NEXT IAS

DAILY EDITORIAL ANALYSIS

TOPIC

TIME TO TACKLE THE MOUNTING DEBT

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Context

- India's **debt-to-GDP ratio** has been a growing concern, surpassing both global and emerging market averages. It requires a concerted effort from both the Central and State governments to ensure economic stability and sustainable growth.

About the India's Debt-to-GDP Ratio

- As of 2024, India's debt-to-GDP ratio stands at approximately 83.1%. It marks a **significant increase from pre-pandemic levels**, where the ratio hovered around 69% until 2018.
- The surge in public debt was primarily driven by increased government spending to mitigate the economic impact of the pandemic, which saw the ratio peak at 90% during the crisis.
- **Central Government Debt:** As of March 2024, the outstanding debt of the Central government stood at `173 lakh crore, more than double the `86 lakh crore recorded in March 2020.
    - Despite efforts to rein in the fiscal deficit to 4.9% of GDP for 2024-25, the debt is projected to rise to `181.6 lakh crore by March 2025.
- **State Government Debt:** State governments also contribute significantly to the national debt, accounting for 33% of the total public debt. Their outstanding liabilities were `82.2 lakh crore at the end of FY24.

Comparison with Global Averages

- Globally, public debt has been on the rise, with the debt-to-GDP ratio increasing from 83.9% in 2019 to 93.2% in 2024.
- India's current debt-to-GDP ratio is higher than the average for emerging market and middle-income economies, which stands at around 70%.
- However, it is still lower than some advanced economies, such as the United States and Japan, which have debt-to-GDP ratios of 121% and 251%, respectively.
    - For instance, the US federal government debt has grown to $36 trillion, contributing to global public debt nearing $100 trillion.

Future Projections

- The **International Monetary Fund (IMF)** projects that **India's debt-to-GDP ratio will peak at 82.3% in FY25** before gradually **declining to 80.5% by FY29.**
- This projection is based on assumptions of continued economic recovery and fiscal consolidation efforts.

Consequences of High Debt

- High debt levels can lead to several negative outcomes, including higher borrowing costs, currency market instability, and increased inflation expectations. These factors can reduce government spending on essential areas, ultimately impacting economic growth.

Factors Contributing to the Debt Levels

- **Fiscal Deficit:** Despite efforts to rein in the fiscal deficit, it remains a challenge. The fiscal deficit for 2024-25 is projected at 4.9% of GDP.
- **High Borrowings:** Governments borrow to meet various expenditures that they are unable to meet through tax and other revenues.
    - Governments may also **borrow to pay interest** on the money that they have already borrowed to fund past expenditures.
    - Public debt in India is **primarily contracted at fixed interest rates**, with floating internal debt constituting only 1.9% of GDP at end-March 2022.

- **Expenditure related to Public Health and Social Safety:** The most obvious reason is the **Covid-induced disruptions** that forced governments to borrow more – **to fund additional public health and social safety net expenditure** requirements – amid a drying up of revenues.
- **High Inflation:** Despite the economic growth rebound from 2020 and much higher-than-expected inflation, public debt remained high.
  - **Fiscal deficits** kept public debt levels elevated, as many governments spent more to boost growth and respond to food and energy price spikes even as they ended pandemic-related fiscal support.
- **Declining Tax Revenue:** A major chunk of **expenses** (*interest payments, pensions, administrative expenses etc.,)* and **rising subsidy** burdens meant that **States** were **overly dependent on Central transfers**.
  - A decline in revenue and an increase in spending meant a sharp rise in debt.
- **State Debts:** State governments also contribute to the overall debt burden, accounting for about 33% of the total public debt.
- **Pandemic Response:** The government's increased spending on healthcare and welfare measures during the COVID-19 pandemic significantly boosted public debt.

Fiscal Prudence: Managing High Debt-to-GDP Ratio in India

- In the realm of economic policy, maintaining **fiscal prudence** is paramount for **ensuring long-term economic stability and growth**. It involves maintaining a balance between government spending and revenue generation to ensure long-term economic stability.
- **Adhering to a Strict Fiscal Deficit as the Norm for Fiscal Prudence**: Fiscal deficit represents the gap between the government's total expenditure and its total receipts, excluding borrowings. Adhering to a strict fiscal deficit limit is crucial for sustainable economic management.
  - As of the **2024-25 Union Budget**, the Finance Minister announced a target to reduce the f**iscal deficit to 4.5% of GDP by 2025-26** from its budgeted level of **4.9% in 2024-25**. It underscores the importance of fiscal consolidation in maintaining economic stability.
- **Public-Private Partnerships (PPP):** Encouraging PPPs for infrastructure projects can help leverage private sector investment and expertise, reducing the financial burden on the government.
- **Enhancing Revenue from Non-Tax Sources:** Exploring avenues to increase revenue from non-tax sources, such as disinvestment in public sector enterprises and monetization of government assets.
- **Boosting Economic Growth:** Implementing policies that stimulate economic growth, such as improving ease of doing business, investing in human capital, and fostering innovation, can increase the overall revenue base.
- **Structural reforms:** These are changes in fiscal, financial, or trade policies to improve the functioning of the economy. They can help increase economic growth and reduce public debt.

Case for a 3% Fiscal Deficit Limit

- Economists and policymakers advocate for a fiscal deficit limit of 3% of GDP as a benchmark for fiscal prudence.
- It is seen as sustainable and manageable, allowing the government to meet its expenditure needs without resorting to excessive borrowing.
- Maintaining this limit is particularly important given the current lower levels of household financial savings, which reduce the available pool of investible surplus.

Policy Recommendations

- **Enhancing Revenue Generation:** Improving tax compliance and broadening the tax base can increase government revenues.
  - The introduction of the GST has been a step in this direction, but further reforms are needed to enhance its efficiency

- **Rationalising Expenditure:** Prioritising essential expenditures and cutting down on non-essential spending can help manage the fiscal deficit. It includes better targeting of subsidies and improving the efficiency of public spending.
- **Strengthening Fiscal Responsibility Legislation:** Reinforcing the **Fiscal Responsibility and Budget Management (FRBM) Act** to ensure adherence to fiscal targets. It includes setting clear and achievable fiscal deficit targets and ensuring transparency in fiscal operations.

Fiscal Responsibility Budget Management (FRBM) Act, 2003

- It sets targets for the government to achieve fiscal stability.
- It proposed that revenue deficit, fiscal deficit, tax revenue and the total outstanding liabilities be projected as a percentage of gross domestic product (GDP) in the medium-term fiscal policy statement.
- It provides the provisions for required flexibility for RBI to:
  - deal with inflation;
  - improve the management of public funds;
  - strengthen fiscal prudence and reduce fiscal deficits;
- It made mandatory to place annually:
  - Union Budget documents;
  - Medium Term Fiscal Policy Statement;
  - Macroeconomic Framework Statement; and
  - Fiscal Policy Strategy Statement in the Parliament.
- It requires the Union government to contain its fiscal deficit to just 3% of the nominal GDP.
  - However, barring 2007-08, India has never met this target.

Conclusion and Way Forward

- India's debt-to-GDP ratio reflects the economic challenges and policy responses of recent years. While the current levels are a cause for concern, the government's commitment to fiscal consolidation and economic recovery offers a path towards sustainable debt levels.
- To tackle the mounting debt, a clear and rigorous action plan is essential. The Finance Minister has promised to reduce the debt-to-GDP ratio in the coming years, but this requires coordinated efforts from both the Centre and the States.
- Measures could include improving tax collection, reducing unnecessary expenditures, and promoting economic growth through sustainable policies.
- Continued vigilance and proactive policy measures will be essential to ensure long-term fiscal health and economic stability.

Source: BL

Mains Practice Question

Do you believe that India's rising debt levels pose a significant threat to its long-term economic growth and stability? What specific policy measures should be implemented to address the growing debt burden while maintaining essential public services and infrastructure development?