INDIA AND INTERNAL DEBT TRAP

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"Free Enterprise was born with man and shall survive as long as man survives".

-A.D. Shroff
1899-1965
Founder-President
Forum of Free Enterprise

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By

Dr. S.R.K. Rao*

Indian economy, no doubt, has made considerable progress since independence. Its achievements in foodgrains production, and fertilisers and in laying foundations for development of heavy industry, oil refineries, ship building, aeronautics, accelerating the expansion of bank network, especially in rural areas, to name a few, cannot be ignored. The rapid stride it made in some sectors such as infotech and software in recent years, cannot be underestimated. Foodgrains production which was around 50 million tonnes in 1950 rose to 198-199 million tonnes in 1996-97, while fertilisers (all NPK) increased from 150 million tonnes in 1960-61 to 13062 million tonnes in 1997-98. During 1950-51 to 1996-97, coal production (including lignite) perked up from 32.3 million tonnes to 208.2 million tonnes. During the same period, production of steel ingots (including mini steel plants) and finished steel (including secondary production) increased from 1.47 million tonnes and 1.04 million tonnes to 23.8 million tonnes and 22.7 million tonnes respectively. In the financial sector, the number of bank branches which were 5,000 in 1961 and 8,000 in 1969 expanded to 65,000 in 1998. After nationalisation of major

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commercial scheduled banks branches in rural areas (with population below 10,000) expanded rapidly; of the total 63,788 branches as on 31st March, 1996, rural branches accounted for 32,806 or 51 per cent. However, these achievements should be viewed against the rise in population, which will cross one billion mark by the beginning of the next century, the stark fact that a little less than two-fifth of the populace is under the "Poverty Line", and the rapid strides the neighbouring economies have made during these years, and the present state of the economy. Perhaps it is the political instability which causes more concern to the central and state governments than the urgency to meet the challenges posed by the economy!

Opportunities to run ahead of other neighbouring economies were lost by India after its independence largely due to, among others, lack of vision and dynamism in the managers of the economy both at the central and state government levels. In their zeal to establish socialism through development of public sector, billions of rupees were sunk in gigantic projects of long gestation designed to attain "commanding heights" in the economy. However, over the years, public sector became a millstone around the neck of the exchequer and "Disinvestment" has now become the "mantra" of former champions of public sector to salvage the economy from the mess into which it landed itself over the last fifty years. As the nation is poised to enter the twenty-first century, Indian economy stands at the cross-roads caught in the "QUO VADIS" syndrome!

Indian economy today presents a disturbing scenario. Gross Domestic Product (GDP) growth has been sluggish; for 1998-1999, it will be below the budgeted growth rate of 6.5 per cent. Estimates vary from 4.5 per cent (Centre For Monitoring Indian Economy) to 5.3 per cent (National Council for Applied Economic Research); Central Statistical Organisation, by making revisions in its calculations, estimated it at 5.8 per cent. Agriculture, which either directly or indirectly provides sustenance to two-thirds of the country's populace, is beset with, among others, problems of low productivity and declining Government's investment. Mere increase in food and non-food production cannot be a substitute to increase in productivity. Government and some sections of the elite public are so obsessed with developments in industry, business, foreign trade and financial sectors that they ignore the regressive trends in the agricultural sector. For over fifty years we have been hearing platitudes of various political parties about land reforms but little was done when they came to power. The crying needs of agriculture among others are land reforms, ample supply of water, power, high-yielding seeds, access to nearby markets, quick delivery of credit at economic cost, and accelerated investment; both private and public.

India, which one time was hailed as a major industrial power, today presents a gloomy picture. Industrial production has slipped down to 4.1 per cent in 1998-1999. About 2.3 lakh small-scale industrial units and 1950 non small-scale industrial units are reported to be "sick". Confederation of Indian Industries (CII) in a survey observed that slow down in the Indian economy continued unabated in 1998-1999 with 32 sectors including steel, automobiles, machine tools, recording negative growth in the first three-quarters of the current year over the previous year. While 51 sectors like cement, crude oil, natural gas, fertilisers and aluminium posted moderate growth of less than 10 per cent, fairly good growth of 20 per cent and above was recorded in 12 sectors. A total of 28 sectors registered growth rates between 10-20 per cent, which included basic goods, like paints, asbestos, cement products, capital goods like pump sets, gas compressors and electronic components. (Times of India, Mumbai, 12th February, 1999). Not only industrial production declined, investment in industry also was sluggish.

Various factors are cited for the present state of the industry. Among them are slow or no development in infrastructure, labour troubles, power cuts, bureaucratic red tape, political instability in the country, monetary and fiscal constraints and the moribund state of the primary market. According to Mr. Yeshwant Sinha, the Union Finance Minister, a major cause for the recession in industry was the restrictive monetary policy pursued by the Reserve Bank in 1997. In an interview with Business Today (January 22, 1999) he observed: "We adopted a monetary policy which had an impact on interest rates, on sentiment. It was a very restrictive monetary policy, as a result of which industrial investment dried up. So you had neither public sector, nor private sector projects going on-stream. An important case in point are the so-called fast-track power projects, which didn't take-off except Enron. So nothing big was happening in the economy". Government tries to attend to the problems of the various sectors of the industry on piece-meal basis. Each Chamber of Commerce, with a view to protecting the interests of its members approaches the Government, especially before the budget session, asking, like Oliver Twist, "Please, Sir, I want some more". If the problems confronting the industry at the macro-level have to be solved, all the Chambers of Commerce in the country should come together and prepare a Plan of Action for the Government to be implemented within a time-frame.

There is not much to gloat over the performance of the external sector of the economy. Exports in 1998-1999 grew below 2 per cent in dollar terms, while imports increased by 5.5 per cent. According to Center For Monitoring Indian Economy (CMIE) Current Account deficit at 2.8 per cent of GDP is higher than 1.7 per cent of last year. According to Reserve Bank of India, in the first half of 1998-1999 trade deficit at US$ 5.80 billion dollars was higher than US$ 2.68 billion dollars during the same period of 1997-1998. Consequently, pressure on Balance Of Payments in 1999-2000 cannot be ruled out, unless large flows of foreign funds enter the economy. Foreign Direct Investment (FDI) is coming into India in trickle; compared to China's US 30-40 billion dollars India's US 3-5 billion dollars are peanuts! Investments by Foreign Institutional Investors (FIIs) are "hot money" and cannot be banked upon. The recent "success" of Resurgent India Bonds needs some examination. State Bank of India could mobilise US 4.15 billion dollars (Rs.17,637 crores at the present rate of exchange) at an overall cost of 12 per cent per annum (assuming an annual depreciation of five per cent) through these bonds of five years maturity. The interest as well as the principal is repatriable. Of this amount, State Bank of India was allowed to keep US $ 3.5 billion dollars with itself in India in rupee terms (Rs.14,500 crore); the rest abroad at a low earning rate. Due to lack of infrastructural projects to finance, the State Bank of India out of Rs.14,500 crore has given Rs.7,500 crore to foreign banks at a low rate of 9.5 per cent. Further, it lent Rs.1,000 crore to IDBI, Rs.100 crore to ICICI, Rs.500 crore to IDFC and Rs.250 crore to Power Finance Corporation, leaving a large balance for on ending by the State Bank itself. (Economic Times, Mumbai, 8th February, 1999). Thus the very purpose of mobilising foreign funds through Resurgent India Bonds (RIB) to finance infrastructure projects is kept in the "shelf" atleast for the present. Further, it is reported that the foreign banks which obtained funds from the State Bank of India at the rate of 9.5 per cent are lending the funds for auto financing consumer durable loans etc. etc. at 17.24 per cent. (Economic Times, Mumbai, 3rd February, 1999). Implications of mobilising funds by the State Bank of India through Resurgent India Bonds in foreign countries cannot be glossed over. First, as observed by the Chairman of the Parliamentary Standing Committee on Finance, Mr. Murli Deora, "there seems to be no effort made by the SBI to channel these funds to those infrastructure projects for which these funds were raised". Further he pointed out there has been no monitoring of the end use of these funds. (The Times of India, Mumbai, 30th January, 1999). Lastly, in view of the continual depreciation of the rupee and compounding interest, according to one estimate, on the principal of US 4.15 billion dollars the repayment burden at the end of five years might be around US 8-10 billion dollars, which would add a heavy burden to our external debt. One can imagine the calibre of the managers of our economy when funds were borrowed from abroad for investment in infrastructure projects at high cost even though there were no blue prints for the projects on the table which would take-off without undue delay. It is like engaging a blind man on a huge salary to catch a black cat in a dark room where there is no cat at all!

In recent years successive governments have tried to fudge figures with a view to convincing the general public that inflation has been under control. To the common man whole sale Price Index (WPI) has no relevance. Measured by the Consumer Price Index (CPI) for Industrial Workers (1982 = 100) the value of the rupee was 18.18 paise in 1991, and it declined steadily to 10.14 paise in 1997 and further to 08.9 paise in October 1998. (Union Minister's reply to a question in Rajya Sabha, Economic Times, Mumbai, 23rd December, 1998). Inflation as measured by the Consumer Price Index is over 10 per cent, which adversely affects the life and standard of living of the poor.

It is difficult to assert how many people are under the "Poverty Line". Planning Commission estimates that in 1993-94 about 36 per cent of the populace is under the Poverty Line while the Indian Statistical Institute (ISI) shows it at 33.47 per cent. Though some non-government figures place it around 40 per cent, it may be said that in India between 35-40 per cent of the population is under the poverty line. This is the position of India after five decades of independence!

Never in the financial history of India a "scam" of such a huge magnitude (estimated between Rs.5,000 crore - Rs.10,000 crore) occurred as the one the nation had witnessed in 1992 on the Indian bourses. The then Union Finance Minister was honest enough to admit that he did not understand how the Stock Exchange worked, and the then Finance Secretary, who is now with the Planning Commission, confessed before the Joint Parliamentary Committee that he had not heard of "Banker's Receipt", until the scam broke out! Compared to the 1992 "scam" the earlier scandals and frauds, such as "la affaire Mundra" stand like lilliputs before a giant. When "Mundra scandal" broke out, there was an open enquiry presided over by the Chief Justice of a High Court, but in "Scam-1992" everything was explained away with an innovative phrase, "Systemic failure"! Genuine investors, especially small investors, are now scared of putting their hard earned money in the primary market. While the primary market is almost moribund, the secondary market, thanks to liberalisation and "Globalisation" since 1991-1992 is at the mercy of Foreign Institutional Investors (FIIs), some financial institutions like UTI and a cartel of brokers. Today debt market dominates the equity market. Unless large investments flow into industry, primary market cannot be activised; only an active primary market will broaden and deepen the secondary market. According to the latest C.S.O. estimates savings ratio to GDP had, declined from 25.4 per cent in 1994-95 to 24.8 per cent in 1997-98, while the investment ratio declined from 25.4 per cent to 24.8 per cent in the same period. Foreign Direct Investment (FDI) is flowing into the Indian economy by trickles as compared to China. While India is attracting US 3 to 5 billion dollars China is obtaining US 30 billion dollars. Only 30-35 per cent of total applications for FDI are materialising in India. Red-tapism at various levels of bureaucracy, confusions and contradictions about policies relating to foreign investment, slow progress in infrastructural development, political instability etc. etc. are some of the factors responsible for the country's inability to attract Foreign Direct Investment on a large scale. A major factor, among others, which impedes larger flow of FDI according to some prospective and potential foreign investors is the labour laws prevailing in our country. They insist that unless the labour laws are brought on lines of those existing in their own countries, they would not be able to operate in India. Labour reforms, like land reforms, is a political issue and we wonder whether any political party that comes to power would dare to touch this "live wire" with their bare hands! When unable to face militant labour unionism the Indian entrepreneurs are shifting from one state to another and/or closing down their shutters, we cannot expect foreign investors to come in droves into India.

Now let me turn to the developments in the financial ownership sector. Insurance Bill is still hanging fire. Opening up of the economy to the foreign insurance companies, investment of foreign provident funds in the Indian capital market etc. etc. are issues yet to be finalised by the Government. I do not propose to discuss the role of Unit Trust of India (UTI) with its Rs.60,000 crore resources in the capital market or about US-64 controversy. I would like to confine myself to commercial banks and Indian financial institutions. Non-Performing Assets (NPAs) of commercial banks increased, over the years, to Rs.48,000 crores, or, a little over 20 per cent of total loan assets of the banks. If international standards are applied to Indian banks, as on March 31, 1998 about one-third of nationalised banks had a Capital Adequacy Ratio (CAR) below 10 per cent. Atleast in the case of a nationalised bank the losses incurred by it (estimated at Rs.1,300 crore) completely wiped out its capital and reserves base. In the case of five nationalised banks, Government of India had to pump substantial amounts to keep them floating. What is distressing is the fact that in the case of Development Financial Institutions (DFIs) also there has been a significant rise in non-performing assets and dubious loans granted under political pressure. For example it is reported that IDBI's (Industrial Development Bank of India's) non-performing assets were as high as 25 per cent, i.e. one in every four loans given by it was a non-performing asset! (Economic Times, Mumbai, 24th December, 1998). I do not wish to attach any importance to the "gossip mill" about the loan granted by it to M.S. Shoe company and the alleged huge losses incurred by it thereby. The state of affairs in some other DFIs appear to be no different from that of IDBI. With a view to bringing down their NPAs, some banks and DFIs have resorted to "evergreening" their loans; i.e., extending another loan to the client company with the help of which it can repay a part of the loan / and / or / interest on the original loan. (This can be facilitated through extending a fresh loan to a company in which the original loanee company has dominant interest; the latter gives a loan to the former and the same amount is "repaid" to the bank/DFI thus converting it into a "performing asset").

The general public is justified in asking what the Banking Department of Union Finance Ministry and Reserve Bank of India, the former owner of nationalised banks and the latter the regulator of the banking system, were doing all the while when NPAs were accumulating in huge magnitudes and the capital base of banks were wiped out by the losses incurred by them? These banks had one nominee director each of the Banking Department and Reserve Bank of India to function as "watch dogs" on their Boards. The efficacy of Reserve Bank's licensing policy also came under criticism when the Bank first granted licences to some companies but later revoked them (e.g.) CRB Global Bank, Cox & King Bank and Bank of Gujarat (Business World, Calcutta, 22 June 1997). Increase in bank frauds, irregularities committed by banks in sanctioning loans which were later regularised by the Department of Supervision of Reserve Bank (under political pressure?), ignoring the violation of rules committed by the State Bank of India while granting Rs.133 crore in what has come to be known as "Urea Scam" (under political pressure?) were some of the issues cited against the functioning of the central bank of the country (Indian Express, 19 October, 1996).

Some banks, especially those operating in India with their head offices abroad, are employing "Agencies" which are but respectable labels for gangs of goons and extortionists to recover loans. This is not only unethical on the part of the banks but also illegal. One of the functions of the bank is to appraise a loan application judiciously and recover it through legal channels if the loanee fails to repay. The justification of the practice of employing "Agencies" is more unprincipled than the practice itself. Will the law permit if an Association of Loan Applicants of banks is formed and "Agencies" are employed by the Association to "persuade" banks to lend to all its members irrespective of their credit worthiness and purpose for which loans are sought? Reserve Bank of India has one of the largest inspection/supervision departments among the central banks. It is possible, (though difficult to believe) that the Bank is not aware of this practice adopted by some banks. However it is not fair to criticise the Reserve Bank for its acts of omissions and commissions in carrying out its supervisory functions and for not taking prompt actions to stem the rot. Firstly, the financial sector comprising, among others, banks and non-banking financial companies, have grown by leaps and bounds since the bank was established in 1935, especially after "liberalisation" and "globalisation" of the economy. However efficient an organisation might be, it becomes difficult for it to tackle with its limited resources the multi-dimensional problems thrown-up by the financial sector, whose contours and complexion have been changing very fast keeping pace with its international counterparts. Secondly, like the Planning Commission which over the years had grown into, what Dr. Parnjapey who studied its organisation and functions, called a "Python", Reserve Bank of India has been loaded with a large number of functions which strictly speaking do not fall within the orbit of central banking. It has about 20 offices all over India and has over 30 departments. Its functions range from issue of currency to approval applications for foreign investment in India.

Secondly, the system under which the Reserve Bank operates gives the impression that it buckles under the pressure of the Government. As one wag has put it "Reserve Bank has full autonomy to do what it wants after getting clearance from the government to do so". This sort of image is created because of the failure of the Bank to take punitive action against banks committing frauds, irregularities, and/or violating foreign exchange rules mentioned earlier. Critics ignore that Reserve Bank does not hesitate to criticise the Government's failures on the fiscal front in its Annual Reports and Reports on Currency & Finance.

Lastly, compared to other institutions in the public sector and even in the Ministries at the central and state levels, Reserve Bank is least corrupt and has a well trained staff. It is not fair to attribute any motive/ malafide intentions to its alleged failures in discharging its functions. If Rajah Vikram had only one "Vetal" to carry on his back, Reserve Bank has a score of "Vetals" in its portfolio. The Committee on Banking Reforms (also known as Narasimham Committee) recommended that the Supervisory functions of Reserve Bank of India should be separated from it and transferred to an autonomous supervisory body to be set up by the Government. Such perfunctory reforms will not solve the basic problems confronting the financial sector in general and the banking system in particular. A clear cut role of the Reserve Bank in the economy, particularly in the money and capital markets, and its relations with the Government should be spelt out clearly. Various suggestions are made in this connection by those who are connected with banking and finance. It is suggested that the Reserve bank should confine itself to classical central banking functions and relieved of "all and sundry" work entrusted to it. The diarchy of Banking Department of the Government and Reserve Bank should be done away with. Perhaps in view of the dominant role of the Government in the financial sector in general and banking system in particular, a cynical suggestion is also made that there is no need for India to have a central bank and the Reserve Bank can be converted into a Monetary Authority! Government of India should appoint a high-powered Banking Commission to examine, among others, the functions and working of Reserve Bank of India and all other institutions in the financial sector and make suitable recommendations. Particular emphasis should be given on the need to restructure the Reserve Bank of India, if any, and underscore its relations with the Government. (About three decades ago a Banking Commission was set-up but even before its recommendations could reach the public, events, such as nationalisation of major banks overtook them and made the Commission's Report redundant). The proposed Banking Commission, should also examine the suggestion to make the Reserve Bank accountable to the Parliament and a permanent Parliamentary Committee should be set-up to review from time to time the working of the Reserve Bank of India, its organisation and its functioning in the money and financial markets.

The Governor of RBI should be given the status of a Union Cabinet Minister. India's external debt as at the end of March 1998 was US 94,404 million dollars, of which 39 per cent was concessional debt, and 61 per cent was non-concessional. Only 5.3 per cent was short-term debt and the rest was long-term debt. Though in US dollar terms external debt is kept under US 95 billion dollars, India has to repay this amount by earning dollars largely through exports and services. In other words, to liquidate this amount of external debt, India will have to earn US dollars in terms of export of goods and services worth Rs.3,75,000 crores! Thus the menace of external debt is no less than that of internal debt to India. (The amount is likely to go up if rupee depreciates vis a vis the US dollar or, if there is another round of devaluation. Already there is a demand for devaluation of rupee with a view to giving fillip to our exports).

The Government claims that our foreign exchange reserves at US 29 billion are at a safe level and sufficient to eight months of imports. In assessing a safe-level of foreign exchange reserves, we have to take into account that (i) 20 per cent of these reserves are "Hot money" comprising mostly NRI deposits, (ii) since "recession" has been pervading the economy, imports have not shown their normal growth. However once the economy gets out of the recessionary cycle, imports are likely to go up; (iii) at present, international oil prices are relatively low and India feels its foreign exchange reserves are at a comfortable level. When oil prices in international markets rise, the import bill of oil and oil products would go up substantially; of the total import bill petroleum, oil and lubricants (POL) account for nearly 25 per cent, and (iv) when repayments of the external loans start over the next five years (including Resurgent India Bonds) if there is no substantial inflow of funds from abroad, India is likely to face foreign exchange crisis.

Government of India may explain away the sluggish growth in the Gross Domestic Product (GDP) as "an international phenomenon". It may attribute the disappointing performance of exports to slow growth in world trade and trade restrictions adopted by some developed countries. It could also find solace for the volatility of exchange rate of the rupee in South East Asian currency crisis. What justification can it give for ballooning internal debt largely to finance non-development expenditure? Speaking at the Ninth Public Sector Banks Meet held in New Delhi on May 30, 1986, I observed the way in which the government was borrowing from the public largely to finance its non-development expenditure would lead the country into what I termed "Internal Debt Trap". (Business Standard, May 31, 1986). Elaborating on the theme at a lecture organised by the Forum of Free Enterprise, Mumbai in 1988 I observed: "I would like to warn that a situation is fast approaching even without raising the interest rates on Government securities and treasury bills, the Centre will have to borrow money just to repay amortisation of debt and interest on borrowings. Unless the Government controls its level of borrowings, it would enter into an internal debt trap situation. I may define the internal debt trap as a situation when the capacity of the market to respond to the government's borrowings being limited, the amount borrowed might be just sufficient to meet the debt servicings burden. After that threshold the country would enter into an internal debt trap, i.e., the borrowings would not be sufficient to meet even the debt servicing charges" ("IS INDIA HEADING TOWARDS AN INTERNAL DEBT TRAP?", Forum of Free Enterprise, Mumbai, 1988). The phrase I coined, "Internal Debt Trap" has since then come into common usage by the economists and the press! Reserve Bank of India's Report On Currency and Finance for the year 1997-98 observed: "The persistent rise in public debt and its servicing, which is the cumulative impact of larger market borrowings resorted to fund expenditure poses serious problems to the fisc". Borrowings *per se* are not to be shunned provided such borrowings by the government are (i) used for productive purposes, (ii) the yield on their investment is higher than the cost of borrowings & (iii) there is accountability of the end-use of the funds borrowed to the Parliament. Unfortunately in India all these parameters are absent. To quote Reserve Bank's Report on Currency and Finance for 1997-98, "the market could not absorb the total gross borrowings of the Government, viz., Rs.80,453 crore as on December 1998. Reserve Bank has taken on its books 39.9 per cent of Government's borrowing programme. Of this, 22.5 per cent is through private placement of the Government bonds and 17.4 per cent through devolvement in auction". But for the "rescue operation" by Reserve Bank, Government could not have raised the required resources from the market to meet with, besides others, amortisation of debt and debt servicing (interest payment). Since the market is not responding to its huge borrowing programmes, the Government is resorting to devious routes to raise resources from the Reserve Bank through "devolvement" and Private placement. From this it is obvious that the Government has been operating its fiscal policy in an "Internal Debt Trap" Syndrome.

A break-up of the total expenditure of the Union Budget expenditure reveals that interest payments and administration expenditure constituted 28 per cent and 10-12 per cent, while subsidies and loans to states accounted for 15 per cent and 5 per cent respectively;

the residue 20 per cent - 30 per cent was for "Others". As revenue receipts did not rise proportionate to increase in expenditure, the "gap" is filled by market borrowals. Increasing market borrowals largely for unproductive/non-development purposes only increase interest burden on the exchequer. Interest payments as a ratio of revenue receipts was around 48 per cent in 1997-98 and might go over 50 per cent in 1998-99. Excluding the "hidden subsidies", subsidies as a ratio of revenue receipts are estimated around 15 per cent in 1998-99. Total subsidies of all types amounted to Rs.1,40,000 crore or 14 per cent of GDP.

Though the Union Budget for 1998-99 indicated fiscal deficit at 5.6 per cent of GDP, it is likely to be 6.0-6.5 per cent. If the fiscal deficits of all states are also included in it, for the country as a whole, fiscal deficit would be more than 10 per cent of GDP, which moves the economy into "Fisc's Danger Zone". There appears to be no check on monetisation of deficit, despite the MoU entered into between Reserve Bank of India and the Government in April 1997 which sought to put a "cap" on adhocs and move into a system of Ways and Means (WMA) advances. Subsequent developments proved that this MoU was a big joke. I observed at that time "when the WMA limit breaches, the Government would resort to market borrowing by floating its securities at a higher rate of interest, and what ever the market could not absorb, would devolve on the Reserve Bank and this is nothing but monetisation of deficit through the back door (Financial Express, Mumbai, April, 1997). Monetised deficit which was about Rs.4,940 crore in June 1997 rose to Rs.15,400 crore in June 1988 and to Rs.16,000 crore in January 1999. Money Supply (M3) which was targeted at 15-15.5 per cent shot up to 19-19.5 per cent in 1998-1999.

Rising fiscal deficit, expanding money supply, sluggishness in investment, recession in industry, fall in export performance, inflation, rising public debt, uneconomic public sector, slow down in reforms, etc. among others, (such as political instability) resulted in down grading India's sovereign rating by international credit agencies. For instance, Standard & Poor downgraded India's sovereign rating to BB+ level, which is below the rating for safe foreign investment.

Various suggestions are made to liquidate the existing public debt and to cry halt to the galloping growth in internal debt. During 1990-91 and 1997-98 (Revised Estimate) internal debt rose from Rs.1,54,004 crore to Rs.3,85,694 crore and to Rs.4,44,712 crore (Budget Estimate) in 1998-99. Thus, during this period internal debt rose by 188.76 per cent. (Revised figures for 1998-99 would be much more than what was indicated in the budget). If we take total liabilities of the Government (i.e. including internal debt, small savings, provident funds and other accounts and Reserve Funds and Deposits) the overall debt burden on the Government is much more than what the economy can bear. Total liabilities of Government rose from Rs.283,003 crore in 1990-91 to Rs.7,18,299 crore (R.E.) in 1997-98 or by 153.8 per cent. They increased to Rs.8,18,516 crore (B.E.) in 1998-99 or by 189.2 per cent between 1990-91-1998-99. In 1998-99 they constituted 51 per cent of GDP. (In the Revised Estimate this amount is likely to be much more than what was indicated in the Budget, as small savings have shot up over the Budget Estimates). We have indicated only the total internal liabilities of the Government; external liabilities which were Rs.31,525 crore in 1990-91 rose to Rs.55,242 crore (RE) or by 75.2 per cent; they increased to Rs.57,295 crore (B.E.) in 1998-99. Thus between 1990-91 and 1998-99 external liabilities of the Government rose by 81.7 per cent. Total outstanding liabilities in 1998-1999 (B.E.) amounted to Rs.8,75,811 Crores, or, 54 per cent of G.D.P.

Various suggestions are made to phase out the internal debt over a period of specified time. Let us examine them. (i) All amounts realised from disinvestment of public sector units (PSUs) should be used to repay a part of the internal debt. Unfortunately, it appears that the Government has decided to use them to reduce Fiscal Deficit in the Budget. (ii) There should be a statutory ceiling fixed on the limits of public borrowing by the Government. In the type of democracy we have, political exigencies dominate economic compulsions. Political parties when in opposition might favour this suggestion, but when they come to power they hesitate to do anything drastic about the "three holy cows" of non-development expenditure, viz., interest payments on internal liabilities, subsidies and defence. To cater to populism and garner votes, the Government would not hesitate to resort to market borrowing and deficit finance and/or monetisation of debt through the back door, i.e. private placement and "devolution" on a large scale. (iii) A radical suggestion was made by a former Finance Minister of a State that the Government should by law cancel whatever it owes to Reserve Bank of India. Since the Reserve Bank is a nationalised institution, its assets and liabilities belong to the Government of India. It was argued that cancellation of debt the Government owes to Reserve Bank of India should make no difference to the overall balance sheet of the nation. If the same logic is extended to cover all financial institutions owned by the Government, such as insurance companies, banks, DFIs in the public sector etc. one can imagine the chaos in the financial sector. (iv) "Gram Rudman Balanced Law of USA", was put forth as a model to be adopted by India to liquidate the public debt. Even the Ninth Finance Commission found merit in it as it recommended gradual phasing out of revenue deficit to zero level over a period of six years. It is doubtful whether such a plan can be implemented and made successful. We witness every now and then one section or the other of the employees agitating for higher wages/salaries and the Government succumbing to their pressure. For example, when the economy was facing financial crisis, the members of the Parliament and members of some State Assemblies helped themselves with bounties in the shape of higher perks, remunerations, etc. Not to be outdone, the previous Government conceded to the recommendations of the Fifth Pay Commission which imposed huge financial burden on the centre and the states.

Now other sections of the community such as bank employees are demanding their share in the nation's cake. We witness a Grand Rudderless Man at the helm of nation's finances who seem to have lost all hope of balancing the budget! (iv) In my discourse on the subject of rising internal debt I suggested the "Disaggregation Model" for India. ("IS INDIA HEADING TOWARDS AN INTERNAL DEBT TRAP?", Forum of Free Enterprise, Mumbai, 1986). Public borrowings by the centre and the states should be centralised, and used for development purposes only. Each "branch" should be earmarked for a specific project/development area and the progress of the investment made in it should be monitored on a continual basis. The minimum yield and the maximum gestation of investment made should be specified and the Government (centre/state) should be made accountable to the Parliament/Assemblies. This "Model" facilitates the twin advantages of (a) checking the diversion of what is borrowed from the market into unproductive/non-development areas, and (b) identifying the project/area where the end-use of the funds is made. Market borrowing for filling-up the "gap" between total expenditure and total revenue receipts for non-development purposes should be made constitutionally illegal. Further, Reserve Bank of India Act, 1935 (as amended upto date) should be amended prohibiting it from facilitating funds, to Government of India by way of "Private placement of Government Bonds" and "Devolvement of Government securities which the market could not absorb when they are auctioned. There is urgency to discipline the finances of the centre and the states.

If necessary, a financial emergency should be imposed for five years to save the economy from bankruptcy!

Some Definitions

(1) **REVENUE DEFICIT** : It denotes the difference between Revenue Receipts and Revenue Expenditure.

(2) **MONETISED DEFICIT** : It is the increase in the net RBI credit to Central Government, which is the sum of increase in the RBI's holdings of (i) Government of India's dated securities, (ii) 90 days Treasury Bills, and (iii) Rupee coins adjusted for changes in cash balances with RBI.

(3) **GROSS FISCAL DEFICIT** : It is the excess of total expenditure including loans NET OR RECOVERY over Revenue Receipts (including external grants) and non-debt capital receipts.

(4) **THE NET FISCAL DEFICIT** : It is the difference between the gross fiscal deficit and NET lending.

(5) **THE GROSS PRIMARY DEFICIT** : It is the difference between the gross fiscal deficit and Interest Payments.

(6) **THE NET PRIMARY DEFICITS** : It denotes Net Fiscal Deficit MINUS Net Interest payments.

(Source : Annual Report of RBI, 1997-98, P. 165)

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

-Eugene Black

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FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Annual Membership fee is Rs.100/- (entrance fee Rs.100/-) and Associate Membership fee Rs.40/- (entrance fee Rs.20/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs.10/- per year (no entrance fee).

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