Chapter 3
Analysis of the Trends in WMA and Overdrafts

Growing fiscal stress

3.1 The use of WMA facility and emergence of overdrafts by States have become more frequent over time reflecting a persistent stress on liquidity management and the underlying structural imbalances in their finances. The continuing problems in the budgetary operations of the State Governments for 1998-99 have been described in the RBI Annual Report for 1997-98 (Paragraph 4.23, PP 63-66) as follows:

> "A preliminary analysis of the consolidated budgetary position of twenty three State Governments reveals a rise in almost all the major deficit indicators. The deterioration in the State finances emanates from a lower growth of 14.6 per cent in revenue receipts in 1998-99 than that of 16.8 per cent in the previous year, and a sharp rise of 16.2 per cent in revenue expenditure on top of an increase of 17.4 per cent in 1997-98. As a consequence, there would be a marked rise in the revenue deficit to Rs.24,861 crore (1.5 per cent of GDP) in 1998-99 from Rs.19,053 crore (1.3 per cent of GDP) in the previous year. The widening of the revenue deficit would, in turn, cause the gross fiscal deficit (GFD) to go up sharply to Rs.56,660 crore (3.5 per cent of GDP) in 1998-99 from Rs.49,708 crore (3.5 per cent of GDP) in 1997-98……. The sharp rise in revenue expenditure in 1998-99 would be mainly on account of the additional burden emanating from the implementation of the Fifth Pay Commission awards and the rising interest burden." (***Table 3.1***).

3.2 During 1997-98, as set out in ***Table 3.2*** and ***Chart 3.1***, of the ***sixteen*** States that resorted to overdrafts, there were ***ten*** States which frequently resorted to overdrafts. Out of these ***ten*** States, ***five*** (Assam, Himachal Pradesh, Manipur, Mizoram and Nagaland) belonged to the special category, while the other five (Andhra Pradesh, Madhya Pradesh, Orissa, Punjab and Rajasthan) were in non-special category States. In three States (Assam, Manipur and Mizoram), payments were stopped as they could not clear their overdrafts with the RBI within the stipulated time limit of ten consecutive working days. The problem was quite severe in Assam, with payments being stopped on as many as eight occasions.

3.3 During the first seven months (April-October) of 1998-99, ***sixteen*** State Governments were in overdrafts with ***ten*** States taking frequent recourse (***Table 3.3*** and ***Chart 3.2***). Of these ten, five (Assam, Himachal Pradesh Manipur, Mizoram and Tripura) belonged to the special category and five (Andhra Pradesh, Madhya Pradesh, Orissa, Punjab, and Uttar Pradesh) were in the non-special category. In four States (Assam, Manipur, Mizoram and Nagaland), payments were stopped as they could not clear their overdrafts with the RBI within the stipulated time limit of ten consecutive working days.

3.4 The average levels of normal WMA, special WMA and overdraft availed by the States during fiscal 1997-98 are presented in ***Table 3.4 through 3.6*** and for the fiscal 1998-99 are set out in ***Table 3.7 through 3.9***. The peak levels are given for 1997-98 and 1998-99 in ***Tables 3.10***

and 3.11, respectively. A summary analysis of these tables indicates that during 1997-98, the peak level, on an average, was Rs.1,207 crore with variations of the peak between Rs.289 crore in June and Rs.2,337 in April. The peak level increased in the first seven months of 1998-99, with the peak varying between Rs.536 crore in May and Rs.2.660 crore in October and the average considerably higher at Rs.1,675 crore. State-wise position of permitted WMA limit ***vis-a-vis*** maximum WMA and overdraft availed during 1997-98 and 1998-99 (April-October) is set out in ***Chart 3.3*** and **3.4**, respectively. Similar information in percentage terms is set out in ***Chart 3.5*** and ***3.6***, respectively.

3.5 Under the existing system of WMA and overdrafts, there is no requirement to vacate the WMA drawn/overdrafts at the end of the financial year. This has encouraged some States to use WMA and overdrafts as a resource and has also led to difficulties in distinguishing between a temporary mismatch between cash receipts and cash expenditure and a manifestation of the underlying structural deficit. In the above context, the amounts held by the States in the public account also assumes critical importance. It is pertinent to note that the States receive public account funds in a role as a banker. It is, therefore, important that these funds are not used for financing a fiscal deficit. The public account funds do, however, provide a cushion to tide over temporary liquidity mismatches.

Liquidity mismatch *vis-a-vis* the underlying structural deficit

3.6 A liquidity mismatch is by definition an ***ex ante*** concept and hence, difficult to estimate. A Government can only spend as much cash as it has. Thus, even when the ***desired*** expenditure is in excess of the available funds, the observed outflow will only be equal to the cash revenues, including loan proceeds. In the WMA context, when a State is not in overdraft and has fully utilised its WMA limit, the mismatch between inflows and outflows will appear to equal the WMA limit, but this does not indicate that the ***true*** mismatch was exactly equal to the limit. The observed mismatches are not, therefore, the indicators of true mismatches.

3.7 Cash flow problems are inevitable in day-to-day budgetary transactions. States without any deficit can and do face liquidity problems during the year. However, in the case of States with deficits, the problems get aggravated because it is difficult to distinguish between a genuine temporary mismatch and a mismatch arising out of a deficit. A deficit implies that receipts falls short of expenditure at the end of the year. More often than not, this year-end shortfall reveals itself during the course of the year.

3.8 If a State has shown in its Budget a year ending revenue deficit, this has to be covered by borrowings so that there is no overall budgetary deficit. States like the special category ones have a revenue surplus arising out of the fact that 85-90 percent of Central Assistance is by way of grants. Yet, both types of States have run into overdrafts. Furthermore, with borrowings financing revenue deficits, no distinction remains between revenue and capital receipts. With no capital asset generating income even to meet its interest liability, the distinction between revenue and capital expenditure has also disappeared. In such a situation the States have become insensitive to the costs of overdrafts. When a State remains in overdraft for such long periods as 200 days in a year, WMA becomes a resource and the overdraft becomes the WMA. The only difference is that the constraint is no longer a financial limit but a time limit. The peak level is no longer determined as a financial limit that can be brought down within the WMA limit within ten consecutive working days. The WMA, which was expected to be the safety net to bridge the gulf between the timing of receipts and payments becomes the safety net between two spells of overdrafts. The crux of the matter is, therefore, not WMA, but the elimination of overdrafts. With the progressive deterioration in the fiscal balances of States over the years, there is a concern that the WMA limit, which is to meet temporary liquidity mismatches, is being used as a resource. This problem gets exacerbated by the growing differences between the Budget Estimates, Revised Estimates and Accounts in the Budget.

3.9 After considerable deliberations, the Committee came to the conclusion that in a situation of pervasive deficit problem, the identification of true mismatches, as distinct from the underlying deficit problem, is one without any easy solutions. Furthermore, given the important role played by the WMA limits and overdraft regulation in the enforcement of a hard budget constraint, the optimum solution is to assume a less than proportionate growth in the mismatches relative to some suitable measure of transactions volumes.

Asymmetry between Central and State Governments

3.10 The problem of liquidity management of the Centre and State is similar. Both of them maintain minimum balances with the RBI and avail of WMA from the RBI to tide over the mismatches between their receipts and expenditure. The State Finance Secretaries pointed out that there are two important asymmetries in the system of minimum balances, WMA and overdrafts operated by the RBI with Centre on the one hand and the States on the other. First, until March 1997, RBI did not have any formalised system of WMA for the Centre. The issue of ***ad hoc*** treasury bills and their placement with the RBI automatically made up any shortfall in the Centre's minimum balance although limits were placed on net creation of ***ad hocs*** during the fiscal years 1994-95 through 1996-97. This asymmetry has ended with the discontinuation of the ***ad hoc*** treasury bills from March 1997 and the announcement of specific WMA limits for the Centre for the two halves of the fiscal year. Second, the WMA limits for the Centre are higher than those for the States taken together although the size of their budgets are roughly the same.

3.11 A straightforward comparison of the WMA of the Centre and the States, however, can be misleading. Almost as much as forty per cent of total Central Government revenues are passed on to the States as shared revenues, grants and loans through devolution and transfers under the dispensations of the Finance and the Planning Commissions. Furthermore, the Central Government also provides ***ad hoc*** grants as well as temporary WMA to States. The nature of transactions of the Centre are not exactly similar to those of States. Therefore, a complete similarity of treatment is not possible.

3.12 The Committee would, however, like to emphasise that given the undeniable fact that the Centre has greater scope for managing its liquidity problem, it should be in a position to set an example to the States. Furthermore, it is understood that RBI is considering a proposal to further lower the WMA limits and have Overdraft Regulation Scheme for the Centre which is more or less similar to the existing one for States, thus, removing the anomaly between the two. The Committee commends this for early implementation.

Limiting overdrafts

3.13 The problem of unauthorised overdrafts has gradually worsened over time. During 1997-98, as many as sixteen States got into such overdrawn position, and the average peak level of overdraft alone was Rs.474 crores. In the current year upto October 1998, the same number of States, i.e. sixteen, were overdrawn and the average peak level was Rs. 784 crore.

3.14 The WMA itself is an overdraft facility designed to help the States to tide over temporary mismatch as between revenues and expenditures. With the objective of freeing States which were prudent, from the problems of overdrafts WMA limits were repeatedly enhanced in the past. But, the problem of overdrafts has persisted. The success achieved has been limited on account of deterioration in the State finances and worsening financial management. A mere revision of WMA limits alone, therefore, is no remedy to the problem of overdrafts. With effect from November 1, 1993, the increase in time limit for clearing overdrafts from seven to ten working days as against fourteen days recommended by the Sarkaria Commission was granted to allow for delays in reporting transactions and arrange for funds for clearing overdrafts. This, however, resulted in some States being encouraged to remain in overdrafts for longer period. In this context what is required are improvements in the information system, smooth release of Central assistance to States and enhanced efficiency of the banking and payments system. Furthermore, what is of paramount importance is that the States ensure good financial management and discipline.

Monetary implications of WMA and overdrafts to States

3.15 It is important to recognise that enhancement of WMA limits increases the potential for their utilisation. Furthermore, utilisation of WMA – both normal and special – and overdrafts has monetary implications. WMA and overdrafts represent RBI credit to Governments. Even the special WMA, where the RBI provides money to States against their holdings of Central Government securities, signifies an inter-Government loan which gets replaced by RBI credit. WMA or overdraft should only provide ***intra-year*** liquidity support without making any resources available for financing a deficit at the end of the year. Nevertheless, Committee would like to underscore that the average level of the money stock or reserve money has its impact on prices and output in an economy, and persistent use of WMA or overdrafts during the year has a monetary impact.

3.16 In the above context, it may, however, be observed that all the States combined together have not contributed much to monetary expansion in the economy. According to the available information, at end-March 1998, RBI credit to Government (both Central and States) amounted to Rs.1,35,160 crore with credit to Central Government at Rs.1,33,617 crore and States accounted for only the residual Rs.1,543 crore. The latest data indicate that net RBI credit to States as on October 30, 1998 amounted to Rs.766 crore. Furthermore, during the past five years, the monetised deficit (i.e. loans given to the States by the RBI net of their deposits with RBI) of States has varied between Rs.16 crore (1995-96) and Rs.898 crore (1996-97). In aggregate the States did not have any monetised deficit in 1997-98.