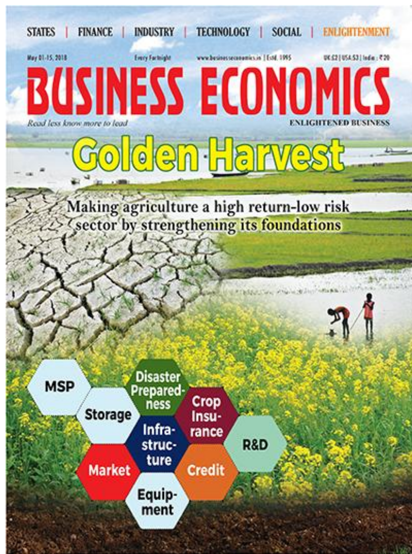

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Rising Public Debt

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The International Monetary Fund (IMF) released its first bi-annual Report on World Economic Outlook (WEO) in mid April, 2018. The WEO is issued usually ahead of the routine Spring IMF and World Bank meetings in Washington, D.C, where world leaders, finance ministers and non-governmental organizations gather.

This year, the Spring Meeting of the two institutions happened to coincide with the 10th year anniversary of the global financial crisis, which was followed by the onset of the Great Recession, which ended after about seven years.

The WEO April 2018 refers to the world economic recovery after the Great Recession. Both monetary and fiscal stimulus measures such as unprecedented pumping-in of liquidity, known as quantitative easing and public investment programmes, all steeped in the lessons learnt from the Great Depression of the 1930s, helped to lessen the impact of misery and avoided the repetition of 1920s.

It also flagged the issue of rising debt in major economies of the world. The recovery and the heating up of the most advanced economy together with rising public expenditures and rising protectionism have also added to the new worries.

First, the good news

The WEO notes the stronger and broader global economic upswing that began around mid-2016. It projects that advanced economies as a group will continue to expand above their potential growth rates in the current year and in 2019, before decelerating and that growth in emerging market and developing economies will rise before leveling off.

Referring to the recovery, IMF says the world growth of 3.8% in 2017 was due to (i) spurt in world trade; (ii) investment recovery in developed countries; (iii) strong growth in Asia, led by China and India; (iv) an upswing in emerging Europe and; (v) recovery in several commodity exporting countries, after a period of low prices. Favourable market sentiments, accommodative financial environment and continuation of expansionary fiscal policy in American economy all helped global growth to a higher level. The projected growth rates for 2018 and for 2019 are 3.9%.

Among the advanced countries, USA which grew in 2017 at 2.3% is forecast to grow at 2.5% in 2018 and 2.2% in 2019. The euro zone is expected grow at 2.9% in 2018, and 2.7% in 2019. The UK, which would grow at 1.8% in 2017, would continue its low profile: 1.6% in 2018 and 1.5% in 2019. Japan would also be in the same boat: with growth at 1.7% in 2017, would grow only at 1.2% in 2018 and still lower at 0.9% in 2019.

The Asian powerhouse and also the global growth driver, China which recorded a growth rate of 6.9% in 2017, would slow down a bit in 2018 at 6.6% and in 2019 at 6.4%. On the other hand, IMF predicts India would perform better in 2018 with a higher rate of growth at 7.4% than what it was in 2017 at 6.7%; and continue to do well and grow at 7.8 %.

Now, the bad news

The IMF cautions rising debt is a real threat to further growth. Global debt is at a historic high at US$164 trillion in 2016, equivalent to 225% of global GDP. This is 12% higher than the previous peak of 2009. The debt was accumulated as advanced countries used the fiscal policy to put their economies on recovery path after the 2008 global crisis.

Table 1 provides details of five top debt ridden countries, which are all advanced countries. The list is headed by Japan (237 % of GDP).

Any recovery after a crisis heats up the economy faster. The rising business sentiments and the animal spirits kicking up, accompanied by growth in jobs and incomes, result in increases in demand for housing and consumer durables. In countries, where policy space prior to the crisis was narrow or negligible, the recovery has to be induced by deficit financing. The resultant increase in public debt would be larger.

Policy space

In their study published last year by National Bureau of Economic Research, *Why Some Times Are Different: Macroeconomic Policy and The Aftermath of Financial Crises*, Professor Christina Romer and Professor David Romer analyzed 24 advanced economies in the post-war period. They concluded that those countries which had adequate fiscal and monetary policy space prior to the crisis did better and accumulated less debts. Specifically, "the decrease in output following a crisis is less than 1% when a country possesses both types of policy space, but almost 10% when it has neither". Their conclusion is monetary and fiscal policies are effective when policy space is ample.

The IMF's message is clear: Now that the recovery has arrived, the time is appropriate for fiscal consolidation and monetary discipline. Countries should now create space in both monetary and fiscal policy areas. The interest rates should be normalized; and fiscal deficits should be reduced.

Table 1. General Government Debt Levels of (% of GDP)

Country	2014	2015	2016	2017	2018	2019
Japan	236.069	231.261	235.627	236.388	235.958	234.182
Italy	131.784	131.509	132.039	131.454	129.745	127.514
United States	105.074	105.295	107.166	107.785	108.021	109.447
Brazil	62.319	72.587	78.441	83.98	87.331	90.24
United Kingdom	87.356	88.206	88.187	87.029	86.335	85.924
Germany	74.749	71.033	68.224	64.137	59.813	55.746
China	39.92	41.066	44.323	47.79	51.213	54.442
SAARC Region						
Bangladesh	35.273	32.439	32.099	32.414	32.704	33.357
Bhutan	93.771	94.35	109.99	102.398	100.386	96.051
India	67.811	69.56	68.891	70.2	68.913	67.293
Nepal	28.304	25.029	27.297	27.15	27.405	28.829
Pakistan	63.472	63.324	67.57	67.173	67.184	67.444
Sri Lanka	72.217	78.487	79.609	79.424	77.343	75.186

Source: IMF World Economic Outlook Data Base April 2018.
Notes: Figures for 2014 to 2016 are actuals; and 2017 to 2019 are projections

The debt overhang

Rising debt means the country has to service the debt for which an increasing proportion of revenue has to be set aside for interest payments each year. This would reduce resources for the growth enhancing investments. If not, it may lead to more borrowing. More borrowing to bridge the deficits would lessen financial resources for private sector and the market interest rate would increase and crowd out private investment. Further a high debt-to-GDP ratio would also cause a spike in risk premiums if investors become skeptical about a country's ability to pay interest charges. The consequence is "debt overhang", which in the context of government debt being dominated by external debt leads to "a situation in which the debt of a nation exceeds its future capacity to repay it." Additional borrowing for debt servicing would mean reduced funds for critical areas, including healthcare and education and maintenance of existing public assets such as roads.

So the advice of IMF to member countries is: when the times are right, start saving and consolidate so that they will stand you in good stead, when the next crisis hits.

Indian Economy

Although the India's projected growth rates for 2017, 2018 and 2019 are better than China's, WEO April 2018 says India's debt to GDP ratio is on the rise. Before it is too late, it is better to apply brakes. The latest news is disturbing.

A Bloomberg Report says citing a HSBC study, some Indian states are now borrowing to finance heavily for writing off farm loans and paying higher salaries for staff. More interest burden, more borrowing will follow! While Reserve Bank of India Governor in the absence of Finance Minister assured IMF that India would adhere to fiscal deficit at 3.5% of GDP, the State borrowings amounted to another 2.9 %.

Table 2: **India: Selected Key Indicators : IMF Forecasts for 2018 to 2019**

	2014	**2015**	**2016**	**2017**	**2018**	**2019**
Real GDP Rs (trillion)	105,277	113,862	121,960	130,181	139,756	150,636
Growth Rate (%)	7.41	8.16	7.11	6.74	7.36	7.79
Investment (% of GDP)	34.27	31.79	30.35	31.69	32.04	32.12
Gross savings (% of GDP)	32.96	30.74	29.68	29.73	29.70	29.99
Inflation(%)	5.80	4.90	4.50	3.60	4.96	4.95
Govt. Revenue (% 0f GDP)	19.15	20.26	20.86	20.85	21.28	21.31
Govt. Exp (% of GDP	26.32	27.29	27.52	27.77	27.82	27.83
Govt. Debt (% of GDP)	67.81	69.56	68.89	70.20	68.91	67.29
Current A/C Balance (% of GDP)	-1.31	-1.05	-0.67	-1.96	-2.34	-2.14
Deficit	-4.1	-3.9	-3.5	-3.5	NA	NA

Source: IMF , World Economic Outlook Database, April 2018

The HSBC study cited by Bloomberg says the states' total deficit of 2.9% and the central government's own fiscal deficit, when put together would take the country's deficit to 6.4%. That will take India to be the "silver medalist", the second largest country among the major economies, next only to Brazil.

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