

DEBT MANAGEMENT MANUAL



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**FINANCE DEPARTMENT
GOVERNMENT OF MIZORAM**

DEBT MANAGEMENT MANUAL

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CHAPTER-1: INTRODUCTION

1.1 What is a Public Debt?:

Public Debt in short consists of all kinds of borrowings of the government to finance its expenditure. In the practice in government expenditure financing, the government expends much more than the resources it can generate through tax and grants. These are expended mainly to finance capital expenditure for creation of capital assets. That expenditure in capital investments with the expectation of overall socio-economic development and future return justify government expenditure even with borrowed funds. For financing such deficit, the government borrows funds from various sources such as Government Bonds by raising market loans, loans from Central Financial Institutions (CFIs) as negotiated loans, loans from the Central Government as loan components in the Block Grants and Centrally Sponsored Schemes (CSS), loans released to the State Government out of the share in the National Small Savings Fund (NSSF), etc. Besides, the State Government also acts as a banker in respect of certain funds in the Public Accounts like Provident Funds, GIS, etc. which are to be repaid with interests to the employees. With such practice of deficit financing over the years, the government debt accumulates and management of debt has become a critical issue in the fiscal management of the government.

1.2 Need for Formulation of Public Debt Policy:

The Government of Mizoram has so far not developed a formal debt management policy and strategy that sets out a clear debt management objective within a risk management framework. There is need for formulation of public debt policy that would set the framework for management of public debt by providing the operating guidelines to implement debt management policies in compliance with the laws, the medium term fiscal framework, debt and risk management policies, limits and controls, etc. for such activities. Having set the public debt policy, operational issues such as the infrastructure needed for debt management, debt recording and management systems, training and capacity building, and the documentation and reporting are required to be formulated and made operational.

1.3 Issues in Debt Management and Capacity Building:

The present system of Debt Management in Government of Mizoram is as follows:

- 1) Debt records are currently being maintained manually. In case of institutional loans, Finance Department mostly depends on the

debt repayment schedules prepared by the lending institutions at the time of according of sanctions and cross checks them manually. In some cases, it has led to delays in debt servicing attracting penalties due. These delays and extra costs can be avoided if the system is automated.

- 2) In repayment of institutional loans, the long drawn practice in the Government of Mizoram is that Finance Department accords expenditure sanction and leaves the actual payment to the concerned line departments which had utilized the fund. Due to the time taken between the movement of sanction letters from Finance Department to the concerned line departments and also due to the delays in the line departments, the debt servicing has been delayed quite often.

From 2011-2012, the new Debt Management Unit (DMU) has been established in Finance Department which has taken up expenditure sanction for all repayment of loans authorizing the Accounting Unit in Fiscal Management Unit (FMU) to arrange actual remittance of payments to the concerned institutions.

- 3) In case of market loans, although debt servicing has been progressing smoothly, the Department follows paper transaction processes which can be automated, especially those with regards to debit of management and maintenance charges to RBI.
- 4) Data on state government guarantees is also maintained manually, making the compilation every year. The updating of annual records is mainly based on the reports of the guarantee institutions, reconciled with the available records in Finance Department. A system for better institutionalization of process of issuance and recording needs to be put in place in Finance Department.
- 5) The government does not have resources in the Finance Department with skills needed for modern debt management. Resources are required to undertake more analysis of the debt and to assess the risks of the debt portfolio. The government therefore, needs to arrange adequate training to the officers This will be more important when the government relies more on market borrowings.

1.4 Essentials of a Public Debt Policy Manual:

This Manual is expected to set out the Government's objectives and strategy for public debt management and the borrowing programme to meet the annual financing requirements of the government. This should be seen not only as an outcome of the medium term fiscal framework and budget planning process but also as an effort to increase predictability and transparency of the actions of the government in

managing public debt. This will be particularly relevant for any fiscal responsibility act. The essential elements of a debt manual should comprise:

- (a)** Institutional and governance structures covering-
 - (i)** Legal framework;
 - (ii)** Roles and responsibilities of the finance department and its different functionaries;
 - (iii)** Governance structures including committees, both external and internal, for debt management policies and its operations; and
 - (iv)** Arrangements with financial and other institutions;
- (b)** Medium term debt strategy outlining-
 - (i)** Debt management objectives; debts levels and their composition, having regard to sustainability of debt;
 - (ii)** On lending and government guarantees; and
 - (iii)** Programme for development of domestic market loans; and
- (c)** Debt management policies, including risk management, monitoring of contingent liabilities and their fiscal risks, accounting policies and reporting. This manual has, therefore been developed as a living document to take care of the above issues and would be revised on need basis or at regular intervals.

1.5 Overview:

This document has been prepared in line with international practices and to suit the need of the Government of Mizoram in formulating policies for effective debt management. The Public Debt Policy Manual documents the government's objectives and strategy for public debt management along with the borrowing strategy to meet the annual financing requirements of the government. Effective public debt management should be seen in a wider context in that it covers the following:

- 1) Managing the stock of debt within a risk management framework,
- 2) Borrowing to meet government's budget financing requirements,
- 3) Funding government's cash and liquidity management requirements,
- 4) Management and servicing of government on-lending,
- 5) Provision and monitoring of government guarantees,
- 6) Monitoring of contingent liabilities and fiscal risks, Management of financial assets assigned to debt management operations.

1.6 Strategic Objective:

Public debt management has the strategic objective of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, pursue its cost and risk objectives, keep the public debt at sustainable levels and to meet any other public debt management goals the government may set through enactment or any other annual budget announcements.

1.7 Responsibility for Public Debt Management:

The Minister of Finance is responsible for authorizing all new borrowing by the Government of Mizoram. The overall responsibility for public debt management is assigned to the Finance Department.

CHAPTER-2: INSTITUTIONAL STRUCTURES AND GOVERNANCE

2.1 Legal Framework:

This section sets out the legal framework for borrowing, servicing of debt obligations and for any debt management operations such as debt swaps. Article 293 of the Constitution sets out provisions for borrowing by the State Governments as follows:

- 1)** Article 293 (1) provides the executive power for the State of Mizoram to borrow within the territory of India upon the security of the Consolidated Fund of the State within such limits, if any, as may from time to time be fixed by the Legislature of the State by law and to the giving of guarantees within such limits, if any, as may be so fixed.
- 2)** Article 293 (2) makes provision for the Government of India to make loans to the State of Mizoram or, so long as any limits fixed under Article 292 are not exceeded, give guarantees in respect of loans raised by the State of Mizoram, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India.
- 3)** Article 293 (3) prohibits the State of Mizoram from incurring a loan, where an existing loan is already outstanding against the State, unless the Central Government gives its consent.
- 4)** Article 293 (4) further provides that while giving consent under Article 293 (3), the Central Government may impose such conditions as it thinks fit.
- 5)** Section 6 (5) of 'The Mizoram Fiscal Responsibility and Budget Management Act' 2006 enjoined that the Government of Mizoram shall ensure that total outstanding debt, excluding public account, and risk weighted outstanding guarantees in a year shall not exceed twice of the estimate receipts in the Consolidated Fund of the State at the close of the financial year;

2.2 Roles and Responsibilities:

This section sets out the roles and responsibilities of the authorities responsible for management of government debt:

1) Minister of Finance:

The Minister of Finance is responsible for authorizing all new borrowings by the Government of Mizoram for a fiscal year. The

borrowings should normally be limited to the extent it is incorporated in the budget and passed by the Legislative Assembly. He shall also authorize renegotiation of existing debts for resetting of interests and for other repayment option such as pre-payment of high cost loans, one-time settlement of loans, etc. In carrying out all such activities, the interests of the government alone shall guide the decisions.

2) *Principal Finance Secretary/Commissioner/Secretary:*

As an administrative head of Finance Department, he shall be responsible for the day to day management of government debt such as raising of new borrowings during the fiscal year, repayment of loans, etc. He shall accord expenditure sanction for all repayment of loans and interests and ensure timely servicing. Under the overall guidance and approval of the Minister of Finance, he shall also carry out renegotiation of existing debts for resetting of interests and for other repayment option such as pre-payment of high cost loans, one-time settlement of loans, etc.

3) *Finance Department:*

The overall responsibility for public debt management is assigned to the Finance Department. It shall be the duty of Finance Department to ensure that the day-to-day management of debt in terms of availing of new loans and servicing of loans are carried out in an efficient manner. As far as practicable, loan management and servicing thereto shall be maintained in a computerized database.

4) *Other agencies of government responsible for debt management:*

The Government shall establish a separate unit purely for management of government debts. This Unit shall co-ordinate and carry out all debt management activities under the overall guidance of the Public Debt Committee.

2.3 Governance Structures:

This section sets out the governance structures that the Government of Mizoram shall put in place to monitor and control debt management activities. International practices have been adopted in that governance structures would include as a minimum a public debt committee and an internal risk committee as follows:

1) *Public Debt Committee:*

The government shall set up a Public Debt Committee in Finance Department. This is the main strategic policy-making committee, which would be chaired by the Principal Secretary/

Commissioner/Secretary, who is the administrative head of Finance Department. It shall include representatives of all functions with a policy interest and would be serviced by the concerned unit in Finance Department which is responsible for daily management of public debt. The composition of the Public Debt Committee shall be as follows:

- a.** Principal Secretary/Commissioner, Finance- Chairman
- b.** Commissioner/Secretary, Planning - Member
- c.** Secretary, Finance - Member
- d.** Principal Adviser, State Planning Board - Member
- e.** Additional Secretary, Finance (FMC) - Member
- f.** Additional Secretary, Finance (EA) - Member
- g.** Additional Secretary, Finance (DMU) - Member
- h.** Chief Controller of Accounts, A&T - Member
- i.** Deputy Secretary, Finance (DMU) - Member-Secretary

The Committee shall meet at least twice a year. It shall assess the overall requirements of new borrowings in each year to finance the government's capital investments. It shall see that the level of net borrowings from all sources is not in excess of the requirements for meeting the estimated gross fiscal deficit of the government. The Committee shall review the proposals against which the Departments propose to utilize the borrowed funds and shall ensure that borrowed funds are utilized only for fruitful capital investments.

2) Internal Risk Committee:

Internal Risk Committee shall be constituted in Finance Department for monitoring risk and other operational aspects of public debt management. The Committee shall consist of officials directly involved in the management of government debt. The composition of the Committee shall be as follows:

- a.** Secretary, Finance - Chairman
- b.** Additional Secretary, Finance (DMU) - Member
- c.** Additional Secretary, Finance (EA) - Member
- d.** Joint /Deputy Secretary, Finance (EA) - Member
- e.** Deputy Secretary, Finance (DMU) - Member – Secretary

The Committee shall meet frequently and at least once every quarter. It shall ensure that risks are identified and prioritized, and the mitigation policies and framework in place and monitored. The Committee shall discuss and monitor the

structure of public debts in terms of loan composition, maturity profile of loans, interest profile of loans, etc. so as to mitigate the risks and interest servicing liability of the government. The options for debt restructuring, pre-payment of debts or resetting of interests will be discussed by this Committee for decision of the appropriate authorities.

2.4 Institutional Arrangements:

This section sets out the roles, responsibilities, and functions undertaken by all institutions involved in public debt management activities. While the Finance Department has overall responsibility for public debt management, other agencies such as the Reserve Bank of India (RBI) performs activities for the Government of Mizoram under an agency arrangement. The list of institutions involved in public debt management activities and debt transactions are:

1) Finance Department:

The overall responsibility for public debt management covering all aspects of loan negotiations, debt recording and servicing, including provision of government guarantees and monitoring of contingent liabilities. Finance Department shall carry out the duties within the debt management framework as provided in this Manual or any other enactments and rules in force from time to time.

2) Other departments under Government of Mizoram:

The Departments are responsible for provision of on-lending and reporting on on-lending to agencies under the administrative control of the Departments, providing of government guarantees to institutions and agencies under their control.

Such Departments shall extend guarantees only after due concurrence of the Finance Department and shall give reports on the details of the guarantees extended by it and give periodical reports and fiscal risks to the Finance Department.

3) Reserve Bank of India:

RBI is the fiscal and paying agent for the government's market loans and other debt transactions like NSSF, provision of Ways and Means Advances and Overdraft. It is also responsible for maintaining the government account at the central bank, and other functions assigned to it from time to time on agreements with the State Government.

4) Central Government:

The Central government provides authority through the Planning Commission and Ministry of Finance on all borrowing activities of the government under Article 293 (3) of the Constitution of India. It also provides loans and advances from Central Government, including funds from borrowing from international financial and multilateral institutions.

5) Accountant General:

It maintains official records of public debt and on-lending, adjusting transactions on loans from the Central Government, government guarantees, and accounting for all debt transactions.

CHAPTER-3: MEDIUM TERM DEBT STRATEGY

3.1 Debt Management Objectives:

This section sets out the Government's objectives for public debt management. The debt management objective broadly is to manage public debt with the objective of providing stable, low-cost funding to meet the financial obligations and liquidity needs of the government. Specific objectives set by the government for managing its public debt activities include the following set of principles:

- 1)** To manage the structure of the debt to protect the government's fiscal position from unexpected increases in interest rates and to limit refinancing needs.
- 2)** To manage the cash position to ensure that adequate liquidity is maintained at reasonable cost and risk to the government.
- 3)** To borrow, using a variety of instruments and a range of maturities, and maintain a diversified investor base.
- 4)** To continue to develop market loans within limits imposed by the Planning Commission, Ministry of Finance and the Reserve Bank of India with the aim of developing market access.
- 5)** To undertake debt swaps, interest resetting, pre-payments and other transactions in order to reduce debt service costs and to manage risks inherent in the debt portfolios.

3.2 Debt Levels & Debt Sustainability Indicators:

This section sets out the government's targets for public debt levels and debt servicing costs as set within the medium term fiscal framework and budget planning process. It shall also capture targets that are documented in the fiscal responsibility act. The information in this section will include up-to-date:

1) Debt levels:

Nominal levels and as percentage to GSDP/Revenue Receipts. The government should take every step to contain the level of debt relative to the Gross State Domestic Product (GSDP) or the total Revenue Receipts accruing during a fiscal year.

While considering the levels of government debt as a percentage of GSDP, the government shall always be guided by the sustainable levels of debt as laid down in 'The Mizoram Fiscal Responsibility and Budget Management Act' and the recommendations of the successive Finance Commissions constituted by the Central Government and the Reserve Bank of India. In its effort to reduce the level of debt as a percentage of

GSDP, the government may take efforts to contain the fiscal deficit within the prescribed levels. The target of the Government of Mizoram to contain the debt levels as a percentage of GSDP for the award period of the Thirteenth Finance Commission shall be as follows:

2010-11	-	87.3
2011-12	-	85.7
2012-13	-	82.9
2013-14	-	79.2
2014-15	-	74.8

The Mizoram FRBM Act provides that the outstanding debt shall not exceed two hundred per cent of the total revenue receipts of the government. The Government shall take steps to progressively bring down the level of debt stock to bring about sustainability in the debt servicing and interest payments.

2) Debt service costs:

The government should properly keep a close watch on the cash flow towards servicing of past debts, cash-based debt service projections and as percentages of revenue expenditure and revenue receipts. Towards this end the government shall carefully keep a constant watch on the maturity profile of loan portfolios so that debt servicing liability in a year does not result in severe cash management problems.

3) Debt targets:

Percentage of GSDP, revenue receipts, revenue expenditure and any limits on debt expansion as may be provided in the fiscal responsibility act or as may be announced in the budget statement.

4) Other targets:

The Government shall, from time to time, adjust the debt management targets and sustainability indicators on taking into account the national and international standard debt sustainability indicators as may be evolved.

3.3 Debt Instruments and Sources of Borrowing:

The Government of Mizoram raises its loans from a variety of sources. This Section provides for the debt instruments and the borrowing sources.

1) Market Loans:

Market loans are raised either by auction or tap as part of a multi-state debt issuance process using the RBI as agent, with a fixed interest rate payable semi-annually and normally with a 10-year maturity.

2) Loans and advances from the Central Government:

The State Government receives loans from the Central Government in the form of loan components of state plan schemes, central plan schemes and centrally sponsored schemes, and for other purposes. These loans have different maturities, interest rates and repayment profiles. These include the loan portion of the assistance provided by multilateral agencies for externally aided state projects. The Debt consolidation and Relief Facility (DCRF) provided by the Twelfth Finance Commission resulting in debt consolidation of all block loans and the facility of write-off of the repayments had brought about changes in the structure of these loans. Further, the continuation of the Facility by the Thirteenth Finance Commission which will result in the write off of CSS loans will further bring about changes in the structure.

3) Loans from Central Financial Institutions (CFIs):

The Government of Mizoram avails loans from the CFIs in the form of Negotiated Loans on the terms and conditions which are negotiated between the parties. The main institutions are LIC, GIC, NABARD, REC, NCDRC, HUDCO, etc. These loans have different maturities, interest rates and repayment profiles.

4) Special securities issued to National Small Savings Fund (NSSF):

The Government of Mizoram receives loans from NSSF out of the net proceeds of small savings schemes administered by the Government of India to mobilize contributions received under various small savings schemes and credited to NSSF net of all withdrawals, with net collections in Government of Mizoram. A certain percentage (presently 80 %) of net proceeds is provided to the Government by way of loans for which the Government of Mizoram issues securities through the RBI to the NSSF. The rate of interest on NSSF is determined by the Government of India.

5) Small Savings and Provident Funds:

The Government of Mizoram utilizes net contributions in Group Insurance Scheme (GIS) and General Provident Fund (GPF) accounts of the employees to finance the expenditure. These funds are kept under Public Accounts of the State

Government providing easy sources of borrowing for the Government.

6) Ways and Means Advances and Overdrafts:

This is the facility provided by the RBI for short-term borrowing to meet temporary cash mismatches funds within a limit fixed with the interest rate at the Bank Rate up to 90 days and 1 % above the Bank Rate for the period beyond 90 days. Special WMA is first provided by the RBI followed by the Ordinary WMA. The ceiling on the facility of Special WMA is determined on the basis of the investment of the State Government in the dated securities of the Government of India. The ceiling on Ordinary WMA is fixed by the RBI in 2006 on the recommendations of Bezbaruah Committee constituted by the RBI.

The RBI also provides an overdraft facility beyond the ways and means advances on certain terms and conditions.

3.4 Limits for Borrowing and Public Debt:

1) Annual borrowing limit:

The Government shall, in liaison with the Government of India, Ministry of Finance, set the borrowing limit for a fiscal year which is announced at the time of the Budget. While fixing the borrowing targets on a year to year basis, the Government shall be guided by a high degree of prudence in fiscal management and ensure that borrowing is not resorted to for meeting current revenue expenditure and only for financing the capital investment requirements of the Government. Besides, utmost prudence shall always be exercise so that borrowing is not in excess of the budgetary expenditure requirements.

2) Maturity profile:

Currently, the maturity is set by the lender and incorporated in the loan conditions and there is little or no scope for the Government to adjust the maturities of such loans. In that circumstance, the Government will determine the average maturity and/or duration limit of public debt and the debt that is due to be serviced in the next 12 months.

3) Interest rate:

Currently, the interest rate is set by the lender and incorporated in the loan conditions and there is little scope for the Government to adjust the interest rate on such loans unless by renegotiation. The Government will determine the average interest rate, average cost of borrowing, fixed/floating composition of public debt, and loans that are high cost.

4) Foreign currency exposure:

Currently, the Government does not have any foreign currency loans due to the special relaxation of the Government of India in respect of Special Category States. As and when the government raises debts on foreign currencies, the government shall take utmost care in its management to avoid undue exposure to exchange rate risks.

3.5 Risk Management:

This section sets out the Government of Mizoram's risk management framework and government's tolerance for risk. The Government of Mizoram will adopt the principle that it will be risk adverse in its financial management, therefore, protecting against adverse events that may impact negatively on government's finances. As financial markets assign the status of sovereign debt to the public debt issued by governments, a status that reflects the highest quality debt issuers in the market, the government is expected to have a risk management culture that reflects the special set of responsibilities associated with representing the government in financial markets. The overriding objective is to ensure that the reputation of the government is maintained and not affected through events that may have an adverse impact on the fiscal deficit. An internal risk committee will be responsible for developing risk management policies and managing risk controls, limits and compliance. The policy for monitoring and managing each category of risk is:

1) Market risk:

It measures the impact of adverse movements in interest and exchange rates (currency risk is not applicable for the government at present but would become applicable if loans in foreign currency are introduced). Currency risk will be managed by establishing an overall foreign currency debt limit and individual foreign currency limits. In the short-term, overall foreign currency debt will be zero. Interest rate risk will be managed by establishing limits for fixed and floating rate debt, on-lent loans, and financial investments.

2) Funding / rollover risk:

This makes it difficult, if not impossible, for the government to access markets when it needs funds and to raise funds at an acceptable cost. Given the borrowing constraints imposed by central government and the lack of a well established primary and secondary market for market loans, the government has a significant funding risk that may make it difficult to raise funds when required. Funding risk will be managed by continuing to

develop access to market loans and by increasing the range of instruments and markets where possible.

3) Credit risk:

It measures the impact of counterparty downgrade or default on on-lending, government guaranteed debt, and financial assets held by the government. Credit risk will be managed by the establishment of appropriate credit limits for each institution and through active monitoring of the credit rating or financial position of each institution. Credit risk for equity, guarantees and contingent liabilities with public enterprises will be managed by monitoring these exposures and identifying the potential fiscal risks of each exposure. To the extent that the government enters into swap and other hedging techniques, credit risk will be managed using standard methods based on the Bank for International Settlements current and potential exposure methodology. A policy will be developed to utilize collateral to cover significant credit exposures such as collateralized swap agreements.

4) Liquidity risk:

It impacts the government's cash management functions with unused funds and idle cash balances, the inability for fast or cost effective liquidation of financial assets, or access to emergency funding facilities. Liquidity risk will be managed through a number of mechanisms. First, through the establishment of minimum cash and investment levels to be maintained by the Government. Secondly, by maintaining capacity to use the Ways & Means Advance with RBI. Third, by close coordination with the cash management functions of the government to enhance cash flow forecasting and improve accuracy of cash position to enable the government to operate with a lower level of cash and investments.

5) Operational risks:

It covers a wide range of potential exposures and events such as settlement failure, transaction errors, inadequacy or failure of internal controls, compliance and legal risks, IT systems and data security, and business continuity planning. Operational risk will be managed by identifying high/medium risk and events with high/medium financial impact and developing policies to set limits and controls, where possible, and to minimize the impact and manage the process should such an event occur.

3.6 Debt Composition:

This section sets out details of the debt composition and targets that have been set by the medium term debt strategy:

1) Currency:

Currently, all debt portfolios of the government are denominated in Indian rupees. The government shall always determine the debts in Indian currency, and even when the foreign currency loans are availed by the government, it shall take efforts to take up hedging of loans so as to avoid the exchange rate risks as well as to facilitate quantification in Indian currency for accounting.

2) Maturity:

The government shall take a constant watch on the maturity profile of loans. Attempt shall always be made to ensure uniform spreading of repayment of principal on outstanding loans to avoid unduly high outflow of cash on account of repayment of loans.

3) Interest rate structures:

Since the interest is the cost that the government bears on the loans and expenditure is wasteful in nature, the government shall take efforts to minimize the weighted average interest costs to contain the interest payments at sustainable levels. For that purpose, the government should take due considerations of the costs of loans vis-à-vis maturity period at the time of loan negotiations.

3.7 Debt Restructuring:

This section sets out the Government's strategies for restructuring its public debt as a continuous exercise. The Government will, from time to time take up loan renegotiations for debt restructuring as follows:

- 1)** The government will seek to negotiate with various lending institutions for resetting of interest rates in conformity with the ruling rates or seek acceptance of prepayment. The Government may carefully examine the cost-benefit in prepaying certain high cost loans by availing some new loans that are available at lower costs or may either arrange prepayment out of its cash balances.
- 2)** The government will continuously take efforts in identifying market loans that are classified as high cost (i.e., have a high interest rate and/or a longer maturity) that could be targeted for buyback on a voluntary basis and discuss with RBI or lender institutions under the programme for buyback and/or debt

swaps in order to reduce stock of high-cost loans and debt servicing costs.

3.8 Development of Domestic Market Loans:

This section sets out the Government of Mizoram's policy for the development of the domestic market for government securities. While the existing domestic market is not well developed and tightly controlled, the Government will develop a strategy in order that it is prepared for any policy changes at central government that may allow states to make greater use of this market. The strategy will involve Finance Department developing a framework and strategy for each of the following areas:

1) *Market Development:*

The key objective for developing the market and market access is to reduce long-term costs of borrowing. This is achieved through increasing liquidity, increasing transparency and predictability, incorporating investor preferences into the programme, and using other markets such as the swaps market (if these are available), to generate cost savings.

2) *Promoting Liquidity:*

Liquid markets are desirable because they lead to lower borrowing cost over the long-term. Investors are more willing to place cash in liquid markets, where they are confident they can convert their investments back to cash quickly and at their true value. A more liquid government market should be more resilient to one-off shocks leading to large increases in the borrowing costs. Finally, a more liquid market would encourage more active trading in the fixed income market, encouraging the development and growth of the repurchase agreement (repo) market, which in turn, would decrease the long-run borrowing costs.

3) *Benchmark Bonds:*

The concentration of activity in fewer bonds with a larger amount on issue (referred to as benchmark bonds) provides greater scope for secondary market trading and encourages market makers to make more of an effort marketing these bonds. This further increases the liquidity of these bonds. The main drawback to developing benchmark issues is the increased rollover risk. Building benchmarks requires concentrating maturities, resulting in large flows through the banking system on the maturity date. This risk is usually mitigated by buyback and debt switching operations, developing liquidity in the short-term money market, issuing long-dated

bonds, and increasing predictability. At present, there is little or no scope to develop benchmark bonds as the issuance of bonds is controlled by RBI and central government.

4) *Increased Transparency:*

More transparent dealings with the market reduce the long term cost of borrowing by promoting a more efficient and lower-risk market. Transparency can enhance good governance through greater accountability of Finance Department and other state institutions involved in public debt management. Transparency involves publicly disclosing public debt management objectives, the roles of the various state institutions in debt management activities, pre-announcing borrowing programmes, as well as maintaining professional relationships with market participants.

5) *Building and Diversifying the Investor Base:*

A key objective is to achieve a broad investor base for government securities. This requires understanding investor preferences and developing relationships with “end” investors. In this way, the debt management cell can factor in investor preferences in making decisions on new borrowing. Also, the debt management cell can use these relationships to promote new debt instruments and initiatives that the Government of Mizoram may wish to introduce. Strengthening demand for government bonds under all market conditions can be achieved by building and diversifying the base of investors.

CHAPTER-4: DEBT MANAGEMENT POLICIES, LIMITS AND CONTROLS

This chapter sets out the formal policies, limits and controls that government has set for public debt management operations. These will be formulated annually as a medium-term debt strategy within the medium-term fiscal framework and budget planning process. The Public Debt Committee will be responsible for assessing and approving the policies, limits and controls.

4.1 Debt Management Policies:

This section sets out the debt management policies, limits and controls covering:

1) *Approved debt management objective and risk management framework:*

The debt management objectives of the government shall be as follows:

- a.** To borrow funds to finance the fiscal deficit of the government on a year to year basis in the most efficient manner.
- b.** To borrow funds on the principle of least-cost to the government.
- c.** Timely servicing public debt and interest payments by making appropriate institutional arrangements.
- d.** Periodically restructure debts so that the weighted average interest rate stabilizes or to reduce high-cost loans.

2) *Level of foreign currency exposure (if any):*

This will be decided by the government as and when it contracts loans in foreign currencies.

3) *Currency composition:*

As far as possible and practicable, the government shall maintain all debt stocks in Indian currency.

4) *Fixed/floating interest rate composition:*

The government may periodically review the options for fixed or floating interests on the debts. However, the government shall be guided by the need to reduce the risks and shall keep maximum of the loans in fixed interest rates.

5) *Maturity structure for public debt:*

Maturity profile of the government shall be proper so that the government is not put into serious fiscal risks due to the heavy repayment of loans in a particular fiscal year.

6) Approved funding sources:

The approved funding sources will be decided by the Public Debt Committee from time to time. Initially, the approved funding sources of government loans will be as follows:

- a. NSSF loans
- b. Market loans (government bonds)
- c. Loans from Central Financial Institutions (NABARD, REC, PFC, LIC, HUDCO, GIC, etc.)
- d. Loans from the Government of India.
Loans from the Reserve Bank of India (Ways & Means Advance, Overdrafts)
- e. Loans from the Public Accounts (Small Savings, Provident Funds, etc.)
- f. Any other loans as may be approved and determined by the Debt Management Committee from time to time.

7) Annual borrowing and debt restructuring programme:

The government may draw up an annual borrowing programme in line with the details already laid down in the Annual Budget and in line with the financing needs of capital investments as duly incorporated in the scheme of financing for the Annual Plan.

8) Approved counterparties for on-lending and investments:

The government of Mizoram may, from time to time identify the list of institutions and agencies to which it may advance loans for specific purposes.

4.2 Government Borrowing Policies:

This section sets out the government borrowing policies, limits and controls covering:

1) Cost of borrowing benchmark(s):

The Public Debt Committee shall, from time to time lay down the borrowing benchmarks in terms of interest rates and the amount of loans that may be raised by the government for various loans depending upon the rates of interests.

2) Agencies to be involved in each phase of the borrowing process:

In respect of market borrowings, the government shall continue to raise loans by floatation of government securities through the Reserve Bank of India. In respect of institutional loans, the government will continue to negotiate directly with the concerned institutions.

4.3 Cash Management Policies:

This section sets out the cash management policies, limits and controls covering the following areas:

1) *Forecasting of government revenue/expenditures and cash requirements:*

For effective management of government finances and for drawing up a borrowing programme, the building up of cash balances in government account needs to be foreseen with a fair degree of accuracy for a certain period of time. For that purpose, the nature of accrual of revenues during the course of the year and the incidence of government payments are the key needs to be carefully planned and forecasted. That will, in turn determine the nature and programming of borrowings during the course of a year. Finance Department shall carry out the forecasting of cash and liquidity requirements of the government on daily, weekly and monthly basis.

2) *Management of cash and deposits:*

It is incumbent upon the government that sufficient cash is available in its accounts at RBI at any given point of time. That is to say, the government should not run out of cash for meeting immediate payments. For that purpose, Finance Department has to make forecast of receipts and expenditure and the requirement of borrowings to fill up the payment requirements. However, in the event of its inability to meet its payment obligations for a short period of time, it may avail the Ways & Means Advance from the RBI. Since lapsing into overdraft indicates serious cash mismatches in the government account, attempts should be made at all times to avoid it.

At any given point of time where the government is not able to meet its payment obligations for reasons beyond the control of the government, it may arrange temporary parking of funds in the deposits under Public Account to avoid cash mismatches. However, the government shall arrange release of such funds as and when cash balances build up.

3) *Use of surplus funds:*

Building up of surplus funds may either be temporary or durable. Durable cash balances indicate built up cash balances due to the increase in the levels of collections of revenues or other financial resources over the estimates which last for a fairly long period. In such situation, it will be beneficial for the government if the cash balances are utilized for productive investments in the form of appropriating for capital investments.

Other fruitful utilization of cash balances will include utilization for pre-paying the high-cost loans of the government.

Temporary surplus funds are the built up of cash balances for a short period pending payments against the expenditure items already approved by the government. In such cases, the surplus funds will not be available for investments and the government shall arrange investments in treasury bills market to earn interests.

4) Reserve and other funds:

The government finances are no longer immune from various risks and various securities need to be put in place to mitigate the risks and for improving the credit rating of the government. For that purpose the government shall put/arrange building up of reserve funds in the following forms:

a. Sinking Fund:

It is the building up of reserve funds for payment of all kinds of government liabilities in the future years. With the increase of government liabilities in absolute numbers, the government needs to slowly build up the reserve fund so that the credit risks are slowly absorbed by the reserve funds for credit worthiness in the eye of investors.

b. Guarantee Redemption Fund:

It is the building up of reserve fund for meeting government obligations in the events of invocation of government guarantees in the loan portfolios guaranteed by it. The government shall monitor the position of such contingent liabilities and arrange building up of corresponding reserve funds so that the government is not faced with serious fiscal risks due to invocation of guarantees.

CHAPTER-5: GOVERNMENT ON-LENDING POLICIES

This section sets out government on-lending the policies, limits and controls covering:

5.1 Principles for On-lending:

On-lending of the government indicates the lending of various kinds of loans and advances to various institutions with the obligations to repay the same with or without interest. The government, from time to time extends various kinds of advances to institutions and agencies as financial assistances or for fulfilling the conditions on receipt of such funds by the government. The on-lending policies of the government shall be governed by the following broad principles-

- 1)** The government's on-lending should be governed by sound principles of financial management.
- 2)** The government shall not be a loser in the on-lending activities. That is to say, the Net Present Value (NPV) of all the receivables in the form of loan repayments and interests should not be less than the amount of loan advanced.
- 3)** As far as practicable, the government shall adopt a uniform principle in a fiscal year in respect of - rate of interest, maturity (period of loan repayment), moratorium, etc.
- 4)** In the case of on-lending out of loans negotiated by the government from financial institutions, the government may make special arrangements in deviation of Sub-clause (3) above in tune with the terms of loans negotiated with the financing institutions.
- 5)** The rates of interests on on-lent activities shall, as far as practicable, be aligned to the prevailing market rates and the rates at which block loans are received by the government.

5.2 Approved government agencies:

The government's on-lending will be limited to the following agencies and bodies:

- 1)** Public Sector Enterprises under the Government of Mizoram in which the share holding of the Government is 51% or more.
- 2)** Authorities, Boards and Agencies under the Government of Mizoram in which the heads of management are the officials and authorities under the Government.

- 3) State Level Co-operative Societies.
- 4) Any other Co-operative Society to which the Government of Mizoram has share holdings.
- 5) Any other entity as may be decided by the Government from time to time.

5.3 Monitoring of on-lending of the government:

Finance Department shall monitor the on-lending activities of the government. For that purpose, Finance Department may utilize the services of concerned government departments in monitoring the performance in the form of timely servicing of loans and interests by such institutions. Periodical reports in the form of quarterly/half-yearly/yearly reports on the position of loans shall be monitored.

In the case of future on-lending, the previous performance in servicing of loans shall be duly considered by the government.

5.4 Policy for loan defaults:

If the on-lent institution defaults in servicing of loans, the government shall take appropriate actions for recovery of loans by various possible measures including the following measures-

- 1) Stoppage of grants from the government
- 2) Adjustment of loans against grants
- 3) Any other measures as the government may deem fit.

CHAPTER-6: GOVERNMENT GUARANTEES

6.1 When to extend government guarantees:

The government's policy for provision of government guarantees is that public enterprises should raise funds on the strength of their balance sheet. The government may provide guarantees only when it is absolutely necessary to do so after assessing the technical feasibility and viability of the underlying project and generation of repayment capacity. In order to enforce discipline and to avoid future invocation, new guarantees may not be issued for public enterprises which have defaulted in principal repayments and/or payment of interest.

6.2 Responsibility of extending guarantees:

Finance Department will be responsible for the provision of all government guarantees and for recording, monitoring and reporting these guarantees. Policies and procedures will be developed and issued to all government agencies that set out the basis for provision of guarantees, approved guaranteed institutions, monitoring of guaranteed institutions, policies for invocation of guarantee, guarantee fees, limits for guarantees, and the provision of a Guarantee Redemption Fund. The government is to set up such a fund for discharging its payment obligations on invocation of guarantees. Guarantee fees collected from public enterprises will be credited to the fund. Efforts will be made to centralize within the Finance Department the issue and management of guarantees such as appraisal of the underlying projects, determination of guarantee commission on default risk perception basis, follow up of realization of guarantee commission, transfer of funds to the Guarantee Redemption Fund, invocation of guarantees, maintenance of records, compilation of data, monitoring of the ceiling prescribed, if any.

6.3 Evaluation of fiscal risks in guarantees:

The Internal Risk Committee will evaluate the fiscal risk of the existing guarantee portfolio on an annual basis with each guarantee classified by high, medium, low, and very low risk. The base for guarantee commission may be enlarged so as to include all public enterprises for all loans raised under government guarantee except loans raised for the government and for repayment of which specific provisions are made in the budget. The rate of guarantee commission may be linked to default risk perception instead of charging commission at a flat rate subject to a present floor of 1% on guaranteed amount.

6.4 Guarantee commission:

The Finance Department will intensify efforts for collection of large amounts of outstanding guarantee commission from defaulting public enterprises. New guarantees will not be issued for any public enterprise unless it clears its outstanding guarantee commission due. In order to provide transparency, government will disclose information on default, invocation and payment performance in Budget Documents (Statement showing the guarantees given by the state government and the financial trend of the state) or in Finance Accounts every year. This disclosure will also cover information on amounts overdue but guarantees not invoked. The rates of guarantee commission to be collected on guaranteed loans shall be as determined by the Government from time to time.

6.5 Monitoring Contingent Liabilities:

This section sets out the policies for monitoring contingent liabilities and fiscal risks. Contingent liabilities are those liabilities incurred by the government by a triggering mechanism or event. These contingent liabilities may be explicit, such as the case of financial guarantees extended by the government to support an infrastructure project, for example. They may also be implicit, such as might be the case with a government financial institution that does not have sufficient financial assets to cover investments or small savings from individuals and where government support is needed to preserve the value of these savings.

6.6 Guarantee Information:

The Finance Department will establish a system for obtaining information from all government agencies in connection with contingent liabilities and maintain a register of all such liabilities. These will be monitored and assessed on the basis set out for government guarantees. The register will include:

- Government guarantees
- Explicit contingent liabilities
 - Quantifiable
 - Unquantifiable
- Implicit contingent liabilities
 - Quantifiable
 - Unquantifiable

CHAPTER 7: RISK MANAGEMENT, ACCOUNTING AND REPORTING

This Chapter sets out the policies for managing risks in management of government debts, accounting policies and reporting procedure in government debts:

7.1: Risk Monitoring:

Responsibilities for risk monitoring, compliance monitoring and reporting

1) *Methodologies for measuring each category of risk:*

The Government shall measure risks in its portfolios taking into account the following parameters:

- a.** Maturity of loan: The shorter the maturity of loan, the higher the risk.
- b.** Moratorium: No moratorium period or a very short moratorium period indicates higher risk
- c.** Periodicity of payment of interests: The higher frequency of payment of interest indicates higher risk.
- d.** Method of calculation of penal interests: Penal interest for delay in servicing of loan repayments or interest is normally calculated from the date of default till payment. Any further accruals over and above this will indicate risks to the government.
- e.** Method of capitalization of interests/penal interests with the loan: Certain institutions capitalize interests and penal interests with the principal amount, thereby making the loan servicing very complex. Such system indicates risks to the government.

3) *Policies for monitoring each category of risk:*

Finance Department (DMU) shall place the position of various loan portfolios before the meetings of the Internal Risk Committee. The Committee shall look into the various aspects of risks on the basis of the above parameters.

4) *Transaction limits, interest rate limits, liquidity requirements, and other limits:*

The Public Debt Committee shall, in each year, lay down various operational limits in debt management in terms of

transaction limits, interest rate limits, liquidity requirements by laying down borrowing calendar and any other limits to be followed by Finance Department in negotiation of loans and in servicing of loans.

In case of non-compliance by Finance Department of the limits laid by Public Debt Committee, the same shall be laid before the Committee with reasons thereof.

7.2 Accounting of Public Debts:

This section sets out the basis for public debt accounting policies:

1) Accounting policies and standards adopted for public debt:

The government shall strictly follow the standard of accounting as prescribed by the Government of India, Comptroller & Accountant General (C&AG) and Controller General of Accounts (CGA) in matters of codification and the formats for recording.

2) Accounting policies for each type of debt transaction:

The government shall follow the following accounting in debt transactions:

A. Sector: All loans contracted under the Consolidated Fund of the State shall be accounted under E-Public Debt. Loans under Public Accounts shall be accounted and repaid under the appropriate heads.

B. Major Heads: All loans under the government shall be credited and repaid under the following major heads:

i. 2049-Interest Payments: All payment of interests accruing out of the loans contracted by the government shall be charged under this head.

ii. 6003-Internal Debt of the State Government: All receipts and repayments thereto on account of internal debts of the government shall be charged under this head.

iii. 6004-Loans & Advances from the Central Government: All receipts and repayments on account of loans received from the Government of India shall be accounted under this head.

iv. Borrowings under the Public Accounts shall be accounted under the appropriate major heads such as 8009-State Provident Funds, 8011-

Insurance & Pension Funds, 8235-General & Other Reserve Funds, 8443-Civil Deposits (not bearing interest), etc.

C. Minor Head, Sub-Minor Head, Detail Head and Object Heads of Account: The normal classification of heads as notified by the CGA shall be followed.

7.3: Reporting of Public Debts:

This section sets out reporting of public debt and government's debt activities. The intention of this part is to ensure publication of the statements of debt of the government for access by the public and government functionaries:

1) Government of Mizoram – fiscal responsibility:

The Government of Mizoram shall lay the position on debt of the government in the Legislative Assembly along with presentation of budget documents. The reporting shall take place as part of the requirement under the Mizoram Fiscal Responsibility and Budget Management Act.

2) Reserve Bank of India:

The Reserve Bank of India, as a debt manager of the State Government, always publish the debt position of the State Government along with other State Governments in its annual publication of 'Finances of State Governments: Study of State Budgets'. The details and composition of debt and comparison with GDP, etc. are always reflected in this publication.

3) Comptroller and Auditor General (C&AG):

The C&AG prepares an annual statement on finances of the State Government 'Finance Accounts' which contain a detailed statement of government debts over the reporting year.

4) Central government:

The Government of India may, from time to time lays down the debt data of the Central Government and the State governments in the reports and in through its web-site.

5) Disclosure of debt information including publications, e-publications and website:

Finance Department shall publish and insert the details of debts and contingent liabilities on a periodical basis (year-wise, etc) through the web-site www.mizofin.nic.in