Understanding Debt Sustainability – Tools for assessment in SAI India

WGPD MEET - BAKU

5-7TH JUNE 2024

OVERVIEW

(I) Regulatory and Constitutional provision on debt, India's debt statistics

(II) Important audit findings on public debt - union and state government

(III) Supreme Court case between Kerala state and Union Government

(IV) SAI India's consolidated guidelines for Debt Sustainability Analysis

I) INDIA'S DEBT STATISTICS

- Total Public debt 2022 = 2.64 trillion dollars
- External debt component = 613 Billion dollars (19% of GDP)
- India's nominal GDP in 2022 = 3.16 trillion dollars
- Debt as a % of GDP = 84%

CONSTITUTIONAL AND REGULATORY PROVISIONS ON DEBT

Article 292. Borrowing by the Government of India

The executive power of the Union extends to ***borrowing*** upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the ***giving of guarantees*** within such limits, if any, as may be so fixed.

Article 293. Borrowing by States

The state governments similarly can borrow to finance their deficits however this Article mandates that without the ***Union government's 'consent',*** a state may not '…raise any loan if there is still outstanding any part of a loan which has been made to the State by the Government of India…' and that the Union while giving this consent may impose ***conditions***.

From 2005 onwards, total target limits on debt and a host of fiscal parameters were prescribed in Fiscal Responsibility and Budget Management (FRBM) Acts, which were passed by Union and State legislatures.

II) IMPORTANT AUDIT FINDINGS ON PUBLIC DEBT - UNION AND STATE GOVERNMENT

For nearly 2 decades now, SAI India has been reporting through its Financial Audit reports on Government Accounts, on the macro-economic fiscal indicators, and more recently on the computation of Public Debt, comprehensiveness of the data relating to PD, and an analysis of its Sustainability, both at the national and provincial/state government levels. The indicators reported upon were as below -

A. Review of government's fiscal parameters -

i. Revenue Deficit/Fiscal Deficit
ii. Debt to GSDP/GDP ratio
iii. Revenue Receipts as a % of GSDP

Contd.

B. Financing pattern of F.D-

i. Quantum and maturity profile of Market Borrowings
ii. Loans from the Union Government
iii. Special Securities against Savings funds etc.

C. Components of Public Debt -

i. Internal
ii. External
iii. Budgeted/Off-Budget Borrowings

Some examples of the comments are on succeeding slides.

KERALA (STATE FINANCES) AUDIT REPORT FOR 2018-19:

a) **Off-Budget Borrowing:**

A Kerala state government authority borrowed/raised funds amounting to XXXX from financial institutions till 2018-19 by issue of bonds etc., which were to be re-paid from the state government's tax revenues. This included an amount of XXXX raised through Masala Bonds in foreign countries.

Since the authority had no source of income, the **State Government stood as a guarantor, and it could ultimately turn out to be a direct liability on the State Government**. Further, such off-budget borrowings are not in accordance with Article 293 (3) of the Constitution of India i.e. Union Government concurrence is not taken.

(Para 1.10.5 of the Report)

Contd.

b) Debt management

Open market borrowings have a major share (54 percent) in total fiscal liabilities of the State.

The net debt available with the State for development activities was only XXXX (13 percent of public debt receipts) during 2018-19.

The maturity profile of the debt shows that about 51 percent of the debt is to be repaid by March 2026.

(Para 1.11 of the Report)

KERALA (STATE FINANCES) AUDIT REPORT FOR 2021-22:

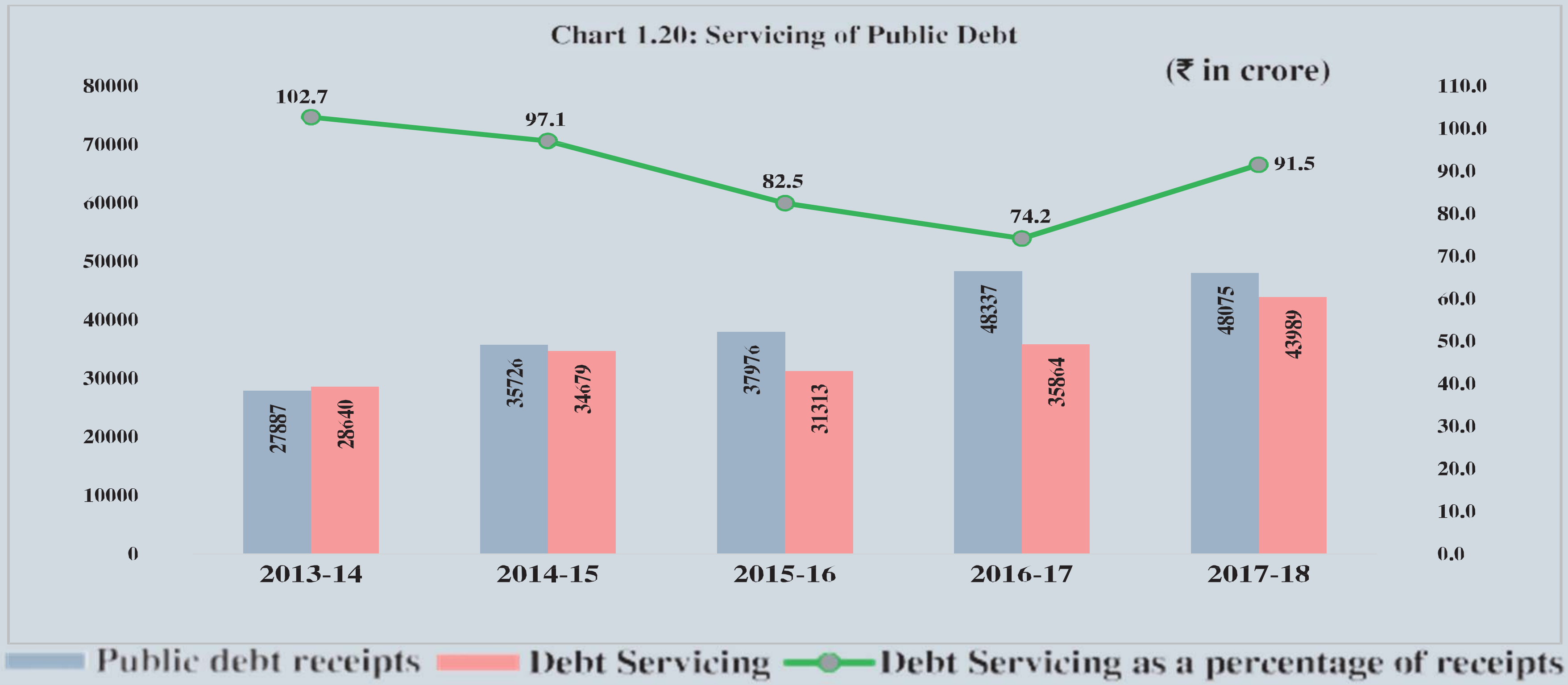
a) **Off-Budget Borrowings:**

The State Government resorted to **off-budget borrowings** amounting to XXXX during 2021-22. This off-budget borrowing will have an impact of increasing the liabilities of the State Government, leading to a debt trap over a period of time.

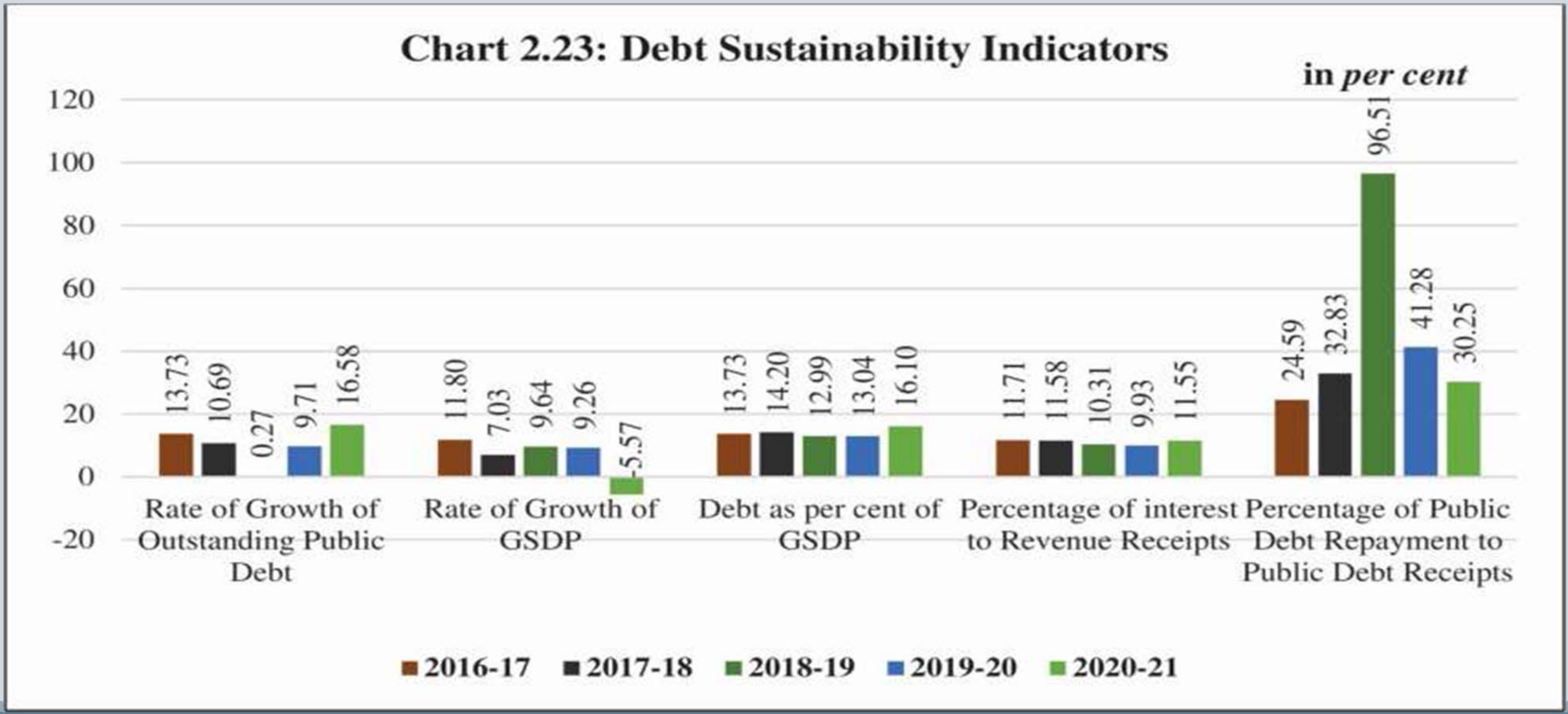
As these borrowings are not disclosed in the budget, the Legislature is unaware of the creation of such liabilities. Non-disclosure of off-budget borrowings in the State budget led to an understatement of Government liabilities by XXXX.

(Para 2.9.1 of the Report)

MAHARASHTRA STATE
AUDIT REPORT (STATE FINANCES) FOR 2018-19:



MAHARASHTRA STATE
AUDIT REPORT (STATE FINANCES) FOR 2020-21:



TELANGANA STATE
AUDIT REPORT (STATE FINANCES) FOR 2018-19:

COMMENT-

The difference between the real growth rate and real interest rate i.e., Domar gap is positive during the period from 2015-16 to 2018-19. Therefore, as per the Domar model, the Public Debt is stated to be stable.

It is, however noteworthy that the Domar gap has been registering a decreasing trend.

Moreover, other factors such as public liabilities and force majeure events have to be reckoned with in assessing debt sustainability/stability of the State.

(Paragraph 1.7.3)

UNION GOVERNMENT

- A Performance Audit on Public Debt Management was conducted in 2015-16 at the national government level and is available on SAI India website.
- DSA and reporting on the quality of data on PD has been a regular feature on Union Financial Audit Reports too.

III) SUPREME COURT CASE BETWEEN KERALA STATE AND UNION GOVERNMENT

The Union exercises oversight over provincial government borrowings through Article 293(3) and (4) of the Constitution of India

In 2023, the Union exercised this power by imposing a Borrowing Ceiling on Kerala state. This meant Kerala couldn't borrow beyond this amount from any source. Kerala state approached the Supreme Court (SC) of the country to protest, in 2023.

The National government also relied on SAI India's Kerala state Financial Audit reports containing comments on PD computation to validate its action and thus avoided an SC stay on the borrowing ceiling prescribed by it (April 2024).

IV) SAI INDIA’S CONSOLIDATED GUIDELINES FOR DEBT SUSTAINABILITY ANALYSIS

- SAI India’s audit over the years has sometimes employed a selective fiscal Indicator-based analysis and sometimes the Domar condition to comment upon debt sustainability.
- A standardization of the analysis was attempted to bring in a uniform template across the board.
- A comprehensive Indicator-based analysis and computation of Domar Gap has now been mandated.

A) DEBT STABILISATION INDICATOR (DSI)

The parameters' computed to assess debt sustainability -

Effective Rate of Interest = Interest Payments/(OB+CB of Public Debt/2) * 100

Real Effective Rate of Interest = ERI - Inflation

Interest Spread = GDP Growth Rate – Effective Rate of Interest

Quantum Spread (Rate spread as a percentage of debt stock)

= Interest Spread / Debt*100

Primary Balance = Govt. Revenue – Non-Interest Exp.

<u>Debt Stabilization Indicator (DSI)</u> = Quantum Spread+ Primary Balance

DSI EXPLAINED

- Debt sustainability condition states that if:
  - ✓ Debt stabilization indicator = 0, Debt-GDP ratio would be constant, or debt would stabilize eventually.
  - ✓ Debt stabilization indicator is negative, Debt-GDP ratio would rise.
  - ✓ Debt stabilization indicator is positive, Debt-GDP ratio would eventually fall.

DOMAR CONDITION

g-r	PB (Primary Balance) <0	PB (Primary Balance) >=0
If g-r > O (strong economic growth)	Real economic growth exceeds real interest rate provided that the PD registered is stable and consistent with debt/GDP then the debt issue is stainable.	Real economic growth exceeds real interest rate and records PS then debt/GDP ratio shall decrease and debt tends toward sustainable level therefore sustainable.
If g-r < O (slow economic growth)	Real economic growth is lower than real interest rate and records PD . Then debt tends to increase without limitations and becomes unsustainable.	Real economic growth is lower than real interest rate and records PS. Then debt is no longer sustainable provided that it is not decreased in the medium or long run .

This gap computation is also done and commented upon in SAI India's reports.

A template for calculation and thereafter deriving conclusions thereon has been circulated for ease of reference.

THANK YOU