DEBT POSITION OF THE STATES AND CORRECTIVE MEASURES

9.1 Paragraph 8 of the President's Order constituting the Commission reads as follows :

"The Commission may make an assessment of the debt position of the States as on the 31st day of March, 1989 and suggest such corrective measures as deemed necessary keeping in view the financial requirements of the Centre. The corrective measures will be with particular reference to investments made in infrastructure projects and shall have linkage with improvements in financial and managerial efficiency."

9.2 This term of reference differs significantly from that given to the Sixth, Seventh and the Eighth Finance Commissions. Unlike in the case of the Eighth Commission, we have not been asked to estimate the likely non-Plan capital gap of the States at the end of the period under our consideration. Second, we have been asked to review the entire debt position of the States, and not "the States' debt position with particular reference to Central loans advanced to them". Third, instead of "appropriate measures to deal with the non-Plan capital gap", this Commission has been asked to suggest corrective measures with particular reference to investments in infrastructure projects and improvements in their performance.

9.3 Since this subject has been referred to us under Article 280(3)(c), we shall determine the scope of our work strictly in accordance with the term of reference. We shall not deal with the non-Plan capital gaps of the States, although as background to our work we did make a rough estimate of the likely gaps during the period 1990-95. We shall make a review of the debt position of the States as on 31.3.1989 and then go on to recommend measures that would prevent the recurrence of "the debt problem" in the long-term context. While the long-term solutions would be our main concern, we shall also indicate some short-term corrective measures by way of relief.

Debt Position Of The States

9.4 Total debt of State Governments is estimated to be Rs. 89,461 crore, as on 31.3.1989, of which liabilities to the Central Government form about 63 per cent (Annexure IX.1). Provident funds, reserve funds and deposits are the next largest source of debt financing, amounting to 23 per cent of the States' total debt. Market loans constitute almost 12 per cent of the debt, and the residual is negotiated loans from public financial institutions and others. About 11 per cent of the total debt is short-term (ways and means advances, reserve funds and deposits).

9.5 The previous Finance Commissions excluded this short-term component in assessing the overall debt position of the States. For comparative purposes, the table below gives the estimated debt excluding short-term liabilities as at the end of 1978-79, 1983-84 and 1988-89 :

Estimated Outstanding Debt Of The State Governments

(Amount in Rs. Crore)

	At the end of 1978-79		At the end of 1983-84		At the end of 1988-89	
	Amount*	%age	Amount#	%age	Amount	%age
1. Internal Debt						
(a) Market Loans	2572	13.7	4236	11.3	10411	13.1
(b) Other Loans	776	4.1	1724	4.6	2032	2.5
2. Central Loans	13463	71.7	27059	72.4	56052	70.4
3. Unfunded Debt	1974	10.5	4387	11.7	11148	14.0
Total	**18785**	**100.0**	**37406**	**100.0**	**79643**	**100.0**

*/ *Seventh Finance Commission Report, Chapter II.*

#/ *Eighth Finance Commission Report, Chapter XIV.*

It is seen that the estimated gross debt of the States as a whole more than doubled (in nominal terms) between 31.3.1984 and 31.3.1989. We notice a shift in the sources of the debt. Although loans and advances from the Centre still account for the bulk of the States' outstanding debt, there has been a marginal decline in the share of Central loans by 2 percentage points since the end of 1983-84, accounted for by increases in the shares of unfunded debt and market loans. Nevertheless, even now loans from the Centre constitute 70 per cent of the total indebtedness of the State Governments (excluding short-term debt).

9.6 As stated earlier, the Central loans account for bulk of the States' indebtedness. As at the end of 1988-89, out of the total indebtedness aggregating Rs. 89,460.77 crore, as much as Rs. 56,051.92 crore was in the form of Central loans. Over the five-year period 1990-95, repayments of Rs. 15,528.59 crore will fall due in respect of these outstandings. Taking all States together, the position in regard to the outstandings as at the end of 1988-89 and repayments falling due during the five years 1990-95 for the major components of the Central loans is shown below:-

Table 2

Outstandings Of Central Loans And Repayments

(Rs. Crore)

	Outstandings as on 31.3.1989	Repayments falling due during 1990-95
1. Loans received upto 1983-84 and consolidated by the previous Finance Commissions		
a) 15 year loans	1650.61	962.00
b) 20 year loans	430.48	134.53
c) 25 year loans	2883.68	686.59
d) 30 year loans	8357.15	1717.33
2. Plan loans received during 1984-89	17955.24	6863.86
3. Small Savings loans	20345.04	3727.26
4. Relief and rehabilitation loans	39.94	12.38
5. Loans to clear overdraft	696.65	132.40
6. Loans to cover gap in resources	248.34	172.25
7. Drought loans	519.57	198.88
8. Special loans	2384.53*	850.57
9. Loans for Hirakud Project	80.80	8.10
10. Other loans	459.89	62.44
Total	**56051.92**	**15528.59**

* *Includes loans of Rs. 2,300.91 crore to Punjab and Rs. 83.62 crore (net of repayment of Rs. 8 crore in 1986-87) to Madhya Pradesh for relief of Bhopal Gas Leak Tragedy.*

Statewise position of outstanding loans is given in Annexure IX.2 and of repayments due in Annexure IX.3

9.7 The major cause for the rapid rise in States' indebtedness is the key role of borrowing in financing investments under the Plan. Money is borrowed by the States not only to finance government sector investments (schools, roads, bridges, etc.) but also to finance investments by departmental and non-departmental enterprises (irrigation works, State Electricity Boards, State Road Transport Corporations and a large number of other enterprises). As seen earlier, more recently, borrowed funds have been used also to cover part of the revenue expenditure. Except for such a diversion of borrowings, growth in indebtedness should not cause any worry if investments yield adequate returns to meet interest and for amortization. In respect

of government owned assets, depreciation or amortization funds are not maintained and hence borrowings contracted for the creation of such assets have to be repaid out of fresh borrowings. As regards investments by State Governments in enterprises by way of loan or equity, the source of trouble in most cases is the extremely poor performance of the enterprises. Because of such performance resulting in meagre or negative returns and insufficient or nil amortization/depreciation, almost the entire burden of servicing the debt contracted on enterprises' account has fallen on the Government budget. While the growing interest burden reduces the amount available for incurring important categories of revenue expenditure, repayment obligations tend to continuously reduce the ratio of net borrowings to gross borrowings. This process was arrested or slowed down as a result of the rescheduling of repayments to the Centre by the previous Finance Commissions. However, the same trend continues operating on the new base after rescheduling.

9.8 As far as market borrowings are concerned, under each Five Year Plan, each State is allocated a share on a net basis, i.e., the States' gross borrowing is fixed by the Reserve Bank of India so as to yield the pre-determined net loan after deducting any repayments due to the market in the concerned year. The State does not have to find resources of its own to meet repayment obligations and so it does not feel any immediate pressure; however, more and more of the gross borrowing is absorbed by repayments and the interest burden grows as the 'old' as well as the 'new' loans have to be serviced.

9.9 Central loans, as part of Plan assistance or for any other purpose, are determined and granted on a gross basis. The entire amount is intended to be used for Plan financing or for any other specific purpose agreed upon. The repayment of outstanding Central loans (contracted earlier) is supposed to be met out of other sources. However, as stated above, no amortization funds are established in respect of government sector investments; and loans to Electricity Boards, which constitute around 66 per cent of loans advanced by State Governments, are given in perpetuity. Hence the only funds available for repayment of loans from the Centre are recoveries of loans and advances by the State Governments and net miscellaneous capital receipts. These do not cover more than a small part of repayment obligations. Therefore, repayment obligations tend to cut into Plan resources to a substantial extent.

9.10 This has led to the complaint by the State Governments that their repayment obligations to the Centre are absorbing a large and ever-increasing proportion of fresh loans. Hence, the demand for relief by way of rescheduling and write-off. We note that as of 1989-90, repayments to the Centre are expected to constitute 32 per cent of fresh loans on the average, with the percentage varying from 18.2 for Punjab to 116.3 for Arunachal Pradesh. (Annexure IX.4)

9.11 The resources for financing State Plans are derived from (a) balance from current revenues, (b) Plan grants and loans from the Centre, (c) net market borrowing, (d) institutional loans and (e) unfunded debt (accrual of provident funds, etc.). On the non-Plan capital side are reckoned repayment of loans to the Centre and institutions (outgoings) and recoveries of loans and advances. The difference between repayments and recoveries has been termed the non-Plan capital gap (negative). The non-Plan gaps tended to absorb a substantial part of Plan resources in the case of most of the States, which then could not have what were considered adequate Plans. Presumably, it is this consideration which led to the three previous Commissions being asked to assess the non-Plan capital gaps of the States and to suggest appropriate measures to deal with those gaps. The "appropriate measures" recommended by the Seventh and Eighth Commissions consisted largely of rescheduling of repayments supplemented by some "write-off". The measures recommended by the Commissions have not led to any improvement in the debt burden faced by the States. Thus, the rough estimate of the total non-Plan capital gaps of the States for the period 1990-95 that we worked out is substantially higher than the estimate of the gaps for the period 1984-89 made by the Eighth Commission (Rs. 6,806 crore).

9.12 This Commission has not been asked to estimate the non-Plan capital gaps of the States, or to suggest measures to deal with those gaps. We refer to this matter only to show that unless some basic changes in policy are adopted, large non-Plan gaps would continue to emerge at the State level and successive Finance Commissions would have to reschedule/write-off loans every five years. That is, loans will first be granted by the Centre at certain rates of interest and with pre-determined maturity periods; but later, some of the loans or part of the total debt will be converted to a grant or the maturity period will be lengthened. The rates of interest might also be changed, as was done by the Seventh and the Eighth Commissions. Such a sequence of policy actions, to be repeated at regular intervals, will neither bespeak an orderly management of financial affairs nor be conducive to the efficient use of funds. We feel that this chain should be broken.

Views Of The State Governments

9.13 In their memoranda to us, several State Governments have made suggestions for reducing their debt, and, in particular, the repayment burden during the period covered by our recommendations. While some States have requested a write-off of some types of debt, others have suggested longer repayment and grace periods. The major suggestions made by the State Governments are as follows:

a. The repayment burden during the period covered by our recommendations should be reduced.

b. Central loans should have longer maturity periods.

c. Loans given and utilised for socially desirable but financially unremunerative projects and for investments in public utilities including power projects should be fully or partially written off.

d. The rate of interest charged to the States should be related to the cost of borrowing to the Centre and in general, much lower rates should be charged than those at present.

e. Loans against small savings should be converted into loans in perpetuity.

f. The pattern of Central Plan assistance should be changed to have a higher proportion of grants, e.g., 50:50 as against 30:70 proportion of grants to loans.

g. The terms of loans relating to externally-aided projects should be changed to be more in line with the terms on which the Central Government obtains assistance from external agencies.

h. Loans given to Arunachal Pradesh, Goa and Mizoram prior to their becoming full-fledged States should be written off.

i. The loan component of drought assistance should be written off 1\.

9.14 These suggestions are based mainly on considerations relating to reasonableness of maturity periods, justifiability of interest rates charged, repaying capacity, appropriate mix of grants and loans, the treatment of loans against small savings and special problems. We shall give due consideration to the suggestions made by the State Governments and accommodate them insofar as they are in conformity with the principles on which we shall base our recommendations. The entire matter relating to Central loans to the States and their repayment must be considered in the light of certain fundamental principles having a bearing on equity, efficiency, financial responsibility and the long-term impact on the economy. It would have been desirable, had it

1\ *There are also demands and suggestions relating to States' share in market borrowing and regulations on overdrafts, witn which we are not directly concerned.*

been possible, to get a part of government investment financed through surplus of revenues over government's current expenditures. In the present situation, when there are large revenue deficits in the Centre and most of the States, this is not possible. Capital investment has to be financed almost solely through borrowed funds.

9.15 When the Central Government borrows from the market and lends to the State Governments, it is, of course, not acting just as an agent through whom the funds are routed. It can and does bring about an allocation of capital funds amongst the States which favours the weaker States; had the monies been borrowed by all the States directly from the market, the richer States would have gained in competition. Second, the allocation of funds gets closely linked with the approval of projects by the Planning Commission. Third, wherever considered appropriate (i.e., in special circumstances), the terms of lending by the Centre could be made softer than the ones at which it borrows funds so that the national taxpayer will bear part of the burden to the benefit of taxpayers in particular States. But in doing so, as in the case of current transfers, the aspect of inter-State equity and the extent to which and the grounds on which the national taxpayer can be asked to shoulder additional burdens for the benefit of taxpayers in the weaker States or in a particular State, must be carefully considered.

9.16 It could be argued that since the Central Government has greater taxing powers, it could bear part of the cost of borrowing on behalf of the State Governments. There could be a case for this but, correspondingly, the amounts available for making direct transfers to the States would be reduced. Also very low rates of interest often lead to uneconomic use of funds.

9.17 We may sum up by saying that the Central Government is not acting merely as a financial agent on behalf of the States in order to reap economies of scale in obtaining funds from the market, but also aims to fulfil certain national purposes such as promoting development and helping weaker States. However, in lending money to the States it is, in fact, channeling a part of private sector savings for investment by the States. The latter fact requires that the funds must be used efficiently and for productive purposes and also that loans must be repaid so that the Central Government can keep down its own gross borrowing correspondingly and re-cycle the returned funds for future lendings for further investment 2\.

9.18 In principle, rescheduling of repayments and write-off of debt are undesirable; instead, the terms on which loans are made must be reasonable and fair taking into account all relevant circumstances, including the terms on which the Central Government obtains funds from the market at home or from abroad. A write-off may be considered only under exceptional circumstances such as when the borrowing State has been plagued by severe natural calamities. Conversions of debt into grants except under special circumstances would not be conducive to the promotion of fiscal discipline. Rescheduling of debt, when the terms of repayment are not unreasonable, also tends to promote uneconomic use of funds and indifference towards the need to make most productive use of the borrowed funds so as to obtain high returns and wherewithal to repay the debt. Besides, as already stated, issues of inter-State equity are also involved, since any scheme of rescheduling tends to favour particular States more than the others (States with higher per capita indebtedness will gain).

Our Recommendations On Corrective Measures

9.19 Ultimately, the solution to the government debt problem lies in borrowed funds (a) not being used for financing revenue expenditure and (b) being used efficiently and productively for capital expenditure so as to earn returns and/or increase productivity of the economy resulting in increased governmental revenues. In order that the capital stock of the country may be maintained intact, there should be adequate depreciation provision or loans should be repaid out of amortization fund. In future, rescheduling of the loans must be avoided. At the same time, the terms on which funds are lent by the Centre to the States must be reasonable and equitable. They should have relation to (a) the maturity period of loans obtained by the Centre, (b) rate of interest thereon, (c) other charges, if any, which the Centre has to bear, and (d) the gestation period of the projects to be financed.

9.20 Keeping these principles in view, we make the following recommendations:

a. While we do not think that a substantial part of government investment can be financed through tax revenues and, therefore, cannot recommend that Plan assistance by the Centre to the non-Special Category States may be given in the ratio of 50 per cent grant and 50 per cent loan as suggested by some State Governments, we feel there would be merit in limiting loans from the Centre as part of Plan assistance to non-Special Category States to 100 per cent of Plan grants. The additional amount which a non-Special Category State is now getting from the Centre under the 70:30 formula may be made available to it as additional market borrowing. In other words, the modified Gadgil formula as well as the 70:30 rule will continue to operate, but part of the loan assistance would now be shifted to the market1/. In order to avoid growth of the indebtedness of the States to the market while the assets created out of the loans would be depreciating, the Reserve Bank of India should work out a suitable formula according to which the States would be required to maintain amortization funds to the extent considered necessary by the Bank. The arrangements we have suggested would serve to reduce the rate of growth of States' indebtedness to the Centre and, in turn, reduce the relative magnitude of the Central Government borrowing, which would serve to slow down the growth of its own debt. Also, the States would enjoy greater flexibility in regard to repayments. We want to make it clear that the new arrangement suggested by us should not result in any reduction in the overall Central assistance to States. Assessment of Centre's resources, determination of Central assistance out of that and State-wise allocation of Central assistance as per Gadgil formula should be done as at present. The only change recommended by us is that a portion of the Centre's market borrowings, taken into account while assessing Centre's resources, will not actually be raised by the Central Government but directly by the States as additional market borrowing over and above their normal market borrowing.

b. We note that the Central Government is now floating loans in the market with 20 years maturity. We, therefore, recommend that direct Central Government loans to the States for financing their Plans from 1990-91 onwards should have a maturity period of 20 years'. Besides, fifty per cent of these loans should be granted a five-year initial grace period, after which repayments should be spread over fifteen years. The grace period would take care of gestation of the capital projects.

c. We do not recommend any change in the terms and conditions relating to Central loans against small savings collections. The present terms, viz., five-year grace period and thereafter repayments to be spread over twenty years are reasonable.

d. As regards assistance in relation to externally aided projects, we suggest the following:

2\ *In the long run, repayment has to be out of amortization so that capital stock is maintained and undue growth of debt is avoided.*

1/ *Thus, if a non-Special Category State is entitled to Plan assistance of Rs. 1,000 crore under the modified Gadgil formula, it would get a Plan grant of Rs. 300 crore, Central Plan loan of Rs. 300 crore and additional market borrowing of Rs. 400 crore.*

(i) At present, assistance to States for externally aided projects is outside the allocation made on the basis of the modified Gadgil formula. The "assistance" granted by external agencies amounts to 50 to 60 per cent of the cost of the projects. Since only 70 per cent of this assistance for such projects is passed on to the States except for assistance for socially oriented projects from 1989-90, the States in effect get assistance for externally aided projects only to the extent of 35 to 42 per cent of the total cost of such projects. We recommend that 100 per cent of assistance should be passed on in all cases. There is no logic in the Centre withholding a part of funds given exclusively for projects.

(ii) The terms of the assistance given to States for externally aided projects are the same as for the assistance under the Gadgil formula. Thus, they get 70 per cent of this assistance in the form of loans and 30 per cent in the form of grants. The rate of interest on the loans and the period of repayment thereof are also the same as for the Plan loans (9.75 per cent and 15 years). These bear no close relation to the terms of assistance granted by the external funding agencies such as IDA and the World Bank. We recommend that World Bank "assistance" be passed on to the States as of now, i.e., 30 per cent in the form of grant and 70 per cent in the form of loans. The rate of interest charged may also be the same as applicable to other Plan loans. The present interest rate of 9.75 per cent actually works out to only 6.8 per cent of total assistance including the grant component. But the repayment period should be the same as prescribed by the World Bank.

(iii) IDA assistance is granted to the country as a loan on very soft terms: 0.75 per cent service charge per annum, ten-year grace period and a forty-year repayment period (that is money is to be repaid only within fifty years). The Government of India, however, has to bear the risk of exchange rate fluctuation/depreciation. While, therefore, IDA assistance cannot be passed on as loans without interest, we think that the Central Government should fix a rate of interest to be paid by the recipient States at a level of six per cent per annum which would provide a substantial cover against the risk of exchange rate fluctuations. The entire amount may be passed off as loan having a maturity period of 30 years including a grace period of 5 years. (iv) It has been argued that assistance given to a particular State for externally aided projects represents "an additionality", i.e., an addition to "normal" Plan assistance. Not all States had projects partly financed by external assistance. This is presumably the reason why 30 per cent of what was received from external agencies was retained by the Centre. We understand from the Ministry of Finance that for some years now there is a greater spread among the States of externally aided projects. Some States which may not have externally aided projects under their Plans may nevertheless be benefiting from the location of externally aided Central projects within their borders. Taking all flows into account, if it is found that the share of some weaker States are unduly low, they should be compensated in some other way. We, therefore, recommend that a larger share of the 10 per cent of Plan assistance reserved for special problems be allocated to such States.

Loan Liabilities Of Erstwhile Union territories

9.21 The Union Territories of Arunachal Pradesh, Mizoram and Goa were constituted as full-fledged States in 1987. Prior to this, as Union Territories they received grants to meet their revenue gap and loans to cover their capital gap. However, under the present pattern, most of the Special Category States get 90 per cent of the Plan assistance by way of grants and the remaining 10 per cent only as loans, while the non-Special Category States get Central assistance in the form of grants and loans in the ratio of 30 to 70. Arunachal Pradesh and Mizoram have been designated Special Category States and Goa as a Non-Special Category State. It is recommended that the excess of the Central loans received by each of these three States for its Plans, upto 1986-87, as Union Territories (and outstanding as on 31.3.90) over what it would have received if it had been a full-fledged State, be written off - the write-off being restricted to the oustandings of such loans as on 31.3.1990. The loans remaining outstanding, if any, after this write-off, as on 31.3.1990, against each State may be consolidated into one loan with a reasonable maturity period and rate of interest. This is estimated to give a relief of Rs. 191 crore to the three States during the period 1990-95, as shown below:

(Rs. Crore)

States	Plan Loans Outstanding As On 31.3.1990*	Excess	Amounts To Be Written Off	Adjusted Outstanding As On 31.3.1990*	Relief In Repayment During 1990-95
1. Arunachal Pradesh	227.44	229.30	227.44	—	116.48
2. Mizoram	120.59	110.49	110.49	10.10	51.20
3. Goa	284.01	22.27	22.27	261.64	23.32
Total					191.00

** These relate to the loans received upto 1986-87.*

Drought Loans To States During 1986-89

9.22 Some States suffered enormously on account of unprecedented droughts during 1986-87 to 1988-89. Additional assistance was provided to them for approved relief expenditure over and above five per cent of annual Plan outlays, which is not adjusted against Plan assistance. Fifty per cent of this additional assistance was given in the form of loans. We feel that the burden of drought relief should not be cast upon the States, as we have indicated in Chapter VI on Financing of Relief Expenditure. We recommend that outstanding loans on account of drought may be written off entirely. This will result in the States having a relief of Rs. 198.88 crore over the five years, 1990-95, as shown below:

(Rs. Crore)

States	Drought Loans Outstanding As On 31.3.1989	Relief In Repayment During 1990-95
1. Andhra Pradesh	5.02	2.09
2. Gujarat	165.31	63.56
3. Haryana	4.81	1.85
4. Himachal Pradesh	2.80	1.08
5 .Karnataka	5.05	2.06
6. Kerala	10.08	3.88
7. Rajasthan	324.35	123.53
8. Uttar Pradesh	2.15	0.83
Total	519.57	198.88

Loans For Relief Works Relating To Bhopal Gas Leak Tragedy

9.23 During 1984-89, the Central Government gave loans totalling Rs. 91.62 crore to the Government of Madhya Pradesh to meet some of the immediate medical and rehabilitation needs of gas victims. It is recommended that all these loans may be written off. Since the entire loans have been recommended to be written off, payments already made by the State Government by way of repayment of principal and interest payment in respect of these loans may be adjusted against other payments due from the Government of Madhya Pradesh.

Special Loans To Punjab

9.24 Special loans to the tune of Rs. 2,300 crore were given to Punjab during 1984-89. An amount of Rs. 766.95 crore in respect of these loans is due for repayment during 1990-95. It is seen that the indebtedness of Punjab has been rising rapidly due to Plan and non-Plan loans of the order of Rs. 600 to Rs. 700 crore a year flowing to it from the Centre. These loans became necessary because of three factors, namely, (a) the high cost of combating terrorism, (b) the power tariff policy on account of which the State Electricity Board, though otherwise performing well, is losing Rs. 300 to Rs. 400 crore a year due to highly concessional tariff, and (c) the State wishing to have a Plan far bigger than what its resources could sustain.

The special circumstances prevailing in the State might be inhibiting the administration from raising resources. And the State certainly has had to bear a high burden in terms of expenditure on law and order. As this case is of a special nature, we recommend a moratorium of two years on repayment of principal and interest. We further recommend that the Central Government, meanwhile, work out a suitable package of measures including debt relief in order to put Punjab's finances on a more sound footing.

Scheme For General Debt Relief

9.25 If the changes in terms of lending by the Central Government to the States are modified in accordance with our recommendations and the investment policies of the governments at both levels are also improved along the lines suggested, it would be possible for the Centre to reduce the rate of growth of its debt and for the States to take care of their liabilities. In future, therefore, there should be no need, as a rule, for debt rescheduling or write-off. However, as regards existing repayment obligations, it might be desirable to grant some relief. In doing so, we need to keep in mind the terms of reference which require us to suggest corrective measures with particular reference to investments made in infrastructure projects and linked to improvements in financial and managerial efficiency. We propose to grant some relief in relation to Plan loans received by the State Governments during the five years 1984-89 and outstanding as on 31.3.1990 after adjusting repayments during 1989-90. Central loans to States outstanding at the end of 1983-84 have been covered by the scheme of debt relief recommended by the Eighth Finance Commission; as such we do not propose to grant relief in relation to them. We propose to link the extent of relief to the performance of the States in respect of their investments in two important sectors, namely, power and road transport. We worked out the rate of return on investments in these two sectors. For this purpose we defined the rate of returns to equal the gross operating surplus after depreciation as a percentage of total (cumulative) investments. While total actual investments were taken in the case of road transport, investments in power sector have been taken after excluding the portion attributable to rural electrification and works-in-progress. On this basis, the States are divided into three categories:

(i) those where the rate of return was above 15 per cent (Andhra Pradesh, Karnataka, Madhya Pradesh, Maharashtra, Orissa and Tamil Nadu);

(ii) those where the rate of return varied between 10 and 15 per cent (Gujarat, Rajasthan and Uttar Pradesh); and

(iii) those where the rate of return was below 10 per cent (Bihar, Haryana, Kerala, Punjab and West Bengal).

The above classification of States has been worked out on the basis of the data obtained from the Planning Commission and the State Governments. It has been found in the past that the data received from the State Governments and from the Boards and Transport Corporations were not always consistent. We would, therefore, suggest that the Government of India, while implementing the scheme, have the data checked up once more with a view to ensuring their accuracy for the purpose of classification.

9.26 We recommend relief in repayment of 1984-89 State Plan loans due during the years 1990-95, to the extent of 10 per cent for the first category of States, 7.5 per cent for the second category of States and 5 per cent for the third category of States. We recommend relief to the extent of 10 per cent uniformly for the Special Category States and Goa. The loans which remain outstanding after this relief, at the end of 1994-95, should be made repayable in 10 equal instalments. In other words, the State Plan loans advanced to States during the five years 1984-89 and outstanding as on 31st March, 1990, should be consolidated and re-scheduled to 15 years in the case of all the States. In the first five years of this 15 year period (i.e., during 1990-95), the repayment should be 10 per cent, 7.5 per cent or 5 per cent less, as the case may be, than that due on the existing basis. The balance of the loan should be repayable in the remaining 10 years (1995-2005). This is estimated to provide relief in repayment to the extent of Rs. 494 crore to States during the five-year period 1990-95. Annexure IX.5 shows the Statewise position of the relief.

9.27 It is recommended that the 1984-89 loans consolidated in the above manner for 15 years should carry a rate of interest of 9.0 per cent per annum.

9.28 The total debt relief on all accounts to each State during 1990-95 under our scheme in respect of the loans outstanding at the end of 1989-90 comes to Rs. 975.62 crore as per details in Annexure IX.6.

9.29 This quantum of relief is less than what the Eighth Finance Commission recommended. However, in this context, the basic difference between the relevant terms of reference of the Eighth and Ninth Commissions has to be kept in view. Unlike the Eighth Commission, we have not been asked to suggest measures to deal with the non-Plan capital gap. We are required to review States' debt position as on 31.3.1989 and suggest corrective measures. This is a matter referred to us under Article 280(3) (c) of the Constitution and, therefore, we have to confine ourselves strictly to the President's Order on this subject which was not the same before the Eighth Finance Commission. As explained earlier in this chapter, the practice of writing off and rescheduling of Central loans in order to cover a part of the non-Plan capital gap has failed to provide a durable solution to the problem of States' indebtedness. The thrust should rather be on corrective measures which would prevent accumulation of excessive debt burden on States. This can be achieved only by suitable changes in the terms and conditions governing Central loans. We have suggested some measures in this new direction. While it is difficult to assess the exact quantum of consequent relief to States during 1990-95, a rough estimate would put it around Rs. 2,000 crore (excluding amortization). However, the net adverse impact on Central budget is likely to be less in view of our suggestion regarding additional market borrowings by States in lieu of a part of Central Plan loans. Our recommendations also aim at recognising the financial and managerial efficiency as indicated in the terms of reference.

9.30 Shri Justice A.S. Qureshi, Member, does not agree with this scheme of general debt relief for the reasons explained in his Note of Dissent given separately.