India Scripts History - General Govt Debt Rising Towards 100% of GDP

NOVEMBER 20, 2021

By Naresh Minocha, Consulting Editor

"INDIA scripts history"
tweeted Prime Minister Narendra Modi on 21st October 2021 with hashtag #VaccineCentury. This pertains to India crossing milestone of administering 100 crore doses of Covid vaccines.

The country is most likely to script another history that no one wishes for. And Mr. Modi has avoided making any reference to it in his daily sermons with clinical precision.

This is about emerging, alarming prospects of India's public debt (PD) / general government debt (GGD) touching unsustainable 100% of gross domestic product (GDP). International Monetary Fund (IMF) last month analysed how close is India towards hitting the maiden GGD century. More of this later in this column.

As it is, official PD data is an under-estimate for two reasons. First, central and state governments continue to contrive new variants of off-budget borrowings (OBBs) to avoid their booking in the fiscal deficit. A search for â€˜OBBs' in CAG reports on central and state finances would show how deeply-entrenched is this problem.

Take, for instance, the CAG Report on Kerala State Finances Audit for 2019-20 that was released on 11th November 2021. It explains: OBB ***"refers to use of those financial resources by the State Government for meeting expenditure requirements in a particular year or years, which are not reflected in the budget for that year or those years, for seeking grant/ appropriation".***

It notes OBBs remain outside legislative control. They are financed through State Government owned or controlled public sector enterprises or departmental commercial undertakings, which raise the resources through market borrowings on behalf of the State Government. However, the State Government has to repay and service the debt from its budget.

CAG report warns:
"If the State Government increasingly resorts to these off-budget route to finance both its capital as well as revenue spending, the liabilities of the State may increase substantially over a period of time leading to a debt trap, without the Legislature even knowing that such liabilities are being created".

Another similar CAG report on Karnataka recently noted that OBBs accounted for 6% of Karnataka overall debt as on 31 March 2020.

It is here apt to recall 15th Finance Commission (15th FC) which submitted its final report during October 2020. It stated ***"We have noted that the off-budget financing of budgetary expenditures has proliferated in the last five years. The Union Government has started disclosing off-budget liabilities to the extent that such liabilities are repaid and serviced from the annual financial statement".***

15th FC report says:
"There is still a significant amount of off-budget expenditure that is subject to subtle interpretations of the law and escape the calculations of deficit and debt. In the case of the many State Governments, despite efforts, we have not been able to arrive at tenable numbers of such liabilities. There is virtually no such disclosure in the budget documents and accounts of States".

Second factor that aids understatement of PD is outright exclusion of debt of local Government bodies such as municipal corporations from national PD. This is due to data deficiency and due to the Centre's aversion to give truthful picture of total GGD.

To be precise, India lacks Whole of Government Accounts (WGA) framework. The UK's WGA, for instance, consolidates the accounts of over 9,000 public sector bodies, including Bank of England, to provide the most comprehensive and authentic image of its public finances.

Modi Government, however, wants to create new India with outdated and opaque transparency and accountability framework. Had the country implemented WGA, it might have found that GGD century had already been hit with a huge six (mega borrowings necessitated by Covid-19 and related lockdowns).

Under the wished-for WGA, the accounts of Central, State, Local government accounts as well as that of their appendages should be integrated to present a credible fiscal picture to the citizens. Let present generation know how political regimes have burdened future generations with debt in their lust for power.

It is here apt to quote Punjab's White Paper on State Finances released in June 2017. It says:
"The art of book cooking comprises (i) fast-forwarding the receipts; (ii) deferring expenditure; (iii) non-provisioning for contingent liabilities and; (iv) incurring off-budget liabilities. In the process, the integrity of the budgets presented by them becomes deeply suspect, thus blunting the very edge of the Government accountability".

This art is practiced across all tiers of governance in India with varying shades and intensity. It calls for a national white paper on financial cobwebs extending from North Block in Delhi to any gram panchayat in a remote corner of the country.

IMF's Staff Report (SR) on India has tried to analyse the ballooning debt and certain other challenges faced by the economy.

SR dated 15th October 2021cautions: ***"Debt dynamics over the medium term are subject to significant uncertainty"***. SR says:
"The stress test corresponding to a contingent liability shock of about 5.5 percent of GDP in FY 2022/23 suggests that debt would peak at above 100 percent of GDP and would decline very gradually in the medium term".

As put by SR,
"Vulnerabilities are high in the heat map, reflecting the high baseline debt-to-GDP ratio. Under all shocks, debt sustainability metrics signal high risks, reflecting the breach of the debt and gross financing risk thresholds in 2020 and constitutes a significant increase in risks related to debt sustainability metrics relative to staff's previous assessment (2019 India Article IV Report)".

There is certain difference between definitions of IMF's GGD and Central Government's PD. According to IMF, GGD ***"includes combined domestic liabilities of CG and states governments, inclusive of MSS bonds, and sovereign external debt at year-end exchange rates. For 2021-22 reflects the additional SDR allocation of about 0.6 percent of GDP".***

It points out that PD figures reported in Debt Sustainability Analysis (DSA) reflect the consolidated liabilities of the central and state governments. PD excludes Special Drawing Rights (SDRs) issued by IMF. PD is thus lower than GGD.

Central PD is estimated to have increased from 49.5% in 2017-18 to 51.7% in 2019-20 to 63 percent of GDP in 2020-21. Central government debt includes SDR, and for FY 2021/22 reflects the additional SDR allocation of about 0.6 percent of GDP.

IMF's SR shows that GGD has risen from 69.7% in 2017-18 to an estimated 89.6% in 2020-21. It is projected at 90.7% for current financial year. It notes that India's debt-to-GDP ratio increased significantly and is projected to remain elevated over the medium term under baseline scenario.

This level of debt burden, far above the globally accepted prudent debt ceiling of 60% of GDP, is largely due to decelerating growth rate. This trend started with the 2016 demonetisation shock. It has gained momentum with renewed zeal for hawking or promising freebies.

Mr. Modi never gets tired of telling citizens that his government is giving free vaccines to all, free ration to poor, free LPG to poor, free cash to all farmers and countless other freebies or subsidies to different sections of society.

Modi's passion for flaunting freebies has given new wings to competitive populism indulged by political parties over decades to seize power at States. We all are familiar with promises being made by different parties to electorate in Uttar Pradesh, Punjab and other States where assembly elections are due.

Voters have been thoroughly corrupted with such institutionalized bribery that poor masses think freebies is their birth right that extends from free ration to free house. What they need freely is the right to work with dignity.

Has PM disclosed to citizens that foreign loans have funded free ration (necessitated by mostly avoidable and mismanaged lockdowns) and Covid-linked cash transfers to the poor? Did he disclose that government also borrowed from multilateral financial institutions (MFIs) such as the World Bank to finance Covid healthcare facilities including medical oxygen? Did he disclose that Government is seeking more Covid-linked loans?

The surge in foreign loans from MFIs turned India's budgeted, negative net external assistance (NEA) of Rs (-) 4744.35 crore to a revised positive estimate of Rs 46702.98 crore in 2020-21. NEA is computed by deducting repayments and interest on earlier loans from fresh borrowings. NEA turned negative for the first time in 2018-19 due to burden of past foreign multilateral and bilateral loans.

Unfortunately, IMF's SR is muted in discussing fiscal indiscipline across all tiers of the governance - central, state and local administration. It is also sheepish in discussing steep increase in poverty and unemployment due to lingering impact of lockdowns. Nevertheless, the Report contains lots of information on what ails Indian economy, the chief being data deficit and fiscal opacity.

According to SR,
"The primary risk to India's debt sustainability is low growth. The stress test corresponding to a growth shock, in which output growth is 3.4 percentage points lower in FY 2022/23 and FY 2023/24, yields a deteriorating debt path with debt-to-GDP peaking at about 97 percent of GDP and gross financing needs reaching a peak of about 17.5 percent of GDP".

The combined macro-fiscal shock incorporates a similar growth shock, a primary balance shock in which none of the planned adjustment is implemented in FY 2021/22 and the medium-term fiscal adjustment is delayed (with a cumulative impact on the primary deficit of about 3.6 percent of GDP relative to baseline), and an interest rate shock which leads to a 270 basis points increase in interest rate relative to baseline through the medium-term".

It notes: ***"In this adverse scenario, debt increases to 100 percent of GDP in the medium-term".***

This brings us to the need for enacting and enforcing stringent debt ceiling law for all tiers of the Government. The need for enacting such a law was perhaps first mooted way back in 1949 by Dr. B.R. Ambedkar. [Replace FRBMA with debt ceiling law as mooted by Dr. Ambedkar]

The debt capping law has been reiterated and articulated by several expert panels over the decades. Successive regimes have resisted this idea due to over-riding compulsion to remain in power. They have preferred frequent tinkering with toothless Fiscal Responsibility and Budget Management Act, 2003 (FRBMA) to serve their short-sighted interests. [Time to Rescue Fiscal Responsibility from Ritualism & Make Fiscal Discipline Enforceable & Independently Verifiable]

Union Government should not only enact integrated debt ceiling & FRBM Act but also constitute an independent fiscal council for half-yearly reports on fiscal situation and outlook. These reforms should be accompanied by enactment of laws to create WGA to give 360 degree of financial health of all governments.

Such reforms would not happen as long as Modi Government believes all is well with the country. This self-righteousness is evident in the Statement by IMF's Executive Director for India, Mr. S. Bhalla annexed to SR.

The Statement contends:
"the conclusion in the Staff Report that â€˜sustained financial sector weaknesses' would lower India's potential growth from the earlier assumed 7.3 % to the Report's forecast of 6 % (emphasis added) is analytically inappropriate".

It adds:
"In deriving their conclusions on poverty trends, it appears that the Fund's Article IV report has not fully appreciated the significant support provided by the government to clash differ mitigate the impact of the COVID induced declines in economic activity and their effect on poverty".

The Statement admonishes IMF experts:
"As a fellow economist, I would request the staff for a deeper and more rigorous analysis of the complex issues like the socio-economic effects of the pandemic, the government's multipronged policy response, and their effectiveness in protecting lives, livelihoods and containing poverty".

To get out of the rut of denial mode, the Centre should take a leaf from White Paper (WP) on Tamil Nadu Government's Finances issued during August 2021. It says: "***The first step in any solution is always a true recognition of the problem***".

WP points out that TN has been borrowing even for non-discretionary spending like salaries, pension and interest payments which were for many years before met out of the regular revenue receipts. It says: "***This practice must be stopped*** ".

WP adds:
"Business-as-usual cannot continue, and our approach must fundamentally change if we are to break out of this vicious cycle of increasing debt and interest costs. On the other hand, this is an opportunity to effect "once in a generation" reforms, many of which should have been undertaken years ago by any responsible Government".

This should be the message for the Centre as well as other States. No regime should interpret popular mandate as licence to splurge cash on freebies and VIP luxuries with borrowings at the expense of future generation(s).