

**Title: The ROI of Government of India**

**Region: INDIA      Date: 29<sup>th</sup> March 2010      No of Pages: 4**

In recent times there has been lot of hue and cry on the mounting Public debts (liabilities of Governments) world over especially in Europe and the risks associated with it. The deteriorating credit quality of AAA rated sovereign balance sheets especially in countries such as US which was the epicenter of the sub prime crisis, are keeping the global rating agencies on its toes. Moreover in the past the credit rating agencies were subjected to severe criticism for not acting on time during the recent financial crisis. This time they have been quicker in downgrading sovereigns such as Portugal and Greece where the fiscal deficits and public debts were higher and unsustainable.

The focus of the sovereign risk usually lies on the liabilities side of the sovereign balance sheets and how large the liabilities are as compared to the Nominal GDP of the sovereign and whether the sovereigns can cut down the same to sustainable levels. But very few analysts pay attention to the flip side, "the Asset Side" of the sovereign balance sheet, which remains as large and as important as the liabilities side. The asset side though being one of the conjoined twins in a balance sheet is largely ignored. An analysis of a balance sheet will never be conclusive if both the assets and the liabilities side are not analyzed together.

Very often the Sovereign Profit & Loss Statements as well as Balance sheets have similar characteristics like any other corporate such with revenues, expenses (capital and non capital), borrowings, interest etc. And its ability to repay its borrowings drives its sovereign credit rating. Though the sovereign accounting and valuation norms are not standardized world over.

Let's consider Government of India's (henceforth GOI) Sovereign Balance Sheet (Table I & II). The Annual Budget documents have given how the GOI balance sheet (estimates) would look in March 2011. Let's start with the Liabilities side.

**Table I: Government of India: Liabilities (summary) excluding off balance sheet liabilities and guarantees.**

Liabilities	Rs in crs	BE March 2011 Rs in crs	Proportion to Total
<b>1. Public Debt</b>		2,898,799	73%
2. Internal Debt	2,736,754		69%
3. External Debt	162,045		4%
<b>4. Other Liabilities</b> (NSS, SPF etc)		1,045,499	27%
<b>Total</b>		<b>3,944,298</b>	

Source: Budget Documents 2010-11 Estimates.

Note: All figures at Book Value or the Original cost, not accounting for any market related price changes.

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The liabilities side of the GOI balance sheet mainly consists of Public Debt and Other Liabilities. The Public Debt further comprises of Internal and External Debt. Internal Debt is the net accumulated money or credit owed (securities issued) by any level of government, from central to state, to its residents. It's more or less the net cumulative fiscal deficits of a country for the past years. External Debt of a country is defined as the total public and private debt owed only to nonresidents and repayable in their foreign currency, goods or services. The Other liabilities consist of payables by the government against securities issued under various small savings and provident funds schemes, and securities issued to IDBI,UTI, FCI,Oil marketing companies etc. For GOI these other liabilities constitute 27% of the total and public debt at balance 73%.

Let's now go to the flip side of the balance sheet "the Assets side ' (Table II):

**Table II: Government of India: Assets (summary).  
Valued at cost and excluding State Government Assets.**

<b>Assets</b>	<b>Rs in crs</b>	<b>BE March 2011 Rs in crs</b>	<b>Proportion to Total</b>
<b>5. Capital Outlay</b>			
6. General ( including Defence Rs 440,381)	490,022		12%
7. Social	23,457		1%
8. Economic (transport, communications ,energy etc),	462,711	976,190	12%
9. Disbursements to UT		2,485	0%
10. Loans Advanced by Central Govt to State Govt,PSU etc)		725,365	18%
11. MSS Cash Balances		50,000	1%
<b>12. Excess of Liabilities over Capital Outlay, Loans and Advances, MSS</b>		<b>2,190,258</b>	<b>56%</b>
<b>Total</b>		<b>3,944,298</b>	

Source: Budget Documents 2010-11

Note: All figures at Book Value or the Original cost, not accounting for any market related price changes.

The flip side of GOI consists of the assets (capital outlays) created by GOI from the money that is being raised over years. This one of the main functions of any government in the world. Raise revenues from various tax and non tax sources and borrow, if the same fall short vis a vis the expenditure, including the capital outlays, in that year.(Budget deficits). The earned or borrowed money is spent on creating "General, Social and Economic Assets" for the long term interest and welfare of the country and its inhabitants. It's the fundamental & constitutional duty of a government. Many of such capital outlays will have "non profit motives too" such as the General outlay has defense

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assets worth Rs 490,022 crs, which are more important from the national security perspective, though may not yield returns. Similarly the assets created under the Social Services too will have similar objectives of welfare of the country rather than profit motive. Many a times such non profit outlays tend to boost the tax or non tax revenue of governments at a future date in an indirect manner.

The Economic Assets include the cost of physical infrastructure and services that has been created by the GOI to facilitate economic growth and provide basic needs to the citizens of the country. Again the same is a fundamental and constitutional duty of the government. The Economic asset consists of investments made by GOI to create the infrastructure for basic needs such as transport, communication, power and energy development, agriculture etc to name a few. The GOI does expect some positive returns (direct or indirect) from its economic assets in long run.

The central government often advances loans to State governments or holds the special securities issued by states. In turn the states are expected to create productive assets in their own balance sheets and generate revenue. Such state level assets are not reflected in the central governments balance sheet. Very often, if states are inefficient, the state level budget deficits ultimately add to burden of central government. Loans are also advanced to Public sector enterprises.

As it happens in every corporate balance sheet, accumulated losses, if any of all previous years are reflected in the asset side of the balance sheet. The GOI balance sheet is not different. The expected accumulated losses of GOI in March 2011 are Rs 2,190,258 crs, which constitutes around 56% of the total assets. And needless to say, 56% of the total assets of GOI are unproductive from the returns perspective. We can also add the defense assets (Rs 440,381 crs) which are 11% of total assets, to the list of unproductive ones only from the returns perspective. That makes around 67% of the total assets as unproductive. Balance 33% is the only assets on which the GOI has to rely on to cover its interest and other payments, especially when it's running a budget deficit.

On its Liabilities the GOI on average must be paying an interest of around 8% pa as its interest on borrowing. That amount of interest comes to around Rs 315,543 crs in 2010-11. To only pay its interest (and not increase the public debts of the subsequent years), GOI has to earn at least 25% on its productive assets (33% of the total assets) other than accumulated losses and defense ones. If GOI does not earn that 25% pa, public debts will go on increasing and it has to borrow more in subsequent years. Tall Task? And 25% return is only to cover interest and not other expenditure.

Well we do have caveats here. One is that the GOI accounts all it's assets at cost or at investment value. No appreciation or depreciation in the market value is taken into account. So the required rate of return may vary depending on the fact whether the market values have gone up or down in that year. Secondly, the GOI has the hidden treasures which can boost revenues on a one off basis such as divestments etc. Third and the most important is the GOI's ability to raise taxes to generate higher revenues and

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print money to repay its debts, ignoring for the time being the social and economic consequences of the same.

The expected return on assets goes up, when the public debts rise and interest rate expense crowd out the developmental expenditure or the asset creation for enhancing long term growth potential. As per the GOI's Budget Estimates 2010-11, the interest expense is 36% of the gross revenue. The inflexible and unproductive portion of expenditure (interest, defence and subsidies) is 66% of the revenue receipts. And if the required return falls short, (revenue estimates are not met, if growth disappoints) the deficit in the same adds to the public debt in subsequent years, thus raising the bar of returns on investment required in coming years. India needs to improve its expenditure efficiency and have some serious expenditure reforms in order to not fall under the familiar category of an "Overburdened Debt Sovereign".

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