Annex 6

Debt Swap Scheme*

The Union Budget for 2003-04 announced a debt swap scheme that would enable States to prepay their high cost debt to the Centre through additional market borrowings and proceeds from Small Savings. Under the scheme, mutually agreed between the Centre and the State Governments, States are allowed to retire loans amounting to Rs. 1,00,000 crore from the Centre bearing coupons in excess of 13 per cent. These loans would be swapped with additional market borrowings of the States and their net small savings proceeds (upto specified limits) at the prevailing interest rates, over a period of three years ending in 2004-05. Accordingly, during 2002-03, the States prepaid Central loans of Rs.13,766 crore under the scheme, of which Rs.10,000 crore were from market borrowings (allocated under the debt swap scheme in addition to the normal borrowing allocations) and the rest through small savings proceeds. As per the Interim Budget 2004-05 of the Union Government, the total debt swap was placed at Rs.46,602 crore in the revised estimates for 2003-04. As per the Reserve Bank records additional market borrowings under the debt swap scheme amounted to Rs.26,623 crore during 2003-04. Thus, so far, of the total debt swapped amounting to Rs.60,368 crore, around 61 per cent have been financed through additional market borrowings at interest rates below 6.5 per cent, i.e., at less than half of the earlier cost. The remaining loans have been financed through issue of special securities to the National Small Savings Fund (NSSF) at interest rates fixed at 9.5 per cent, i.e., at less than three-fourth of the earlier cost. Clearly, therefore, this scheme has helped States to reduce their interest burden.

The debt swap scheme, *ipso facto,* is debt neutral. It only results in a change in the level and composition of capital expenditure and receipts. On the expenditure side, repayment of loans to the Centre shows an increase while on the receipts side, gross market borrowings would be higher. As far as the financing of the States' fiscal deficit is concerned, while (net) market borrowings would increase, (net) loans from the Centre would show a decline. Over a period of time, savings by way of lower interest payments are expected to reduce the pressure on the States' revenue account and thereby on their overall borrowing requirement.

It may be added that the data on transactions under the debt swap scheme are not separately provided in the budget documents of the State Governments. Data on the actual transactions in respect of market borrowings under the scheme are, however, available as per the Reserve Bank records, which may differ from the estimates provided in the budget documents. Illustratively, total repayments of loans to the Centre are budgeted at Rs.25,909 crore in 2003-04 whereas, actual repayments of loans to the Centre through additional market borrowings under the debt swap scheme, as per the Reserve Bank records, are placed at Rs.26,623 crore. Taking into account other repayments, the actual total repayment of loans to the Centre during 2003-04 is likely to be much higher than the budget estimates. As a corollary, it may not be possible to work out the precise impact of transactions under the debt swap scheme on the capital account of the State Governments.

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* State Finances: A Study of Budgets of 2003-04 by the Reserve Bank of India