

CHAPTER I

INTRODUCTION, RESEARCH METHODOLOGY AND REVIEW OF LITERATURE

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CHAPTER I

INTRODUCTION, RESEARCH METHODOLOGY AND REVIEW OF LITERATURE

1. INTRODUCTION

In developing countries, which have adopted the mixed economy pattern of development, the governments - both central and state - are required to play a major part in financing the process of economic development along with welfare functions undertaken mainly to reduce poverty and increase employment. The wide ranging governmental functions necessitate massive public expenditure - both revenue and capital - in the budgets which calls for rapid resources mobilisation- both internal and external. Expansion of the public sector, capital outlays on infrastructure development, development of socio-economic overheads require capital expenditure, which is normally debt financed. Public debt of the governments consists of internal debt as well as external debt. The lateris being significant, as it is one of the sources of foreign capital inflow, the need of which is necessary for developing countries. Rising external debt is associated with the process of economic development of all developing countries. It has provided the necessary foreign capital. But its growth is also associated with number of crisis that developing countries had to face, especially in the 1970s and 80s. Hence, the issue of external debt sustainability becomes crucial, as rise in external debt is associated with the country having sufficient foreign exchange reserves to meet the debt-servicing burden.

The composition pattern of external debt is also a problem, if in the total debt liabilities short-term external debt and commercial borrowings form a major component. The external debt crisis faced by Latin American countries, especially Brazil and Mexico, are sufficient proof that external debt crisis can bring major macro economic instability in the economy.

In the era of globalisation with financial sector liberalisation, there is a rapid increase in the foreign capital flows from developed to developing countries in debt form mainly, portfolio investments and foreign direct investments. This financial integration of the stock exchanges needs proper foreign debt management, as the investor's confidence in the monetary and macro economic stability of developing countries becomes important to avoid volatility in these foreign capital inflows. Hence, in the era of the New Economic Policy, proper external debt management becomes crucial. The monetary and financial crisis faced by East Asian countries is an example where volatility in foreign capital inflows brought a number of macro economic problems in the country.

2. PERIOD OF STUDY

It is against this background that the present dissertation makes an attempt to review the growth, composition and burden of external debt of the Government of India, during the period 1980 to 2000. The period of study spans twenty years because we have studied the problem before and after New Economic Policy introduced in India since 1991.

3. TITLE OF DISSERTATION :-

The present dissertation is entitled, " THE TRENDS IN INDIA'S FOREIGN DEBT IN THE CONTEXT OF NEW ECONOMIC POLICY : 1980 TO 2000 ".

4. SCOPE OF THE STUDY :-

In broad sense the term external debt connotes all outstanding external debt liabilities of a country, private or government owned. It includes all private and government borrowings abroad. However, the scope of our study is limited to the external debt of the Government of India only, wherein we have taken for study,

1. Multilateral Debt – both concessional and non-concessional.
2. Bilateral Debt – concessional and non-concessional.
3. International Monetary Fund Borrowings.
4. Rupee Debt.

As regards comparison of external debt indebtedness of developing countries, fifteen developing countries were selected for study and were classified into –

- a. Heavily Indebted
- b. Moderately Indebted and
- c. Less Indebted.

This classification follows the method adopted by World Bank in its "Global Development Finance Report".

5. OBJECTIVES OF STUDY :-

The following are the main objectives of the study -

1. Under take a survey of theoretical literature regarding public debt
2. Study the growth of external debt of Government of India from 1980-2000.
3. Undertake the cross-country comparison of fifteen external debt indebted countries in relation to the level of indebtedness.
4. Analyse the changing composition of foreign capital inflows to India.
5. Analyse the composition trends of the external debt of Government of India.
6. Study the burden of external debt and measure the growth in total debt servicing burden and interest burden of Government of India.
7. Draw conclusions and make suitable suggestions in the light of the above analysis.

6. RESEARCH METHODOLOGY :-

The present dissertation is essentially a library work based on published secondary data. The secondary data is collected by visiting the following libraries :-

1. Late D.R.Gadgil Library, Gokhale Institute of Politics and Economics, Pune.
2. Barr. B. R. Khardekar Library, Shivaji University, Kolhapur.

Necessary secondary data is collected from the following official sources.

1. World Debt Tables, published by World Bank for relevant years.
2. Global Development Finance Reports, published by World Bank for relevant years.
3. Reserve Bank of India, Monthly Bulletins, issues related to Central Government Finances for relevant years.
4. Reserve Bank of India, Report on Currency and Finance, Volume I and II.
5. Indian Economic Survey, published by Ministry of Finance, Government of India.
6. [www.rbi.org.in/ publications/ foreign inflows](http://www.rbi.org.in/publications/foreign_inflows).

Data collected from the above sources is tabulated and interpreted with the help of appropriate statistical tools. Compound Growth Rate ratio analysis and percentage methods are used for data analysis.

7. LIMITATIONS OF THE STUDY

In the process of the data tabulation certain limitations were noted. The year wise figures of revenue deficit, primary deficit and budgetary deficit for the years 1981-82 to 1985-86 were not available and hence not studied. Similarly, internal debt liabilities, external debt liabilities and total liabilities as percentage to GDP data for the years 1981-82 to 1989-90 were not available. Outstanding debt liabilities for

the year 1981-82 were not available. The data regarding total debt or capital receipts, the figures given in the tables ' Growth and Composition of Total Debt of Government of India ', ' Composition of Total Receipts of Government of India ' and ' Repayment Burden of External Debt of the Government of India ' are not strictly matching. As in the earlier table gross receipts of external debt are taken whereas, in the later tables the net receipts are considered. Hence, data in these tables is not strictly matching. Similarly, the figures of year wise outstanding and March ending outstanding are not strictly comparable.

8. CHAPTER SCHEME : -

The data tabulated from the above sources is analysed according to the following chapter schemes.

CHAPTER I

INTRODUCTION, RESEARCH METHODOLOGY AND REVIEW
OF LITERATURE

CHAPTER II

REVIEW OF THEORIES OF PUBLIC DEBT IN ECONOMIC
LITERATURE

CHAPTER III

OVERALL BUDGETARY POSITION AND GROWTH OF
CAPITAL RECEIPTS OF GOVERNMENT OF INDIA

CHAPTER IV

GROWTH AND COMPOSITION OF THE EXTERNAL DEBT OF
GOVERNMENT OF INDIA

CHAPTER V

EXTERNAL DEBT SERVICING BURDEN ANALYSIS

CHAPTER VI

SUMMARY, CONCLUSIONS AND SUGGESTIONS

9. REVIEW OF LITERATURE :-

9.1 BOOKS :-

Chandra dalaya is one of the first economists in India, who has studied the growth and problems of India's public debt. The author's work is published in two separate books namely ' Internal Debt of the Government of India ' (1966) and ' External Debt of the Government of India ' (1970). Both the above books are a very good combination of theoretical issues and actual data analysis of India's public debt. The growth and composition of India's public debt, especially before independence is studied in an elaborate contents. As regards the second book, the author has mainly concentrated on analysing the growth of India's external debt, consequences of external debt, utilisation and problems related to growth in external debt. The author feels that external debt, as a source of foreign capital no doubt has helped India, in the early phases of planning. But what is important is the proper utilisation of the external debt receipts. The author feels that, the external debt receipts in the early period of planning were used mainly for capital project financing which had long gestation period and therefore, the problem of external debt servicing would arise. It is the author's belief that in the planned development in future therefore, the role of external debt should be made marginal and importance should be given to rapid internal development. So that the burden of external debt can be reduced and the future need of foreign debt decreased.

Ghuge V. B. has written the book ' The Burdens and Benefits of India's National Debt ' in 1977. In this book author has attempted to investigate the various aspects of India's national debt from 1941 to 1974 pertaining to allocatory burdens and benefits, redistributive burdens and benefits, effects of national debt on economic stability, relation between public debt management and monetary policy, burdens and benefits of India's foreign debt. This book is an improved version of the thesis for which the author received Ph. D. The author has observed that the national debt of India has grown enormously in the period he has examined. He specifies that the debt has increased particularly since 1956 and has assumed national significance from fiscal and monetary points of view. In the present work, the author seeks to examine the problems of inter-state debt and external debt, which have become serious in periods under study in the book. After examining these issues, he had also provided some solutions. For this purpose, new concepts and methods based on fairly valid assumptions have been developed also. Moreover, in order to get a proper perspective of public debt problems, the ideas of foreign and Indian economists have also been critically examined.

' Problems of Public Borrowings in Under-developed Countries ' by Lal S. N. was published in 1978. In this book author preferably studied the various facets of public debt and in it mainly internal borrowings. In general, he has examined the need for capital for economic development of the underdeveloped countries and the role of public debt as a good option for capital formation. The theories and

concepts and the views of different economists regarding the burden of public debt are also discussed here. Particularly about Indian situation, the author took India as an underdeveloped economy and further he studied some points about it, like Green Revolution and Public Debt policy, burden of the internal debt, its trend and composition etc. One more question arises in the public debt literature is the proper management of debt, is also examined in the present work. Increasing public debt with different maturity, rate of yield, denomination etc., poses some intricate problems before the public debt management. The author holds the view that, public debt policy, which is subsidiary to the general economic policy, has to be formulated in the background of a particular country, one policy may not hold well in all settings. Author further suggested that, India having different background and problems than the developed countries and will have to evolve her own debt policy, which augments the rate of capital formation - a prime mover in the process of development. But at the same time author also preferred the objective of growth with stability. How far India's public debt policy has been successful in welding these objectives is a crucial question to be examined. The present work is a modest effort in this direction.

A similar study on India's public debt is studied in the book, 'India's Public Debt and Policy Since Independence', (1978) authored by Kiran Barman. This book also forms the basis of the author's Ph. D. from the University of Allahabad. The public debt of the Government of India - both internal and external debt as well as public debt of the

state governments is studied in this book. The author has made an elaborate study on modern developments, the theory of public debt and on the fiscal and monetary impact on public indebtedness on the economy. She has laid great stress on public debt management and debt redemption analysis. While analysing the problems of debt management ownership pattern of public debt, maturity pattern, debt management and interest rate policy, debt management and monetary policy is studied. While analysing debt redemption, methods of debt redemption, the problems of internal debt redemption in India and the problem of external debt servicing in India are analysed

The book ' The Debt Rescheduling Process ' by Marko Milivojevic (1985) is based on the premise that the debt problem of the developing countries and the handling of these problems in the rescheduling process are the most important issues in the area of international economic affairs at the present time.

The political economy of the debt rescheduling process in the developing countries is the primary concern here. The choice of political economy, as opposed to conventional economic analysis, is based on the view that, while the literature on the debt problems of the developing countries is very strong as regards economics and econometric analysis, the politics of the debt problem have not received the same sort of detailed attention.

The author argues that though the international financial system, and the developing countries involved in the rescheduling or adjustment processes, have shown remarkable resilience since the debt

crisis began in 1982, the debt problem reached a critical turning point at the beginning of 1985 will relations between the developing countries and their foreign creditors continue to be cooperative, or will they become increasingly confrontational? is also discussed in this book.

The contents of the book are, growth of developing countries debts since 1973 to 1982, consequences of it in the same period, further discussed point is debt rescheduling process, implications of it and the politics behind debt.

D. R. Mishra in his book entitled, ' Public Debt and Economic Development in India ' (1985), has studied the growth and composition of the internal as well as external debt of India in a detailed manner. As regards external public debt, the growth and composition of the external public debt of the Government of India before and after 1951 is studied along with growth of public debt in each of the Five-Year Plans is undertaken. He also studied the composition profile of the external debt and the use of external public debt for industrial, transport and infrastructure, power generation and agricultural development in India. The burden of external public debt and the problem of debt servicing are studied in a separate chapter. Debt Service- National Income Ratio, Debt Service and Gross External Aid Flows Ratio, Debt Service-Export Earnings Ratio and Debt Service- Revenue Receipts Ratios are used to measure the financial burden of external debt servicing in India.

9.2 ARTICLES :-

The paper, ' Debt Sustainability Issues : New Challenges for Liberalising Economies ' is benefited from the discussions of the

‘ International Seminar on Issues in Managing External Debt ’ and is written by Raj Kumar. This paper looks at the framework, including the criteria commonly used for determining debt sustainability. The paper reviews a current international norm that govern the thinking about debt sustainability and considers the additional key factors that would need to be taken on board in developing a debt sustainability framework that is more appropriate for countries. The paper is organised in five sections. Section I considers conceptual issues surrounding debt sustainability. Section II reviews the commonly used indicators that are relevant for assessing country’s debt and debt service situation. Section III highlights the official debt sustainability criteria being implemented internationally. While, the key vulnerabilities shown by East Asian Crisis and their bearing on debt management are discussed in Section IV. Section V addresses the new factors that would need to be considered in a debt sustainability framework, including how debt sustainability should be implemented at the country level. The paper concludes by reiterating the basic sound debt management principles that countries must continue to adopt whatever the vulnerabilities they face to optimise the use of borrowed resources to meet their growth and development objectives.

Mridul Saggar and Seema Saggar unitedly presented the article entitled, ‘ Factors Affecting External Indebtedness : Cross- Country Evidence ’. The paper raises some issues linking key macro economic variables with external debt. While current account gaps of the countries could be an optimal response to inter-temporal choices of

economic agents to their consumption smoothing behaviour, unsustainable levels of current account deficits often lead to unsustainable levels of external debt. The microeconomic foundations of factor, other than debt, debt servicing and repayments, output, and interest rates, which may be impacting the solvency constraints, are not adequately developed. However, cross-country evidence presented in this paper from panel data shows that the external debt is linked to conventional parameters of macroeconomic stability as well as some other non-conventional policy variables. The evidence is interpreted along with cross-country experience of external debt management in severely indebted countries from a policy viewpoint.

The rest of the paper is organised in remaining four sections. Section II discusses some policy issues concerning external debt management, especially in respect of solvency, transversality, consumption smoothing, investment, growth and sanctions. Section III presents cross-country experience from recent episodes of debt crisis as well as from episodes in past to draw some inferences in respect of sanctions and debt re-contracting issues. Section IV presents evidence from a panel of eighty-three countries for the period 1971-1993 using fixed and random effects model. Section V concludes by drawing some policy inferences from the above.

John Williamson authors ' Implications of the East Asian Crisis for Debt Management'. The current paper starts by discussing conventional wisdom about what constitutes a desirable profile of external debt. The paper then proceeds to argue that the deviation from

this profile was a major factor in making the East Asian countries vulnerable to contagion. The next question discussed is how they built up their vulnerability. That lays the basis for consideration in the final section of the paper of how India can make sure that it does not expose itself to similar problems at some time in the future, when the international capital market again booms, as it surely will in due course.

Mythili Bhusnurmath in the article, ' The Untold Story ', Economic Times 13th Sept. 2002, reviews the public debt profile of India and is of the opinion that the Reserve Bank of India has done a commendable job of managing public debt but the major area of problem according to her is the rapid growth in the internal debt. The Government will have to reduce internal borrowings which if not done may lead to a crisis which the Reserve Bank of India may not be able to prevent.

Somya Kanti Ghosh and Somen Bagchi in their joint paper ' Capital Account Liberalisation in India ', Economic and Political Weekly Dec. 7, 2002, studied the consequences for India on account of capital account liberalisation. They are of the opinion that capital account liberalisation has to be done in a phased manner without which there will be financial problems. In their paper they have built up a model to establish a formal link between capital flows and economic growth in Indian context. The paper undertakes a broad overview of the domestic capital market, examines the composition of foreign capital flows into India in the 90's, analyse the use of foreign capital flows for urban basic services. They are of the opinion that foreign

direct investments are the best form of capital inflows, which can boost economic growth and infrastructure building. For this, a stable and liberal foreign direct investment policy has to be developed by the government.

Raghabendra Jha and Mridul K. Saggar in their paper 'Determinants of Sovereign Borrowings', *Economic and Political Weekly*, Sept. 8, 2001, make a critical review of International Monetary Fund's role in international economy, particularly in helping those countries that are going through Balance of Payment crisis. The paper reveals that, reliance on International Monetary Fund loans is still important for developing countries, but its role has decreased for the OECD countries. Secondly, the response of International Monetary Fund loans to macro economic variables of different countries varies considerably. Hence, the authors argue that there is some degree of arbitrariness in the International Monetary Fund's loan program.

The essay, 'External Debt Management : The Indian Experience' is designed by Michael Debabrata Patra, Sumit Basu, Satyananda Sahoo and Sunil Kumar jointly. In this paper they have attempted to examine the external debt management policy in the context of Indian approach. For some countries, access to capital at international interest rates and the compulsion of servicing imposed by external indebtedness has ensured resource allocation strategies, which maximise the efficiency of investment out of externally borrowed resources. These countries have derived beneficial effects of external resources for their growth processes. On the other hand, where the

accumulation of debt has been allowed at a pace and up to a level at which debt service obligations have exceeded the debt servicing capacity, seizures of economic activity have occurred. The debt servicing capacity of an economy is essentially a reflection of its macro economic performance. Within the framework of macroeconomic policies, debt management policy has a complex role to play. Real sector and fiscal policies set the economy's requirement of external debt as also the economy's underlying debt servicing capacity through productivity improvement and sustained growth of output and exports; monetary, exchange rate and financial policies are directed at evening out the impact of the debt on macro economic stability. The principal objective of the debt manager is to ensure access to the external financing requirement of the economy while simultaneously limiting the magnitude of debt to a level which does not interrupt current and future debt service. Against this backdrop, an exploratory attempt is made in this present paper to empirically assess the performance of external debt management policy in India, particularly in view of the critical importance assigned to debt management in the aftermath of the Balance of Payments crisis of 1990-91. Drawing from the stylised facts and an overview of the evolution of debt management strategies set out in the first section, in the following section an analytical model of balance of payment, based on structural characteristics is estimated. In addition to this, an empirical evaluation of debt management policy is presented in terms of objectives and performance in this paper. Concluding remarks are contained in the final section.

Lekha S. Chakraborty in the article, ' Fiscal Deficit and Rate of Interest ', Economic and Political Weekly, May 11, 2002, examines whether under the New Economic Policy shift in the financing pattern of the fiscal deficit, more by internal borrowings has created an upward pressure on the rate of interest in India. The study found that, it was not fiscal deficit but the rising interest payment of the governments, which increase revenue deficits and hence the growth in fiscal deficits. This result is in conforming of the recent trend in Indian public finance where the share of non-interest expenditure in total expenditure is on the decline. This is due to sharp increase in interest paying obligations arising due to rising cost of servicing the internal debt.