Public Debt Dilemmas: Navigating India's Fiscal Landscape

This editorial is based on "**The dispute on India's debt burden**" which was published in The Hindu on 04/01/2024. The article discusses the concerns on debt sustainability and advocates for a prudent approach to managing public debt in India.

For Prelims: IMF**,** GDP**,** Public debt**,** External Debt, Internal Debt, Debt-to-GDP ratio, NK Singh Committee, Fiscal Responsibility Budget Management (FRBM) Act 2003, **PPP Model**, **Public Financial Management System (PFMS)**, Public Debt Management Agency (PDMA)

For Mains: Key Observations of the annual consultation report from the IMF, About Public Debt, Key Concerns for Public Debt Management in India, Way Forward.

The latest annual consultation report from the **IMF** has projected a balanced outlook for India's economic growth. The report has acknowledged India's effective inflation management but it has also expressed concerns about the long-term sustainability of India's debts. The report emphasises the need for a sensible approach to managing debt in the long run.

What are the Key Observations of the IMF Report?

- **Concerns over the long-term sustainability of India's debts:** India's government debt could reach 100% of **GDP** by 2028 under adverse circumstances.
- **Reclassified India's exchange rate regime:** The IMF reclassified India's exchange rate regime, labelling it a "stabilised arrangement" instead of "floating," indicating a shift in the perception of how India manages its currency.
  - In a stabilised arrangement, the government fixes the exchange rate, whereas in a floating exchange rate system, it is determined by the demand and supply forces in the foreign exchange market.
- **High Long-Term Risks in Debt Management:** Long-term risks in debt management are high because considerable investment is required to reach India's climate change mitigation targets.

What is Public Debt?

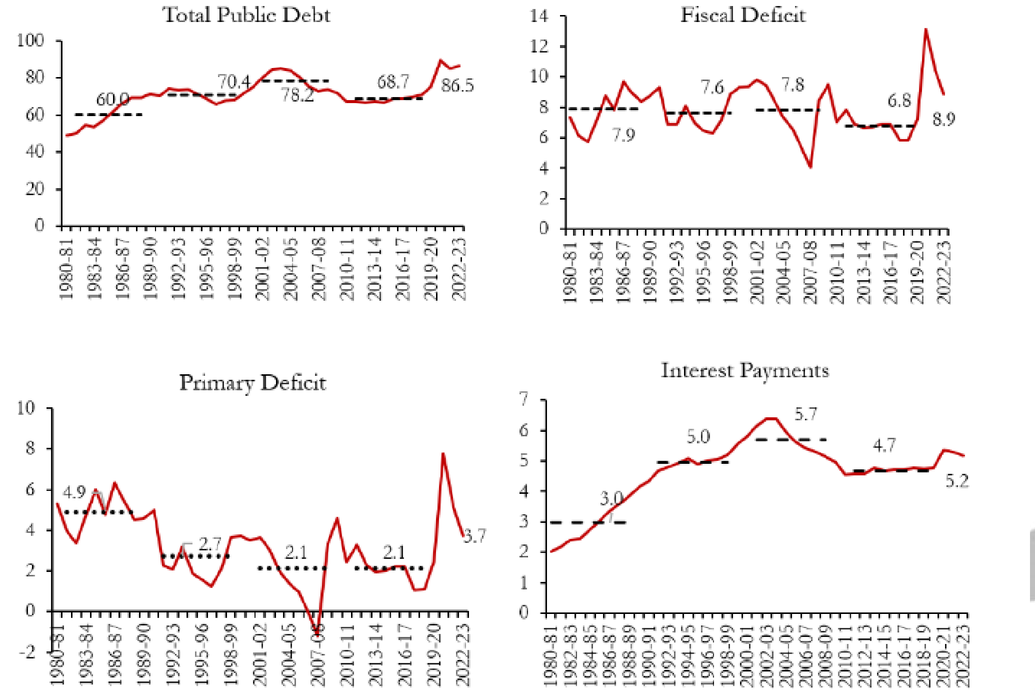
- **About:**
  - Public debt refers to the total amount of money that a government owes to external creditors and domestic lenders.
  - In India, public debt comprises all obligations of the Union government that are required to be settled using funds from the **Consolidated Fund of India.**
- **Main Types:**
  - **External Debt:** This is the portion of a country's debt owed to foreign creditors, including foreign governments, international organisations, and private entities outside the country.

    - **Internal Debt:** This is the debt owed to lenders within the country, including individuals, banks, and other domestic institutions.
        - Internal debt is further categorised into marketable and non-marketable securities.
- **Objectives:**
    - **Financing Government Expenditure:** One primary objective is to provide a stable and reliable source of funding for government expenditures, especially during times of budget deficits.
    - **Stabilising the Economy:** Public debt can be strategically used as a counter-cyclical measure to stabilise the economy during economic downturns. Increased government spending through borrowing can stimulate economic activity.
    - **Managing Liquidity:** Public debt can serve as a tool for managing liquidity within the financial system, allowing governments to control the money supply and interest rates.
    - **To Finance Development Plans:** Public debt can be employed to fund critical infrastructure projects, including the construction of roads, bridges, and public utilities, thereby fostering economic development, and supporting the advancement of education, health services, and other essential sectors.
- **Measuring Mechanisms:**
    - Public debt is expressed as a percentage of the country's Gross Domestic Product (GDP), known as the debt-to-GDP ratio.
        - A higher ratio indicates a larger debt burden relative to the size of the economy.

What are the Key Concerns for Public Debt Management in India?

- **Burgeoning Public Debt Levels in India:**
    - The Union government’s debt was ₹155.6 trillion, or 57.1% of GDP, at the end of March 2023, with state governments adding about 28% of GDP to the overall debt burden.
    - India's public debt-to-GDP ratio slightly increased from 81% in 2005-06 to 84% in 2021-22, and then back to 81% in 2022-23.
- **High-Interest Payments:**
    - Interest payments in India, amounting to more than 5% of the GDP and 25% of revenue receipts on average, exceed government spending on vital areas such as education and healthcare.
- **Limitations on Fiscal Policy:**
    - High levels of public debt may restrict the government's capacity to enact counter-cyclical fiscal measures in times of economic downturns.
    - This limitation can impede the government's effectiveness in responding to shocks and economic challenges.
- **Lower Credit Ratings:**
    - Persistently high deficits and debt levels can lead to lower sovereign ratings by rating agencies which can increase the cost of external commercial borrowing, making it more expensive for the government to raise funds from international markets.
- **Misuse of Public Money and Burden on Future Citizens:**
    - A significant amount is allocated to government departments where corruption, bribery, and bureaucratic hurdles are prevalent, leading to the misuse of public money.
    - The excessive accumulation of debt may give rise to concerns regarding **intergenerational equity,** as future citizens could be burdened with repaying both the principal and interest accrued during the period of financial imprudence.
        - The infusion of capital into state-run banks through recapitalisation bonds has implications for intergenerational burdens.
- **Crowding Out Private Investment:**
    - Large government borrowings may crowd out private investment by absorbing available funds in the financial market, impacting economic growth.
    - When private investment is crowded out, businesses may face challenges in expanding operations, adopting new technologies, or enhancing productivity, which could impact the overall competitiveness of the economy.
- **Financial System Risks:**
    - A high concentration of debt in the financial system can pose systemic risks which could trigger a chain reaction affecting the stability of the entire financial system.

General government debt and fiscal indicators, as a percentage of GDP



Notes: i) Total public debt in India includes debt issued and other liabilities in the Public Account consisting of National Small Saving Fund (NSSF), Provident Fund, Deposit and Reserve funds, securities issued to finance subsidies on oil, food and fertilisers, etc. ii) Dashed horizontal lines are decadal averages from 1980-81 to 1989-90, 1990-91 to 1999-2000, 2000-01 to 2009-10, and 2010-11 to 2019-20, respectively.

What Should be the Way Forward?

- **Prudential Stance:**
  - **Achieve Fiscal Consolidation:** The **NK Singh Committee** on FRBM had envisaged a debt-to-GDP ratio of 40% for the central government and 20% for states aiming for a total of 60% general government debt-to-GDP.
  - **Fiscal Reforms at the State Level:** The central government may promote the adoption of prudent fiscal policies by states and **discourage excessive borrowing by offering rewards or incentives** to states committed to fiscal discipline.
- **Raise Additional Revenue:**
  - **Enhance Tax Collection and Compliance:** Improve tax administration and compliance to increase government revenue. **Utilising technology for cross-matching of GST and income-tax returns** can enhance tax collection efficiency and curb tax evasion.
  - **Administrative Streamlining:** Raise additional revenue through administrative streamlining, and the adoption and better administration of new taxes.
  - **Disinvestment and Efficient Asset Management**: Pursue disinvestment and strategic asset management to optimise government resources and reduce the need for excessive borrowing.
- **Re-orient Spending in Infrastructure and Capacity Building:**
  - **Infrastructure Investments:** Prioritise investments in physical infrastructure, human capital, and green initiatives to enhance economic productivity and foster sustainable development.
  - **Privatisation of Loss-making PSUs:** The government may think of privatising loss-making public sector undertakings (PSUs) **as done in the case of Air India.**
  - **PPP Model in Social Schemes:** The government may think of a public-private partnership (PPP) model in social schemes like **Deen Dayal Upadhyay Grameen Kaushalya Yojna (DDU-GKY).** This may help in reducing public debt.
  - **Introduce Green Debt Swaps**: In a green debt swap, a debtor nation and its creditors negotiate to exchange or restructure existing debt in a way that aligns with environmentally friendly and sustainable projects.
    - It enables the low-income countries to redeploy part of their debt repayments to

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        invest in measures to tackle climate change, nature protection, health, or education. With the agreement of creditors, debt swaps can **help the world's low-income countries avoid default.**

- **Utilise Institutional Mechanisms:**
    - **Leveraging the Public Financial Management System (PFMS):** Leveraging the PFMS to its fullest potential is integral to effective fiscal deficit management, ensuring heightened transparency and accountability in government expenditures.
    - **Establishment of Public Debt Management Agency (PDMA):** PDMA will centralise expertise and responsibilities related to public debt management, ensuring a focused and specialised approach.
        - This can lead to more effective decision-making and strategic planning in handling the complexities of public debt in the country.

Conclusion

As the Finance Ministry dismisses IMF projections as a **'worst-case scenario'** and not a done deal, India should aim to build a financial environment characterised by prudence, transparency, and sustainable fiscal practices.

Drishti Mains Question:

Examine the challenges and propose strategies for achieving sustainable management of public debt in India.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims:

Q. Consider the following statements: (2018)

1. The Fiscal Responsibility and Budget Management (FRBM) Review Committee Report has recommended a debt to GDP ratio of 60% for the general (combined) government by 2023, comprising 40% for the Central Government and 20% for the State Governments.
2. The Central Government has domestic liabilities of 21% of GDP as compared to that of 49% of GDP of the State Governments.
3. As per the Constitution of India, it is mandatory for a State to take the Central Government's consent for raising any loan if the former owes any outstanding liabilities to the latter.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: C

Mains:

Q. Public expenditure management is a challenge to the Government of India in the context of budget-making during the post-liberalization period. Clarify it. **(2019)**

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