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Indian Public Debt

D. T. LAKDAWALA

RESERVE SECTION

RES.

X751.2.N8

No

226973

R. R. KALE MEMORIAL LECTURE, 1990

GOKHALE INSTITUTE OF POLITICS AND ECONOMICS,
Pune 411 004

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Professor Lakdawala has many important publications to his credit such as Justice in Taxation in India (1946), International Aspects of Indian Economic Development (1951), Taxation and the Plan (1955), Union-State Financial Relations (1967), Commodity Taxation in India (1972), Readings on Theory of International Trade and Commercial Policy (1973), etc.

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Price : Rs. 20

PRINTED IN INDIA

Printed by V.S. Chitre at Mudra, 383 Narayan, Pune-411 030;
and published by him at the Gokhale Institute of Politics and
Economics Pune-411 004

'Positive Enterprises' 390-B 1, Dattadham Apartment, Narayan Peth,
Pune-411 030

Indian Public Debt*

D. T. Lakdawala

I am extremely grateful to the Gokhale Institute of Politics and Economics and to Dr. Vikas Chitre for giving me this opportunity to meet old friends, make new ones and discuss with them one of the burning problems of Indian economy, the Central Government Public Debt. Both the Institutes with which I have been closely associated, the Department of Economics, University of Bombay and the Sardar Patel Institute of Economic and Social Research, Ahmedabad, have admired the spirit of devotion and the technical competence which have marked its research work in its long career. The Sardar Patel Institute has been formed on the model of the Gokhale Institute. I take this opportunity to convey my respects to all of you who have humbly contributed to building up this great Institute. I feel here an atmosphere of sympathy and friendliness, which has emboldened me to accept an invitation which otherwise I should have great hesitation in doing.

A vigorous controversy has arisen about the dangers arising from the large size of public debt in India, internal and external, and the increasing burden of debt-servicing, and foreign exchange requirement on the Treasury and the nation. There is, however, some ambiguity and uncertainty on the precise nature of the adverse consequences to be guarded against and the advisability of the remedies suggested. It may be worthwhile at this stage, before entering into any details, to clarify our ideas on some of the concepts involved. A Government raises the money it needs for the purpose of discharging its essential functions in various ways through taxation and other means of revenue like fees for its services, through borrowing, and through deficit financing. Taxation is largely compulsory; its avoidance is possible but in a well-devised tax system, costly. It, therefore, arouses a degree of displeasure, but its main advantage is that it leaves no problems behind for the future. Borrowing is largely voluntary

* Text of Rao Bahadur R.R. Kale Memorial Lecture delivered at the Gokhale Institute of Politics and Economics, Pune, on 7th April, 1990.

but leaves the legacy of a future burden on the budget by way of interest payments and repayment charges. In order to induce persons to lend to the Government rather than to many other openings available in a modern society, the terms of payment have to be competitive. The Government has, however, some choice of offering a lower interest rate and promising tax concessions which seemingly reduce the burden for a short term but increase it afterwards though in a concealed form. Also, the Government has an obligation to ensure a sound investment policy in the interests of the general public, for institutions like banks, insurance companies, provident funds and pensions etc. Since the Government bonds are the securest investment, the Government can lay down without arousing any strong opposition that a considerable proportion of their increasingly large funds will be invested in Government securities. The Government has in this case scope by restricting alternative opportunities to obtain more favourable terms, but as for the rest it has to compete in the market. The strains of an increasing public debt can be seen in the increasingly more attractive terms the Government has to offer, the limit to which this can be pressed in attracting voluntary savings, and the undesirable crowding out of private investment it thereby causes. The increasing burden of interest charges on the budget is another limitation though the net interest burden is much more important than the gross burden. A State in a delicate financial position may find that the burden can only be borne by incurring a deficit. It may have to incur more debt to pay interest and a time may come when it cannot even do so. There is a possibility of providing for a part of the borrowing needs in cooperation with the Central Bank by monetizing debt. It can, then, be costless or low cost to the Government, but it may result in price instability and all the dangers associated with it. Inflation reduces the interest and repayment commitments of all internal debt in real terms. The advantages may, however, disappear when inflation becomes expected; and the lenders try to safeguard against its impact on them by insisting on better terms.

Size of Debt and Interest Charges

Indian public debt (Central and States) even in 1950-51 was large (Table I). It constituted 32% of GDP, increased fast to 48% in 1960-61, wavered round that till 1975-80 and even in 1980-85 it was 51%. It showed a more rapid increase in the Seventh Plan and reached 64% in 1988-89. External debt was a small proportion throughout. With less than one per cent of GDP in 1950-51, it reached its maximum of 14% in 1970-75, but came down to less than 8% in 1980-85, and has been around 7% in the Seventh Plan. Confining oneself to the outstanding liabilities of the Central Government, which constitute the major part of Indian debt, since 1974-75 the liabilities less than doubled in the first five years, slightly more than doubled in the second five and are estimated to have again more than doubled by the end of the Seventh Plan (Table II). Thus, in course of fifteen years, the total liabilities increased fifteen fold. Alarming as this increase is, the increase in the interest to be paid is more terrifying. Instead of rising ten fold, it has risen seventeenfold -- from Rs. 1,001 crores in 1974-75 to Rs. 17,710 crores in 1989-90 (R.E.). It is the fastest growing item in the non-developmental current expenditure of the central budget in the Seventh Plan (Table III) more important (4% of GDP in 1989-90 R.E.) even than defence and there is no scope for its immediate curtailment. It forms an important component of deficit financing on current account.

Purpose of Debt

But, regarding the extent of public debt or gross interest charges as a burden ignores the purpose for which it is used. It is assumed that debts are incurred for purposes like war or for meeting revenue deficits which leave no assets behind and which create no incomes for the exchequer. From the point of view of the community, the borrowings are assumed to come out of savings and thus, a deduction from potential private assets. It was not recognised that the State may rightly think of building up productive and remunerative assets; which may replace private assets or which may even create more opportunities for quicker growth.

The liabilities of the Government of India were mainly incurred for plan purposes -- building up central assets like railways, post and telegraph, other communications, etc., and since they were not in a position to raise large loans, giving loans and advances to the States, local bodies and public corporations and companies for doing the same. Out of the total liabilities of the Central Government by 1989-90 (R.E.) of Rs. 267 thousand crores, Rs. 108 thousand crores were capital outlay, Rs. 102 thousand crores loans and advances, and Rs. 57 thousand crores had been spent for current purposes or for capital purposes but written off. The capital outlay of the Central Government had been mainly incurred on industry and minerals (21%), energy (17%), defence service (18%) and railway (14%). 64% of the loans were given to the States and 35% to public sector enterprises, port trusts, municipalities, etc. Thus, 79% of the liabilities were backed by assets or loans for asset creation (Table IV). In fact, in the earlier plan years revenue surpluses were created as a matter of policy and utilised for the purpose. Upto 1979-80, the assets exceeded the liabilities, but 1980-81 showed a net surplus of the latter over the former. And then, the excess began to increase uninterruptedly with the exception of 1983-84. The behaviour was directly connected with the increasing budget deficits on revenue account. But even now, it explains only a part of the liabilities. In 1980-81, it accounted for only one-fifth of the gross fiscal deficit; in the Seventh Plan, it would explain two-fifths (Table V).

The large part of the liabilities is explained by the public sector investment not matched by its savings. Whereas since the Third Plan, nearly 40-50% of the gross domestic capital formation has been in the public sector, the public savings have been 15-20% of the gross domestic savings (Table VI). The public sector had, therefore, to depend on savings from outside for the remaining capital needs. This large gap had to be filled in mainly through the central budgetary mechanism, either directly where central departmental enterprises were involved or through loans to public enterprises, the State Governments and other public bodies. In so far as 80% of the liabilities are backed by assets and loans to the State Governments and public enterprises for a similar purpose, the debt may be regarded as legitimate and worthwhile.

Income from Assets

Where there was no asset, there was no income. All liabilities did not necessarily lead to asset-creation nor did all assets create incomes, and all incomes are not noted in the books of account. Mention is sometimes a matter of convention. Government buildings used by Government agencies are not credited with any

regular receipts though they do save rent which would have to be paid if the Government were to hire the premises of others' buildings. Loans to the States have been written off on the recommendations of the Sixth, Seventh, Eighth and now the Ninth Finance Commissions or otherwise. Sometimes assets lead to an increase in national income and production though because of institutional arrangements nothing directly accrues to the Treasury or can be credited to the Government in that account. Good roads, for instance, do increase the use of cars and other road vehicles, facilitate traffic, and thus add to the proceeds of vehicle tax, passenger and freight taxation, petrol tax, etc. But it is difficult to link the spendings on road construction and maintenance with these. Toll tax is the only way of directly linking the two, but except in special circumstances it is looked down upon. The availability of water greatly adds to the productivity of land and very much to agricultural income but we have found that in many cases charges for the use of water and betterment levy do not even cover the maintenance charges of major and medium irrigation works, much less cover the interest on capital spent on irrigation. Power rates can be levied according to commercial principles, but often a subsidy element creeps in. We are on much firmer grounds in viewing the net proceeds earned from the assets built from capital expenditure against the costs incurred. If the assets are built out of the funds of the Central Government lent to some other statutory or corporate body, the budget will contain no profit or loss statement of these, but the interest received from the bodies can be seen against the interest to be paid. The interest may have been paid from cash received from elsewhere or depreciation funds. To the extent that income from the asset or interest received on advances and loans covers the interest paid, the interest payments are no burden on the Treasury.

Looking at the Indian data on these aspects, there are two startling facts. Whereas the interest paid increased seventeenfold between 1974-75 and 1989-90, the interest received only increased elevenfold. The net burden on the Treasury increased fortyfold. The three major reasons for this were (i) the already noted fact that more debt was being incurred for current purposes, (ii) higher interest rate had to be paid and (iii) that after 1979-80, the assets ceased to pay their way and became somewhat more of a liability.

Diverse Liabilities

To understand more fully the phenomenon of higher interest rate, the three diverse sources from which the Government gets funds have to be separately analysed; internal debt consisting mainly of market loans and treasury bills, external loans, and other liabilities like small savings, State Provident Funds and Deposits (Table VII). The external loans are mainly secured from foreign Governments and international organizations, and a part of them consist of soft loans from the IDA given on highly concessional terms. Owing to the scarcity of resources and increase in the number of eligible members, the IDA has, of late, been able to satisfy a smaller proportion of Indian needs. For instance, in 1980-81 the IDA aid as a proportion of total aid authorisation was 40%. It declined to 14% in 1987-88. Foreign governments have increased their interest rates. Depreciation of the rupee increased the interest charge on external debt in

terms of rupees. As a result, the average interest rate of foreign loans increased from 2.05% in 1980-81 to 5.20% in 1989-90 (R.E.). It must be remembered that this increased interest rate was still lower than that on internal debt. External debt as a proportion of total debt is, as we have seen earlier, going down. Market loans are issued at different rates of interest depending upon the period for which they are issued. In order not to go to the loan market every year for unduly large gross amounts, an effort has been made to lengthen the duration of loans. The weighted average maturity period of security issued under the borrowing programme for 1968-69 was 18.1 years; it rose to 25.8 years in 1985-86. The weighted average of interest on fresh loans increased from 6.68% in 1979-80 to 11.28% in 1987-88. The reasons for the rapid rise in the eighties are interlinked with the larger market borrowings sought. The main purchasers of these securities were banks, insurance companies and provident funds. Since these were legally bound to invest some of their funds in government securities, they constituted a captive market. The market was, however, limited as seen from the fact that a large part of these securities remained with the Reserve Bank and served as high-powered money. By 1987-88, net outstanding RBI credit to the Government stood at Rs. 52,793 crores, 35.8% of gross domestic debt and 16% of GDP. Treasury bills were issued at low rates of interest but they were very short term and the capacity of the market to absorb them was limited. Other liabilities like small savings had to be attractive enough and where the interest rate was slightly lower than that on other secure investments like first class debentures, it had to be compensated by tax concessions or other conditions. Provisions could be made to increase the percentage investments of banks and insurance companies in Central Government loans. What made it easier was that most of them had been nationalized. But they were institutions of great national importance and their viability had also to be guarded. They were to continue to serve the purposes for which they had been started; they had to continue to attract deposits and insurance premia. Persistently rising price was another important element which led to an allround increase in money interest rates, and government securities could not be out of the vortex when they constituted such a significant portion of the money market. What makes the sharp increase in interest rates witnessed during this decade more alarming is that the rise in the interest rate immediately applies only to loans issued during the year but it will also have to be applied to old loans as they mature.

Company Analogy

One does not object when a company increases a debt if it is utilised for a productive project. It would be preferable if the money were raised through equity capital so that there would be no future fixed burden, but one knows that the best is not always possible not profitable. However, it is regarded as prudent to keep the debt : equity ratio within a limit depending on the nature of the business. Unlike a company, the government has its non-business revenues, if need be, to bear the fixed burden. The acid test of the government's internal debt must be whether this is used for purposes which will yield enough to the Treasury to meet interest payments on the money borrowed. If it does, no burden is involved and there is no question of a limit to its size, except the general limit of savings and investment. As far as the Indian situation is concerned, the public debt interest payment is a burden as only half of it is covered by the interest received.

The other half constitutes a burden on the budget and contributes to a considerable part of the budget deficit.

Crowding Out Private Investment

Even if productive assets are built out of public debt, is there no danger that it may lead to crowding out of private investment? In an economy where there is a shortage of funds, the possibility of crowding out cannot be denied; but much depends on the complementarity of investment. This aspect was seen in the plan holiday years 1966-69, when a curtailment of public investment led to a long slowing down of the economy. A large investment by one party always carries the threat of making another investment more difficult if the two are competitive. But the question is which is more productive, and whether we are prepared to go by market test. The Government has, as a part of its Long Term Fiscal Policy, permitted the public enterprises to float bonds instead of lending them directly. If the same policy had been pursued in the past, it would have reduced the size of the public liabilities but the possibility of its crowding out private investment would not be less. In fact, the tax-free status of some bonds may have made them more effective. The major question would really be if any more worthwhile investment proposal failed because of it. No such instances have been cited. Prior to Government thinking of public sector bonds, the organised capital market had been divided into two compartments: that of Government loans issued at comparatively lower rate of interest where only banks, insurance companies and State Provident Funds were the buyers, and the share and the debenture markets where mainly private parties operated. The issue of the public sector bonds at competitive rates of interest or even with more attractive terms broke this barrier. To make their wares more attractive, the large private sector companies resorted to fully and partly convertible debentures, and made them appear tempting with the help of advertising. Investors were attracted more because of the possibilities of immediate capital gains rather than earning long term rewards. The 1988-89 corporate profits were quite high and led to a buoyant market. Capital issues in 1989 reached a record figure of Rs. 10,000 crores compared with Rs. 1,351 crores in 1984 (Table VIII). Private corporate investment certainly reached the Plan target. How long this happy state of affairs will last is anybody's guess but so far there is no crowding out.

Net Interest Burden

One is naturally worried about the fast increasing net interest that is paid from the Treasury and constitutes a burden. A study by Dr. A Seshan in 1987 had come to the conclusion that if net market borrowings and net annual interest payments continued to increase at the same rate as between 1979-80 and 1986-87, then by 1992-93 the net annual interest payments on market borrowings will exceed the annual net market borrowings.^{1/} Working from a wider perspective on more detailed assumptions of (i) real GDP growth of 5%, (ii) inflation rate of 7%, (iii) nominal interest rate on domestic debt held outside RBI = 10.2%, on that held by R.B.I. = 5.3% and on Government's domestic lending = 7.4%, (iv) proportion of domestic borrowings lent by Government = 0.4 and (v) ratio of RBI credit to Government in GDP and net inflow of foreign reserves at 1987-88 level of 16% and 0.87% respectively, debt:GDP ratio of 103.4% will be reached in 1999-2000 and that is not sustainable.^{2/}

Remedy

If this situation is to be remedied the first and most effective step that should be taken to prevent a further deterioration in the situation is to ensure that there are no budgetary deficits on current revenue account. If the entire public sector is looked upon as consisting of three parts, government administration, departmental enterprises and public enterprises, it will be seen that the Seventh Plan has witnessed the largest decline in savings in Government administration (Table IX). This must be corrected.

It has been regarded as legitimate to borrow for capital expenditure and lendings, but this is on the assumption that the assets built out of capital expenditure will prove productive enough to pay for themselves and that public enterprises to which loans are given will, on the whole, develop enough capacity not only to pay interest but to repay the loan. A technical examination may reveal that our detailed accounting system, our expenditure classification, and our decisions regarding equity: loan financing are not devised to satisfy these. It had been urged that a development bank would be a better vehicle for distribution of development funds among purposes, among that States and among institutions to ensure their viable and effective use. As yet we do not have a consolidated balance sheet for public enterprises as a whole. The nearest approximation that we have for this purpose is the annual reports of the Bureau of Public Enterprises which cover Central non-departmental, non-financial public enterprises. These accounted for half the gross capital formation and one-third of the gross value added by all public sector enterprises in 1987-88. Compared with similar private sector companies, their accounts make a discomfoting reading (Table X). The equity and preference dividends as percentage of equity and preference share capital for the last five years in the public sector formed near 1% compared with 11.8 - 16.6% in the private sector. Since public sector enterprises get loans from the Government at cheaper rates, the comparison in terms of return on employed capital would be more unfavourable. The bonus shares constituted less than 1/2% compared with 47% in the private sector, and reserves and surplus were less than one-fifth of the net worth compared with more than three-fourths in the private sector. The situation of other Central and State enterprises and public enterprises in the State sector is much worse. "The commercial losses of SEBs, have risen steadily and amounted to as much as Rs. 2,700 crores in 1988-89. In the same year the losses of departmentally run undertakings of the State governments were around Rs. 150 crores, of the Road Transport Corporations around Rs. 250 crores".^{3/} The losses of all non-departmental enterprises are not fully reflected in the Central or State budgets. As long as they pay interest on the loans they have taken and the loan is not written off, their unprofitable working can only be traced from their annual accounts which are not easily or in time available.

LTFP

It may be noted that in the Long Term Fiscal Policy for the Seventh Plan announced in December 1985, aimed at reducing market borrowing and deficit financing, the major effort was at increasing the contributions of public undertakings and thus raise the extra-budgetary support. The attempt did not succeed to the

desired extent, and hence borrowing and deficit financing as a proportion of GDP did not decrease according to the desired extent and deficit financing increased (Table XI). It must be noted that except for some vagueness the strategy was basically sound. The increase in public sector contributions could, however, come through increased efficiency or/and through price increases to keep up with increases in costs. Substantial organizational and attitudinal changes were needed and the nation had to be prepared for reasonable price changes. The then Finance Minister had more than once expressed his readiness to have a public dialogue on this issue, but with his resignation the issues were not followed with the needed determination. For greater success the same policy will have to be pursued with greater firm-mindedness.

There is, however, a part of the strategy which may need some change. To help the extra-budgetary support to the Plan from public enterprises, they were permitted to float loans on competitive terms in the market. The logic behind this move was that the public enterprises were, thus, permitted access to the wide world instead of confining them to only one lending source - the Government - and they would thereby be able to raise more and take the burden off the budget. It would also induce them to earn more to pay the higher interest charges. The public sector enterprises used this facility liberally (Table X). Some of them, however, pleading their inability to bear higher interest charges asked for tax concessions which would enable them to float loans at lower interest rates. Accordingly, income-tax free 10% (9% later) bonds were permitted. This amounted to a concealed subsidy. Also, the device served to postpone selfreliance to the future.

Other Suggestions

A practical suggestion to help the Government in the present financial stringency is the sale of some of the shares of the highly profitable public enterprises to the public. In the present conditions of stock exchanges the shares would command a high premium. The sales can be confined to a part of the equity, so that the ownership would remain predominantly public. The high prices of private shares are partly due to the prospects of high dividend distribution, of liberal bonus issues and continued confidence in management policies. Whether public management would command the same score as private management on these counts remains to be seen, but the experiment may be worth trying.

There are some other suggestions which deserve only a brief discussion. Of the gross aggregate internal liabilities, half are departmental capital assets; the rest are lendings to others. Capital expenditure is mostly Plan expenditure and its curtailment in terms of GDP may endanger our growth rate. If other capital disbursements by way of lendings are reduced, and borrowers are asked to make alternative arrangements, apart from other disturbances it will create, it will only be a transfer of greater burden to other public institutions, which will even be less in a position to bear it.

Privatization

A more radical remedy often discussed is reduction in the importance of the public sector. If more activities are left to the private sector not only the public debt will accumulate at a slower rate but what is much more important, the activities,

it is claimed, will be more profitably run. National interest requires that public sector enterprises are run not only more profitably but also more purposively. These were started with an aim and unless it has lost its relevance, they should be so run as to serve it. There is no doubt that private parties will run them profitably, because that is their very purpose of running them. If they cannot, they will close them. But most of the enterprises being of the economic and social infrastructure type or basic industries must be run, and run in a way to subserve national welfare. It has generally been found that entrepreneurs who express their keenness to take over nationalized industries make conditions which Government finds difficult to agree to.⁴ The general conditions mentioned are price changes and reduction in and redeployment of labour personnel. If these two conditions are agreed to, many of the problems of public enterprises may also be solved. Selected and profitable sectors like urban electrification and banking cannot be handed over to private enterprise without making adequate arrangements for the remainder. Whatever the decisions regarding handing over, if these are core industries, adequate finance would have to be provided for them so that the economy can develop. These have essentially to come from household savings in the first instance, which industries may find as difficult to attract as Government.

There are two general ways of increasing profits: (i) improving efficiency and productivity and adopting improved methods of production and (ii) increase in prices of products and services. The first method is preferable because it has no adverse reactions on others. Many of the public enterprise products and services are monopolies and therefore there is possibility of increasing their prices. But these will naturally be resisted if it is felt that the costs can be reduced. We have a feeling, however, that a number of public utilities have suffered because they have not been allowed to raise prices in line with reasonable increase in their costs. There is no competition here to ensure an average degree of efficiency in production; but this should not make us feel that whenever costs go up, they are only a reflection of inefficiency. In fact in the final instance if inefficiencies cannot be traced and remedied, persistence of prices below cost will ensue in subsidiness to consumers at public cost. In our circumstances, there are few products and services which should be distributed according to the price mechanism and yet at a subsidy. In fact most of the products in the private sector have to bear both the profit of the entrepreneur and tax burden - excise, sales tax and octroi. It is true that the price increases will affect directly and indirectly the general price level but the costs will be much more purposefully distributed and lead to better adjustments than inflation. In fact to some extent the policy of making the public enterprises pay more for the Plan systematically pursued in the Seventh Plan has succeeded in maintaining the real size of the Plan with less of additional budgetary support. More vigorously pursued it can lead to more public savings and less need of borrowing.

External Debt

So far, we have dealt with the Central Government debt internal and external as one whole, but there are some problems peculiar to external debt, and for some purpose it is better to take it along with the question of the total outstanding external debt including non-Governmental. As far as the budget is concerned,

the external debt being incurred in foreign currency, with a change in the foreign value of the rupee, the interest and repayment burden will change. The more important difference is that, unlike internal debt, it is not a transfer item; when it is incurred, it adds to the real resources of the nation; when interest has to be paid or the repayment falls due, it is a subtraction from the real resources. If large sums have to be paid, the transfer may create an additional burden through change in terms of trade. There is, therefore, relevance in thinking of the debt as a proportion of national product, and of debt-servicing charges i.e. interest and repayment obligations as a proportion of export earnings or, even better, earnings on current account.

There is a grave discrepancy between the size of Indian foreign debt as given by the Government of India which at the end of 1988-89 is put at Rs. 68,631 crores and as given in foreign sources which put it much higher (Table XII). The difference largely arises because the official figures exclude NRI deposits which are generally compounded with interest and renewed. When these are included, the debt amounts to Rs. 83,000 crores. Official outstanding debt has in less than a decade increased more than fivefold from Rs. 13,430 crores in 1979-80. The foreign debt is a reflection of the foreign exchange scarcities we passed through and the foreign aid we got to push through our development programmes. Compared with many other developing countries we have relied less on foreign aid, and after the Third Plan our reliance on funds from abroad has become marginal. The per capital foreign debt is, therefore, small. But the burden it annually imposes can only be measured in relation to current earnings. It is not insignificant and has reached the high proportion of 22-24%. If the interest charges cannot be met from the current account surplus (excluding debt-servicing), it has to be met from import on the capital side or from foreign exchange reserves. India so far does not have a surplus on current account of that magnitude nor is capital import surplus adequate to pay for it, so that since 1980-81 there has been decline in foreign exchange reserves also. This is a grave situation. Rapid development and industrialization need large imports of machinery, components and minerals which we cannot produce or can only produce at much higher costs. We have repeatedly tried to cut down imports of non-essential consumption goods and other goods connected with them and a further effort can yield only very limited results. We have pressed import substitution policies to the farthest. After some earlier faltering attempts at promoting exports, we have been able to stimulate exports on a much bigger scale for the last three years.^{5/} If we persist in our efforts and the world atmosphere does not deteriorate we may be able in another five years or so to eliminate our trade deficit. Since our manufactured exports now amount to almost half of our export and there is a good world demand for high value-added manufactured goods, if we keep our costs low and manufacture the right quality, in the longer run the debt burden will be manageable. But the medium term problems will remain. We have temporarily gone in for high commercial borrowings. We have stretched far the readiness of international economic organizations and developed countries to help us. But our credit rating is yet high and there will be possibilities of getting more foreign market borrowings if we want to. Since these are short term, an increase in them can lead to many problems. Our ability to attract more equity will essentially depend on the policy change we are prepared to make. A conditional IMF loan can only help if the conditions are in broad accord with the

economic policies of the Eighth Plan and we are able to put through in the duration of the loan a programme which will tackle the exchange scarcity. In the meantime, we have to strive our utmost with the various ad-hoc devices we know.

To conclude: (i) The present debt situation if allowed to persist will throw a grave burden on the Treasury and an intolerable monetary deficit. There is little that can be done immediately to relieve the burden of the gross interest on public debt because it is a fixed charge. Even if the debt and interest rate do not increase but remain constant, as old loans mature and have to be renewed, the effective interest rate will be higher. The mechanism of captive market has been extended to the utmost, and can, therefore, not be used to further lower interest rates. A decline in interest rates only possible if the inflation rate is reduced and that requires very radical changes and will take time. Steps can, however, be taken to reduce the rate of increase in public debt. (ii) Deficits on revenue account, which have contributed two-fifths of gross fiscal deficit in the Seventh Plan, must be stopped. (iii) Capital expenditure of the Central government has been mainly for Plan purposes and while all efforts should be made to ensure cost effectiveness and greater productivity, a serious curtailment in it as a proportion of GDP is out of question. (iv) Lendings to the State governments, local bodies etc. fulfill a similar purpose, and these cannot be reduced without setting in motion many undesirable consequences. (v) An experiment that has been made with asking public sector corporations to search more funds from the organised capital market reduces the budgetary burden but carries some risks with it. It has only led to hidden losses for the Treasury by way of tax concessions and greater pressures on the capital market which it has fortunately borne easily so far but may not always be in a position to do. (vi) Overall deficit financing is a cheaper way of financing. Inflation has the effect of lightening all fixed burdens, but the other consequences for the society are so grave as to rule it out. (vii) If public enterprises can be made more profitable, say to yield 12-14% post-tax net returns on capital invested, the problems of public debt will become easily manageable. Net interest charges decline and greater part of needs of expansion will also be met from this source. (viii) Restricting the scope of public enterprises, provided it does not adversely affect investment programmes in core sectors, and even transfer of management or ownership of some existing firms to the private sector, has been tried in the Seventh Plan, but so far the response has been very limited. (ix) External public debt is only a small part of total public debt, but in view of our limited foreign trade, the debt-service charge has now reached more than 20%. We do not have enough current account surplus to pay these, and have, therefore, either to pay it out of more capital imports or foreign exchange reserves. The consoling feature is that exports are increasing fast for the last 3 years and given the present growth rate of exports and imports, we will have a trade surplus by the end of the Eighth Plan. Till then, ad hoc import cuts, commercial borrowings and in the last analysis IMF loans if available without hindering our development goals are the only resorts.

Table-I India's Public Debt as % of GDP

	1950- 51	1960- 61	1970- 75	1975- 80	1980- 85	1985- 89	1988- 89
Total Domestic Debt (Centre and States)	31.62	41.80	35.77	37.73	43.63	55.50	57.48
External Debt	0.33	6.67	14.09	9.93	7.66	6.85	6.72
Aggregate Debt	31.95	48.47	49.86	47.66	51.29	62.35	64.20

SOURCE: Dr. Bagchi & Dr. Nayak: Public Finance and Planning Process, Paper at International Seminar in Public Economics, New Delhi, 11-13 January 1990 (Table 2.5).

Table-II Liabilities of the Central Government

	Liabilities		Interest paid		Interest received		Col.
	Rs.	% in-	Rs.	% in-	Rs.	% in-	(5) as
	crores	crease	crore	crease	crores	crease	% age
	(1)	(2)	(3)	(4)	(5)	(6)	of to
							Col (3)
1974-75	26,836		1,001		776		77.5
1979-80	50,215	87.1	2,210	120.8	1,360	75.3	61.5
1984-85	1,13,441	125.9	5,974	170.5	3,963	191.4	66.3
1989-90(RE)	2,66,913	135.3	17,710	196.5	8,665	118.6	48.9

SOURCE: CMIE, A Review of Central Budget: 1990-91 (Table 2.6).

Table III Interest Payments, Defence and Subsidies as % of Current Expenditure.

	Interest Payments	Defence	Subsidy
1974-75	12.09	19.87	4.34
1979-80	13.39	15.55	9.15
1984-85	14.77	13.78	9.65
1988-89 (R.E.)	19.08	12.11	8.48

SOURCE: Amresh Bagchi, Debt, Deficits and Taxation in India's Government Finance, (Table 9).

Table IV

Outstanding Debt and Interest Charges of the Central Government:
1974-75 and 1979-80 to 1990-91

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(Rs. crores)

At the end of the year	Liabilities					Assets			
	Debts			Other obli- gations (b-a)	Total liabi- lities	Loans & ad- vances	Other assets	Total	% of total lia- bili- ties
	Inter- nal	Exter- nal	Total						
1974-75	12,370	6,421	18,791	18,045	26,836	14,029	14,779	28,808	107.3
1979-80	24,399	9,964	34,363	15,852	50,215	26,634	25,580	52,494	104.5
1980-81	30,864	11,298	42,162	17,587	59,749	29,836	29,834	59,670	99.9
1981-82	35,653	12,328	47,981	20,205	68,186	33,900	34,132	68,032	99.8
1982-83	46,939	13,682	60,621	24,251	84,872	40,400	38,887	79,287	93.4
1983-84	50,263	15,120	65,383	29,878	95,261	45,849	44,973	90,822	95.3
1984-85	58,537	16,637	75,174	38,267	113,441	52,294	52,829	105,123	92.7
1985-86	71,039	18,153	89,192	48,292	137,484	61,902	62,064	123,966	90.2
1986-87	86,312	20,299	106,611	59,935	166,546	71,076	72,700	143,776	86.3
1987-88	98,646	23,223	121,869	73,792	195,561	79,237	83,573	162,810	83.3
1988-89	114,498	25,746	140,244	89,527	229,771	89,390	94,914	184,303	80.2
1989-90 (RE)	133,361	28,517	161,878	105,035	266,913	101,756	108,348	210,104	78.7
1990-91 (BE)	151,037	31,851	182,887	123,989	306,876	112,563	122,513	235,076	76.6

SOURCES: CMIE, A Review of Central Budget, March 1990, Table 2.6.

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Table IV Contd. ...

At the end of the year	Net liabilities	(Rs. crores)			
		Interest during the year			
		Paid	Received	Net paid	Interest received as % of interest paid
1974-75	-1,972	1,001	776	225	77.5
1979-80	-2,269	2,210	1,360	850	61.5
1980-81	79	2,657	1,795	862	67.6
1981-82	154	3,195	2,215	980	69.3
1982-83	5,585	3,938	2,852	1,086	72.4
1983-84	4,439	4,796	2,668	2,128	55.6
1984-85	8,318	5,974	3,963	2,011	66.3
1985-86	13,518	7,503	4,586	2,917	61.1
1986-87	22,770	9,236	5,339	3,897	57.8
1987-88	32,751	11,236	5,745	5,491	51.1
1988-89	45,468	14,261	6,973	7,288	48.9
1989-90 (RE)	56,809	17,710	8,665	9,045	48.9
1990-91 (BE)	71,800	20,850	9,519	11,331	45.7

SOURCES: CMIE, A Review of Central Budget, March 1990, Table 2.6.

Table V

Gross Fiscal Deficits of the Central Government:
1970-71 to 1989-90

(Rs. crores)						
	Balance on revenue account	Capital expendi- ture	Net domestic lendings	Grants	Gross fiscal deficit (2+3)-(1+4)	Col.(5) as % GDP
	(1)	(2)	(3)	(4)	(5)	(6)
1970-71	163	942	630		1,409	3.5
1980-81	(-11.6)	3,983	3,189	373	8,514	6.3
1984-85	-3,497 (20.1)	7,843	6,444	394	17,390	7.5
1985-86	-5,565 (32.1)	3,956	8,314	484	17,351	6.6
1986-87	-7,776 (35.0)	5,583	9,306	436	22,229	7.6
1987-88	-9,137 (41.2)	5,197	8,327	492	22,169	6.7
1988-89	-10,515 (41.0)	5,594	10,153	600	25,662	6.6
1989-90	-12,436 (42.9)	5,110	12,366	913	28,999	6.6

Figures in brackets give percentages to gross fiscal deficits.

Table VI

Gross Domestic Saving and Gross Domestic Capital
Formation in Public Sector: 1950-51 to 1988-89
at Current Prices

	<u>Saving</u>		<u>Investment</u>	
	Rs. crores	% share in total	Rs. crores	% share in total
<u>Average</u>				
1951-56	169	16.2	358	33.0
1956-61	273	16.6	871	43.0
1961-66	679	23.7	1,687	50.4
1966-69	731	16.0	2,211	41.8
1969-74	1,341	16.9	3,370	40.7
1974-79	3,830	21.3	7,891	44.9
1979-80	4,967	20.1	11,818	46.8
<u>Average</u>				
1980-85	6,607	18.3	20,141	52.1
1985-88	7,411	11.5	35,707	49.4

Table VII
Interest Burden on Various Categories of Borrowings by Central Government
1980-81, 1985-86 to 1990-91

	(Rs. crores)							Increase (No. of times) between 1980-81 and 1990-91
	1980-81	1985-86	1986-87	1987-88	1988-89	1989-90 (RE)	1990-91 (BE)	
Internal Debts : Bearing Interest								
Outstanding	18,013	45,025	66,436	90,618	100,225	108,484	116,945	6.49
Interest paid during the year	812	2,496	3,130	3,727	5,065	6,362	7,990	9.78
Average rate of interest (%)	4.51	5.54	4.71	4.11	5.05	5.87	6.79	1.51
External Debts								
Outstanding	11,298	18,153	20,299	23,223	25,746	28,517	31,851	2.82
Interest paid during the year	231	537	766	977	1,484	1,484	1,626	7.03
Average rate of interest (%)	2.05	2.96	3.77	4.21	5.20	5.20	5.11	2.50
Total: Public Debt								
Outstanding	29,311	63,178	86,735	113,841	125,971	136,951	148,796	5.08
Interest paid during the year	1,043	3,033	3,896	4,704	7,124	7,846	9,566	9.17
Average rate of interest (%)	3.56	4.80	4.49	4.13	5.66	5.73	6.48	1.81
Small Savings and Provident Funds								
Outstanding	13,953	36,859	44,928	54,528	68,536	84,226	100,174	7.18
Interest paid during the year	901	2,869	3,489	4,490	5,752	7,667	9,618	10.67
Average rate of interest (%)	6.46	7.78	7.77	8.23	8.39	9.10	9.60	1.49
Reserves, Deposits and other obligations: Bearing interest								
Outstanding	1,832	8,574	9,854	6,718	7,854	9,704	11,148	6.08
Interest paid during the year	49	186	228	271	274	435	366	7.47
Average rate of interest (%)	2.67	2.17	2.31	4.03	3.49	4.48	2.28	1.23

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Table VII Contd. ...

	1980-81	1985-86	1986-87	1987-88	1988-89	1989-90 (RE)	1990-91 (BE)	Increase (No. of times) between 1980-81 and 1990-91
Total Debt and Obligations:								
Bearing Interest:								
Outstanding	45,096	108,611	141,517	175,087	202,361	230,881	260,113	5.77
Interest paid during the year	1,994	6,088	7,613	9,465	13,150	15,948	19,550	9.98
Average rate of interest (%)	4.42	5.61	5.38	5.41	6.50	6.91	7.52	1.70

CMIE, Review of Central Budget : 1990-91, Table 2.15

Table VIII
Capital Issues to Public, 1984 to 1989

	(Rs. crores)					
	1984	1985	1986	1987	1988	1989
Total Capital Issues	1351	2111	4576	3676	4735	10358
As % of Net Domestic Saving	5.0	7.7	13.6	11.2	10.5	21.9
Public Sector Units	-	-	1543	1184	1850	3060

Table IX

Structure of Public Sector Saving as Percentage of GDP:
1970-71 to 1988-89

	Government adminis- tration	Public sector enterprises			Total gross savings
		Depart- mental	Non- depart- mental	Total	
1970-71	1.4	0.7	1.0	1.7	3.1
1980-81	1.6	0.4	2.4	2.8	4.4
1984-85	-0.1	0.3	2.7	3.0	2.9
1985-86	0.2	0.5	2.8	3.3	3.1
1986-87	0.9	0.5	3.1	3.6	2.7
1987-88 (a)	1.7	0.6	3.2	3.8	2.1
1988-89 (b)	2.2	0.7	3.1	3.8	1.6

(a) Provisional

(b) CSO Quick Estimates

SOURCE: Government of India, CSO National Accounts Statistics,
Various Issues.

Table X

Working of Central Government Enterprises and Private Sector Companies: 1983-84 to 1988-89

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89

Net Profits after Tax as % of Net Worth						
(i) Public sector	0.5	4.5	5.3	6.3	4.9	
(ii) Private sector	-	8.4	9.5	6.3	4.9	10.0
Equity and Preference dividends/ Equity and Preference Capital(%)						
(i) Public sector	0.9	1.1	1.0	1.0	0.9	
(ii) Private sector	-	13.1	12.8	11.8	12.1	16.6
Bonus Share	(in Rs. crores)					
(i) Public sector	70	70	93	93	93	-
(ii) Private sector	-	931	975	1143	1337	1462
Reserves and Surplus						
(i) Public sector	342	230	1056	2459	4056	-
(ii) Private sector	-	5214	7349	8125	8614	10274
Equity and Preference						
(i) Public sector	13130	14539	16777	18431	19595	-
(ii) Private sector	-	2129	2223	2462	2789	3103
Net Worth						
(i) Public sector	12789	14769	17832	20890	23651	-
(ii) Private sector	-	7343	9,572	10587	11402	13377

CMIE, Trends in Company Finance : Industry Aggregates,
Jan. 1990, pp.xi, xii, xxi and xxii.

Table XI

Long Term Fiscal Policy - Aims and Achievements

	(As % of GDP)							
	1984-85 R.E.	Sixth Plan	1988-89 Targets	1988-89 Achievements (R.E.)	1989-90 Targets	1989-90 Achievements (R.E.)	Seventh Targets	Plan Achievements
1. Non-Plan revenue expenditure	10.9	9.8	11.6	11.9	11.9	12.8	11.5	11.8
2. Tax revenue	8.2	7.9	9.2	8.3	9.4	8.6	8.7	8.4
3. Non-tax revenues	3.0	2.6	2.7	2.7	2.7	3.3	2.8	2.8
4. Total revenue (2+3) receipts	11.2	10.5	11.9	11.0	12.1	11.9	11.5	11.2
5. Balance from current revenues (4-1)	0.3	0.7	0.3	-0.9	0.2	-1.0	Neg.	-0.7
6. Contributions from public undertakings	2.7	2.1	4.0	3.2	4.1	3.5	3.6	3.0
7. Public savings (5+6)	3.0	2.8	4.3	2.3	4.3	2.6	3.6	2.3
8. Market borrowings	1.9	2.1	1.5	1.9	1.8	1.7	1.6	1.8
9. Budgetary deficit	1.8	1.3	1.0	2.0	0.9	2.7	1.1	2.3
10. Others	2.3	1.8	1.9	3.2	1.8	2.4	2.3	3.0
11. Domestic borrowings (8+9+10)	6.0	5.2	4.4	7.1	4.2	6.8	5.1	7.0
12. Net capital inflow from abroad	1.4	1.2	1.5	0.9	1.6	1.1	1.4	1.0
13. Centre's resources for the Plan (7+11+12)	10.3	9.2	10.1	10.3	10.1	10.4	10.1	10.3

SOURCE: Lakdawala's Financing the Seventh Plan, Table XI - worked out by CMIE.

Table - XII

India's Outstanding External Debt as on 31 March 1989

	(Rs. crores)
Government Account	46,838
Non-Government Account	1,164
Commercial Borrowings	17,482
IMF Liability (EEF)	3,347
Total	68,831

Note: These figures differ from those given in Table IV taken from the Budget document (Receipt Budget), presumably because the latter are the book values and not the rupee value of foreign currency denominated debt converted at current exchange rate.

SOURCE: Reply to Lok Sabha Question No.737 on 16 March 1990.

Acknowledgement

My thanks are due to my colleagues at the Centre for Monitoring Indian Economy (CMIE) who have greatly helped in preparing this lecture.

Notes and References

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- "Despite the fact that the Union Government has been thinking aloud for the active participation of the private sector, progress on this count has been extremely slow". CMIE, *The Liberalization Process*, February, 1990.
- "Assuming average growth rates for exports and imports for the past two and half years to continue in the next few years, we would have the welcome prospect of running a trade surplus in 1991-92". CMIE, *Economic Outlook*, December, 1989, p.v.

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