Debt-to-GDP Ratio

Debt-to-GDP ratio is the ratio between a country's debt and its gross domestic product. It is a reliable indicator on how capable a country is in paying its debts.

Generally a low debt-to-GDP ratio is a measure of a healthy economy that produces and sells goods and services without accumulating future debts.

The Debt-to-GDP ratio will be covered in this article within the context of the Civil Services Examination.

Definition of Debt-to-GDP Ratio

A debt-to-GDP ratio is an indicator on how much a debt a country owes and how much it produces to pay off its debts. Expressed in percentages, it is alternatively interpreted as the number of years needed in paying back the debt, in case the entire GDP has been allocated for debt repayment.

The indicator of a stable economy is the one where a country is able to pay off its external debts without external funds injection and steady economic growth. On the other hand, a country that has problems in paying off its debts is an indicator of a high debt-to-GDP ratio. Extravagantly high debt-to-GDP ratios may deter creditors from lending money altogether.

In the event there is a debt default on part of the country there will be a financial panic in domestic as well as international markets. The higher a debt-to-GDP ratio, the higher the chances of default. In the event of a war, stagnant economic growth or civil unrest, the economy of a country is slow to pick its pace at the time. So in order to stimulate the economy and boost demade, governments increase borrowing which inadvertently gives rise to a high-debt ratio.

What is a sustainable Debt-to-GDP Ratio?

As per the World Bank and the International Monetary Fund (IMF) " a country can achieve sustainable external debt if its future and current external debt service obligations are met in full, without accumulating more debt and without compromising growth".

According to these two institutions, external debt sustainability can be obtained by a country "by bringing the net present value (NPV) of external public debt down to about 150 percent of a country's exports or 250 percent of a country's revenues".

India's Debt-to-GDP Ratio

According to the data by the International Monetary, India’s public debt is expected to increase by 17% due to increased public spending in the wake of Covid-19.

India’s public debt-to-GDP ratio has remained stable at 70% since 1991.

The increase in public spending is due to the loss in revenue caused by the economic lockdown of important industries in the wake of the pandemic. As per the IMF projections the debt-to-GDP ratio will be stabalised by 2021 before going into a decline towards the end of 2025. This pattern is similar to percentage increase/decrease around the world.

To know more about the GDP of India, visit the linked article.

In order to support the poorer and backward sections of society, fiscal action should be taken, supported by a medium-term fiscal consolidation plan that can strengthen market confidence and reforms to further enhance India’s economic growth.

India achieved the millenium development goal of reducing poverty by half in 2015 as compared to its 1991 numbers. To further progress in Sustainable Development Goals, financial stability is an important condition and for that a healthy debt-to-GDP ratio must be maintained.