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A Study of External Debt Trap Threat Faced by Indian Economy

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ABSTRACT

A debt trap occur to a country when somebody takes debt on a high-interest rate acceptance and is barely able to disburse back the responsibility of interest, thus being continuously trap in debt even by refinancing. Public debt is often a country's major accountability: This is principally factual in developing countries, where a substantial sum of national income is exhausted repay such debt obligation. High debt servicing has thrown developing countries into a "debt trap", depriving them of the resources needed to secure long-term economic development and build up strong social and physical infrastructures. In current decades, unsustainable debt – mostly external – has brought country after country into deep economic crisis, with dramatic social consequences for their populations. This is a concealed virus eating India's Budget and it is quite untreatable. It is called a "debt trap" and its reason is simple — greed. India's problem is that it spends much more than it earns. That is all the term "fiscal deficit" means. The focus of paper in this study is to investigate the impact of debt on Indian economy and how government fills the gap between its earnings and spending through relentless borrowing.

Keywords : Debt Trap, GDP, Indian Economy, External Debt

I. INTRODUCTION

An incentive structure that attempt to accept debt obligations under circumstances that strongly support the lender. The victims of debt traps are frequently disallowed from discharging the debt through techniques such as uncommonly high or variable interest rates, altering compensation plans, and irrationally high penalty for delayed payments sometimes these crises have taken on national or even worldwide magnitude. Although good debt execution will not by itself assurance beside prospect debt crises, which are often outside government power, it can trim down a country's fiscal exposure to outer and inner shock. Appropriate debt management should make sure that a government's finance requirements and disbursement obligation which are met at the lowest probable expenditure over the medium to long term, and that debt is understood with a cautious level of threat. The challenges governments face differ from country to country according to their levels of development. In various cases, access to concessional borrowing at concessional and – low-interest borrowings with long maturity of payback periods – and debt reorganization take precedence. In others, access to capital markets is more important. But in all situations, governments must have capacity to manage debt efficiently. When a government faces the risk of being paid a high debt trap, debt monetization may become an alluring option. However, independent central banks may be able to relieve debt concerns without compromise of price

strength. One option is financial domination which, despite linked distortions, can create some fiscal space while retaining price stability. Financial repression is a feature of quantitative relief, which has confirmed to be an unbeaten policy tool at the zero lower bound.

Objective of the Study:

The main objectives of the study are to examine and evaluate the impact of external Debt on Indian economy, and to analyze the impact of debt management, and also to evaluate the relation between debt and GDP of India. In addition, for improved prospect of Indian economy and development will suggest rational approach to manage Dept trap curse by recommendation to government for debt management.

II. Research Methodology

The study is done to examine and evaluate the impact of External Debt on Indian economy for this purpose secondary data and reports are used, which are collected from published economical and commercial reports, magazines, RBI annual report, research articles and financial institutions websites. To study the effects of public debt we have to first draw a distinction between internal debt and external debt. When a government borrows money from its own citizens by selling bonds or long-term credit instruments an internal debt is created. It is owed by a nation to its own citizens. So, it may actually seem that an internal debt does not enforce any burden on society because we be indebted it all to ourselves, While the Internal debt is that part of the total debt that is owed to lenders within the country. It is the money the government borrows from its own citizens. The government borrows by issuing the Government Bonds and T-Bills (Treasury Bills). It also includes the Market borrowings by the government. The government bonds and T-Bills are traded in the market which is also known as Gilt Market. External debt is to be paid to creditors outside the nation. The outsider creditors can be foreign governments, International Financial Institutions such International Financial Institutions such as World Bank, Asian Development Bank etc., corporate and foreign private households. External debt may be of numerous kinds such as multilateral, bilateral, IMF loans, Trade credits, External commercial borrowings etc. When the non-resident Indians park their funds in India, it is also a type of external debt and is called NRI deposits. If the external debt is demonian Indian Rupee, it is called Rupee Debt. The flow of external debts in recently is in forms of

1. External Assistance
2. External Commercial Borrowing
3. Borrowing from IMF
4. NRI Deposits
5. Foreign Investments.

After judicious evaluation of government borrowing and its efficient debt management impacts, conclusion and suggestion is drawn. The outcome of the study depends on the selected period by the researchers and applicability of trend analysis and Regression analysis on it.

III. Review of Literature

A review of Literature plays important role in creation of relative investigation of past and present studies, it help researchers to investigate new magnitude and potential in view to anticipate the future. This study is been undertaken to examine and evaluate the impact of External Debt on Indian economy, and to analyze the impact of debt management, and also to evaluate the relation between debt and GDP of India. There are some studies which shows the effect of external debt on GDP while some studies shows that there is negative impact of external debt on GDP while some shows that there is positive impact of external debt on GDP.. In addition, for improved prospect of Indian economy and development will suggest rational approach to

manage Dept trap curse by recommendation to government for debt management. The studies used for research are of, O' Brien and David (2010) in their study found that 90% of all innovative external financing of company is debt money. They also found that debt money has their own pros and cons and has power to manipulate the growth of companies and its planned outlay, Kayo and Kimura (2011) in his study explain that , a positive relationship theory of debt financing and profitability and also envisage together which generally prone in the direction of trade theory and negative relationship which support peaking order theory, Berger, Oztekin and Flannery (2012) in their study found that corporation having more liquidity can mobilize them as another resource of funds as a substitute of debt, leading to reduced debt financing levels according to the pecking order theory, Ofek and Yermack (2012) in their study found that there are some hypothetical point of view and some pragmatic indication that due to market instability, potential profitability and information supporting the evidence to the managers became entrench and may digress from choosing most advantageous debt financing, Joeveer (2013) in his study found that there are certain factors which influence adoption of debt finance like corporation profitability, corporations size and growth, nature of assets, non debt tax shields, liquidity and probability of bankruptcy, corporation tax rates, business risks, access to capital markets, the finance manager's gender and composition of the board of directors, Drobetz, Gounopoulos, merikas and Schroder (2013) in their study reviled the fact that in the period of high inflation rates corporations tend to use currently weak currencies to repay debt and simultaneously lower their debt financing levels. It is therefore expected that inflation rates should be negatively related to the debt financing levels of corporations, Mokhova and Zinecker (2014) in their study emphasized that due boost in economy, growth in gross domestic product increases which resulted in increase in profitability of the corporations thus corporations will prefer internal sources of financing which will ultimately reduce the debt financing levels.According to a study conducted by Aminu Umaru, Ahmadu Aminu Hamidu and SalihuMusa (2013)in Nigeria has identified that external debt possessed negative impact on the economic performance of Nigeria while domestic debt possessed positive impact on factor productivity. Kirandeep Kaur (2014) in time Series Analysis of Indian External Debt, Total Reserves and economic growth rate has studied on linkage between economic growth and external long run and short run debt in India by using time series data of Indian External Debt, Total Reserves an arrived with the conclusion that there is a positive Impact of both short term and long term external debt and reserves on economic growth of India.

Analysis and Interpretation:

1. External debt with Positive impact on GDP.
2. External debt with negative impact on GDP

Impact of GDP on external debt: Here in our study we have tried to see the impact of External debt on GDP for which a simple regression Analysis has been done.

Model: Ed=$\alpha + \beta.ED + \mu$

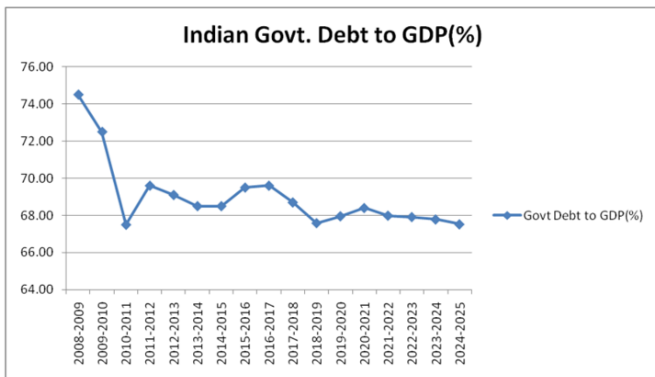
Hypothesis:

H0: There is no significant impact of external debt on GDP.

H1: There is significant impact of external debt on GDP.

Year	Indian Govt. Debt to GDP (%)
2008-2009	74.50
2009-2010	72.50
2010-2011	67.50
2011-2012	69.60
2012-2013	69.10
2013-2014	68.50
2014-2015	68.50

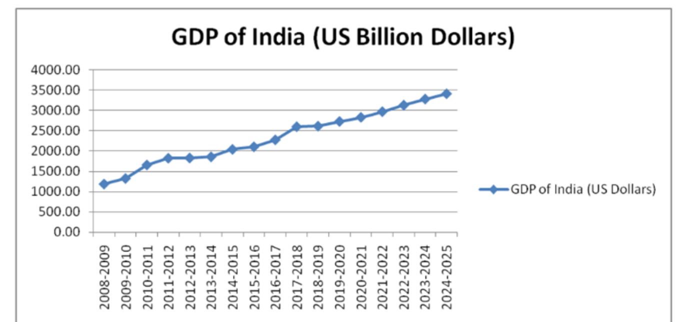
2015-2016	69.50
2016-2017	69.60
2017-2018	68.70
2018-2019(expected)	67.59
2019-2020(expected)	67.95
2020-2021(expected)	68.40
2021-2022(expected)	67.99
2022-2023(expected)	67.91
2023-2024(expected)	67.78
2024-2025(expected)	67.52



Source: tradingeconomics.com

The percentage of government debt to GDP has been plotted in the Y-Axis whereas the X-Axis represents time period which in our research study ranges from 2008 to 2025 respectively in which till 2018 the data are actual while further data are expected data which are calculated with the help of trend analysis. GDP has shown an accelerated rate of growth from 2008 after the advent of reforms in India. The figure also represents the trend line of expected GDP in India and though for a significant time period the expected was higher than the achieved, after the second phase of reforms the achieved became higher than the expected with a considerable residual .The external debt of Indian Economy has been plotted in the following figure. The time period taken is 2008 to 2025

Year	GDP of India (US billion Dollars)
2008-2009	1186.95
2009-2010	1323.94
2010-2011	1656.62
2011-2012	1823.05
2012-2013	1827.64
2013-2014	1856.72
2014-2015	2039.10
2015-2016	2102.40
2016-2017	2274.40
2017-2018	2597.49
2018-2019(expected)	2610.64
2020-2021(expected)	2827.99
2021-2022(expected)	2966.71
2022-2023(expected)	3127.21
2023-2024(expected)	3276.89
2024-2025(expected)	3407.56



Year	External Debt to GDP (%)
2008-2009	224.40
2009-2010	224.50
2010-2011	260.90
2011-2012	317.90
2012-2013	360.80
2013-2014	409.40
2014-2015	446.20
2015-2016	474.70
2016-2017	484.80
2017-2018	471.30
2018-2019(expected)	552.38
2019-2020(expected)	588.18
2020-2021(expected)	616.46
2021-2022(expected)	641.51
2022-2023(expected)	668.08

2023-2024(expected)	695.14
2024-2025(expected)	725.51

Year	External Debt	GDP
2008-2009	224.4	1186.95
2009-2010	224.5	1323.94
2010-2011	260.9	1656.62
2011-2012	317.9	1823.05
2012-2013	360.8	1827.64
2013-2014	409.4	1856.72
2014-2015	446.2	2039.1
2015-2016	474.7	2102.4
2016-2017	484.8	2274.4
2017-2018	471.3	2597.49

Regression Statistics						
Multiple R	0.913035					
R Square	0.833633					
Adjusted R Square	0.812837					
Standard Error	181.8284					
Observations	10					
ANOVA						
	df	*SS*	*MS*	*F*	*Significance F*	
Regression	1	1325324	1325324	40.08654	0.000225	
Residual	8	264492.6	33061.58			
Total	9	1589817				
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	522.6797	220.2531	2.373087	0.045029	14.7751	1030.584
External Debt	3.663096	0.578561	6.331393	0.000225	2.328933	4.99726

Model: FDI = 522.6797+ 3.66ED+ μ

F calculated value is greater than F book value and P value is less than value of alpha (.05) and hence we reject the null hypothesis and accept the alternative hypothesis and thereby conclude that there is significant impact of External debt on the country's GDP.

IV. CONCLUSION

Most of India's debt is internal (97%) and we are not under huge external debt. India fares much better than its BRICS counterparts except China. Further, India's borrowing from the International Monetary Fund has been falling since 2014 this is quite comfortable position despite of liberalization, privatization and globalization. There has been a rise of 9.2% in per capita total debt (internal and external) as on March 31, 2016 as compared to March 31, 2015. The per capita internal debt increased by 9.2% while per capita external debt increased by 5.1% during the given period. Public debt has both short-term and long-term implications as far as the management of the economy is concern with its operational efficiency. After analyzing financial theories of different writers and academicians of their respective era it is realized that all these theories have their importance depending on time period and prevailing circumstances. It has been found that all the theories

which have been reviewed for the purpose have some similarities and difference which significantly impacted the decisions of management. It is very much true that adoption of financial structure by the management largely depend upon their financial strength of the companies and existing information. The difficulties of service a large external debt burden and the efficiency loss of revenue generated through taxation due to payment of interest on internal debt. Ultimately the Indian Economy faces the problem of diversion of limited Capital resources from dynamic private sector to blocked public sector it will lead to Capital Displacement or Crowding –out effect. It also reduces the rate of development of the Indian Economy. India is borrowing money from Foreign nation it has to pay interest on such debt along with the principal amount which is to be made in foreign currencies .As India is in Debt trap it does not have sufficient reserve of foreign exchange so, forced to export goods and services to foreign country by curtailing. The government and non-government borrowings have been increased in an average 256.47% and 775.respectively during the last 15 years. The total borrowings of India have been increased in an average 281.60% during the last 15 years. The Revenue & Expenditure of India have been increased by 169.75% & 194.96% respectively from last eight years The Gap between the revenue & Expenditure has been increased to Rs.881909 crore during the year 2013-2014. The ever increasing demand for money and depleting sources of income has forced for the borrowing of funds from both internal sources as well as external sources, it is learned that 20% total expenditure in India's budget are for the repayment of interest on debt. Now it is the time for the governments to take it higher priority to reduce the gap between income and expenditure so that the dependency on borrowings can be minimized.

V. SUGGESTIONS

India's situation is worsening due to surplus borrowing of government. National debt is rational if the money is used to construct infrastructure or support emergencies. India is neck-deep in debt simply because consecutive governments have got the nation addicted onto populist schemes stuffed with corruption. Food, fuel and fertilizer subsidies, wonky welfare programs and spiraling defense spending swallow 30% of India's budget. With interest eating up 25%, only concerning 40% of India's budget is available for everything else, including health and education. Even in this there is widespread waste and corruption. To break out of the debt trap, the government would have to elevate revenues and hack spending. Indians need to comprehend that while the state must help the poor, it cannot pamper the middle-class. Voters would have to accept that low-priced fuel, food, electricity, water and cooking gas are not birthrights. Those backing huge defense spending would need to see one cannot build a first-class military with a third world economy. Massive administrative reforms would be needed to cut corruption and waste. Citizens would require clinching the fact that apart from voting it is also their primary obligation to pay taxes honestly. In our hearts we know these are pipe dreams. Politicians' short-term electoral goals have collective with our own myopic hunger for free lunches to create a poisonous combination of voracious greed that demands immediate satisfaction we want it all and we want it now, even if we cannot afford it. The requirement of disciplined effort, political maturity and social transformation is required at priority level by government. The refinements in Balance of payment data components are needed for strengthening the data reporting tool. Balance of Payments data needs to be expediting with a view to extra refinement for items of the Bop statistics. In fact, there should be a constant review of the methods of collecting data with regard to BoP on account of the projected developments in liberalization of external sector transactions on both the current and capital accounts. The PDMC has only advisory functions to avoid any conflict with the statutory functions of the RBI. The Joint Secretary (Budget) in Department of Economic Affairs is the overall in-charge of the

PDMC. t is important to see that debt can be reduced only by repay and to plan government borrowings, including market borrowings and other borrowings, like Sovereign Gold Bond issuance with other functions of PDMC are to manage government's liabilities, monitor cash balances, improve cash forecasting and foster a liquidity . The DMFAS Program is a world foremost provider of technical support and advisory services in the area of debt management. Integrated as a key activity of the United Nations Conference on Trade and Development (UNCTAD), the Program has been flourishing in serving governments to improve their capability to supervise debt for over 25 years. It has so far work straight at the country level with 66 countries (mostly low and lower-middle income) and more than 100 institutions. Who we are in recent decades, unsustainable debt – mostly external – has brought country after country into deep economic crisis, with dramatic social penalty for their populations. Unsafe borrowing and high debt servicing has thrown developing countries into a "debt trap", depriving them of the resources needed to secure long-term economic development and build up strong social and physical infrastructures. The need for good debt management is underlined by growing international recognition of its importance and by global initiatives such as the Monterrey Consensus, the Millennium Declaration and the Millennium Development Goals. These stress the importance of, inter-alia, debt management and debt relief for achieving poverty reduction. In this context, there is increasing recognition that good debt management is an intrinsically important component of Public Financial Management and overall good governance. It is now globally accepted that building national capacity in the area of debt management is essential in order for highly indebted poor countries to reach debt sustainability. Similarly, it is widely recognized that good debt management within an effective macroeconomic framework will improve overall democratic governance and lead to greater economic stability, economic growth and social development. This will increase the resources available to low-income countries for allocation to priority areas such as education and health, thus improving the lives of poor people. In order to attain sustainable debt levels and to use debt instruments as an efficient tool for development, prudent debt management and the availability of reliable and timely debt data are essential. Many governments, however, lack the appropriate human and technical capacity for handling public resources and liabilities more effectively, despite their commitment to development. This is particularly the case for developing countries and where UNCTAD's DMFAS Program makes a difference. The installation of DMFAS and training given has helped to develop a comprehensive database on government debt and upgrade the procedural skills of the staff. One main result of this proposal will also be improved transparency, through more timely, complete and accurate reporting of the status of the public debt reduction. The Program offers countries a set of proven solutions for improving their capacity to handle the day-to-day management of public liabilities and produce reliable debt data for policy-making purposes. This includes its specialized debt management software, DMFAS – which greatly facilitates the work of the debt office – as well as advisory services and training activities in debt management.

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