Sustainability of Public Debt

This editorial is based on **How to make public debt sustainable** which was published in The Hindu BusinessLine on 05/10/2021. It talks about the issues related with the burgeoning public debt and suggests a way forward.

In its recent research report, Morgan Stanley forecasted that India will be included in **global bond indices** in early 2022 and this will result in investment inflow of USD 170-250 billion into the Indian sovereign bond market during the next decade.

Global Bond Indices

It includes the emerging markets in debt, which monitor local currency bonds issued by governments of developing countries. India has been present in most benchmark equity indices but absent in the bond indices market.

Of late, the Indian bond market has been in the news for various reasons. Out of all, sustainability of public debt is one of the critical issues from the point of view of policymakers.

Objectives of Public Debt/Borrowing

- **Income and Revenue**: The target of public debt normally is to cover the gap that developed due to mismatch between proposed expenditure and expected revenue.
    - Whenever because of increased administrative expenditure or flood, feminine, earthquake and communicable diseases like unexpected problems, the government's income becomes less because they have to spend it to cover these problems.
- **In Times of Depression:** Depression is the condition when costs reduce, there is a lack of courage in people spending money on industries and in future there is no possibility of getting gain.
- **To Curb Inflation**: Inflation is the name of that condition at the time of increased cost. So, the government by taking debt can take back a big quantity of work power from the hands of people.

- **To Finance Development Plans**: In a developing economy, there is always a lack. The government cannot take shelter on heavy taxation. But to remove poverty from the country, this is also most needed and important to do arrangements of development plans.

  In this condition, the only way is to take public debt. So, the government takes debts from within the country or from foreign governments or from people to do finance arrangements.
- **Expansion of Education and Health Services:** Government also takes debt for the construction and development of education and health services and other services like this.
- To **Make the Public Verdict Favourable:** When the citizens are not able to pay the tax then the government has to take debt. Sometimes even then the more capability of the public, the government never increases taxes because the public verdict sticks to favourable(populist measures).

Burgeoning public debt

- India's public debt (combined liabilities of the Central and State governments) to gross domestic product (GDP), at constant prices, increased to a record high of 100.86 per cent in 2020 as against 76.86 per cent in 2014, as per the data from the Reserve Bank of India.
- Now, India has become the most indebted nation after Brazil and Argentina among the emerging market economies. In South Asia too, India is the most indebted after Bhutan and Sri Lanka. Interestingly, Brunei, United Arab Emirates, and Russia have low debt-to-GDP ratios with 2.46 per cent, 19.35 per cent, and 19.48 per cent respectively.

Reasons of Higher Public Debt

- **Bank Recapitalisation**: Infusing capital in state-run banks using recapitalization bonds in 2017-18 increased the total central government debt in both absolute terms and as a percentage of GDP that fiscal.

  In 2017-18, Rs 80,000 crore of recapitalization bonds were used to fund state-run banks.
- **UDAY bonds:** The liabilities of states have increased during 2015-16 and 2016-17, following the issuance of **Ujwal Discom Assurance Yojna (UDAY)** bonds.
- **Small Share of Taxes in National Income:** After India got independence, there is an increase in national income four times more.
  - Gross tax-to-GDP in India is around 10.2% in 2021.
  - And the most part of the tax income is from indirect taxes.
- **Imperfect Tax System**: The Indian tax system has many loopholes. In India, there is very high tax evasion because our tax system is full of errors.

- **Misuse of Public Income:** There is a big quantity spent on government departments where there is corruption, bribe, and red tapism available and work is completed with very difficulty. For this reason, there is a reduction in production.

Impact of Burgeoning Public Debt

- It is well-recognised that excessive public debt leads to higher risk premium in interest rates, which results in reduction of private investment (**crowding out effect)** as well as **contraction of GDP** in the long run.
- Though an increase in public debt will stimulate aggregate demand and output in the short-run, the economic growth will turn negative in the long run if the debt-GDP ratio exceeds 90%.

Way Forward

- **Privatisation of Loss-making PSUs**: The government may think of privatising loss-making public sector undertakings (PSUs) such as Air India.
    - Further, '**minimum government and maximum governance' principle** may be adopted in privatising any PSU.
- **Prudential Stance:** As per the **Fiscal Responsibility Budget Management (FRBM) Act 2003,** it is the onus of the government to achieve fiscal consolidation and to achieve long term macro-economic sustainability through effective conduct of monetary policy and prudential debt management in a transparent manner.
    - In line with this, the RBI has been sensitising States such as Chhattisgarh, Goa, Manipur, etc., about prudential measures of cash and debt management.
- **Leveraging of PFMS**: The Central Government has been implementing over one thousand social welfare schemes through its various ministries with an annual expenditure outlay of around Rs. 3-lakh crore.
    - As part of better fiscal deficit management, maintaining enhanced transparency and accountability, the **Public Financial Management System (PFMS)** should be leveraged to the maximum possible through real-time. consolidated and granular data on advances, transfer of funds and utilisation.
- **PPP Model in Social Schemes**: The government may think of a public private partnership (PPP) model in social schemes such as **Deen Dayal Upadhyay Grameen Kaushalya Yojna (DDU-GKY).**
- **Harmonisation of tax regime**: Though Goods and Services Tax (GST) subsumed almost all the indirect taxes, it is not applicable to alcohol, petroleum products, electricity, etc., as on date. Besides, multiple GST rates are in vogue.
    - Hence, GST needs to be harmonised and expanded to other areas to reach national consensus with a view to improving the tax-GDP ratio.
    - Besides, the government should create an investor-friendly environment for additional sources of financing to replace the high public debt.

- **Thrust on renewable energy**: India imports nearly 80% of its domestic requirement of crude oil. India can become a USD 5 trillion economy by 2025 if it gives more thrust on renewable energy by reducing its reliance on fossil fuels, thereby saving on foreign exchange.

  Further, the government should enhance efficiency of public debt management by adhering to the canons: low cost, risk mitigation and market development.

Drishti Mains Question

The government should make the public debt sustainable by carefully crafting its strategy on contours of growth with financial stability in mind. Comment.
