Editorial

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Debt-swap scheme: Stalemate continues

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IN A bid to make a dent on the problem of unsustainable budget deficit of the State governments, the Centre has proposed the swapping of their high-cost debt with low-interest bearing loans. It may be interesting to examine what the package looks like, and whether it will help prune State deficits.

The total debt of all States put together was around a staggering Rs 5,90,000 crore as on March 31, 2002. Of this, the Government intends to cover Rs 90,000 crore under the debt swap scheme over a period of three years — Rs 20,000 crore during 2002-03, Rs 30,000 crore in 2003-04 and Rs 40,000 crore over 2004-05.

The debt of Rs 90,000 crore represents loans taken about a decade ago at an average interest of 13.5 per cent. The prevailing interest rates being substantially lower (7.5 to 9.0 per cent), substitution of these by fresh loans will result in substantial reduction in liability towards interest.

According to an estimate, the States will save about Rs 37,000 crore during the period up to the maturity of the loans. And, since interest payments constitute a sizeable component of revenue expenditure, this will have a 'salutary' effect on the budget deficit.

The money needed for retiring the high-cost debt can come either from collections under the small savings scheme (SSS) or from market borrowings. While the amount available by way of fresh loans raised in the market place cannot be ascertained, under SSS, the States will have about Rs 50,000 crore during 2002-03.

Under the scheme, the Government is insisting that the State governments should use at least 20 per cent of this amount or Rs 10,000 crore to become eligible for additional market borrowings of Rs 10,000 crore during the current year. This gives a total of Rs 20,000 crore for 2002-03

For the next two years, while, retaining additional market borrowings at Rs 10,000 crore, the Centre wants the State governments to increase the contribution of SSS to Rs 20,000 crore during 2003-04 and Rs 30,000 crore during 2004-05, representing 30 per cent and 40 per cent of the net collections respectively.

The States have rejected this package. They are not prepared to spare even a rupee from the SSS kitty. The debt-swap scheme was a major item on the agenda of the recent conference of Chief Ministers in New Delhi. However, in view of the extreme positions, the issue was not even discussed.

What has prompted Government to dictate terms to the States in regard to use of funds under the SSS? Why are the States opposing use of funds from this kitty? Why is the Centre so keen to put a 'cap' on market borrowings by the States? In order to find an answer to the above questions, it is necessary to assess how the interests of Government, on the one hand, and the state governments, on the other, will be impacted by implementation of the scheme.

At the outset, let us take a close look at the implications for the Centre. The States owe about 50 per cent of their outstanding debt to Government. Now, if the scheme is implemented, this will inevitably involve retirement of the loans taken by the former from the latter.

As stated earlier, under the scheme, the States will save about Rs 37,000 crore up to maturity of the loans. Apply a factor of 50 per cent to this amount. On a rough-and-ready basis, about Rs 18,500 crore will be by way of savings in interest on loans taken from Government. For every rupee saved by the States, there will be corresponding loss for Government. Indeed, Rs 18,500 crore is a huge amount. And, in view of Centres' own budgetary position being no less precarious (it accounts for about half of the combined fiscal deficit of Centre and States), it will take this loss with a pinch of salt.

The Government is also worried over the consequences of the State Governments going in for 'market borrowings' on a large scale. It apprehends that this may lead to increase in the interest rate. That apart, the Centre may face serious difficulties in successfully completing its own borrowing programme (it has to borrow over Rs 100,000 crore every year).

> If the Central and State governments are really serious about the debt-swap scheme, the former should merely indicate the overall target and leave the details to the latter. Depending on the specific circumstances, each State can decide on the mix of the two sources — small savings and market borrowings. As for the States, they need to rationalise and trim their expenses under various schemes to generate the cash required under the plan.

Clearly, the Centres' own financial position will be 'negatively' impacted by implementation of the scheme. But, having mooted it, it does not dare oppose at least in public. It may, therefore, be contemplating other means to ensure that the scheme does not take off!

Let us look at things from the perspective of the States. The reason why they do not want any 'encroachment' on the funds with them under SSS is pretty obvious. They fear this will affect their cash flows.

The Madhya Pradesh Chief Minister, Mr Digvijay Singh, went a step further when he stated that "retention of 20 per cent of the net collections under SSS during 2002-03, and 30 per cent during 2003-04 will affect the plan performance of the States".

Mr Singh's statement is highly misleading as bulk of the cash with the States (including money in SSS kitty) is spent on 'current' consumption. Consequently, any reduction under this head is unlikely to affect the pace of development.

The States need to look beyond their day-to-day concerns. It is well known that State exchequers are bleeding on account of huge interest liabilities (in 2001-02, they spent Rs 54,000 crore under this head). This is one of the biggest stumbling blocks in the way of development.

The debt-swap scheme offers an excellent opportunity to combat this menace. Over a period of time, this will help in releasing lot of resources for supporting developmental activity. But, for this, the States need to make a bit of sacrifice now. They obviously cannot have the cake and eat it too.

The majority of the States are keen to use market borrowings 'alone' for replacing the high-cost debt. In view of interest rate on these (7.5-8.0 per cent) being lower than the interest payable on small savings (8.5-9.0 per cent), this may be a more attractive option. But given their track record in servicing debt, who will lend them the money?

The proof of the pudding is in the eating. In recent months, several States have not been able to find subscribers to their bonds. This is despite their offering interest as high as 11.0 per cent (this is significantly higher than interest on small savings). Rating agencies such as Crisil, etc., have downgraded some of these bonds to default category (for instance, Maharashtra Government).

Clearly, the States have proved incapable of tapping money from the market. And yet, by advocating a case solely for market borrowings, they have made themselves a laughing stock. Further, by insisting that they will not draw funds from the SSS kitty either, they have *de facto* said 'no' to the scheme.

If the Central and State governments are really serious about the scheme, both need to shed their intransigence. The former should merely indicate the overall target and leave the details to the latter. Depending on the specific circumstances, each State can decide on the mix of the two sources — small savings and market borrowings.

The Centre need not be unduly perturbed over the excessive borrowings by the States as the market will 'automatically' exercise a check.

As regards its own loss by way of higher interest foregone, it may look for other measures to offset this. For instance, the Government could go in for a swap of its own high-cost debt with low-interest fresh loans.

As for the States, instead of standing on prestige and looking for alibis, they should extend their full cooperation in implementing the scheme. They need to rationalise and trim their expenses under various schemes — Plan or non-Plan — to generate the required cash for meeting the obligations under the debt-swap plan.

The debt-swap scheme is only a small step in the direction of dealing with the unsustainable deficit faced by the States.

It covers only 15 per cent of their total debt. Here, again, the scheme merely aims at reducing the cost of servicing the debt, and not extinguishing it.

To make a real dent on the problem, the States will have to take bold steps. Some major areas crying for immediate attention are:

(i) drastically reducing the subsidies, especially on power and irrigation

(ii) drastically reducing the transmission and distribution losses (read large-scale power theft) of SEBs

(iii) drastically reducing the establishment expenses, including wages and salaries and other overheads, and

(iv) drastically reducing support to loss-making State undertakings.

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