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GOVERNMENT CANNOT FUNCTION WITHOUT BORROWING

- The government can efficiently carry out its existing activities, improve them, and demonstrate its capabilities.
- However, implementing new initiatives requires substantial funds. These funds can be obtained either by increasing revenue or through borrowing.
- For a state government, the opportunities to increase revenue are very limited. This is because individual state governments do not have the authority to make decisions regarding the Goods and Services Tax (GST), which contributes a major share of their revenue.
- Unlike the Union Government, state governments have very limited opportunities to generate revenue through dividends from public sector enterprises and the Reserve Bank of India. Such opportunities are almost nonexistent.

» Importance of Finance

- The Tamil Nadu Government has estimated that it can generate a maximum of Rs.15,000 crore in additional revenue by following the recommendations of the committee appointed to identify ways to increase its revenue.
- Furthermore, additional funds can be mobilised by avoiding wasteful expenditure. Existing expenditure can be reduced, and the savings can be utilised for new schemes.
- However, the reality is that many expenditures cannot be reduced. For example, as mentioned in the White Paper recently released by the Tamil Nadu Government, approximately 64% of the government's revenue is spent on committed expenditure, namely salaries, pensions, and interest payments.
- Furthermore, approximately 23% of the revenue is spent on legally mandated subsidies, the state's contribution to centrally sponsored schemes, and other compulsory expenditures.
- According to the White Paper, these expenditures also cannot be reduced. Only 13% of the revenue remains.

» Borrowing Is Unavoidable

- Apart from unavoidable expenditures, borrowing is the only available option to mobilise funds for other expenditures and the implementation of new schemes.

- If a government wants to implement new schemes essential for the country's development, it must necessarily borrow funds.
- Otherwise, economic growth and development will be obstructed, and the economy will remain stagnant at its existing level.
- Therefore, the financial capacity of a government depends on how much it can borrow. However, borrowing must also comply with legal regulations.
- According to the rules framed under the Fiscal Responsibility Act, 2003, state governments are advised to limit their borrowing to a maximum of 3% of the Gross State Domestic Product (GSDP).
- Within this limit, the Tamil Nadu Government has planned to borrow Rs.1,73,445 crore during 2026–27.
- Furthermore, the Union Government has issued a guideline stating that the total outstanding debt, including previous borrowings and loans obtained during the current financial year, should not exceed 20% of the Gross State Domestic Product (GSDP).

» How Can This Situation Be Managed?

- While the Union Government's guideline specifies a debt limit of 20%, economist K. R. Shanmugam states, based on his study, that the limit can be as high as 23%.
- Following this guideline is not mandatory. Nevertheless, adhering to such a limit is desirable to ensure sustainable economic growth.
- Otherwise, a major portion of government revenue will be spent on interest payments, leaving insufficient funds for other expenditures. This will adversely affect economic growth.
- Interest payments represent the portion of the current year's revenue used to meet obligations arising from loans borrowed in previous years to finance past expenditures.
- At a certain stage, the government may be forced to borrow further funds to pay interest and repay existing loans.
- This situation is known as falling into a debt trap. Under such circumstances, no one will be willing to provide new loans.
- This will create a situation in which the government cannot repay its previous debts and cannot mobilise funds to meet its current financial requirements.
- To avoid this situation, borrowing must remain within a sustainable limit.
- Since current expenditures are being financed through borrowing, the government has a moral obligation to avoid unnecessary expenditures and undertake only those expenditures that contribute to the country's development.
- Wasteful expenditure will create a shortage of funds for development schemes and negatively affect economic growth.
- Consequently, unemployment arising from reduced economic growth will severely affect the people.

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