Chapter 7

Conclusion, Major Findings and Policy Recommendations

Based on the analysis presented in the foregoing chapters, the present chapter aims at highlighting the broad but integrated observations of the study to enable to suggest various policy implications and planning in challenging problems and prospect of public debt management and its impact on human development.

It is evident from the foregoing chapters that central loans constitute an important mechanism for transfer of resources from the centre to the states. Central Loans to states accounts for the largest proportion of the total loans of states (and their total liabilities). Large part of these loans arise in the process of inter Governmental fiscal transfers through the planning commission. These are loans that are combined with grants that are given to state governments to finance state plans. These loans are largely formula based and thus may have very little to do with a states borrowing capability.

The outstanding public debt of Manipur has increased from Rs.29.82 crores in 1972 to Rs.3193.19 crores in 2005. It has increased by more than 107 times. It is also clear that the outstanding central loans to the state have increased to from Rs.28.54 crores in 1972 to Rs.1480.50 crores in 2005. It has increased by more than 51 times. It is also clear from the table that Public debt of Manipur increased from Rs.2982 crores in 1972 to Rs.79.48 crores in 1981. Since then it increased to Rs.236.30 crores in 1988, it has further increased to Rs.3193.19 crores in 2005. Thus, within 17 years, Manipur’s public Debt has increased by more than 13 times. Thus, this rapid increase in the Public Debt of the state government shows
its ever increasing dependence on loan finance particularly on the central Government. Although the share of central in the state’s debt declined in the recent years, it continued to be the largest share in the state’s debt and it is found that the magnitude of central loans to the state has enormously increased during the study period. It is clear that income effect of the financial burden of interest charges on central loans has been fluctuating and in some years, it was below 3 percent and the magnitude of the percentage was also small. This is due to the debt relief given by the Finance Commissions. The interest charges as a proportion of the states revenue expenditure has been fluctuating, it was 4.09 percent in 1980-81 and declined to 1.94 percent in 1983-84. Then it started rising absolutely from 1990 till 2005-06.

The findings regarding, the decision about the burden of public debt is that the burden would be measured only with reference to the growth of national income and that the growing Public debt need not cause any concern so long as National Income rises adequately. This point of view has a special appeal to a special category state like Manipur where Public debt plays a very significant role in mobilizing financial resources for undertaking a higher volume of investment which otherwise would not be possible and in creating a suitable institutional framework for effective implementation of monetary policy. However, it is found out that, the rate of growth of central loans and that of state’s net domestic product are almost steady. The rate of growth of outstanding central loans were more than that of that of NSDP in the following years, in 1980-81, 82-83, 83-84, 85-86 to 88,1990-91,1994-95,1998-99,2000-01,2002-03. This is certainly not good.

Coming to the burden of debt-repayment and servicing, it is seen that, it started to increased abruptly from 2000-01 and it had almost the same in the subsequent three years but it fell down to 6.43 percent in 2005-06. This shows that economic development burden has increased year after year. The position is bound to worsen further in the coming years unless
some corrective measures are evolved and applied. It is welcome decision of the central Government to include this question in terms of reference of reference to the Twelfth Finance commission which looked into the specific debt problems and corrective measures. This is indicative of the extent of misutilisation of the central loans to the state in the name of capital expenditure. The central loans are not accompanied by the increase in the rate of asset creation. If the borrowed funds are used for asset creating public projects, the income of the state is bound to increase. The cost of the burden would be then off set by the benefits that the debt-creation confers. However, at least the part of the rise in state income may be attributed to the rise in central loans which provided funds for public investment.

In the findings regarding the social and human development impact, what emerges unambiguously is that, the state maintained the share of social services in total revenue expenditure at pre-crisis period levels, which was 42.83 percent, declined to 38.60. If the public expenditure is already high but social allocation ratio is low, the financing of expenditure needs budgetary reassessment to see which area of expenditure can be reduced. If PER and SAR are comparatively high but the ultimate human development is low, the social priority must be increased. If the problem is low public expenditure ratio, raising this would call for raising revenue and this should be an essential part of the financing strategy. Empirically it is observed that the ratio of public expenditure tend to rise with per-capita income. However, there are no clear cut rules guiding the appropriate levels of public expenditures relative to GNP or its desirable allocations across sectors at different stages of development. The recognition of the right to education as a fundamental right, and the consequent responsibility thrust on state government to ensure that universal primary education is achieved in the near future makes it imperative to increase allocations to this sector.
Given the high level of states outstanding liabilities, certain corrective measures are inevitable. Corrective measures leading to sustainability of debt can be effective only when state governments make a persistent attempt to put their finances on sound footing by additional revenue effort, expenditure compression and re-prioritization in line with the restructuring plans. Bailouts through write-offs/ waivers can never be a long term solution. Waivers of loans and interest should be strictly restricted so as to avoid moral hazard problems and encourage debt repayment discipline. Relief of debt should be incentivised by clearly linking it with simple monitor able reforms or processes.

Against this backdrop, any attempt to suggest solutions to the problem of burden of burden of union loans on the states should have both long term and short term perspectives. This is essential because any realistic solution should go to minimize the immediate financial burden of the Union loans on the states, as otherwise they will not help much in solving their immediate financial problem. At the same time, these short term solutions should not become adhoc measures as in the case of the recommendations of the finance commissions which after temporarily easing the financial emergency will perpetuate the basic problem in the long run.

Before proceeding further in detail, we may analyze certain solutions without making any in depth study of the problem. Mr K. Venkataraman\(^1\) has advocated that in future union loans should be related to the nature of the schemes o be undertaken by the state governments. He has suggested that:

1. Union loans for such ‘non productive social infrastructure facilities as roads and housing should be provided directly by the Union government at 3% interest rate.

2. Union loans for productive schemes like irrigation, electricity generation, industrial and commercial undertakings should be

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\(^1\) Mr. K. Venkataraman. State Finances (London:George Allen & Unwin), 1968, p. 171- 176
 channelled through a central loan council, consisting of central loan council, consisting of representatives from the state governments. Reserve Bank of India, Planning Commission and Union Finance ministry, which should function strictly on commercial principles. These loans should bear an interest rate of 6 percent.

3. And the presently outstanding Union Loans should be consolidated and standardized with regard to their interest rates and repayment period.

Proposals made by Mr Venkataraman\(^2\) to distinguish between socially productive, but financially non productive and financially productive proposes of state’s borrowings from the Union is realistic. But his suggestion to encourage the states to borrow from the market (which suitably include ways and means, requirements and relief works), is most unrealistic. His short term solution though inconsistent with his long term solutions, has already been implemented by Union government on the recommendation of sixth finance commission\(^3\). It may be recalled in this context that the sixth Finance Commission was asked to suggest a National Relief Fund for assisting such states which would be affected by natural calamities to which both the union government and the state governments should contribute from their own normal revenues. The sixth Finance commission ruled out the case for such relief fund and instead, suggested that states should prepare special plans for such areas and integrate them into their five year plans\(^4\).

Another short term solution is rescheduling the existing loans by extending the period of repayment from the existing fifteen years and twenty five years for medium and long term loans respectively to twenty

\(^2\) Mr. k. Venkataraman. State Finances, ibid.177
and thirty years respectively. A similar recommendation has already been made by the sixth finance commission and has been accepted by Union government only in the case of some loans. However, our contention is that it should be uniformly and be made applicable to all loans. Third, the rate of interest charged on Union loans for socially productive schemes such health and education should not exceed the cost of borrowing by the Union Government. This may also become a long term policy measures. Finally, the rate of interest charged by reserve bank of India for ways and means advances should not exceed the treasury bill rate.

D.M Nanjundappa⁵ has suggested that the future union loans to the states should be linked to the stage of development of each state government. For this purpose, he has classified the schemes of development into three categories: (i) self liquidating, (ii) socially productive and (iii) unproductive. He has recommended that plan assistance for unproductive schemes should be given to all states entirely in the form of grants rather than loans, and the loan content of the plan assistance should vary directly with the stage of development achieved by each state. However, his suggestion refers to future loans; as a result they become long term solution unless they are made to apply to the past loans also. If that is done, most of the loans for unproductive purposes should be written off and other loans will have to be adjusted according to the relative proportion of loan grants contents which is not easy task for the reason mentioned. For an important drawback of this suggestion is that the Union government will have to keep on estimating the relative stage of development of each state for each year or plan period in terms of his suggested development index, which is time consuming and unreliable in view of the all too obvious statistical problems involved in estimating it. The report of the study team on centre state relationships submitted to the administrative Reform commission has analyzed the problem of union

loans to the states and has made certain interesting suggestions to solve
the whole problems of Union Loans to the states. For this purpose, the
study team has classified purpose loans viz. share of small savings and
ways and means advances. These are entirely non-plan loans but like
market borrowings are available to the states for any purpose. Therefore
the study team has recommended that repayment obligations of these
loans should remain entirely the responsibility of states. Second, loans
utilized by the states for relending to third parties for both plan or non-
plan purpose. In this case, the study team has recommended that a state
should be able repay these loans out of the recoveries effected from them
and hence these loans need not pose any problem to the states except that
their difference to the task of recovery should be dispensed with. Third,
loans which are given for specific purposes and utilized by the states
towards direct expenditure for plan and non-plan purpose. Most of these
loans are utilized for plan and non-plan purposes.
The study Team has recommended that these loans in future should never
be allowed to be used for revenue expenditure purposes and it has
proposed the following schemes for this type of Loans.

1. They should be available only for financially productive schemes
though in special cases some financially non-productive but
socially productive schemes may also be encouraged with these
loans.

2. For the remaining schemes (both economically and socially
unproductive schemes), assistance should be given in the form of
revenue and capital grants for the respective for the respective
unproductive purposes should be tied to each an every schemes so
that the states will not be able to divert these earmarked fund for
the other purposes.

G. Thimaiyah, Burden of Union Loans on the States, Sterling Publishers, Pvt. Ltd., New
Delhi.1977, op.cit., p.,223
3. Loans for productive purposes should be non-repayable but should bear in appropriate rate of interest with an option that a state that a state should however be free to refund the whole or part of such loan at anytime. the loan should be tied to a scheme or a group of schemes as may be prescribed and a state should have the option of taking repayable loan on the useful terms if it feels that the terms of a non-repayable loan are less advantageous.

The study team has maintained that its proposal of non repayable loans for productive schemes will be a novel feature. Such loans will finance schemes and hence will be comparable to the investments made by the union government in public sector enterprises. Just as these enterprises are expected to pay dividends on investments, state government should likewise assure the union government of a minimum return by way of interest charges on such non-repayable loans.

The study team has recommended that the planning commission, in consultation with the ministry of finance and other concerned minister, should identify the productive schemes and lay down norms for repayable loans. The rate of return that a scheme should be required to yield may vary from scheme to scheme and there need to be a single minimum rate for all schemes. Finally, the study team has opined that miscellaneous development loans must be dispensed with.

The study team has rightly recognized one important drawback of its recommendation, namely, that the suggested no repayable loan will reduce the flow of funds to the union government which in turn will reduce the flow of funds to the Union government which will in turn reduce financial resources available for assisting the state governments. However, it has maintained that widening gap between fresh loans and loan repayments shows that even if a moratorium were placed on repayment, the Union government will have sizable capital resources left from which to provide financial assistance to the states.
The long-term solutions suggested by the study team are worth serious consideration of the government of India. But these suggestions are not integrated with any short term solutions to ease the immediate financial burden of Union loans on the states.

No federal Government can have a short or long term practical relevance unless it begins with measures to chop the extravagant and populist expenditure of the state. The state should rationalize its expenditure policy. The states expenditure policy is defective insofar as the development the non-development has risen rapidly. The non-developmental revenue expenditure is dominated by the outlays on servicing the state's debt particularly central loans. The non-developmental capital expenditure is dominated by the amortization charges of the state debt. Such tendency should be checked.

The state, on its part, will have to take stricter steps to generate more resources for investment. The state government does not exhibit enough political courage in the levy of new taxes and raising the rates of existing taxes. There is no doubt that the state has not been able to mobilize financial resources commensurate with the rising expenditure, mainly because of the its inability to tax adequately the agriculture sector.

The centre should increase the devolution of taxes, duties and grants to the state. Thus on the one hand, amounts to the recognition of the right of the state on national resources and, on the other hand, reduce their dependence on the centre for resources in the form of loans. Reduced dependence on plan finance means reduced dependence on Central loans. Therefore, a dynamic pattern of fiscal transfers from the centre to the states should be evolved so that not only the gap in the non-plan revenue and capital accounts of the state is fully bridged but also the state is enabled to emerge as a financially viable unit of the Union.

Regarding the Loan policy of the state, the problem can be divided into two categories (1) that which relates to past debts and (2) that which relates to future debts. It is suggested that the problems of existing central
loans may not be tackled merely through rescheduling of repayment. The existing loans may be classified into productive and unproductive ones. The latter should be outright written off and former should be rescheduled and made softer. Within the framework of this policy guidance, the following suggestions are worth considering.

Rescheduling of the terms of repayment and writing off certain loans made for socially and financially unproductive purposes are short term measures. It is relevant to mention here that there are certain loans given in the past by central government for such purposes as meeting a part of the expenditure of the natural calamities, maintenance of law and order and tackling of insurgency problems.

It may be noted that the major part of the plan assistance is invested in infrastructure projects and in social services like health, education, roads, welfare etc. These investments do not yield direct tangible monetary returns to the state and therefore the plan expenditure on these items should be in shape of grants. It is suggested to write off the interest payments due on such loans and convert the principal amount into grants. The central government should provide grants to the state for such works in future. It will reduce the allocational burden of Union loans on the state. There has to a time lag between plan investments and flow of benefits from such investments. The time lag has to be reflected in terms of repayment. Therefore, in the case of such loans, there should be an initial period of such moratorium both on capital and interest payment and the period should correspond with the expected time taken for the fructification of such schemes. The repayment schedule should with the maturity of such schemes. Besides, these loans may carry rates equivalent to the estimated internal rate on each project.

The states’ borrowing powers are restricted unduly by the constitution under Article 293(1 and 3). The Sarkaria Commission has taken the view

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that "it should apply only to long and medium term borrowing from the open market and not to borrowing from financial institutions or short term for less than one year."\(^8\)

It can be done under Article 293(4) and no amendment of the constitution shall be needed for this. This will give more elbow room to the state. D.M. Nanjundappa\(^9\) has rightly suggested that the future Union Loans to the States should be linked to the stage of development of each state and purpose for which Loan is sought by the State Government. For this purpose, he has classified the schemes of development into three categories, namely (1) self Liquidating, (2) Socially productive and (3) unproductive. He has recommended that the Plan assistance for unproductive schemes rather than Loans, and the Loan content for the schemes s of socially unproductive nature less than the productive nature, and besides, the loan content assistance should vary directly with the stage of development achieved by each state. However, his suggestion refers to future loans and as a result they become long term solutions unless they are made to apply to the past loans also. If that is done, then most of the loans for unproductive purposes should be written off and other loans have to be adjusted according to the relative proportion of loan grant contents which is not an easy task for the reason mention below. For, an important drawback of this suggestion is that the Union government will have to keep on estimating the relative stage of development of each state for each year or plan period in terms of his suggested development index, which is time consuming and unreliable in view of the all too obvious statistical problems involved in estimating it. Besides it creates uncertainty in regard to the quantum of grants and loans to which state becomes entitled in each year/plan period. This means the state

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\(^8\) Sarkaria Commission Report on Centre and State Relations, 1988 p., 373

\(^9\) D.M. Nanjundappa, Intergovernmental Financial Relations in India, Sterling Publishers, New Delhi, 1974, chapter 6
governments cannot reliably estimate in advance their share in the plan
assistance from the Union government under each five year plan.
What emerges from the above study boils down to what Prof. Thimmaiah\(^{10}\)
writes—“The only solution to this problem is to reduce the size of the loan
assistance to the states”. If the central government is interested in assisting
the states in development activity, as far as possible, all non-self
liquidating projects should be assisted by grants. The loan assistance
should be categorically confined to self-liquidating (revenue yielding)
projects. This should exclude irrigation projects which are presently
classified as self-liquidating.
The writings of the Fourth Finance Commission are still resounding in our
ears that the entire question of indebtedness of states should be reviewed
‘as much in the interest of the states as that of the government of India and
that ‘in the interest of financial soundness, such an enquiry ought not be
delayed any further\(^{11}\). The Thirteenth Finance Commission, no doubt, will
have to perform a right rope walk. It may be repeated once more that the
vice like debt trap is fast closing in on the state and unless multipronged
strategy is not adopted to stem it, the state is likely to reach the point of
debt trap. Another major issue, which has not received much attention, is
the maturity pattern of market loans vis-à-vis central government loans.
The central government loans to states are given for a period of 25 years
with a moratorium of five years. In contrast, market loans normally have a
maturity period of 10 years with bullet repayment at the end of the
maturity period.
Regarding debt service burden, the level of borrowing has to be
maintained at a sustainable level and resource requirements may be
financed more through increasing revenue receipts and economy in

\(^{10}\) G. Thimmaiah, Federal Fiscal Systems of Australia and India, Associated Publishing House,
New Delhi.1976, Ch.6

\(^{11}\) Thimmaiah G., Burning issues in centre-state Financial Relations, Ashish publishing
House,8/81, Punjabi bagh, New Delhi. 1985 p.56-57
development expenditure, which cuts into resources required for sustaining social and economic infrastructure.

Expenditure on the police also needs to be reduced through better public co-operation in maintaining law and order and mobilizing social defense through voluntary service from the public. With the massive growth in unemployment in Manipur, there is likely to be corresponding growth in crimes originating from unemployment and poverty, leading to higher expenditure on police and law and order.

Here, it will be useful to highlight some recommendations made by Rajendra R. Vaidya\textsuperscript{12} and other related observations to enable to suggest various feasible policy implications.

1. There is a need to re-examine at entire federal fiscal transfer mechanism. If this transfer mechanism is unable to deal both the vertical and horizontal gaps then state governments would be forced to depend increasingly on debt to finance expenditures.

2. The entire system of fiscal transfers needs to be made more transparent and predictable so that the uncertainty about the exact amount of resources a state would have at its disposal in the future can be substantially reduced. One possible of way of achieving this would be to do away with the distinction between plan and non plan assistance to states.

3. Loans from the national government are subject to an “ex post efficiency risk”. It arises because of a lack of incentive for the sub national government to exert adequate effort while under taking the project financed by the loan. This lack of incentive in turn arises because of the inability of the national government to make a credible threat of not refinancing debt. The threat of non-refinancing can be made credible in a system where national

\textsuperscript{12} Rajendra Vaidya. Borrowing, Debt Management and Contingent Liabilities: A Study of Indian State Governments. This report was prepared by consultants for the Asian Development Bank. 2005
government only makes capital grant allocations (through a system which uses transparent economic allocation criteria and has in place a good monitoring system). The 12th finance commissions recommendation that the center transfer funds to states only in terms of tax shares and grants alone and not through loans should be vied in this light.

4. The financial markets in India are not in position to discipline state government borrowing. The following measures need to be taken if markets can depended to enforce disciple on states.

5. Abolish SLR.

6. Improve accounting standards and bring uniformity in the way state governments present their budgets.

7. Have a mechanism in place such that policy responds to market signals.

8. Evolve a clear procedure of rescheduling debt in case a state government either defaults or is close to defaulting its interest and debt repayment obligations.

9. In the medium term, while the institutions needed for market discipline are being built, a rule-based control on state government borrowing seems to be a workable option. Rules that would prohibit states from raising loans to fund current expenditures and a maximum specified debt service to revenue ratio look particularly attractive.

10. Currently, it is too early to pass judgment on the success or failure of the FRLs but given the inadequacies of the over all inter governmental fiscal transfer mechanism and the fact that not all states have enacted such a legislation its immediate influence on the states’ debt position is likely to be negligible. Further more with the central government itself putting its own FRL on “pause” the states have little incentive to be serious about their own FRLs.
In the longer term though with proper institution building the FRLs are may possibly be successful.

11. There is an urgent need to force state governments to abandon the current provident fund scheme for state government employees that creates an un-funded debt and move to a fully funded scheme.

12. The states governments should consider the creation of a trust fund that would manage contingent liabilities especially loan guarantees. Unless this is done state budgets would always be at risk from unforeseen events like defaults on debts guaranteed by it.

In this context, it is quite relevant to analyze a study of debt sustainability at state level (RBI) by Indira Rajaraman and others\textsuperscript{13}, the study observed that Fiscal responsibility legislation enacted by states can be strengthened by enacting a formal ceiling on incremental borrowing by law. The limit on market borrowings of the state government each year is fixed by the ministry of finance in consultation with the Planning Commission. As already mentioned, the borrowing limit extends only to market borrowings and borrowing from the Centre as a part of institutional lenders like LIC and GIC. Although the total quantum of this borrowing is in principle limited by the size of Plan expenditure agreed to by the Planning Commission, a systematic procedure for ensuring that the limits are adhered to has been introduced only very recently. The Loan Council recommended by the TFC, if operationalised, will provide a more effective cap, but one that may be at odds with the fiscal deficit correction path in the states’ individual FRBM legislation. Finally, the limit does not encompass borrowing from the National Small Saving.

Funds (NSSF) against small savings collections in the state, and states’ own small savings deposit collection schemes. States influence the collection under the small savings through aggressive marketing of small saving schemes. In order to impose a hard budget constraint on the states.

\textsuperscript{13} Indira Rajaraman and others. A Study of Debt Sustainability at State level in India RBI. 2005. p..55
the overall borrowings including borrowing from all sources should be capped. Where there is unforeseen variation in autonomous borrowings such as small savings flows, corresponding adjustments need to be made under discretionary borrowings. The only other option to a formal state-specific ceiling covering global borrowing from all sources, is to let plan assistance. States are also free to take what are called negotiated loans from the market determine risk premia on state debt. In the Indian context, however, this will lead to fiscal collapse in the highly indebted states. A formal ceiling may in effect be the only way by which to restore sustainability in these states.

The Twelfth Finance Commission, in consultation with the planning commission would recommend that in future planning commission would not give approval for a state Plan in excess of its estimated resources. As regards market borrowing for financing the Plan, the current system needs some modification. The twelfth finance commission recommended a body like the Australian Loan council (ALC) to fix the borrowing limits for states. The government of India accepted this recommendation and indicated that this would be implemented in a phased manner. There is no indication about the role of the planning commission in the changed scenario It seems that planning Commission’s role would be restricted to determining plan grants to states, while the propose Loan council would determine loan component of state plans. While better off states would be able to access to the market at reasonable terms, backward states would be wore off. They may have to pay a premium over that paid by other states as their credit worthiness would be lower and risk perception higher among lending agencies. Weakness in the finances of some state governments manifested in the widening of the spread and under subscription of their market borrowing in 2004-05.

The Planning Commission, after a careful assessment of the state’s fiscal position would fix an overall ceiling only up to which approval for market borrowing through the RBI of India would be given and for the balance amount the states may have to find for themselves from the market.

Central transfer with regard to the reduction in the interest burden, an important area which needs to be addressed is the interest rate on funds for centrally sponsored schemes (CSS) and those for externally aided projects (EAP). Significantly, these two together account for a sizeable proportion of total fresh loans and advances from the central government. It could be noted that the interest cost on central loans at present exceeds 10 percent. Aligning the interest rate on these funds with the actual cost (of central government could make a major dent in the interest burden of the states. Similarly, states also need to focus on the interest rate offered by them on their public account borrowings, which are far above market interest rates. Regarding the interest rates on small savings schemes, it is quite relevant to mention what the Reddy Committee’s recommendation that interest rates on small savings schemes should be benchmarked to the secondary market yields of the government securities market. Accordingly, the central government, since 2000-03 is aligning the interest rates on various saving schemes. States could align interest rates on their small savings schemes to market rates. States, apart from small savings and PF collections, also holds deposits (in some cases with chequeable facility) under public accounts. Thus functioning identically like a bank without safeguards of prudential regulations or provisioning requirements.

In India, transfer from the centre to states constitutes a large proportion of Planning commission transfers. Linkages between loan disbursement from the planning commission for capital projects and actual spending on

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16 Abha Prasad, Raman Goyal Anupam prakash, States’ Debt and Debt Relief, Economic & Political Weekly, June 2. 2004

17 The Expert committee to review the system of Administered Interest rates and other related issues 2001 set up under the chairmanship of Y.V. Reddy
capital project is weak. It is necessary to review the planning process and do away with the plan/non-plan dichotomy as the TFC urged. The integrity of the constitutional scheme of transfer would require all revenue transfers to be mediated by FC. This would imply the plethora of centrally sponsored schemes would end and the plan grants also should come within the purview of the FC with the PC asked to look after only the capital requirement of the state which are deficient in infrastructures.

There is an urgent need to change the modality and mechanics of planning since the main culprit of the fiscal crisis in the states is the plan. The principal difficulty arises because plan size (which determines the size of loans from center) has never been linked to sustainable levels of state debt. No state government can or does refuse to take these loans because it does not see itself in a position to repay the loans nor does the central government refuse to give loans to state governments like Manipur whose financial position is weak. Legally the states are under no obligation to ask for or accept loans from the Union Government. Thus, it can be observed that, the mounting burden of central loans on state’s finances as well as unauthorized overdrafts of the state governments are the prominent factors which have affected the gamut of Central-state financial relations in the recent past. The problem is that in the past fiscal reform period, the approach to financing the state plans hasn’t undergone a change. All of it continues to be what it was earlier, even though the entire fiscal regime has undergone fundamental changes. The result is that it is impossible for the states to finance their plans in a manner that doesn’t add to their fiscal woes.

The resource position of the states is so poor that they cannot even finance the same plan size as last year. Yet they are committed to a plan size that

18 Anupam Rastogi, Restructuring in Public Finances, Economic & Political Weekly, June 26, 2004
cannot be lower than last year given that they have to meet the tenth five year targets in terms of investment. And this is to the fact that no state government political party wants a smaller plan; a bigger plan even if partially unfunded is preferred to a fully funded smaller plan.

Another finding of the study is the worrisome aspect of state debt management revealed in this exercise is the changing maturity structure of states' debt towards shorter dated securities in recent years. This trend is prominent in fiscally weak states\(^{21}\). To, conclude, the debt management policy should ensure that in a deregulated financial regime, the states are able to borrow at terms comparable to that of central government so that the spread of interest rates between the centre and state declines. The higher premium on state government debt vis-a-vis the centre goes against the fundamental objectives of debt management, which aims at minimizing the cost of debt servicing by eliminating market fragmentation. In this context, the Twelfth Finance Commission’s recommendation that “The central government should not act as an intermediary for future lending and allow states to approach market directly”\(^{22}\) hopefully would achieve the parity in interest rates but its success would critically depend on the improvement in the overall fiscal health of the individual states.

Coming to the Debt relief, on the whole, the package of general debt relief and debt write-off does not address the problems of severely indebted states like Manipur. Single-minded pursuit of fiscal correction to get the benefit of debt relief can have disastrous implications for those states where social and infrastructure investments have been insufficient in the past.

A major shortcoming of the debt relief plan of the TFC is that it is confined to only a small part of the outstanding debt of the states viz. loan

\(^{21}\) Pinaki Chakraborty. Debt swap in a low interest rate regime Economic & Political Weekly, Oct.1, 2005

\(^{22}\) Twelfth Finance Commission Report p. 266
liabilities to the centre, which constitute only about one sixth of the total. NSSF loans which account for 30 percent of th state’s borrowing are left out. While lending by the centre has ceased, the states are now required to depend heavily on funds accruing from small savings by borrowing from the NSSF, clearly a cost source. The institutional change envisaged by TFC for state’s borrowing will naught unless the states are freed from NSSF and accretions to NSSF are treated as part of the funds in the financial market.  

The most important reform of the borrowing regime would be to introduce an aggregate borrowing cap and allow for greater flexibility over the choice of borrowing instruments within the cap. The problem of excessive inherited debt of poor states certainly needs to be addressed; provision of conditional debt relief may not be the best way forward.

The foregoing analysis shows that mere rescheduling of repayment does not provide a rational and realistic solution to the problem of the Center’s loans have to be reclassified according to the critter suggested by us and thereby determine de nova the indebtedness of the states and the reschedule the repayment considering the life of the remunerative asset and the intensity of payoff. Here, it is quite relevant to quote what D.M Nanjundappa noted. “While the actual proportion of grants and loans for any spectrum can further be argued and adjusted, the principle of varying proportions favoring relatively poorer states and reflecting the repaying capacity of investment seems absolutely essential in any realistic solution to the problem of the center’s loans to the states”.  

In the interest of achieving balance in loan assistance, the poorer states should not be strained with increased debt servicing liabilities On the contrary, in the process of rationalizing and enabling sound debt

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23 ibid., p. 3394

management of the states, the total size of the debt of poorer states should be prevented from undue rise by transferring more resources to them by way of grants until they become viable to manage higher debt burden.

**Major findings**

A review of various aspects of problems and prospects of public debt management and its impact on social and human development brought to the fore several interesting insights. The main findings emerging from our study now may be summed up as follows:

1. It is evident from the foregoing chapters that central loans constitute an important mechanism for transfer of resources from the centre to the states. Central loans to states accounts for the largest proportion of the total loans of states (and their total liabilities). Large part of these loans arise in the process of inter Governmental fiscal transfers through the planning commission.

2. The findings regarding, the decision about the burden of public debt is that the burden would be measured only with reference to the growth of NSDP and that the growing Public debt need not cause any concern so long as NSDP rises adequately. This point of view has a special appeal to a special category state like Manipur where Public debt plays a very significant role in mobilizing financial resources for undertaking a higher volume of investment which otherwise would not possible and in fostering the growth of capital and money markets and in creating a suitable institutional framework for effective implementation of monetary policy. However, it is found out that, the rate of growth of central loans and that of state’s net domestic product are almost steady.

3. Coming to the burden of debt-repayment and servicing, it is seen that, it started to increased abruptly from 2000-01 and it had almost the same in the subsequent three years but it fell down to 6.43 percent in 2005-06. This shows that economic development burden has increased year after year. The position is bound to worsen
further in the coming years unless some corrective measures are evolved and applied.

4. The government of Manipur has been often resorting to ways and means advances and overdrafts from the centre, although in recent years, no. of days and occasions of state’s overdraft reduced.

5. Manipur government’s activities are not restricted as only to development activities and to maintain law and order which has necessitated use of borrowed funds for unproductive purposes such as modernization of police force, security to government officials, etc. The centre should bear all the expenses incurred in maintaining law and order, on the other hand expenditure on the police needs to be reduced better public cooperation in maintaining law and order and mobilizing through social defense through voluntary Service from the public.

6. It may be noted that the major part of the plan assistance is invested in infrastructure projects and in social services like health, education, roads, welfare etc. These investments do not yield direct tangible monetary returns to the state and therefore the plan expenditure on these items should be in shape of grants.

7. The mismanagement of debt is another reason for the present state’s debt problem. In theory debt can be justified and welcomed on the grounds that it should be directed towards predictive investments which yield net profits. But, this not the case in the special category state like Manipur which needs huge investments in social infrastructure, as investments in these areas yield no profit: aggravates the debt servicing burden.

8. The findings regarding the social and human development impact, what emerges unambiguously is that, the state maintained the share of social services in total revenue expenditure at pre-crisis period levels, which was 42.83 percent, declined to 38.60.
9. In the interest of achieving balance in loan assistance, the poorer states should not be strained with increased debt servicing liabilities. On the contrary, in the process of rationalizing and enabling sound debt management of the states, the total size of the debt of poorer states should be prevented from undue rise by transferring more resources to them by way of grants until they become viable to manage higher debt burden.

**Policy Recommendations:**
Based on the analysis made above, the following policy intervention deserves necessary attention for adoption.

1. The only solution to this debt problem is to reduce the size of the loan assistance to the states. If the central government is interested in assisting the states in development activity, as far as possible, all non-self liquidating projects should be assisted by grants. The loan assistance should be categorically confined to self-liquidating (revenue yielding) projects. This should exclude irrigation projects which are presently classified as self-liquidating.

2. Manipur government’s activities are not restricted as only to development activities and to maintain law and order which has necessitated use of borrowed funds for unproductive purposes such as modernization of police force, security to government officials, etc. The centre should bear all the expenses incurred in maintaining law and order. On the other hand expenditure on the police needs to be reduced better public cooperation in maintaining law and order and mobilizing through social defense through voluntary Service from the public.

3. It may be noted that the major part of the plan assistance is invested in infrastructure projects and in social services like health, education, roads, welfare etc. These investments do not yield direct tangible monetary returns to the state and therefore the plan expenditure on these items should be in shape of grants. It is
suggested to write off the interest payments due on such loans and convert the principal amount into grants. The central government should provide grants to the state for such works in future. It will reduce the allocational burden of Union loans on the state. There has to a time lag between plan investments and flow of benefits from such investments. The time lag has to be reflected in terms of repayment. Therefore, in the case of such loans, there should be an initial period of such moratorium both on capital and interest payment and the period should correspond with the expected time taken for the fruitification of such schemes. The repayment schedule should with the maturity of such schemes. Besides these loans may carry rates equivalent to the estimated internal rate on each project. The state Government should urge the central government and finance commission to write off loans invested in infrastructure projects and in social services.

4. State Government needs to ascertain the current and long term financial needs of the state and to maintain strict financial discipline. This is possible, firstly by maximum resources mobilization so that heavy dependence is avoided on the one hand and various programmes for increasing the state’s own resources in shortest possible time can be taken.

5. Another short term solution is rescheduling the existing loans by extending the period of repayment from the existing fifteen years and twenty five years for medium and long term loans respectively to twenty and thirty years respectively. A similar recommendation has already been made by the sixth finance commission and has been accepted by Union government only in the case of some loans. However, our contention is that it should be uniformly and be made applicable to all loans. Third, the rate of interest charged on Union loans for socially productive schemes such health and education should not exceed the cost of borrowing by the Union
Government. This may also become a long term policy measures. Finally, the rate of interest charged by reserve bank of India for ways and means advances should not exceed the treasury bill rate.

6. Reduced dependence on plan finance means reduced dependence on Central loans. Therefore a dynamic pattern of fiscal transfers from the centre to the states should be evolved so that not only the gap in the non-plan revenue and capital accounts of the state is fully bridged but also the state is enabled to emerge as a financially viable unit of the Union.

7. In the interest of achieving balance in loan assistance, the poorer states should not be strained with increased debt servicing liabilities. On the contrary, in the process of rationalizing and enabling sound debt management of the states, the total size of the debt of poorer states should be prevented from undue rise by transferring more resources to them by way of grants until they become viable to manage higher debt burden.

8. Fiscal health of the state is an important factor at the macro level. It is evident from our analysis that political commitment to social sector has to extend beyond raising relative fiscal allocations. It has also to find resources to finance their sectors. The fiscal stress experienced in 1990’s during the study period implies that enhancing allocations to social sector would require the structuring the state finance as well. However, the raising of allocations for social sectors as well as restructuring of state finance are easily possible when NSDP growth is more than growth in public debt and the rate of growth of population is controlled.

9. Lack of understanding and co-ordination of synergy among the programmes designed and implementation by the government for social sector and recognition of linkages between economic growth and human development on the one hand inhibits government from reallocating substantial proportion of budgetary resources away
from productive sectors towards social sector. Therefore, there is a need to recognize and highlight the linkages between economic growth and social sectors on the hand and the role of social sectors is enhancing equity on the other.

10. Social infrastructure and maintenance which bears the burden cut in revenue expenditure may benefit from abolition of artificial distinction between plan and non plan expenditure. Rethinking on institutional role of the state planning bodies and central planning commission needs to be undertaken when allocations of resources are guided by markets. Transfer to states partly as as fixed sum and the rest linked to specific programme/project-with or without incentive payment-can ameliorate the cascading effect of lower than anticipated revenue collection. There is need to break the nexus between state governments revenue deficit with that of the central government by making the committed expenditure on social infrastructure free from economic growth cycle. Incentive based transfer to sector specific and project specific is required to improve productivity of capital expenditure.

11. It is necessary to review the planning process and do away with the plan/non-plan dichotomy as the TFC urged. The integrity of the constitutional scheme of transfers would require all revenue transfers to be mediated by FC. This would imply the plethora of centrally sponsored schemes would end and the plan grants also should come within the purview of the FC with the PC asked to look after only the capital requirement of the state which are deficient in infrastructures.