KASHMIR READER

Causes of an insolvent economy

Ajaz Ahmad Rather

October 14, 2015

In a recent article on the US economy for Cato Institute's Tax and Budget bulletin, Chris Edwards called its debt as "Washington's largest monument". The author cautions about $13.2 trillion debt (74 percent of the US GDP) and its detrimental impact on the current economy as well as one standard of future generations.

Like government non-intervention of the strict Washington consensus type, profligacy in the name of Keynesian counter cyclical economic approach is another form of economic extremism. When standard and time tested economic approaches are adjusted for personal and political reasons they lose their essence and even generate self-defeating results. Perhaps the conditions of the finance for our state are titled to the latter extreme. As the 14th finance commission of India under the chairmanship of YV Reddy submitted its report for the period 2015-20, fiscal recklessness of the state resulting in heavy debt, though not of the US variety, has also become somewhat "monumental". This is true at least in the immediate federal context.

The average annual outstanding debt and liabilities of the state economy for the last eleven years is a whopping 54.7 percent of GSDP against an annual average of 25 percent for all Indian states combined. More importantly, the debt liability at the aggregate level declined more than ten percentage points from 31.1 percent in 2004-05 to 21 percent in 2014-15, while as it remained almost stagnant for Kashmir. The latest comparative figures for Kashmir and the aggregate of Indian states for 2014-15 have been 50.7 and 21 percent respectively. As mentioned in the budget document of the state for the current year, current debt mainly comprised internal debt (55 per cent of the total debt liabilities) and provident funds (26.63 per cent). The loans advanced from the New Delhi government are almost 4 percent and other obligations almost 13 percent.

As a result of large debt liabilities, the interest payments made by Jammu and Kashmir is the largest for any state. The state has been paying 4.21 percent of its GDP in debt servicing for the past eleven years. The all India average of the same has been 1.85 percent. What is important is that the debt at all India state level has consistently been declining over the last decade but the figures for Kashmir have almost been stagnant. Currently the state is paying 3.7 percent of its GDP against the all India average of 1.51 percent in debt servicing.

One of the explanations and in fact complaints from governments for the high level of deficits and debt for their economies could be tax evasion and lack of tax buoyancy in the state economy. Evasion of taxes could be one of the sources of mismatch of expenditure and revenue for any government. But the report projects the state in a good light in this regard. In comparison to overall 6.5 percent own tax revenue as percent of the GSDP of the states at collective level, the state is privileged with a rate of 8.1 percent. The state has maintained above average own tax revenue consistently from 2007-08. Similar is the case with own non-tax revenue of the state which has been consistently higher than the average at the collective level during the same period.

What is really problematic with the state economy is the low level of economic growth. As per the Indian Planning Commission document for the 12th five-year plan, the growth rates for the past four plans have been weak. At a time when the aggregate economy grew rather rapidly, a growth rate of 5.1 percent led to unpromising outcomes. This includes worsening of fiscal and debt situation of the state. Among the 28 Indian states considered by the document, Kashmir falls in the category of least growth states. Further, the document places J&K at the bottom with 6.5 percent against 8 percent projected growth for the entire economy for the 12th plan. Successive economic crises at the global and regional level and last year's floods shrunk even these prospects.

Due to weak economic performance, the state economy has been through a rather notorious fiscal record. In the past eleven years the Gross Fiscal Deficit of the state has been 5.81 percent of GSDP against an annual average of 2.27 percent for all India states level. But the deficit has progressively been experiencing decline over this period and comes closer to the all the states' average progressively. Among the issues of profound concern is the destination of debt. Had it been capital formation, particularly infrastructure development, it would have been a matter of lesser concern. However, the case is otherwise. As per the current budget document, expenditure goes to subjects which do not create capital for expansion in productive capacity. About 78 percent is spend on other items like salaries, pensions, interest, power and others, and 22 percent is allocated to the capital expenditure. Given the high state of corruption and low level of economic efficiency in the state, a part of this 22 percent would be incrementally, but definitely lost at different levels without contributing to capital creation.

The point is that current levels of economic growth do not warrant continued state of profligacy in consumption. If such debts are not invested to increase productive capacity, increasing burdens for future generation either in the form of large debt servicing or curtailment of social and economic services or both will be in inevitable. And in the absence of either increasing economic growth or measured curtailment of expenditure, debts and deficits will obviously be monumental.