

Chapter 5

MANAGEMENT OF FISCAL LIABILITIES

5.1 Internal debt, external debt and other liabilities are the three sets of liabilities that constitute the Union Government debt. Internal and external debts constitute public debt and are secured under the Consolidated Fund of India. Internal debt includes market loans, special securities issued by Reserve Bank of India and National Small Savings Fund, compensation and other bonds and other rupee securities. External debt represents the loans received from foreign governments and bodies. The other liabilities of the government arise more in its capacity as a banker or a trustee rather than a borrower and include employees' provident funds, reserve funds and sinking funds (created by charging an expenditure while actual expenditure/disbursement is yet to be made) and deposits. These borrowings or accruals are not secured under CFI and are shown as part of the public account. All these liabilities, however, are obligations of the government either in terms of their repayment or specified expenditure.

5.2 Government incurs these liabilities to meet its resource requirements for repayment of debt; discharge of liabilities on the public account; capital expenditure and such other current expenditure requirements that may remain uncovered by revenue and non-debt capital receipts.

Aggregate Fiscal Liabilities: Trends and Composition

5.3 Table 5.1 presents aggregate liabilities of the government including internal debt and external debt reckoned both at the current rate of exchange and at the historic rate (the rate at which the debt was originally contracted) and the Public Account during 1985-2005. Annual total liability in terms of its composition is indicated in **Appendix-V-A**.

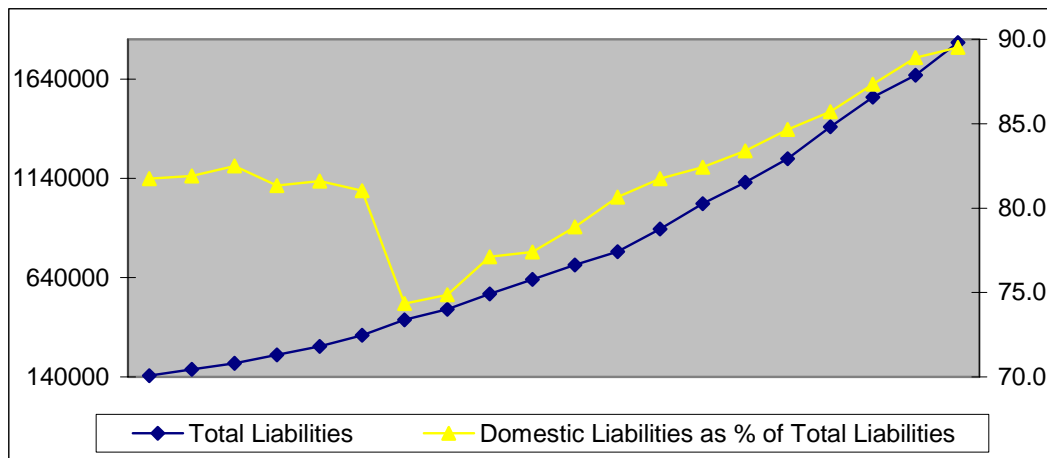
Table 5.1: Aggregate Fiscal Liabilities- Trends & Composition

<i>(Rupees in crore)</i>						
Period	Internal Debt	External Debt at historic rates	Public Account	Total liabilities (at historic rates)	External Debt (at current rates)	Total liabilities (at current rates)
1985-2005	445607	45270	211226	702101	127399	784231
VIII Plan (1992-1997)	272725	49206	218152	540082	137732	628608
IX Plan (1997-2002)	655942	61703	292049	1009694	183073	1131064
2003-04	1141706	46125	333725	1521556	184203	1659634
2004-05	1275971	60877	356037	1692885	191271	1823279
Average annual Rate of Growth (per cent)						
1985-2005	16.73	6.52	10.30	13.99	11.06	14.04
VIII Plan (1992-1997)	14.13	5.95	14.80	13.62	5.88	12.48
IX Plan (1997-2002)	25.42	6.77	-7.05	12.80	5.05	11.85
2003-04	11.86	-22.63	0.70	7.78	-6.05	7.20
2004-05	11.76	31.98	6.69	11.26	3.84	9.86

Depiction of external debt at current rate of exchange in finance accounts commenced from 1991-92. Earlier data of external debt at current exchange rate have been taken from Reserve Bank of India to complete the series.

**Public Account liabilities since 1999-2000 exclude the liabilities on account of small savings to the extent of securities issued to National Small Savings Funds (NSSF) by State Governments*

5.4 Aggregate fiscal liabilities increased from an average of Rs. 628,608 crore during the VIII Plan (1992-1997) to Rs. 1823,279 crore in 2004-05. Average annual trend rate of growth of these liabilities was 14.04 *per cent* during 1985-2005. Internal debt was not only the most predominant component of the aggregate liabilities, accounting for around two thirds of these in 2004-05, but was also the fastest growing component with its growth averaging 16.73 *per cent*. Public account liabilities had the lowest growth of 10.30 *per cent*. These two components, which in terms of the origin are domestic liabilities, constituted around 90 *per cent* of the aggregate liabilities in 2004-05. Share of these two components in aggregate liabilities also improved from an average of 78 *per cent* during the VIII Plan (1992-1997) to the current level. External liabilities at the current exchange rate constituted a little over 10 *per cent* of the aggregate liabilities in 2004-05. Aggregate liabilities showed deceleration in their growth rates. The growth of external liabilities at historic rate was lower. However, this is only of accounting interest as repayment obligations of this debt are to be met at the current rate of exchange only. Total liabilities and the share of domestic liabilities in these is depicted in the following graph.



Fiscal Liabilities relative to GDP

5.5 Table 5.2 gives the aggregate fiscal liabilities of the Union Government relative to GDP. Aggregate fiscal liabilities-GDP ratio peaked during 1991-92 when it reached 65.43 *per cent* of GDP. This ratio decelerated to an average of 60.72 *per cent* during the VIII Plan (1992-1997) and further to an average of 59.08 *per cent* during the IX Plan (1997-2002). In the recent two years, while the ratio of fiscal liabilities to GDP increased to 60.13 *per cent* in 2003-04, it decelerated in the current year to 58.71 *per cent*, lower than the long-term trend levels. The long-term tendency of the ratio of fiscal liabilities to GDP was of stability with an average annual rate of shift of only 0.13 *per cent* during 1985-2005. While the average annual rate of shift in the ratio of internal debt-GDP was 2.49 *per cent*, a negative shift rate for the other two components more or less squared it to sustain debt-GDP at the trend level.

Table 5.2: Fiscal Liabilities Relative to GDP

(Per cent)

Period	Internal Debt	External Debt at historic rates	Public Accounts	Total liabilities	External Debt at current rates	Total liabilities
1985-2005	34.08	3.46	16.15	53.70	9.74	59.98
VIII Plan (1992-1997)	26.34	4.75	21.07	52.16	13.30	60.72
IX Plan (1997-2002)	34.26	3.22	15.26	52.74	9.56	59.08
2003-04	41.37	1.67	12.09	55.13	6.67	60.13
2004-05	41.09	1.96	11.46	54.51	6.16	58.71
Average Annual Rate of Shift in Relative Shares						
1985-2005	2.49	-6.47	-3.16	0.23	-2.49	0.13

5.6 If various components of the fiscal liabilities in 1985-86 are set to 100, the index value of internal debt, external debt and total liabilities in 2004-05 would be 1796, 718 and 1249 respectively as against the index of GDP at 1117 indicating buoyancy of greater than one for internal and total debt component of the liabilities. Buoyancy of internal debt and total liabilities (with external debt being reckoned at the current exchange rate) with reference to GDP was 1.20 and 1.01 respectively during 1985-2005.

5.7 It would be appropriate to look at the aggregate fiscal liabilities relative to the revenue receipts of the Union Government. This ratio is considered a better indicator of debt stock because it is directly related to the resources that are available for its servicing and redemption. Table 5.3 gives the ratio of outstanding fiscal liabilities as a percentage of the non-debt receipts and revenue receipts.

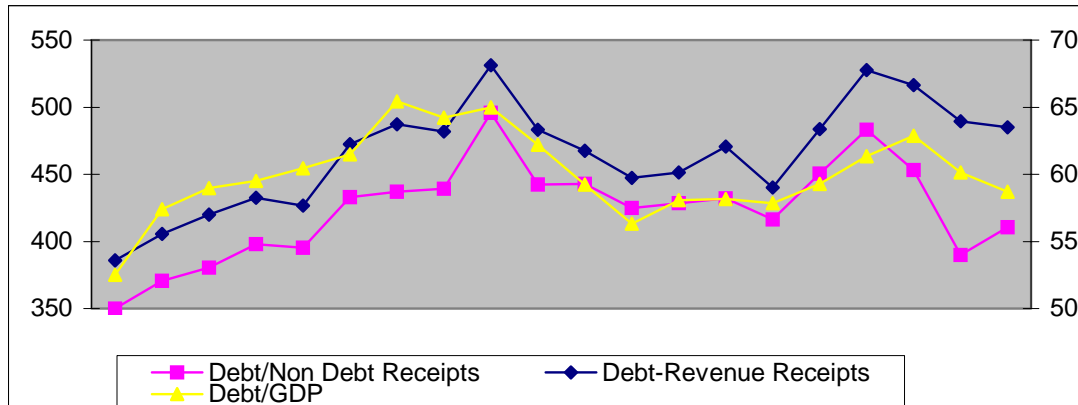
Table 5.3: Outstanding Fiscal Liabilities as a percentage of Non-Debt Receipts and Revenue Receipts

Period	Non-Debt Receipt	Revenue Receipt
1985-2005	429	478
VIII Plan (1992-1997)	446	478
IX Plan (1997-2002)	444	476
2003-04	390	489
2004-05	409	484
Average Annual Rate of Shift in Relative Share		
1985-2005	0.71	0.97
Average Annual Rate of Growth of the Parameter		
1985-2005	13.23	12.94

Note:- Non-Debt Receipts are Revenue Receipts (net of the States' share in taxes) and non-debt capital receipts.

5.8 The ratio of fiscal liabilities to revenue and non-debt had a positive shift rate during 1985-2005. The trend rate of growth of fiscal liabilities exceeded the rate of growth of the above two parameters. Average ratio of fiscal liabilities to non-debt receipts increased from 446 *per cent* during the VIII plan (1992-97) to a peak of 483 in 2001-02 before decelerating to the current level of 409 in 2004-05. This deceleration was due to a moderate growth of fiscal liabilities relative to non-debt receipts in the last three years. In case of the ratio of aggregate fiscal liabilities to

revenue receipts, a similar trend was observed. Buoyancy of the aggregate fiscal liabilities to non-debt receipts and revenue receipts during 1985-2005 was 1.06 and 1.09 respectively. Internal debt and domestic debt (internal debt and public account surpluses combined), however, had greater buoyancy as lower growth of external debt liabilities had a moderating impact. The ratio of fiscal liabilities to the three parameters of GDP, non-debt receipts and revenue receipts is depicted in the following graph:



Debt Sustainability

5.9 Fiscal liabilities are considered sustainable if the government is able to service the stock of these liabilities over the foreseeable future and the debt-GDP ratio does not grow to unmanageable proportions. A necessary condition for stability is the Domar's Debt Stability Equation. It states that if the rate of growth of economy exceeds the rate of interest on the debt, the debt-GDP ratio is likely to be stable provided primary balances are either zero or positive or are moderately negative. In a situation where the rate of interest is higher than the rate of growth of output, the debt-GDP ratio would continue to rise unless the primary balances turn positive. The sustainability of debt is also examined in relation to the inter-temporal budget constraints; sustainability rests on whether the past behaviour of revenue, expenditure and fiscal deficits could be continued indefinitely without any adverse implications or response from the lenders. As such, the question of sustainability of debt involves consideration of whether Ponzi Financing has been used as a debt management strategy. The solvency or the overall budget constraints also require that initial debt stock equals the present discounted value of primary surplus in future. The equality of the current debt and the present value of surplus does not necessarily imply that the debt is ultimately re-paid or even that it is ultimately constant. All it implies is that the debt ultimately grows less rapidly than the interest rate. Debt stabilisation can take place in one of two possible ways. If the nominal growth rate of the economy exceeds the nominal rate of interest on domestic debt, which can happen under financial repression, stabilisation of domestic debt is possible while still running a primary deficit (even in excess of monetisation). But if the nominal interest rate exceeds the growth rate, the primary deficit must be sufficiently less than monetisation for debt stabilisation to be possible.

5.10 The average interest rate (nominal) on total debt over time, as indicated in Table 5.4, remained lower than the rate of growth of GDP at the market prices during

1985-2005. However, the spread declined from an average of 8.63 *per cent* during the VIII Plan (1992-1997) to an average of 1.37 *per cent* during the IX Plan (1997-2002). The spread between GDP growth and interest rates became negative in 2002-03 but recovered later to a positive 3.77 *per cent* in 2003-04 and further 4.63 *per cent* in 2004-05.

5.11 Average interest rates on fiscal liabilities, however, moved in a narrow range. Average annual rate of interest on external debt was 2.58 *per cent* during 1985-2005. It decelerated from an average of 3.07 *per cent* during the VIII Plan (1992-1997) to 1.52 *per cent* in 2004-05. For the domestic liabilities (public debt and public accounts) the average rate of interest was 10.42 *per cent* during the IX Plan (1997-2002), which got moderated to 9.24 *per cent* in 2003-04 and further to 8.69 *per cent* in 2004-05. The deceleration in the average rate of interest on domestic liabilities started in 2000-01 and in the last four years witnessed a decline of 210 basis points (the peak rate of interest was 10.79 *per cent* in 1999-2000).

Table 5.4: Average interest rate on fiscal liabilities

<i>(Per cent)</i>					
Period	Internal liabilities	External debt	Aggregate liabilities	Rate of growth of GDP	Interest spread
1985-2005	9.54	2.58	8.36	13.89	5.54
VIII Plan (1992-1997)	9.37	3.07	7.91	16.54	8.63
IX Plan (1997-2002)	10.42	2.51	9.06	10.43	1.37
2003-04	9.24	1.60	8.28	12.04	3.77
2004-05	8.69	1.52	7.89	12.52	4.63
Average Annual Rate of growth					
1985-2005	1.93	-2.79	1.93		

*Average interest rate is = Interest paid/Outstanding Liabilities at the beginning of the year*100*

5.12 It is not uncommon for the government to borrow funds for creating capital assets or for making investment. Though in government accounting system comprehensive accounting of the fixed assets like land and buildings etc., owned by the government is not done to create a kind of a balance sheet, accounts do capture and provide the assets created out of the expenditure incurred. Government's investment, outstanding loans and advances and cumulated capital expenditure could be considered as its assets. The ratio of these assets to its aggregate fiscal liabilities could be considered a surrogate measure of quality of its application of borrowed funds.

Table 5.5: Buoyancy of assets and Ratio of Assets to Liabilities

(Rupees in crore, Ratio and Growth rates in per cent)

Period	Aggregate Liabilities	Aggregate Assets	Ratio of Assets to Liabilities	Annual Growth of Liabilities	Annual Growth of Assets	Buoyancy of Assets
1985-2005	784231	405600	51.72	14.04	10.00	0.71
VIII Plan (1992-1997)	628609	362555	57.68	12.48	10.31	0.83
IX Plan (1997-2002)	1131064	575689	50.90	11.85	8.28	0.70
2003-04	1659634	688434	41.48	7.20	-0.70	-0.10
2004-05	1823279	717675	39.36	9.86	4.25	0.43

5.13 The ratio of assets to liabilities witnessed a secular decline from an average of 57.68 *per cent* during the VIII Plan (1992-97) to 41.48 *per cent* in 2003-04 and further 39.36 *per cent* in 2004-05. Average annual rate of shift in this ratio was (-) 3.54 *per cent* during 1985-2005. By 2004-05, over 60 *per cent* of the union government liabilities had ceased to have any asset back up. Overall rate of growth of assets not only remained lower than the rate of growth of liabilities, the spread between these growth rates was also widening. Buoyancy of the assets to the liabilities also declined from 0.83 during the VIII Plan (1992-1997) to 0.43 in 2004-05 (Table 5.5). In 2003-04, aggregate assets actually declined due to the accelerated recovery of the loans and advances, while liabilities continued to grow.

5.14 Another issue in debt sustainability is the ratio of the debt redemption to total debt receipts. A higher ratio would indicate that to the extent debt receipts were used in debt redemption, there was less net accrual of resources. Table 5.6 gives the ratio of debt redemption to debt receipts during 1985-2005 and other VIII and IX Plan periods along with the information of the two most recent years.

Table 5.6 Ratio of Debt redemption to Debt Receipts

Period	Debt Receipts	Debt Repayment		Debt Repayment (1)/Debt Receipts	Debt Repayment (2)/Debt Receipts
		Principal (1)	Principal+Interest (2)		
	<i>(Rs. in crore) (Annual Average)</i>			<i>(Per cent)</i>	
1985-2005	384649	307434	365868	79.93	95.12
VIII Plan (1992-1997)	266443	203787	248066	76.48	93.10
IX Plan (1997-2002)	530341	411106	502208	77.52	94.70
2003-04	811010	726131	854245	89.53	105.33
2004-05	1070716	894577	1025535	83.55	95.78

Debt receipt and payments are average of the years indicated and net of Ways and Means Advances.

5.15 The debt sustainability issues have also been discussed by the successive Finance Commissions. The Ninth Finance Commission observed that ultimately the solution to the government debt problem lies in borrowed funds – (a) not being used for financing revenue expenditure; and (b) being used efficiently and productively for capital expenditure which either provides returns directly or results in increased productivity of the economy in general which may result in increase in government revenue. The Eleventh Finance Commission suggested that debt sustainability could be significantly facilitated if the incremental revenue receipts could meet the incremental interest burden and the incremental primary expenditure. Table 5.7 indicates the resource gap as defined above for the VIII and IX Plans and for the two recent years. It would be observed that during 1985-2005, incremental revenue receipts fell short of meeting the incremental revenue expenditure by about one third. This gap increased to over 45 *per cent* during the IX Plan (1997-2002). In the last two years, however, due to a moderate growth in expenditure and moderation in interest rates, there was a positive gap.

Table 5.7: Shortfall of incremental revenue receipts to meet incremental revenue expenditure and interest payments

(Rupees in crore)

Period	Incremental				Resource Gap
	Receipts	Non-interest Revenue Expenditure	Interest Expenditure	Total Expenditure	
1985-2005	16737	15338	6700	22038	-5301
VIII Plan (1992-1997)	16887	13589	6576	20166	-3279
IX Plan (1997-2002)	18621	23212	10939	34151	-15530
2003-04	39274	26954	3541	30495	8779
2004-05	37771	12641	2844	15485	22286

Cash Management

5.16 With the Union Government entering into an agreement with the Reserve Bank of India in 1994, a system of automatic monetisation of budget deficit was phased out in 1997. Effective from April 1997, a new scheme of Ways and Means advances (WMA) was introduced to facilitate the government to overcome the temporary mismatches in its cash flows. This system had demanded greater skill in debt management and also cash management. While there was a need to avail WMA on a continuous basis, the system seems to have stabilised. There were no outstanding WMA balances after the year 2002-03 (Table 5.8).

Table 5.8: Ways and Means Advances

(Rupees in crore)

Year	Opening Balance	Addition during the Year	Discharge during the Year	Outstanding Ways and Means Advances
1999-00	3042	124972	127032	982
2000-01	982	131300	126887	5395
2001-02	5395	170953	171172	5176
2002-03	5176	118961	124137	Nil
2003-04	Nil	96615	96615	Nil
2004-05	Nil	62080	62080	Nil

Unutilised Committed External Assistance

5.17 As on 31 March 2005, unutilised committed external assistance was of the order of Rs. 68435 crore. Much of the unutilised external assistance was for projects in the infrastructure sector (details in **Appendix-V-B**). Table 5.9 shows the year-wise unutilised committed external assistance.

Table 5.9: Unutilised Committed External Assistance

(Rupees in crore)

Year	Amount
2000-01	56920
2001-02	62565
2002-03	67365
2003-04	64521
2004-05	68435

5.18 Commitment charges on un-drawn external assistance are to be paid on the amount of principal rescheduled for drawal on later dates. As there is no distinct head

in the accounts for reflecting the payment of commitment charges, it is shown under the head 'interest obligation'. Table 5.10 indicates charges paid to various bodies/governments during 2000-2005 as commitment charges for rescheduling of drawal of assistance at a later date. This points to continued inadequate planning resulting in avoidable expenditure in the form of commitment charges amounting to Rs. 165.11 crore in 2004-05.

Table 5.10: Commitment Charges

(Rupees in crore)

Year	ADB	France	Germany	IBRD	Total
2000-01	13.52	0.27	0.19	26.25	40.23
2001-02	12.84	0.22	0.76	34.64	48.46
2002-03	26.45	0.19	0.95	39.60	67.19
2003-04	38.23	0.02	8.99	45.91*	93.15
2004-05	45.10	Nil	2.07	117.94*	165.11

*Source: External Assistance Brochure 2002-2003. *includes IDA assistance*

Growth in Contingent Liabilities of the Union Government

5.19 Contingent liabilities of the Union Government arise because of its role in promoting investment and in reducing the credit risk for investors, especially in those activities where the nature of investment is characterised by long gestation periods. While guarantees do not form part of debt as conventionally measured, in the eventuality of default, this has the potential of aggravating the debt position of the government. The issue of guarantees assumes significance in the context of the growing investment needs for infrastructure, participation by the private sector in such projects and its increasing probability of being invoked. In exchange risk guarantees provided for Resurgent India Bonds and India Millennium Deposits there was substantial financial outgo from the government receipts. Table 5.11 gives the position regarding the maximum amount of guarantees and sums guaranteed and outstanding at the end of the financial year during 1999-2005.

Table 5.11: Guarantees Given by Union Government

(Rupees in crore)

Position at the end of the year	Maximum amount of guarantee	Sums Guaranteed Outstanding	External Guarantees Outstanding	External Guarantees Outstanding as percentage of sums Guaranteed Outstanding
1999-2000	144438	83954	47663	56.77
2000-01	135678	86862	55664	64.08
2001-02	168712	96859	57006	58.65
2002-03	174487	90617	51097	56.39
2003-04	184420	87780	50328	57.33
2004-05	132728	107957	48276	44.72

5.20 Total outstanding guarantees were 4.27 per cent of GDP and 35.22 per cent of the revenue receipts that accrued to the union. These guarantees, however, do not include the volume of implicit contingent liabilities in the nature of open-ended pension payments.