

PUBLIC DEBT AND FISCAL DEFICIT IN INDIA: ISSUES OF SUSTAINABILITY

SAM SANET KUMAR.S

ABSTRACT

A number of studies have examined the growth of government debt and fiscal deficit in India focusing on whether debt is sustainable or not and whether the government is solvent. If government debt is not sustainable, it is relevant to measure the extent to which it departs from sustainability. We need a measure that will give an idea as to how effective the current fiscal stance is in achieving sustainability. In this paper, an index of fiscal stance is used, which is based on a comparison of the target level of the debt-GDP ratio with the forecasted level of the debt-GDP ratio. The forecasts may be based on a Vector Auto Regression (VAR) model or a structural model. In this paper, an index of the fiscal stance is constructed for the Indian context and forecasts are generated using a VAR model. This follows the methodology suggested by Polito and Wickens (2006) where the index of fiscal stance was defined and a VAR model was used for USA, UK, and Germany. The target level of debt-GDP ratio for the combined finances of the central and state governments, as specified by the Twelfth Finance Commission in their restructuring programme, has been taken as 56 percent of GDP at market prices. Forecasts are made for the period of 2006-07 to 2054-55. The relevant tests indicate that the current fiscal policy stance is not sufficient to achieve the target level of debt-GDP of 56 percent by the middle of the current century.