

STATE GOVERNMENT FINANCES

**Adoption of Working Group's
guidelines by states could boost
prudence in guarantee extension,
improve monitoring**

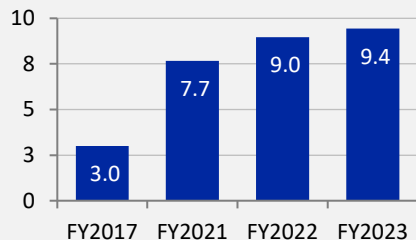
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Exhibit: Combined guarantee stock of 17 states* (Rs. Trillion)



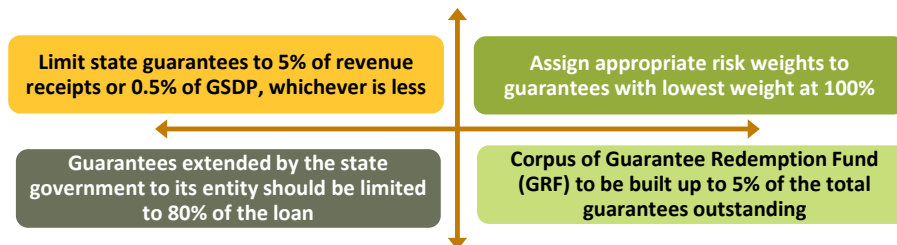
Source: Comptroller and Auditor General of India (CAG); Reserve Bank of India (RBI); ICRA Research

*Excludes north-east and hilly states and Goa

The total stock of guarantees extended by the 17 major state governments is estimated to have tripled to Rs. 9.0 trillion at end-March 2022 from Rs. 3.0 trillion at end-March 2017. Based on the data provided by the Reserve Bank of India (RBI), the rise in banks' exposure to loans guaranteed by all state governments is equivalent to the entire increase in guarantees of the aforesaid states during FY2017-22. While guarantees are contingent liabilities, they may pose a risk to the state governments' fiscal health if a substantial proportion of the stock needs to be serviced by the states, warranting robust guarantee monitoring and prudent extension of guarantees in the future.

The Working Group (WG) on State Government Guarantees set up by the RBI in 2022, recently released its report. The guidelines include tighter rules for ascertaining guarantee ceiling by a state government than is being currently implemented by most states as well as assigning risk weights to guarantees, in addition to enhanced monitoring. The guidelines state that guarantees should not be extended for external commercial borrowings, the amount guaranteed should be limited to 80% of the loan etc. Moreover, the guarantees should not be used for obtaining finance through state-owned entities, which substitutes budgetary resources of the state government. The latter is in line with the change in guidelines on off-budget debt issued by the Government of India (GoI) in FY2023. Together, these two would nudge states to become more selective while extending guarantees to their entities. Additionally, the WG has urged the lending institutions to assess a loan proposal from state-owned entities without taking comfort of a guarantee, which should make the lenders more cautious, going forward as well.

Exhibit: Key recommendations of RBI's WG





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