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**LEKHA CHAKRABORTY, ANINDITA GHOSH & MD AZHARUDDIN KHAN**

Chakraborty is professor, and Ghosh and Khan are research fellows, NIPFP

● **TELANGANA**

# Indebted to growth

When elongation of debt maturity structure is crucial for economic growth

**T**HE NEWEST STATE of India, Telangana, since its formation, is on the high growth trajectory and the economy is growing at a higher rate than national GDP growth. The state was formed on June 2, 2014, as per the Andhra Pradesh Reorganisation Act, 2014. The state maintains a zero revenue deficit, satisfying the “golden rule” of the FRBM (Fiscal Responsibility and Budget Management) that a state must meet its revenue expenditure from its revenue receipts. But Telangana has a fiscal deficit-GSDP ratio slightly higher than the FRBM-legislated threshold at 3%.

The outstanding liability of the state is around 22% of GSDP, when the FRBM stipulates it to be only 20%. Laudable are the achievements of the new state in terms of economic growth, but macro-fiscal fundamentals like fiscal deficit and outstanding debt not in concomitant with the FRBM targets is a concern. Telangana has formulated a medium-term fiscal framework to work towards stipulated threshold in debt-deficit dynamics.

According to the 14th Finance Commission, had the state been maintaining fiscal deficit at 3%, and the outstanding debt-to-GSDP ratio below 25% (along with a macro-fiscal ratio of interest payment to revenue receipts at 10%), it would have been eligible for 0.5% additional borrowing power. But Telangana missed this extra borrowing power granted by the 14th Finance Commission.

Yet another point to be noted is that states have significantly resorted to market borrowing in financing the fiscal deficits (following the recommendations

of the 14th Finance Commission) to exclude states from the National Small Savings Fund (NSSF) financing facility (except Delhi, Madhya Pradesh, Kerala and Arunachal Pradesh). The power bond scheme titled UDAY (Ujwal Discom Assurance Yojana) has deteriorated state finances further. The RBI State Finances report 2019 noted that the “state governments are mandated to fund a progressively greater share of discom future losses from their own finances, and prevent ballooning of losses on discoms’ books. The impact of this provision on

state finances could increase significantly in 2019-20 and 2020-21 due to: i) higher share of losses to be funded; and ii) reduction in revenue benefits to discoms from the conversion of state government debt into grants on account of varied debt restructuring models adopted by state governments.” The NIPFP study on power bonds by this author and Amandeep Kaur showed that there is no financial efficiency or operational turnaround in discoms across states, ex post to UDAY.

On the expenditure side, Telangana has ambitious projects. It was the first state to announce an income support scheme for farmers, among the other five states in 2019-20. This is in the form of unconditional cash transfers to farmers, instead of providing them loans. Farmers’ credit waiver has created “moral hazard” issues. The RBI State Finances report noted that these income support transfers are categorised as “Green Box payments” within the framework of the World Trade Organisation (WTO). The new state has given importance to capital projects. The flagship capital projects in Telangana include public irrigation projects and a comprehensive drinking water programme termed “Mission Bhagiratha” to provide safe drinking water to all the households. On the revenue side, given the uncertainties in GST revenue, taxes are buoyant

and estimates are above unity.

The intergovernmental fiscal transfers from the 15th Finance Commission are a potential source of revenue to finance their ongoing capital projects. The chairman of the 15th Finance Commission, NK Singh, during the commission’s state visit noted that though capital projects in Telangana have a multiplier effect on economic growth, the rising debt and deficit is a matter of concern. The state has echoed the concern that the potential significant weightage to “population 2011” in the forthcoming tax transfer formula of the 15th Finance Commission can plausibly reduce fiscal transfers to Telangana, unless the commission designs a transfer scheme to mitigate this potential loss to those states that have well managed demographic transition.

Given the aspirational development agenda of the new state, it is a formidable challenge to maintain the stipulated growth path at 14-15%, and even at the projected 20% in the long run, while adhering to fiscal rules by containing the debt-GSDP ratio at 20%.

Against this backdrop, Telangana has adopted a new debt strategy. The state has decided to go for elongation of maturity structure of outstanding debt. The RBI State Finances report noted that elongation of maturity structure of debt is important to mitigate “roll-over risks and debt servicing costs, which impinge on the efficacy of debt management strategies.” Satyajit Chatterjee and Burcu Eyigungor, in their paper titled “Maturity, Indebtedness, and Default Risk” published in the American Economic Review (2012) noted that when the possibility of self-fulfilling rollover crises is

taken into account, “long-term debt is superior to short-term debt.” This study was conducted in the context of Argentina. The other plausible benefit of long-term bond issuance is that it can fix the yield rate at current levels of interest rate scenario, and also act as “reference rates.”

The recent OECD Sovereign Borrowing Outlook report also showed that the share of long-term debt in the central government marketable debt reached 90% in 2015 in the OECD region, and is projected to

rise gradually. This relatively high level of longer-term debt redemption profile in the OECD region is to limit the potential rollover risk and to make the debt portfolio resilient. The RBI State Finances report emphasised that, in India, the maturity structure of debt of the government of India has been steadily increasing, with the tenure of the longest sovereign debt security being 40 years.

The maturity pattern of outstanding debt across Indian states and Union Territories has also been increasing (see table). As noted by RBI, since 2015-16, 15 state governments including Telangana and the UT of Puducherry have issued longer tenor securities. Among these states, Telangana has the longest tenor for state government securities, with the debt maturity profile being 30 years. This is instructive, and of interest to public policy researchers, how a state within the framework of fiscal rules manages to keep aspirational choices to take itself to higher growth trajectory. This is also challenging, especially when there is no “economic convergence” in the state, with the poor regions “catching up” with the rich regions, and the spatial inequality “within the state” significant. It is to be noted that only four districts, including Hyderabad, are contributing around 50% to the state’s growth, and the rest of the regions require high investment to reach the comparable growth trajectory within the state. The “fiscal agency” of the new state is thus grappled between the “equality in processes” and “equality in outcomes.”

**Given aspirational development agenda of the state, it is a challenge to maintain the stipulated growth path at 14-15% while adhering to fiscal rules by containing debt-GSDP ratio at 20%**

Maturity profile of outstanding state\* govt securities (as % to total)

State/UT	Andhra Pradesh Gujarat Haryana Maharashtra Odisha Telangana Puducherry							All state and UTs
	Andhra	Pradesh	Gujarat	Haryana	Maharashtra	Odisha	Telangana	
2019-20	7.6	5.7	2.8	6	3.6	-	9	5.3
2020-21	7.6	6.4	3.2	7.4	8.9	-	10.8	5.3
2021-22	8.3	9.8	7	10.9	12.4	-	9.6	7.3
2022-23	9.8	8.2	10.3	8.8	12.5	0.9	9.1	7.7
2023-24	11	8.1	12.2	9.3	13	0.9	9	8.3
2024-25	8.8	8.3	11.9	9.8	3.6	8.7	8.5	9.3
2025-26	8.9	8	13.7	12.7	7.1	14.2	8.1	11.5
2026-27	7.9	10.7	12.4	12.7	7.1	16.7	5	13.1
2027-28	5.5	13.4	11.8	6.2	1.8	0.9	7.2	11.8
2028-29	6.1	20.3	5.3	5.1	1.8	0.9	4.5	11.4
2029-30	4.1	-	-	5.5	3.6	0.9	4.1	1.3
2030-31	3.4	1.1	-	-	-	0.9	4.5	1
2031-32	3	-	-	2.1	8.6	4.4	10.4	0.9
2032-33	3.7	-	-	3.5	3.6	4.7	-	1.6
2033-34	2.5	-	1.4	-	1.8	-	-	1.4
2035-36	0.2	-	0.5	-	5.4	-	-	0.1
2036-49	1.7	-	7.5	-	5.4	46.2	-	2.9
<b>TOTAL</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

\*Select states; (outstanding as on March 31, 2019); Note: compensation bonds, loans not bearing interest and special bonds (UDAY) are not included.

Source: RBI records

