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An Analysis of Growth And Composition of India's External Debt

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Abstract

External debts for a developing country is one of the major sources of finance for development and economic growth, but have always been a debatable topic among economists due to some problems associated with it such as debt accumulation and sustainability. Importance of external debt cannot be overlooked as it is the booster of economic growth. It is crucial to understand the Indian economy through the adjustment of fiscal dimension like external debt raised by government of India. Hence, the current study will aim to analyze the growth of external debt and its components and the reasons behind it. Also studied the implications of polices adopted by government in two different phases.

Key Words

External Debt, Economic Growth, Concessional Debt, Financial Crises, Debt Sustainability

INTRODUCTION

External debt (or foreign debt) is that part of the total debt in a country that is owed to creditors outside the country. The debtors can be the government, corporations or citizens of that country. The debt includes money owed to private commercial banks, other governments, or international financial institutions such as the International Monetary Fund (IMF) and World Bank. During the early nineties of 20th century, India experienced worst economic crisis ever in the history since independence (Saxena & Shanker, 2017). Oil price hike due to the

Gulf War and other external forces directly impacted the Current Account Deficit (CAD), which eventually led to the crisis of Balance of Payment (BOP). Prolonged negative impact on India's Current Account Deficit (CAD) eventually led to the crisis of Balance of Payment (BOP) and severe conditions like hyper-inflation over 13 per cent during early 1990s (Shanker, 2014).To alleviate this crisis, Government of India decided to borrow funds from International Monetary Fund (IMF) and brought significant economic reforms since 1991. These external borrowings led to expeditious increase in external debt and mounted up country's debt account. However, this convertibility led to the depreciation of Indian Rupee and swollen the value of external debt tremendously. This scenario forced policy makers to disturb the foreign reserves and public treasury to meet the external liabilities.

LITERATURE REVIEWS

The study of (Agarwal & Gangal, 2015) examined the long-run and short-run causality relationship between external debts, foreign direct investment and current account balance in reference to India from 2000-01 to 2012-13. The analysis was done by using Granger causality and Vector Error Correction models (VECM). It was assessed that selected variables were integrated of order 1 that is I(1). Results of VECM models showed that there was only long-run causality relationship between external debts and current account balance but not in the short-run.

The study titled "How excessive are external imbalances in selected transition countries" by (Aristovnik, 2006) found the evidence that there was a positive and statistically significant relation between total (lagged) external debt and the current account balance for selected European countries such as Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia and others. The study applied generalized method of moments (GMM) to investigate the relationship. It was found that a 1% point increase in total external debt led to 0.02-0.04% point increase in current account balance in the next year.

Cline (1985) studied the relationship between the economic growth and external debt. According to his studies, external debt contributes positively to growth. He argued that external debt will have a positive impact on the economy of the borrowing country, if marginal productivity of each available external debt is greater than or equal with the principal and the interest.

Jayme (2001) examined the sustainability of external debt in Brazil to check whether Brazilian economy in consideration of its external debt repayments was kept solvent from 1969 to 2000. The study used Augmented Dickey-Fuller

(ADF) Test and Johansen Co-integration Test allowing for linear deterministic trend and non-deterministic trend in the data. It was found that there existed positive and significant relationship of GDP and GDP per capita between inflows and indebtedness.

Siddique and Selvanathan (2015) investigated a negative effect of the external debt on economic growth of 40 poor countries over the period 1970-2007. Empirical evidence revealed the the main causes for the debt overhang problem are poor internal and external economic policies.

RESEARCH GAP

The existing literature depicts the relationship between external debt and the economic growth of country as well as the impact of main macro-economic variables on external debt. One study also identifies the poor economic policies are the cause for the debt overhang problem. But, there is lack of in-depth research on trends and growth of external debt and its components in two different phases of developing country.

RATIONALE FOR THE STUDY

The current research aimed to examine the growth and trends of external debt comprising of government borrowings and non-government borrowings and further their components to analyze which sector is demanding more external debt and reasons behind it, so that necessary polices should be framed and implemented for the effective management of external debt.

OBJECTIVES OF THE STUDY

- To analyze the trends in growth and composition of India's external debt before and after financial crises
- To study the percentage change in government and non-government borrowings
- To study the policies and strategies implemented by government of India for external debt.
- To suggest optimal policy options for effective management of external debt.

SCOPE OF THE STUDY

External debt had been one of the prominent topics of debate among economists. Some economists argue that external debt is one of the important sources of capital for a country as it has positive impact on investment and the economic growth. Others contradict this view, as they describe the problems associated with external debt, e.g., problem of debt accumulation, inability of a country to meet debt obligations, debt sustainability, difficulty in raising foreign loans in its own currency etc. With this scenario, current research aimed to examine the trends and growth of external debt that cover all the years from 2000-2017.Therefore,it takes into account significant global and national economic events such as financial crises 2007-08, European sovereign debt crises and demonetization in India 2016

METHODOLOGY

(a) Sources of Data

The study is based entirely on the secondary data which has been collected from the various sources such as data base of Reserve Bank of India and various government sources and published journals and articles. The annual data for each year corresponded to the financial year starting from April 1 of one year to March 31of the next year.

(b) Selection of Time Period

The study covers the period of 17 years from 2000-2017.The entire time period has been divided into two phases. The first phase is from 2000-2007, which has been taken as pre-financial crises period. The second phase is after 2007-2017 which has been taken as post-financial crises period. The justification of dividing the period in two phases is to compare the movement of external debt and getting a clear idea that how it has changed over the two phases.

(c) Data Analysis Procedure

The study intends to analyze the growth of external debt and its components under different phases. For this purpose, simple statistical tools such as trend analysis and percentage analysis to know AGR (Annual Growth Rate) are used. It is analytical research in nature. The following formula was used to compute the rate of change.

$$\text{Rate of Change} = \frac{\text{Value in the Current Year} - \text{Value in the Previous Year}}{\text{Value in the Previous Years}} \times 100$$

ANALYSIS

Pre-financial Crisis Period (2000-2007)

According to Twelfth Status Report published by Department of Economic Affairs under the Ministry of Finance, Government of India, the country's external debt increased to USD 125.2 billion in March, 2006 from USD 123.2 billion in 2005 (Department of Economic Affairs, 2006). However, the report mentioned that the debt indicators in the same period showed persistent improvement.

Table 1

Data for External Debt During April 2000-March 2007 (US$ billion)

Year	External Debt	% Change (External Debt)	Total Government Borrowing	% Change (Total Government Borrowing)	Total Non-Government Borrowing	% Change (Total Non-Government Borrowing)
2000-01	31.105	-1.06	27.414	-0.62	3.691	-4.23
2001-02	31.899	2.55	28.29	3.20	3.609	-2.22
2002-03	29.994	-5.97	27.271	-3.60	2.723	-24.55
2003-04	29.297	-2.32	26.826	-1.63	2.471	-9.25
2004-05	31.744	8.35	29.204	8.86	2.54	2.79
2005-06	32.62	2.76	29.996	2.71	2.624	3.31
2006-07	35.337	8.33	32.514	8.39	2.823	7.58

In Table 1, one could see the trend analysis of government borrowing, non-government borrowing, and total external debt for the period 2000-01 to 2006-07. The values clearly indicate that the external debt remained relatively stable till 2005-06 when the external debt was USD 32.62 billion and subsequently it increased to reach USD 35.337 billion in 2006-07. The rise in the external debt can be attributed to the disturbances in the global economy which occurred in 2004 and eventually resulted from huge corporate borrowings overseas via external commercial borrowings and foreign currency convertible bonds which were demonstrating a rise in the domestic investment activities (Rais, 2013). According to Global Development Finance 2006 by World Bank, the external debt of India improved significantly after 2000 with regard to its obligated counterparts (Department of Economic Affairs, 2006). The main reason for the considerable stability of external debt is the significant increase in foreign exchange reserve assets.

The Figure 1, shown above, clearly indicates the trend analysis during pre-financial crisis period. The external debt increased from USD 31.105 billion in 2000-01 to USD 35.337 billion in 2006-07. However, the total non-government borrowing fell from USD 3.691 billion in 2000-01 to USD

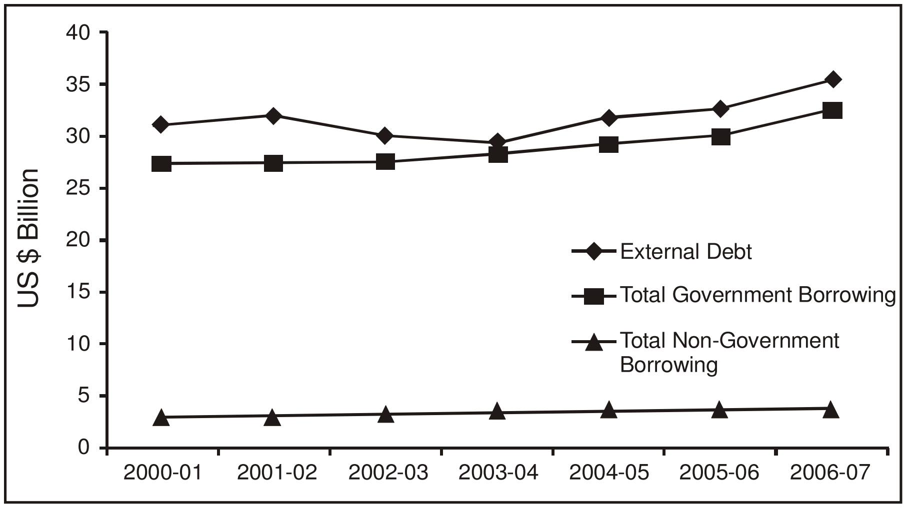

Figure 1 : Trend Analysis of External Debt During April 2000-March 2007

2.823 billion in 2006-07. The figure clearly indicates that there were not many fluctuations in the level of external debt, total government borrowing and the total non-government borrowing. The pre-global economic and financial crisis of 2008, i.e., years between 2004-05 and 2007-08, there was a change in the composition of external debt inflows. According to the World Bank statistics, during period 2001-07 India continues to be among the less indebted low income

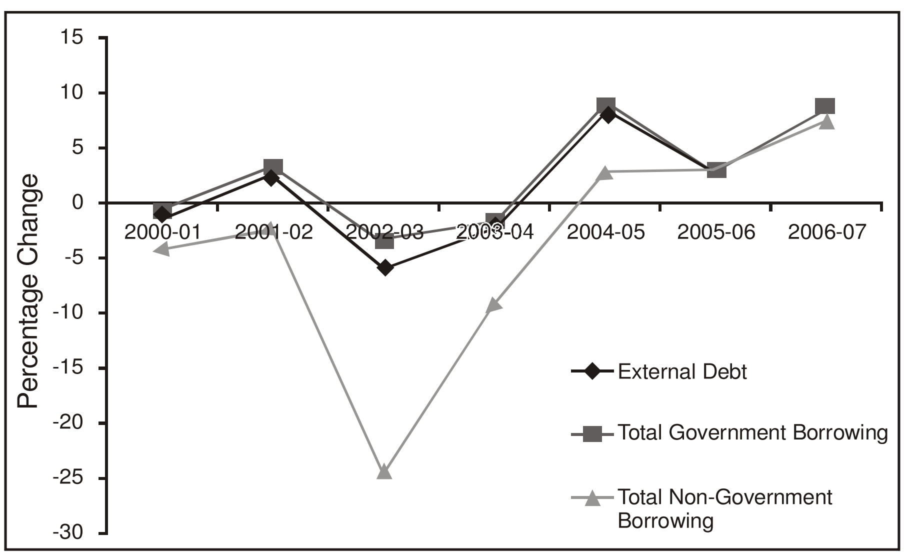

Figure 2 : % Change of the External Debt During April 2000-March 2007

countries, however, the acceleration in the buoyant exports and foreign reserves have strengthened India's external debt management (International Working Group, 2009). The moderate growth in external debt during 2001 to 2007 was due to sustained initiative towards debt consolidation.

The above graph shows the percentage change in the components of external debt during the period of 2000 to 2007.The graph clearly indicates that the external debt declined during 2002-03.In the similar context, the total non-governmental borrowing fell during the same period and increased in the subsequent years. The Table 1 also indicates that total non-government debt fell by 24.55 % in 2002-03 and the external debt fell by 5.97%. In this context the study of (Topalova & Nyberg, 2010) stated there was a continuous fall in the debt service payments during the period of 2002-03. To this, the study of (D. C. Mohan & N. Chitradevi, 2014). highlighted that there was a continuous rise in inflation rate due to the external disturbances also increased external debt after 2004.

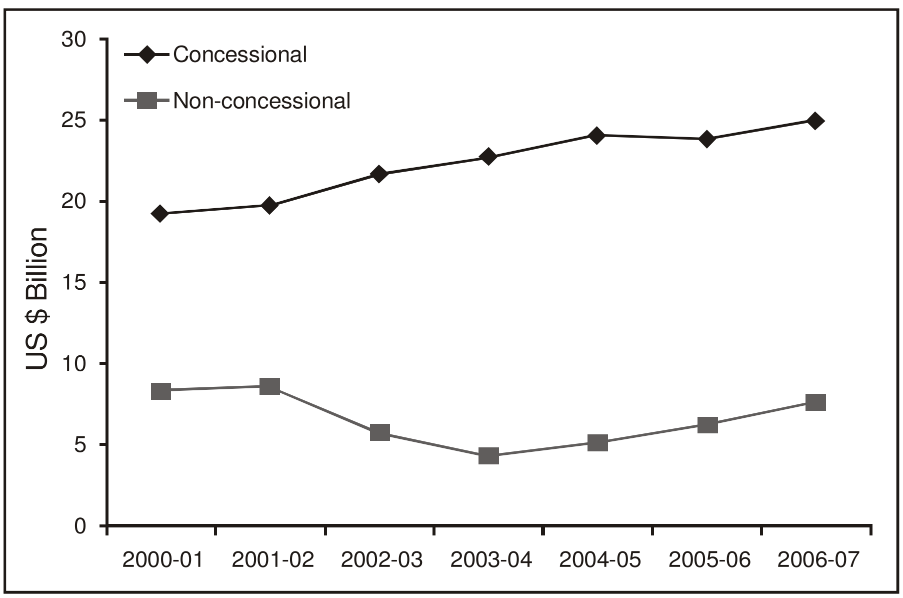

Figure 3 : Trend Analysis of the Components of Government Borrowing

The figure, shown above, clearly indicates that concessional and non-concessional debt in the pre-financial crises period. The figure clearly indicates that the concessional debt in total multilateral level of external debt of the country kept on increasing after 2001 except in the year 2005-06 and held a significant portion in the total exposure, which was good since this component of liability could decrease the cost of debt. The non-concessional debt fell till 2003-04 and increased after this period and that was because of the rise in the non-concessional private debt. In this context, the study of (Waheed, 2009) highlighted that the concessional and the non-concessional didn't witness much fluctuations in the pre-financial crisis period.

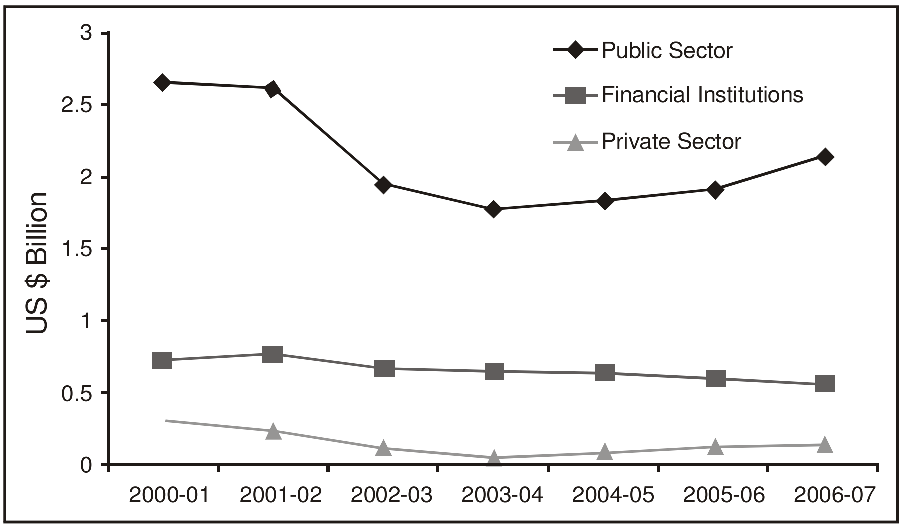

Figure 4 : Trend Analysis of the Components of Non-Governmental Borrowing

The above graph highlights the components of non-governmental borrowing during the pre-financial crises period. The trend lines clearly indicate that there was a fall in the amount of public debt. On the other hand, debt of the financial institutions and the private sector was relatively stable. In this context, the study of (Waheed, 2009) stated that the majority of the public sector undertakings which were undergoing loss were sold or acquired by the private sector. This improved the efficiency of the public sector due to which they witnessed the amount of loans in this sector reduced.

Post-financial Crisis Period (2007-2017)

Even during the global financial crisis in 2007, the Government of India was able to bring down the gross fiscal deficit to below 4 per cent of the GDP due to strong revenue growth and mobilization of foreign exchange reserves (Pradhan, 2014). However, the after effect of financial crisis was evident in the fiscal deficit of 2008-09 by recording 8 per cent of GDP. In addition, the debt (both internal and external) to GDP ratio was about 70 per cent, which was higher than the target figure of 60 per cent set by finance commission. It was believed to be that the worst performance of Current Account Deficit as the main reason for the huge fiscal deficit for India after 2008.

Table 2
Data for External Debt During April 2007-March 2017 (US$ billion)

Year	External Debt	% Change (External Debt)	Total Government Borrowing	% Change (Total Government Borrowing)	Total Non-Gov-ernment Borrowing	% Change (Total Non-Government Borrowing)
2007-08	39.49	11.75	36.17	11.25	3.32	17.57
2008-09	39.54	0.12	35.72	-1.24	3.81	14.91
2009-10	42.86	8.39	37.83	5.88	5.03	31.93
2010-11	48.48	13.11	42.58	12.57	5.90	17.17
2011-12	50.45	4.08	43.69	2.60	6.77	14.77
2012-13	51.59	2.25	43.54	-0.34	8.05	18.97
2013-14	53.42	3.54	44.60	2.43	8.82	9.55
2014-15	52.39	-1.92	43.02	-3.55	9.38	6.30
2015-16	54.00	3.07	44.17	2.69	9.83	4.83
2016-17	54.50	0.93	44.36	0.42	10.15	3.23

According to the Department of Economic Affairs, (2014), the increase in the external debt could be contributed to the fact that the international bodies like IMF, World Bank, stepped in with emergency financing for the economies that badly impacted by the global and financial crisis of 2007-08. The studies argued that the overall proportion of debt creating inflows in the capital inflows rises from 29.6 per cent in the year 2009 to 36.7 per cent in 2012 of all the developing nations (Department of Economic Affairs, 2014).

In Table 2, one could see the values of government borrowing, non-government borrowing, and total external debt for the period 2007-08 to 2016-17. The Table clearly indicates that there was a big jump of total external debt from USD 39.49 billion in 2008 to USD 54.502 billion in 2016-17. It might be due to the acceleration in the short-term debt along with a high rise in commercial borrowings in 2007 revealing the weakening of the US dollar against other major world's economies which further accompanied by the rise in trade credit in 2008, therefore, contributing to acceleration of the external debt in 2008-2009 (Rais, 2013). During the beginning of the 2010, India comes out as a world's fifth largest indebted nation in the world. This increase in debt was attributed to both internal as well as the external reasons. The external factor raised in the form of spillover effects of the financial crisis of 2008. On the other hand, the internal factor was increase in the government spending in different welfare schemes as the eleventh five year plan aimed at more inclusive growth. The government increased its expenditure in to achieve the state level targets that were related to income poverty education health infrastructure and environment (Pradhan, 2014).

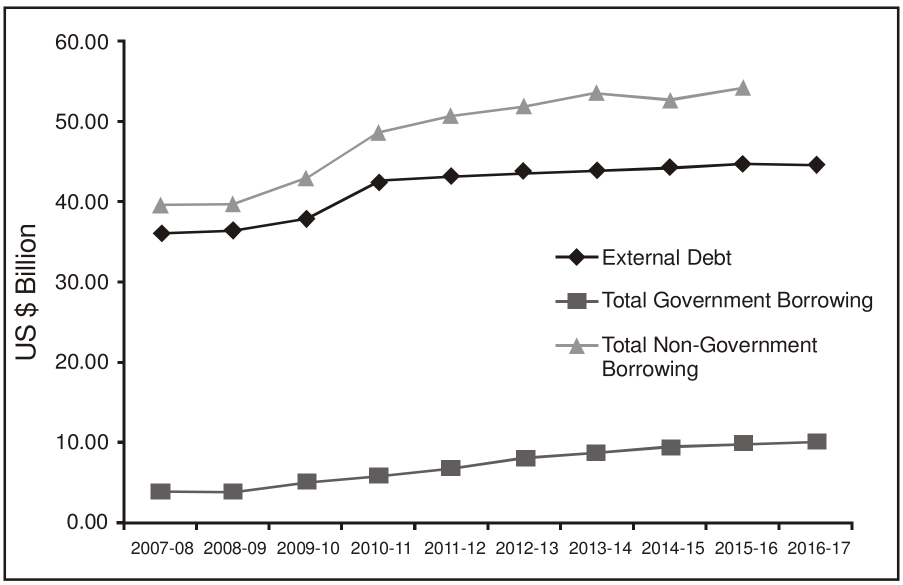

Figure 5 : Trend Analysis of External Debt During April 2007-March 2017

The figure highlights the trend analysis for external debt and its components for the post-financial crisis period. The figure clearly indicates that there was rise in the external debt and the total government borrowing. Moreover, the government borrowing contributed around more than 80 per cent in the total exposure and rest of the portion by non-governmental borrowing However, the total non-government borrowings were stabilized during the period. The study indicates that the majority composition of external debt is multilateral levels and the external debt inclined significantly over the period of 2006 to 2016. The report by (STCI Primary Dealer Ltd., 2017) shows that there was a declination in the external debt of India in 2017 as compared to 2016. The author believes that this declination in India's external debt was mainly due to the significant rise in NRI deposits, External Commercial Borrowings and short-term debts, which hold significant quota in external debt. The author also hints that the debt sustainability India started to become an issue and to resolve it the policy makers have to take care about key macroeconomic indicators

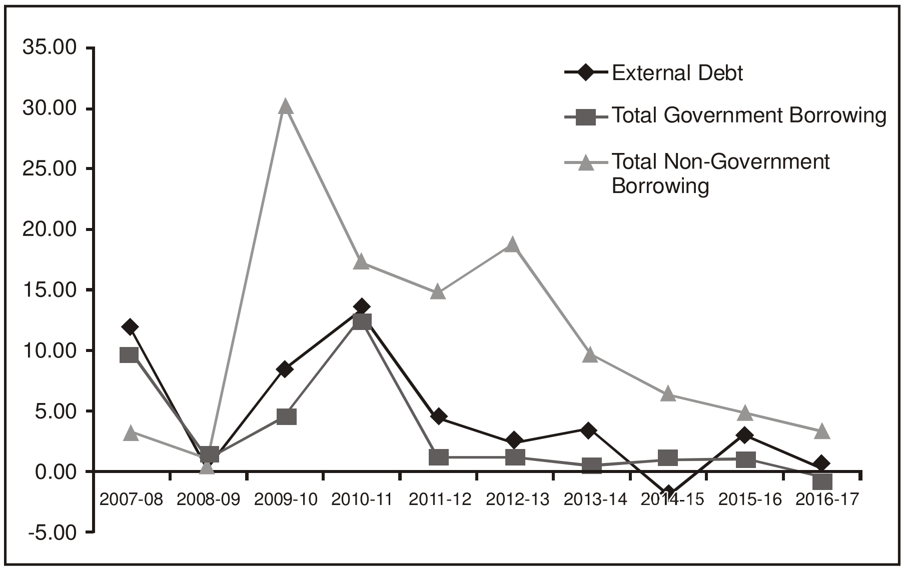

Figure 6 : % Change of the External Debt During April 2007-March 2017

The fluctuation of percentage change in external debt is associated with decline in non-resident Indian (NRI) deposits and commercial borrowings. In addition, the intense fluctuation of external debt is also associated with depreciation of the US dollar (Reserve Bank of India, 2018). The figure 6 shows the huge variations in the percentage change of external debt (multilateral level) in each year with respect to the previous year at the same period. The year after the global financial crisis, Indian economy experienced a huge inclination in the external debt related to the multilateral level by around 28 per cent as compared to the previous period. However, the year 2010 witnessed a significant decrease in the external debt of India. This is mainly associated to the fact that the borrower classification found the outstanding debt of the Government increased by 5% approximately. On the other hand, non-Government debt declined by the end of the quarter. This was, however, found to be associated with the decreased valuation of US Dollars by 0.5% approximately (Reserve Bank of India, 2018).

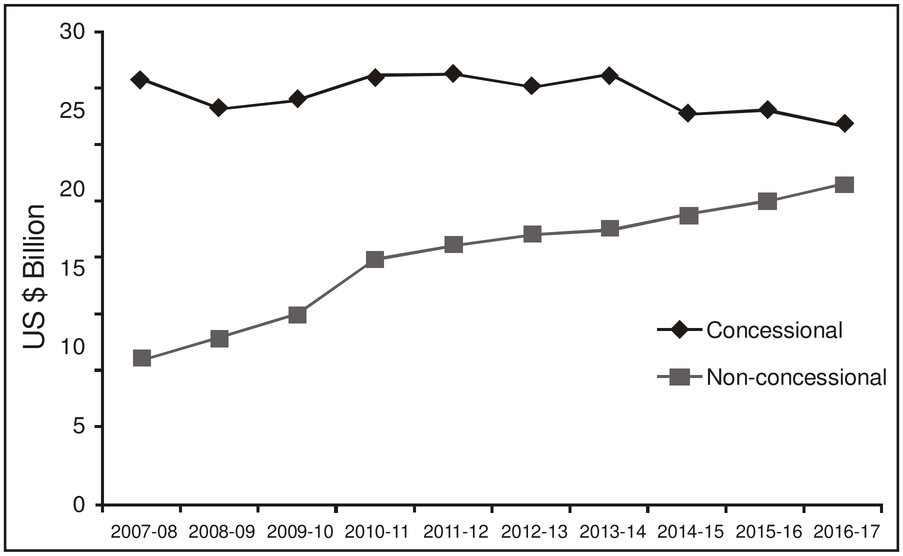

Figure 7 : Trend Analysis of the Components of Government Borrowing

The above figure indicates the trend analysis for two major components of government borrowing including the concessional and non-concessional debt for the post-financial crisis period. The graph clearly indicates that there is consistent rise in the amount of non-concessional debt. In this context, the study of (Eswaran & Meenakshisundaram, 2017) indicates that the among the components of the external debt, the major increase was witnessed during the period of 2007 to 2016.

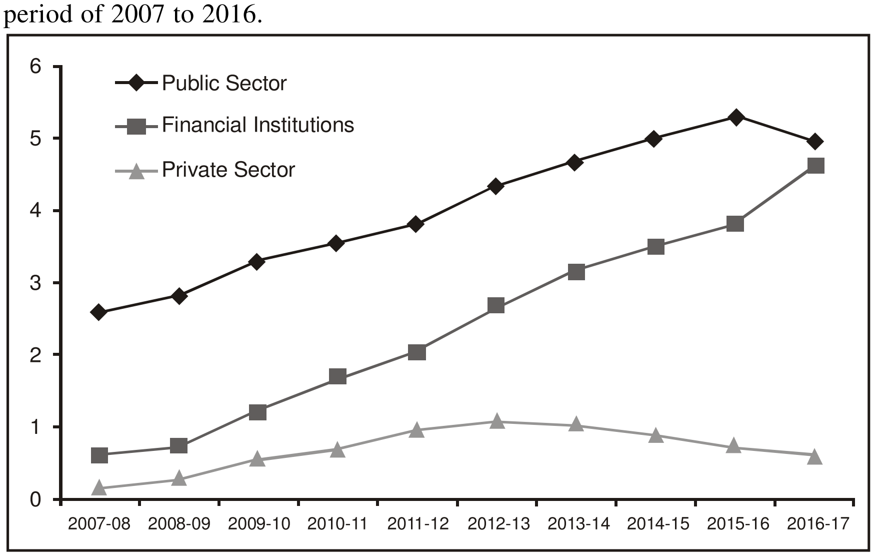

Figure 8 : Trend Analysis of the Components of Non-Government Borrowing

The above figure indicates the trend analysis of the components of non-government borrowing, i.e., public sector, financial institutions and private sector in the post financial crisis period. The figure clearly indicates that there is continous increase in the amount of debt taken by the public sector and the financial instituitions. On the other hand, the debtof the private sector remianed relatively stable.In this regard, the study of (Waheed, 2011) highlighted that in comparison to the other developing countries, India was facing a high rate of financial debt in the post finanacial crises period.The reveue generated by the public sector units fell and the government had limited options of repaying the debt through the potential taxation.

POLICY IMPLICATIONS

Policies in the Pre-Financial Crisis

The government undertook measures in the public and private sector to reduce the level of government debt. The government encouraged the private and public sector undertaking to repay the high cost commercial borrowing. Most of the borrowings undertaken by these units were raised up in the international capital markets. In addition to this, the government allowed the private sector undertaking to convert the outstanding loans to equity shares. New methods and software like Commonwealth Secretariat-Debt Recording and Management System (CS-DRMS) were adopted for calculating the data of external debt. Further, the government adopted new efforts in order to improve the coverage and presentation of the external debt statistics. Lastly, the Government of India focused upon raising new funds through the concessional terms from the less expensive sources which have long-term maturities(Arora, Rathinam, & Khan, 2010). The Government of India created a channel for private investment through privatization of public sector :-companies and inviting foreign investors to invest, which also helped the Indian economy to bring down the external liabilities significantly. Since, the incorporation of FEMA in 1999, the policy makers brought a number of liberalizations in capital account management and this led to increase in foreign exchange assets and capital inflows through private sector channel (Partha Ray, Sur, & Nandy, 2017)

Policies in the Post-Financial Crisis

The RBI took several steps to prevent fast depreciation of Indian rupee due to massive capital outflow by FIIs by selling billions of dollars in the foreign exchange market from its reserves. According to the Banking Regulation Act, 1949 (as amended by The Banking Regulation (Amendment) Act, 2017), banks have to maintain – in addition to cash reserve requirements – assets in India amounting to 40% of their total liabilities in India. Besides, unwinding of some market stabilization scheme was also undertaken to increase liquidity with the banks. In this way about Rs. 2,00,000 crores had been infused into the domestic money market to alleviate the pressures brought on by deterioration in global financial environment. In addition two more policies were formed, the first aimed at developing a deep and liquid bond market in India. It was to enable setting up of a Public Debt Management Agency and unification of debt market with the securities market infrastructure and regulatory framework. The second aimed at creating legal framework for orderly resolution of failing financial firms, where there exists a vacuum in India today. The act was to enable the setting up of a resolution framework for financial firms and a Resolution Corporation.

SUGGESTIONS

Though various polices have been introduced by the government of India and have shown some rate of success to deal with external deb. But, here are some suggestive polices for the effective management of external debt that have proved successful in other countries to deal with the debt problems. Firstly, Interest Rate Manipulation-maintaining low interest rates is one of the way government seek to stimulate economy as it facilitates to generate tax revenue and reduce national debt. As it make easy for business and individuals to borrow money that further spend on buying goods and services, which creates tax revenues and jobs. This policy is adopted by the United States, European Union, United Kingdom & other nations with some success. Secondly, Instituting Spending Cuts - In 1990, double digit budget deficit was faced by Canada. The nation reduced its budget deficit to zero within three years and cut its one-third public debt within five years. This was done without raising taxes by the country. Thirdly, Lowering Debt Successes - In 1994, Sweden was close to financial ruin but, the country had a balanced budget through a combination of spending cuts and tax increases by late 1990s.Tax increases and spending cuts play a role in both efforts. Fourthly, Pro Business/Pro Trade - It's another way nations can reduce their debt burdens. Debt burden was reduced to 10.2% in 2010 from 80% of gross domestic product in 2003 by Saudi Arabia by selling oil.

CONCLUSION

In the pre-financial crisis period external debt witnessed both positive and negative trend in the expansion of external debt of the country. The year

2003 and 2004 took huge turn around by decreasing the external debt by around 8 per cent as compared to the previous period. However, thereafter the economy experienced a significant expansion in the external debt. In the post financial crisis period, the trend of external debt was fluctuating around, both positive and negative phase. In 2009, after the global financial crisis, the Indian economy saw a humongous jump in the external debt expansion. It expanded around 28 per cent compared the previous period of the financial crisis year. It was believed that the deterioration of Indian Rupee value as the main reason for this huge expansion. Despite this crisis, the Indian economy again managed to decrease the external debt significantly in 2010.

For India, to achieve a sustainable growth there is a need to use external debt in developmental activities to generate revenue to pay debt. Earlier external debt leads to crises because it was used for non-developmental purposes like Lok-Sabha elections. External debt is not a burden if it is wisely used to generate higher returns or revenues and if the optimal polices are implemented by the government timely for the effective management of external debt.

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