



## Growth and Structure of Outstanding Public Debt in Himachal Pradesh

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### ABSTRACT

*Accumulation of previous year's public debt is termed as outstanding public debt and can be defined precisely as a burden on economy. Higher amount of outstanding public debt leads to debt servicing which implies expenditure made on interest payments and repayment of public debt. In Himachal Pradesh, outstanding public debt increased at the rate of 13.26 per cent and 13.99 per cent in pre and post reform period respectively. Present study covers a period of 35 years (1980-81 to 2014-15) which is divided into two broad heads i.e. pre and post reform period. To understand the debt burden of outstanding public debt, various indicators have been formulated and compared with National Level. Outstanding public debt as percentage to GSDP, which is one of the important indicators of the study, is quite poorly placed in Himachal Pradesh as compared to the national level. However, it was also found out that the state has achieved its targets regarding this ratio as recommended by 13<sup>th</sup> Finance Commission.*

**Keywords:** *Public debt; Himachal Pradesh; GSDP; Interest payment.*

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### 1.0 Introduction

Public debt means debt incurred by the government in mobilizing savings of the people in the form of loans, which are to be repaid at a future date with interest. An increase in the size of public debt of its own cannot be considered as an unhealthy development. That is so because due to the paucity of internal resources, it is not possible to sustain the large outlays without recourse to public borrowings for any state. Thus what is important is not just the rise of the debt, rather what is relevant is that how effectively it is utilized for the production of assets, which ultimately results in the generation of additional revenue to the state. In the absence of its effective utilization,

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growing public debt will accumulate and ultimately constrain the State into borrowing more and more. Such an accumulated previous year's public debt is termed as outstanding public debt and can be defined precisely as a burden on economy. Higher amount of outstanding public debt leads to debt servicing which implies expenditure made on interest payments and repayment of public debt. Huge expenditure made on interest payments implies that, the committed expenditure of the state is very high, therefore leaving very little space for discretionary expenditure which in most of the cases is going to be made on the development of social and economic sectors of the economy. Higher the amount of outstanding public debt, higher will be the debt servicing. This way the outstanding public debt will increase leading to fiscal unsustainability. In this backdrop, in the present study an attempt is made to study the growth of outstanding public debt in Himachal Pradesh. It is important to note here that outstanding public debt is classified into outstanding internal debt and outstanding loan and advances from central government.

- **Outstanding Internal Debt:** It includes outstanding market loans and outstanding loans taken from various autonomous bodies and institutions like the Life Insurance Corporation of India, GIC of India, NABARD, State Bank of India & other Banks, National Co-Operative Development Corporation, RBI and Other Financial Institutions.
- **Outstanding Loan and Advances from Central Government:** It includes outstanding non- plan loans, outstanding loan from state/ UT plan scheme, outstanding loan from central plan scheme and outstanding loan from centrally sponsored plan scheme and ways and mean advances.

An analysis of growth and structure of outstanding public debt is of special importance particularly in Himachal Pradesh because of the peculiar circumstances in which the state is placed. Himachal Pradesh being a very small state has some peculiar circumstances which increases the role of government expenditure all the more. For instance, being a mountainous state with a rugged terrain and rarefied airs, the cost of living, production and construction, is relatively very high in the state. The state has a poor revenue base therefore, to finance its various projects and schemes, it has been heavily borrowing from various agencies. These borrowings have to some extent created a situation like debt trap in the state.

## 2.0 Review of Literature

Various relevant studies relating to burden of public debt and growth behaviour of outstanding debt with other variable revealed some diverse issues relating to the

present study. Modigliani (1961) described national debt as a burden for next generations, which comes in the form of a reduced flow of income from a lower stock of private capital. He pointed out that the gross burden of national debt may be offset in part or in total when debt financed government expenditure contributes to the real income of future generations, such as productive public capital formation. Naidu and Rao (1975) examined the management of internal public debt of the Government of India during the period 1950-51 to 1973-74. They measured the burden of public debt in terms of financial and real burden. The mounting debt burden of the Government of India, by way of debt servicing increased during the period 1965-66 to 1974-75. They concluded that although the ratio of internal debt to national income was small, the rate of growth of public debt was higher than the rate of growth of national income, so it imposed a heavy real burden.

Rao and Reddy (1980) examined the extent of indebtedness of the states to the Centre and the financial burden that was imposed on them during the period 1951 to 80. They classified states' debt into central loans and non-central debt. They discovered that the amount of central loans to state governments had increased during these 30 years and this growing indebtedness of the states to the Centre led to emergence of many problems. Garg (1993) analysed the selected data on external public debt of India for period 1980 to 1989, for total debt outstanding, total debt service and debt service ratio. He further analysed the Indian debt structure for the same period and concluded that the debt structure for India has consistently deteriorated due to typically higher costs associated with borrowing from private sources. Zaidi (1997) described debt burden of Pakistan as the single biggest problem of the country. It was observed that domestic debt of Pakistan had accumulated to 42 per cent of GDP with debt servicing accounting for more than 5 per cent of GDP each year. Fiscal deficit stood much higher due to large amount of domestic debt and interest payments. It was also observed that interest payments and defense absorb most of the expenditure and leave nothing for development and social sector. Further, he suggested to increase the real rate of growth over real rate of interest, as higher growth rate would generate higher revenue which can solve the problem of debt and deficits.

Kemal (2001) explained the debt accumulation and its implications on growth and poverty in Pakistan. The study revealed that debt accumulation (domestic and external) and debt servicing has negatively affected the economy of Pakistan. The findings of the study illustrated that even though debt burden as a percentage of GDP of Pakistan exceeds that of all South Asian countries but, it is not still so high as to go for debt write off. It indicated that Pakistan has the capacity to service the debt. Chowdhury and Dasgupta (2012) made an attempt to understand the reasons of high debt-GSDP ratio

in west Bengal, which underlie the fiscal stress in the state. The state had the second highest debt-GSDP ratio in the country during the year 2008-09 among the non-special category states. By using Domar condition for debt sustainability it was explained that debt problem of the state is not because of the higher expenditure, but the low level of revenue receipts on the one hand and high effective rate of interest on the other are the main factors responsible for it. It was observed that interest burden of the state has continuously increased during the period under study. Further, it was concluded that due to rigid conditions imposed by 13th Finance Commission and non-compliance by the state government, state has failed to qualify the debt and interest relief from the Centre.

In the Indian context and more specifically in context of Himachal Pradesh, there are some issues which have not been dealt in depth at the states level such as, growing behaviour of debt burden, outstanding public debt as percentage to GSDP, Public Expenditure, Revenue Receipts and per capita outstanding public debt etc. In this background, the present study makes an attempt to analyse the outstanding debt position of Himachal Pradesh and discusses various issues impinging upon its growth in Himachal Pradesh. In addition, another important reason for this research lies in the fact that the findings and conclusion of non-hill states cannot be fully applicable in context to Himachal Pradesh due to variety of inherent constraints and peculiar features of the state.

### **3.0 Methodology and Objective of the Study**

The present study covers a period of 35 years i.e. from 1980-81 to 2014-15. In this study, a detailed analysis of growth of outstanding public debt during two broad periods is analyzed i.e. pre and post reform period. The analysis is based on secondary data which is obtained from the various government reports, survey and publications of Himachal Pradesh (India). Main objective of the study is to analyze the growth and structure of outstanding public debt in Himachal Pradesh. In order to study the growth of outstanding public debt in the state the linear exponential growth rate has been calculated with the help of following equation:-

$$Y_t = a e^{r.t}$$

where

Y is ending amount of a variable at time t (whose growth rate has to be observed)

a is the beginning amount of the same.

t is time, and

r is the exponential growth rate.

In addition to the debt burden of outstanding public debt, certain indicators have also been formulated. Following is the list of different indicators through which growth and structure of outstanding public debt is measured;

1. Per capita Outstanding Public Debt
2. Outstanding Public Debt as percentage to public expenditure,
3. Outstanding Public Debt as percentage to revenue receipts,
4. Outstanding Public Debt as percentage to GSDP.

As far as indicators of debt burden of outstanding public debt in Himachal Pradesh are concerned, they are compared with those of averages of all the states taken together.

#### **4.0 Findings of the Study**

In Table 1 various indicators of outstanding public debt in Himachal Pradesh and at the national level (when all the states are taken together) is shown through which growth and structure of outstanding public debt is measured. Outstanding public debt in Himachal Pradesh on an average increased from ₹ 558 crore per annum in pre-reform period to ₹ 10313 crore per annum in the post-reform period. In the state, it increased at the rate of 13.26 per cent and 13.99 per cent in pre and post reform period. It further revealed that during the first phase it recorded lower rate of growth in Himachal Pradesh vis-à-vis the average of all the states taken together. In contrast, during the second phase outstanding public debt in Himachal Pradesh grew at a higher rate than averages of all the states taken together.

The ratio of outstanding public debt to public expenditure also to some extent reveals various relevant insights of burden of public debt in Himachal Pradesh. Public expenditure is a double edged weapon. On the one hand its growing size leads to more and more borrowings (hence leading to debt burden) and secondly, public debt then raised causes further increase in public expenditure (through interest payments) hence, starting a vicious circle of public debt. Total outstanding public debt as a ratio to public expenditure in Himachal Pradesh on an average increased from 98.21 per cent per annum during pre-reform period to 128.24 per cent in the post-reform period. In brief, Himachal Pradesh was better placed vis-à-vis all other state taken together with respect to this indicator during the pre-reform period but, in the post-reform period it was vice-versa. However, such a high ratio reveals an exceptionally grave financial scenario in the state.

Outstanding public debt as percentage to revenue receipts in Himachal Pradesh on an average increased from 113.04 per cent per annum during the decade of 80's to

158.20 per cent during the post-reform period. It is observed that during the decade of 80's, Himachal Pradesh performed better than the combined average of all the states taken together (138.96 %). But from the post-reform period, this ratio stood more in Himachal Pradesh than the combined average of all the states taken together.

**Table 1: Outstanding Public Debt**

S. No.	Heads	Phases					
		1980-81 to 1990-91 (Pre Reforms)		1991-92 to 2014-15 (Post Reforms)		Overall (35 years)	
		H.P	India	H.P	India	H.P	India
1	Outstanding Public Debt (on an Average ₹ in Cr.)	558	50073	10313	746608	7247	527697
2	Growth rate of Outstanding Public Debt (in %)	13.26	15.75	13.99	13.01	14.59	13.90
3	Outstanding Public Debt as % to Public Expenditure	98.21	101.73	128.24	113.68	127.30	113.28
4	Outstanding Public Debt as % to Revenue Receipts	113.04	138.96	158.20	147.34	156.69	147.08
5	Per Capita Outstanding Public Debt (in ₹)	1158	345	15566	6529	11038	4680
6	Rate of Growth of Per Capita Outstanding Public Debt	11.37	12.45	12.64	11.59	13.07	11.89
7	Outstanding Public Debt as % to GSDP	36.11	15.67	33.59	17.94	33.65	17.86

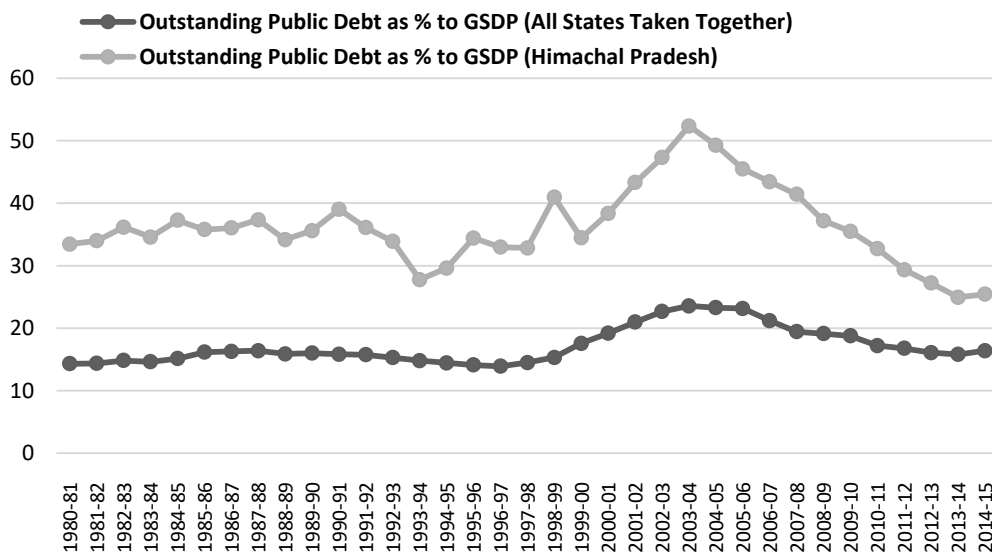
Source: Data compiled on basis of information collected from various relevant issues of (a) Annual Financial Statements: Government of Himachal Pradesh, (b) Finance Accounts (various issues): Government of Himachal Pradesh, Comptroller and Auditor General of India.

Per capita outstanding public debt is another important dimension explaining the burden of public debt in the state. In the pre-reform period per capita outstanding public debt in Himachal Pradesh increased at a lower rate (11.37 %) than recorded by all the

state taken together (12.45 %), however, in the post-reform period it was vice versa. In Himachal Pradesh per capita outstanding public debt in post-reform period increased at a rate of 12.64 per cent in contrast to 11.59 per cent recorded by all the states taken together.

In Himachal Pradesh Outstanding Public Debt as percentage to GSDP on an average stood at 36.11 per cent during the decade of eighties. If a comparison is made between pre and post reform period, this ratio on an average declined slightly in the later period. This ratio on an average, stood at 33.59 per cent during the post-reform period. As against it, the corresponding ratio for all the states taken together throughout continued to be considerably low. Figure 1 depicts the trends of outstanding public debt as percentage to GSDP in Himachal Pradesh as well as at national level since 1980-81 to 2016-17. This implies that with respect to this indicator Himachal Pradesh is quite poorly placed vis-à-vis the average of all the states taken together.

**Figure 1: Outstanding Public Debt as Percentage to GSDP**



Source: As per Table 1.

In this backdrop, an important issue which needs to be discussed is that whether outstanding public debt is sustainable or not in Himachal Pradesh. It has been analysed

in the light of two different aspects, one under FRBM act and the other on the basis of the recommendations of 13th Finance Commission of India.

The FRBM Act 2005 provides targets to ensure that government finances are managed with a view to achieve equitable and stable growth. FRBM Act proposed the state to reduce its outstanding liabilities to 50 per cent of the estimated GSDP by the year 2011. The Thirteenth Finance Commission was required to review the operation of the States' Debt Consolidation and Relief Facility (DCRF), and suggest measures to maintain a stable and sustainable fiscal environment consistent with equitable growth.

To support States towards urgent fiscal correction, 13th Finance Commission worked out a fiscal consolidation roadmap for each state, requiring States to eliminate revenue deficit (RD) and achieve fiscal deficit (FD) of 3 per cent of their respective Gross State Domestic Product (GSDP) by 2014-15. Thirteenth Finance Commission also recommended a combined debt target in terms of outstanding debt to GSDP ratios for each State yearly. Based on these recommendations, all states, with the exception of Goa, have amended their FRBM Acts. In Table 2 combined debt target for Himachal Pradesh, recommended in FRBM Act in terms of outstanding debt to GSDP (2010-11 to 2014-15) has been shown. As per 13th Finance Commission this value set for Himachal Pradesh was 49.70 per cent for the year 2010-11, 47.00 per cent for 2011-12, 44.40 per cent for 2012-13, 42.10 per cent for 2013-14 and 40.10 per cent for 2014-15.

**Table 2: Outstanding Public Debt GSDP Ratio in Himachal Pradesh**

Year	Outstanding Public Debt of HP as % GSDP	Targets of FRBM Act	Target achieved or not
2010-11	32.74	49.70	Target achieved
2011-12	29.36	47.00	Target achieved
2012-13	27.23	44.40	Target achieved
2013-14	24.96	42.10	Target achieved
2014-15	25.45	40.10	Target achieved

Source: Finance Department and Finance Accounts.

After the enactment of FRBM, outstanding debt-GSDP ratio has declined considerably in Himachal Pradesh. As an aftermath of the passing of this Act and recommended by FRBM Act and recommended by 13th Finance Commission, Himachal Pradesh has succeeded in bringing down its outstanding debt-GSDP ratio. It is revealed that the state has achieved the targets regarding this ratio as recommended by 13th



Finance Commission and adherence to FRBM Act helped the state to achieve these targets.

## **5.0 Conclusion**

There has been an alarming deterioration in the financial position of the state due to increased borrowings and almost stagnant non-tax revenue, indicating worsening of the fiscal and debt stability parameters. The growth rate of GSDP has declined from 18.24 per cent in 2010-11 to 11.35 per cent in 2014-15. The growth rate of revenue receipts consistently decreased from 22.86 per cent in 2010-11 to 13.57 per cent in 2014-15. As per FRBM Act 2005, the revenue deficit which was required to be brought down to zero level during 2011-12 and maintain revenue surplus thereafter could not be achieved. The state recorded huge revenue, fiscal and primary deficit during the period 2010-15 (except for the year 2011-12). It was observed that the fiscal deficit was 4.39 per cent of GSDP during the year 2014-15 which was significantly above the target fixed by FRBM Act and projections made by 13th Finance Commission (i.e. 3 %). Along with this, the state is in a debt trap with total debt of ₹ 25728.51 Crore and every year interest payments take away more than ten per cent of its revenue and grants from the Government of India.

Since the amount of public debt raised in 2013-14 and 2014-15 is much higher in Himachal Pradesh, it will lead to unmanageable increase in interest payments in near future. Himachal Pradesh does not enjoy a good financial scenario because of growing debt liabilities and consequent burden on the state. Mounting outstanding liabilities are a big challenge to the state government in the efficient delivery of its routine functions.

Such a growing outstanding public debt has raised certain doubts about the sustainability of fiscal finances in the state. As debt servicing becomes difficult for the state, interest payment on debt may crowd out vital public expenditure on health, education and other social economic welfare projects. Repayment of debt may substantially reduce the net borrowings and erode resources for public investment. It may crowd out private investment and affect growth especially when public debt is utilized for current expenditure. Though the state finances to some extent are going to be regulated under the FRBM Act framework, but how with restrictions on debt and expenditure of the government, development pace is going to be affected remains to be seen. With a strict ban on regular employment how the efficiency of the government departments has been affected, how capital expenditure which is the backbone of development activity has been affected under regulations are some serious issues, which

need lots of intellectual and academic exercise. In fact, more important is how efficiently and judiciously public debt is used in the economy.

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