Debt Sustainability: G20 should seek interest rates lower than growth rate

High interest rate affects public debt management when debt servicing becomes costlier. The pragmatic baseline for the G20 fiscal sustainability is to have a check on the cost of borrowing and rate of economic growth, opt for debt restructuring and go soft on numerical thresholds

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Should G20 countries worry about high public debt in the post-pandemic fiscal strategy as riskier if the markets perceive that it is tied to capex.

In a low-interest rate regime, high public debt can be defended if it is used for strengthening capital infrastructure. However, with interest rates rising globally, public debt management has become costlier. Fiscal policymakers are now facing huge pressure to

consolidate high debt and deficits and to return to medium-term fiscal consolidation. If fiscal consolidation happens through revenue buoyancy, there is nothing to fear. However, consolidation through public expenditure compression can affect the economic growth recovery process.

Given that the monetary policy stance is entirely focused on price stability, economic growth has become the priority of fiscal authorities. However, with rising fiscal risks, there is a growing recognition among finance ministries of the G20 countries that deficits need to be “consolidated”.

India’s **finance minister Nirmala Sitaraman** has already clearly articulated that public debt management will be a priority issue in the G20 forum for India, and she has categorically highlighted the need to go soft on external debt of emerging and developing countries. The point to be noted here is that she has spoken about **debt restructuring** from an international public policy perspective. In India, the external financing of public debt is very negligible. Unlike Pakistan and Sri Lanka, we finance the deficits predominantly through internal bond issuances.

Capping Interest Payments

A well-articulated fiscal sustainability path and **debt restructuring** will receive attention at the G20 forum. The discretionary space available to fiscal authorities is indeed the public expenditure minus interest payments. If the interest payments to revenue receipts mount to above 25-30 percent, it can crowd out the productive public expenditure.

Yet another crucial articulation about the renewed fiscal rules is about the debt-GDP threshold ratios. How to provide guidance to countries to bring down public debt to GDP ratios without huge expenditure compression. The fiscal rules and the medium-term fiscal consolidation frameworks require fresh deliberation at the G20 meetings.

Fiscal sustainability will also be interpreted by markets if countries are able to 'grow out of debt’. Instead of rigid debt numerical thresholds to GDP, investors’ confidence can be boosted if the

country experiences a growth rate (g) greater than the real interest rates (r). If the cost of borrowing (r) is below the growth of the economy (g), markets will be happy, as it is a clear condition for fiscal sustainability and strong macroeconomic fundamentals.
As long as $r<g$, there is fiscal sustainability. However, markets have the tendency to go into panic if the public debt numerical thresholds to GDP cross the 'dangerous' limits, i.e., if it is beyond the articulated fiscal rules about public debt sustainability. There will be a clear deliberation, hopefully, about the numerical debt thresholds during the G20 meetings. Credit rating agencies might go into panic if their forecast model for a country’s growth is affected by ‘dangerous’ levels of public debt-GDP ratio, though the macroeconomic condition of $r<g$ is satisfied.

Concerns To Address

How will the G20 deliberations address this concern and inform the nations about the fiscal rules and frameworks of post-war and crisis fiscal strategy? This needs to be keenly observed in the forthcoming G20 meetings in India in early September 2023. The fiscal risks cannot be perceived as mild once ‘r’ goes greater than ‘g’. How to plan for these fiscal risks in future will hopefully receive a clear articulation from the world leaders, the ministry of finance and central bank leaders at the upcoming G20 meetings.

The punch line is: should G20 countries worry about high public debt in the post-pandemic fiscal strategy as riskier if the markets perceive that it is tied to capex, and as long as the countries are 'growing out of debt' till the uncomfortable moment of $r>g$. Can $r<g$ be a macroprudential norm for fiscal rules rather than strict numerical threshold ratios of debt? Can markets perceive and understand the fiscal sustainability strategy once articulated through lower borrowing costs than growth rates?

Would it boost and ‘crowd in’ private investment? This can happen only when markets perceive that deficits and debt cannot be a villain in increasing interest rates, as generally perceived by neo-classical economists. Rather it is the other way around — high interest rate affects public debt management when debt servicing becomes costlier. The pragmatic baseline for the G20 fiscal sustainability is to have a check on ‘r’ and ‘g’, opt for debt

restructuring, and go soft on debt numerical thresholds if it is tightly used by the G20 nations for their social infrastructure and capex.

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