IS INDIA HEADING TOWARDS AN 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*

The unbridled growth in public debt has been a matter of concern in recent years. The "Economic Survey" has been harping for the last two years on the "disturbing feature of the Centre's budgetary developments", and "the emergence and widening of the deficit in current account since 1979-80". The Survey observed that the deficit as a proportion of GDP at current market prices which was only 0.6 per cent in 1979-80, had reached a level of 2.1 per cent in 1985-86 and 2.5 per cent in 1986-87 (R.E.). It warned that the Centre's balance of current revenues,** which at current market prices was over 2 per cent of GDP in 1978-79, has been eroded in recent years, and turned *negative* in 1986-87 and might worsen further in the current year,[2] (i.e. 1987-88). The Long Term Fiscal Policy (LTFP) projected the levels of market borrowings and budgetary deficits as a proportion of Gross Domestic Product during the Seventh

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* The author is a Former Principal Adviser to the Reserve Bank of India. The views expressed are personal views of the author. This text is based on a public lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on 31st August, 1988.

** Balance for current revenues (BCR) is defined for the Centre in Plan documents as the balance of current receipts (excluding external grants) over non-Plan revenue expenditure (including capital outlay on border roads and defence).

Plan period and concluded that "the projected Seventh Plan shares for the two components are noticeably lower than the actual corresponding averages for the Sixth Plan and reflect our concern that the Government's recourse to bank credit be contained to levels with reasonable price stability". Reserve Bank of India, in its Annual Reports, especially during the last two years, had also underscored the desirability of checking the growth in non-plan, non-development expenditure and the need for keeping the growth in public debt of the Centre and the States under control. In its Annual Report for 1986-87, the Reserve Bank observed "... mention was made in the last year's Report about the continuance of large budgetary deficits on revenue account which were financed by the surpluses on the capital budget. This results in pre-emption of resources for financing current expenditure at the expense of development expenditure. This trend has continued during 1987-88". The Eighth Finance Commission also exhorted on the need for controlling non-plan expenditure including subsidies. However, the credit for focusing the nation's attention on the danger of growing public debt in India and its implications for the present and the future generations should go to Mr. N. A. Palkhivala. In his talk in Bombay on the Union Budget 1988-89, he observed, "The most alarming feature of the Budget is the unbriddled growth in the total liabilities of the Government, which include not only what is narrowly and misleadingly called the "national debt" but also liabilities to repay the citizens the amounts due to them on account of provident fund, small savings, etc. It puts the nation at risk. The interest burden and repayment burdens will have to be shouldered by our children and will have to be discharged by taxation on them. For years to come, the dead hand of the excessive national debt will continue to rest heavily upon the productive energies of the country. .... As a compulsive borrower, the Government is mortgaging the economic future of the country". Thanks to Mr. Palkhivala, "Internal Debt Trap" which I first enunciated on May 30, 1986 but remained as a mere "reportage", became an issue of national debate!

I

BACKGROUND TO "INTERNAL DEBT TRAP" CONCEPT:

Speaking at the Ninth Public Sector Banks' Economists' Meet held in New Delhi on May 30, 1986, I wondered at the wisdom of the recommendation of the Report of the Committee on Monetary System (Chakravarty Committee Report) to hike the interest rates on the treasury bills and long-dated government securities. I contested the assumption that by raising the interest rates on treasury bills and long-dated government securities, a substantial portion of household sector savings could be mobilised by the government. Under the Indian conditions, treasury bills and goverment securities have a very limited market, which is almost a captive market. A Survey of the Ownership Pattern of Government Securities conducted by the Reserve Bank's research department some years ago revealed that more than 92 per cent of the government securities was held by the Governmental and Quasi-governmental institutions, (a recent estimate by the same source has kept this figure as high as 99 per cent),* and individuals accounted for a very small proportion. Under these circumstances, the assumption that by raising interest rates on treasury bills and government securities, Government could attract large amounts of savings from the household sector did not appear to be justified. I expressed my apprehension that such a measure might result in greater debt burden on the Government rather than reducing the level of deficit financing. I concluded by saying, "In this connection, I would like to warn that a situation is fast approaching even without raising the interest rates on government securities and treasury bills, when the Centre would have to borrow money

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* Source: "Ownership of Government (Rupees) Debt, March 1982: Preliminary Trends in 1983 & 1984" (R.B.I. Bulletin, January, 1984).

just to pay amortisation of debt and interest on domestic borrowings. Unless the Government controls its level of borrowings, it would enter into an internal debt trap. 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 with the debt servicing burden. After that threshold, the country would enter into an internal debt trap, i.e., the borrowings would not be sufficient enough to meet even the debt servicing charges. Therefore, what is needed is a drastic cut in the non-developmental and non-plan expenditure. The Government would have to take a hard decision in this matter".

The four parameters on which my "Internal Debt Trap" concept rested were explained by me as follows: It is generally argued that Government borrowings facilitate asset creation which would take care of debt repayment. However, historic experience pointed out the other way. By and large, Government borrowings were used more for meeting with non-plan, non-development expenditure than for asset creation.

This was confirmed by the Reserve Bank's assessment of the fiscal situation. While the Centre's tax to GDP ratio rose from 10.3 per cent in 1980-81 to 10.9 per cent in 1984-85, and further to 12.0 per cent in 1986-87, the ratio of non-plan expenditure to GDP increased from 10.2 per cent in 1980-81 to 11.6 per cent in 1984-85 and to 13.8 per cent in 1986-87. There had been a persistent divergence between the rates of growth in revenue receipts and revenue expenditure. The higher growth rates had not only neutralised the effect of the rise in revenue but it had also pre-empted resources away from the Plan.

Impact of mounting public debt on capital accumulation at macro-economic level had been discussed at length by various authorities and there is a vast literature on the subject. Prof.

James Tobin succinctly described it as follows: "The more the Central Government borrows, the less is available for capital accumulation by business households, and local governments and for the acquisition of net claims against the rest of the world. Less is available, that is, for those allocations of wealth which are the sources of productivity advances and future imports. The burden of public debt on our children and on our children's children is that we collectively bequeath them smaller stocks of assets on which their living standards will depend".

Secondly, even if it is presumed that a significant proportion of public borrowings was invested in productive enterprises, the inordinate delays in the fructification of investment slows down the growth process in the economy. The growth rate in debt burden, however, rises unabated!

Way back in 1970, I published two interesting studies, namely, "Delays in Implementing Public Sector Projects" (The Economic Times, June 20, 1970), and "Time Lags In Steel Plants" (Lok Udyog, August, 1970) in which I quantified the inordinate delays time lags in selected public sector projects at different stages, as well as, quantified the huge monetary losses incurred by them due to these delays. I am not sure that matters have improved since then!

Thirdly, Government Securities and treasury bills have a captive market and the household sector savings account for an insignificant proportion of the total Government's public borrowings. The situation would not undergo any drastic change when interest rates are skewed upwards.

Lastly, with the acceptance of monetary targeting by the Government, it would not be possible any more for the Reserve Bank to absorb the residuary portion of the Government's loan tranches.

While discussing the problem of mounting public debt, all the time the focus had been on the *demand* side only – to what extent the Government should borrow, at what rate of interest it should borrow, what should be the maturity pattern of the loans, etc., etc. The *supply* side was taken for granted. The protagonists of unbriddled government borrowings may cite the example of some highly developed industrialised countries where debt-GDP ratio is very high. *If* a large part of household sector savings flows into treasury bills and government securities, GDP gets growing. In such a situation, notwithstanding high public debt-GDP ratio, debt service burden may not pose a problem.

Similarly, if foreign funds seek investment on a continual basis *and* in substantial amounts, in a country's treasury bills and government securities, public debt-GDP ratio might not work as a true barometer.

However, since these conditions are not obtained in India, for the first time and as an innovation, I tried to probe into *supply side* of the funds that would be available for public borrowing. Applying the historic behaviour of the market to Government loan tranches; peculiarities of the ownership pattern of Government Securities; Reserve Bank's role in the initial cash subcriptions to Central loans etc., etc. I concluded that, given the four parameters outlined earlier, the market for Government borrowings is not an inexhaustible well from which the Government could draw as much as it wished.

One could discern close similarity in the fiscal situation obtained in the case of Argentina, Brazil, Chile, and Mexico (ABCM Countries) during the 'Seventies and the present day India. First, the "SYBARITIC PSYCHOLOGY". The ABCM Countries, when the going was good, went on a borrowing spree abroad and used most of the borrowed resources for non-developmental purposes or for investment in projects with very long gestation lags. These countries also took supply of funds for granted until eternity! *Secondly,* when commodity/oil prices sharply fell, and foreign borrowings became difficult, these countries, inflicted by rampant inflation, could not raise enough funds from within their own economies. The earnings from exports and capital receipts, were not sufficient to meet with their external debt servicing charges. Thus, they found themselves in an "External Debt Trap".

I was glad that subsequently eminent economists like Dr. Manmohan Singh, the then Deputy Chairman of Planning Commission, Dr. I. G. Patel, the then Director, I.I.M., Ahmedabad, Prof. Bhabatosh Datta, etc. expressed their fears of India entering into an "Internal Debt Trap". Even "Economist" (London) in one of its issues* dealt with India's mounting debt and warned the possibility of its getting into an Internal Debt Trap! At last the apprehension I expressed and the phrase I coined on May 30, 1986 at the Ninth Public Sector Bank Economists' Meet in New Delhi not only got acceptance by eminent Indian economists but also obtained international recognition. Some consolation at least to their author!# However, Mr. Palkhivala had the intellectual honesty to give me whatever little credit I deserved for being the first to warn the country of the danger of its entering into an "Internal Debt Trap". I am indeed grateful to him for this gesture.

II

RECENT TRENDS IN THE GROWTH OF PUBLIC DEBT IN INDIA

An analysis of the growth in public debt of the Central Government in recent years reveals some disturbing features. The "Economic Survey" did not mince words about the

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* January 31, 1987, P. 31.

The Reporter of "Business Standard" (Calcutta) in New Delhi met me after the Conference and held a long discussion on "Internal Debt Trap". Next day, the summary of the concept and its implications appeared on the front page of "Business Standard" (May 31, 1986) under the head "Internal Debt Trap Looms". Since my AIR talk on the same subject was recorded and broadcast later, the credit for being the first to popularise the term "Internal Debt Trap" in the media should go to "Business Standard". This is for purpose of record.

emerging and widening deficit in current account since 1979-80. The deficit as a proportion of GDP has been growing at a high rate. Not that the revenues, particularly tax revenues, did not show improvement. From 10.6 per cent in 1984-85 and 11.2 per cent in 1985-86, they rose to 12.0 per cent of GDP in 1986-87 (R.E.). Commenting on the causes of rise in current expenditure, the "Economic Survey" observed; "Among the major items of expenditure, the growth in interest payments has been most pronounced, from about 2.2 per cent of GDP in mid-eighties to the current level of 3.3 per cent and should be a cause for concern". Other factors which contributed to the rise in revenue expenditure were subsidies (1.8 per cent of GDP), amounts of grants to States and Union Territories (2.7 per cent of GDP) and defence expenditure which rose from 2.8 per cent during the last decade to 3.8 per cent of GDP in 1986-87. The enormity of the burden caused by interest payments can be gauged from the fact that their magnitude is as high as that of defence expenditure. It is pertinent to quote here Prof. James Tobin's view on raising interest rates with a view to mobilising larger borrowals. "Interest rates cannot be taken as constant while the debt grows relative to the economy. Increases in interest rates are the mechanism by which government borrowing squeezes out capital investment. As the capital stock declines relative to output, its rising marginal productivity pulls interest rate up. The vicious circle is that the higher rates in turn accelerates the growth in debt".

The reading of the fiscal situation by the Reserve Bank of India was not different from that of "Economic Survey". The Bank in its Annual Report for 1986-87 while pointing out that there had been a persisting imbalance between the growth rates in revenue receipts and current expenditure observed that this structural imbalance between the two reflected primarily the fact that the buoyancy of revenues with respect to income at current prices (1.022 over the period 1974-75 to 1984-85) was lower than that of revenue expenditure (1.232 during the same period). The tax revenue of the Centre as a proportion of GDP rose from 10.3 per cent in 1980-81 to 10.9 per cent in 1984-85 and went up to 12.0 per cent in 1986-87, while the ratio of non-plan expenditure to GDP rose from 10.2 per cent in 1980-81 to 11.6 per cent in 1984-85 and to 13.8 per cent in 1986-87. The Bank also identified the major factors responsible for the acceleration in the rate of growth in non-plan expenditure as defence, interest payments and subsidies. The share of these items in total non-plan expenditure had risen sharply from 67.2 per cent in 1984-85 to 73.3 per cent in 1987-88 Union Budget. It concluded "The higher growth rate in non-plan expenditure not only neutralised the effect of the rise in revenue but also has pre-empted resources away from the Plan". The message was the same, though the handwriting was different!

To those who believe that a large part of the market borrowing by Government is for asset creation which would ultimately pay off the debt burden, the Reserve Bank has this to say: "Excessive borrowings store up problems for the future, especially when the rate of return on the assets created out of these funds falls short of the interest to be paid ..... more importantly there is need to contain the growth in non-plan expenditure".

In an incisive analysis, the Comptroller and Auditor-General (CAG) in his latest Report on Public Debt laid on the table of the Parliament on July 29, 1988 (a summary of which appeared in the Press on July 30, 1988) observed that the Government's total liabilities have increased by 179 per cent from Rs. 59,749 crores in 1980-81 to Rs. 1,66,546 crores in 1986-87. As a proportion of GDP, the liabilities were 64 per cent at the end of 1986-87. The Report blames the high level of borrowings by the Government responsible for leading to a situation in which liabilities of the Government had exceeded the assets. This excess which stood at Rs. 79 crores in 1980-81 rose to Rs. 22,477 crores in 1986-87 and is likely to rise further to Rs. 40,079 crores in 1988-89. The Report warned that if the present rate of borrowing continued, the Government will be required to manage an extremely difficult internal debt situation.

"Borrowing for productive purposes" has become a platitude in our country. The experience since the Sixth Plan has been that public borrowing was resorted to by the Government more to bridge the structural resource imbalance between revenue and expenditure. According to CAG's Report while receipts had grown at an average of 17.2 per cent, the revenue deficit had grown at the average rate of 18.3 per cent over the same period. The revenue deficit had increased from Rs. 293 crores in 1981-82 to Rs. 7,599 crores in 1986-87. The Report commented that the trend since 1980-81 indicated that such sharp increases in the size of the deficits were invariably associated with a corresponding increase in public borrowing and deficit financing.

The Ninth Finance Commission was requested, in making its recommendations, to "adopt a normative approach in assessing the receipts and expenditure on the revenue account of the States and Centre and, in doing so, keep in view the special problems of each state, if any, and the special requirements of the Centre such as defence security, debt servicing and other committed expenditure or liabilities." In its Discussion Paper outlining the normative approach for assessing revenue receipts and expenditure of the Centre and the States, the Commission observed: "It is only through the assessment of revenues and expenditures on a normative basis that the Commission can reverse the trend of increasing revenue deficit and thus induce fiscal discipline in the country". While setting for itself the zeroing of revenue deficits of the Centre and the States over a period of six years as its target, it admits that the "present scenario is not expected to be any more favourable in the immediate future, for the revenue deficit of the Central Government alone in 1987-88 is expected to be 2.6 per cent of GDP and the budgeted revenue deficit-GDP ratio for 1988-89 is even of higher magnitude at 2.8 per cent. Realistically, therefore, the Commission may only expect that in 1988-89, the revenue deficit would be around 2.9 per cent of GDP". Considering the contours of the Union Budget for 1988-89, even the Ninth Finance Commission appears to be somewhat pessimistic about the "immediate future". According to Mr. N. A. Palkhivala "In 1988-89, the total liabilities of the Union Government will come to Rs. 2,24,000 crores and the total interest burden will form the largest item of non-plan expenditure, even more than defence which will cost Rs. 13,000 crores. Further, borrowings of Rs. 27,000 crores are planned for the next year, which means that half of the fresh borrowings would be merely to discharge the interest liability".

III

IS INDIA HEADING TOWARDS AN INTERNAL DEBT TRAP?

When I first cautioned that the country might get into an internal debt trap, my rough calculations pointed out its possibility by the beginning of 21st Century. With a view to testing this concept empirically, I had initiated the exercise in our "study circle" in the Reserve Bank. My colleague Mr. A. Seshan evinced interest in "putting figures into the concept" and worked hard on it.* He concretised my concept on the basis of

* Mr. Seshan was assisted in this exercise by my other colleagues, viz., Mr. R. K. Patnaik, Mr. V. T. Hardalvekar & Mr. D. C. Patra.

certain reasonable assumptions, while taking into account the four parameters I laid down governing the internal debt trap. He worked out the growth rates in Gross Aggregate Internal Liabilities (GAIL), and derived Net Aggregate Internal Liabilities (NAIL) from them, and taking into account the maturity pattern of government loans, estimated interest burden. On the basis of historic experience, it was observed that net market borrowings and interest payments on such borrowings were growing at annual rates of 15.3 per cent and 25.7 per cent respectively between 1979-80 and 1986-87 (these growth rates are the end-results of the fiscal operations of the Central Government). It was concluded that *if* this trend continued – the ubiquitous IF in any economic forecasting – and given the four parameters spelt out by me, the annual interest payments on market borrowings would exceed annual net market borrowings by 1992-93. Thus the exercise was mainly to test empirically the validity of my concept, with all its qualifications, and it succeeded in proving that internal debt trap is not an abstract or a hypothetical situation, or an imaginary Frankenstein, but a possible reality by 1992-93.

Assumptions in growth rates in Government borrowings and interest payments can be altered; calculations may be contested and the bases of estimates can be modified, but the fact remains that so long as it is not realised that, to quote Mr. N. A. Palkhivala, "India is already in the danger zone, if it has not yet entered the debt trap situation", the fiscal crisis facing the country cannot be wished away. It must be admitted that there is nothing definitive about 1992-93 as the year of reckoning; it is only indicative of the fiscal crisis looming large on the country's economic horizon. It could happen much earlier if the signals in the economy are ignored; it may happen by 1992-93 if the assumptions made in the exercise come true, or it could happen later if the growth rates proved to be less than what were assumed in the exercise. However, given no change (a) in the

Sybaritic psychology" and (b) in the utilisation pattern of resources borrowed by the Government, the internal debt trap is bound to be a reality sooner or later.

And it seems it would happen sooner than later, if we go by what the CAG Report has to say on the present public debt situation. The Report observed that the estimated borrowings of Rs. 7,000 crores during 1988-89 would be barely sufficient to meet the interest payments of Rs. 7,027 crores on internal debt alone. What will be the position after 1988-89 ? The interest burden due to cumulative public debt outstanding would be much higher than before, necessitating a larger amount of public borrowing. Policy options are very limited, viz., further recourse to deficit financing, larger absorption of "residuary" of loan tranches by the Reserve Bank and external borrowing to finance internal fiscal deficits. Inflation has already crossed the double digit level and any further digging into created money would prove the remedy being worse than the malady. Further, it adds to the already bulging debt burden.

Given the assumption that monetary targeting would not be traded off for expediency, and the definition of "deficit financing" as spelt out by the Chakravarty Committee Report would be adhered to as agreed upon by the Government, Reserve Bank as the absorber of the "residuary" loan tranches should be ruled out.

External borrowing as a means of financing internal fiscal deficits would only shift debt servicing burden from the internal to external front. Further, the country's position in regard to external debt servicing ratio is not altogether happy. The external debt servicing ratio has crossed the "safe" limit of 20 per cent and is above 24 per cent today even according to

Government's own admission. (It is a different thing if the World Bank estimates it above 30 per cent on the basis of its own calculations). Lastly, whatever the country can borrow abroad on favourable terms and conditions should be earmarked for more important productive purposes than for financing non-development expenditure. As such, the repayment of the "principal" is being made, to some extent, from external borrowing. While replying to a question of Prof. Ramakrishna More, the Union Finance Minister said in Lok Sabha, that of the (internal) debt service charges, the interest charges are met from revenue receipts, repayments of the principal is a part of the capital budget, which includes internal market borrowings and external assistance. (The Economic Times, August 8, 1988). That external borrowing is no panacea to mounting internal debt burden is made clear by the latest World Bank Report on India and the dependence on this source would be even more dangerous. The World Bank observed that "temporary respite might be achieved through greater dependence on external loans, but current conditions in international capital markets would make large increases in foreign borrowings difficult, and in any case, the cost of non-concessional funds, including foreign exchange risks, probably would be unattractive for many projects. Continuation of the trends over a larger period would be "even more dangerous". The experience of other countries suggest that rising public debt levels increasingly confront governments with a choice between two undesirable options: inflating the debt or offering steadily higher rates of interest to investors who increasingly fear that the government may adopt the "inflation escape route".

Neither the growth rate in revenue receipts can be accelerated sharply nor the growth rate in current expenditure can be slowed down drastically. The saving rate in the country has been showing a declining trend for the last two years. According to my calculation, the saving rate, which was around 24 per cent two years ago, would be about 21 per cent in 1987-88. The Ninth Finance Commission admitted in its Discussion Paper that it would not be realistic to expect any drastic reduction in current expenditure in the immediate future. Judged by the definition of "Internal Debt Trap", and going by what the latest CAG Report on the internal debt position says, it may be concluded that India has already arrived at the "threshold". Whether it would stay there, recede or crosses it in 1989-90 is anybody's guess!

IV

POLICY ALTERNATIVES

What are the policy alternatives for the country to extricate itself from the fiscal crisis in which it has found itself today? Pious platitudes, expression of honest intentions, prescription of "dos" and "don'ts", etc., at their best, would do good for the pages produced by Committees and commissions, and at their worst, remain cliches in the literature on fiscal affairs! The need of the hour is a determined political will and ruthless administrative efficiency to evolve a suitable policy measure and implement it to stem the adverse tide that had set in since 1979-80 in the fiscal affairs of the country.

A tried formula, adopted by some industrially developed countries, is to place a statutory ceiling limit on the public borrowing by the Government. Article 292 of the Indian Constitution empowers the Government to borrow upon the security of the Consolidated Fund of India *within limits* that may be fixed by law. The measure to enact a law to fix the ceiling on the public borrowing was recently advocated by Dr. B. K. Madan, and also by the Public Accounts Committee.

However, problems arise when it has to be decided: (a) at what level, and how the ceiling would be fixed; and (b) whether the power to raise the ceiling level "under exceptional circumstances" be denied to the Parliament? "Exceptional circumstances" as we all know, is a "Cinderella phrase" which cannot be strictly defined in statute books!

Another "model" put forth for India is the Gram-Rudman Balanced Budget Law of U.S.A. The Ninth Finance Commission appears to have found merit in the gradual phasing out the revenue deficit to zero level over a period of six years. To quote the Discussion Paper, "The Commission's endeavour should be to phase out this revenue deficit during the next six years to be covered by its recommendations, so that by 1994-95, the revenue deficits for not only the Centre and the States taken together would be wiped out, but also they would separately balance or have surpluses in their revenue budgets". Even in the United States where it originated, "the Gram-Rudman Law" did not meet with sufficient success. In a country like India, it is doubtful whether this sort of "Six-Year-Plan" of deficit reduction can prove more successful than the Five-Year-Plans! Further, the Government is bound by various commitments imposed on it such as the decisions of Pay Commission; policies enunciated by Five-Year-Plans and approved by the National Development Council, expenditures both within and outside the country authorised by the Parliament. From time to time, demand for unpredictable and unknown quantities like drought relief, flood relief, etc., *might* arise during the next six years. The mechanistic formula, laboriously evolved by adopting a "normative approach" might break-down under these circumstances.

Not that public borrowing in itself is an evil, and should be shunned. If borrowed funds are used for productive purposes, with minimum time-lag, and generate a fair rate of return which, in the short run is not below the rate of borrowing, and in the long run, is higher than the rate of borrowing, then irrespective of the scale, public borrowing will function as a catalyst to economic growth. This can be facilitated by "DEBT PLANNING". Planning of public borrowing by the Government should be related to the growth in real resources. It is true that both the Ministry of Finance and Planning Commission do carry out exercises as to how much should be borrowed, at what rate etc. for their Annual Plans and Five-Year-Plans. But there is no "Debt Planning" in these exercises, in that these exercises are more to bridge the gap in resources required for development and non-development, Plan and non-Plan expenditures than exclusively for development. Efficient use of resources raised through public borrowing can be achieved only through "Debt Planning".

"Disaggregation Model" merits examination in this context. The entire public borrowing by Government (with the exception of a small specified proportion) should be earmarked only for productive purposes. Each loan tranch should have "tags"of projects/areas in which it is invested. The minimum yield and maximum "lag" for its gestation should be defined and made accountable to the Parliament. This has the twin advantages of (a) checking the diversion of Government borrowings into unproductive channels, and (b) identifying the projects/areas where proper utilisation of investment has not been made. The rate of interest, maturity of the loan, etc., may be determined on the basis of the average of the expected yields of the investments made in different projects, and the average of their "lags".

V

CONCLUSIONS

The Union Government is fully aware of the problems of mounting internal debt. It is not that the imbalances in revenue account, bulging deficit financing, unbriddled public borrowings, etc., had raised their heads all of a sudden in Circa 1988. The Long Term Fiscal Policy, "Economic Survey", Annual Reports of Reserve Bank of India, etc. dealt with these problems at length. Even the World Bank in its recent Report on "India: Recent Development and medium term issues" observes that there are, however, indications that the country's ability to absorb large public sector deficits may be diminishing. The household savings rates seem to have plateaued and crowding out problems are likely to appear in 1988-89, unless the government strives to control deficit. The possibility of financing spending with additional borrowings is also falling in relative terms, as more and more loans are needed just to finance interest costs, past deficits, etc. In 1987-88 interest costs represented 56 per cent of non-RBI borrowings as compared with 44 per cent in 1980-81.*

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* The World Bank's concept of "deficit" is wider than what is shown in the Union Budget. It comprises the *entire* deficit of the Government that has to be financed by long-term, medium-term and/or short-term borrowing. Government borrowings, according to the World Bank's concept include both the loans raised by the Central Government and those raised by the Public Sector enterprises.

It appears some critics are not amused by this concern for mounting public debt. That was why perhaps the whole exercise done and published in the RBI Occasional Papers, (June 1987) on internal debt trap was dismissed as an "accountant's scrap book because there is no economics in it". Another critic went even further by asserting, "There is no optimum level of public debt as a proportion of GDP. Countries like the U.K. have lived with a débt-GDP ratio of 100 per cent. Others with a lower ratio have gone through traumatic experience. So it depends on many factors". The tragedy – if it can be called tragedy – of a true economist is that he cannot abdicate an accountant's vigilance to suit administrative or political expediencies in his projections and forecasting.

International comparisons are sometimes misleading. As explained earlier, if the public borrowings are largely utilised for productive purposes, high debt-GDP ratio need not be a cause of concern. In the absence of this pre-requisite, the comparison becomes irrelevant. It would be like asking when a country like Bolivia could live with an inflation rate of 5000 per cent, why should a developed country like West Germany get into tantrums when its inflation rate goes beyond 7-8 per cent? Or, it would be like asking why India should get worried if the inflation rate goes up to 20 per cent when it *did* live with such a situation a decade ago!

A press report says, "in an answer to a question in Rajya Sabha, the Government ruled out reduction at present in the absolute level of the country's debt, external and internal, on the ground that it would constitute a reverse flow of resources and affect the implementation of development plans, Mr. Faleiro said. (sic) The debt position of the Government of India is kept under constant review and is within manageable limits".

Juvenal, the Second Century Roman Satirist and poet, once asked: "quis custodiet ipsos custodes"? (Who will guard the guards themselves?)

The views expressed in the booklet are not necessarily the views of the Forum of Free Enterprise.

"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

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