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A STUDY ON THE FISCAL SUSTAINABILITY OF PUBLIC DEBT IN INDIA FROM 1990-91 TO 2020-21

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Abstract

India's public debt level is a crucial concern, primarily due to a rising debt-to-GDP ratio that potentially hinders private investment. The government's market borrowing to service this debt may lead to higher interest rates, underscoring the need for debt sustainability to support stable economic growth. However, India's debt remains manageable due to favorable growth prospects and the limited role of external debt in its portfolio, as nearly all government debt is at fixed interest rates. The predominance of internal debt helps contain vulnerability, yet the crowding out of private sector borrowing by public sector debt raises concerns over external vulnerability. Additionally, inadequate fiscal adjustments pose a significant risk to long-term debt sustainability in India.

Key Words: Public Debt, Fiscal Sustainability, Central Liabilities, GDP, Growth

1. Introduction

In this regard, there are two rules that are basically influenced by the Maastricht Treaty and U.K. Golden rule. The Maastricht Treaty which was signed in February 1992 by the members of the European community in Maastricht, Netherlands stated that country's overall budget deficit for each fiscal year must be equal to or below 3 percent of GDP. The U.K. has been operating a Golden rule since 1997 whereby borrowing should be made only to finance capital spending. Fiscal imbalances of a state generally occur mainly due to excessive growth of expenditure and inability of the state government to meet that expenditure out of their revenue and capital receipts. The theoretical underpinning of the budget deficit lies in the fact that until the Keynesian revolution (Keynes, 1936), budget deficits were considered as signs of profligacy. Governments were often forced to incur large deficits in times of war or natural calamities; but the prudent ones used to pay off debt by running surplus budget when

normalcy had returned (Rajaraman and Mukhopadhyay, 2005). With the advent of Keynesian economics, budget deficit was even considered essential for macro stabilization. Counter-cyclical fiscal policies require the government to run budget deficits in times of demand deficiency and fiscal squeeze during booms. If the business cycle is symmetrical around the economy's full employment growth path, such policies help to keep the budget balance over a typical cycle and there is no tendency for a secular increase in public debt. But if the budget deficit is chronic instead of cyclical, then resulting accumulation of debt make the budgetary process unsustainable. Debt financing is problematic in the demand deficient economy when the deficiency is chronic or structural rather than cyclical (Rakshit, 2005).

There is a growing awareness among the states in India in recent decades to contain fiscal imbalances which has led to accumulation of debt and deterioration in the fiscal indicators (Rao, 2002; Srivastava, 2009). Earlier, most Indian economists were of the view that the growth of public debt in planned magnitude was normal and desirable in a developing country like India where borrowing represents the absorption by the government of a part of domestic savings and the inflow of capital from abroad to finance and promote capital formation in the public sector and priority areas in the private sector (Chelliah, 1996). But this view assumed that borrowed funds would be used only for capital purposes and the resultant investment would yield adequate direct and or indirect returns. But these assumptions were not often fulfilled in case of both central and state governments in India. The fiscal crisis and the resultant exponential growth of public debt in India in later part of 1990s was not merely because of rising revenue expenditure ahead of current revenues, but also because capital expenditure financed by borrowings did not yield adequate returns (Chelliah, 1996). The deterioration in the fiscal indicators and rising public debt of the state governments in India during that period disrupted the normal functioning of the economy (Rao, 2005). Deterioration in the fiscal indicators of the state governments contributed towards macroeconomic instability of the whole nation. Considering that fact, the recent Finance Commissions of Government of India in their terms of reference have given importance on fiscal and debt sustainability (TFC, 2009). A sustainable fiscal policy helps a state to maintain a stable fiscal position without undertaking drastic and painful reforms measures. The significance of fiscal sustainability is more for poor, backward and developing nations as deterioration in their fiscal position may hamper the overall economic development. As India is a fast-developing nation with lots of deficiencies particularly in the infrastructure sector, it is necessary to study the sustainability of the fiscal position of the

state. Considering the significance of fiscal and debt sustainability on state finances, issue of fiscal and debt sustainability of the state has been carried out in this chapter.

2. Sustainability of Public Debt

Testing the sustainability of public debt involves assessing whether the current level of debt is sustainable in the long run, given the expected economic and financial conditions. One commonly used indicator of debt sustainability is the debt-to-GDP ratio. A high debt-to-GDP ratio can signal that the government's debt burden is becoming unsustainable. However, this measure does not consider the maturity structure of the debt, the interest rate environment, and other factors that may affect the sustainability of public debt.

There is no fixed or universally accepted debt-to-GDP ratio that is considered acceptable for India or any other country. The acceptable level of debt-to-GDP ratio depends on various factors such as the stage of economic development, the size of the economy, the government's ability to repay the debt, and the economic conditions prevailing in the country.

However, in India, a debt-to-GDP ratio of up to 60% is generally considered sustainable for developing countries like India, beyond which it may have adverse effects on the economy. The government has set a target of reducing the debt-to-GDP ratio to 60% by 2024-25, which was recommended by the Fiscal Responsibility and Budget Management (FRBM) Review Committee in 2017. However, due to the impact of the COVID-19 pandemic, the government has announced a temporary suspension of the FRBM Act's fiscal deficit targets for the period 2020-21 to 2024-25.

Along with this, the past literaturehas proved that if the growth rate of GDP is higher than the growth rate of debt then the debt is sustainable.

2.1 Central Liabilities to GDP Ratio

Central liabilities are often expressed as a percentage of Gross Domestic Product (GDP) in order to provide a standardized measure of the government's debt burden relative to the size of the economy. This approach allows policymakers and analysts to compare the debt levels of different countries or time periods, and to assess the sustainability of government finances. GDP is a commonly used metric for economic activity, as it reflects the total value of goods and services produced within a country's borders. By expressing central liabilities as a

percentage of GDP, analysts can gauge the government's capacity to service its debt based on the level of economic activity in the country.

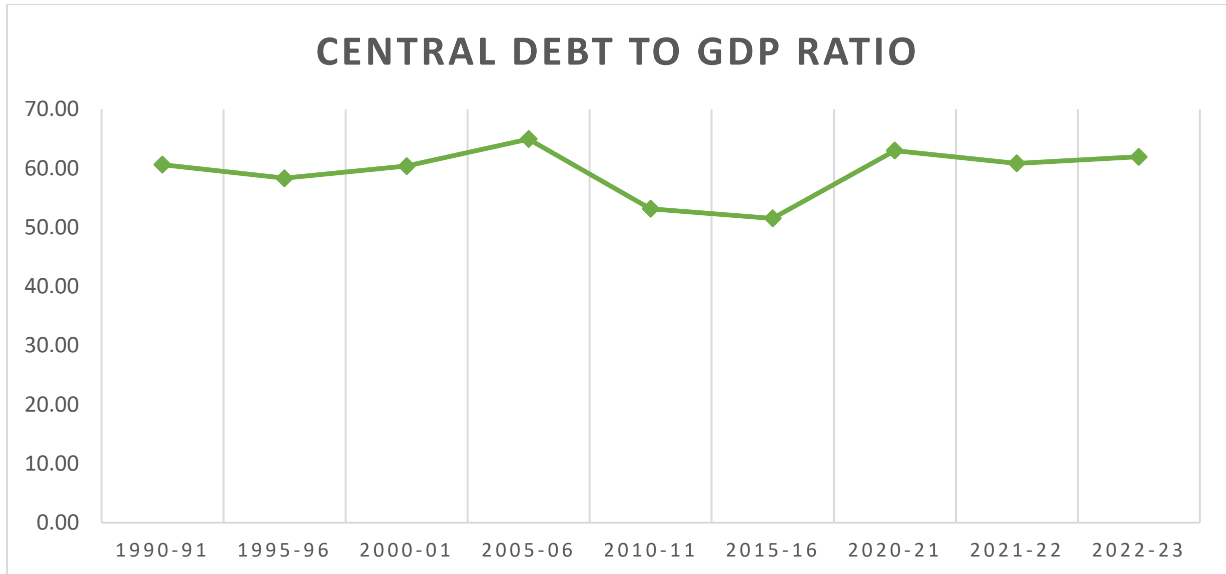
Furthermore, the relationship between central liabilities and GDP is important for understanding the potential impact of government debt on the broader economy. Excessive debt can lead to higher interest payments, which can crowd out other government spending and reduce private sector investment. This can in turn lower economic growth and exacerbate fiscal challenges. Therefore, expressing central liabilities as a percentage of GDP can provide insights into the risks associated with the level of government debt, and can inform policy decisions aimed at managing debt levels and promoting long-term economic sustainability.

Table 1: Share of Central Liabilities in GDP from 1990-91 to 2022-23 (in Rs. crores)

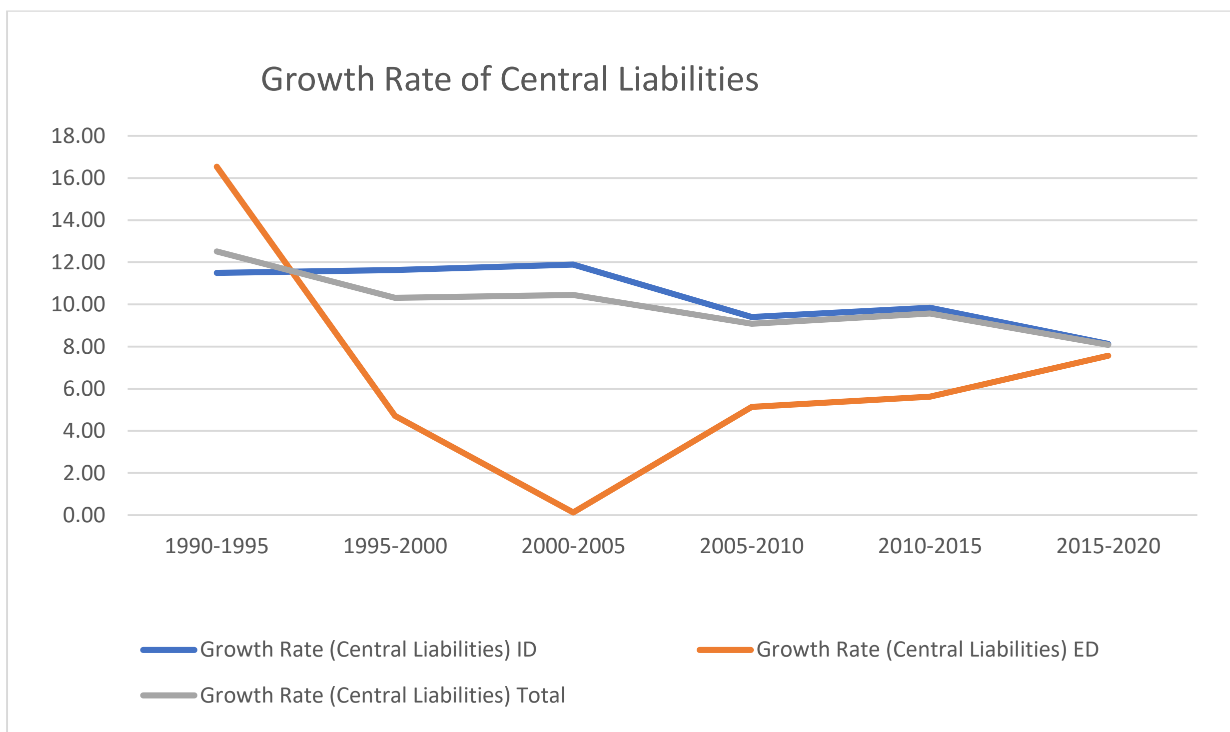
Year	Total Central Liabilities	GDP at current prices	% of GDP
1990-91	349347	576109	60.64
1995-96	703381	1205583	58.34
2000-01	1292586	2139886	60.40
2005-06	2359972	3632125	64.97
2010-11	4059590	7634472	53.17
2015-16	7098298	13771874	51.54
2020-21	12443910	19745670	63.02
Compound Annual Growth Rate of Central Liabilities from 1990-91 to 2020-21		12.65 %	
Compound Annual Growth Rate of GDP at current prices from 1990-91 to 2020-21		12.50%	
Source: 1. Handbook of Statistics on Indian Economy, 2021-22, RBI, New Delhi, India 2. Union Budget Document, various years			

The share of central liabilities as a percentage of GDP is shown in Table 1. GDP of India at current prices has been considered for this. In the year 1990-91, 60.64% of GDP was of central liabilities. It remained almost stagnant in the next decade with few fluctuations but only around 60%. By 2020-21, the share increased slightly to 63.02%. However, the fact that central liabilities account for more than half of GDP is not to be taken lightly. The debt to GDP ratio was mostly under 60%. This means that the public debt made by central government is sustainable.

The Compound Annual Growth Rate (CAGR) of central liabilities for the study period 1990-91 to 2020-21 is 12.65%. On the other hand, the CAGR of GDP at current prices is 12.50%. This highlights the fact that public debt by central government has been unsustainable in last thirty years.



Source: Table 1



Source: Handbook of Indian Statistics, 2021-22, RBI, New Delhi, India

2.2 Combined Liabilities of Central and State Governments to GDP Ratio

The combined liabilities of the central and state governments are shown as a percentage of GDP because it provides a measure of the government's overall debt burden relative to the size of the economy. This is important as a fiscal indicator as it helps to assess the

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sustainability of the government's borrowing and spending activities. A high level of combined liabilities as a percentage of GDP indicates that the government has a significant amount of debt relative to the size of the economy. This can be a cause for concern as it suggests that the government may struggle to meet its debt obligations and may need to borrow more in the future to finance its spending activities. This, in turn, can lead to higher interest payments, which can divert resources away from other areas such as education, healthcare, and infrastructure.

Furthermore, a high level of combined liabilities as a percentage of GDP can also indicate a lack of fiscal discipline on the part of the government. If the government consistently spends more than it earns, it will accumulate debt over time, which can lead to a debt crisis if not managed properly. Therefore, monitoring the level of combined liabilities as a percentage of GDP is crucial for ensuring fiscal sustainability and avoiding potential economic instability.

Overall, the combined liabilities of central and state governments shown as a percentage of GDP serves as an important fiscal indicator as it helps to assess the sustainability of the government's borrowing and spending activities. It provides a measure of the government's overall debt burden relative to the size of the economy, which is essential for ensuring fiscal discipline and avoiding potential economic instability.

Table 2: Combined Liabilities as a percentage of GDP from 1990-91 to 2021-22

Year	Combined Liabilities (Rs Crores)	GDP at current prices (Rs Crores)	% of GDP
1990-91	477502	576109	82.88
1995-96	952916	1205583	79.04
2000-01	1886733	2139886	88.17
2005-06	3507689	3632125	96.57
2010-11	5888566	7634472	77.13
2015-16	10316424	13771874	74.91
2020-21	17704031	19745670	89.66
Compound Annual Growth Rate of Combined Liabilities from 1990-91 to 2020-21		12.80 %	
Compound Annual Growth Rate of GDP at current prices from 1990-91 to 2020-21		12.50%	
Source: 1. Handbook of Statistics on Indian Economy, 2021-22, RBI, New Delhi, India 2. Union Budget Document, various years			

Therefore, the Table 2 gives a view of the share of total combined liabilities of Central and State governments as a percentage of GDP at current prices. In 1990-91, combined central

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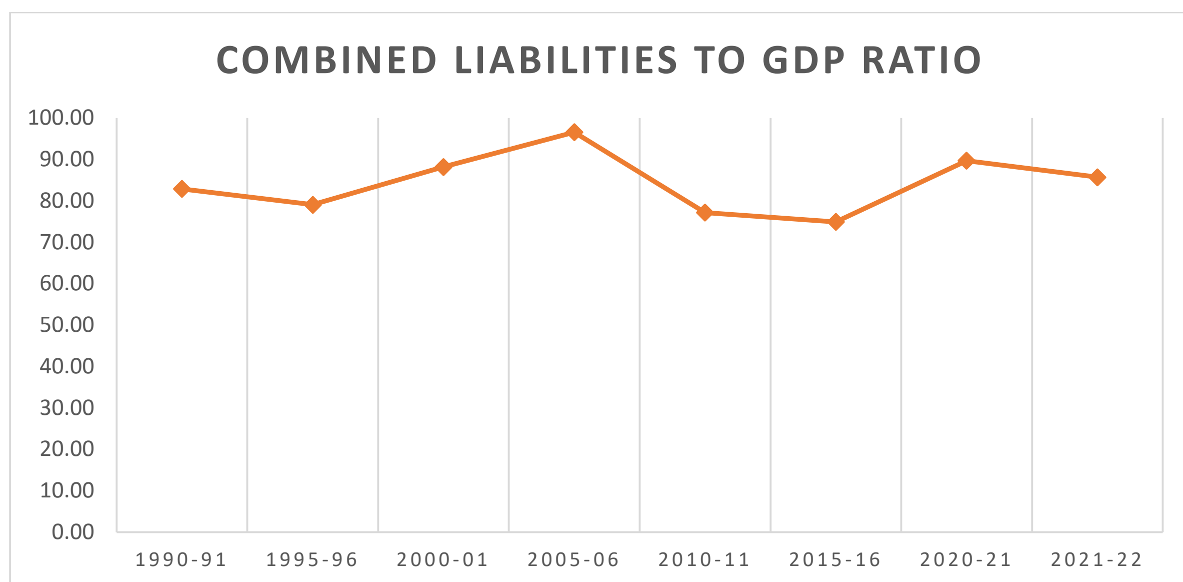
and state governments liabilities constituted 82.88% of total GDP. It peaked in the year 2005-06 at 96.57%. However, with the introduction of FRBM Act, it decreased to 74.91% by 2015-16, which is a decade later. By 2020-21, the share is at 89.66%.

The CAGR of combined liabilities is 12.80% for the last three decades. However, CAGR of GDP is only 12.50%. This clearly indicate that the combined public debt of the Central and State Governments in the past thirty years has been unsustainable for the CAGR of debt is higher than the GDP. In simpler words, the growth rate of debt is faster than the growth rate of GDP. This is highly risky for a developing economy like India.



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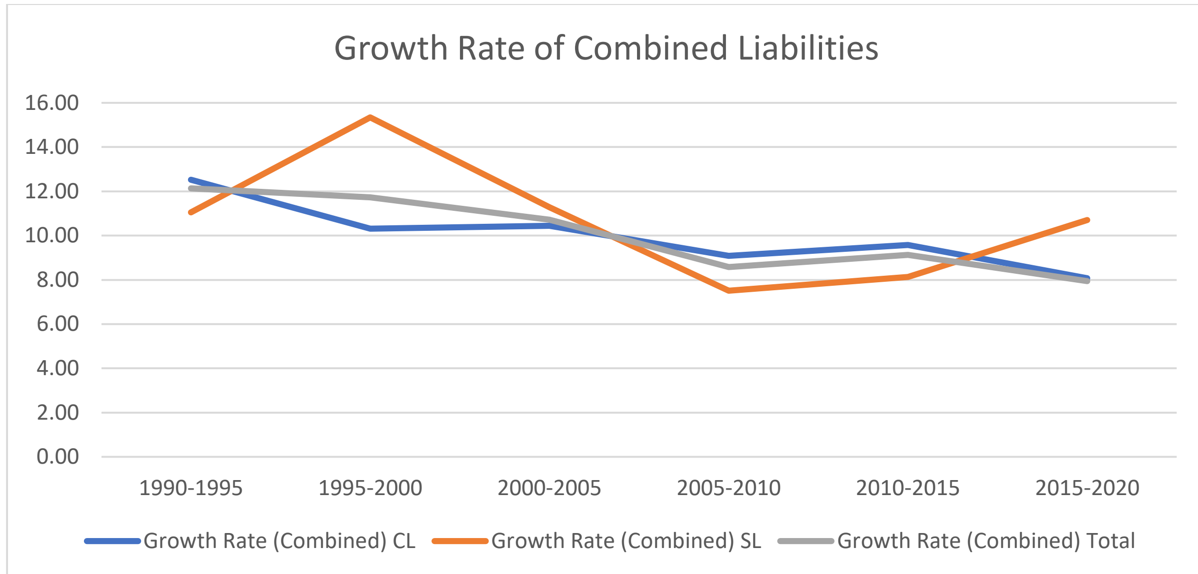

Source: Handbook of Indian Statistics, 2021-22, RBI, New Delhi, India

3. Conclusion

The 12th Finance Commission in India, which submitted its report in August 2004, did not recommend any specific acceptable debt-to-GDP ratio for the country. However, the commission did recommend measures to improve fiscal discipline and debt sustainability, such as the adoption of the Fiscal Responsibility and Budget Management (FRBM) Act, greater transparency in public debt management, and the creation of a debt management office. The commission also recommended that the central and state governments should undertake debt consolidation and rationalization measures to reduce the debt burden and improve debt sustainability over the medium term.The 14th Finance Commission in India had also suggested that the central government's debt-to-GDP ratio should be brought down to 40% by 2019-20, and that the states' debt-to-GDP ratio should be brought down to 20% by the same year. The commission also recommended measures to improve fiscal discipline and debt sustainability, such as the adoption of the Fiscal Responsibility and Budget Management (FRBM) Act, greater transparency in public debt management, and the creation of a debt management office.

The data and analysis so far indicate that the debt to GDP ratio of central liabilities has been sustainable for the past three decades. However, when the CAGR is considered for the same, the debt has increased at a faster rate than the GDP in the past three decades.

4.Policy Suggestions

- Government of India needs to constrict the public debt and deficit situation well within the reasonable level to keep the central finances in good condition.
- India can get free from the burden of high debt and deficits if available recourses are used properly by check the misuse of recourses and reducing high non-developmental expenditures of the government.
- As the Domar model suggests that policies that promote economic growth, such as investments in infrastructure, education, and technology, can contribute to the sustainability of public debt by increasing the economy's growth rate. Additionally, policies that help to manage and reduce the interest rate on public debt, such as sound monetary and fiscal policies, can also contribute to debt sustainability. India should, therefore, focus on promoting its economic growth using sustainable fiscal and monetary policies.

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