# Chapter 2
# Existing System of Ways and Means Advances, Overdraft and Investment of Surplus Fund

**Agreements with States : Main Provisions**

2.1 A State entrusts its banking business to the RBI by voluntarily entering into an agreement under Section 21A of the Reserve Bank of India Act, 1934**.** Twenty-three States entered in to such agreements with the RBI to undertake general banking business in India, including payments, receipts, collection, remittance of money, management of public debt and issue of new loans. Two States – Jammu & Kashmir and Sikkim – have agreements with the RBI only for the limited purpose of managing their public debt. The RBI is not entitled to any remuneration for the conduct of ordinary banking business other than the advantages which may accrue to it from the holding of their cash balances free of obligation to pay interest thereon. Maintenance of such interest-free balances are subject to periodic agreements between the States and the RBI. The RBI advises the States about their daily cash balance at the close of each working day.

**Ways and Means Advances**

2.2 Under Section 17(5) of RBI Act, 1934**,** the RBI provides Ways and Means Advances (WMA) to the States banking with it to help them to tide over temporary mismatches in the cash flow of their receipts and payments. Such advances, are under the Act, "..repayable in each case not later than three months from the date of making that advance". There are two types of WMA – normal and special. While normal WMA are clean advances, special WMA are secured advances provided against the pledge of Government of India dated securities. The operative limit for special WMA for a State is subject to its holdings of Central Government dated securities upto a maximum of limit sanctioned. In addition, the RBI has determined limits for normal and special WMA for each State as multiples of the prescribed minimum balance required to be maintained with the RBI by that State. These limits have been revised periodically. The present limits, effective from August 1, 1996 and presented in ***Table 2.1***, work out to an aggregate of Rs.3,085.60 crore – Rs.2,234.40 crore (normal WMA) and Rs.851.20 crore (special WMA). At the time of the last revision in 1996, the ceilings for normal and special WMA were fixed at 168 times and 64 times of the minimum balance of Rs.13.30 crore, respectively.

2.3 The minimum balances and limits for WMA (at amounts equal to their respective minimum balances) of States were fixed for the first time on April 1, 1937. The limits were fixed on the basis of the ratio of their total revenue and expenditure to the corresponding total of the Centre prior to the introduction of provincial autonomy. The limits became effective from April 1, 1938, when the then provincial Governments became responsible for managing their own ways and means position. After the formation of the Part B States, in 1953, the minimum balances were revised in line with the growth in revenue receipts and expenditure in the intervening period. In the same year, the WMA limits were liberalised to twice the revised balances, and a special WMA facility against the pledge of Central Government securities was introduced for the first time. The special WMA was subject to a uniform Rs. 2 crore limit for each State. After 1953, in the two successive revisions in 1967 and 1972, the minimum balances were revised upwards as a multiple of the minimum balances fixed in 1953 and the WMA limits were liberalised by increasing the multiples of the revised minimum balances. From 1976 onwards, the minimum balances were not changed but the WMA limits were increased by increasing the multiple in successive revisions as indicated in ***Table 2.2.*** A brief account of the revisions in WMA limits since 1937 is set out in ***Annexure 2.1***.

**Overdraft Regulation Scheme**

2.4 Any amount drawn by a State in excess of WMA is an overdraft. As per the Overdraft Regulation Scheme, in force from October 2, 1985, no State was allowed to run an overdraft with the RBI for more than seven continuous working days. In case an overdraft appeared in the State's account and remained beyond seven continuous working days, the RBI and its agencies stopped payments on behalf of the State. On a further review of the Overdraft Regulation Scheme in 1993, the time limit for clearance of overdraft was increased from seven consecutive working days to ten consecutive working days with effect from November 1, 1993. This position continues.

2.5 At the instance of Governments of Assam and Manipur, RBI has agreed to a ceiling on their overdrafts at Rs.252 crore and Rs.10 crore, respectively. If this ceiling is exceeded even within a time frame of ten consecutive working days as stipulated under the Overdraft Regulation Scheme, the RBI suspends payments on behalf of these State Governments.

**Monitoring of WMA Overdrafts and Enforcement of Stoppage of Payments**

2.6 The position of WMA actually utilised and overdrafts of various States is closely monitored in the Internal Debt Management Cell (IDM Cell), RBI, on a daily basis on receipt of the position from Central Accounts Section (CAS), RBI, Nagpur. When a State avails of WMA in excess of ***75 per cent*** of the aggregate limit (aggregate = normal ***plus*** operative limit for special WMA), the State is cautioned to take remedial measures to avoid emergence of overdraft in its account. Whenever a State, after availing of normal and special WMA, emerges in overdraft, the IDM Cell conveys, by facsimile message, the position of its overdraft to the concerned State on a daily basis, with a request to clear it within a period not exceeding ten consecutive working days. If the account of a State continues to be overdrawn on the eleventh continuous working day, the RBI suspends payments on behalf of the State until the overdraft is cleared.

**Interest Rate on WMA and Overdrafts**

2.7 The interest rate charged on WMA and overdrafts at present are the Bank Rate (9 per cent) and the Bank Rate plus two percentage points (11 per cent), respectively.

**Surplus Investments**

2.8 The RBI acts as the sole agent for investment of the State's surplus funds. Surplus cash balance of a State beyond a level indicated by it is automatically invested in 14-day intermediate Treasury bills, on which, the rate of interest at present is 6 per cent. The States are also free to participate in 14-day and 91-day Treasury bills auctions as non-competitive bidders for investment of their durable surplus.