

Net RBI Credit to the Government: A Note*

The purpose of this note is to explain briefly the concept of net Reserve Bank credit to the Government and its constituents, against the backdrop of the recent changes in the method and practice by which the Reserve Bank acquires net claims on Government. The note is divided into two sections: the net RBI credit to the Central Government, which is the major component of the RBI's support to Government fiscal operations and the net RBI credit to State governments.

I. Net RBI Credit to the Centre

The RBI acts as the banker to the Central Government under Sections 20 and 21 of the Reserve Bank of India Act, 1934 (hereafter referred to as the RBI Act). The precise terms and conditions are laid out in agreements between the RBI and the Centre, beginning with the principal agreement signed on April 5, 1935 and subsequent supplemental agreements. According to the agreement between the RBI and the Central Government in January 1955, the Centre would maintain a minimum balance of Rs.50 crore on Fridays and Rs.4 crore on all other working days with the RBI. Until March 31, 1997, if the Government balance fell below the stipulated minimum, the RBI created 91-day *ad hoc* Government of India Treasury Bills at a fixed interest rate (4.6 per cent from July 1974), in its favour in order to replenish the Central Government balances (refer [Box 1](#) of the Bank's Annual Report 1993-94). Such *ad hoc* Treasury Bills could be cancelled prior to maturity if the Centre's cash position improved. The RBI and the Government signed a supplemental agreement on September 9, 1994, setting intra-year and year-end limits to the net issuance of *ad hocs* for the fiscal years 1994-95, 1995-96 and 1996-97 with a view to phasing out *ad hoc* Treasury Bills effective April 1, 1997 (refer [Box I.1](#) of the Bank's Annual Report 1994-95). The RBI and the Centre signed a further supplemental agreement on March 26, 1997 by which the system of *ad hoc* Treasury Bills was discontinued and a new system of Ways and Means Advances (WMA) put in place to provide temporary accommodation to the Central Government (refer [Box I.2](#) of Bank's Annual Report 1996-97). The Centre's minimum balance has been revised to a minimum balance of Rs.100 crore on Fridays and Rs.10 crore on all other working days with the RBI effective April 1, 1999.

Apart from meeting day-to-day liquidity requirements of the Central Government, the RBI also acts as a manager of public debt of the Central Government requiring it to ensure successful floatation of government securities. This function may entail direct absorption of government securities in the RBI's portfolio, keeping in view the demand for government paper and the interest rate situation. The RBI's operations in the government securities market are also motivated by monetary policy operations, resulting in indirect provision of credit to the Government. [Box 1](#) gives details of the content of the RBI's net credit to the Centre.

The net RBI credit to the Centre is compiled on the basis of the RBI's weekly statement of liabilities and assets which provides data on RBI's holdings of Government of India securities (both of Treasury Bills and dated securities), loans and advances to Centre and holdings of rupee coins on the asset side, and deposits of the Central Government with the RBI on the liability side. The net RBI credit to the Centre thus represents gross claims of the RBI on the Central Government comprising loans and advances from the RBI to the Centre, RBI's holdings of Government of India securities and rupee and small coins adjusted for Centre's

Box I: Variations in the Reserve Bank's Net Claims on the Central Government

Net Change in Net RBI Credit to the Centre (I+II+III+IV-V)

I. Net Change in Loans and Advances to the Central Government (Ways and Means Advances)

II. Net Change in Treasury Bills held by the RBI (1-2)

1. Increase in RBI's holdings of Treasury Bills (a+b)
 - a) RBI's subscriptions to Treasury Bill auctions
 - b) Reverse Repos/ second leg of Repo transactions
2. Decrease in RBI's holdings of Treasury Bills (a+b+c)
 - a) Maturity of Treasury Bills held with the RBI
 - b) RBI's open market sales of Treasury Bills
 - c) Repos/ second leg of Reverse Repo transactions

III. Net Change in RBI's holdings of dated Government Securities (1-2)

1. Increase in RBI's holding of dated Government Securities (a+b+c+d+e+f)
 - a) Private placements with the RBI
 - b) Devolvments in auctions
 - c) Reverse Repos/ second leg of Repo transactions
 - d) Open Market Operation (OMO) Purchases
 - e) Issue of Special Securities
 - f) Special arrangements for disinvestment of Central Government securities by Central Government and others to meet cash deficit
2. Decrease in RBI's holding of dated Government Securities (a+b+c+d)
 - a) Redemption of Central Government Securities held with the RBI
 - b) Open Market Operation (OMO) Sales
 - c) Repos/ second leg of Reverse Repo transactions
 - d) Special arrangements for investment of surplus in Central Government securities by Central Government and others

IV. Net Change in RBI's holdings of Rupee Coins

V. Net Change in Central Government Deposits with the RBI

deposits with the RBI. The data on holding of government securities as given in the balance sheet is reckoned on a net basis, which takes into account the increase in holdings of Treasury Bills and government securities adjusted for decrease in such holding, that arise as a result of transactions between the Government and the Reserve Bank. Such data for the period 1994-95 to 1998-99 are given in [Table 1](#).

TABLE 1 : VARIATIONS IN NET RESERVE BANK CREDIT TO THE GOVERNMENT

(Rupees crore)

Variations in	1998-99	1997-98	1996-97	1995-96	1994-95
1	2	3	4	5	6
I. Net RBI Credit to the Government (II+III)	17,379	10,979	2,832	19,871	2,178
	(12.9)	(8.8)	(2.3)	(19.6)	(2.2)
II. Net RBI Credit to the Centre (II.1+II.2+II.3+II.4-II.5)	11,800	12,914	1,934	19,855	2,131
	(8.8)	(10.7)	(1.6)	(20.1)	(2.2)
II.1 Loans and Advances to the Centre +	1,042	2,000	0	0	0
II.2 Treasury Bills held by RBI (II.2.1+II.2.2+II.2.3)	148	- 44,026	10,086	9,601	785
II.2.1 <i>Ad hoc</i> Treasury Bills		- 33,738	4,631	5,896	1,730
II.2.2 Discounted Treasury Bills		- 9,464	7,126	659	- 418
II.2.3 Auction Treasury Bills	148	- 824	- 1,671	3,045	- 527
II.3 RBI's holdings of Dated Securities @	10,817	55,666 £	- 8,607	11,782	42
II.3.1 Central Government Securities	10,817	24,843 \$	- 8,620	11,782	42
II.4 RBI 's holdings of Rupee Coins	42	- 118	28	- 2	91
II.5 Central Government Deposits with the RBI	248	608	- 428	1,526	- 1,213
III. Net RBI Credit to State Governments (III.1-III.2)	5,579	- 1,936	898	16	47
	(361.5)	(- 55.6)	(34.8)	(0.6)	(1.9)
III.1 Loans and Advances to State Governments	5,579	- 1,936	898	16	47
III.2 State Governments' Deposits with the RBI	0	0	0	0	0

Memo Items :

1. Market Borrowings of Dated Securities by the Centre *#	83,753	43,390	27,911	38,634	21,250
2. RBI's subscription to fresh dated securities *	38,205	13,028	3,698	12,655	157
3. Repos (-) / Reverse Repos (+) *	395	2,442	- 1,424	99	815
4. Open Market Sales *	26,348	7,614	10,464	583	748

* At face value. # Excludes Treasury Bills.

+ Also known as Ways and Means Advances.

@ Represent change in holdings through direct devolvments, private placements, reverse repo and repo operations, open market operations, maturities and special securities.

£ Includes Special Securities 1997 worth Rs.50,818 crore created on conversion of *ad hoc* and tap Treasury Bills outstanding as on Mach 31, 1997.

\$ Includes special securities worth Rs.20,000 crore converted into marketable securities.

Parenthetic figures constitute percentage variations over previous year.

1. *Ways and Means Advances*

The practice of providing temporary accommodation to the Central Government through WMA from the RBI had been prevalent till 1942-43. It was replaced by the system of *ad hoc* Treasury Bills in 1955. This system was subsequently discontinued and a new provision of WMA was put in place since April 1, 1997.

Under the present dispensation, the RBI provides the Central Government WMA as and when the deposits of the Central Government fall below the agreed minimum balance, subject to mutually agreed limits for the first and the second half of the fiscal year on outstanding WMA. Any drawal beyond the limit is taken to be overdraft which, effective April 1, 1999, is allowed up to ten consecutive working days. If the Central Government balances with the RBI exceed the minimum balance, such WMA are retired. Surplus balances over and above the minimum level, after liquidating the WMA, are invested in Central Government's securities purchased from the RBI, so as to provide a means by which such balances could be remuneratively deployed. Whenever Central Government balances again fall below the minimum, the securities are transferred back to the RBI's account, and the rupee value is credited to the Central Government account with the RBI.

2. *Treasury Bills*

Treasury Bills are the main instrument of short-term borrowing by the Central Government and also serve as a convenient gilt-edged security for the money market. Treasury Bills, of varying maturities, are sold by the RBI, as the agent of the Central Government, at a discount. Treasury Bills could be sold in two ways: *viz.*, by allotment to the highest bidder at an auction (*i.e.*, by tender) or at a pre-announced discount rate (*i.e.*, on tap).

The auction of Treasury Bills was discontinued in July 1965 but revived with the auction of 182-day Treasury Bills in November 1986. The RBI, at present, auctions Treasury Bills of varying maturities, *viz.*, 14-day, 91-day, 182-day and 364-day. The Reserve Bank used to sell 91-day Treasury Bills on tap and at the same time provide re-discounting facilities to facilitate short-term cash management of banks and other eligible parties. In view of the need for developing a short-term money market and with the abolition of *ad hocs*, the 91-day tap Treasury Bills lost their relevance. Accordingly, these Bills were discontinued effective April 1, 1997.

The RBI which used to hold 91-day Treasury Bills in its portfolio in the form of i) *ad hocs*, ii) tap Treasury Bills re-discounted with it and iii) 91-day auction Treasury Bills which had devolved on it, at present holds 14-day, 182-day and 364-day auction Treasury Bills since the introduction of notified amounts in such Treasury Bill auctions (effective April 1, 1998 in case of the 14-day and 364-day Treasury Bill auctions). The net RBI credit to the Central Government on account of Treasury Bills is measured by holding of all types of Treasury Bills at book value.

3. *Dated Securities*

The RBI is authorised to engage in the purchase and sale of government securities under Section 17(8) of the RBI Act. The RBI as a part of its day-to-day monetary policy operations as also for funding the Government borrowing programme may acquire marketable dated Central Government securities in the primary market through direct devolvments and private placements and in the secondary market through reverse repo operations with eligible parties and open market purchases. The RBI can sell such securities through repo operations with eligible parties and open market sales. The RBI also has certain special arrangements with the Central Government, by which the Centre's day-to-day cash surplus can be invested in government securities from the RBI portfolio and can be returned when the cash position falls below the stipulated minimum.

Repos refer to the sale of dated Government securities by the RBI for very short periods with a confirmed buy-back provision. Reverse repos are the mirror image of repos. The RBI conducts repo operations with banks and other eligible parties and reverse repo operations with primary dealers and other eligible parties in order to maintain orderly conditions in the domestic money market since December 1992. The contractual period has varied in case of repos from three/four days to a 14-day cycle. There is no legal definition of repos as a composite instrument. From the angle of accounting, the RBI treats repos as sell/buy and reverse repos as buy/sell transactions. Although certain countries treat repos as collateralised borrowing, the RBI does not do so as it cannot borrow any amount in excess of its paid up capital of Rs. 5 crore under the law.

Apart from these, the RBI's portfolio also consists of non-transferable undated special securities which were issued earlier by way of conversion of outstanding *ad hoc* and tap Treasury Bills. Conversion of Treasury Bills into special securities by its very nature implies change in the composition of the RBI's portfolio and hence, has no net impact on the net RBI credit to the Centre except the valuation factor that arises since Treasury Bills are marked at discount basis in the RBI's books, whereas special securities being non-marketable annuities are marked at face value. Special securities worth Rs.20,000 crore have been converted into marketable Central Government dated securities during 1997-98.

4. *Rupee Coins and Small Coins*

The RBI is the sole agent of the Central Government in the distribution, issue and handling of rupee and small coins, which are liability of the Central Government under Section 38 of the RBI Act. Rupee coins are held in the Issue Department as eligible assets at face value against issuance of notes under Section 33 of the RBI Act. The RBI holds rupee and small coins against credit to Government account in the Banking Department.

5. *Deposits*

The above four items (1 to 4) constitute gross claims of the RBI on the Central Government. The Centre's deposits is netted out from the gross claims in order to arrive at net RBI credit to the Centre. As the banker to the Centre, all cash deposits of the Central Government are maintained with the RBI, free of interest.

Valuation Issues

The RBI's investments in government securities are taken at book value in the calculation of the net RBI credit to the Central Government. The RBI's investments in rupee securities were initially valued at the end of the RBI's accounting year (July-June). Since 1996-97, rupee securities are valued at the end of each month. Rupee securities are valued at the lower of the book value or the market value or rates based on the yield curve prevailing on the last business day of the month, where market value for such securities are not available. Such depreciation is adjusted against current income in the Interest Income on Investments (Rupee Securities) Account, which is a part of the RBI's net non-monetary liabilities and therefore, has no monetary impact.

Net RBI Credit to States

State governments entrust their banking business to the RBI by voluntarily entering into agreements under Section 21A of the RBI Act. As of now, twenty three States have entered into such agreements with the RBI, while two States, *viz.*, Jammu and Kashmir and Sikkim, have agreements with the RBI only for the limited purpose of managing their public debt.

The net RBI credit to States is the sum of the RBI's loans and advances to State governments, net of their deposits with the RBI. The RBI's loans and advances to States may take the form of either WMA or overdrafts. The RBI may provide WMA to State governments banking with it to help meet temporary mis-matches in their cash flows under Section 17(5) of the RBI Act. WMA may be of two types, *viz.*, i) normal WMA which are clean advances and ii) special WMA, which are secured advances provided against pledge of Central Government dated securities. The limits for normal and special WMA were linked to the cash balances maintained by the State with the RBI. The Informal Advisory Committee on Ways and Means Advances (Chairman: Shri B.P.R. Vithal), constituted by the RBI, has rationalised the WMA scheme in respect of State Governments. Based on the recommendations of the Committee, the WMA limits have been revised effective March 1, 1999. The revised normal WMA limits have been delinked from the minimum cash balance and are now based on the three-year average of revenue receipts plus capital expenditure. States would be provided special WMA against their actual holdings of Central Government securities. States may draw overdrafts up to ten consecutive days within limits linked to the normal WMA limit. The minimum balances to be maintained by the States have been revised upwards linking them to the volume of budgetary transactions as in case of normal WMA (refer [Box IV.2](#) of the Bank's Annual Report, 1998-99).

It may be indicated that the RBI acts as the agent of the investment of the States' surplus funds. Surplus cash balances of State governments are automatically invested in 14-day intermediate Treasury Bills. In addition, States are free to participate in 14-day and 91-day Treasury Bill auctions as non-competitive bidders for investment of their durable surplus. With effect from

May 7, 1999, the State governments were allowed to avail of special WMA against the collateral of their investments in Treasury Bills in addition to their holdings in government dated securities. It may be noted that States' investments in such Treasury Bills have implications for the Centre's recourse to the RBI.

Appendix Table : Net RBI Credit to the Government: A Summary Account

No.	Account Head	Sub Account	Selected Remarks
1	2	3	4
I.	Net RBI Credit to the Government (II+III)		The RBI used to publish data on net RBI credit to the Government till the second Working Group on Money Supply (1978) split the RBI's net claims on the Government in respect of the Central and State Governments.
II.	Net RBI Credit to the Centre (II.1+II.2+II.3-II.4)		
II.1.	Loans and Advances to the Centre		The RBI is authorised to make Ways and Means Advances (WMA) to the Central Government under section 17(5) of the RBI Act, which are repayable within three months from the date of the advance. Such WMA have been provided till 1942-43 and thereafter from April 1, 1997. While there are no statutory provisions regarding the maximum amount and rate of interest, these are fixed in consultation with the Government of India.
II.2.	Investments in Government Securities (II.2.1+II.2.2)		The RBI is authorised to engage in the purchase and sale of government securities under Section 17(8) of the RBI Act. Such securities are eligible assets against issuance of currency under Section 33 of the RBI Act.
II.2.1	Investments in Treasury Bills (II.2.1.1+II.2.1.2+II.2.1.3)		

II.2.1.1	<i>Ad hoc</i> Treasury Bills	<i>Ad hoc</i> Treasury Bills were issued as and when the Central Government account with the RBI fell below the minimum balance. These bills were held in the Issue Department and cancelled when the balance returned to the minimum level. The Central Government funded <i>ad hocs</i> into marketable dated Government securities since 1958-59 and into non-transferable special securities beginning 1981- 82 in order to avoid problems of roll-over of floating debt. <i>Ad hocs</i> were phased out effective April 1, 1997.
II.2.1.2	Discounted Treasury Bills	The RBI used to issue 91-day Treasury Bills at a discount rate, on tap, as agent of the Central Government. The tap Treasury Bills could be re-discounted with the RBI at any time before maturity upon terms and conditions determined by it from time to time. Sale of such tap Treasury Bills was discontinued effective April 1, 1997.
II.2.1.3	Auction Treasury Bills	Treasury Bills auctions were discontinued in July 1965 and revived in November 1986. The RBI's subscription to such Treasury Bills provides accommodation to the Central Government. The RBI also sells such Treasury Bills in the secondary market. Treasury Bills may also be used as repos.

No.	Account Head	Sub Account	Selected Remarks
1	2	3	4

II.2.2 Investments in Long-term Government Securities
(II.2.2.1+II.2.2.2+ II.2.2.3)

II.2.2.1 Special Securities *Ad hoc* Treasury Bills have been periodically funded into non-transferable special securities without any fixed maturity in favour of the RBI from 1981-82 onwards. *Ad hoc* Treasury Bills outstanding as on March 31, 1997 were funded into Special Securities 1997 on April 1, 1997. Tap Treasury Bills outstanding as on March 31, 1997 were also funded into Special securities 1997 on maturity. Special Securities worth Rs.20,000 crore were converted into marketable securities in four *tranches* of Rs.5,000 crore, each in 1997-98.

II.2.2.2 Marketable Central Government Securities
(II.2.2.2.1+ II.2.2.2.2 - II.2.2.2.3+II.2.2.2.4 +II.2.2.2.5)

II.2.2.2.1 RBI sub- scription to New Loans The RBI subscribes to new loans floated by the Central Government in the form of either devolvments in auctions or private placements. As noted above, special securities may also be converted into marketable securities.

II.2.2.2.2 Operations under special arrangements The RBI has special arrangements with i) the Central Government and ii) the Welfare Commissioner, Bhopal Gas Victims, New Delhi.

If the Central Government's deposits with the RBI exceed the minimum balance, after vacating WMA, this surplus is invested in Central Government securities purchased from the RBI since such surplus, if parked in the deposit account with the RBI, would not earn any interest.

Monies not immediately required for settlement of the claims of the Bhopal gas victims are invested in Government securities purchased from the RBI with buy-back arrangements under which such securities can be sold back to the RBI at the selling price.

II.2.2.2.3 Repos The RBI conducts ready forward transactions (repos) with banks and other eligible parties. The repo securities are transferred to the party's books for the repo period and thereby reduce the monetised deficit.

II.2.2.2.4 Reverse Repos The RBI conducts reverse ready forward transactions (repos) with primary dealers and other eligible parties. The reverse repo securities are transferred to the RBI's books for the reverse repo period and thereby increase the monetised deficit.

No.	Account Head	Sub Account	Selected Remarks
1	2	3	4
	II.2.2.2.5	Open Market Operations (OMO)	The RBI purchases and sells dated government securities in the secondary market for the purpose of OMO. OMO purchases/sales increase/decrease the Centre's monetised deficit.

II.2.2.3	Other dated securities	<p>Include i) special non-negotiable non-interest bearing Rupee securities, incurred on account of Reserve Asset subscription to the IMF towards the quota increases, ii) Gold Bonds 1998 and iii) special securities to be created in the event of Government contributions to the Resurgent India Bonds (RIBs) Maintenance of Value (MoV) Account. Since the RIBs MoV Account will be part of the RBI's net non-monetary liabilities, such securities will not have any monetary impact. Certain dated securities such as IBRD shares, Commonwealth bonds, <i>etc.</i> which were part of the RBI's claims on the Government were re-classified as part of foreign assets by the second Working Group on Money Supply.</p>
II.3	RBI's holding of Rupee Coin	<p>Rupee coins are held in the Issue department as eligible assets against issuance of notes under Section 33 of the RBI Act. The RBI may also hold Rupee coins and small coins against credit to Government account in the Banking Department as till money.</p>
II.4	Centre's Deposits with the RBI	<p>The Central Government deposits all its cash balances with the RBI, free of interest. The minimum balance to be maintained was revised from Rs.50 crore to Rs.100 crore on Fridays and Rs.4 crore to Rs.10 crore on working days effective fiscal 1999-2000.</p>

III. Net RBI Credit to State Governments

(III.1-III.2)

III.1	Loans and Advances to State governments (III.1.1+III.1.2+III.1.3)
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III.1.1	Normal WMA	The RBI provides WMA to States under Section 17(5) of the RBI Act. Normal WMA is linked to the three-year average of revenue receipts plus capital expenditure. Special WMA is provided against States' holding of Government securities.
III.1.2	Special WMA	
III.1.3	Overdrafts	States may draw overdrafts up to ten consecutive days within limits linked to normal WMA limits.
III.2	Deposits of State governments with the RBI	Minimum cash balances are linked to the volume of budgetary transactions.
