

Chapter 58

Causal Links Among Banks' Investments on Government Securities, GDP and Different Heads of Central Plan Expenditures in India

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ABSTRACT

Most of the countries from the developing zones used to generate funds through sales of their securities to the commercial banks, among others. The generated fund, a type of public debt, is intended to spend on economic and social infrastructure developments of the countries which further accelerate their GDPs. India is not an exception to this strategy. The present article examines whether there are causal linkages among the banks' investment on government securities, all heads of central plan expenditures and GDP in India for the period 1981-2014. Using the Granger causality tests, the study observes that banks' security investments make a cause to food and fertilizers subsidy, irrigation and flood control, energy and transport sector and, on the other hand, GDP is a cause to total heads of expenditures, total subsidy, food and fertilizers subsidy, irrigation development, rural development, total infrastructure, energy, transport and social services. There are no way causations between either security investment or GDP with agriculture and communication sectors.

INTRODUCTION

It has been the common feature to most of the developing countries in their history of developments that they have to sell out their securities to the public and banking institutions, among others, to take funds to finance their developmental projects. The banking system is the major part in making the purchases of government securities of different forms. In other way to state that the banking institutions invest

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their loanable funds on the government securities of the country over the statutory limits and get interest earnings over the periods. The banking institutions prefer to invest on government securities over the lending to the other real sectors like agriculture, industry and service sectors because the return from the former source is secured and that of the latter is not so secured. The concept of non-performance of assets (NPA) is, thus, applicable to the three prime sectors mentioned above. The funding system through sale of government securities to the banks constitute a major part of public debt which is a type of loan taken by the government of a country by selling its securities to the public or financial institutions.

There is a great debate on whether public borrowing or debt is good for the economy or it is a burden to the society. Traditionalists viewed negative relationship between public debt and economic growth whereas Ricardian theory viewed neutrality of debt to growth. Keynesian new theory of public debt (or 'no burden' thesis) relied on positive aspects of public borrowings; according to which, through debt creation, the government can tap savings streams, put the resources thus raised to productive use and bring out an increase in national income. Meade (1958), a Keynesian economist, refuted the argument that public debt is bad for the economy as well as to the society. He, rather emphasized that, a domestic debt in the national economy might have far reaching effects upon crucial variables like incentives to save, incentives to work and people's attitudes to take risks. In another study specific to India, the effort of Kaur and Kaur (2015) analyzed the empirical relationship between public debt, investment and economic growth of the country for the period 1981-82 to 2012-13. Applying the Granger's causality analysis, the study showed the evidence of positive, but indirect relationship between public debt and economic growth via investment in the way that there were positive and statistically significant relationship between public debt and investment and public debt had effects upon economic growth. Singh (1999) investigated recent trends in the relationships between domestic debt and economic growth in India for the period 1959-1995 using the cointegration and Granger Causality Tests. The results indicated that there was no causal relationship between unanticipated domestic debt and growth that supported the Ricardian equivalence hypothesis. In a study with different flavor, Ahlborn and Schweickert (2016) challenged the common myth that the relationship between public debt and economic growth implicitly assumed homogeneous debt effects across the samples they considered. In their study, they had identified three country clusters with distinct economic systems: Liberal (Anglo Saxon), Continental (Core EU members) and Nordic (Scandinavian). They argued that different degrees of fiscal uncertainty at comparable levels of public debt between those economic systems constitute a major source of heterogeneity in the debt-growth relationship. Their study results, thus, supported this assumption in the way that the Continental countries faced more growth reducing public debt effects than especially Liberal countries. There, public debt apparently exercised neutral or even positive growth effects, while for Nordic countries a non-linear relationship was discovered, with negative debt effects.

The study of Kumar and Woo (2010) established opposite results. It examined the impact of high public debt on long-run economic growth of a panel of advanced and emerging economies for the period 1970-2007. The results indicated an inverse relationship between initial debt and subsequent growth, controlling for other determinants of growth. Additionally, the analysis of the components of growth suggested that the adverse effect largely reflected a slowdown in labor productivity growth mainly due to reduced investment and slower growth of capital stock.

Whether a public debt works optimally in favour of economic growth rates has been examined by Checherita and Rother (2010). The study investigated the average impact of government debt on per-capita GDP growth in twelve euro area countries over the period of 1970-2010. It observed a non-linear impact of debt on growth with a turning point of 90-100 per cent debt-GDP ratio beyond which the

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