

Sustainability of Public Debt: An Analytical Framework

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Sustainability is a term that has been used with increasing frequency in the academic literature and recent multilateral policy discussions. Taking note of the crises in different countries heading for a debt trap, it is necessary to look at the right combination of fiscal parameters and growth to achieve sustainability and stable development. Fiscal prudence involves exercise of good judgment, common sense and even caution in the conduct of fiscal policies, especially on the expenditure front. This paper deals with finding: (a) debt-GDP threshold which will support to find out at what threshold level there is nonlinear relationship between debt and GDP, (b) sustainability indicators which gives the overall depiction of the fiscal side which guides for fiscal prudence policies, and (c) Markov regime switching model which explains the relationship of debt and growth. The period of study is from 1980 to 2016 and it is with respect to the central government.

Introduction

The nexus between debt and growth has become a matter of major concern for the Indian economy. As in the case of many countries, it went through the process of fiscal consolidation and prudence in different phases. Debt and growth are inseparable. For India and other economies debt has to be incurred if they have to grow but till what optimal level the debt can be incurred for growth to have a positive relationship, is a question. In this section we will empirically find the threshold limit of debt-GDP ratio after which increase in debt will lead to negative growth. To undertake this task we use Markov regime switching model. In this paper we also discuss some fiscal indicators which will help in policy decisions. In 1990-1991 the New Policy Regime consisting of liberalization, privatization and globalization was introduced. When the combined deficit of both the centre and states touched 9.6 per cent of GDP to curtail which Fiscal Responsibility and Budget Management Bill, usually is referred to as FRBM was passed in 2002-2003. As the deficit was high around 7.8 per cent of GDP in 2011-2012, Kelkar

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