Issues Relating to Mismatches between Loan Repayment by the States and Repayment to the Investors of Small Savings (The Overhang Problem): Magnitude and Transitional Arrangements

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The issue of mismatches between loan repayments by the States and repayments to the investors of small savings arises from the existing arrangement for the sharing of small savings and terms of repayment. From the gross mobilisation during a year, after meeting the repayments, the net collection of small savings is shared between the Centre and States. The amount given to States used to be in the form of loans from Centre, till 1998-99 and since then it is in the form of investment by National Small Savings Fund (NSSF) in State Government securities. The terms of this transfer to States imply that States have to repay the funds in 25 years (including a moratorium of 5 years). This leads to mismatch between loan repayment by the States and repayment to the investors of small savings. As the small savings collection is growing year after year and distribution is made after meeting the repayments, the mismatch, however, has not been noticeable. In the context of the proposal to transfer all small savings collections to States, the mismatch arising out of current outstanding constitutes an overhang problem, which has to be tackled with minimum disruption. This paper while examining the magnitude of the overhang problem, proposes some transitional arrangements.

I. Small Savings Collection and Issue of Mismatches

The gross collections of small savings have witnessed a significant rise from Rs. 18,920 crore in 1990-91 to Rs. 75,542 crore in 1999-2000. During 1999-2000, out of gross collections of Rs. 75,542 crore, repayments to the investors were made to the extent of Rs. 36,889 crore (i.e., 49 per cent) (Table A). The net amount of Rs. 38,653 crore was distributed between Centre and States. The pattern of distribution of net small savings collection between the Centre and States was 25.0 per cent and 75.0 per cent, respectively, during the nineties and changed to 20.0 per cent and 80.0 per cent since 2000-01. While the share of States was Rs. 26,937 crore in 1999-2000, the repayments made by the States to the Centre against the small savings loans were only at Rs. 2,475 crore. These mismatches arise from the fact that while the average maturity of small savings deposits works out at 6.2 years, the average maturity of loans extended to States against their share in small savings is 15.5 years.

Table A: Small Savings Gross Collections and Repayments

(Rs. crore)

Year	Gross Collection	Repay-ments	Net Collection	Repayments/ Gross Collection (Per cent)	Share in Net Collection		Repayments by State
					Centre		States
1990-91	18,920	9,816	9,104	51.9	2,078	7,026	492
1998-99	62,157	29,113	33,044	46.8	9,247	23,788	2,225
1999-2000	75,542	36,889	38,653	48.8	8,979	26,937	2,475
2000-01 (RE)	86,000	43,000	43,000	50.0	7,950	31,799	..

2001-02 (BE)	93,500	46,500	47,000	49.7	9,000	36,000	..

.. Not available. RE-Revised Estimates BE-Budget Estimates
Source: (1) Government of India, note on "Small Savings Schemes – An Overview".
(2) Budget documents, Government of India.

The following sections deal with issues of mismatches between the repayment to the investors and loan repayment by the States and the overhang problem under the proposed scheme under which the entire collections of small savings are passed on to the States.

II. The Existing Repayment Arrangement and the Problem of Overhang

Prior to the setting up of the NSSF, the Central government assumed the responsibility of interest payments and repayment of the principal of small savings to the depositors as also the management cost. All withdrawals under small savings schemes by the depositors were ensured by the Centre through a system where the transfers to the States were made after provisioning for repayments from gross collections. The State governments made repayment for the loans against the small savings collections to the Centre depending upon the maturity period of such loans. Since the setting up of the NSSF in the Public Account of the Centre in 1999-2000, all small savings collections are credited to this Fund and withdrawals by the depositors are made out of the accumulation of the Fund. The balance in the Fund is invested in the Central and State Government securities. The amount released to States is treated as investment in special securities to be redeemed from the sixth year over a period of 20 years.

With the change in accounting practice, the outstanding amount of small savings at Rs.1,76,221 crore at end- March 1999 was converted into NSSF's investment in Central government securities and is treated as internal debt of the Central government. Though the amount outstanding is treated as the internal liabilities of the Centre, a major part of it is due to States' liabilities to the Centre. As per the Finance Accounts of Government of India (1998-99), the outstanding loan of States against small savings as at end-March 1999, amounted to Rs. 1,01,211 crore. By netting out this amount from the total outstanding of small savings at Rs.1,76,221 crore, the balance of Rs.75,010 crore amounts to Centre's liability. These respective shares of Centre and States in the total outstanding liabilities form the base for estimating the future liabilities.

The outstanding liabilities for the subsequent three years (1999-2000 to 2001-02) are derived based on the distribution of net collection between Centre and States in the ratio of 20:80. Accordingly, the total outstanding liabilities under small savings is placed at Rs. 3,04,791 crore at end-March 2002 (Table B). Out of the total small savings liabilities at end-March 2002, the States' share amounts to Rs. 1,97,413 crore (i.e., 65 per cent), and the balance (35 per cent) amounting to Rs. 1,07,378 crore is Centre's liability.

Table B: Small Savings Liabilities
(Outstanding)

(Rs. crore)

Year (End-March)	Centre	States	Total
1998-99	75,010	1,01,211	1,76,221
	(42.6)	(57.4)	(100.0)

1999-00	86,643 (40.3)	1,28,148 (59.7)	2,14,791 (100.0)
2000-01	96,378 (37.4)	1,61,413 (62.6)	2,57,791 (100.0)
2001-02	1,07,378 (35.2)	1,97,413 (64.8)	3,04,791 (100.0)

Note: (1) Figures in brackets are percentage to total.
(2) The figures on outstanding since 1999-2000 are derived by adding the securities issued against small savings over the outstanding position at the base year (1998-99). The details on the methodology are given in Annexure I.

The Structure of Future Repayment Liabilities

Given the existing arrangement for repayment of small savings, the repayment schedule for the outstanding small savings liabilities of Centre and States has been worked out. It may be mentioned that the estimates on total repayments to the depositors are based on the average maturity of small saving schemes (i.e. 6.2 years) and may not exactly correspond with the actual data. However, the amounts of repayment by the States to Centre are based on the actual maturity [Details are set out in Appendix Table 1]. Based on average maturity of 6.2 years for the small savings deposits, the annual repayment to the depositors works out to Rs. 49,160 crore up to 2007-08 and Rs. 9,832 crore in 2008-09, the year when outstanding liabilities are extinguished, reflecting the extent of overhang of the outstanding liabilities (Table C). It may be noted that as the maturity period of schemes like PPF is considerably longer than the average maturity of 6.2 years, liabilities would remain outstanding for that long period. But this will be a matter of accounting adjustment and effectively, the outstanding liabilities at the switchover time would be extinguished by the year 2008-09. As per the existing arrangement, these repayments are undertaken by the Centre. However, as the States are given loans against their share of small savings collections, they make annual repayments to the Centre from the sixth year onwards over a period of 20 years. Based on the actual maturity for the repayment by the States, the annual repayment of liabilities outstanding upto March 2002 to be made by the States would initially rise and then taper off till these liabilities are completely extinguished by 2026-27 (Table C). Taking into account the repayments by States, the net amount of repayment by the Centre works out to Rs. 45,248 crore in 2002-03 and steadily declines to Rs. 38,609 crore in 2007-08. However, the States would continue to make repayments till 2026-27, the year when their past outstanding small savings liabilities are fully redeemed.

III. Alternative Repayment Schemes Suggested under the New System

Given the large overhang of small savings liabilities both for the Centre and the States, the methods for repayment of such outstanding liabilities need to be devised before switching over to a system where the entire small savings would be transferred to the Sates. Although under the existing system, since 1999-2000, the small savings liabilities of the States are only to the extent of the NSSF's investment in special securities of States, the share of States under the system prior to NSSF forms substantial part of the States' liabilities to the Centre.

Table C: Repayment Schedule of Small Savings

Outstanding at end-March 2002

(Rs. crore)

Year	Total Repayment*	Repayment by States**	Repayment to be met by the Centre (2-3)
(1)	(2)	(3)	(4)
2002-03	49160	3912	45248
2003-04	49160	4684	44476
2004-05	49160	5852	43308
2005-06	49160	7167	41993
2006-07	49160	8795	40365
2007-08	49160	10551	38609
2008-09	9832	10495	0
2009-10	10426		
2010-11	10329		
2011-12	10184		
2012-13	10044		
2013-14	9889		
2014-15	9679		
2015-16	9391		
2016-17	9040		
2017-18	8766		
2018-19	8553		
2019-20	8303		
2021-22	7819		
2020-22	7320		
2022-23	6786		
2023-24	5999		
2024-25	4810		
2025-26	3463		
2026-27	1800		

* Estimates based on the average maturity of 6.2 years for small savings deposits.
** Repayment computed based on the actual repayment period for the States (Appendix Table 1).

Before proposing any arrangement to tackle the problem of overhang, it may be kept in view that the new liabilities of small savings to be incurred by States from the switchover point (say, April 2002), will become repayable after around six years (i.e., the average maturity of small savings). This period of six years provides a sufficient cushion to deal with the outstanding liabilities accumulated till March 2002, without putting much pressure on Centre and State finances.

Two alternative repayment schemes to extinguish the repayment liabilities have been worked out both for the outstanding liabilities of the past and the fresh liabilities (exclusively for States) after the introduction of new system. The baseline used in the exercise is 2001-02, for the treating past liabilities and fresh liabilities after the introduction of the new scheme. These two alternative schemes for repayment are: (a) repayment profile exclusively for the Central Government; and (b) repayment profile exclusively for the States. The repayment liabilities of States include the repayment of the past liabilities and repayment arising out of the fresh liabilities under the new scheme.

Assumptions

For convenience, several assumptions are made to work out repayment schemes to deal with the problem of the overhang of small savings. However, more detailed work is needed to firm up any arrangement for the future. The two alternative repayment schemes worked out are based on the following assumptions:

(i) The new system, under which the entire small savings would be transferred to States, is assumed to come into existence from 2002-03.
(ii) All the small savings collections would accrue to the NSSF, and investment by the NSSF would be made after meeting the repayments to the depositors.
(iii) The small savings liabilities outstanding up to March 2002 would be repaid by the Centre and the States, depending on their respective shares in the small savings.
(iv) For making repayments to the depositors by NSSF, the average maturity of the small savings liabilities outstanding up to March 2002 is assumed at 6.2 years.
(v) For repayment of the outstanding liabilities up to March 2002, under the old system, the average maturity for the Centre is assumed at 6.2 years, while for the States, it is as per the terms of loans from Centre to States, i.e., to be redeemed from the 6th year onwards over a period of 20 years.
(vi) The projections of gross collections of small savings from 2002-03 onwards are made at 10 per cent growth for working out the repayment schedule and net accruals.
(vii) Under the new system, 100 per cent of the net collections would accrue to the States. Thus, the Centre would cease to have any share in the net collections.
(viii) The average maturity of the small savings deposits under the new system is assumed at 6.4 years[1] , i.e., the maturity at which deposits are repayable by States on back to back basis.

(a) *Central Government*

As regards Central Government, once the new scheme is introduced, the repayment liabilities relate to only the outstanding part of the small savings upto the switchover point. From that point onwards, no fresh flow of small savings would accrue to the Centre, implying thereby that the discharge of outstanding liabilities would be a draft on the Centre's resources. Two alternative schemes of repayment for Centre are set out below.

(i) As mentioned earlier, the amount outstanding at end-March 2002 needs to be fully redeemed by the year 2008-09. In this case, the average annual repayments work out Rs. 49,160 crore during 2002-03 to 2007-08, if the entire repayment burden is borne by the Centre. However, the repayment burden of the Centre would be moderated to the extent it would receive annual repayment by the States against the small savings loans extended to them.

(ii) Alternatively, repayment is worked out assuming that the Centre is liable to repay only to the extent of its share in the outstanding small savings (Rs.1,07,378 crore at end-March 2002). With average maturity of small savings being 6.2 years, the average annual repayment would be Rs. 17,319 crore for the period 2002-03 to 2007-08 and Rs. 3,464 crore for the year 2008-09, when these liabilities would be fully repaid.

(b) *State Governments*

The States' liabilities against small savings to Centre and NSSF together is placed at Rs. 1,97,413 crore at end-March 2002. Two alternative schemes of repayments have been worked out for the States to extinguish their share of small savings liabilities outstanding at end-march 2002. First scheme of repayment is based on the existing terms of repayments for the States. Second scheme is based on the actual maturity of small savings.

(i) Under the first scheme for the States, the small saving liabilities outstanding upto end-March 2002 are to be redeemed from the sixth year onwards over a period of 20 years. Based on this, the small saving liabilities of States outstanding at end-March 2002 would be extinguished by the fiscal year 2026-27. The average maturity period for the repayment of small savings raised under the new system (2002-03 onwards) works out 6.4 years[2] , the repayment for which would commence in 2008-09. Thus, from 2008-09 onwards, the repayments would include both arising out of the past liabilities and the fresh liabilities.

[1] The average maturity increases on account of lengthening of the maturity of Kisan Vikas Patra from 6.5 to 7.25 years.

(ii) Under the second scheme, it is assumed that the existing system of repayment out of gross collections would continue even after the introduction of the new scheme of transferring entire small savings to States and the States getting 100 per cent of the net collection. The gross small savings collections have been worked out at a modest rate of 10 per cent to assess the impact on net flows to States after reckoning for entire repayment to the depositors. Any growth in small saving collection higher than 10 per cent would provide that much more resources to the States. It can be observed that even at a moderate growth of 10 per cent in the gross collections, the net flow of small savings to States would continue to rise after meeting the repayments (Table D). Thus if the States agree to prepay their liabilities to the Centre ahead of the schedule, the pressure on the Centre for funds would be lessened to that extent. Further, gross small savings to NSSF would be enhanced to the extent of repayment made to the NSSF by the Centre against its share of outstanding small savings liabilities, which would facilitate larger net accrual of small savings to States. Under this situation, before the back to back arrangement for repayment of fresh small savings liabilities begins in 2008-09, the repayment of old loans would have been completed.

The advantage of prepayment of the outstanding small saving liabilities by the States under the second scheme will be replacing their high cost borrowing of the past with low cost borrowing. Added to this would be reduction in the interest burden.

It may be stated that the above analysis with respect to States is at the aggregate level. The individual States' position can be worked out on the same lines.

The existing administrative machinery and collection process for small savings can continue with post offices/NSSF collecting necessary costs.

In case, some States do not wish to have share in small savings, they should be given the choice to opt out of the scheme.

[2] Based on the weighted average maturity also taking into account the change in the maturity of Kisan Vikas Patra from 6.5 to 7.25 years.

Table D: Alternative Scheme for Repayment of Small Savings Liabilities of States

(Rs. crore)

Year	Gross Collection (estimated Assuming 10% growth)	Repayment to the Depositors*	Repayment by the Centre	Repayment Attributable to States (3-4)	Net Collection Available to States (2-5)	Amount Repayable by States	Excess Payment by States (5-7)
1	2	3	4	5	6	7	8
2002-03	102850	49160	17319	31841	71009	3912	27929
2003-04	113135	49160	17319	31841	81294	4684	27156
2004-05	124449	49160	17319	31841	92608	5852	25989
2005-06	136893	49160	17319	31841	105053	7167	24674
2006-07	150583	49160	17319	31841	118742	8795	23046
2007-08	165641	49160	17319	31841	133800	10551	21290
2008-09	182205	112682	3464	109218 #	72987 @	109218	0
2009-10	200426	113135	-	113135	87291 @	113135	0

* Repayment till 2008-09 relating to old liabilities is based on average maturity of 6.2 years.
# Includes repayment of old as well as new small saving liabilities.
@ The net collection for the year may be even higher as the actual repayment may spread over a larger period on account of longer maturity of the schemes like PPF, while the average maturity assumed for computing

repayments is about 6 years.

IV. Conclusion and Suggestions

The issues of mismatch and the problem of overhang arises from the present maturity structure of small savings deposits and loans repayments by the States. As the small saving collection is growing year after year and distribution is made after meeting the repayments, the mismatch has not been noticeable. However, in the context of the proposal to transfer entire small savings collections to States, the mismatch becomes a matter of concern as it leads to significant repayment burden of outstanding liabilities.

From the switchover point while the Centre would not get share in the small savings, it would have outstanding liabilities to NSSF, the discharge of which would make additional demand on Centre's resources. In case, the entire outstanding small savings liabilities at end-March 2002 is to be repaid by the Centre, the average annual repayment liabilities of the Centre works out Rs. 49,160 crore for the period 2002-08. However, if the Centre were liable for repayment only to the extent of its share of small savings, the average annual repayment by the Centre would be Rs.17,319 crore.

The State Governments, under the new system of transferring entire net small savings, would be in a position to prepay their past liabilities. Further, as the average maturity of deposits under the new system (say, since 2002-03) works out to 6.4 years, the repayment of these new liabilities would begin only in 2008-09. This period of six years provides a sufficient cushion to deal with the outstanding liabilities accumulated till March 2002, without putting much pressure on Centre and State finances. Even assuming a moderate annual growth of 10 per cent in the gross collections, the States would have adequate net resources to prepay the past liabilities during the transition period. It would be beneficial for the States to replace their high cost liabilities of the past with low cost borrowings in a declining/stable interest rate environment. The prepayment would result in significant reduction in the interest payments of States.

Annexure I: Methodology and Data Sources

The estimates presented in the study are based on fiscal accounting. The series on the outstanding of small savings liabilities of the Centre and the States after 1998-99 is derived by using it as the base and adding the annual net flow shown in the NSSF to the outstanding liabilities of the respective governments. For the States, the outstanding are taken from the Finance Accounts, Central Government. To build the series for the end-March 2000, 2001 and 2002, the NSSF's net investment in States' securities is added to the stock outstanding against States at end March 1999 (i e,. $D_t = D_{t-1} + b_t$, where D_t = outstanding stock at period t, b is the net flow during period t). For the Centre, the outstanding small savings are derived by subtracting the States' liabilities from the total outstanding small savings shown in the NSSF.

Under the old system, the amount released to States is to be redeemed from the sixth year onwards over a period of 20 years. The effective average maturity at the existing arrangement is computed as:

$$m_w = [\ S\ (.05\ SS_t)^*\ m_i]/SS_t$$

where i = 6,…..,25 years.

m_w = weighted average maturity, SS = Small saving collections during a year (which is equally distributed for repayment for the entire repayment) m_i = maturity of small savings loans, i.e., 6 to 25 years.

The repayment schedule for the loans against small savings to States used in this note is worked out on the basis of actual maturity of loans extended while the repayment schedule for the small savings deposits is worked out on the basis of average maturity of 6.2 years. The repayment schedule worked out on the basis of the average maturity may not exactly correspond with the actual repayment streams, but will predominantly represent the redemption during the time horizon.

The data on the gross, repayments, net and outstanding under the NSSF and for the Centre and the States, separately, are sourced from the Central government budget documents.

Appendix Table 1: Matrix of Repayment of Small Savings Loans of States Outstanding at end-March

Year	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1
	289	444	625	712	882	1,104	1,399	1,935	2,903	2,800	3,097	4,205	5,742	7,026	5,481	4,264	5,000	9,675	9,990	10,671	15,732	2:
1977-78																						
1978-79																						
1979-80																						
1980-81																						
1981-82																						
1982-83																						
1983-84	14.5																					
1984-85	14.5	22.2																				
1985-86	14.5	22.2	31.3																			
1986-87	14.5	22.2	31.3	35.6																		
1987-88	14.5	22.2	31.3	35.6	44.1																	
1988-89	14.5	22.2	31.3	35.6	44.1	55.2																
1989-90	14.5	22.2	31.3	35.6	44.1	55.2	70.0															
1990-91	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8														
1991-92	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2													
1992-93	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0												
1993-94	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9											
1994-95	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3										
1995-96	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1									
1996-97	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3								
1997-98	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1							
1998-99	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2						
1999-00	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0					
2000-01	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8				
2001-02	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5			
2002-03	14.5	22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6		
2003-04		22.2	31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	
2004-05			31.3	35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2005-06				35.6	44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2006-07					44.1	55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2007-08						55.2	70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2008-09							70.0	96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2009-10								96.8	145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2010-11									145.2	140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2011-12										140.0	154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2012-13											154.9	210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2013-14												210.3	287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2014-15													287.1	351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2015-16														351.3	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1

2016-17	274.1	213.2	250.0	483.8	499.5	533.6	786.6	1
2017-18		213.2	250.0	483.8	499.5	533.6	786.6	1
2018-19			250.0	483.8	499.5	533.6	786.6	1
2019-20				483.8	499.5	533.6	786.6	1
2020-21					499.5	533.6	786.6	1
2021-22						533.6	786.6	1
2022-23							786.6	1
2023-24								1
2024-25								
2025-26								
2026-27								