XI PUBLIC DEBT MANAGEMENT

11.1 Under the market borrowing programme for 2001-02, the Central Government mobilised a gross amount of Rs.1,33,801 crore as against the budget estimate of Rs.1,18,852 crore. Net of repayments, the borrowings amounted to Rs.92,302 crore as against the budget estimate of Rs.77,353 crore. The gross and net borrowings through dated securities amounted to Rs.1,14,213 crore and Rs.87,714 crore, respectively, while Rs.19,588 crore (gross) and Rs.4,588 crore (net) were raised through 364-day Treasury Bills. The gross and net market borrowings of the State Governments amounted to Rs.18,707 crore and Rs.17,261 crore in 2001-02 as compared with Rs.13,300 crore and Rs.12,880 crore in the previous year, respectively.

11.2 Comfortable liquidity conditions, low inflation rate and low credit off-take facilitated smooth completion of the market borrowing programme in an environment of falling yields. In case of States, the increase in the borrowing needs rendered the completion of the market borrowing programme difficult but it could be managed satisfactorily. Debt management continued to combine private placement of debt with the Reserve Bank and open market operation (OMO) sales to modulate the timing of new issues and market liquidity over the year. The weighted average cost of primary issuance of Government of India dated securities declined from 10.95 per cent in 2000-01 to 9.44 per cent during 2001-02 (Charts XI.1).

11.3 Notable developments in the framework of debt management included the reintroduction of floating rate bonds after nearly 7 years, the introduction of a scheme of non-competitive bidding up to 5 per cent of the notified amount for retail and mid-segment investors, increasing the notified amount of 364-day Treasury Bills from Rs. 750 crore to Rs. 1,000 crore every fortnight and the announcement of a calendar for the core component of Government of India dated securities for the first half of fiscal 2002-03. Other important landmarks in the evolution of government securities market during the year were the operationalisation of the first phase of the Negotiated Dealing System (NDS) and the establishment of Clearing Corporation of India Limited (CCIL).

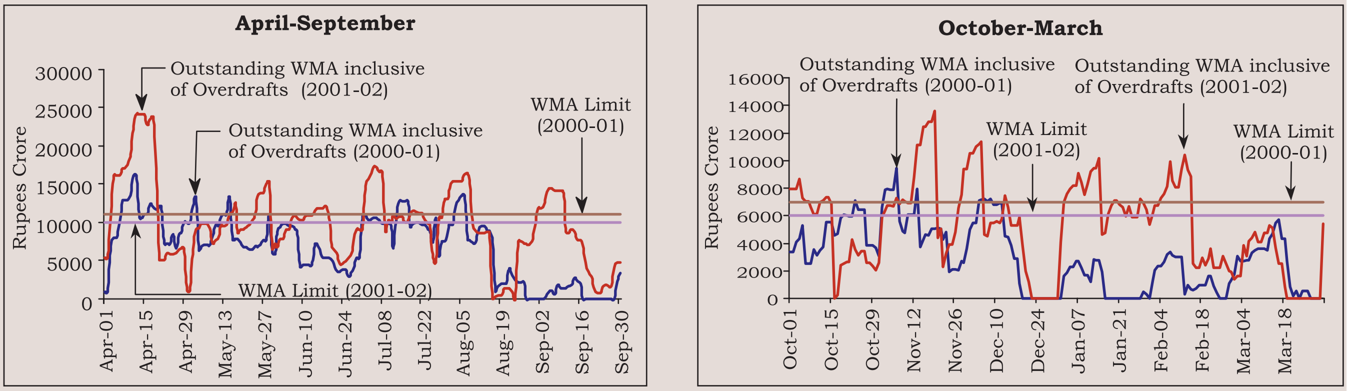
Chart XI.1 : Weighted Average Yield of Central Government Borrowing

CENTRAL GOVERNMENT

Ways and Means Advances

11.4 In terms of the Supplemental Agreement between the Reserve Bank and the Government of India on March 26, 1997, the Reserve Bank is required to set the limits of Ways and Means Advances (WMA) to the Government of India. The arrangements in respect of the WMA to the Central Government remained the same for the fiscal year 2002-03 as in the previous year. The limits have been continued at Rs.10,000 crore for the first half of the year (April-September) and Rs.6,000 crore for the second half (October-March). When 75 per cent of the limit for WMA is utilised by the Government, the Reserve Bank may trigger fresh floatation of market loans depending on market conditions. The interest rate on WMA is the Bank Rate and on overdrafts at Bank Rate *plus* two percentage points. The minimum balance required to be maintained by the Government of India with the Reserve Bank is not less than Rs.100 crore on Fridays, as at the close of the Government's financial year and on June 30, and not less than Rs.10 crore on other days. Overdrafts are limited to ten consecutive working days (Table 11.1).

Chart XI. 2 : Centre's WMA



11.5 The daily average utilisation of WMA and overdraft by the Central Government was higher during 2001-02 when compared with the utilisation pattern in the preceding year (Chart XI.2).

11.6 The Centre was in overdraft for 113 days (20 occasions) during the year 2001-02 as compared with 27 days (11 occasions) in the previous year (Table 11.2).

Table 11.1: WMA Limits of Government of India

(Rupees crore)

Year	Limit during April to September	Limit during October to March
1	2	3
1997-98	12,000	8,000
1998-99	11,000	7,000
1999-2000	11,000	7,000
2000-01	11,000	7,000
2001-02	10,000	6,000
2002-03	10,000	6,000

Treasury Bills

11.7 The gross amounts mobilised through 14-day and 182-day Treasury Bills before their discontinuance with effect from May 14, 2001 were Rs.1,100 crore (inclusive of Rs. 400 crore from non-competitve bidding) and Rs.300 crore, respectively. With the increase in the notified amount of the 91-day Treasury Bill from Rs.100 crore to Rs.250 crore from May 16, 2001, the gross amount mobilised stood higher at Rs.20,216 crore (inclusive of Rs. 8,016 crore from non-competitive bidding) during 2001-02 as against Rs.7,255 crore during the preceding year. The gross amount raised through 364-day Treasury Bills was also higher at Rs.19,588 crore as against Rs.15,000 crore during 2000-01 (Appendix Table V.8). There was no devolvement on the Reserve Bank in any auction of the Treasury Bills during 2001-02. The dates of payment of 91-day and 364-day Treasury Bills was sychronised (See

Table 11.2 : Overdraft Position of Central Government

(Rupees crore)

Month	2002-2003			2001-2002			2000-2001		
	Range of overdraft	No. of days	No. of occasions	Range of overdraft	No. of days	No. of occasions	Range of overdraft	No. of days	No. of occasions
1	2	3	4	5	6	7	8	9	10
April	144-6,300	13	2	556-14,193	10	1	712-5,107	7	2
May	734-7,773	12	2	199-5,346	8	2	38-2,312	5	3
June	359-5,154	9	3	303-2,173	10	1	–	–	–
July	85-3,893	13	4	30-7,267	16	4	1,126-1,718	2	1
August				4,454-6,399	6	1	1,103-2,479	2	1
September				1,856-4,383	7	1	–	–	–
October				103-2,635	10	1	115	1	1
November				356-7,581	13	2	863-2,432	5	2
December				627-5,393	6	2	67-242	5	1
January				120-4,138	17	4	–	–	–
February				145-4,383	10	1	–	–	–
March				–	–	–	–	–	–
Total				**30-14,193**	**113**	**20**	**38-5,107**	**27**	**11**

Table 11.3 : Weighted Average Yield and Maturity for Market Loans of Central Government

Year	Range of YTMs at Primary Issues (Per cent)			Weighted Average Yield (Per cent)	Range of Maturity of Loans (years)	Weighted Average Maturity (years)	Weighted Average Maturity of Outstanding Stock* (years)
	under 5 years	5-10 years	Over 10 years				
1	2	3	4	5	6	7	8
1997-98	10.85-12.14	11.15-13.05	–	12.01	3-10	6.6	6.5
1998-99	11.40-11.68	11.10-12.25	12.25-12.60	11.86	2-20	7.7	6.3
1999-00	–	10.73-11.99	10.77-12.45	11.77	5-19	12.6	7.1
2000-01	9.47-10.95	9.88-11.69	10.47-11.70	10.95	2-20	10.6	7.5
2001-02	–	6.98-9.81	7.18-11.00	9.44	5-25	14.3	8.2
2002-03 (April-August 16, 2002)	–	6.65-8.14	6.84-8.62	7.53	7-25	12.3	8.6

* end of period

Sections V and IX for details). The notified amount of 364-day Treasury Bill was raised from Rs.750 crore to Rs.1,000 crore from April 3, 2002 with a view to improving supply in the market.

Dated Securities

11.8 The gross and net borrowings through dated securities amounted to Rs.1,14,213 crore and Rs.87,714 crore, respectively, while Rs.19,588 crore (gross) and Rs.4,588 crore (net) were raised through 364-day Treasury Bills. Favourable liquidity conditions engendered by continuous accretion to foreign exchange reserves, strong deposit growth, low credit off-take and the easing of monetary policy enabled the smooth absorption of the Centre's borrowing by the market. There was only one occasion of devolvement on the Reserve Bank of Rs.679 crore during the year. Large unanticipated funds requirement of the Central Government, however, necessitated private placements amounting to Rs. 28,213 crore with the Reserve Bank (Appendix Table V.7).

11.9 The consolidation of government stocks was carried forward in 2001-02. As large net market borrowing of the Government limits flexibility in active consolidation, the Reserve Bank has been attempting "passive consolidation" since April 1999 by reissuing the existing stocks through price-based auctions, thereby limiting the number of outstanding stocks. Thus, 23 securities, each with an outstanding amount of Rs.10,000 crore or more, accounted for more than half of the total outstanding amount of Rs.5,36,325 crore comprising 111 securities at the end of March 2002.

11.10 The maximum maturity of primary issuances of fresh paper was raised from 10 years to 20 years in 1998-99 and then to 25 years in 2001-02; the weighted average maturity rose from 6.6 years in 1997-98 to 14.3 years in 2001-02 (Table 11.3).

11.11 Since 1998-99, debt management policy has entailed a strategy of elongating the maturity of new issuances, reversing the phase of shortening of maturity during 1992-93 to 1997-98 which resulted in bunching of redemptions (Table 11.4 and Box XI.1). The modified duration of the outstanding dated securities was 5.26 years as on August 07, 2002.

11.12 In case liquidity conditions in the market are not appropriate for a market issue, or in the event of the market expecting unreasonably high yields from the primary offering as reflected in the bids received, private placement or devolvement are resorted to.

Table 11.4: Maturity Profile of Market Loans of Central Government

(Per cent of total)

	Outstanding as on March 31			Raised during the Year		
Year	Under 5 Years	5-10 Years	Over 10 Years	Under 5 Years	5-10 Years	Over 10 Years
1	2	3	4	6	7	8
1996-97	45	29	26	50	50	–
1997-98	41	41	18	18	82	–
1998-99	41	42	16	18	68	14
1999-00	37	39	24	–	35	65
2000-01	27	47	26	6	41	53
2001-02	31	36	33	2	24	74

Box XI.1

Elongation of Maturity of Government Debt : Issues

The financial sector reforms initiated in 1991 led to the introduction of auction system for market borrowings of the Central Government. In the initial years, considering the market perception and the period of transition from pre-announced coupon to market related rates, as well as movement from investment by captive investors to wider market participants, the maximum maturity was reduced from 20 years to 10 years and the minimum maturity was reduced from 5 years to 2 years. This led to redemption pressure on the Government finances in the immediate years. To smooth out redemption pressure of internal debt on the government budget over time, it was essential to adjust the maturity profile of new loans. To avoid such bunched repayments in future years, and also not to add to the redemption pressure in immediate years entailing refinance risk, a conscious decision was taken in 1998 to lengthen the maturity profile of issues. Thus, there was an elongation of the weighted average maturity of the loans issued from 5.5 years in 1996-97 to 14.3 years in 2001-02. As a result, the weighted average maturity of outstanding debt which had fallen from around 16 years at end-March 1991 to 6.3 years at end-March 1999 rose to 8.2 years at end-March 2002. The successful elongation of the maturity in a market related environment of interest rates was made possible due to the benign inflationary environment and development of the government securities market during the period.

Elongation of the maturity profile of debt, however, cannot be an independent exercise. As a debt manager, Reserve Bank also has the obligation of minimising the cost of borrowing to the Government. With an upward sloping yield curve, the longer the maturity, the higher is the cost. On the other hand, short-term borrowing increases the refinancing or rollover risk. Thus, there is a trade-off between the tenor of borrowing and its cost. The softening interest rate scenario in the last two years, however, has helped the Reserve Bank to achieve the twin objectives of elongating the maturity profile of new debt and reducing the cost of borrowing at the same time. The average cost of issuance of dated securities issued during 2001-02 has come down substantially.

Since banks are mandated to hold government securities, they have little control on either the interest rate risk of their portfolio or the impact on the balance sheet (asset-liability mismatch). The increase in maturity of new debt increases the interest rate risk of the investment portfolios of banks. One way in which the interest rate risk can be addressed is through the issue of Floating Rate Bonds (FRBs). Their short duration reduces the interest rate risk of holders. The share of FRBs in the total issuance is governed by factors such as the need to avoid large debt servicing burden on Government in the event of rising short-term interest rates that may be necessitated due to macroeconomic conditions.

The Reserve Bank is actively pursuing the creation and development of the Separate Trading for Registered Interest and Principal of Securities (STRIPs) market. The shorter duration coupon STRIPs will help banks to reduce the interest rate risk of their investment portfolios, while the longer duration STRIPs are expected to find natural demand from pension/provident funds and insurance funds who typically have long term liabilities. Besides, STRIPs will help in addressing the asset-liability mismatch problem of banks as also the reinvestment risk faced by long-term investors.

The Reserve Bank offloads such initial acquisitions when the liquidity conditions/expectations stabilize, or, at its discretion through strategic open market sales depending upon capital flows, credit growth and requirements of monetary management (Tables 11.5 and 11.6).

Table 11.5 : Private Placement/Devolvement with the Reserve Bank during 2001-02

Date of Issue	Security	Notified Amount (Rupees crore)	Residual Maturity (years)	Private Placement (Rupees crore)	Devolvement (Rupees crore)	Yield (Per cent)
1	2	3	4	5	6	7
April 20, 2001	11.50 % GS 2011	4,000	10.59	4,000	–	10.32
April 20, 2001	10.71 % GS 2016	4,000	15.00	4,000	–	10.64
April 20, 2001	11.60 % GS 2020	4,000	19.69	4,000	–	11.00
May 30, 2001	10.25 % GS 2021	5,000	20.00	5,000	–	10.25
June 20,2001	11.03 % GS 2012	4,000	11.08	4,000	–	9.71
August 9, 2001	9.81 % GS 2013	4,000	11.81	–	679	9.53
November 20, 2001	10.18 % GS 2026	4,000	24.81	4,000	–	8.95
March 30, 2002	10.25 % GS 2021	3,213	19.17	3,213	–	7.96
Total				**28,213**	**679**	

Table 11.6: Change in Reserve Bank's Holding of Government Securities (G-Sec) through Private Placement, Devolvement and Open Market Operation (OMO)

(Rupees crore)

Year	Gross Market Borrowings (Dated securities)	Amount of Devolve-ment on Reserve Bank	Private Placement taken by Reserve Bank	OMO Purchases by Reserve Bank	Total addition to stock of Reserve Bank 's investments in G-Sec (3+4+5)	Open Market Sales by Reserve Bank	Net addition to stock of RBI in G-Sec (6-7)
1	2	3	4	5	6	7	8
1996-97	27,911	3,698	–	623	4,321	11,206	-6,885
1997-98	43,390	7,028	6,000	467	13,495	8,081	5,414
1998-99	83,753	8,205	30,000	–	38,205	26,348	11,857
1999-00	86,630	–	27,000	1,244	28,244	36,614	-8,370
2000-01	1,00,183	13,151	18,000	4,471	35,622	23,795	11,827
2001-02	1,14,213	679	28,213	5,084	33,976	35,419	-1,443

11.13 Central Banks in many countries undertake public debt management operations in addition to monetary management. There is considerable debate on whether debt management function should be with the Reserve Bank (Box XI.2).

Box XI.2

Separation of Debt and Monetary Management : Central Bank Independence

An important aspect of debt management is close co-ordination with the monetary and fiscal authorities. These functions reinforce one another in maintaining an appropriate structure of long-term interest rates. In countries with very developed financial markets, debt management is based on the fiscal operations of the Government while monetary policy is carried out independently. This helps to ensure that the debt management decisions are taken independent of the interest rate decisions and perception of conflict of interest in market operations is avoided.

Achieving a separation between debt management and monetary policy might be difficult in countries with less developed financial markets, since debt management operations may have effects on interest rates and the local capital markets. Therefore, sequencing of reforms to achieve the separation is important. The central bank undertakes debt management functions in many countries. This is mainly because the central bank has the required expertise to monitor relevant information and to modulate market liquidity as part of its monetary policy operations. In the last two decades, a consensus seems to have emerged on the need to ensure that the responsibility for debt management policy should be separated from monetary management. Where the central bank has an operational role for debt management, the nature of the role, the timing and quality of policy operation should be specified.

The Committee on Capital Account Convertibility (1997) recommended the separation of debt management from monetary management. The Advisory Group on Transparency in Monetary and Financial Policies (2000) recognised that separation of debt management and monetary policy is a necessary but not sufficient condition for effective monetary policy which would also require a reasonable degree of fiscal responsibility.

In India, debt and monetary management functions are vested with the Reserve Bank. A decision to separate the two functions is considered desirable in principle. It was, however, felt that separation of the two functions would be dependent on the fulfilment of three pre-conditions, *i.e.*, development of financial markets, reasonable control over fiscal deficit and necessary legislative changes. Significant progress has been made in the development and integration of financial markets with the introduction of new instruments and participants, strengthening of the institutional infrastructure and greater clarity in the regulatory structure. The recent amendment to the Securities Contracts (Regulation) Act, 1956 demarcated the regulatory roles of the Reserve Bank and the SEBI with respect to the financial markets. In the Budget Speech of 2000-01, the Finance Minister expressed the need to accord greater operational flexibility to the Reserve Bank for conduct of monetary policy and regulation of the financial system. The Reserve Bank has already proposed amendment to the Reserve Bank of India Act, 1934 to take away the mandatory nature of management of public debt by the Reserve Bank and vest the discretion with the Central Government to undertake the management of the public debt either by itself or to assign it to some other independent body, if it so desires. The proposed Fiscal Responsibility and Budget Management Bill (FRBMB) envisages prohibition of direct borrowings by the Central Government from the Reserve Bank. With the setting up of the CCIL, the evolution of the full-fledged LAF and the other technological infrastructure being put in place, the

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Reserve Bank will be able to operate its instruments of monetary policy with greater flexibility and the proposed separation of debt management could greatly facilitate the performance of monetary management by the Reserve Bank.

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11.14 During 2001-02, the Central Government entered the market on 25 occasions through auctions of dated securities. In view of the ample liquidity available in the system, the response in the primary auctions of dated securities was generally favourable, except in August 2001 and February 2002.

11.15 The scheme of retailing of Government securities through non-competitive bidding was operationalised with the auction of 15-year Government Stock for a notified amount of Rs.5,000 crore in January 2002. A maximum of 5 per cent of the notified amount was reserved for the non-competitive bidders.

11.16 As a part of the initiative to divest itself of development financing functions so as to enable it to focus on core central banking activities, the Reserve Bank transferred the assets on account of loans and advances worth Rs.3,792 crore (face value) to the Developmental Financial Institutions out of National Industrial Credit (Long-Term Operations) Fund to the Government, replacing them with long-term Government of India securities (10.25 per cent Government Stock 2021 of Rs.3,213 crore face value) through private placement. The transaction was effected by matching the discounted present values (discounted at yields prevailing on March 28, 2002) so that it was cash neutral. This amount is included in the market borrowing programme of the Central Government for the year 2001-02. The repayment schedule of outstanding market loans is presented in Table 11.7.

Table 11.7 : Repayment Schedule for Market Loans of Central Government

(As on March 31, 2002)P

(Rupees crore)

End-March	Central Government
1	2
2002-2003	27,420
2003-2004	32,909
2004-2005	34,316
2005-2006	32,630
2006-2007	36,894
2007-2008	34,151
2008-2009	40,223
2009-2010	37,195
2010-2011	38,609
2011-2012	40,610
2012-2013	20,255
2013-2014	26,691
2014-2015	22,588
2015-2016	28,857
2016-2017	32,130
2017-2018	–
2018-2019	16,632
2019-2020	2,000
2020-2021	11,000
2021-2022	13,213
2022-2023	–
2023-2024	–
2024-2025	–
2025-2026	–
2026-2027	8,000

P : Provisional

11.17 From the inception of the auction system, multiple price auction format has been used for auction of dated securities. With uniform price auctions being adopted in the issuance of 91-day Treasury Bills (since November 6, 1998), the Monetary and Credit Policy Statement of April 2001 proposed to extend the uniform price auction format to the auctions of Government of India dated securities on a selective and experimental basis. In line with this policy, the uniform price auction format was extended to the auctions of Floating Rate Bonds (FRBs) on November 21 and December 5, 2001. The government securities auction held on April 4, 2002 was also based on uniform price auction.

11.18 While uniform price auction addresses the problem of the "winner's curse" an important disadvantage of the uniform price system is that of indiscriminate or irresponsible bidding, out of alignment with the market, as bidders are sure to succeed at the most favourable rate. Under multiple price auction, on the other hand, bidders get differential rates in accordance with their need and assessment of cost.

Consequently, greater commitment to bidding is likely to be ensured and the intensity of demand in the market is clearly reflected in the bidding pattern. While there is no conclusive evidence about the superiority of one method over the other, country experience shows that both the methods are widely used (Box XI.3).

11.19 With a view to enabling institutional and retail investors to plan their investment, the Reserve Bank introduced a core calendar for issuance of dated securities for Rs.68,000 crore for the period April to September 2002 indicating the amounts and maturities of loans to be issued. The calendar is subject to variations depending on market conditions and other factors. In addition to the calendar, the Reserve Bank has the option of additional issuances as per emerging requirement of the Government and market conditions (Table 11.8).

11.20 The gross and net market borrowings of the Central Government during 2002-03 are budgeted at Rs.1,42,867 crore and Rs.95,859 crore, respectively. The gross borrowings through dated securities are budgeted at Rs.1,16,867 crore and through 364-day Treasury Bills at Rs.26,000 crore.

11.21 During the current year up to August 16, 2002, the Central Government has raised Rs.80,028 crore (Rs.70,000 through dated securities and Rs.10,028 crore through 364 day Treasury Bills) which was 56.02 per cent of the budgeted amount of gross borrowings. On April 16, 2002, Government of India converted Rs.10,000 crore of Government of India Treasury Bills (Conversion) Special Securities, 1988 held by the Reserve Bank into dated securities *viz.*, 7.49 per cent GS 2017 and 7.37 per cent GS 2014 of face value Rs.5,000 crore each.

Box XI.3

Methods of Issuance of Government Securities in Select Countries

Country	Issuance Mechanism	Bonds	Bills
1	2	3	4
Canada	Multiple price auction Uniform price auction (inflation-linked bonds)	Monthly	Weekly
France	Multiple price auction	Monthly	Weekly
Germany	Multiple price auction	Quarterly (2-, 5-year bonds)	Weekly
Italy	Multiple price auction (bills), Uniform price auction (bonds)	Every 15 days	Every 15 days
Japan	Multiple price auction	Monthly	
Sweden	Multiple price auction	Every 15 days (nominal bonds), on tap (index-linked bonds)	Every 15 days
United Kingdom	Multiple price auction (gilts and bills, Euro notes and bills), Uniform price auction (index-linked)	Quarterly (conventional gilts, index-linked gilts, Euro notes)	Weekly (national currency bills), monthly (Euro bills)
United States	Uniform price auction	Monthly (2-year notes), quarterly (5-, 10-year fixed principal notes), semi-annually (10-, 30-year indexed notes and bonds, 30-year fixed-principal bonds)	Weekly (13-, 26-week bills), quarterly (52-week bills)
Brazil	Multiple price auction	Monthly	Weekly
Hungary	Multiple price auction	Every 15 days	Weekly
Malaysia	Multiple price auction	Irregular (2- to 21-year bonds, 3- to 7-year floating rate)	Irregular
Mexico	Multiple price auction	Weekly (3-year floating rate bonds); biweekly (3-, 5-year inflation-indexed bonds)	Weekly

Source : Developing Government Bond Markets - A Handbook, The World Bank and IMF, 2001

Table 11.8 : Indicative Calendar and Actual Borrowings through Dated Securities for first half of 2002-03

(Amount in Rupees crore)

Auction Calendar			Actual Borrowings		
Period of auction	Amount	Maturity Period of the Security	Date of Auction	Amount	Maturity Period of the Security (year)
1	2	3	4	5	6
1. April 1-6	7,000	Below 10 year security for Rs.3,000 crore and	April 4, 2002	3,000	7.0
		10 year security for Rs.4,000 crore	April 4, 2002	4,000	10.0
2. April 15-19	6,000	15 year security	April 15, 2002	6,000	15.0
			April 22, 2002*	6,000 P	10.4
3. May 1-6	6,000	10 year security	May 2, 2002	6,000	10.0
4. May 13-18	6,000	Below 10 year security for Rs.3,000 crore	May 13, 2002	3,000	8.0
		and 20 Year security for Rs.3,000 crore	May 13, 2002	3,000	20.0
			May 21, 2002*	6,000 P	10.0
5. May 27-30	6,000	15 year security for Rs.4,000 crore and	May 30, 2002	4,000 P	14.9
		above 20 year security for Rs. 2,000 crore	May 30, 2002	2,000 P	24.3
6. June 3-7	6,000	10 year security for Rs.4,000 crore and	June 5, 2002	4,000	9.9
		above 20 year security for Rs.2,000 crore	June 5, 2002	2,000	19.9
7. July 1-6	7,000	Below 10 year security for Rs.4,000 crore and	July 1, 2002	4,000	7.9
		15 Year security for Rs.3,000 crore	July 1, 2002	3,000	15.0
			July 17, 2002*	3,000	10.0
			July 17, 2002*	4,000	14.5
8. August 1-6	8,000	10 year security for Rs.6,000 crore and above	August 2, 2002	5,000	8.9
		20 year security for Rs.2,000 crore	August 2,2002	2,000	24.1
9. August 26-30	8,000	15 year security for Rs.6,000 crore and 20 year security for Rs.2,000 crore			
10. September 5-10	8,000	15 year security for Rs.4,000 crore and 20 year security for Rs.4,000 crore			
Total	**68,000**			**70,000**	

* Additional borrowings over and above the indicative calendar.
P : Private placement with RBI.

STATE GOVERNMENTS

Ways and Means Advances

11.22 Under Section 17(5) of the Reserve Bank of India Act, 1934, the Reserve Bank provides Ways and Means Advances (WMA) to the States banking with it to help them tide over temporary mismatches in the cash flow of their receipts and payments. While normal WMA are clean advances, special WMA are secured advances provided against the security of Government of India dated securities.

11.23 The WMA/Overdraft position of States reflected continued pressure on the States' finances. The recourse to WMA in 2001-02 was generally higher than that in the previous year (Chart XI.3). During 2001-02, 20 States resorted to overdraft as against 19 States during 2000-01. In 2001-02, it was observed that there is a general tendency to resort to overdrafts as an extension of the normal WMA limits (Table 11.9). Six States did not avail of overdraft at all. The WMA Scheme was reviewed in 2001 by a Group of State Finance Secretaries and a revised Scheme came into

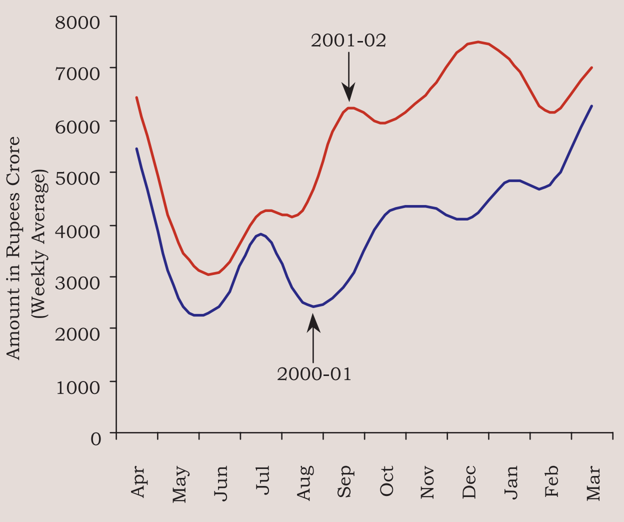
Table 11.9 : WMA, Special WMA, Overdraft and Investment in Treasury Bills

(Rupees crore)

Month	Weekly Average											
	Normal WMA			Special WMA			Overdraft			Investment in Treasury Bills		
	2002-03	2001-02	2000-01	2002-03	2001-02	2000-01	2002-03	2001-02	2000-01	2002-03	2001-02	2000-01
1		2	3		5	6		8	9		11	12
April	2,924	3,925	2,288	835	666	767	2,987	1,863	2,392	1,652	2,832	1,481
May	2,961	2,638	1,610	480	345	496	1,428	681	469	2,404	3,483	1,610
June	3,007	2,223	1,464	559	331	478	1,022	508	467	3,670	4,664	2,550
July	3,295	2,875	2,376	658	491	879	1,252	863	546	2,727	4,219	1,486
August		2,798	1,775		539	344		911	368		2,916	3,170
September		3,542	1,791		760	535		1,851	460		1,764	3,190
October		3,586	2,554		652	681		1,693	935		1,704	1,645
November		3,730	2,770		769	602		1,990	983		1,595	1,244
December		4,244	2,387		950	806		2,292	921		1,232	2,066
January		4,217	2,862		951	927		2,024	1,058		1,067	1,808
February		3,506	3,398		922	583		1,733	765		1,437	2,678
March		3,746	3,481		839	704		2,447	2,109		955	2,726

effect from February 1, 2001. According to the recommendations of the Group, the normal WMA limits should be revised every year. Accordingly, the revised limits were made applicable from April 1, 2002. As per the Overdraft Regulations Scheme, no State is allowed to run an overdraft with the Reserve Bank for more than a stipulated number of working days. In case an overdraft appears and remains beyond the stipulated number of working days, the Reserve Bank suspends payments (Table 11.10).

Chart XI.3 : WMA and Overdraft of States 2000-01 and 2001-02



Market Borrowings

11.24 The gross and net market borrowings of the State Governments amounted to Rs.18,707 crore and Rs.17,261 crore in 2001-02 as compared with Rs.13,300 crore and Rs.12,880 crore, respectively, in 2000-01 (Table 11.11).

11.25 The completion of the market borrowing programme of State Governments involved difficulties despite favourable conditions of comfortable liquidity and softening yields (Box XI.4).

Table 11.10 : Normal WMA and Overdraft of the State Governments

Year	Normal WMA limits (Rupees crore)	No. of consecutive Working Days allowed in Overdraft
1	2	3
1985	520	7
1986	624	7
1988	745	7
1993	1,117	10
1996	2,234	10
1999	3,685	10 (3)
2001	5,284	12 (5)
2002	6,035*	12 (5)

Note : Figures within brackets indicate the number of working days that the State Government can remain in overdraft in excess of its normal WMA limit.

*Minimum Rs. 50 crore for any state.

Table 11.11 : Market Borrowings of State Governments during 2001-02

(Rupees crore)

	State	sGross Borrowings	Net Borrowings	Gross Amount raised by Auction	Gross Amount raised by Tap	Gross Amount raised through Traditional Tranche
1		2	3	4	5	6
1.	Andhra Pradesh	2,055	1,896	475	697	883
2.	Arunachal Pradesh	27	27	5	11	11
3.	Assam	531	510	–	301	230
4.	Bihar	1,116	1,025	–	684	432
5.	Chhattisgarh	269	256	67	117	85
6.	Goa	89	89	–	29	60
7.	Gujarat	1,406	1,349	440	377	589
8.	Haryana	295	261	–	115	180
9.	Himachal Pradesh	376	364	–	215	161
10.	Jammu and Kashmir	280	263	45	166	69
11.	Jharkhand	370	340	–	250	120
12.	Karnataka	1,135	1,047	395	340	400
13.	Kerala	966	878	200	766	–
14.	Madhya Pradesh	713	676	148	290	275
15.	Maharashtra	1,290	1,229	290	500	500
16.	Manipur	45	38	–	25	20
17.	Meghalaya	88	85	–	38	50
18.	Mizoram	44	44	–	21	23
19.	Nagaland	156	146	–	78	78
20.	Orissa	838	742	–	368	470
21.	Punjab	419	397	130	89	200
22.	Rajasthan	1,192	1,086	–	396	796
23.	Sikkim	10	10	–	–	10
24.	Tamil Nadu	1,160	1,042	320	242	597
25.	Tripura	57	49	–	–	57
26.	Uttar Pradesh	2,449	2,185	–	1,276	1,173
27.	Uttaranchal	212	198	–	40	171
28.	West Bengal	1,119	1,030	250	407	463
	Total	**18,707**	**17,261**	**2,765**	**7,838**	**8,104**

11.26 Some States responded to the decision taken in November 1997 to allow them the choice of raising between 5 to 35 per cent of their allocation through auctions. During 2001-02, 12 States resorted to the auction method. A decision was, therefore, taken through consensus in the Conference of State Finance Secretaries held in November 2001, to complete the remaining borrowing programmes through tap issuances

Box XI.4

Market Borrowings of State Governments

The allocation to State Governments under the Market Borrowing Programme (MBP) is finalised by the Government of India and the Planning Commission in consultation with the Reserve Bank. The Reserve Bank enters into an agreement with the State Governments under Section 21 A of the Reserve Bank of India Act, 1934 to manage the public debt of the State Governments. At present, the Reserve Bank is the debt manager for all the State Governments in India.

Until 1998, the Reserve Bank used to complete the combined borrowing programme of all the States generally in two or more tranches through issue of bonds with a pre-determined coupon and pre-notified amounts for each State (Traditional Tranche Method). High statutory pre-emption in the form of statutory liquidity ratio (SLR) and the small size of State Government borrowings ensured the success of these primary issues. However, progressive reduction in SLR requirements which resulted in most banks having excess SLR securities in their investment portfolio and differing perceptions of individual States by the investor community required a move away from marketing State Government loans using this method.

This mechanism was reviewed in the context of financial

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sector reforms and to provide scope to better managed States to access funds at market rates. Accordingly, an option was made available to the State Governments to enter the market individually to raise resources using the auction method or tap method (auction between 5 to 35 per cent of the allocated market borrowings, at the discretion of the State) in 1997. The first State to avail of the option of using the auction method was Punjab in January 1999. In February 1999, Andhra Pradesh, Goa and Uttar Pradesh mobilised resources through the Tap method (without notified amount). So far 14 States have availed of the option of borrowing through the auction/tap method. Of the States that used the auction method, some were able to mobilise loans at competitive rates (at relatively lower spreads from the secondary market yield as compared with securities of the Central Government of similar residual maturity), whereas other States had to pay higher rates (about 30-68 basis points over comparable Central Government securities). The factors which seem to determine the spreads, apart from size and timing of issues are: (i) overall economic strength and prospects of the State; (ii) fiscal position and the overall indebtedness profile, including off-budget borrowings and contingent liabilities like guarantees of State Governments; (iii) efforts to control indebtedness; and (iv) the track record in honouring guaranteed commitments.

Some of the States have preferred not to adopt the flexible auction method. For such States, borrowing through the traditional tranche method has been perceived as both preferable and cost efficient. However, it was becoming difficult to complete the borrowing programme for the notified amounts. Firstly, banks and financial institutions are increasingly linking their allocations to individual States depending on the track record of States in making payments in respect of their guaranteed bonds, servicing of loans taken by State owned enterprises, *etc.* Secondly, most banks have exceeded their SLR requirement, and thirdly, the choice of investing in government securities is increasingly based on factors such as liquidity, among others.

To avoid the risk of under-subscription, the Tap Tranche method was introduced during 2001-02. Under this method, borrowings for all States together are raised, indicating a total targeted amount at a predetermined coupon but without notifying the amounts for individual States. The tap is normally kept open for 1-3 days and is closed as soon as the targeted amount is mobilised, or depending upon the decision taken by the State to close the tap.

Until recently, under the traditional tranche method, pre-announced coupon was being fixed at around 25 basis points over Central Government securities of corresponding maturity. However, as interest rates fell sharply in 2000-01, and yield differences started emerging between liquid and illiquid Central Government papers, it became difficult to complete the MBP of the States at these spreads. Since 2001, such spreads have increased to around 50 basis points.

The issues that have arisen in ensuring the successful completion of the MBP of States are scope of underwriting by Primary Dealers, allowing States to access funds beyond the current 35 per cent ceiling of allocation through the 'flexible' method, difficulties in accessing market for those States who have not yet cleared the overdues in respect of bonds raised by State level undertakings with State Government guarantees, separation of debt management from monetary management and thereby having a separate institutional framework for mobilising State Government borrowings.

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without notifying amounts for individual States. Thus, different methods were used to raise the borrowings of the State Governments during the year 2001-02.

Traditional Tranche Method

11.27 In the traditional method, two tranches were conducted to raise market borrowings during 2001-02. In the first tranche, 10.35 per cent 10-year State Development Loans in respect of 27 State Governments opened for subscription for an aggregate notified amount of Rs.3,800 crore on May 8, 2001. The subscriptions received aggregated Rs.5,916 crore and the amount retained was Rs.5,307 crore. In the second tranche, 9.45 per cent 10-year State Development Loans in respect of 22 State Governments were offered for an aggregate notified amount of Rs.2,759 crore on October 10, 2001. The subscriptions received aggregated Rs.3,280 crore but Rs.2,797 crore was retained.

Auction Method - Individual and Group of States

11.28 The total amount raised through auctions during the year 2001-02 was Rs. 2,765 crore as compared with Rs. 1,670 crore in 2000-01. 15 auctions were conducted during the year for 12 States (Table 11.12). The maturity

Table 11.12: Market Borrowings by States through Auctions

(Rupees crore)

	State	2001-02 Date of Auctions	Amount	Cut-off	2000-01 Date of Auction	Amount	Cut-off
	1	2	3	4	5	6	7
1	Andhra Pradesh	13.08.2001	475	9.53	08.08.2000	400	11.80
2	Arunachal Pradesh	14.12.2001	5	8.60			
3	Chhattisgarh	26.02.2002	67	8.10			
4	Gujarat	20.07.2001	190	9.50			
		06.08.2001	250 @	9.40			
5	Jammu and Kashmir	14.12.2001	45	8.50			
6	Karnataka	05.11.2001	315	9.10	05.12.2000	250	11.57
		26.02.2002	80	7.80			
7	Kerala	17.04.2001	200	10.53	29.08.2000	200	11.75
8	Madhya Pradesh	13.08.2001	105	9.55			
		14.12.2001	43	8.50			
9	Maharashtra	28.08.2001	290	9.40	08.08.2000	280	11.70
10	Punjab	28.08.2001	130	9.40			
11	Tamil Nadu	28.08.2001	320	9.38	08.08.2000	290	11.70
12	West Bengal	13.08.2001	250	9.72	08.08.2000	250	11.80

@ 8 year.

was 10 years across the States except for one auction of 8-year paper by Gujarat.

Tap Tranche Method - All States-Pre-determined coupon without pre-notified amount

11.29 During January 28-30, 2002, 26 State Governments excluding Tripura and Sikkim raised an amount of Rs.4,149 crore through tap issue of 8.30 per cent State Development Loans, 2012. The market borrowing allocation to States increased in February 2002 necessitating a second tranche of tap issue in which 26 States entered the market through tap issue of 8.00 per cent State Development Loan, 2012 on March 13-15, 2002 for Rs.2,562 crore.

11.30 In regard to tap issue of 8.30 per cent State Development Loans, 2012 for 26 State Governments during January 28-30, 2002, the tap sale for 16 State Governments was closed on the first day. The sale for 3 States was closed on the second day after receiving the target amounts. The tap sale for the remaining 7 States was closed on the third day. Out of the total subscription, 90 per cent were received in Mumbai and only 10 per cent were received from other Centres. The tap issue of 8.00 per cent State Development Loan, 2012 on March 13-15, 2002 for 26 States also showed varied responses in terms of closure.

Tap Method-Individual and Group of States-Pre-determined coupon

11.31 Five states raised a total of Rs. 1,127 crore through this method during 2001-02. After Kerala raised Rs. 290 crore on August 23, 2001, four other states *viz.*, Andhra Pradesh, Kerala, Maharashtra and Uttar Pradesh raised Rs.350 crore, Rs.139 crore, Rs.141 crore and 207 crore, respectively, at a rate of 8.37 per cent through a tap issue of 10 year-security on December 20-21, 2001. While the taps were closed on the same day for Kerala and Maharashtra, it was kept open for two days for the other two States.

11.32 The weighted average cost of borrowings of State Government securities declined significantly during 2001-02 in line with fall in yields in the Government securities market (Table 11.13).

Table 11.13 : Weighted Average Yield of State Government Loans

(Per cent per annum)

Year	State Government Securities Range	Weighted Average Yield
1	2	3
1995-96	14.00	14.00
1996-97	13.75-13.85	13.83
1997-98	12.30-13.05	12.82
1998-99	12.15-12.50	12.35
1999-2000	11.00-12.25	11.89
2000-01	10.50-12.00	10.99
2001-02	7.80-10.53	9.20
2002-03 (up to Aug 16, 2002)	7.80-8.00	7.82

11.33 The State-wise maturity profile of loans indicates that a bulk of the outstanding loans at the end of March 2002 were with a maturity of 6-10 years (Table 11.14).

Table 11.14: Maturity Profile of State Government Loans (end-March 2002)P

(Rupees crore)

State	0-5 years	6-10 years	Total
1	2	3	4
1. Andhra Pradesh	2,110	8,921	11,031
2. Arunachal Pradesh	19	82	101
3. Assam	651	2,140	2,790
4. Bihar	2,104	5,268	7,372
5. Chhattisgarh	-	340	340
6. Goa	61	397	457
7. Gujarat	953	4,229	5,182
8. Himachal Pradesh	162	1,137	1,299
9. Haryana	511	1,514	2,025
10. Jammu & Kashmir	265	957	1,222
11. Jharkhand	-	493	493
12. Karnataka	941	4,597	5,538
13. Kerala	1,344	4,032	5,376
14. Maharashtra	1,580	4,851	6,432
15. Madhya Pradesh	1,437	4,124	5,562
16. Manipur	71	212	282
17. Meghalaya	90	375	464
18. Mizoram	47	162	208
19. Nagaland	139	585	723
20. Orissa	1,500	4,179	5,679
21. Punjab	766	2,226	2,992
22. Rajasthan	1,510	6,042	7,552
23. Sikkim	51	170	221
24. Tripura	84	386	470
25. Tamil Nadu	1,697	5,163	6,861
26. Uttaranchal	-	228	228
27. Uttar Pradesh	4,030	12,220	16,250
28. West Bengal	1,763	5,114	6,877
Total	**23,884**	**80,142**	**1,04,026**

P : Provisional.

11.34 Reflecting the growing borrowing requirement, the repayments will increase from Rs.1,789 crore during 2002-03 to Rs.21,807 crore by 2011-12 (Table 11.15).

Table 11.15: Repayment Schedule for Market Loans of State Governments (end-March 2002) P

(Rupees crore)

End-March	Amount of Repayment
1	2
2002-2003	1,789
2003-2004	4,145
2004-2005	5,123
2005-2006	6,274
2006-2007	6,551
2007-2008	11,554
2008-2009	14,400
2009-2010	16,511
2010-2011	15,870
2011-2012	21,807

P : Provisional

Government Securities Act

11.35 The Union Cabinet has approved the proposal to replace the existing Public Debt Act, 1944 by the Government Securities Act. The new Government Securities Act will simplify the procedures for transactions in Government securities, allow lien marking/pledging of securities as also electronic transfer in a dematerialised form. The State Governments except the state of Jammu and Kashmir have passed the resolution under Article 252 of the Constitution of India empowering the Parliament to enact the Government Securities Bill (Box XI.5).

Box XI.5

Government Securities Act : Highlights

The law relating to Government Securities and their management by the Reserve Bank is laid down in the Public Debt Act, 1944. The Act is applicable to all market loans of the Central and State Governments. Over the years, provisions of the Act and the Rules framed thereunder have been found to be inconsistent with the developments that have taken place in the financial markets. On the other hand, the rise in volume of the public debt and the consequent growth in the government securities market warrant an investor friendly legal framework. The archaic nature of the existing Act has been one of the constraints that comes in the way of efficient and improved customer service by the Reserve Bank and its agency banks. It, therefore, became imperative to undertake a thorough and comprehensive review of the existing Act and if necessary, to replace it with a new Act which will be suitable to the changed times. Accordingly, the Reserve Bank took the initiative in drafting a new legislation called the Government Securities Act, 2000. All the State Governments except the State of Jammu and Kashmir have conveyed their consent for the legislation and the proposed Act is awaiting Parliamentary approval.

The proposed legislation has been aimed at facilitating a liquid, safe and investor-friendly government securities market. While on the one hand, it seeks to broaden the market for government securities by facilitating a retail interest, it also aims at ensuring an orderly secondary market, on the other.

The substantive improvements that the new legislation is likely to offer in the management of public debt are: (i) recognition of beneficial ownership in the case of securities held in Constituents' Subsidiary General Ledger (CSGL) Account; (ii) provision for nomination facility to individuals/

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joint account holders of government securities held both in dematerialised and stock form; (iii) enhanced powers to enforce penalties/other action for misuse of SGL Account facility; (iv) provision for hypothecation, pledge and creation of lien on government securities; (v) authorisation to the Reserve Bank to issue directions and inspect books of accounts of its agents as regulator of government securities market; (vi) enlarged scope of legal representation to recognise claims of legal representatives of deceased holders with increase in the monetary ceiling for summary proceedings; (vii) issuance of government securities in a Government Promissory (GP) note form to Trusts; (viii) provision for holding government securities on behalf of minors by their parents irrespective of personal laws; (ix) maintenance of records and transfer of ownership in electronic form; (x) stripping and reconstitution of government securities to facilitate Government's debt management objectives on the one hand and to cater to the needs of investor segments on the other; (xi) authority to the Reserve Bank to introduce instruments of transfer suitable to the computerised environment; and (xii) larger scope for dematerialised holding of government securities in the form of a new "Bond Ledger Account" which the banking sector with its wide network can provide to their customers along with a cash account.

Conference of State Finance Secretaries

11.36 The conference of State Finance Secretaries is organised twice in a year to discuss the issues and problems related to cash and debt management of the State Governments. These Conferences have emerged as a useful forum for interactions and for evolving measures to address issues in State finances *viz.*, revisions in the Ways and Means Advances, guarantees extended by States, market borrowing programme, Consolidated Sinking Fund (CSF), transparency in fiscal operations, Guarantee Redemption Fund, interest burden on States and finances of local bodies, accounting standard and information dissemination, fiscal reforms of the States and automatic debit mechanism. The first conference was held on November 8, 1997. So far 10 Conferences of the State Finance Secretaries have been organised. During the year 2001-02, two conferences were organised on May 26, 2001 and November 28, 2001, respectively. The Tenth Conference of the State Finance Secretaries was held on June 7, 2002. The important issues like fiscal risk of State Government guarantees, difficulties in the market borrowings of the State Governments, overdraft regulation scheme for States and finances of local bodies were deliberated upon.

Automatic Debit Mechanism

11.37 Some State governments had earlier given instructions to debit their accounts on specified dates to meet certain obligations/specified events. Such automatic debits carry an overriding priority over other payments. This issue had earlier been examined by the Technical Committee of State Finance Secretaries on State Government Guarantees (1999) which had observed that pre-emption through automatic debit mechanism runs the risk of resulting in insufficient funds for financing critical minimum obligatory payments, such as, salaries, pensions and interest payments. In view of the recommendation of the Committee and the experience with automatic debits, Monetary and Credit Policy for the year 2002-03 announced the abolition of such automatic debits in future where there are no legal or other compulsions and a review of all existing automatic debit arrangements in consultation with State governments and others concerned.

Outlook

11.38 Favourable market conditions augur well for the market borrowing programme for 2002-03. While the market borrowing programme in respect of some States has come under stress, it is expected that debt management would be conducted without serious pressure on overall liquidity and interest rates. Persistent overshooting of the market borrowings of the Central and State Governments has tended to impose constraints on the conduct of market borrowing programme putting pressure on yields. In turn, this often predicates the subservience of monetary policy operations to the goals and objectives of debt management. Accordingly, even as the debate on the separation of the two functions is intensifying, changes in the legal framework are being envisaged to improve the functional autonomy of the Reserve Bank in its operations. The Fiscal Responsibility and Budget Management Bill 2000 seeks to set an operational rule for fiscal policy which would considerably strengthen the redefinition of roles and responsibilities between the Government and the Reserve Bank in the management of public debt. In the interregnum, the Reserve Bank would persevere in its efforts to elongate the maturity profile of public debt, minimise costs, enhance fungibility and liquidity through consolidation of debt and the introduction of new instruments, improve the functioning of financial markets to enable the orderly absorption of market borrowings, and to develop the institutional wherewithal to minimise solvency and liquidity risks. At the same time, greater transparency is being imparted to debt operations as part of a conscious attempt to share with market participants a common set of expectations relating to the future sustainability of public debt management.