OPINION | COMMENT

Why India needs a Fiscal Council

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Fiscal transparency and accountability must be ensured to create room for market confidence in a high public debt regime

Globally public debt, i.e. the total borrowing incurred by a government, is mounting. **The International Monetary Fund (IMF) Global Financial Stability Report, published in April 2022** revealed that in the emerging market economies, the average ratio of public debt to GDP (gross domestic product) rose to a record 67% last year. Public debt to GDP surged in advanced economies too, from 103% in 2019 to 123% in 2020, before declining to 115% of GDP in 2022. India registered a significant increase in this ratio, from 75.1% in 2019 to 90.1% in 2020. However, it is expected to decline to 85.3% by 2025, as per the recent IMF Fiscal Monitor.

Amid rising rates

In a low interest rate regime, it is easier to handle public debt as the cost of borrowing is relatively lower. Therefore, from a macroeconomic perspective, higher public debt in a low would 'crowd-in private investment', and also to reduce the output gap. Prevailing low real interest rates indeed created a perception of painless fiscal expansion. However, with central banks across the world raising interest rates and global risks persisting, the focus is now back on the sustainability of public debt — because with higher interest rates, the cost of borrowing goes up.

The internal market borrowing constitutes around 70% of public debt in India for this fiscal year. A look at the internal debt maturity profile revealed that the proportion of securities maturing in less than one year has increased from 3.9% in March 2020 to 5.44% of the total outstanding in December 2021.

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Moreover, the proportion maturing in less than five years during the same period has shown an increase to 29.94%, from 28.97%. The implication of short-term debt (less than one-five years) is the immediate refinancing risks. A recalibration of debt maturity structure more towards long-term securities is crucial to lessen the negative fallout of hikes in interest rates. However, **external debt** is not a cause for concern as it is just 0.70% of the public debt in this fiscal year and mostly from official sources which are long term and concessional in nature.

Debt servicing — the burden of public debt — is also mounting. In India, the interest payments to revenue receipts ratio is reaching 42.6% (BE, or Budget Estimates) in the current fiscal compared to 39% last year (RE, or Revised Estimates). The ratio of interest payment to revenue expenditure is rising to 29.4% this fiscal compared to 25.7% last year.

Against the backdrop of geopolitical risks and uncertainties, the fiscal rules and Fiscal Responsibility and Budget Management (FRBM) threshold ratios of public debt and deficits need an emphasis. The medium-term fiscal consolidation path articulated by the Finance Minister — to reduce the fiscal deficit to GDP ratio to 4.5% by 2025-26 — is welcome.

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Rethink debt sustainability in terms of key ratios

Debt sustainability in terms of key ratios like the 60% debt to GDP ratio needs a rethink. Ideally, public debt is considered sustainable if a country can 'grow out of debt'. Technically this requires that the real rate of interest is not greater than real growth of economy. Hence, paying attention to growth is also important. Fiscal policy has remained very accommodative to support the growth recovery process, especially when monetary policy has to respond to mounting inflation by hiking the interest rates. Fiscal policy is moving away from pandemic emergency packages-related spending towards the formation of robust capital

To get a consolidated picture of general government deficits, an analysis of debt-deficit dynamics at the State level is crucial. In India, the threshold of fiscal deficit to GDP for States is enhanced to 4% of GSDP, within which 0.5% of this extra borrowing space is linked to structural reforms in the power sector. The emphasis on structural reforms is welcome especially when the downturn in the growth is a 'scarring process' rather than a transient cyclicality in growth downturn.

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To conclude, an earlier than expected fiscal normalisation process by drastically curbing public debt can affect growth recovery. So strengthening the credibility of fiscal policy is significant to ensure fiscal marksmanship. 'Communication' of the medium-term fiscal framework by providing the roadmap to reduce the public debt is important to gain investors' confidence. Fiscal transparency and accountability need to be ensured to create room for market confidence in a high public debt regime. Constituting a Fiscal Council in India is therefore crucial at this juncture to analyse the fiscal risks and to formulate post-pandemic fiscal strategies to ensure fiscal credibility in times of geopolitical uncertainties.

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