provide support to a strong institutional mechanism, the Fiscal Responsibility and Budget Management Act (FRBMA) was enacted on August 26, 2003 and the Act and the rules were notified to come into effect from July 5, 2004. FRBMA is an important institutional expression to ensure fiscal prudence and support for macroeconomic balance. With the enactment of the FRBMA, the traditional annual budgeting moved to a more meaningful medium-term fiscal planning framework. According to the FRBMA Rules, revenue deficit is to be reduced by an amount equivalent to half percent or more of the estimated GDP at the end of each financial year and eliminated by March 31, 2009, fiscal deficit is to be reduced by an amount equivalent to 0.3 percent or more of the estimated GDP at the end of each financial year, and reduced to no more than three percent of the estimated GDP by the financial year ending on March 31, 2009.

**Review of Literature**

There is a growing awareness today in India of the urgent need to contain public debt at sustainable levels. Continuous government borrowings to cover fiscal imbalances results in ever rising public debt, the servicing of which is done from public revenues in future. With accumulation of public debt is the concern of whether the government will be able to service the debt. Once the financial markets realize this, lending to the government will cease, or at least be adversely affected.

Thus sustainability of public debt concerns the way in which budgetary viability may get eroded over time due to financing of government expenditure
through borrowing. Fiscal deficit represents the scale of such financing and accumulation of public debt over the year.

While examining the sustainability issue, three things need to be considered

(a) The first relates to the burden of public debt.
(b) The second is whether the continuing fiscal deficit leads to an explosion of the debt GDP ratio.
(c) The third examines the deleterious impact of debt financing on the economic system.

Starting with the work of Bhattacharya and Guha (1990), their joint study aims to analyse growth and composition of internal debt of the government of India (GOI) during the period 1970-71 to 1987-88. It is part of a larger study by the first author on various aspects of public debt of both GOI and state government. Internal liabilities accounted for about 90% of aggregate gross internal and external liabilities of central and state governments at the end of March 1989. Out of this the share of the centre (including centre’s borrowings for loans and advances to states) is 90%. These internal liabilities of GOI account for more than 80% of all government liabilities. Internal debt of the centre is also rising faster.

Dasgupta (1996) discusses the transfer problem which besieged the debtor developing world following the outbreak of the debt crisis in the early 1980s. The upsurge of the debt crisis in 1980s posed a potential threat to the international commercial bank because of their
large developing country exposures. Several debt management strategies were evolved in dealing with the debt servicing problem of the developing world. The main objectives was to ensure an immediate aversion of default risks. The net financial transfer problem exists or arises where debtors pay more interest on external debt than they receive in new loans. Instead of facilitating return to voluntary credit flows to the developing countries these net financial transfer of resources from the debtor developing countries created bottleneck for development there in 1980 (Sen 1996). The situation in the 1990s has become for more complex than before.

Simultaneously, a large number of low income developing countries, mostly located in sub-Saharan Africa, are still languishing under severe debt servicing problems. We define net financial transfer (NFT) as net new credit flows minus interest payments. The flows of capital should occur from the surplus developed countries to the deficit developing countries. However, the debt crisis of the 1980s reversed this direction of the international capital flows in the preceding decade. The financial transfer of resources from developing countries did have its adverse impact on their GDP growth rate. The ‘sustainable’ debt process along with negative net transfer of financial resources entails an anti-growth bias for the debtor countries. It can be shown in terms of the various policy instruments that standard adjustment package which the
IMF/world bank imposes upon the debt ridden countries, ensures financial flows from the latter to the creditors.

The article of Singh (1999) explores the relationship between domestic debt and economic growth in India. In India, domestic debt has been incurred with the main objective of enhancing planned investment for economic development. The rising trend in securing financial resources through public borrowing has especially been steep since the early 1980s.

The impact of domestic debt on economic growth can be analysed in the context of two contrasting views – Traditional and Ricardian.

In the traditional view, an increase in government debt is a burden on the economy. In the short run, in view of the increase in government debt, the consumer would consider himself to be wealthier and therefore would resort to higher spending. As the marginal propensity to consume is higher than the marginal propensity to save, the increase in private savings falls short of the government dissaving. The real interest rate would rise in the economy encouraging capital inflow from abroad. In the long run, the higher interest rate would discourage investment and thus crowd out private investment. The inflow from abroad would result in greater foreign debt. The higher aggregate demand results in a higher price level which adjusts over time and the economy returns to natural rate of output. Therefore, the overall impact when considering the long run period would be smaller total output and eventually lower
consumption and reduced economic welfare. This is also referred to as the burden of public debt, as each generation burden the next, by leaving behind a smaller aggregate stock of capital. [Meltzer 1951; Modigliani 1961; Ferguson 1964; Patinkin 1965]

In Ricardian view, government debt is considered equivalent to future taxes (Barro 1974). Considering that consumers are rational and forward-looking, the discounted sum of future taxes is equivalent to the current deficit. Thus the shift between taxes and deficits does not generate aggregate wealth effect. The increase in government debt does not affect consumption. The rational consumer facing current deficits, saves for future rise in taxes and therefore total savings in the economy are not affected. A decrease in government dissaving is matched by increase in private savings. In view of unchanged total savings, investment and interest rate are also unaffected and so also the national income.

In economic literature, two views on the relationship between domestic debt and growth are prevalent. The first view considers debt to be a burden on future generation in the long run. The other view popularly called the Ricardian equivalence hypothesis, considers the effect of debt to be neutral on the economy.

The paper of Dhar (1999) seeks to understand the effect of the financial system, based on fictitious capital, on the operation of real capital. At a broader level, the paper explores the extent to which real
capital has become subordinate to international financial markets, and whether or not states have any room to influence their economies. This is an extremely important dimension, particularly at the present juncture, where push towards globalisation seems to have put in serious doubt the ability of the states to play a meaningful role in policy making.

According to Harris, the issues of the relationship between the real economy and the global financial system have to be explored through the transmission mechanism that links the two worlds. This the author has tried to analyse by looking at the globalization of the equity markets and its effect on national real investment. Evidence is provided which indicates that low proportions of real investments were financed by new equity issues.

On the other hand, available evidence also supports the view that investment is systematically related to the variables representing firm’s internal funds or current cash flows.

Shankar (2000) explained that the state government has failed to raise revenue to match the growing needs of the state. Uttar Pradesh is not only a poor performer in resource mobilisation, but is utilising the resources in a highly inefficient manner. In the early 1980s, revenue expenditure used to be 66 percent of total expenditure while one-third used to be capital expenditure. The state heavily depends on borrowing which has led to higher debt servicing charges. During the last 30 years
interest payment has shot up by nearly 115 times. Borrowings were estimated at Rs. 14,044 crore in budget 1999-2000 but in the revised estimates, it was estimated at Rs. 18,218 crore, i.e., it increased by 30 percent.

The indebtedness of the state is increasing fast. In the early 1980s the same used to be round Rs 4,000 crore. It rose to about Rs 18,000 crore in 1990-91. For the year 1999-2000, it was estimated at Rs 67,955 crore and is estimated at Rs 77,821 crore for the year 2000-01. Indebtedness is now rising by about Rs 10,000 crore annually where as state’s own tax and non-tax revenue is increasing by barely Rs 2,000 crore annually.

Interest payment is the largest component of revenue expenditure which now accounts for almost one quarter of all revenue expenditure. Expenditure on administrative services rose from Rs 3399 crore in 1999-2000 to Rs 4,282 crore in 2000-01. Pension payment likewise is estimated to increase from Rs 1,768 crore to Rs 2,126 crore. Thus 90 percent of the increase in revenue receipts is to be diverted to non-developmental heads leaving little for developmental heads. In fact there is an absolute reduction in the revenue expenditure on education and sports from Rs 6,169 crore to Rs 5,627 crore in 2000-01. Likewise there is an absolute decline in expenditure on industries, water supply, sanitation and urban development. Provision for rural employment
through various schemes like Jawahar Rozgar yojana forms only one percent of the revenue budget.

Thus, debts are incurred not to meet the capital investment needs of the economy but largely to repay past debts. The state is indeed in a debt trap.

A study was undertaken by Labonte and Makinen (2002) about the burden of public debt, the nature of that burden, and who bears that burden. The United States has been free of a national debt for only two years, 1834 and 1835. The United States began its existence as a country in 1790 with a debt of $75 million, which has risen to $3.3 trillion in 2001. It rose to a high of 108.6 percent of gross domestic product (GDP) at the end of World War II. It declined to a post-World War II low of 23.8 percent of GDP in 1974; and then rose to another high of 49.5 percent of GDP in 1993. The major cause of debt accumulation has been war. The United States has financed the extraordinary expenditures associated with war by borrowing rather than by raising taxes or printing money. This pattern was broken by the large budget deficits of the 1980s and 1990s which caused the national debt to rise substantially as a fraction of GDP during peace time.

The source of the burden associated with a national debt is the government budget deficit that gives rise to the debt. In a fully employed economy, the deficit "crowds out" private sector spending, especially spending on capital goods. Thus, a smaller private capital
stock and a lower level of output are passed on to future generations and it is this lower level of output that is the ultimate burden of the national debt. And, it is a burden that is largely shifted forward to future generations. Thus, according to the consensus view, the burden of a national debt is borne by future generation.

When the national debt is retired through budget surpluses, the effect on the economy is the reverse of debt increases. Future generations acquire a large capital stock (on a larger American owned capital stock) and a higher level of output (or increased material well-being).

Karnik (2002) in an article describes that the state’s gross fiscal deficit has deteriorated significantly. It is absolutely necessary, therefore, for the centre to be seen to be fiscally prudent, which will be signal to the states of the centre’s seriousness in regard to fiscal management.

Fiscal prudence remains a positive quality whether the economy is doing well or badly. However, pressure to abandon such prudence and embrace fiscal profligacy become dangerously seductive during a slow down.

Fiscal policy can play a significant role in the revival of the economy. The problem is to be posed in the context of deteriorating fiscal balances at the level of the centre and state government. The Gross Fiscal deficit (GFD) of the centre as a proportion of GDP at
market prices has come down to 5.35 percent from 7.85 percent in 1990-91. Simultaneously, the GFD of the States has worsened and at the moment the combined deficit of the centre and state is as high is as 9.44 percent (as compared to 9.42 percent in 1990-91). Thus the combined deficit is slightly worse 10 years after reform began. This obviously means that fiscal profligacy in the state has been rampant; The ratio of state’s GFD has worsened from 3.30 percent to 4.68 percent.

In the paper of Chakraborty (2002) entitled ‘Fiscal deficit and Rate of Interest’ the author discusses about the link between fiscal deficit and interest rate in India for the post-financial Liberalisation period.

Interest rate deregulation is aimed at developing an efficient and competitive financial system to achieve allocative efficiency of available resources. One of the main objectives of improving allocative efficiency was to reduce the excessive dependence of government on captive investors to finance the fiscal deficit.

In a deregulated financial system, the supply of and demand for funds determine the rate of interest. An increasing demand for funds by the government to finance its increasing fiscal deficit may create a shortage of loanable funds in the financial system, which in turn may create an upward pressure on interest rate and thus can lead to a decline in the interest-sensitive components of private spending such as investment.
An extensive debate has developed to explain the link between deficit and interest rate. There are three different theoretical paradigms, viz. neoclassical, keynesian and Ricardian under which this relationship can be viewed.

According to neoclassical view, rise in deficit leads to an increase in the rate of interest and in turn crowds out private investment, whereas the Keynesians visualise that although increase in the deficit leads to an increase in the rate of interest, such an increase stimulates savings and capital formation.

Ricardian theorem argued that deficit merely postpone taxes and therefore tax-financing and debt financing of deficit have equal impact on the economy and thus deficit does not have any impact on interest rate. [Barro-1974]

This impact of fiscal deficit on rate of interest depends not only on the levels of deficit but also on the financing pattern of deficit. Government can finance deficits by seigniorage and through the creation of debt, both internal and external. Excessive use of any mode of financing deficit results in the macroeconomic imbalances, viz. Seigniorage financing leads to inflationary pressure in the economy, domestic debt financing leads to a credit squeeze through higher interest rates or, when interest rates are fixed through credit allocation, there is even more stringent financial repression and the crowding out of private investment and consumption. Excessive financing of deficit through external debt may lead to current account deficit and appreciation of the
real exchange rate leading to a balance of payment crisis (if foreign reserve are run down) or an external debt crisis (if debt is too high) [Easterly and Klaus Schmidt-Hebbel, 1994].

The paper, presented in IMF Staff Seminar India in October 2002 by Khatri and Kochhar discusses the lead up to the current fiscal situation in India, compares India’s key fiscal indicators with those of other emerging markets, and draws lessons for India from the successful fiscal adjustments of other countries. India’s deficit and debt are high by international standards and are broadly accepted to be unsustainable. Revenue to GDP in India is significantly lower than that of other emerging markets (while expenditure is comparable), suggesting much scope to pursue improvement in revenue collection. Factors such as the size and composition of the adjustment, and a high initial debt level are associated with these successful fiscal adjustments.

In an article of Rangarajan, Srivastava (2003) entitled “Dynamics of Debt Accumulation in India, Impact of Primary Deficit, Growth and interest rate,” discusses the analysis of accumulation of the debt. Two factors are identified as contributing to the debt-GDP ratio. One is the cumulated primary deficit and the other, the cumulated effect of the difference between growth rate and interest rate. This paper looks at the relative contribution of cumulated primary deficits and the cumulated effect of the excess of growth rate over interest rate on the accumulation of outstanding liabilities of the central government in India over the period 1951-52 to 2001-02.
In this discussion interest rate refers to the effective interest rate of the central government, calculated as the ratio of interest payments in a year to the outstanding liabilities at the beginning of the year. This paper particularly highlights the implication of the sign reversal in the difference between real growth and interest rates, evidenced during the past three years. Throughout the stretch of 45 years from 1955-56 to 1999-2000, the real growth rate was in excess of the real interest rate. Since 2000-01, for three consecutive years, the real growth rate has been less than the real interest rate. During the nineties, even when the GDP growth rate remained in excess of the interest rate, the gap between the two has been narrowing. If the days of large positive differences between growth and interest rates are all but over, there are serious implications for strategies aimed at containing the growth of debt relative to GDP. We are entering into an era where corrections in the primary balance profile of the central government have became imperative.

The article of Mohan, Dholakia, Karan (2005) entitled “Is India’s central debt sustainable, revisiting an old debate”. Their joint study aims to analyse the proposition that India’s debt problem is unsustainable in light of the recently changed outlook for growth and interest rates. Using a decomposition model, it separates out the effects on the fiscal deficit of growth and government behaviour in the past. If recent government behaviour were to continue, the economy would need to grow at 6.1 percent in the coming years for the centre’s debt to be sustainable, a growth rate that seems eminently achievable. If a real growth rate of 6.2 percent is posited in the coming years, only a
modest degree of fiscal adjustment would be required, or none at all, to reach a tolerable level of the debt to GDP ratio by 2009-10.

In an article of Ratha (2002) entitled “Did BIS Regulations Shorten Debt Maturity in Developing Countries” discusses that the Bank for International Settlement’s 1998 Capital Accord recommends a smaller risk weight for short-term exposures to developing countries than for exposures with more than one year maturity. This paper shows that such differential treatment of risk may have been one of the factors behind the rapid growth of short-term banking debt to developing countries in the 1990s, believed to be one of the major causes of the financial crises in Asia, Russia and Brazil.

This paper was presented by Dutt (1999) entitled “India’s External debt, Need for cautious Approach” discusses that the finance ministry has released in June 1999 a status report on India’s external debt. It has been mentioned that India’s stock of external debt, at US $ 95.72 billion at end-December 1988 reflects “considerable improvement” in the external indebtedness position of the country, with the short-term debt component declining from 7.2 percent at end-March 1997 to 3.8 percent at end-December 1998.

The status report has highlighted the trend of key debt indicators given below:

1) Debt service as proportion of current receipts, which reached a peak of 35.3 percent in 1990-91, came down steadily to 19.8 percent in 1997-1998.
2) Debt-GDP (Gross Domestic Product) Ratio, Another key indicator of debt burden, measuring the size of the debt in relation to domestic output – also indicated improvement from the peak of 37.7 percent in 1991-92 to 23.8 percent in 1997-98. This indicates better debt management by India.

3) India’s short-term debt (with an original maturity of upto one year) was at a high level of US$ 8.54 billion at end-March 1991 – 10.2 percent of the total debt. The short-term debt declined to $ 5.05 billion at end of March 1998 and has further declined to $ 3.63 billion at end-December 1998 – 3.8 percent of the total debt. Quoting the World Bank’s Global Development Finance Report 1999, the status report took credit for the fact that the share of the short-term debt to total debt at 5.3 percent for India, is among the lowest, next only to the Russian Federation at 4.9 percent at the end of 1997.

4) Analysing the different component of debt stock, at end-December 1998, multilateral debt was US $ 30.15 billion accounting for 31.9 percent of the total external debt.

The share of bilateral debt (excluding rupee debt) in total external debt declined from 20.5 percent at end-March 1998 to 18.5 percent at end-December 1998. The share of total official debt, which includes multilateral, bilateral, IMF, and rupee debt reached a peak of 63.5 percent at the end of March 1994, and thereafter, declined to 55.8 percent at end December 1998.
This implies that the share of private creditors in the total external debt has begun to gradually rise after March 1994.

Another important development is the decline in the proportion of concessional debt from 45 percent in 1994-95 to 39.3 percent at end-December 1998. This implies that the share of non-concessional debt has begun to increase after March 1994. This will result in higher interest burden in future.

The status report mentions that the improvement in India’s external indebtedness in recent years was not by “default but by design”. This has been made possible through a conscious debt management policy that emphasises sustaining a high growth rate of exports, keeping the maturity structure as well as the total amount of commercial debt under manageable limits, prioritising the use of commercial credit and encouraging foreign investment.

Tanzi and Blejer in their article jointly describe that survey has been attempted to see the public debt situation of a group of developing countries referred to as the fifteen Baker countries. It has shown that in recent years there has been, first a sharp increase in foreign borrowing accompanied by an equally sharp accumulation of foreign debt, followed by a sharp deceleration in net foreign borrowing as foreign credit became very expensive and much less readily available. The switch has reversed the net flow of resources, forcing the developing countries to run very large trade surpluses. This situation has necessitated drastic changes in economic policy. Some of these changes have inevitably had a significant impact on the performance of these economies. In recent years there has been an ongoing debate over whether the imbalances of
the developing countries should be financed or whether these countries would have to adjust. We are now well beyond that debate; the countries have been adjusting, and on a large scale. In fact, some would say on too large a scale. It is hoped that more financing will be once again available to those countries willing to pursue policies consistent with growth.

Ghughe's (1970) study attempts to calculate the inflationary impact of the internal debt of the Union and State Governments in India and point out its allocation and redistribution effects during the period 1956 to 1966. The analysis distinguishes three effects of internal public debt-

(a) Primary liquidity effect

(b) Monetisation liquidity effect

(c) Income effect.

The Primary Liquidity effect is generated when money supply with the public expands as a result of government borrowing and spending on the basis of fresh Treasury bills and securities from the Reserve Bank and commercial banks, which in order to purchase them, may borrow from the Reserve Bank in case of the exhaustion of their cash reserves.

The monetisation liquidity effect is generated when money supply increases consequent upon the monetisation of bonds by the private persons including companies, under certain conditions, such as rising prices which render bonds bearing fixed rates of interest, unattractive and make other avenues of investment, whose yield vary with prices, more attractive.
The income effect of public debt is generated by the interest charges borne by privately held negotiable public debt only, as the interest payment received annually by the private bond holders are likely to be spent for consumption and speculative purposes. Whereas interest charges borne by public debt, held by government institutions, being formal, do not generate income effects. The interest charges of non-negotiable public debt too do not engender income effect. The interest charges of small savings and deposits, etc, investment in bonds are added to the principal amount and are not paid out annually and therefore are not available for financing consumption expenditures until the completion of the maturity periods or withdrawals of principal amounts. The interest charges payable on provident funds investment in bonds may not augment institutional propensity to consume but may encourage sound investment, since these institutions have to provide for the payment of accumulated provident funds of their employees and the interest there of.

All these effects which amount to expansion in money supply, will bring about inflationary rise in price. The effects of inflation are increase in the living cost of the working class, increase in the profits of industrialists and traders and big farmers, and the resultant increase in the consumption of luxury goods. Among the allocative effects, mention is made of the lowering of savings by the working class and diversion of savings by the well-to-do classes to investments in the form of gold and real estate. This study also mentions effects on balance of payments and economic growth.
Saiyed’s (2007) study concerns with government fiscal operations and debt management in the Indian context. This study covers three decades from 1970 to 2005. It concludes by making following observations -

1. National debt has strong positive impact on Reserve Bank of India (RBI) debt holding operations.

2. Domestic debt and deficit have moved together and are congruent.

3. The RBI credit to government is statistically, strongly, and positively influenced by deficit.

4. Fiscal policy has strong influence on the behaviors of the RBI particularly in its debt holding operations.

5. Fiscal and monetary policies are intertwined in Indian context.

This study also includes policy recommendations for macro economic stabilisation.

1. It would be most desirable if large parts of debt are being held by commercial banks or non-banking public. This requires deregulation of interest rates offered on claims issued by Government. High return on these claims would make them more attractive to holders and it would reduce the RBI obligations to hold them.

2. In fact the RBI has lost its autonomy in monetary management and it has to dance to the tune set by the fiscal authority, ie, Government. Hence they recommend that all attempts should be made to reduce deficit by controlling government expenditure particularly on subsidies of all types. Efforts should be made to raise tax revenue by widening the basis
of taxation, preventing avoidance and large scale tax evasion. This would necessitate training of personnel and reforms in tax laws and administration.

3. In recent years government has shifted its emphasis from debt management to fiscal operations. Government has resorted to tax rate reduction and widening tax base, and effort is directed to tax compliance. On expenditure side government has tried to reduce non-plan expenditure by curtailing subsidies and reducing repayment of interest through economising debt raising activities. Actually more efforts are needed on fiscal front and many activities are out of tax net. Agricultural sector is totally outside the purview of tax net and the burden of subsidies is very high.

4. Unless we move to perfect market mechanism with free choices and pricing policies, growth objectives and stability would remain a far cry.

5. Liberalisation and globalisation of early 1990s have now been accepted in India. The task of RBI is going to be much more difficult while designing and conducting appropriate monetary policy for achieving macro economic goals. So they recommend that there is an urgent need in India under changing economic scenario to review the role of monetary authority. The RBI would be required to play a key role in sterilising influence of external capital inflow so as to minimise undesirable changes in the foreign exchange rate which is a key factor governing international economic relations. They suggest that RBI
should be liberated from the unwanted regulations and obligations imposed on its behaviour to serve the need of government for monetary resources. This would call for amending the RBI Act and other related provisions. But it is a must in the present context.

6. For sustained economic growth, the debt and fiscal management should be given top priority and monetary authority must adjust its tools to counteract the side effects of fiscal changes that have been effected. In a nutshell fiscal and monetary management efforts should be well coordinated to macro fundamentals, because every fiscal action has monetary implication. Thus, both fiscal and monetary policies must be intertwined. They are optimistic on growth front and hope that efficient fiscal, monetary and debt management would be able to hit the target.

Burman (1978) takes India as a case study and subjects it to a critical examination in the light of recent thinking and research on public debt policy and management. Burman enunciates a series of rules appropriate to the requirements of debt management under Indian conditions. She points out that Government securities have not been competitive; rising prices have discounted the value of the money rate of interest, investments in real assets are much more attractive in times of spreading inflation. She assesses the relative technique of debt management in India should be more effective than it has been in the past and that main problem in developing economies is that of extracting 'more saving out of low saving'.
Pathak’s (1978) study is an attempt to examine the role played by the central monetary authority- The Reserve Bank of India (RBI) in facilitating the government debt management operations. It also examines the impact of government expenditure, revenue and budgetary deficits on central bank’s debt holding operations. It further endeavours to evaluate the fiscal and monetary role of the Reserve Bank’s open market operations policy. The main findings of the study are that monetary and fiscal policies are inextricably intertwined in India.

The Chakravarty Committee (1989) appointed by the Reserve Bank of India (RBI) pointed out in its Report the defects in the existing official measure of budgetary deficit and the need to include the entire net Reserve Bank of India (RBI) credit to the government. This Report has stressed on the need for managing public debt for regulating money supply and reducing budgetary deficit of the Government to provide stability to the Indian monetary sector.

Hasib’s (1979) work discusses the role of the Reserve Bank of India in the management of public debt and explains the open market operations of the banks. The study is divided into the following four parts; (i) Need for government borrowing (ii) Structure of market for public debt, (iii) Management of public debt by the Reserve Bank of India, (RBI) and (iv) Open market operations of RBI. It is pointed out that any discussion on public debt management must not lose the perspective that it is indispensable in an economy where government has assumed heavy responsibilities for the economic development of the country. In this perspective, public debt is
incurred in order to transfer part of the resources of the rest of the economy to
the public sector and the objective of public debt management is to ensure that
it is done with the maximum possible efficiency in the allocation of resources
to various sectors of the economy.

Bhattacharya (1992) has examined effects of these policy changes on the
Indian economy. The focus is on fiscal crisis, debt burden and stabilization
programme. Other policy measures are analyzed only in the context of their
effects on government revenue and expenditure and inflation. The analyses are
simple and no technical knowledge other than elementary economics is
assumed. Econometric results are presented in simple language.

Rangrajan and Arif’s (1990) study focuses on the interaction between
monetary, fiscal and real sector in a close economic framework. Their study
highlights that Government expenditure adjusts more rapidly than receipts to a
given change in price level. As a result inflation tends to widen the fiscal
deficit leading to larger public debt and larger money supply.

Scope and Objectives

The objective of the present study is to analyse the role of public debt of
India (internal and external) in India’s economic development. In a developing
economy like India public debt is a very important source of mobilizing the
savings of the people for the purpose of financing the government’s share of
economic development. Internal debt produces a number of economic effects
due to transfer of funds from the public to the government. It is said that
internal debt does not create a real burden on the society due to mere transfer of
funds from the private pocket to the government pocket and reverse at the time of repayment. Thus the real wealth of the nation remains within the country. On the other hand with respect to external debt, the real burden is on the society due to transfer of funds from one country to another country. It means that external debt has to be repaid as a principal amount with the interest payment so it causes burden on the existing and future generation. However in recent years the government has borrowed more internally as compared to externally. The internal debt stood Rs. 1,891,346 crore in 2006-07 (B.E) whereas external debt stood Rs 76716 crore in 2006-07 (B.E). Consequently interest payments on internal debt have grown enormously. However so long as growth in GDP is more than growth in public debt (and interest payment) it is not a worrisome factor for the government. But interest payments on external debt constituted the largest single item of revenue expenditure of the central government.

The present work contains seven chapters. In chapter one, the main aspect of economics of government borrowing have been highlighted as the introduction of the thesis. It also deals with the Review of Literature which is a study of the works of different economists on different aspects of public debts. For this purpose the help of literature from authentic sources including the works of eminent economists has been sought.

Chapter two deals with the historical background of public debt. The viewpoints of different schools of thought on the burden of public debt have
been studied. The discussion was on the history of ideas, clash of ideas and finally a tentative movement towards a synthesis of conflicting views.

Chapter three explains the different internal and external sources through which government borrows funds. It also discusses why the need for public debt arises and how increasing public debt creates burden on the society. It also analyses the compound growth rate of public debt.

Chapter Four discusses the growth and composition of internal public debt. This study has been made since 1990. But we have taken the data of 1950's to 1980's for the sake of comparison. The growth of internal debt and the market loans, Treasury bills, special bearer bonds, Gold bond, securities issued to international financial institutions etc. have been focused to understand the realities of the government borrowing internally.

Chapter Five discusses the growth and composition of external debt in India. It also analyses government borrowing externally for development plans, and the interest obligations of government on external loans.

Chapter Six discusses the role of public debt in development finance. It discusses how borrowing has been useful in mobilising resources for development plans, and shows how much government spends on asset creation. Subsequent discussion is a profile of interest payments in India. In this chapter we calculate Public debt as percentage of GDP, interest as percentage of GDP, interest as percentage of revenue receipts, interest as percentage of revenue expenditure and lastly ratio of developmental expenditure to non-developmental expenditure.
Chapter Seven contains summary and conclusion of this study.

**Methodology and Data Base**

Generally Secondary data has been used for this study. Indian Public Finance Statistics constitute the main source of information. Other sources were the Annual Union Budget, Report on Currency and Finance of RBI, Economic Survey of Government of India, Union Finance Accounts, Handbook of Indian Statistics, India Budget Papers, CMIE and the work of various experts of public finance in India’s context.

**Period covered by the study**

This study covers the period from 1990-91 to the latest data available to us. Though the total public debt should include the debt of the centre, state and local government, this study covers the public debt of central government (internal and external) only. Debt of the states and Local authorities are not included in this study. The debt of the centre is itself a wide concept. However, to understand trends and the fiscal policy stance of government, data with respect to an earlier period has been referred to as and when needed.

**Hypothesis of the Study**

The growing public debt in India and huge interest payments being made as a consequence, is causing a heavy burden on the economy. As a result lesser amount of funds are available for financing development programmes which are so essential in a developing country like India.
Limitations of the Study

An empirical study could not be undertaken on account of lack of familiarity with quantitative techniques. Besides this the issue of sustainability of public debt could not be undertaken for the same reason.
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