

NEXT IAS

**DAILY EDITORIAL
ANALYSIS**

TOPIC

**Controversy Around Net Borrowing Ceiling
(NBC)**

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CONTROVERSY AROUND NET BORROWING CEILING (NBC)

Context

- The recent imposition of the Net Borrowing Ceiling (NBC) by the central government has sparked significant debate and controversy, particularly in the context of federalism and fiscal autonomy in India.

Background

- In 2023, the Central Government imposed a **Net Borrowing Ceiling on the State of Kerala**, restricting its **borrowing capacity to 3% of its projected Gross State Domestic Product (GSDP)** for the fiscal year 2023-24.
- It significantly **impacted Kerala's financial position**, making it challenging for the State to meet its expenditure and invest in developmental and welfare activities.
- This has led to political and legal disputes, with **Kerala approaching the Supreme Court of India**. The State argues that the **NBC encroaches on its executive power** to borrow on the security and guarantee of the Consolidated Fund, as conferred by **Article 293 of the Constitution of India**.

About Net Borrowing Ceiling (NBC)

- It is a **fiscal policy tool** imposed by the central government **to regulate the borrowing capacity of state governments**.
 - ♦ For the **fiscal year 2023-24**, the NBC is set at **3% of each state's projected GSDP**. This ceiling encompasses all forms of borrowing, including loans from financial institutions, open market borrowings, and liabilities from the public accounts of the states
 - ♦ Additionally, the ceiling has been extended to cover borrowings by State-owned enterprises to prevent circumvention of the borrowing cap..
- The NBC aims **to ensure fiscal discipline among states**, but it has also sparked debates about its impact on states' financial autonomy and their ability to invest in developmental and welfare activities.

Constitutional Provisions

- **Chapter II of Part XII of the Constitution** deals with the borrowing powers of the Centre and States.

Centre's Borrowing Powers (Article 292)

- The central government can borrow money **upon the security of the Consolidated Fund of India**.
- The extent of borrowing is **subject to limits** set by laws enacted by Parliament.

States' Borrowing Powers (Article 293)

- State governments can borrow within India upon the security of the **Consolidated Fund of the State**.
- The borrowing **limits for states** can be set by their **respective legislatures**.
- However, Article 293(3) imposes restrictions on State governments if they have outstanding loans or guarantees from the central government.
- The **Centre can impose conditions** on such borrowing consents.

Arguments in Favour of the NBC

- **Ensuring Fiscal Discipline:** The NBC is designed to prevent states from accumulating unsustainable levels of debt, which can lead to financial instability.
 - ♦ By capping the borrowing limit, the central government aims to ensure that states maintain fiscal discipline and avoid excessive borrowing.
- **Transparency in Borrowing:** The NBC includes all forms of borrowing, including off-budget borrowings by state-owned enterprises.

- ◆ It is intended to enhance transparency and prevent states from circumventing borrowing limits through indirect means.
- ◆ It ensures that all liabilities are accounted for, providing a clearer picture of the state's financial health.
- **Macroeconomic Stability:** High levels of state debt can have adverse macroeconomic consequences, such as lowering the country's sovereign credit rating.
 - ◆ By controlling state borrowing, the NBC helps maintain macroeconomic stability and protects the national economy from potential risks associated with high debt levels.
- **Compliance with Fiscal Responsibility and Budget Management (FRBM) Act:** The NBC aligns with the principles of the FRBM Act, which aims to ensure responsible fiscal management and long-term sustainability of public finances.
 - ◆ The ceiling is set based on recommendations from the Finance Commission and includes incentives for states to implement power sector reforms and other fiscal measures.
- **Equitable Distribution of Resources:** By regulating state borrowing, the NBC ensures a more equitable distribution of financial resources across states.
 - ◆ It prevents financially stronger states from borrowing excessively at the expense of weaker states, promoting balanced regional development.

Arguments Against the NBC

- **Erosion of Fiscal Autonomy:** Critics argue that the NBC undermines the fiscal autonomy of states, which is a fundamental aspect of federalism.
 - ◆ States like Kerala have contended that the ceiling restricts their ability to manage their finances independently and make decisions based on their unique economic conditions.
- **Impact on Developmental Activities:** The borrowing cap has been criticised for hampering states' ability to invest in developmental and welfare activities.
 - ◆ States rely on borrowing to fund infrastructure projects, social programs, and other initiatives that drive economic growth and improve public welfare.
- **Legal and Constitutional Concerns:** The NBC has raised legal questions regarding the interpretation of Article 293 of the Constitution, which governs the borrowing powers of states.
 - ◆ States argue that the central government's imposition of borrowing limits encroaches on their constitutional rights and executive powers.
- **Political Tensions:** The NBC has exacerbated political tensions between the Centre and the states.
 - ◆ States perceive the borrowing cap as an overreach by the central government, leading to conflicts and legal battles, such as the case brought by Kerala to the Supreme Court.
- **Economic Disparities:** There is concern that the NBC does not account for the varying economic conditions and needs of different states.
 - ◆ A uniform borrowing ceiling may disproportionately affect states with higher developmental needs or those facing economic challenges, thereby widening regional disparities.

Way Forward

- **Revisiting Constitutional Provisions:** There is a need to revisit and possibly amend Article 293 of the Constitution to provide clearer guidelines on the borrowing powers of States and the Centre's role in regulating these powers.
- **Collaborative Framework:** Establishing a collaborative framework where both the Centre and States can discuss and negotiate borrowing limits and fiscal policies. This can help in addressing the unique financial challenges faced by different States.
- **Judicial Clarity:** Seeking judicial clarity on the interpretation of Article 293 can help resolve ambiguities and ensure that both the Centre and States operate within their constitutional boundaries.

- **Periodic Reviews and Adjustments:** Implementing a system for periodic reviews and adjustments of the NBC based on economic conditions and developmental priorities can ensure that the borrowing limits remain relevant and effective.
- Other key suggestions are like **transparent sharing of financial data; flexibility in borrowing;** strengthening fiscal responsibility and autonomy to states etc.

Conclusion

- The imposition of the Net Borrowing Ceiling by the central government has far-reaching implications for the financial autonomy of States and the federal structure of India.
- As the Supreme Court reviews Kerala's challenge, the outcome will be crucial in determining the future dynamics of Centre-State financial relations and the broader framework of fiscal federalism in India.

Source: TH



Mains Practice Question

[Q] Critically analyse the impact of the 'net borrowing ceiling' imposed by the Central government on Indian states. Evaluate the extent to which this ceiling hinders the fiscal autonomy of states and their ability to undertake developmental expenditure.

