

## **Chapter 1**

### **Introduction**

#### **1.1 Public Debt**

Public debt occupies a centre stage in public financial management. Public debt is the total financial obligations incurred by the entire public sector of a nation, including guarantees and implicit debt. Public debt would include obligations evidenced by a legal instrument issued by the Central, State, Municipal, or Local Government or Enterprises owned or controlled by the Government; and other entities considered public or quasi public. The public debt portfolio is often the largest financial portfolio in the country and can have a far-reaching impact on financial stability.

Most governments have large financial needs as they seek to grow their economies and expand social services in their countries. A country is required to borrow both for consumption as well as investment to promote growth which would help in improving the living standards of its population. In theory, public borrowing is an effective tool for generating economic growth by expanding the production and consumption choices of current and future generations and fairly distributing the debt burden between current and future generations of taxpayers. Without public borrowing, Governments may have to reduce the number and amount of productive investments or impose high taxes on current taxpayers or reduce current spending on services to its citizens or choose a mix of these choices.

Public debt, while giving an opportunity to the country to fuel economic growth and ensure inter-generational equity, also places onus on the country for being responsible in its use of the borrowed funds. Borrowing for this purpose, when not justified by a national need, could be inconsistent with sustainable economic policy.

#### **1.2 Public Debt Management**

Public debt management is the process of establishing and executing a strategy for managing public debt in order to raise the required amount of funding at the desired risk and cost levels. It should encompass the main financial obligations over which governments, central, regional and local, exercise control. Public debt management is important for a number of reasons like:

- ensuring that the level and rate of growth of public debt is sustainable in a wide range of circumstances;

- lowering public borrowing costs over the long term, thus reducing the impact of deficit financing and contributing to debt and fiscal sustainability; and
- avoiding economic crisis because of poorly structured debt.

### **1.3 Public Debt of Union Government**

India, like most of the developing countries, seeks to grow its economy and to expand social services to its citizens. This raises large financing needs on the country resulting in excess of expenditure over non-debt receipts, termed as fiscal deficit. The fiscal deficit is sought to be plugged by borrowing, which adds to the country's outstanding debt stock. In other words, fiscal deficit can be seen as being indicative of the net incremental liabilities of the Government or its additional borrowings to bridge the budgetary gap. The shortfall is met either by internal or external borrowing contracted on the security of the Consolidated Fund of India (CFI) or by the use of surplus fund in the Public Account. In the budget documents, internal debt and external debt together are referred to as 'Public Debt'.

Internal debt refers to rupee-denominated debt, consisting of marketable securities (dated securities, treasury bills) and non-marketable securities (14 days Intermediate Treasury Bills, compensation and other bonds, securities issued to international financial institutions etc.).

External debt refers to the debt raised by the Union Government from non-domestic sources, namely, multilateral institutions like the International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), Asian Development Bank (ADB) etc. or bilateral sources, i.e., directly from the foreign countries.

Liabilities in the Public Account (referred to as 'other liabilities') include National Small Savings Fund (NSSF), Provident Funds, Reserve Funds and deposits and special bonds issued to oil marketing companies, fertilizer companies and Food Corporation of India. 'Other liabilities' are not included in the public debt.

Besides above direct liabilities, the Union Government provides guarantees for repayment of borrowings and payment of interest thereon, repayment of share capital and payment of minimum dividend, payment against agreements for supplies of materials and equipment on credit basis, etc. on behalf of Government Companies/Corporations, Railways, Union Territories, State Governments, Local Bodies, joint stock companies, co-operative institutions etc. These guarantees constitute contingent liability of the CFI.

The details of the outstanding total liabilities of the Union Government at the end of each year from 2011-12 to 2014-15 is presented in **Table 1.1**.

Table 1.1: Union Government Liabilities

(₹ in crore)

Period	Gross Domestic Product (GDP) at current prices	Internal debt	External debt (at current rate)	Public debt	Other liabilities	Total liabilities (at current rate)
(1)	(2)	(3)	(4)	(5=3+4)	(6)	(7=5+6)
2011-12	88,32,012 <sup>@</sup>	32,30,622 (36.58)	3,22,897 (3.66)	35,53,519 (40.24)	5,97,765 (6.77)	41,51,284 (47.00)
2012-13	99,88,540 <sup>@</sup>	37,64,566 (37.69)	3,32,004 (3.32)	40,96,570 (41.01)	6,10,016 (6.11)	47,06,586 (47.12)
2013-14	1,13,45,056 <sup>@</sup>	42,40,767 (37.38)	3,74,483 (3.30)	46,15,250 (40.68)	6,44,060 (5.68)	52,59,310 (46.36)
2014-15	1,25,41,208 <sup>\$</sup>	47,38,291 (37.78)	3,66,384 (2.92)	51,04,675 (40.70)	6,71,010 (5.35)	57,75,685 (46.05)

Note: Figures in parenthesis show percentage of Gross Domestic Product (GDP). GDP data is based on new series (Base year 2011-12). Data for the years 2009-10 and 2010-11 is not included due to change in base year of GDP to 2011-12.

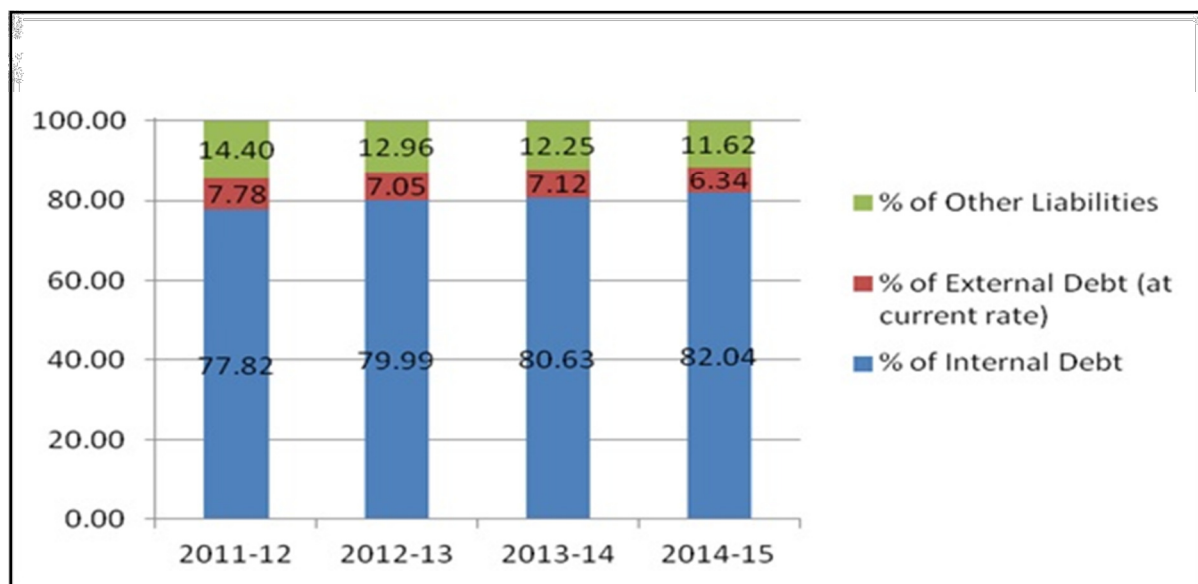
<sup>@</sup> Source: Central Statistical Office (CSO), Ministry of Statistics and Programme Implementation, Press Note dated 30 January 2015

<sup>\$</sup> Source: Central Statistical Office (CSO), Ministry of Statistics and Programme Implementation, Press Note dated 29 May 2015

From **Table 1.1**, it can be seen that the outstanding total liabilities of the Union Government had generally been around 46 per cent of the GDP of the country over the period from 2011-12 to 2014-15.

The internal debt forms the major portion of the outstanding Union Government Liabilities as depicted in **Chart 1.1** below.

**Chart 1.1: Union Government Liabilities**



Further, guarantees were outstanding for an amount of ₹ 2,94,700 crore as on 31 March 2015.

#### 1.4 Servicing of Public Debt of Union Government

The interest payment and repayment of principal for the period from 2009-10 to 2014-15 are presented in **Table 1.2**.

**Table 1.2: Servicing of Public Debt**

(₹ in crore)

Period	Interest Payment			Repayment of Principal			Public debt receipts			Servicing as a percentage of receipts		
	Internal		External	Internal		External	Internal		External	Internal		External
	Short Term	Long Term		Short Term	Long Term		Short Term	Long Term		Short Term	Long Term	
2009-10	10,026	1,65,224	3,629	29,17,992	1,56,660	11,140	29,08,223	4,74,927	22,177	101	68	67
2010-11	12,047	1,84,958	3,156	26,70,008	1,32,992	11,774	26,77,767	4,64,009	35,330	100	69	42
2011-12	26,288	2,07,431	3,501	33,83,996	98,347	13,586	35,10,862	5,26,280	26,034	97	58	66
2012-13	30,129	2,49,248	4,019	33,11,674	99,111	16,108	33,65,024	5,79,705	23,309	99	60	86
2013-14	34,346	3,08,852	3,880	33,48,315	1,44,852	18,124	33,56,044	6,13,506	25,416	101	74	87
2014-15	35,702	3,33,943	3,766	35,00,183	1,86,916	20,601	35,09,362	6,75,300	33,534	101	77	73

(Source: Finance Accounts, GOI for the year)

It can be seen from the above table that servicing (interest payment + repayment of principal) was more than 97 per cent of the total short term debt receipts in each of the six years in

respect of short term internal debt, which is understandable as short term debt is normally repaid within a period of one year. In the case of long term internal debt, the corresponding percentage ranged from 58 *per cent* to 77 *per cent* while in case of external debt, it ranged from 42 *per cent* to 87 *per cent* over the period from 2009-10 to 2014-15. In 2014-15, 77 *per cent* of the long term internal borrowings and 73 *per cent* of the external borrowing were utilized for debt servicing implying that a larger percentage of debt was being used for debt servicing which in turn meant lower percentage of debt taken was available for meeting developmental expenditure to promote growth, which is one of the reasons for contracting debt.

### **1.5 Rationale for Audit**

As per Article 149 of the Constitution of India read with the provisions of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971, it is the duty of the Comptroller and Auditor General of India to audit all receipts and expenditure of the Union Government and State Governments. Public debt constitutes a significant portion of the receipts of the Union Government. Further, audit of public debt would help in underlining the significance and benefits of public debt management and also help policymakers to understand the risks of public debt. It would make their operations more effective and increase the efficiency of internal administrative processes. Such audit would also enhance public debt transparency and accountability.

In the last few years, several countries across the world have faced public debt crisis. The frequency and severity of debt crisis and the consequent adverse impact on managing of public finances reinforces the need for promoting responsible lending and borrowing practices.

It is in this background that the topic of Public Debt Management was selected for performance audit.

### **1.6 Audit Methodology**

An introductory meeting was held with the Department of Economic Affairs (DEA), Ministry of Finance (MOF) on 12 March 2014 and with the Reserve Bank of India (RBI) on 04 April 2014 to understand and assess the entire gamut of public debt management of the Union Government. Performance audit on this topic commenced with an Entry Conference with RBI on 16 July 2014 and with DEA on 05 August 2014 during which the audit methodology, scope, objectives and criteria were discussed.

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Audit was conducted in the offices of DEA and RBI. In order to assess the processes involved in the public debt management, the audit procedure included inspection and examination of records and documents as well as data analysis. Draft Performance Audit Report was issued to DEA/RBI on 19 August 2015. On receipt of reply from RBI and clarifications from DEA, another draft of the report was issued to DEA on 02 December 2015. An exit conference with RBI was held on 06 November 2015 and with DEA on 04 April 2016. Responses of RBI and DEA to the Draft Audit Report and views expressed by them during exit conference have been duly considered and suitably incorporated in the report.

National Institute of Public Finance and Policy (NIPFP), a society engaged in research in public economics and policies, provided consultancy in the conduct of this audit.

### **1.7 Audit Objectives**

The Performance Audit on Public Debt Management was conducted in order to assess whether the Government of India:

- had a clear and explicit legal as well as organizational framework for managing Public Debt;
- had a debt management strategy to enable minimization of the risk and cost involved;
- had established an arrangement for effective execution of debt management activities and adopted sound practices in debt servicing; and
- had set up effective information systems which enabled complete and accurate public debt reporting system/debt database, to provide reliable financial information and to meet legal requirements.

### **1.8 Audit Criteria**

The audit objectives were benchmarked against audit criteria drawn from :

- Laws and regulations governing public debt activities viz.
  - Fiscal Responsibilities and Budget Management (FRBM) Act, 2003
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  - Government Securities Act, 2006
  - Government Securities Regulations, 2007
  - Reserve Bank of India Act, 1934
- International practices
  - Guidelines for Public Debt Management prepared by International Monetary Fund(IMF) and World Bank (WB)

- Manual of Effective Debt Management by Economic and Social Commission for Asia and the Pacific issued by United Nations
- Circulars/guidelines issued by Government of India (GOI)/RBI from time to time
- Quarterly/Annual Reports relating to Public Debt
- Status Paper on Government Debt issued by DEA
- Manuals of Internal Debt Management Department (IDMD) of RBI/Middle Office etc.
- Annual Financial Statements of the Government of India

## **1.9 Audit Scope**

The performance audit covered internal and external debt of Union Government. The period of audit coverage was for the five years from 2009-10 to 2013-14. However, facts and figures were updated upto 31 March 2015.

## **1.10 Acknowledgement**

We acknowledge the cooperation of DEA and RBI in facilitating the audit by providing necessary records and information in connection with the conduct of this performance audit. We also acknowledge the support and guidance provided by NIPFP.