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Debt Position of the Central Government of India: Analysis of Pre and Post-Reform Period

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ABSTRACT

The present paper discusses the debt position of the central government of India since 1975. It first analyses the fiscal situation of the central government of India and looks at the trends of public debt of the central government of India during pre and post-reform period. Further the relative magnitude of the public debt and the national income should be taken into consideration to assess the burden of public debt, as it is an important indicator of the financial burden of debt. Lastly, the findings that came out from the review of foregoing analysis are summed up.

Introduction

Earlier, public debt was considered an important instrument for temporarily augmenting revenue or purchasing power in exchange for an obligation (under a promise) on the part of the government to repay the principal sum borrowed and in most instances interest on that principal. However, it has become a permanent feature. As mentioned in the "Encyclopedia of Britannica", Public debt refers to "obligations of Governments, particularly those evidenced by securities to pay certain sums to the holders at some future date." In fact public debt is constituted when the government floats loans and borrows from the public. "The instrument of public borrowing is in the form of various types of government bonds and securities" (Saket, 2006). Government needs to borrow when current revenue falls short of public expenditure. The advantage of a widely held public debt is considered in the maintenance of a high level of consumption. For instance, holdings of highly liquid government bonds by small income receivers may be liquidated for expenditure in emergencies or for purchase of durable consumers' goods. A further potential advantage in public debt lies in the provision of greater mobility of resource utilization. It also channelizes saving into productive use. Thus, in this sense, public debt is a necessary evil, no matter what its burden and if the benefits could be secured with fewer burdens, it would be less preferable. In fact, Alexander Hamilton rightly said that a widely-held public debt "will be a powerful cement of union" (Taylor, 1961).

Now, most of the nations of the world are resorting to this instrument (public debt) for various reasons. India is also one among them.

Before explaining why India's central government is resorting to large number of borrowings and growing debt burden, it seems important to analyse deficit indicators of the same.

Deficit indicators measure the excess of government spending over revenues and reflect the fiscal health of an economy. Deficits may, therefore, emerge either due to the deliberate decisions to spend beyond revenue constraints or because established flows of spending and taxing react differently to shifts in the aggregate bases in the economy.

The fiscal situation of the central government represented by the various deficit indicators has worsened since the mid-1980s. The central government of India has been facing gross fiscal deficit and gross primary deficit since 1975-76 and revenue deficit since 1979-80 (Table 1). The latter half of the 1980s saw gross fiscal deficit in the range of 7-8 per cent of GDP and gross primary deficit and revenue deficit in the range of 4-5 per cent of GDP and 2-3 per cent of GDP, respectively. Fiscal consolidation was hence a major focus of the reform process introduced in 1991-92. The 1990s have also seen varied performance in the deficit indicators. Gross fiscal deficit immediately declined by more than 2 percentage points of GDP during 1991-92. The period 1991-92 to 1996-97 with the exception of 1993-94 has seen a decline in the fiscal deficit through a combination of an increase in revenues coupled with a reduction in expenditure and other deficit indicators as a percentage of GDP. From 1997-98, expenditure started rising once again and by the year 2001-02, all the major deficit indicators rose to levels higher than those prevalent at the beginning of the reform process. With the Fiscal Responsibility and Budget Management Act (FRBMA), 2003 in place since 2003-04, not only the gross fiscal deficit as a proportion of GDP declined, but a commensurate decline in the revenue deficit was noticed leading to a marked improvement in the quality of deficit. This fiscal correction in the central

Table 1: Deficit Indicators of the Central Government as per cent of GDP

Year	Gross Fiscal Deficit	Gross Primary Deficit	Revenue Deficit	Budgetary Deficit*	Revenue Deficit as per cent of Fiscal Deficit
1975-76	3.60	2.14	-1.05	0.43	-29
1980-81	5.71	3.92	1.40	1.77	25
1985-86	7.77	5.10	2.09	1.75	27
1990-91	7.84	4.06	3.26	1.99	42
1995-96	5.05	0.86	2.49	0.82	49
2001-02	6.19	1.47	4.40	2.76	71
2007-08	2.68	-0.93	1.11	0.16	41

*** Includes treasury bills and draw down of cash balances since 1997-98.**

Note: 1. Negative (-) sign indicates surplus in deficit indicators.

2. Revenue deficit is the difference between revenue expenditure and revenue receipts.

3. Gross fiscal deficit (GFD) is aggregate disbursements (net of debt repayments) less revenue receipts, non-debt capital receipts and recovery of loans and advances. Since1999-2000, it Excludes States' share in small savings as per the new system of accounting.

4. Gross primary deficit is defined as GFD minus interest payments.

Source: Various issues of Handbook of Statistics on the Indian Economy and Indian Public Finance Statistics.

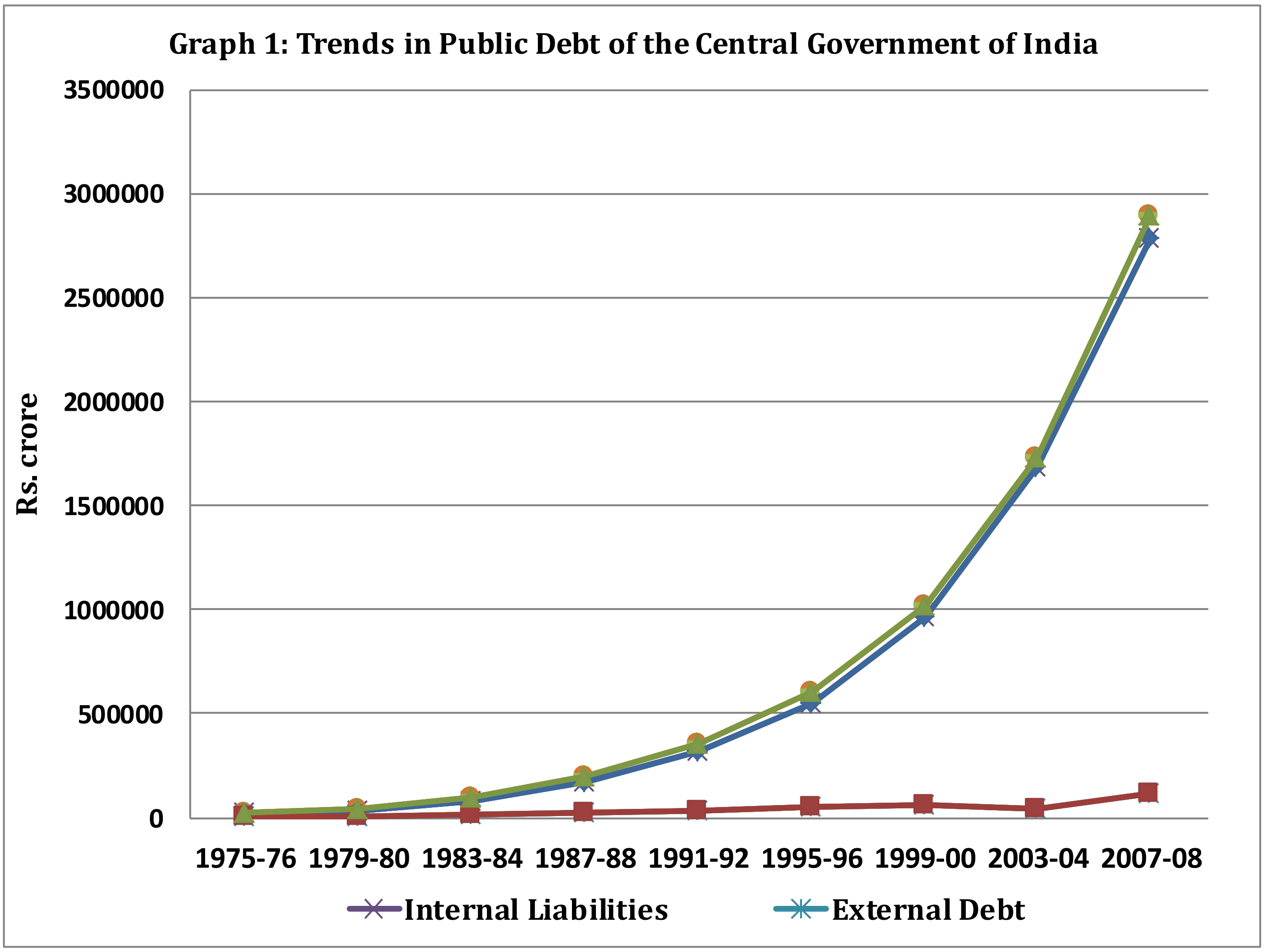
government since 2003-04 has been achieved on the strength of higher revenues. Success in containing or managing expenditure has been limited. Table also reveals that the ratio of revenue deficit to fiscal deficit of the central government, which indicates the extent to which borrowing are used to meet current expenditure, increased from 11 per cent in 1979-80 to 34 per cent in 1988-89. The revenue deficit, which constituted 42 per cent of fiscal deficit in 1990-91, accounted for 80 per cent of fiscal deficit in 2003-04. This is reflective of the fact that a larger portion of fiscal deficit goes to finance public consumption expenditure. Since FRBMA, 2003 resulted in a decline in the proportion of revenue deficit to fiscal deficit by 39 percentage points in four years. It was 41 per cent in 2007-08 implying a “progressively better utilization of borrowed resources towards asset creation”

Trends of Public Debt of the Central Government of India

Under Article 292 of the constitution of India, the central government is empowered to resort to borrowings either within or outside India, upon the security of the Consolidated Fund of India, within limits permitted by the Parliament to meet certain unavoidable expenditure.

Public debt in India consists of internal liabilities and external debt. Internal liabilities are composed of internal debt and other internal liabilities. Internal debt includes market loans and bonds, treasury bills, special securities issued to Reserve Bank of India (RBI) and special bearer bonds. These are secured under Consolidated Fund of India. The other internal liabilities include small savings collections, provident funds, reserve funds and deposits. These are not secured under Consolidated Fund of India. External debt represents loans received from foreign governments and bodies. These are secured under Consolidated Fund of India.

Graph 1 show that public debt of the central government has been continuously increasing in India since 1975. Public debt of the central government of India recorded the growth of 16 per cent per annum from 1975-76 to 2005-06 (Table 2). The reliance on borrowing increased substantially in 1980-81 due to the serious erosion in the current savings of the central government in 1979-80. The increase in the resources of the public sector undertakings tapered off after 1982-83. This led to substantial increase in borrowings in 1984-85. To meet its expenditure commitments the reliance on borrowed funds rose in 1989-90. Total public debt, as a whole, registered a sharp increase from Rs. 27393 crore in1975-76 to Rs. 268193 crore in 1989-90 - registered the growth of 18 per cent per annum. Increasing dependence on borrowings to meet the deficit on revenue account has led to a continuous growth in the total indebtedness. However, an increase in debt puts pressure



Source: Computed on the basis of data compiled from various issues of Indian Public Finance Statistics.

on interest payments which in turn necessitates a further build up of debt. It rose from Rs. 354662 crore in 1991-92 to Rs. 2260145 crore in 2005-06 – showing therein the growth of 14 per cent per annum during the post-reform period.

Internal liabilities, as a component of public debt, recorded the growth of 20 per cent per annum during the pre-reform period of fifteen years. The major contributory factors were oil shocks and political expediency (Singh, 2005). This increase was also on account of increase in other internal liabilities vis-à-vis market borrowings. The share of this category in total public debt increased from 72.66 per cent in 1975-76 to 89.43 per cent in

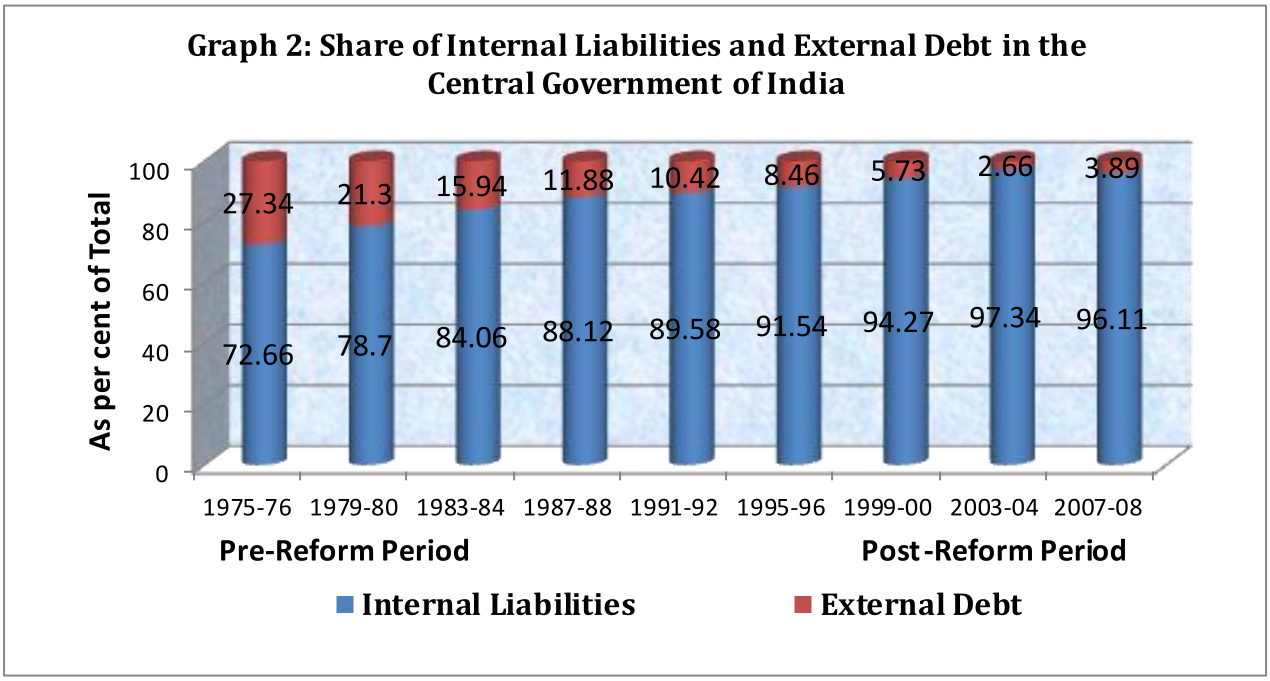
Table 2: Compound Growth Rates of Public Debt of the Central Government of India and its Components

(per cent)

Year	1975-76 to 1989-90	1990-91 to 2005-06	1991-92 to 2005-06	1975-76 to 2005-06
Public Debt	**18**	**13**	**14**	**16**
(i) Internal Liabilities	**20**	**13**	**15**	**17**
(ii) External Debt	**10**	**4**	**4**	**8**

Source: Computed on the basis of data compiled from various issues of Indian Public Finance Statistics.

1989-90. The declining trend in the fiscal deficit had a salutary impact in the accumulation of internal liabilities of the centre. Reflecting this trend, internal liabilities recorded the growth of 13 per cent per annum during 1990-91 to 2005-06 and 15 per cent per annum during 1991-92 to 2005-06. The share of internal liabilities, which was nearly 90 per cent in 1990-91 reached up to 96.11 per cent in 2007-08. Further, external debt of the centre has increased and showing the rate of growth of 10 per cent per annum during the pre-reform period of fifteen years. It was due to the financing of large current account deficit that emerged since the beginning of eighties through inflow of capital from abroad by way of multilateral and bilateral assistance, commercial borrowing and non-resident deposits (Saket, 2006). In 1990-91, India faced a Balance of Payment (BOP) crisis which was to some extent due to an external debt problem. Despite the reforms undertaken by the central government on the front of borrowings, the external debt of the centre has risen from 1991-92 to 2005-06 and showing the growth of 4 per cent per annum during the post-reform period. It rose to Rs. 112686 crore in 2007-08. This hike in external debt was brought about by a rise in External Commercial Borrowings (ECBs), NRI deposits and short-term debt (Singh, 2008). But the



Source: Computed on the basis of data compiled from various issues of Indian Public Finance Statistics.

share of external debt as proportion of total public debt has shown a continuous decline. It declined from 27.98 per cent in 1976-77 to 10.57 per cent in 1989-90. However till 1980's external debt was not a major problem primarily because India had not resorted too much of market and market related external borrowings (Saket, 2006). Since 1990-91, a continuous decrease in the share of external debt has been observed and it was as low as 3.89 per cent in 2007-08. Continuously dependence on borrowings over the years has led to a continuous growth in the public debt GDP ratio of the central government of India. Public debt of the central government, comprising of internal liabilities and external debt, continuously increased during the eighties. Public debt formed about 32.52 per cent of GDP at the end of 1975-76 and the ratio increased to over 54.99 per cent by the end of 1989-90 (Graph 3). This growth of public debt has led to a substantial increase in gross interest payments. The fiscal reform measures adopted in 1991 such as absorption of Government of India dated rupee securities, longer term treasury bills and introduction of auctions of repurchase agreements (REPOS) of dated securities aimed at reducing the central government's fiscal deficit. These measures curtailed the rising trend in debt-GDP ratio from 55.22 per cent in 1990-91 to 49.0 per cent in 1996-97. From 1997-98, expenditure started rising once again, and by the year 2001-02, public debt-GDP ratio rose to the level higher than those prevalent at the beginning of the reform process. This increase in the debt-GDP ratio witnessed since 1999-2000 was mainly on account of increase in the internal liabilities of the central government. The debt-GDP ratio rose to about 61.33 per cent in 2007-08. The increasing trend in government public debt as a GDP ratio was a matter of serious concern because of the associated pre-emption of resources from the private sector.

Looking at internal liabilities as percentage of GDP, these registered a sharp increase in the pre-reform period from one-fourth in mid-1970s to nearly half of GDP in 1989-90. This development resulted in the higher interest rates, crowding out of interest-sensitive investments in the short-run and lowering of the growth rate of the economy (Singh, 2008). During the post-reform period, internal liabilities as per cent of GDP declined marginally for two years of 1991-92 and 1992-93 but have been continuously growing since 1997-98 and crossed the figure of 60 per cent during 2000s. It has declined to 58.94 per cent of GDP in 2007-08. The reason for increase in internal liabilities was mainly due to continuously increasing in internal debt

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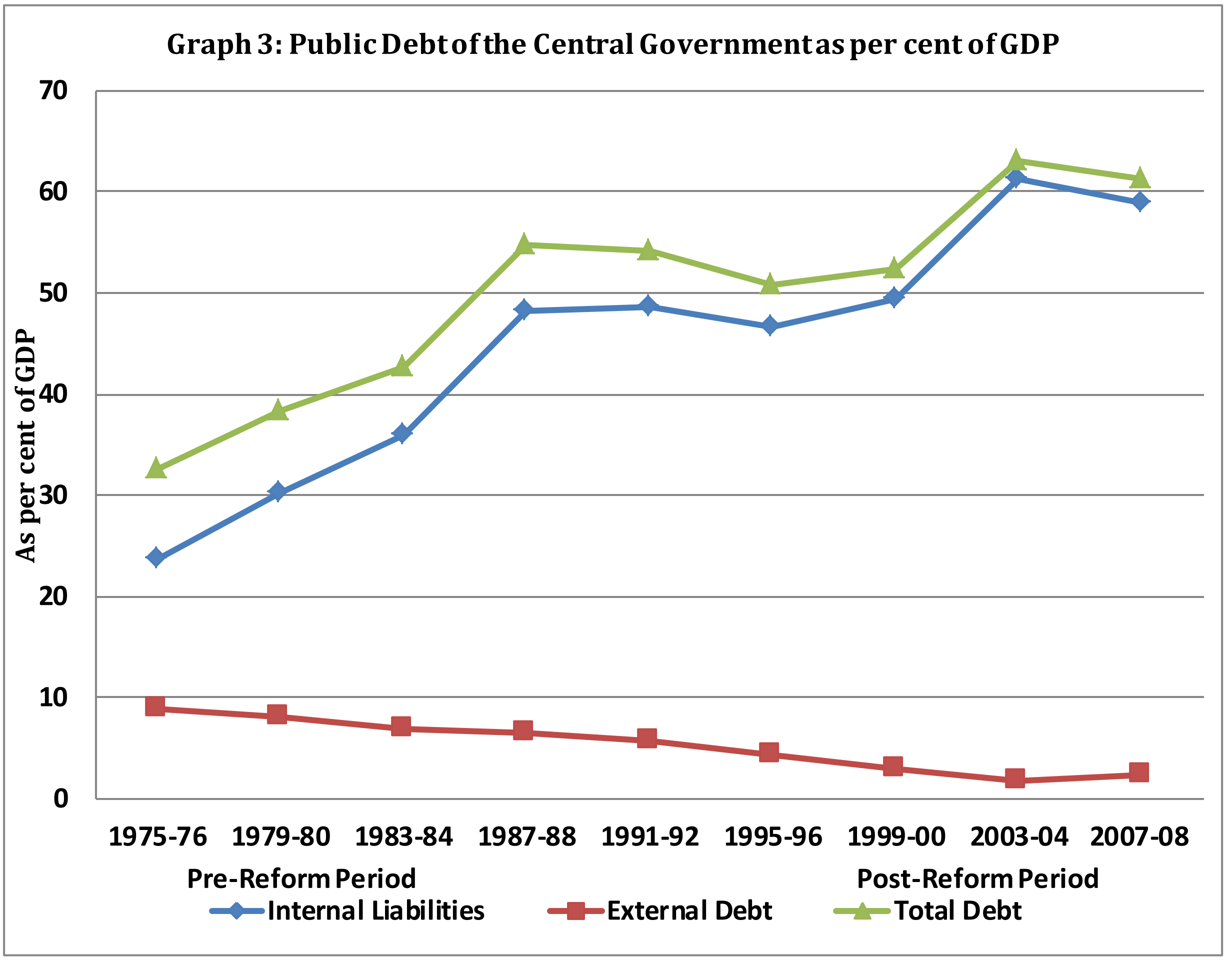
External debt as a ratio of GDP started declining in the late eighties. As a percentage of GDP, it declined from 8.89 per cent in 1975-76 to 6.8 per cent in



Source: Computed on the basis of the data compiled from various issues of Indian Public Finance Statistics.

1983-84 and further to 5.81 per cent in 1989-90. In the post-reform period, it reduced from 5.64 per cent of GDP in 1991-92 to 4.3 per cent of GDP in 1995-96. This was mainly due to the devaluation of rupee. Since then, external debt declined continuously and reached to 1.67 per cent of GDP in 2003-04. It again has started increasing and reached to the level of 2.39 per cent of GDP in 2007-08.

Burden of Public Debt

Whether the present size of public debt is burdensome or not? This important question has been examined by taking into account all relevant factors. It has been assessed in relation to national income and interest payments.

The relative magnitude of the public debt and the national income should be taken into consideration for assessing the burden of public debt, as it is an important indicator of the financial burden of debt. If the rate of increase in the national income approximately keeps pace with that of the growth of debt, there is apparently not much to worry. If the rate of increase in income is greater than the rate of increase in debt, the magnitude of the burden can be said to have declined. But if the rate of increase in debt is greater than the rate of rise in income, the magnitude of debt service costs may be said to be increasing. The economy may face crisis resulting from a higher debt-income ratio. It is, therefore, important that the debt-income ratio is kept as low as possible either by restraining recourse to debt burden or by promoting income generation or by doing both together.

Between 1975-76 and 1989-90, the public debt of the central government of India has grown at the rate of 18 per cent per annum whereas national income has recorded the growth of 13 per cent per annum. Since the rate of growth of public debt was higher than the rate of growth of national income during pre-reform period, as such it imposed a heavy burden on the Indian economy. During post-reform period, national income recorded the growth of 12 per cent per annum and public debt registered the growth of 13 per cent per annum during this period. The rate of growth of public debt is more than the rate of growth of national income. Similar to pre-reform period, the burden of debt during post-reform period also increased tremendously.

Debt and Interest Burden of the Central Government

The annual interest payments required are the main factors to measure the financial burden imposed by public debt upon the economy. As the interest payments entail a large claim on public resources, it curtails the government's capacity to spend on social sectors and developmental activities. Interest payments can be reduced either by retiring debt, particularly higher interest bearing debt, or by curbing the growth of new debt.

Table 3 demonstrates the debt and interest burden of the central government of India. This was due to the increasing relying on borrowed funds to meet the expenditure commitments. Continued dependence on borrowings for financing the major portion of the gap in resources has resulted in a significant increase in interest payments. Interest payments stepped up from Rs. 1228.16 crore in 1975-76 to Rs. 21498.25 crore in 1989-90 – recording the growth of 22 per cent per annum against public debt's growth of 18 per cent per annum during this period. Thus a higher growth of interest payments resulted in a heavy burden on the economy in terms of growing government borrowings in the future too. There has been a considerable increase in the growth of interest payments during post-reform period. Due to such an increase of interest payments, the country has been facing a fiscal crisis during post-reform period. Between 1990-91 and 1992-93, interest payments increased by Rs. 9577.22 crore. About 25 per cent of this rise in interest payments was due to the hike in average interest rate. The remaining 75 per cent was due to the increase in debt during 1990-91 and

Table 3: Debt and Interest Burden of the Central Government of India

(Rs. crore)

Year	Interest Payments	Public Debt
1975-76	1228.16	**27393**
1979-80	2209.86	**46770**
1983-84	4795.46	**94904**
1987-88	11251.36	**195561**
1991-92	26595.63	**354662**
1995-96	50045.03	**606232**
1999-00	90249.32	**1021029**
2003-04	124087.82	**1736678**
2007-08	**171971.13**	**2897037**

Source: Computed on the basis of the data compiled from various issues of Indian Public Finance Statistics.

1991-92. Thereafter, interest payments rose to Rs. 171971.13 crore in 2007-08. Interest payments recorded comparatively a lower growth of 11 per cent per annum against 13 per cent per annum growth of public debt during post-reform period. This growth in the interest liability is the outcome of rising fiscal deficits and recourse to market borrowings to meet the deficits.

Conclusion

It can be concluded here that central government's fiscal position is dissatisfactory since 1975-76 as the budgets has shown gross fiscal and gross primary deficits since then. But up to 1990-91, gross fiscal deficit was increasing and reached the highest limit. Revenue deficit as per cent of fiscal deficit was continuously increasing since 80s and touched the height of 80 percent in 2003-04. It is only since 2004-05 that this share has started declining. Thus, because of fiscal deficit, primary deficit and revenue deficit for such a long time have increased the public debt of the central government of India at the rate of 16 per cent per annum during the period 1975-76 to 2005-06. While analyzing the rate of growth of internal liabilities and external debt, it is observed that rate of growth of internal liabilities and external debt is lower in the post-reform period in comparison to the pre-reform period. Looking at the share of internal liabilities and external debt in the total public debt of the central government, it can be observed that internal liabilities has constituted the highest share in total public debt since 1975 and even reached to the level of more than 96 per cent. This highlights an increasing dependence of the central government on internal liabilities. On the other hand, the relative share of external debt fell continuously from 27 per cent in 1975-76 to 3 per cent in 2007-08. As a proportion of GDP, public debt as well as internal liabilities of the central government has increased throughout the study period. This shows that reform measures could not do more to curtail the rising trend of debt-GDP ratio. On the other hand, external debt-GDP ratio declined due to devaluation of rupee in the post-reform period. While analyzing debt burden of the central government of India, it can only be reduced by decreasing interest payments. As such government should formulate such policies so that the interest payments are reduced to maximum level.

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