V Outstanding Liabilities, Market Borrowings and Contingent Liabilities of State Governments

Over the years, a high level of revenue deficit has led to large fiscal deficits and spiraling debt resulting in the emergence of a vicious cycle of deficit, debt and debt servicing for the State governments. Increasing outstanding liabilities also raise questions not only about debt sustainability, but also about inter-generational equity. Realizing this, the TwFC had suggested a rule based fiscal correction and consolidation process through the enactment of State level FRLs to contain their key deficits at a sustainable level over the medium term. In addition, various State governments have set up Consolidated Sinking Funds and Guarantee Redemption Funds and placed ceilings on guarantees which are facilitated at containing the magnitude of outstanding liabilities. Recognising the sustainability issue related to the high level of debt, many of the State governments have placed limits in their FRLs on the level of debt to be achieved within a stipulated time frame. Consequently, all the parameters of debt showed an improvement during the period 2005-08. In line with the enlargement of deficits during 2008-09 (RE) and 2009-10 (BE), the debt level is expected to rise. Market borrowings have emerged as an important instrument of financing fiscal deficits of the States.

1. Introduction

5.1 The improvement witnessed with regard to the debt indicators of the States during the recent past is expected to suffer a setback during the current year. As a part of counter cyclical measures to minimize the impact of the global financial crisis and economic slowdown, the Central government allowed the States to increase the limit of fiscal deficit to 3.5 per cent of their respective GSDP during 2008-09. Thus, States were allowed to raise additional market borrowings to the extent of 0.5 per cent of GSDP. This additional space was to be utilised for making capital investments. Furthermore, Union Budget 2009-10 permitted the State governments to borrow an additional 0.5 per cent of their GSDP by relaxing the fiscal deficit target under FRBM from 3.5 per cent to 4.0 per cent of their GSDP. In addition to the relaxed GFD-GSDP norm for the State governments, the DCRF requirement of maintaining revenue deficit at zero has also been relaxed. The Government of India has suggested the States to amend their FRLs accordingly. Despite the additional fiscal space allowed to the States, 14 States were able to contain their GFD below 3.5 per cent in 2008-09 (RE) while 13 States proposed to contain the GFD-GSDP ratio below 4.0 per cent in 2009-10 (BE). Nonetheless, a higher consolidated GFD-GDP ratio at 2.6 per cent and 3.2 per cent in 2008-09 (RE) and 2009-10 (BE), respectively—as compared with 1.5 per cent in 2007-08 (Accounts)—is expected to have implications for the debt sustainability of the State governments. In this context, allocation State governments' expenditure assumes importance as it would have implications for their prospective debt servicing capacity.

5.2 In the context of debt sustainability, the TwFC emphasised the need for fiscal discipline on the part of the States and suggested that the overall borrowing programme of a State should be within a prescribed limit, determined annually, taking into account borrowings from all sources. The State governments have been gradually putting in place institutional mechanisms to contain the level of debt and also to bring it to a sustainable level by way of the enactment of FRLs, setting up of Consolidated Sinking Funds and Guarantee Redemption Funds and placing ceilings on guarantees. This Chapter analyses the outstanding liabilities, market borrowings, contingent liabilities and ways and means advances-overdraft (WMA-OD) of the State governments.

2. Outstanding Liabilities[10]

Magnitude

5.3 The consolidated outstanding liabilities of the State governments as at end-March 1991 were placed at Rs.1,28,155 crore (22.5 per cent of GDP). The debt-GDP ratio, which was as low as 20.7 per cent as at end-March 1997, rose sharply to 32.8 per cent as at end-March 2004 on account of large and persistent revenue deficits resulting in high GFD leading to large accumulation of debt and a concomitant increase in the debt service burden during the period. Realising the sustainability issue of the high level of debt, many of the State governments have placed limits on the level of debt to be achieved within a stipulated time frame in their FRLs. The TwFC had recommended for a debt-GDP ratio of 30.8 per cent to be achieved by the States at end-March 2010. Furthermore, the TwFC had recommended an overall cap on borrowings (3 per cent of GSDP) to be achieved by the State governments by the end of 2009-10. The TwFC also recommended the ratio of interest payments to revenue receipts at 15 per cent to be achieved by 2009-10. The debt relief mechanism prescribed by the TwFC, incentivised by adherence to the rule-based fiscal regime by the States helped to contain the magnitude of outstanding liabilities.

5.4 From the peak level of 32.8 per cent as at end-March 2004, the debt-GDP ratio of State governments came down to 26.2 per cent in 2008-09 (RE) (Table V.1, Chart V.1 and Appendix Tables 19-20). The combined IP-RR ratio of the States declined from 26.0 per cent in 2003-04 to 14.4 per cent in 2008-09 (RE).

5.5 Notwithstanding the increase in outstanding level by 10.1 per cent to Rs.1,462,755 crore at end-March 2009 from Rs.1,328,302 crore at end-March 2008, the debt-GDP ratio declined by 0.6 per cent over the year. However, outstanding debt is budgeted to increase to Rs.1,636,403 crore (26.5 per cent of GDP) at end-March 2010. Despite this, the States would be able to contain the debt-GDP ratio below 30.8 per cent by the end of March 2010 as prescribed by the TwFC.

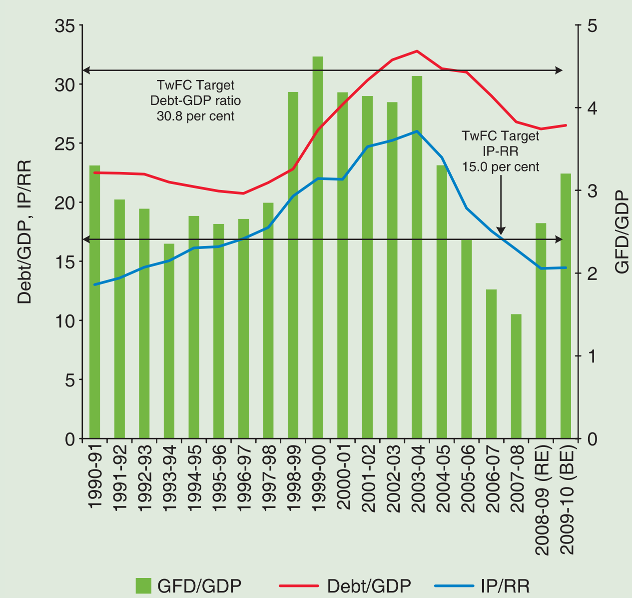
Table V.1: Outstanding Liabilities of State Governments
(As at end-March)

(Rs.crore)

Year	Amount	Annual Growth (Per cent)	Debt /GDP (Per cent)
1	2	3	4
1991	1,28,155	-	22.5
1997	2,85,898	14.6	20.7
1998	3,30,816	15.7	21.7
1999	3,99,576	20.8	22.8
2000	5,09,529	27.5	26.1
2004	9,03,174	14.8	32.8
2008	13,28,302	7.0	26.8
2009 (RE)	14,62,755	10.1	26.2
2010 (BE)	16,36,403	11.9	26.5

RE : Revised Estimates. BE : Budget Estimates. '–' : Not applicable.
Source : 1. Budget Documents of the State Governments.
2. Combined Finance and Revenue Accounts of the Union and State Governments in India, CAG, GoI.
3. Ministry of Finance, Government of India.
4. Reserve Bank records.
5. Union Finance Accounts, GOI.

Chart V.1: Deficit, Debt and Interest Burden



[10] The outstanding liabilities of State governments have been compiled from various sources including Combined Finance and Revenue Accounts of the Union and State governments in India, CAG, GoI, Finance Accounts of Union Government, information obtained from the Ministry of Finance, Reserve Bank records and budget documents of State governments.

Composition of Debt

5.6 The structure of outstanding debt has an important bearing on interest payment as different debt instruments carry different rates of interest depending on the type of borrowing and maturity structure. It is evident from the Table V.2 and Chart V.2 that the share of market borrowings has increased sharply over the years and it would comprise almost one-third of the total outstanding liabilities as at end-March 2010. However, there has been a substantial decline in the share of loans from the Centre. The dominance of NSSF has also declined persistently since end-March 2007 and is budgeted to contribute around one-fourth of the total outstanding liabilities as at end-March 2010. The share of high cost debt instruments, *i.e.,* public accounts items like small savings and provident fund in total outstanding liabilities which had increased marginally to 26.9 per cent at end-March 2008 from 25.5 per cent at end-March 2005, thereafter showed a declining trend. Market borrowings comprising one-third of the outstanding liabilities reflect the low cost debt segment of the States.

5.7 It is important to highlight here that the budget documents of the State governments do not provide sufficient details of their outstanding liabilities including the amounts under various categories and associated terms and conditions (such as rate of interest and maturity structure). This is particularly evident in the case of negotiated loans from banks and financial institutions. Consequently, an in-depth analysis of the debt position of the State governments remains circumscribed. The detailed

Chart V.2: Composition of Outstanding Liabilities (as at end-March)

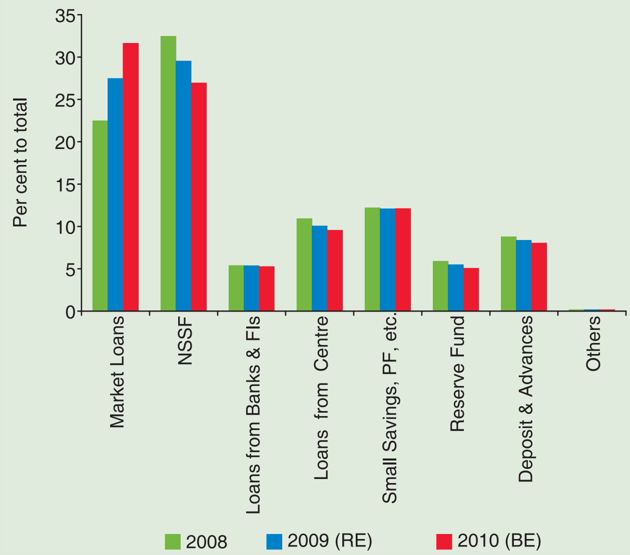


Table V.2: Composition of Outstanding Liabilities of State Governments
(As at end-March)

(Per cent)

Item	1991	2000	2005	2006	2007	2008	2009 (RE)	2010 (BE)
1	2	3	4	5	6	7	8	9
Total Liabilities (1 to 4)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
1. Internal Debt	15.0	24.8	58.7	60.9	61.5	62.1	63.9	65.1
of which:								
(i) Market Loans	12.2	14.8	21.1	19.9	19.6	22.5	27.5	31.6
(ii) Special Securities issued to NSSF	–	5.0	27.8	31.9	34.3	32.4	29.5	26.9
(iii) Loans from Banks and FIs	2.0	3.4	6.7	6.3	5.6	5.4	5.4	5.3
2. Loans and Advances from the Centre	57.4	45.2	15.8	13.7	11.8	10.9	10.1	9.6
3. Public Accounts (i to iii)	26.8	29.9	25.5	25.3	26.6	26.9	25.9	25.2
(i) Small Savings, State PF, *etc.*	13.2	15.8	12.9	12.3	12.1	12.2	12.1	12.1
(ii) Reserve Funds	3.7	3.9	5.2	5.5	6.3	5.9	5.5	5.1
(iii) Deposits & Advances	10.0	10.2	7.4	7.6	8.1	8.8	8.4	8.0
4. Contingency Fund	0.8	0.3	0.1	0.1	0.1	0.2	0.2	0.2

RE : Revised Estimates. BE : Budget Estimates.
'–' : Nil/Negligible/Not applicable.
Source: Same as Table V.1.

composition of outstanding liabilities of State governments from 1990-91 to 2009-10 (BE) are presented in Appendix Tables 19 and 20, while the State-wise composition of outstanding liabilities is provided in Statements 26-28.

3. State-wise Debt Position

5.8 This section presents State-wise variation in the level of debt[11] among the non-special and special category States. The State-wise debt-GSDP position is presented in Table V.3.

Non-Special Category States

5.9 All the non-special category States, except Goa, registered an improvement in the debt-GSDP ratio in 2008-09 (RE) as compared with 2005-08 (Average). Orissa registered the highest improvement of more than 9.5 per cent of GSDP during the period, followed by Gujarat (5.4 per cent each) and Chhattisgarh (4.9 per cent). During 2008-09 (RE), the debt-GSDP ratio would be as high as 50.8 per cent in case of Uttar Pradesh, followed by Bihar (49.1 per cent), Rajasthan (43.8 per cent), West Bengal (43.2 per cent) and Punjab (40.0 per cent). On the other hand, it would be as low as 17.8 per cent in the case of Haryana, followed by Chhattisgarh (19.0 per cent), Tamil Nadu (24.2), Karnataka (25.5 per cent), Maharashtra (26.1 per cent), Andhra Pradesh and Gujarat (30.0 per cent each) and Jharkhand (30.5 per cent). Only above eight States were able to achieve the debt-GSDP target of 30.8 per cent of the TwFC in 2008-09 (RE) (Chart V.3).

5.10 The high burden of interest payments tends to widen the revenue deficit and in turn the GFD. Consequently, a vicious circle of deficit, debt and interest payments becomes formidable. The ratio of interest payments to revenue receipts, which has a bearing on debt sustainability, was well below the TwFC target of 15.0 per cent in the case of eleven non-special category States, *viz.*, Chhattisgarh, Bihar, Haryana, Tamil Nadu, Karnataka, Andhra Pradesh, Madhya Pradesh, Uttar Pradesh, Jharkhand, Goa and Maharashtra

Table V.3: Debt Indicators of State Governments

(Per cent)

State	2005-08 (Avg.)	2008-09 (RE)
	Debt/ GSDP	Debt/ GSDP
1	2	3
I. Non-Special Category		
1. Andhra Pradesh	33.6	30.0
2. Bihar	51.8	49.1
3. Chhattisgarh	23.9	19.0
4. Goa	38.5	36.7
5. Gujarat	35.4	30.0
6. Haryana	22.5	17.8
7. Jharkhand	30.6	30.5
8. Karnataka	27.1	25.5
9. Kerala	37.1	35.6
10. Madhya Pradesh	40.5	38.8
11. Maharashtra	30.8	26.1
12. Orissa	46.0	36.5
13. Punjab	43.2	40.0
14. Rajasthan	48.2	43.8
15. Tamil Nadu	25.4	24.2
16. Uttar Pradesh	54.0	50.8
17. West Bengal	47.1	43.2
II. Special Category		
1. Arunachal Pradesh	76.5	74.3
2. Assam	30.4	29.2
3. Himachal Pradesh	63.9	57.4
4. Jammu and Kashmir	68.9	69.7
5. Manipur	79.3	77.5
6. Meghalaya	41.4	41.5
7. Mizoram	115.8	115.9
8. Nagaland	51.1	50.1
9. Sikkim	70.3	74.1
10. Tripura	47.5	37.2
11. Uttarakhand	44.0	40.3
All States#	**28.9**	**26.2**
Memo Item:		
1. NCT Delhi	19.5	15.2
2. Puducherry	31.8	42.4

Avg. : Average.
GSDP : Gross State Domestic Product.
: Data for All States are as per cent to GDP.
Source: Based on Budget Documents of the State Governments.

[11] The detailed State-wise and component-wise break-up of outstanding liabilities is provided in Statements 26-28. The outstanding liabilities as at end-March 2000 of the three bifurcated States (Bihar, Madhya Pradesh and Uttar Pradesh) have been apportioned to the three newly formed States (Jharkhand, Chhattisgarh and Uttarakhand), respectively on the basis of their respective proportion of the population.

Chart V.3: Debt-GSDP -Non Special Category States

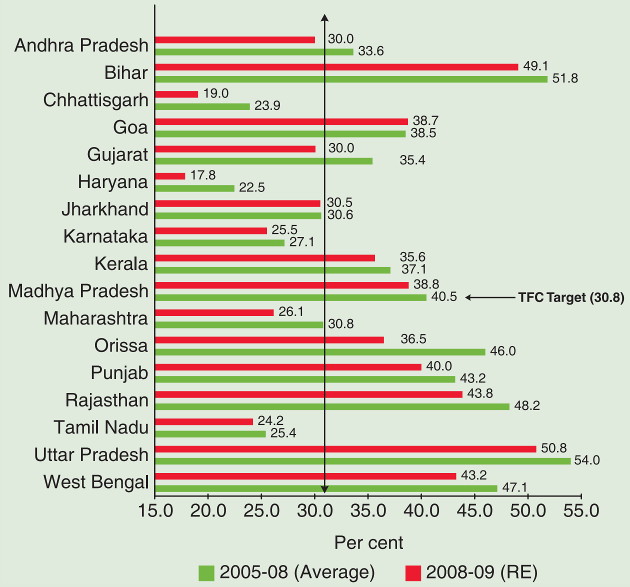
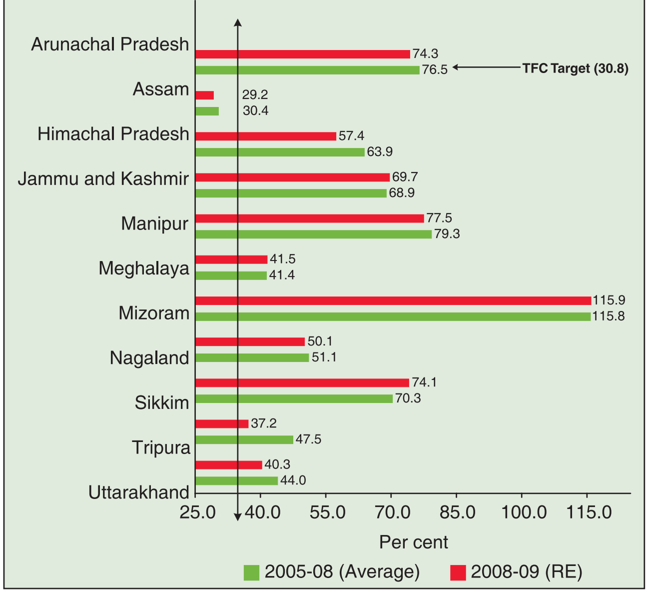


Chart V.4: Debt-GSDP -Special Category States



in 2008-09 (RE). However, in case of six non-special category States *inter alia*., West Bengal, Punjab, Gujarat, Kerala, Rajasthan and Orissa the IP-RR ratio was higher than the prescribed limit of the TwFC target of 15.0 per cent, although the IP-RR ratio for these six States came down in 2008-09 (RE) as compared to 2005-08 (Average). The higher share of the IP-RR ratio makes the expenditure management of State governments less flexible as a bulk of the resources get pre-empted and cannot be used to finance priority sectors, *i.e.*, social sector expenditure and development expenditure.

Special Category States

5.11 Out of eleven special category States, seven States registered an improvement in the debt-GSDP ratio in the revised estimates of 2008-09 (RE) over 2005-08 (Average). Tripura registered the maximum improvement of 10.3 per cent in the debt-GSDP ratio, followed by Himachal Pradesh (6.5 per cent), Uttarakhand (3.6 per cent), Arunachal Pradesh (2.2 per cent), Manipur (1.8 per cent), Assam (1.1 per cent) and Nagaland (1.0 per cent) in 2008-09 (RE) as compared with 2005-08 (Average). On the contrary, four special category States *viz.*, Sikkim, Jammu and Kashmir, Meghalaya and Mizoram registered deterioration in the debt-GSDP ratio during the same period. During 2008-09 (RE), Mizoram recorded the highest debt-GSDP ratio of 115.9 per cent, followed by Manipur (77.5 per cent), Arunachal Pradesh (74.3 per cent), Sikkim (74.1 per cent) and Jammu and Kashmir (69.7 per cent). Among all the special category States, only Assam was able to achieve the debt-GSDP target of 30.8 per cent during 2008-09 (RE) (Chart V.4). All the special category States, except Himachal Pradesh, achieved the TwFC target with respect to IP-RR (15.0 per cent) in 2008-09 (RE). The IP-RR ratio was the lowest in the case of Sikkim (4.7 per cent), followed by Arunachal Pradesh and Meghalaya (6.2 per cent each).

4. Market Borrowings

Consolidated Position

5.12 The State governments issue dated securities of varying tenures (mostly of 10 years maturity) that are mostly subscribed by banks and financial institutions. The share of market borrowings in the total outstanding liabilities of State governments has shown a rising trend since end-March 2000 reaching 27.5 per cent as at end-March 2009 as compared to 14.8 per cent at end-March 2000. The greater reliance on market borrowings has been on account of a decline in collections under NSSF.

5.13 The share of high cost market loans (interest rate over 10.0 per cent) of State governments declined further during 2008-09. As at end-March 2009, the share of outstanding stock of market loans with interest rate of 10 per cent and above declined to 10.1 per cent from 18.4 per cent as at end-March 2008 (Table V.4). Another encouraging trend observed in 2008-09 (RE) is the increase in the share of outstanding market loans with interest rate of less than 8 per cent. However, the share of outstanding market loans with interest rates ranging between 8-10 per cent increased from 27.3 per cent in end-March 2008 to 34.4 per cent as at end-March 2009.

Allocation of Market Borrowings during 2008-09

5.14 The net allocation of market borrowings to the State governments as per Reserve Bank records have increased steadily since 2002-03 (Table V.5 and Appendix Table 21). The total net allocations increased sharply to Rs.1,14,709 crore during 2008-09 as compared with Rs.69,015 crore in the previous year. This was mainly on account of an additional allocation on account of the NSSF shortfall and the second stimulus package amounting to Rs.62,990 crore. Taking into account repayments of Rs.14,371 crore, the gross allocation of market borrowings amounts to Rs.1,29,081 crore of which 91.5 per cent was actually raised by State governments during the year. During 2008-09, the two States namely, Chhattisgarh and Orissa did not participate in the market borrowings programme as compared to four States, *viz.*, Chhattisgarh, Haryana, Orissa and Tripura during 2007-08.

Table V.4: Interest Rate Profile of the Outstanding Stock of State Government Securities

(As at end-March)

Range of Interest Rate	Outstanding Amount (Rs. crore)		Percentage to Total	
	2008	2009	2008	2009
1	2	3	4	5
5.00-5.99	33,825	34,825	11.3	8.7
6.00-6.99	58,564	74,606	19.6	18.6
7.00-7.99	69,759	1,13,906	23.4	28.3
8.00-8.99	76,112	1,25,750	25.5	31.3
9.00-9.99	5,412	12,371	1.8	3.1
10.00-10.99	14,418	14,418	4.8	3.6
11.00-11.99	16,869	14,583	5.7	3.6
12.00-12.99	23,550	11,465	7.9	2.9
13.00-13.99	–	–	–	–
Total	**2,98,508**	**4,01,924**	**100.0**	**100.0**

Source : Reserve Bank records. '–' : Nil.

Table V.5: Market Borrowings of State Governments#

(Rs. crore)

Item	2007-08	2008-09	2009-10
1	2	3	4
1. Net Allocation	28,781	51,719	1,02,458 ^
2. Additional Allocation	4,454	14,326	–
3. Additional Allocation on account of NSSF shortfall	35,780	19,768	–
4. Additional Allocation towards second stimulus package		28,896	–
5. Total (1+2+3+4)	69,015	1,14,709	1,02,458
6. Repayments	11,555	14,371	16,238
7. Gross Allocation (5+6)	80,570	1,29,080	1,18,696
8. Total Amount Raised (i + ii)	67,779	1,18,138	1,14,091
(i) Tap Issues	–	–	–
(ii) Auctions	67,779	1,18,138	1.14,091 *
9. Net Amount Raised (8-6)	56,224	1,03,767	97,853
Memo item:			
(i) Coupon/Cut-off Yield Range (%)	7.84-8.90	8.39-9.90	7.04-8.49
(ii) Weighted Average Interest Rate (%)	8.25	7.90	8.06
(iii) Average Maturity (in years)	10.00	10.00	10.00

* Amount raised upto February 8, 2010.

^ : Net Allocation has not been finalised for Andhra Pradesh, Jharkhand and Maharashtra.

: Includes the Union territory of Puducherry.

Note : Data on market borrowing as per RBI records may differ from that reported in the budget documents of the State Govedrnments.

Source : Reserve Bank records.

5.15 During 2009-10 (up to February 8, 2010), the States had raised market loans amounting to Rs.1,14,091 crore (or 96.1 per cent of the budgeted allocation) through auctions with a cut-off rate in the range of 7.04-8.49 per cent. In 2009-10 (up to February 8 2010), the entire amount of market borrowings was raised through the auction route as was the case in the previous two years, indicating State governments' intention to raise market borrowings based on their improved financial conditions.

5.16 The weighted average interest rate on market borrowings which had declined since the mid-1990s up to 2003-04, firmed up to 8.25 per cent during 2007-08 in line with that of the Central Government securities, reflecting the general upward movement in interest rates (Table V.6). However, thereafter, reflecting the softer interest rate environment, the weighted average yield of State government securities issued during 2008-09 and 2009-10 (up to February 8, 2010), was lower than 2007-08, despite a significant increase in market borrowings by the States.

5. Liquidity Position and Cash Management

5.17 Keeping in view the cash surplus position of the State governments, the WMA limits of State governments have been left unchanged since 2006-07. Accordingly, the extant State-wise normal WMA limit was fixed at Rs.9,925 crore for 2008-09 (inclusive of Rs.50 crore for the Union Territory of Puducherry) and the limit has been retained for 2009-10 as well. The rate of interest on normal and special WMA and OD continued to be linked to the repo rate (Table V.7).

5.18 During 2008-09, the average utilisation of normal WMA, special WMA and overdrafts by the States remained low reflecting an improvement in the overall cash position resulting in a build-up of high levels of surplus cash balances by most of the State governments. During 2008-09, six States, *viz.,* Kerala, Madhya Pradesh, Nagaland, Punjab, West Bengal and Uttarakhand resorted to WMA as against eight States, *viz.*, Kerala, Nagaland, Punjab, West Bengal, Himachal Pradesh, Manipur, Mizoram and Uttarakhand in the previous year. However, during 2009-10, the situation deteriorated as the number of States that availed WMA increased to ten comprising Andhra Pradesh, Haryana, Kerala, Madhya Pradesh, Punjab, Uttar Pradesh, West Bengal, Mizoram, Nagaland and Uttarakhand. During 2009-10 so far (February 11, 2010), Punjab availed of WMA for a maximum 93 days, followed by Nagaland (45 days) and West Bengal (15 days) (Chart V.5).

Table V.6: Weighted Average Yield of State Government Securities

Year	Yield Range (Per cent)	Weighted Average Yield (Per cent)	Gross Amount (Rs. crore)
1	2	3	4
1991-92	11.50-12.00	11.82	3,364
2000-01	10.50-12.00	10.99	13,300
2007-08	7.84-8.90	8.25	67,778
2008-09	5.80-9.90	7.87	118,138
2009-10*	7.04-8.49	8.06	1,14,091

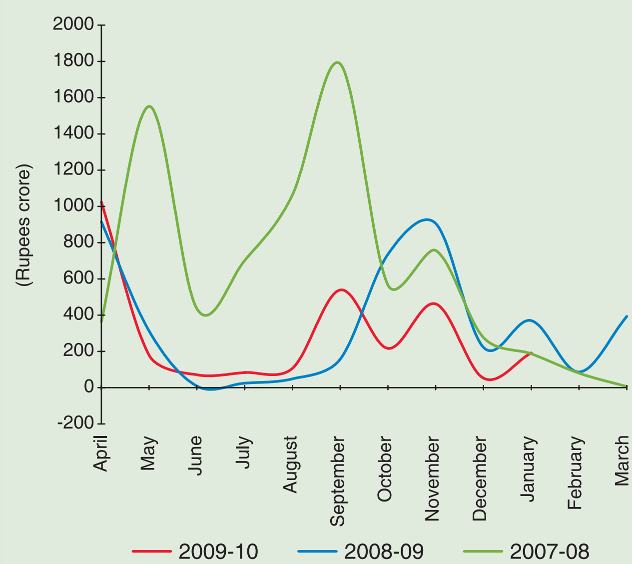
* Up to February 8, 2010.
Source: Reserve Bank records.

Table V.7: Normal WMA Limits – 1996 to 2009

Period	Amount (Rs. crore)
1	2
i. August 1996 to February 1999	2,234
ii. March 1999 to January 2001	3,941
iii. February 2001 to March 2002	5,283
iv. April 2002 to March 2, 2003	6,035
v. March 3, 2003 to March 31, 2004	7,170
vi. April 1, 2004 to March 31, 2005	8,140
vii. April 1, 2005 to March 31, 2006	8,935
viii. April 1, 2006 to March 31, 2007	9,875
ix. April 1, 2007 to March 31, 2008	9,925
x. April 1, 2008 to March 31, 2009	9,925
xi. April 1, 2009 to March 31, 2010	9,925

Source : Reserve Bank records.

Chart V.5: Utilisation of WMA and Overdraft by States*



* Average of Daily Outstandings.

5.19 The monthly average utilisation of overdrafts (ODs) by the States in 2008-09 was significantly lower than the previous year. Three States, viz., Nagaland, West Bengal and Uttarakhand resorted to ODs during 2008-09 while Kerala, West Bengal and Nagaland were the three States that resorted to ODs in 2007-08. During 2009-10 (February 11, 2010), Punjab availed of OD for 16 days, followed by Nagaland (13 days) and Uttarakhand and West Bengal (8 days each) during the year (Statement 38).

5.20 Data on Centre's (gross) WMA to the State governments, as reported in the State governments' budget documents during 2000-01 to 2009-10 (BE) are set out in Statement 39. The total amount of such advances has consistently declined from Rs.3,329 crore in 2002-03 (twelve States) to Rs.10 crore in 2008-09 (RE) (one State). However, it is budgeted to increase to Rs.360 crore in 2009-10 (two States). Assam, among the special category States, and Kerala among the non-special category States, have budgeted for such advances during 2009-10.

6. Contingent Liabilities

5.21 State governments have been issuing guarantees and letters of comfort on behalf of PSUs and other institutions (including urban local bodies) to enable them to raise resources to meet the requirements of public investment. This is primarily because the States are not in a position to provide budgetary support for such investments. Although contingent liabilities do not form a part of the debt of the States, in the event of default by borrowing entities, the States will be required to meet the debt service obligations. At the same time, non-adherence to payment obligations committed by the States with respect to guarantees already provided by them would have adverse implications on their sovereign credibility. In view of the fiscal implications of the rising levels of guarantees, many States have taken initiatives to place ceilings (statutory or administrative) on guarantees. Eighteen State governments have so far fixed statutory/administrative ceilings on State government guarantees. Nine States have set up Guarantee Redemption Funds (GRF).

5.22 The Reserve Bank maintains the Consolidated Sinking Fund (CSF) and the Guarantee Redemption Fund (GRF) on behalf of State governments from contributions made by them. While the CSF provides a cushion for amortisation of market borrowing/liabilities, GRF provides a cushion for the servicing of contingent liability arising from invocation of guarantees issued by the State governments with respect to bonds issued and other borrowings by State level undertakings or other bodies. The aggregate outstanding investments in CSF by the 18 State governments increased to Rs. 24,032 crore at end-March 2009 from Rs.18,946 crore with respect to 17 States at end-March 2008. As on March 31, 2009, nine States had notified their GRF schemes and the aggregate outstanding investments in GRF by these States increased to Rs.3,082 crore as on March 31, 2009 from Rs.2,805 crore with respect to 8 States as on March 31, 2008.

5.23 Based on information made available by select State governments, the outstanding guarantees of State governments increased sharply from Rs. 1,32,029 crore (6.8 per cent of GDP) as at end-March 2000 to Rs.2,19,658 crore (8.0 per cent of GDP) as at end-March 2004. The outstanding guarantees of State governments have declined thereafter to Rs.1,71,058 crore (3.5 per cent of GDP) as at end-March 2008 (Table V.8 and Statement 43).

Table V.8: Outstanding Guarantees of State Governments

Year (end-March)	**Amount** (Rs. crore)	**Percentage of GDP**
1	2	3
1992	40,158	6.1
2000	1,32,029	6.8
2004	2,19,658	8.0
2005	2,04,426	6.3
2006	1,96,914	5.3
2007	1,54,183	3.6
2008 P	1,71,058	3.5

P : Provisional.

Note : Data pertain to 17 States up to 2005 ,16 States for 2006 19 States for 2007 and 17 States for 2008.

Source: Information received from State Governments and Budget Documents of the State Governments.

7. Assessment of the Debt Position of State Governments

5.24 One important issue related to State finances pertains to sustainability of debt, which indicates the ability of the State governments to service their debt obligations. Accordingly, this section assesses the sustainability of the debt of State governments in terms of burden of interest payments and the maturity pattern of State government securities and issues arising in the context of liquidity management by the State governments.

Table V.9: Average Interest Rate on Outstanding Liabilities of State Governments

(Per cent)

Year	Average Interest Rate*
1	2
1991-92	8.54
1999-00	11.17
2007-08	8.04
2008-09 (RE)	8.00
2009-10 (BE)	7.96

RE : Revised Estimates. BE : Budget Estimates.
* : Worked out by dividing interest payments of the current year by outstanding debt of the previous year
Source : Same as Table V.1.

Debt Sustainability

5.25 A trend analysis of the debt-GDP ratio of State governments shows that it started showing an upward trend in 1997-98 as States started implementing the recommendations of the Fifth Central/State(s) Pay Commission. A sharp rise in the debt-GDP ratio by 3.3 percentage points to 26.1 per cent was discernible in 1999-2000 as compared to 22.8 per cent in 1998-99. In addition to the implementation of the Fifth Central/State(s) Pay Commission recommendations, this reflected the States' rising borrowing needs on account of a fall in Central transfers in 1998-99 and 1999-2000. Thereafter, the debt-GDP ratio rose gradually to 32.8 per cent in 2003-04 before moderating marginally in 2004-05 and 2005-06. Since 2006-07, at the consolidated level the States have been able to keep the debt-GDP ratio below the TwFC target of 30.8 per cent. As at end-March 2009, the debt-GDP ratio stood at 26.2 per cent. As a result of various schemes and reform measures, there has also been a significant reduction in the average interest rate on outstanding debt from 11.17 per cent in 1999-2000 to 7.96 per cent in 2009-10 (BE) (Table V.9).

5.26 Another target envisaged by the TwFC was with regard to the IP-RR ratio at 15 per cent to be achieved by 2009-10. An inter-temporal comparison shows that the IP-RR ratio during 2000-01 and 2004-05 (EFC award period) was significantly higher than 18 per cent as prescribed by the Eleventh Finance Commission (EFC). Although the IP-RR ratio started declining gradually since 2004-05, the States could bring it within the TwFC target of 15 per cent in 2008-09 (RE) (14.4 per cent) which would continue to remain so as per the budget estimates of 2009-10 (14.9 per cent). The process of fiscal correction and consolidation seems to have enabled the States to improve their debt sustainability position in recent years. Moreover, in addition to the Debt Swap Scheme, the scheme of conditional debt restructuring and interest rate relief recommended by the TwFC encouraged the States to enact FRLs targeting revenue balance by 2008-09 and GFD at 3 per cent of GDP by 2009-10. In fact, many of the States have adopted a specific target for their outstanding debt-GSDP ratio for a pre-specified date in the future.

5.27 An analysis of achieving the TwFC targets with respect to debt-sustainability at the State level shows that at the consolidated level, these targets have been achieved well ahead of the terminal year 2009-10. However, as per the budget estimates for 2009-10, the States may witness a slight deterioration in the debt-GDP and IP-RR ratios *albeit* remaining within the TwFC limits.

5.28 As far as the growth in outstanding debt is concerned, it was significantly higher at 10.1 per cent and 11.9 per cent in 2008-09 (RE) and 2009-10 (BE) respectively as compared with 7.0 per cent in 2007-08. Thus, it is important that incremental debt is used efficiently. In the present context, two issues are perceived to be important for the States. First, the States that propose to undertake additional expenditure during the current phase of the slowdown need to ensure an efficient allocation of their expenditure so that adequate debt-servicing capacity is generated. In other words, dedicated fiscal stimulus packages need to be strictly used for undertaking capital investments by State governments. However, budgeted estimates for 2009-10 do not seem to substantiate such a desired pattern of expenditure. It is evident that the revenue expenditure(RE)-GDP ratio is estimated to be higher in 2009-10 (BE) while the capital outlay-GDP ratio is proposed to be lower. Second, the States need to review their FRLs keeping in view the current phase of the slowdown and the need to resume the path of fiscal correction and consolidation.

Maturity Profile of State Government Securities

5.29 In terms of the maturity profile of the outstanding stock of State government securities, more than half, *i.e.,* 53.4 per cent of the outstanding stock of State governments' securities as at end-March 2009 belonged to the maturity bracket of 7 years and above, while 17.1 per cent was under the 5-7 years bracket and 15.6 per cent was below the 5 years bracket (Table V.10).

Table V.10: Maturity Profile of Outstanding State Government Securities
(As at end-March 2009)

State	Per cent of Total Amount Outstanding				
	0-1 years	1-3 years	3-5 years	5-7 years	Above 7 years
1	2	3	4	5	6
1. Andhra Pradesh	5.5	10.5	16.0	14.1	53.9
2. Arunachal Pradesh	1.6	8.5	10.1	18.5	61.2
3. Assam	4.5	10.6	15.2	20.3	49.3
4. Bihar	3.7	17.2	18.6	20.2	40.3
5. Chattisgarh	12.1	23.6	26.6	24.7	13.0
6. Goa	4.4	10.0	14.0	15.9	55.8
7. Gujarat	3.5	8.0	17.9	11.3	59.3
8. Haryana	4.4	9.0	21.8	24.3	40.5
9. Himachal Pradesh	3.2	8.6	17.1	19.6	51.6
10. Jammu & Kashmir	1.7	8.0	13.5	9.7	67.0
11. Jharkhand	2.8	12.9	14.6	17.7	52.0
12. Karnataka	5.6	12.1	17.2	19.8	45.2
13. Kerala	3.5	9.9	11.5	16.6	58.4
14. Madhya Pradesh	4.7	8.9	15.5	23.2	47.8
15. Maharashtra	2.0	5.4	12.2	13.7	66.7
16. Manipur	3.1	7.0	9.2	28.4	52.3
17. Meghalaya	5.6	11.8	9.7	22.2	50.7
18. Mizoram	3.6	8.2	15.4	20.1	52.7
19. Nagaland	5.4	12.3	12.4	20.4	42.7
20. Orissa	7.8	22.7	29.8	30.8	8.9
21. Punjab	3.5	4.8	16.1	16.0	59.5
22. Rajasthan	5.7	11.2	16.4	17.5	49.3
23. Sikkim	5.2	4.8	3.7	14.3	72.0
24. Tamil Nadu	3.0	9.1	15.0	15.6	57.3
25. Tripura	8.1	14.0	16.7	28.3	33.0
26. Uttarakhand	2.4	5.8	29.1	25.1	33.3
27. Uttar Pradesh	6.0	11.3	14.2	19.9	48.7
28. West Bengal	2.2	5.7	14.3	14.7	58.8
All States	**4.0**	**9.4**	**15.6**	**17.1**	**53.4**

Source: Reserve Bank records.

5.30 The maturity profile of market borrowings shows large repayment obligations from 2012-13 onwards due to a high amount of borrowings during 2002-03 and 2004-05 under DSS. The repayment obligations will be more than four times in 2017-18 over the previous year on account of the large magnitude of borrowings during 2008-09 as States were permitted to borrow 0.5 per cent of their GSDP on account of the economic slowdown to spur demand in their economies (Table V.11) (also see Statements 34-35).

8. Investment of Cash Balances

5.31 Despite the pressure on account of the implementation of the Sixth Pay Commission/ States' own Pay Commissions and the prevailing slowdown, State governments continue to hold large amounts of surplus cash balances as reflected in their investments in 14-day Intermediate Treasury Bills (ITBs) and Auction Treasury Bills (ATBs). The weekly average investment by the States in the 14-day ITBs and ATBs during 2009-10 amounted to Rs.83,647 crore (as on January 30, 2010) as compared with Rs.79,128 crore in the corresponding period of the previous year (Chart V.6). The upsurge in surplus cash balances at the State government level since the middle of 2004-05 has

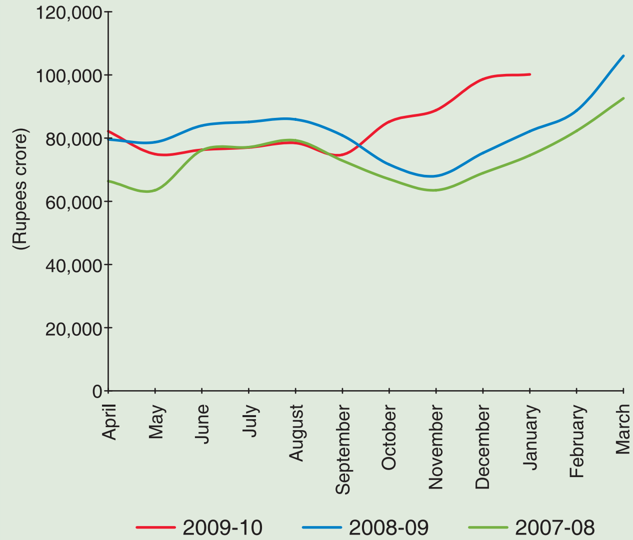
Table V.11: Maturity Profile of Outstanding State Loans and Power Bonds
(As at end-March 2009)

(Rs. crore)

Year	State Loans	Power Bonds	Total
1	2	3	4
2009-10	16,238	2,907	19,145
2010-11	15,660	2,907	18,566
2011-12	21,993	2,907	24,900
2012-13	30,628	2,870	33,498
2013-14	32,079	2,870	34,949
2014-15	33,384	2,870	36,254
2015-16	35,191	2,907	38,098
2016-17	31,522	1,453	32,975
2017-18	67,442	–	67,442
2018-19	1,15,524	–	1,15,524
2019-20	160	–	160
2020-21	2,103	–	2,103
Total	**4,01,924**	**21,690**	**4,23,614**

Source : Reserve Bank records.

Chart V.6: Investments in 14-day Intermediate and Auction Treasury Bills by State Governments
(Average of Daily Outstandings)



implications for the cash management of States as well as the Central government. The factors enabling surplus cash balances of State governments and the possible options for better cash management are discussed in Box V.1.

9. Debt Consolidation and Relief

5.32 To achieve fiscal sustainability, the TwFC recommended the Debt Consolidation and Relief Facility (DCRF) with two components: (i) a general scheme of debt relief applicable to all States; and (ii) a write-off scheme linked to fiscal performance with a view to providing an incentive for achievement of revenue balance by 2008-09. The availing of DCRF is subject to the enactment of FRL, the quantum of reduction in RD in each successive year and the containment of GFD at the level of 2004-05. During 2008-09, twenty-three State governments benefited from debt relief and twenty-five State governments benefited from interest relief. The aggregate debt and interest relief given to the State governments during 2008-09 amounted to Rs.5,748 crore and Rs.3,398 crore respectively. Three State governments, *viz.*, Jammu and Kashmir, Sikkim and West Bengal failed to receive either debt or interest relief during 2008-09. In the non-special category States, Uttar Pradesh received the highest debt and interest relief under the DCRF scheme recommended by the TwFC, followed

Box V.1: Surplus Cash Balance of the State Governments: Issues and Challenges

During the late 1990s and in the beginning of the 2000s, State governments used to avail WMA/OD quite often (with the objective of covering temporary mismatches in the cash flows of their receipts and payments) and the level of their surplus cash balance was quite negligible. However, a rising trend in the cash balances of States can be observed, particularly since 2004-05. During 2005-06 and 2008-09, the cash surplus balance of all the States grew at a compound annual growth rate of 57 per cent. Not surprisingly, a majority of the States stopped seeking short-term liquidity support from the Reserve Bank through the WMA window and OD facility. Though the build-up of surplus cash balances was initially contributed to by an excessive autonomous inflow of NSSF collections, the phenomenon of high surplus cash balances has persisted despite a sharp decline in NSSF inflows in recent years. This might be due to the fact that most States tend to exhaust their allocated market borrowing limits during the last quarter of the year and thereby build up surplus cash positions to be used for the first quarter of the next financial year when cash inflow generally remains low, but heavy spending by government departments takes place. The upsurge in the surplus cash balances at the State government level since the middle of 2004-05 has posed newer challenges for State governments' financial and cash management. The build-up in the surplus cash balances has implications for: (i) revenue balances of States; (ii) Centre's cash management; and (iii) open market operations of the Reserve Bank.

Why the States accumulate surplus cash balances instead of spending? The reason appears to be that States intend to avoid resorting to 'WMAs' or 'Overdraft' in the event of major payment obligations coming forth. In order to avoid any shortage of liquidity for making any lump-sum payment, they might have built up a surplus cash position in recent years.

It is observed that around 90 per cent of the surplus cash balances have been contributed by 13 States, mainly the non-special category States. Of these, some States have already achieved their deficit and debt targets well ahead of the stipulated time as prescribed by the TwFC. Despite the improvement observed in terms of deficit and debt indicators in a few States, their capital outlay as a percentage of GSDP is either stagnant or on the lower side. This indicates that either there is no further capacity in the States to absorb additional capital spending or they are too conservative in their approach. The build-up of cash balances across States has been an outcome of the States' own efforts to augment tax revenues and exogenous factors including larger devolution and transfers by the TwFC through shareable Central taxes and grants.

With regard to the options available for the investment of cash surplus, a possible option could be using surplus cash balances at the time of a cyclical downturn, when the States can draw down their surplus balances to supplement their expenditure programmes for undertaking countercyclical measures. During the current phase of the macroeconomic slowdown, it is widely expected that the States may tend to spend more to boost domestic demand while there is considerable uncertainty on the tax collection front, both at the Centre and State levels. Thus, the high level of cash surplus accumulated at the State level in recent years seems to provide some headroom to withstand pressures on finances. The States may be encouraged to build the capacity of projecting their cash flows on account of receipts and expenditures and rationalising their surplus cash balances with the purpose of minimising costs. One possible alternative may lie in allowing the States to carry forward a part of their allocated but unavailed amount of borrowings to the next financial year. This will not only make the States' borrowing programmes more need-based but will also provide the States adequate flexibility to borrow during opportune times in a cost effective manner. During the boom period, the States may borrow less and save their unborrowed quota for the downturn phase when there is the need to spend more to boost the economy. Another possible alternative could be setting up of a Budget Stabilization Fund by the States utilizing the durable component of surplus cash balances which can be used at the time of need. Such an arrangement would make the States more confident to undertake countercyclical fiscal policies. Taking cues from Orissa and Rajasthan, the States may explore the option of repaying high cost debt by replenishing surplus cash balances.

Further, the States should make serious efforts towards building up the capacity for better cash management. Apart from greater coordination among the government entities required for making realistic assessment of cash needs, States may attempt to avoid unwarranted build-up of cash surplus by adopting advanced forecasting and monitoring mechanisms keeping in view the best practices across advanced economies. As a result of effective cash management and better synchronisation of cash inflows and outflows, the States may be able to minimise their borrowing requirements. This may also help, to some extent, to curb an unwarranted build-up of cash surpluses by the States which has implications not only for the Centre's cash balances but also for monetary policy.

by Andhra Pradesh and Gujarat during 2008-09 (Statement 48). In the case of special category States, Assam received the highest amount under the debt relief facility, followed by Manipur and Tripura. However, in the case of interest relief Himachal Pradesh followed by Tripura received the highest amount during 2008-09.

10. Conclusion

5.33 In accordance with the TwFC's recommendation, all States (except Sikkim and West Bengal) enacted FRLs thus limiting their annual borrowing requirements to a sustainable level. As a result, from the peak level of 32.8 per cent as at end-March 2004, the debt-GDP ratio of State governments came down to 26.2 per cent in 2008-09 (RE) and below the TwFC target of debt-GDP ratio of 30.8 per cent by end-March 2010. Further, as against the TwFC target of interest payment to revenue receipts (IP-RR) ratio of 15 per cent to be achieved by 2009-10, the combined IP-RR ratio of the States declined from 26.0 per cent in 2003-04 to 14.4 per cent in 2008-09 (RE). However, the outstanding debt is budgeted to increase to 26.5 per cent of GDP at end-March 2010. The IP-RR ratio is budgeted to rise marginally to 14.5 per cent in 2009-10

5.34 The dominance of NSSF in outstanding liabilities has also declined persistently since March 2007 and is budgeted to contribute around one-fourth of the total outstanding liabilities as compared to one-third during 2005-06 to 2007-08. The share of high cost debt instruments *i.e.,* public accounts items like small savings and provident fund in total outstanding liabilities which had increased to 26.9 per cent in March 2008 from 25.5 per cent in March 2005, thereafter showed a declining trend. Market borrowings comprising one-third of the outstanding liabilities reflect the low cost debt segment of the States.

5.35 In recent years, State governments have been maintaining large amounts of surplus cash balances in terms of treasury bills of the Central Government. Consequently, the dependence of the State governments on WMA/OD has come down substantially during the last two years.