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Financing the pandemic rescue package

The govt. must issue GDP-linked bonds, tap the excess liquidity of PSUs, and monetise non-core assets

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The priority for India is to ensure that it overcomes the COVID-19 pandemic and kick-starts GDP growth rather than fix the weaknesses in the macroeconomy: a high fiscal deficit of 7.49% and government indebtedness that was 69% of GDP in 2019.

When COVID-19 cases began to increase, the Government of India (GoI) swung into action by announcing a 21-day national lockdown and a ₹1.7-lakh crore (approximately $22.59 billion) rescue package. Available in the state disaster relief fund is ₹60,000 crore, comprising ₹30,000 crore of outstanding balance and the Central government's allocation of a similar amount for FY2021. Hence, the GoI needs to raise an additional ₹1.1-lakh crore, i.e., 65% of the rescue package outlay. Its financing strategy should be to raise long-term funds at cost effective rates, with flexible repayment terms that allow it to take tactical advantage of market movements.

Funds that can be tapped

The government can mandate public sector enterprises to transfer their non-core properties to a holding company

Amount as on March 31, 2019 (₹ crore)

Name of the Central PSE	Financial investments	Cash & cash equivalents	Non-operating assets	Statutory payments due
ONGC	33,860	4,106	43,515	5,094
Coal India	2,709	2,276	35,477	6,204
BPCL	6,818	414	17,109	3,881
NTPC	-	244	3,036	501
IOC	32,034	933	36,982	7,681
GAIL	10,626	297	13,544	454
Power Grid	4,858	3,648	16,264	308
Bharat Electronics	834	760	1,850	108
Container Corporation of India	1,172	129	1,475	-
MIDHANI	2	140	200	0
RITES	120	169	1,452	3
SAIL	135	66	1,041	-
BHEL	3	796	7,747	1,311
NMDC	-	46	4,774	154
IRCON International	391	892	3,516	206
Total	**93,562**	**14,914**	**1,87,983**	**25,904**

Source: CPSEs FY2019 annual reports and analyst calculations

GDP-linked bonds

The GoI may issue listed, Indian rupee denominated, 25-year GDP-linked bonds that are callable from, say, the fifth year. The coupon (interest) on a GDP-linked bond is correlated to the GDP growth rate and is subject to a cap. The issuer, the GoI, is liable to pay a lower coupon during years of slower growth and vice-versa. The callable feature from the fifth year till maturity allows the GoI to effect partial repayments during high growth years and when it earns non-recurring revenues such as proceeds from disinvestment of public sector enterprises (PSEs). The listing of bonds provides investors an exit option. Costa Rica, Bulgaria and Bosnia-Herzegovina issued the first pure GDP-linked bonds in the 1990s. Argentina and Greece issued warrant-like instruments similar to GDP-linked bonds in 2005 and 2012 respectively. India could learn from their experience.

Publishing reliable and timely GDP data is a prerequisite for the successful issue of GDP-linked bonds, which the GoI may use to part-finance the COVID-19 rescue package and to diversify its borrowing sources.

Streamlining PSEs

The 15 largest non-financial central PSEs (CPSEs) in the S&P BSE CPSE index contributed approximately 75% of the GoI's ₹48,256.41 crore dividend income from PSEs in FY2020. The Union Budget projected PSE dividends to increase by 36.25% to ₹65,746.96 crore in FY2021. This milestone is unlikely to be achieved in the current environment.

The 15 CPSEs have accumulated sizeable non-core assets including financial investments, loans, cash and bank deposits in excess of their operating requirements, and real estate. The return on these assets (excluding real estate) is around 200 basis points lower than the returns on their core businesses. These CPSEs owe the government ₹25,904 crore as of end-March 2019. These non-core assets must be monetised to repay statutory dues and upstream dividends to GoI.

While loans and excess cash and bank deposits may be monetised within three months, streamlining investments and selling real estate is a time-consuming process. It is imperative for the GoI to form a PSE and public sector bank holding company ('Holdco') along the lines of Singapore's Temasek Holdings and Malaysia's Khazanah Nasional Berhad to enable PSEs to monetise their non-core assets at remunerative prices, maximise their enterprise value and focus on their core businesses.

The ₹30,168 crore loans that CPSEs have extended to employees, vendors and associates may be securitised or refinanced, with CPSEs guaranteeing loans extended to weak counterparties.

It is essential that businesses maintain liquidity, especially during a downturn. However, the outstanding cash and bank deposits of the 15 CPSEs (₹64,253 crore) is in excess of their operating requirements. CPSEs must determine the cash they require to meet, say, six months of operating expenses and use the excess cash to repay statutory dues and upstream dividends to the GoI. Banks must extend to CPSEs committed lines of credit that the latter may draw down during exigencies.

The 15 CPSEs have accumulated ₹93,562 crore financial investments comprising listed and unlisted debt, equity and mutual fund units. These exclude investments in associates and joint ventures. The CPSEs ought to transfer these investments to Holdco, which can manage the portfolio and transfer the returns to the original investors.

One important non-core asset, whose value is likely to exceed the combined value of other non-core assets, is the real estate holdings of PSEs. In September 2018, the GoI identified properties of nine PSEs (Air India, Pawan Hans, Hindustan Fluorocarbons, Hindustan Newsprint, Bharat Pumps & Compressors, Scooters India, Bridge and Roof Co, Hindustan Prefab, and Projects & Development India) to be divested. The GoI must mandate all PSEs and government departments to transfer their non-core properties to Holdco, which can opportunistically sell these properties and transfer the proceeds to the owners.

RBI dividends

The Reserve Bank of India (RBI) has allocated ₹1 lakh crore to carry out long-term repo operations in tranches and has reduced the repo rates by 75 basis points to 4.4% to help banks augment their liquidity in the wake of the pandemic. Recognising the RBI's liquidity requirements, the GoI must refrain from asking the RBI to pay more dividends that it can viably pay. During the five years ending on June 30, 2019, the RBI paid the GoI 100% of its net disposable income, with its FY2019 dividends more than trebling to ₹1.76 lakh crore from ₹50,000 crore in FY2018. The Bimal Jalan panel constituted in 2019 to review the RBI's economic capital framework opined that the RBI may pay interim dividends only under exceptional circumstances and that unrealised gains in the valuation of RBI's assets ought to be used as risk buffers against market risks and may not be paid as dividends.

This sound recommendation must be adhered to in letter and spirit. The GoI may finance the COVID-19 rescue package by issuing GDP-linked bonds, tapping PSEs' excess liquidity and monetising non-core assets. Further, it is in India's self-interest to allow a robust and independent RBI to defend the financial sector's stability.

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