

An Overview of Public Debt in India

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ABSTRACT

India needs public debt to finance its budget deficit, which occurs when government spending exceeds revenue. It is also used to fund critical expenditures like infrastructure development and social welfare programs, which boosts economic growth and improves living standards. Additionally, public debt helps manage economic downturns and unexpected crises by providing funds for relief and stimulus measures.

KEYWORDS: Debt, Government, Significance, Infrastructure, Manage Critical Situation, Development, Growth.

INTRODUCTION

India's public debt history is shaped by evolving financing needs, from military campaigns to post-independence five-year plans and market reforms. Initially driven by campaigns and later by financing railways and canals, the debt surged during wartime and became influenced by development plans in the post-independence era. Since 1991, the focus has shifted to comprehensive reforms of the government securities market and an active debt management policy.

Public debt meaning

It is the total amount of money that is owed to the public by the government to meet the development funds. In public finance, it is also known as public interest, government debt, national debt and sovereign debt. The public debt can also be owed to lenders within the country. Even foreign leaders can owe money to the public, but this type of debt is called external debt. By handing out government bonds and bills, the government can create public debt.

The debt that is the addition of all prior deficits is also termed public debt. If one person wants to analyse the public debt, the common method to do so is to check the duration until the repayment is due. Debt can be either short-term, medium-term or long-term. A debt of one year or less is generally considered short-term debt. In contrast, the ones that go for around ten years or longer come under long-term debt. The one that is between these two ranges is the medium debt.

History of public debt

Pre-1947: Public debt was largely driven by the needs of military campaigns and financing infrastructure projects like railways and canals.

1940–1946: Wartime inflation led to increased borrowing to absorb incomes.

1947–1951: An unstable post-partition period where the government struggled to achieve its borrowing targets.

1951–1985: Borrowing was heavily influenced by the five-year plans for economic development.

1985–1991: An attempt was made to align interest rates on government securities with market rates following the recommendations of the Chakraborti Committee.

1991–Present: A major shift occurred with comprehensive reforms to the government securities market and the implementation of an active debt management policy.

Overview of Public Debt

Economists have varying perspectives on public debt, but largely agree that its effects depend on the amount, purpose, and management of the debt. While it can serve as a vital tool for economic development and stability, excessive or poorly managed debt can lead to severe economic problems.

The classical and neoclassical view: “Public debt as a long-term drag”

The traditional view, held by classical and neoclassical economists, is that public debt is generally harmful to long-term economic growth.

- **Discourages private investment:** Government borrowing increases demand for funds in financial markets, which can raise interest rates. These higher rates make it more expensive for private companies to borrow and invest, an effect known as "crowding out".
- **Reduces savings:** According to the Ricardian equivalence theorem, people will save more in anticipation of higher future taxes needed to repay the debt. However, in reality, government borrowing often leads to a decrease in national savings, which reduces the total capital stock available for future generations.
- **Increases tax burden:** Future generations may face higher taxes to pay the principal and interest on the debt, placing an unfair burden on them. In this scenario, the debt acts as a transfer of wealth from taxpayers to bondholders.

The Keynesian view: “Public debt as a short-term stimulus”

In contrast, Keynesian economics suggests that government borrowing can be a powerful tool to stimulate the economy, especially during a recession.

- **Stabilizes the economy:** During downturns, government spending financed by debt can boost aggregate demand, create jobs, and increase income.
- **Funds productive investments:** Debt can be used to finance productive projects, like infrastructure, education, and research that increase the economy's productive capacity and lead to long-term growth. The income generated by these projects can ultimately offset the cost of the debt.

The modern view: Public debt as a "two-edged sword"

Contemporary economists view public debt with greater nuance, recognizing it has both benefits and costs.

- **Non-linear effects:** The impact of debt is often non-linear, meaning low-to-moderate levels of public debt can aid growth, while excessive amounts can harm it. Research suggests a threshold exists, beyond which public debt has an increasingly negative effect on economic growth.
- **Debt overhang:** This phenomenon occurs when a country's debt burden is so high that it discourages new investment. Investors believe that a significant portion of future economic output will go towards repaying old debts, leading them to avoid or postpone new projects.

- **Sustainability is key:** The crucial factor is a country's debt sustainability—its ability to service its debt obligations without major fiscal correction. This depends on a country's debt-to-GDP ratio, its capacity to service debt, interest rates, and overall economic growth.
- **Consider context:** The relationship between debt and growth depends heavily on country-specific factors like governance, institutional quality, and the type of investment the debt is financing. Policies that work in one country may not be effective in another.

Objectives of public debt

Finance budget deficits: When government expenditure exceeds its revenue, it can borrow through public debt to meet this gap instead of solely relying on raising taxes.

Fund development projects Governments borrow to finance investments in areas like infrastructure, education, and healthcare, which promotes long-term economic growth.

Meet emergency needs: Public debt is used to finance large, unforeseen expenditures, such as those required during wars or other national crises.

Minimize borrowing costs: A primary objective of public debt management is to raise the necessary funds at the lowest possible cost over time, thereby reducing the burden on the economy.

Promote macroeconomic stability: Effective debt management helps stabilize financial markets and ensures the debt remains on a sustainable path, which is crucial for long-term fiscal health.

Boost investor confidence: By managing debt responsibly, governments can maintain and build confidence among domestic and international investors, ensuring they can access liquidity when needed.

Significant of Public Debt

Public debt is significant because it allows governments to finance development projects like infrastructure and public services, stimulate economic growth, and manage crises. However, it also has significant negative implications, including high interest payments that strain budgets, the potential to crowd out private investment, and the risk of a debt trap if it becomes unsustainable. The significance of public debt lies in balancing its potential benefits against the risks of over-borrowing.

Positive significance:

- ❖ **Financing development:** Public debt provides a crucial source of funding for public goods such as infrastructure (roads, bridges, power grids), education, and healthcare, which are essential for economic progress.
- ❖ **Economic growth and stability:** It can be used to fund programs that stimulate the economy, create jobs, and support living standards, especially during an economic downturn.
- ❖ **Inter-generational equity:** Governments can use debt to finance large, long-term projects, spreading the cost across generations of taxpayers rather than burdening current taxpayers with the entire expense.
- ❖ **Crisis management:** Debt allows governments to raise funds quickly to respond to emergencies, such as natural disasters or economic crises.

Negative significance:

- ❖ **Interest payments:** A large debt requires significant interest payments, which can divert funds from other essential public services or development projects.

- ❖ **Crowding out private investment:** When a government borrows heavily from domestic markets, it can reduce the pool of available credit for private companies, potentially leading to higher interest rates and lower private sector investment.
- ❖ **Debt trap:** A government may be forced to borrow more simply to repay existing debt, creating a cycle of escalating debt and interest that is difficult to escape.
- ❖ **Inflation risk:** If a government resorts to printing money to finance its debt, it can lead to inflation, devaluing the currency.
- ❖ **Reduced fiscal flexibility:** A high debt burden limits a government's ability to respond to future economic shocks or fund new initiatives.

CONCLUSIONS

Public debt can be beneficial for growth by funding development, but also has significant risks. A major conclusion is that high public debt can be unsustainable, especially with rising interest payments that can consume a large portion of government revenue, crowding out spending on public services and development. The relationship is complex; excessive borrowing can create a fiscal crisis, while carefully managed debt can support strategic investments, making prudent management critical for fiscal sustainability and long-term economic health. Economists agree that public debt is neither inherently good nor bad. It is a powerful financial tool that can be used for economic development but carries significant risks if not managed responsibly. The debate centers on the conditions under which it can be used effectively without causing long-term harm.

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