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THE DISPUTE ON INDIA'S DEBT BURDEN

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Two recent observations by the International Monetary Fund (IMF) sparked reactions from the Indian Government. First, the IMF has raised concerns about the long-term sustainability of India's debts. Second, it reclassified India's exchange rate regime, terming it a "stabilised arrangement" instead of "floating". These emerged from the annual Article IV consultation report, which is part of the Fund's surveillance function under the Articles of Agreement with member countries. The report also acknowledged India's effective inflation management and projected a balanced outlook for India's economic growth. While the remark on the exchange rate can be viewed as comments on 'excessive management', as the rupee moved in a narrow band due to Central Bank interventions, the concerns on debt sustainability can be construed as a call for more prudent management of debt in the medium term.

The IMF, in the report, states that India's general government debt, including the Centre and States, could be 100% of GDP under adverse circumstances by fiscal 2028. According to them, "Long-term risks are high because considerable investment is required to reach India's climate change mitigation targets and improve resilience to climate stresses and natural disasters. This suggests that new and preferably concessional sources of financing are needed, as well as greater private sector investment and carbon pricing or equivalent mechanism." The Finance Ministry refutes IMF projections as this is "a worst-case scenario and is not fait accompli".

There are no two arguments on the fact that government borrowings can play a vital role in accelerating development, as governments can use it to finance their expenditures and invest in people to pave the way for a better future. However, the weight of debt can act as a drag on development due to limited access to financing, rising borrowing costs, currency devaluations and sluggish growth. As noted by the United Nations, "Countries are facing the impossible choice of servicing their debt or serving their people." According to the UN in 2022, 3.3 billion people live in countries that spend more on interest payments than on education or health.

Editorial | Debt debate: On the IMF's latest India consultation details, Finance Ministry's response

Global public debt has increased more than fourfold since 2000, outpacing global GDP, which tripled over the same period. In 2022, global public debt reached a record USD 92 trillion.

Developing countries accounted for almost 30% of the total, of which roughly 70% is attributable to China, India and Brazil. Public debt has increased faster in developing countries compared to developed countries over the last decade. The rise of debt in developing countries is due to growing development financing needs — exacerbated by the COVID-19 pandemic, the cost-of-living crisis, and climate change. As a result, the number of countries facing high levels of debt increased from 22 in 2011 to 59 in 2022.

Further, the burden of debt is asymmetric between developed and developing countries as the latter — even without considering the costs of exchange rate fluctuations — have to pay higher interest rates than the former. It has been well documented that countries in Africa borrow on average at rates that are four times higher than those of the United States and even eight times higher than those of Germany. This higher borrowing costs undermines debt sustainability of developing countries, as the number of countries where interest spending represents 10% or more of public revenues increased from 29 in 2010 to 55 in 2020. IMF's worst-case scenario projections for India need to be viewed in this context of persistent debt conundrum in developing countries.

Apart from managing public debt deftly to ensure that it does not breach sustainable levels, India faces challenges in enhancing its credit ratings. As elucidated by S&P Global Ratings, "Credit ratings are forward-looking opinions about the ability and willingness of debt issuers, like corporations or governments, to meet their financial obligations on time and in full. They provide a common and transparent global language for investors and other market participants, corporations and governments, and are one of many inputs they can consider as part of their decision-making processes". Elevated debt levels and substantial costs associated with servicing debt impact credit rating.

Even with the tag of being the fastest-growing major economy and being called a 'bright spot' in the global economy, sovereign investment ratings for India have remained the same for a long time. Both Fitch Ratings and S&P Global Ratings have kept India's credit rating unchanged at 'BBB- with stable outlook'. It should be noted that BBB- is the lowest investment grade rating and India has been on that scale since August 2006. Though one could raise methodological issues and biases on the rating process, rating agencies believe that India's stronger fundamentals are undermined by the government's weak fiscal performance and burdensome debt stock. Further, India's low per capita income is a major factor that pulls down score in the sovereign rating.

The central government's debt was 155.6 trillion, or 57.1% of GDP, at the end of March 2023 and the debt of State governments was about 28% of GDP. As stated by the Finance Ministry, India's public debt-to-GDP ratio has barely increased from 81% in 2005-06 to 84% in 2021-22, and is back to 81% in 2022-23. This, however, is way higher than the levels specified by the Fiscal Responsibility and Budget Management Act (FRBMA). The 2018 amendment to the Union government's FRBMA specified debt-GDP targets for the Centre, States and their combined accounts at 40%, 20% and 60%, respectively. Part of the present high levels of debt-GDP ratio can be attributed to the disruptions due to the pandemic, which resulted in a major deterioration in the debt-GDP ratios across the board.

Adding to this are the emerging worrying signs on the fiscal front. Despite handsome growth in tax collections, there is the possibility of a fiscal slippage in FY24, according to a report by India Ratings and Research (IR&R). IR&R attributes this to higher expenditure on employment guarantee schemes and subsidies. They state that budgeted fertilizer subsidy of 44,000 crore was almost over by end-October 2023 and the Union government has now increased fertilizer subsidy to 57,360 crore. Similarly, due to sustained demand for employment under Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), a sum of 79,770 crore has

already been spent till December 19, 2023, as against the budgeted 60,000 crore and an additional sum of 14,520 crore has been allocated through the first supplementary demand for grants. Increased subsidies do not come as a surprise as the country is heading for general elections next year, but the MNREGA outlay increase raises questions about employment growth and livelihoods in rural areas. Though the IMF's debt projections could be viewed as worst-case scenarios of the medium term, the short-term challenge of sticking to the fiscal correction path in an election year might go a long way towards avoiding worst-case scenarios.

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