Public Debt

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Why is in news? Three ways to deal with the high govt debt

All new governments, including those starting fresh innings, carry legacy burdens inherited from their predecessors. It would be no different for the next government taking over post the April-May 2024 national elections.

The Narendra Modi-headed National Democratic Alliance (NDA) government will end its second term with **overall public debt in excess of 80% of India's gross domestic product (GDP)** at current market prices.

Public debt:

Public debt is the **total amount borrowed by the government** of a country.

In the Indian context, public debt includes the **total liabilities of the Union government** that have to be paid from the Consolidated Fund of India.

Sometimes, the term is also used to refer to the **overall liabilities of the central and state governments**. However, the Union government clearly distinguishes its debt liabilities from those of the states.

It calls overall liabilities of both the Union government and states as General Government Debt (GGD) or Consolidated General Government Debt.

Government debt is basically the **outstanding domestic and foreign loans raised by the Centre and states – plus other liabilities,** including against small savings schemes, provident funds and special securities issued to the Food Corporation of India, fertiliser firms and oil marketing companies – on which they have to pay interest and the principal amounts borrowed.

As per the **Fiscal Responsibility and Budget Management (FRBM) law**, which the Vajpayee-headed NDA government had enacted in 2003, the general government debt was supposed to be **brought down to 60% of GDP by 2024-25**. The Centre's own total outstanding liabilities were **not to exceed 40%** within that time schedule.

Sources of Public Debt:

These are listed as follows: Dated government securities or G-secs, Treasury Bills or T-bills, External Assistance, Short term borrowings, Public Debt definition by Union Government.

The Union government describes those of its liabilities as public debt, which are contracted against the Consolidated Fund of India. This is as per **Article 292** of the Constitution.

Types of Government debt:

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:

One primary objective is to provide a **stable and reliable source of funding** for government expenditures, especially during times of budget deficits.

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.

Public debt can serve as a **tool for managing liquidity** within the financial system, allowing governments to control the money supply and interest rates.

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.

Why has debt spiralled?

The most obvious reason is the **Covid-induced disruptions** that forced governments to borrow more – to fund additional public health and social safety net expenditure requirements – amid a drying up of revenues.

The combined gross fiscal deficit of the Centre and the states – the gap between their total spending and revenue receipts – went up from 5.8% and 7.2% of GDP in 2018-19 and 2019-20 respectively, to 13.1% and 10.4% in the next two fiscals.

The **Centre's fiscal deficit alone increased** from 3.4% of GDP in 2018-19 to 4.6% in 2019-20, 9.2% in 2020-21 and 6.8% in 2021-22.

India was no exception though. Most countries sought to mitigate the impact of the pandemic through fiscal stimulus and relief programmes.

General government debt climbed from 108.7% of GDP in 2019 to 133.5% in 2020 and 121.4% in 2022 for the **US**; from 97.4% to 115.1% and 111.7% for **France**; from 85.5% to 105.6% and 101.4% for the **United Kingdom**; and from 60.4% to 70.1% and 77.1% for **China** during these years.

Some had turned on the fiscal taps even after the 2007-08 global financial crisis; the US had a debt-GDP ratio of just 64.6% in 2007!

The Indian government, apart from spending more on income and consumption support schemes, also stepped up public investments in roads, railways and other infrastructure. The Centre's capital expenditure, as seen from chart 2, dropped from 3.9% to 1.5% of GDP between 2003-04 and 2017-18. It revived significantly thereafter to reach 3.2% in 2023-24 and 3.4% in the Interim Budget for 2024-25.

All these, of course, **widened the deficits and only added to debt**.

Issues associated with India's debt:

Financial repression:When the interest rate on government debt is lower than the growth of GDP, the debt may decline but the financial market gets distorted.

Electoral budget cycle: With elections to a number of States scheduled in 2023 and the general election for 2024, this could push the debt ratio further.

Large interest payments: It constitutes over 5% of GDP and 25% of the revenue receipts which is more than the government expenditure on education and health care put together.

This reduces the expenditure capability in physical infrastructure, human development and emerging priorities to make the green transition.

High levels of debt: This make it difficult to calibrate counter-cyclical fiscal policy and reduces the ability of the government to respond to shocks.

Captive debt market: This is due to the participation of commercial banks and insurance companies in reserve and priority lending requirements.

Low sovereign ratings: Rating agencies keep low sovereign ratings if deficit and debts are high, this will drive the cost of borrowings of the manufacturing sector.

Tax burden: As today's borrowing is taxing tomorrow' and the burden of large deficits and debt will have to be borne by the next generation, this will increase the tax burden of the people.

Public debt management:

Sovereign or public debt management is the process of **establishing and executing a strategy** for managing the government's debt to raise the required amount of funding.

It aims to **achieve its risk and cost objectives** and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

In 2015, the creation of a statutory body called **Public Debt Management Agency (PDMA)** was envisaged in India.

As the RBI set interest rates and conducted the purchase and sale of government bonds, it raised issues of conflict of interest.

Till the time a PDMA comes into place, the government created an interim arrangement that deals with the management of public debt called the **Public Debt Management Cell**.

Some measures to control public debt:

The **Reserve Bank of India (RBI) is responsible for managing India's public debt**, especially debt denominated in the domestic currency. The debt of the state governments, on the other hand, is managed by the RBI under bilateral agreements.

March 1997 supplemental agreement between the RBI and the government: The supplemental agreement discontinued the issuance of ad-hoc treasury bills by the government to the RBI to finance the fiscal deficit.

Fiscal Responsibility and Budget Management Act (2003) mandated the government to limit its fiscal deficit to 3% of GDP.

That helped in improving interest payment burden, leaving more fiscal space for developmental as well as welfare measures. However, the pandemic led to increased government borrowings.

Public mindset about freebies needs to change, as what is spent by the government is eventually borne by the taxpayer.