

XI

PUBLIC DEBT MANAGEMENT

11.1 The conduct of public debt management by the Reserve Bank in 2003-04 was marked by significant gains in terms of its objectives of minimisation of cost and elongation of maturity profile for limiting the rollover risk. Lower net market borrowings by the Central Government considerably strengthened debt management operations in an environment characterised by large capital inflows, easy liquidity and generally stable inflation expectations. Innovative efforts were directed towards restructuring and consolidating States' debt and lowering the debt servicing burden. The borrowing programme of the Central Government was completed successfully in 2003-04 without any devolvement on the Reserve Bank for the first time since the introduction of auctions in primary issuances in 1992-93. Market borrowings by the States also elicited good response.

11.2 The review of debt management operations in 2003-04 presented in this Section indicates distinct progress in ensuring the sustainability of public debt. At the level of the Centre, the review underscores a noteworthy turnaround from Ways and Means Advances (WMA)/overdrafts to surplus cash balances and investments, a strong appetite for Treasury Bills which became an effective instrument for absorbing excess liquidity in the system, a softening of yields on dated securities and elongation of maturities, including that of States' debt. Strategies for debt

consolidation, which included debt buyback from the banking system and prepayment of external debt, were aimed at replacing high cost debt. As regards State finances, debt swaps with the Centre have provided headroom to the States in terms of lower debt service. Structural reforms of State finances, however, continue to hold the key to a sustainable level of indebtedness.

CENTRAL GOVERNMENT

Ways and Means Advances

11.3 The Ways and Means Advance (WMA) limits of the Centre were kept unchanged at Rs.10,000 crore for the first half (April-September) and Rs.6,000 crore for the second half (October-March) of 2003-04. The Central Government was in overdraft for only 43 days and on 10 occasions during the year (Table 11.1). A noteworthy development was the absence of recourse to WMA in the second half of the year, which was unprecedented.

11.4 Beginning August 8, 2003 (and up to April 29, 2004), the Central Government continuously maintained surplus cash balances in its current account with the Reserve Bank mainly due to substantial inflows on account of the debt swap scheme and increased issuance of 91-day Treasury Bills. The Central Government had an investment balance of Rs.26,669 crore at end-March 2004 (Chart XI.1). In view of the

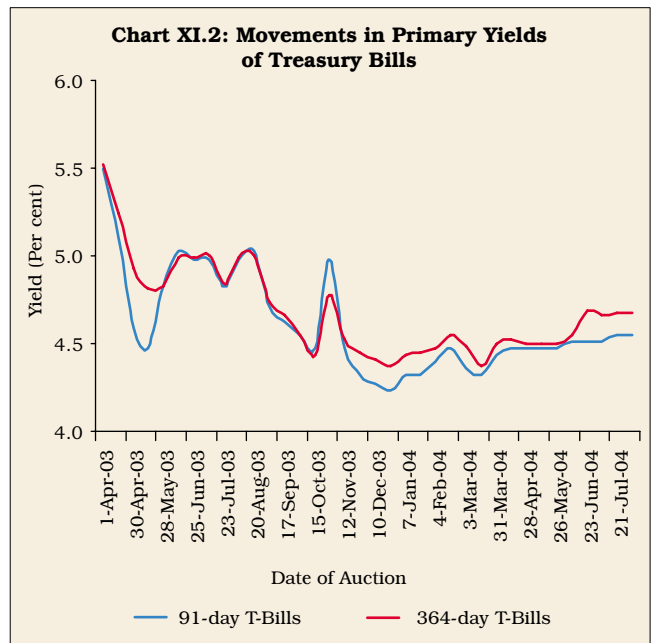
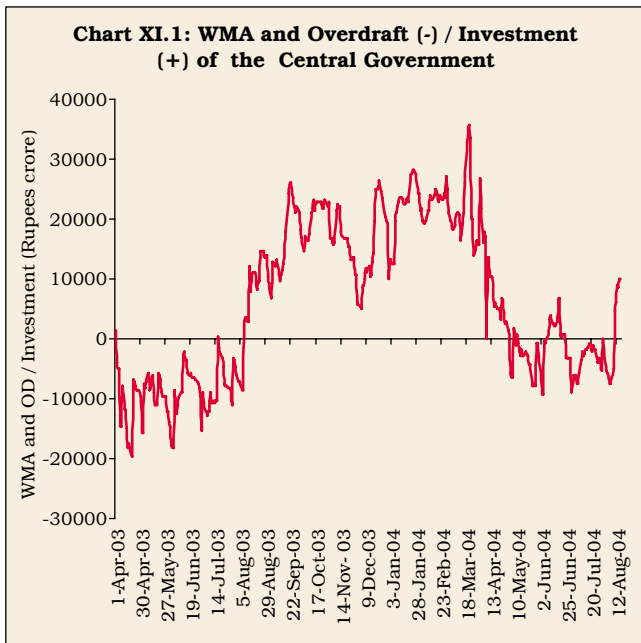
Table 11.1: Overdraft Position of the Central Government

(Rupees crore)

Month	2003-04			2002-03		
	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
April	1,642 - 9,656	15	2	144 - 6,300	13	2
May	900 - 5,867	9	3	734 - 7,773	12	2
June	875 - 8,349	5	1	359 - 5,154	9	3
July	383 - 5,288	14	4	85 - 3,893	13	4
August	—	—	—	25 - 3,863	10	2
September	—	—	—	—	—	—
October	—	—	—	—	—	—
November	—	—	—	—	—	—
December	—	—	—	39 - 1,711	2	2
January	—	—	—	—	—	—
February	—	—	—	—	—	—
March	—	—	—	—	—	—
Total	0 - 9,656	43	10	0 - 7,773	59	15

— : No overdraft.

Note : The Central Government did not resort to overdraft during 2004-05 (up to August 14, 2004).



need by the Reserve Bank to preserve its existing stock of securities for the conduct of monetary policy operations, investment of the Central Government's surplus cash balances in dated securities was discontinued temporarily from April 8, 2004. From June 12, 2004 the arrangement of investment of surplus balances was partially restored for investment up to Rs.10,000 crore due to reduction in outstandings under the Liquidity Adjustment Facility (LAF), partly facilitated by absorption under the Market Stabilisation Scheme. After maintaining surplus cash balances for a brief period in June 2004, the Centre took recourse to WMA to the tune of Rs.2,632 crore at end-July 2004.

Treasury Bills

11.5 The notified amount of 364-day Treasury Bills was maintained at Rs.1,000 crore in 2003-04, while that of 91-day Treasury Bills was refixed at Rs.500 crore from February 2003. The notified amount of 91-day Treasury Bills was raised temporarily to Rs.1,500 crore for eight auctions conducted between August 6, 2003 and September 24, 2003 with a view to absorbing the abundant liquidity in the system. The

weighted average primary market yields of 91-day and 364-day Treasury Bills declined by 110 basis points and 125 basis points, respectively (Table 11.2 and Appendix Table V.8).

11.6 The reduction in the repo rate in August 2003 led to softening of yields in respect of both 91-day and 364-day Treasury Bills. Between May and mid-October 2003, the spread between cut-off yields on 91-day and 364-day Treasury Bills narrowed to near convergence. Frequent OMOs absorbed Rs.13,986 crore from the system during October 2003, which led to a rise in the cut-off yield on 91-day Treasury Bills to the extent of 22 basis points higher than the cut-off yield on 364-day Treasury Bills. Beginning November 2003, the cut-off yields on 91-day and 364-day Treasury Bills remained lower than the repo rate, resulting in an inverted yield curve at the short end (Chart XI.2).

11.7 The positive response to Treasury Bill auctions in the primary market led to improved bid-cover ratio during the year (Table 11.3). Consequently, there was no devolvement on the Reserve Bank in any of the auctions during the year.

Table 11.2: A Profile of Treasury Bills

(Rupees crore)

Type of T-Bill	Weighted Average Cut-off Yield (per cent)		Gross Amount		Net Amount		Outstanding Amount	
	2003-04	2002-03	2003-04	2002-03	2003-04	2002-03	2003-04	2002-03
1	2	3	4	5	6	7	8	9
91-day	4.63	5.73	36,786	26,402	(-) 2,488	4,626	7,139	9,627
364-day	4.67	5.92	26,136	26,126	9	6,538	26,136	26,126

Table 11.3: Treasury Bills - Primary Market@

Month	Average Implicit Yield at Minimum Cut-off Price (Per cent)		Bid-Cover Ratio*	
	91-day	364-day	91-day	364-day
1	2	3	4	5
2003				
April	5.04	5.19	4.13	2.56
May	4.56	4.77	1.94	1.88
June	4.95	4.95	1.91	2.51
July	4.87	4.88	3.06	2.15
August	4.90	4.96	1.73	2.01
September	4.60	4.65	2.91	3.32
October	4.61	4.53	2.24	2.38
November	4.37	4.42	3.23	2.32
December	4.19	4.32	2.76	1.80
2004				
January	4.25	4.37	2.01	1.98
February	4.38	4.44	3.07	1.72
March	4.27	4.39	3.42	2.28
April	4.39	4.45	2.16	2.68
May	4.40	4.43	2.93	2.46
June	4.46	4.56	2.49	1.29
July	4.48	4.61	2.54	2.07

@: As per dates of auction.

* : Ratio of competitive Bids Received (BR) to Notified Amount (NA).

11.8 During 2004-05 (up to August 4, 2004), the primary market cut-off yields on 91-day and 364-day Treasury Bills moved up to 4.49 per cent and 4.62 per cent, respectively, from 4.24 per cent and 4.31 per cent, respectively, at end-March 2004.

Dated Securities

11.9 The Central Government raised a gross amount of Rs.1,21,500 crore (a net amount of Rs.88,807 crore) through issuances of dated securities during the year (Appendix Table V.5). Of this, Rs.1,00,000 crore was raised through auctions (28 auctions comprising 19 reissues and 9 new issues) and Rs.21,500 crore by way of private placements (mainly for the prepayment of external debt). Taking into account the four dated securities issued on July 22, 2003 under the debt buy-back scheme amounting to Rs.14,434 crore, issuances of dated securities aggregated Rs.1,35,934 crore (Appendix Table V.7). The conversion of Government of India Treasury Bills (Conversion) Special Securities amounting to Rs.61,818 crore into dated securities added to the stock of marketable securities of the Reserve Bank. Of the 124 outstanding marketable securities amounting to Rs.8,24,314 crore as on March 31, 2004, 41 securities with outstanding amount of Rs.10,000 crore or more accounted for 63 per cent.

11.10 Private placements of the Centre's dated securities with the Reserve Bank were restricted mainly

to the prepayment of external debt. Out of Rs.21,500 crore (17.7 per cent of the gross borrowings through dated securities) placed privately with the Reserve Bank, Rs.16,500 crore was for the purpose of prepayment of external debt. Although this arrangement was reserve money neutral, it added to the stock of marketable securities with the Reserve Bank. Securities amounting to Rs.5,000 crore were placed privately with the Reserve Bank on April 23, 2003 outside the calendar for market borrowing and these, together with Rs.7,000 crore raised through auctions as per the borrowing calendar on the same day, wiped out the Central Government's overdraft, which had peaked at Rs.9,656 crore on April 22, 2003.

11.11 The calendar of dated securities issuance for the first half (April-September) of 2003-04 covering 50.6 per cent (*i.e.*, Rs.71,000 crore) of the budgeted amount was mostly adhered to even as the actual mobilisation by the Government was somewhat higher at Rs.80,000 crore (excluding Rs.14,434 crore issued under the debt buyback scheme). After adjusting for the amounts received from the State Governments towards prepayment of high cost loans and keeping in view trends in other receipts, the calendar for the second half of 2003-04 (October-March) was announced for an aggregate borrowing of Rs.25,000 crore. This had a softening impact on the market yields as market participants had anticipated an amount of Rs.60,000 crore. The weighted average yield of dated securities issued during the year and of the total outstanding stock declined by 163 and 114 basis points, respectively (Chart XI.3).

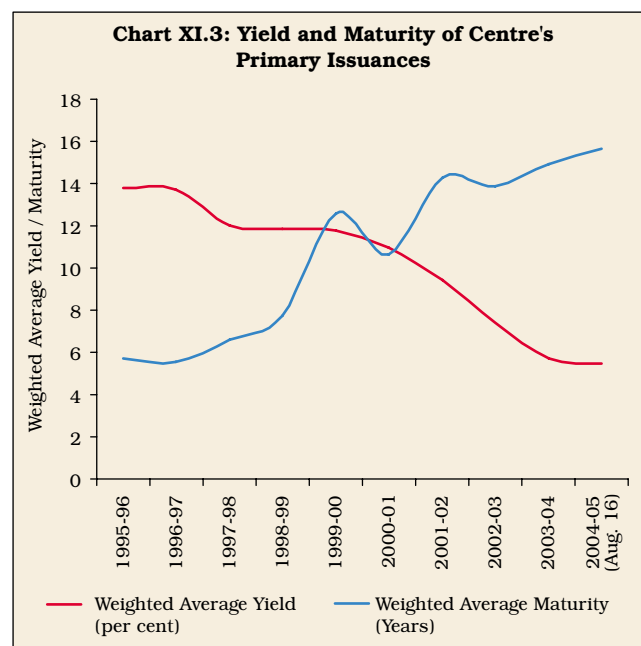


Table 11.4: A Profile of Central Government's Market Loans

(Yield in per cent/Maturity in years)

Year	YTM's at Primary Issues (per cent)			Weighted Average Yield	Maturity of New Loans	Weighted Average Maturity	Weighted Average Maturity of outstanding stock	Weighted Average Yield of outstanding stock
	Under 5 years	5-10 years	Over 10 years					
1	2	3	4	5	6	7	8	9
1997-98	10.85-12.14	11.15-13.05	–	12.01	3-10	6.6	6.5	n.a.
1998-99	11.40-11.68	11.10-12.25	12.25-12.60	11.86	2-20	7.7	6.3	n.a.
1999-00	–	10.73-11.99	10.77-12.45	11.77	5-19	12.6	7.1	n.a.
2000-01	9.47-10.95	9.88-11.69	10.47-11.70	10.95	2-20	10.6	7.5	n.a.
2001-02	–	6.98-9.81	7.18-11.00	9.44	5-25	14.3	8.2	10.84
2002-03	–	6.65-8.14	6.84-8.62	7.34	7-30	13.8	8.9	10.44
2003-04	4.69	4.62-5.73	5.18-6.35	5.71	4-30	14.94	9.78	9.30
2004-05 (up to August 16, 2004)	–	–	4.49-7.50	5.52	11-30	15.68	9.84	8.95

n. a.: Not available. – : No issues. YTM : Yield to Maturity.

11.12 The response at primary auctions was generally favourable with the average bid-cover ratio working out to 1.7 in 2003-04 as against 2.1 in 2002-03. For the first time, there was no devolvement on the Reserve Bank or on primary dealers in any auction during the year.

11.13 The policy of elongation of maturity of dated securities continued during the year with the multiple objectives of developing a yield curve for the long end of the maturity spectrum, managing rollover risk and locking in borrowings at low costs. The weighted average maturity of the securities issued during the year and outstanding dated securities increased to 14.94 years and 9.78 years, respectively (Table 11.4).

11.14 The weighted average yield of the dated securities issued during 2004-05 (up to August 16, 2004) worked out to 5.52 per cent as against 5.89 per cent during the corresponding period of the previous year. The weighted average maturity of the dated securities issued during 2004-05 (up to August

16, 2004) was 15.68 years as compared with 15.84 years during the corresponding period of 2003-04.

11.15 Securities over 10-year maturity constituted the largest share in the outstanding stock of securities as well as in new issuances (Table 11.5).

11.16 The Central Government converted the balance stock of 4.6 per cent Government of India Treasury Bills (Conversion) Special Securities held by the Reserve Bank into marketable lots on a private placement basis. This considerably enhanced the stock of marketable securities in the portfolio of the Reserve Bank, strengthening the conduct of sterilisation operations (Table 11.6).

Table 11.5: Maturity Profile of Central Government Securities

(Per cent)

Year	Outstanding Stock			Issued During the Year		
	Under 5 Years	5-10 Years	Over 10 Years	Under 5 Years	5-10 Years	Over 10 Years
1	2	3	4	5	6	7
1997-98	41	41	18	18	82	–
1998-99	42	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
2002-03	26	35	39	–	36	64
2003-04	24	32	44	5	15	80

Table 11.6: Reserve Bank's Stock of Central Government Securities@

(Rupees crore)

Year (end-March)	Outstanding Dated Securities*	Special Securities Issued to RBI in Conversion of <i>Ad-hoc</i> Treasury Bills	Total Outstanding*
1	2	3	4
1996-97	6,666	1,21,818	1,28,484
1997-98	31,977	1,01,818	1,33,795
1998-99	42,212	1,01,818	1,44,030
1999-00	35,190	1,01,818	1,37,008
2000-01	41,732	1,01,818	1,43,550
2001-02	40,927	1,01,818	1,42,745
2002-03	55,438	61,818	1,17,256
2003-04	77,397	0	77,397
2004-05 (As on August 9, 2004)	1,02,402	0	1,02,402

@ : Does not include other special securities.
* : Inclusive of securities sold under the LAF.

Table 11.7: Repayment Schedule for Centre's Market Loans Outstanding
(As on March 31, 2004)

Year	(Amount in Rs. crore)
1	2
2004-05	34,316
2005-06	35,631
2006-07	39,079
2007-08	45,876
2008-09	44,028
2009-10	49,589
2010-11	50,586
2011-12	50,581
2012-13	57,074
2013-14	55,009
2014-15	42,018
2015-16	41,244
2016-17	36,130
2017-18	50,774
2018-19	37,478
2019-20	28,000
2020-21	11,000
2021-22	13,213
2022-23	24,000
2023-24	21,000
2025-26	16,688
2026-27	15,000
2027-28	8,000
2028-29	6,000
2032-33	12,000
Total	8,24,314

11.17 The profile of repayments of outstanding market loans of the Central Government indicates some bunching between 2006-07 and 2013-14 in nominal terms (Table 11.7).

Table 11.8: Interest Rate Profile of Outstanding Central Government Securities
(As on March 31, 2004)

Interest Rate (Per cent)	Outstanding (Amount in Rs. crore)	Share in Total
1	2	3
4.50-4.99	27,500	3.34
5.00-5.99	78,818	9.56
6.00-6.99	1,16,835	14.17
7.00-7.99	1,10,541	13.41
8.00-8.99	29,638	3.60
9.00-9.99	51,744	6.28
10.00-10.99	83,537	10.13
11.00-11.99	1,86,344	22.61
12.00-12.99	1,07,135	13.00
13.00-14.00	32,222	3.91
Total	8,24,314	100.0

11.18 Securities with coupon at 10 per cent and above declined to 49.6 per cent of the total stock outstanding as on March 31, 2004 from 67.6 per cent as on March 31, 2003 (Table 11.8).

11.19 With a view to enabling institutional and retail investors to plan their investment better and for imparting transparency and stability to the Government securities market, it was decided in consultation with the Government to continue with the system of releasing an indicative calendar for the period April to September 2004, specifying the amounts and maturity of loans to be issued. The calendar is subject to variations depending on market conditions and other factors. In addition to the borrowing schedule as per the calendar, the Reserve Bank has the option of additional issuances as warranted by the Government's requirement and market conditions (Table 11.9).

Table 11.9: Issuance Calendar and Actual Borrowings
(April 1, 2004 to September 30, 2004)

Borrowings as per Issuance Auction Calendar			Actual Borrowings		
Period of auction	Amount (Rs. crore)	Maturity Period of the Security	Date of Auction / Date of issue	Amount (Rs. crore)	Tenor of the Security (Years)
1	2	3	4	5	6
April 12-20,2004	5,000	15 to 19 year	No Issue		
May 3-10,2004	6,000	i) 10 to 14 year	May 6/7, 2004	6,000	12.00
	3,000	ii) 20- year and above	May 6/7, 2004	3,000	23.88
June 1-8,2004	6,000	i) 10 to 14 year	June 3/4, 2004	6,000	12.00
	4,000	i) 20- year and above	June 3/4, 2004	4,000	23.81
June 17-24,2004	6,000	i) 10 to 14 year	June 17/18, 2004	6,000	11.21
	3,000	ii) 20- year and above	June 17/18, 2004	3,000	23.96
July 1-8, 2004	6,000	i) 10-14 year	July 1/2, 2004	6,000	11.00
	2,000	ii) 20-year and above	July 1/2, 2004	2,000	23.92
August 2-9, 2004	6,000	i) 10-14 year	August 9/10, 2004	6,000	11.00
	2,000	ii) 20-year and above	August 9/10, 2004	2,000	30.00
September 2-9, 2004	6,000	i) 5-9 year			
	4,000	ii) 15-19 year			

Box XI.1 Debt Buyback Scheme

The first ever buyback auction was conducted for 19 high coupon but relatively illiquid Government of India dated securities at a price range of Rs.122.75-148.87 on a voluntary basis through a live interactive platform where participants were allowed to revise their bids. In all, 131 offers amounting to Rs.14,434 crore (face value) were received. The entire amount was accepted as the offers were at or above the minimum discount of 7.5 per cent (to the market value) expected by the Government. The market value of the securities bought back amounted to Rs.19,394 crore. The difference between the market value and the face value (*i.e.*, Rs.4,960 crore) was shared

between the Government and market participants. While the premium paid to market participants amounted to Rs.3,472 crore, the Government saved Rs.1,488 crore or 7.67 per cent of the market value or the discount. In exchange of the securities bought back, the Government reissued four existing liquid securities of equal face value (Rs.14,434 crore). The prices at which the securities were reissued were the weighted average prices during the period July 14-18, 2003. Banks were allowed additional deduction for tax purposes to the extent such income was used for provisioning of non-performing assets (NPAs).

11.20 Net market borrowing of the Central Government for the year 2004-05 was placed at Rs.90,365 crore in the Union Budget. Including repayments of Rs.60,451 crore, gross market borrowings are expected to be of the order of Rs.1,50,817 crore (Rs.1,24,817 crore through dated securities and Rs.26,000 crore through 364-day Treasury Bills), as against Rs.1,47,636 crore raised in 2003-04. The issuance calendar for dated securities of the Central Government for the first half of 2004-05 was drawn up on the assumption that Rs.24,000 crore would be prepaid by the States during the first half. This amount was to be raised by way of market borrowings (Rs.12,000 crore) and by utilising small saving receipts (Rs.12,000 crore). Accordingly, it was announced on March 25, 2004 that Rs.59,000 crore would be raised by way of dated securities during the first half of 2004-05.

11.21 Excluding the amount raised under the Market Stabilisation Scheme, the gross market borrowings raised by the Central Government during 2004-05 (up to August 14, 2004) amounted to Rs.54,035 crore (Rs.44,000 through dated securities and Rs.10,035 crore by way of 364-day Treasury Bills) as compared with Rs.98,464 crore (Rs.88,434 crore through dated securities and Rs.10,030 crore through 364-day Treasury Bills) during the corresponding period of the previous year. The net market borrowing amounted to Rs.18,229 crore as against Rs.50,875 crore during the corresponding period of the previous year.

Debt Restructuring - Central Government

11.22 The Union Budget, 2003-04 envisaged measures for debt restructuring as a part of the process of fiscal consolidation - the buyback of loans by the Central Government from banks on a

voluntary basis, prepayment of external debt and the States' debt swap scheme. The Reserve Bank conducted a buyback auction of high coupon but relatively illiquid securities for the first time on July 19, 2003 (Box XI.1).

11.23 Taking into account the comfortable foreign exchange reserves and soft domestic interest rates, the Central Government prepaid high cost external debt amounting to US \$ 3.8 billion. Private placement did not have a monetary impact and was neutral to public debt as it involved substitution of external debt with domestic debt.

STATE GOVERNMENTS

Ways and Means Advances

11.24 A majority of States reduced their recourse to normal WMA and overdrafts (OD) during 2003-04 (Table 11.10). The use of special WMA by the States increased by 52.7 per cent during 2003-04, mainly due to the change in provision that special WMA should be availed first before availing the normal WMA as recommended by the Ramachandran Committee (2003). The interest rate charged on Special WMA is one percentage point less than the rate on normal WMA (Chart XI.4). The buoyant proceeds from small savings and higher market borrowings (other than under the debt swap scheme) also contributed to the substantially lower recourse to the normal WMA *vis-à-vis* the aggregate limit of Rs.7,170 crore available for the year 2003-04.

11.25 During 2003-04, some States, especially Tamil Nadu, Haryana, Nagaland and Uttaranchal considerably reduced their recourse to WMA (in terms of number of days) and overdraft (both in terms of number of days and number of occasions) (Table 11.11).

Table 11.10: WMA/Overdrafts and Investment of the State Governments*

(Rupees crore)

Month	Normal WMA		Special WMA		Overdraft		Investment in 14-day Intermediate Treasury Bills	
	2003-04	2002-03	2003-04	2002-03	2003-04	2002-03	2003-04	2002-03
1	2	3	4	5	6	7	8	9
April	2,145	2,924	989	835	1,088	2,987	3,894	1,652
May	1,816	2,961	941	480	445	1,428	4,987	2,404
June	1,179	3,007	937	559	204	1,022	6,232	3,670
July	2,160	3,295	1,138	658	612	1,252	4,095	2,727
August	2,183	2,058	968	507	658	817	5,193	4,367
September	1,681	2,875	959	610	532	924	5,190	4,389
October	2,464	3,238	1,150	709	946	1,860	3,690	3,156
November	3,829	3,673	1,246	704	1,053	1,575	3,497	2,396
December	4,513	4,454	1,216	833	1,185	1,407	2,820	2,440
January	3,417	3,982	1,055	922	1,203	1,431	3,716	3,299
February	3,274	3,352	1,023	493	698	1,351	4,208	3,371
March	2,068	2,806	811	832	703	715	4,234	3,301
Average	2,379	3,219	1,036	679	777	1,397	4,313	3,098

* : Average of Friday outstandings.

11.26 Effective April 1, 2004 the formula-based aggregate normal WMA limit of the State Governments was revised upwards by 13.5 per cent to Rs.8,140 crore on the basis of higher average revenue receipts of the States in the preceding three years (Table 11.12).

Market Borrowings

11.27 Gross market borrowings raised by the State Governments increased by 63.7 per cent during

2003-04 (Table 11.13). Of the total amount of Rs.29,000 crore allocated under the debt swap scheme (DSS), Rs.26,623 crore was utilised towards repayment of debt under the DSS. A part of market borrowings under the DSS was allowed to be retained by a few States for other purposes, while a small portion of the DSS remained unsubscribed.

11.28 Of the total borrowings by the States during 2003-04, 94.3 per cent was through sale of securities on a tap basis. Interest rates on States' market borrowings softened during 2003-04 even as the maturity profile of select tap tranches was extended up to 13 years to minimise the rollover risk and bunching of repayments arising from the higher market borrowings under the DSS (Table 11.14).

11.29 Borrowings raised by way of auctions aggregated Rs.2,895 crore, accounting for 5.7 per cent of total borrowings. The spread *vis-à-vis* Central Government dated security of similar maturity ranged at 48-88 basis points (Table 11.15).

11.30 The weighted average yield of the State Government loans declined in 2003-04 (Table 11.16). The spread in the case of tap issues was fixed at a mark-up of about 50 basis points over the secondary market yield on the Central Government dated securities of similar maturity.

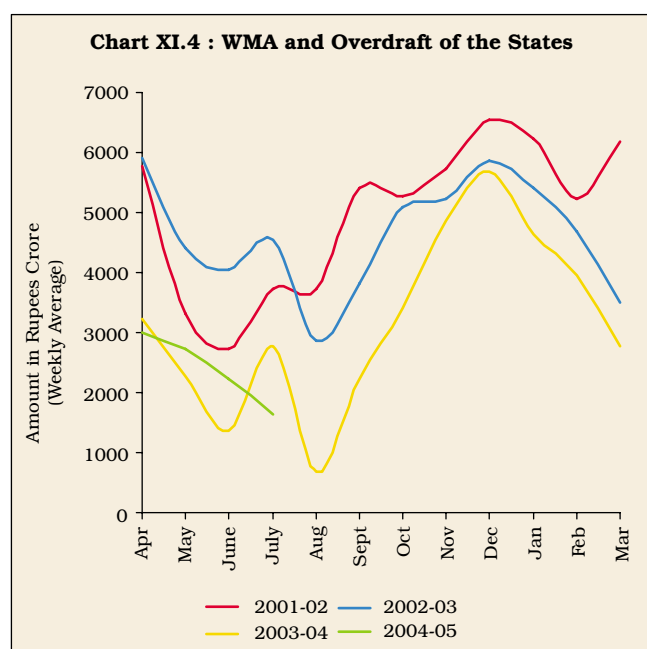


Table 11.11: State-wise Availment of WMA/Overdraft

(Rupees crore)

State	WMA		Overdraft			
	2003-04	2002-03	2003-04		2002-03	
	No. of days	No. of days	No. of Occasions	No. of days	No. of Occasions	No. of days
1	2	3	4	5	6	7
Non-Special Category States						
1. Andhra Pradesh	173	72	6	30	6	33
2. Bihar	92	1	5	44	0	0
3. Goa	270	266	8	48	9	66
4. Gujarat	203	219	4	21	13	47
5. Haryana	24	64	0	0	4	21
6. Karnataka	196	157	6	33	1	1
7. Kerala	328	330	27	178	28	196
8. Madhya Pradesh	261	251	10	59	22	176
9. Maharashtra	207	301	5	39	17	154
10. Orissa	315	329	19	168	21	189
11. Punjab	291	214	14	131	11	53
12. Rajasthan	303	329	16	94	21	151
13. Tamil Nadu	38	326	1	2	13	73
14. Uttar Pradesh	321	229	10	100	14	79
15. West Bengal	362	318	21	140	28	260
16. Chhattisgarh	0	0	0	0	0	0
17. Jharkhand	31	0	0	0	0	0
Special Category States						
1. Arunachal Pradesh	0	27	0	0	0	0
2. Assam	337	121	20	235	24	315
3. Himachal Pradesh	327	252	14	109	27	181
4. Manipur	268	333	14	201	19	350
5. Meghalaya	31	78	0	0	1	1
6. Mizoram	131	184	3	5	4	24
7. Nagaland	12	297	0	0	19	143
8. Tripura	25	28	0	0	0	0
9. Uttaranchal	78	180	3	13	9	41

11.31 The weighted average maturity of the State Government securities issued during the year increased to 11.05 years in 2003-04 from 10 years in 2002-03. Of the outstanding loans of the State Governments, securities in the maturity range of 6-10 years constituted the largest share (53.9 per cent), followed by 0-5 years (32.1 per cent) and above 10 years (14.0 per cent) (Table 11.17). The weighted average maturity of the outstanding stock of the State Government securities stood at 9.32 years at end-March 2004.

11.32 The annual repayment schedule of the State Government market loans (including power bonds) indicates some amount of bunching of repayments during the three year period from 2011-12 to 2013-14 (Table 11.18), reflecting large amount of

market borrowings in recent years inclusive of borrowings under the DSS.

11.33 The interest rate profile of the outstanding stock of State Governments indicates that 53.1 per cent was contracted at interest rates ranging from 5.00 to 9.99 per cent and the remaining at 10 per cent and above (Table 11.19).

11.34 The net initial allocations under the market borrowing programme for the State Governments for 2004-05 were placed at Rs.12,947 crore, including additional allocations of Rs.230 crore, Rs.50 crore and Rs.0.8 crore to Tamil Nadu, Himachal Pradesh and Nagaland, respectively. Taking into account the repayments of Rs.5,123 crore, the gross allocation amounted to Rs.18,070 crore excluding Rs.24,000 crore allocated under the debt swap scheme (DSS).

Table 11.12: Normal WMA Limits of the States

(Rupees crore)

State	WMA Limits 2004 (effective April 1, 2004)	WMA Limits 2003 (effective March 3, 2003)	WMA Limits 2002 (effective April 1, 2002)	WMA Limits 2000 (effective February 1, 2001)	WMA Limits 1999 (effective March 1, 1999)
1	2	3	4	5	6
Non-Special Category States					
1. Andhra Pradesh	700	620	520	463	288
2. Bihar	340	305	245	220	195
3. Chhattisgarh	155	130	100	91	82
4. Goa	65	50	50	25	24
5. Gujarat	520	485	445	393	243
6. Jharkhand	175	105	75	57	51
7. Haryana	245	205	180	167	99
8. Karnataka	505	460	375	331	228
9. Kerala	315	270	225	215	144
10. Madhya Pradesh	395	345	275	244	221
11. Maharashtra	1,000	905	760	685	483
12. Orissa	250	215	185	159	141
13. Punjab	325	240	235	200	141
14. Rajasthan	405	365	310	288	202
15. Tamil Nadu	615	570	415	402	281
16. Uttar Pradesh	835	755	630	559	531
17. West Bengal	480	420	360	295	235
Sub Total	7,325	6,445	5,385	4,794	3,589
Special Category States					
1. Arunachal Pradesh	50	50	50	35	28
2. Assam	250	210	180	161	114
3. Himachal Pradesh	140	135	115	92	59
4. Manipur	50	50	50	38	25
5. Meghalaya	50	50	50	30	25
6. Mizoram	50	50	50	28	25
7. Nagaland	60	55	50	40	26
8. Tripura	70	60	55	46	31
9. Uttaranchal	95	65	50	19	19
Sub Total	815	725	650	489	352
Total	8,140	7,170	6,035	5,283	3,941

11.35 During 2004-05 (up to August 14, 2004), the State Governments raised gross amount of Rs.22,259 crore under the market borrowing programme (inclusive of Rs.13,782 crore under the DSS). On April 21, 2004 all the 28 States raised Rs.7,500 crore through tap issuances of 5.60 per cent 10-year State Development Loans 2014 under the market borrowing programme. On May 26-27, 2004, 19 States raised an amount of Rs.8,471 crore at a coupon of 5.70 per cent for a tenure of 10 years through tap sale, of which Rs.8,091 crore went towards the debt swap scheme. On July 28-29, 2004

19 States raised an amount of Rs.6,288 crore at a coupon rate of 6.35 per cent for a tenure of nine years through a tap sale, of which Rs.5,691 crore went towards the debt swap scheme.

States' Debt Swap Scheme

11.36 Under the DSS, the Central Government permitted State Governments to prepay high cost debt from the Centre aggregating over Rs.1,00,000 crore (contracted at interest rates of 13 per cent or more) over a three-year period ending 2004-05. During

Table 11.13: Market Borrowings of the State Governments - 2003-04

(Rupees crore)

State	Gross Allocation	Repayment	Net Allocation (Col. 2 - Col.3)	Gross Amount raised by Auction	Gross Amount raised by Tap	Gross Borrowings (Col.1 5+ Col.6)
1	2	3	4	5	6	7
1. Andhra Pradesh	3,226	393	2,833	500	2,726	3,226
2. Arunachal Pradesh	131	5	126	–	131	131
3. Assam	943	124	819	–	943	943
4. Bihar	2,131	309	1,822	–	2,131	2,131
5. Chhattisgarh	742	48	693	–	642	642
6. Goa	240	10	230	–	240	240
7. Gujarat	3,333	138	3,195	250	3,083	3,333
8. Haryana	1,165	79	1,086	–	1,165	1,165
9. Himachal Pradesh	882	26	856	–	882	882
10. Jammu and Kashmir	522	45	478	–	522	522
11. Jharkhand	575	105	470	–	575	575
12. Karnataka	2,779	181	2,598	–	2,779	2,779
13. Kerala	1,931	220	1,711	450	1,481	1,931
14. Madhya Pradesh	2,405	133	2,272	220	2,185	2,405
15. Maharashtra	6,449	226	6,223	700	5,749	6,449
16. Manipur	192	15	177	–	192	192
17. Meghalaya	166	17	149	–	166	166
18. Mizoram	101	5	96	–	101	101
19. Nagaland	227	20	207	–	227	227
20. Orissa	2,119	300	1,819	–	2,101	2,101
21. Punjab	2,056	51	2,006	190	1,867	2,056
22. Rajasthan	2,714	249	2,465	–	2,714	2,714
23. Sikkim	62	7	55	–	62	62
24. Tamil Nadu	2,851	313	2,538	250	2,601	2,851
25. Tripura	229	20	209	–	229	229
26. Uttar Pradesh	5,540	766	4,774	–	5,375	5,375
27. Uttaranchal	1,366	41	1,325	–	1,366	1,366
28. West Bengal	5,729	300	5,429	335	5,394	5,729
Total	50,805	4,145	46,659	2,895	47,626	50,521

2003-04, the States repaid Rs.46,211 crore under the DSS. This included Rs.26,623 crore prepaid to the Centre out of fresh market borrowings. For the year 2004-05, the States would raise an additional Rs.24,000 crore from the market under the DSS.

Working Group on Model Fiscal Responsibility Legislation at the State Level

11.37 A Working Group comprising Finance Secretaries of States that have already enacted the Fiscal Responsibility legislation (or placed the bill before the Legislature), a representative each from the Central Government and the Reserve Bank was constituted in October 2003 to draft a model fiscal responsibility legislation at the State level in

recognition of the importance of a rule-based fiscal policy to achieve fiscal sustainability (Box XI.2). The draft report was discussed in the 14th Conference of the State Finance Secretaries held on August 13, 2004. The report would be finalised after taking into account the comments of the State Finance Secretaries.

Guarantees Issued by the State Governments

11.38 State Governments have been issuing a large number of guarantees and letters of comfort to the State-level institutions, both in the public and private sectors, to enable them to mobilise resources for investment in infrastructure and for promotion of rural development (Table 11.20).

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Table 11.14: Market Borrowings Raised Through Tap Issuances - 2003-04

(Amount in Rs. crore)

State	Period of Tap Issue/Coupon						
	Feb. 19-20, 2004, 5.85 per cent***	Jan. 19-20, 2004, 5.90 per cent **	Oct. 13-15, 2003, 5.85 per cent *	Aug. 25, 2003, 6.20 per cent *	Jul. 30, 2003, 6.20 per cent	Jun.12, 2003, 6.35 per cent	May 12-13, 2003, 6.40 per cent
1	2	3	4	5	6	7	8
1. Andhra Pradesh	0	306	264	462	462	404	828
2. Arunachal Pradesh	23	58	12	10	10	9	9
3. Assam	0	205	158	130	130	113	207
4. Bihar	22	569	202	337	337	295	369
5. Chhattisgarh	0	302	100	83	83	73	0
6. Goa	0	49	57	25	25	22	62
7. Gujarat	0	629	300	630	630	551	343
8. Haryana	0	141	199	212	212	186	216
9. Himachal Pradesh	0	110	176	141	141	124	190
10. Jammu and Kashmir	0	75	17	109	109	96	116
11. Jharkhand	0	28	147	83	83	72	162
12. Karnataka	500	221	519	340	340	297	562
13. Kerala	300	119	115	192	192	168	395
14. Madhya Pradesh	800	129	220	228	228	200	379
15. Maharashtra	50	884	567	1254	1254	1097	644
16. Manipur	28	50	58	10	10	9	27
17. Meghalaya	11	39	52	10	10	9	35
18. Mizoram	12	33	18	7	7	6	17
19. Nagaland	21	42	82	8	8	7	58
20. Orissa	481	464	183	220	220	193	339
21. Punjab	250	256	0	402	402	351	206
22. Rajasthan	300	230	571	381	381	334	517
23. Sikkim	0	30	10	5	5	5	7
24. Tamil Nadu	250	443	150	383	383	335	657
25. Tripura	13	56	62	20	20	18	39
26. Uttar Pradesh	474	865	795	808	808	708	916
27. Uttaranchal	0	0	263	339	339	297	128
28. West Bengal	500	899	164	1,171	1,171	1,024	466
Total	4,036	7,233	5,460	8,002	8,001	7,002	7,893

* : Tenure 12 years.

** : Tenure 13 years.

*** : Tenure 11 years.

11.39 The devolvement of guarantees on a State Government has implications for its debt sustainability and overall financial stability. The development of a

comprehensive database and an appropriate reporting system would help promote market discipline and effective supervision of financial intermediaries

Table 11.15: Market Borrowings Raised in Auctions - 2003-04

(Amount in Rupees crore/rate in per cent)

State	Date of Auction	Notified Amount (per cent)	Market Rate*	No. of Bids Received	Amount Offered (per cent)	Weighted Average (per cent)	Cut-off Rate	Spread (Col. 8- Col. 4)
1	2	3	4	5	6	7	8	9
1. Andhra Pradesh	13.08.03	500	5.52	79	2,362	5.98	6.03	0.51
2. Gujarat	13.08.03	250	5.52	56	1,630	5.98	6.00	0.48
3. Kerala	13.08.03	250	5.52	57	1,397	5.99	6.02	0.50
	25.03.04	200	5.17	38	430	5.76	5.80	0.63
4. Madhya Pradesh	08.09.03	220	5.28	19	408	5.99	6.00	0.72
5. Maharashtra	08.09.03	400	5.28	55	1,116	5.78	5.78	0.50
	12.01.04	300	5.12	31	303	5.81	6.00	0.88
6. Punjab	20.09.03	190	5.31	21	357	5.88	5.90	0.59
7. Tamil Nadu	13.08.03	250	5.52	64	1,799	5.97	6.00	0.48
8. West Bengal	08.09.03	335	5.28	27	962	5.78	5.78	0.50

* : Yield on Central Government dated security of similar maturity.

Table 11.16: Weighted Average Yield of State Government Market Loans

(per cent per annum)

Year	Range	Weighted Average
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
1999-00	11.00-12.25	11.89
2000-01	10.50-12.00	10.99
2001-02	7.80-10.53	9.20
2002-03	6.60-8.00	7.49
2003-04	5.78-6.40	6.13

subscribing to bonds and providing advances. A Working Group on Information on State Government Guaranteed Advances and Bonds (Chairman: Shri G. Padmanabhan) was set up to evaluate the status of the reporting system

Table 11.17: Maturity Profile of Outstanding State Government Market Loans (At end-March 2004)

State	Percentage to total amount outstanding			Total Amount Outstanding (Rs. Crore)
	0-5 years	6-10 years	Above 10 years	
1	2	3	4	5
1. Andhra Pradesh	34.7	59.3	6.0	17,090
2. Arunachal Pradesh	16.0	44.7	39.3	262
3. Assam	35.0	54.1	11.0	4,496
4. Bihar	37.1	51.9	11.0	10,243
5. Chhattisgarh	0.0	66.4	33.6	1,445
6. Goa	31.0	53.5	15.5	843
7. Gujarat	26.1	59.5	14.4	10,846
8. Himachal Pradesh	19.8	65.2	15.0	2,839
9. Harayana	32.7	52.9	14.4	3,825
10. Jammu and Kashmir	25.3	65.9	8.9	2,277
11. Jharkhand	0.0	83.1	16.9	1,523
12. Karnataka	29.0	54.6	16.4	9,645
13. Kerala	38.5	52.7	8.8	8,221
14. Maharashtra	27.4	52.4	20.2	13,655
15. Madhya Pradesh	37.7	46.8	15.5	8,867
16. Manipur	31.4	41.0	27.6	529
17. Meghalaya	39.3	44.6	16.1	700
18. Mizoram	29.6	53.8	16.6	422
19. Nagaland	36.6	49.4	14.0	1,098
20. Orissa	37.5	47.0	15.5	8,681
21. Punjab	29.8	55.3	15.0	6,059
22. Rajasthan	33.9	54.0	12.1	12,282
23. Sikkim	56.1	28.7	15.2	296
24. Tripura	34.8	46.1	19.2	792
25. Tamil Nadu	32.0	57.4	10.6	11,537
26. Uttaranchal	0.0	76.3	23.7	2,543
27. Uttar Pradesh	39.8	46.2	14.0	23,739
28. West Bengal	27.4	54.0	18.6	14,711
Total	32.1	53.9	14.0	1,79,465

Table 11.18: Maturity Profile of Outstanding State Market Loans and Power Bonds (As at end-March 2004)

(Rupees crore)

Year	State Loans	Power Bonds	Total Outstanding
1	2	3	4
2004-05	5,123		5,123
2005-06	6,274		6,274
2006-07	6,551	1,480	8,031
2007-08	11,555	2,961	14,515
2008-09	14,400	2,961	17,361
2009-10	16,511	2,961	19,472
2010-11	15,870	2,961	18,830
2011-12	22,032	2,961	24,993
2012-13	30,628	2,961	33,589
2013-14	25,790	2,961	28,751
2014-15	4,036	2,961	6,997
2015-16	13,462	2,961	16,423
2016-17	7,233	1,480	8,713
Total	1,79,465	29,606	2,09,071

from the perspective of the intermediaries with exposure to the State Government guaranteed loans and bonds. It was also required to develop a reporting framework that would provide comprehensive data coverage and a transparent reporting system on State Government guarantees (Box XI.3).

Scheme for Settlement of Dues of State Electricity Boards

11.40 Under the One-Time Settlement Scheme for dues of the State Electricity Boards (SEBs), Power Bonds amounting to Rs.28,984 crore in respect of 26 States were issued to the Central Public Sector

Table 11.19: Interest Rate Profile of the Outstanding Stock of State Government Market Loans (As at end-March 2004)

Range of Interest Rate (per cent)	Outstanding Amount (Rupees crore)	Percentage to Total
1	2	3
5.00-5.99	18,641	10.39
6.00-6.99	52,274	29.13
7.00-7.99	11,029	6.15
8.00-8.99	8,004	4.46
9.00-9.99	5,412	3.02
10.00-10.99	14,563	8.11
11.00-11.99	17,062	9.51
12.00-12.99	30,485	16.99
13.00-13.99	15,720	8.76
14.00 and above	6,274	3.50
Total	1,79,465	100.00

Box XI.2

State Government Debt – Sustainability Issues

The fiscal health of the State Governments has deteriorated steadily from the early 1980s as reflected in the sharp rise in the debt/GDP ratio from 16.7 per cent in 1980-81 to 29.4 per cent in 2003-04. The persistent increase in non development expenditure - debt service payments, subsidies, wage and pension outgo - the erosion in the tax/GDP ratio, inadequate returns from public investment and insufficient growth in central transfers have led to a hard budget constraint facing States. This has eased somewhat in the recent period on account of buoyant small savings, including securities issued to the National Small Savings Fund (NSSF), borrowings through State level PSUs and Special Purpose Vehicles (SPVs), funding of large arrears of State Electricity Boards through power sector bonds and provision of guarantees.

Debt sustainability assumes an inter-temporal dimension in the context of the States, *i.e.*, movements in the debt/GDP ratio, the primary deficit and the interest rate on the debt stock have to be monitored in terms of a sustainable path. Sustainability also depends on the extent of the development of the financial markets, which determines the absorptive capacity of the markets. Forward-looking financial markets can demand a higher risk premium leading to a higher cost of borrowing for the Government. Thus, even without any increase in the primary deficit, high debt ratios can become unstable. The assessment of public debt should relate to combined finances of the Centre and the States, which exclude the impact of inter-governmental transfers emerging from the financial intermediary role of the Central Government. Among the positive developments during 2003-04, the States had a lower recourse to WMA/OD and there was a perceptible decline in interest rates on their market borrowings, although they witnessed a rise in the debt-GDP ratio. The States would need to accelerate the fiscal consolidation process through revenue augmentation and reduction of non-Plan expenditure. Additional measures are also desirable in the form of setting up consolidated sinking funds, establishing guarantee redemption funds, imposing

ceiling on guarantees and introducing guarantee fees, fostering transparency with regard to budgeting, accounting and auditing, levying appropriate user charges and promoting private-public partnerships for infrastructure projects and public utilities. Five States have already enacted fiscal responsibility legislations to safeguard fiscal discipline and impose a statutory limit on the size of States' debt and/or borrowings (including guarantees). The Act is being enacted by one more State. The remaining States would need to enact similar legislation.

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Undertakings (CPSUs) in September 2003 (with retrospective date of October 1, 2001). Power Bonds in respect of Jharkhand were issued for Rs.622 crore in May 2004. Goa does not have any outstanding dues in respect of its SEB. Thus, the total loans issued amounted to Rs.29,606 crore. Ten per cent of the bonds could be taken to the market each year for trading for imparting liquidity to the bonds, once the overdue interest (for the period beginning from October 1, 2001 to September 30, 2003) is paid by the States to the CPSUs by September 2004.

Conference of State Finance Secretaries

11.41 The Reserve Bank has been organising the Conferences of the State Finance Secretaries in a structured manner since 1997, wherein a consensual approach among the Central Government, State Governments and the Reserve Bank has evolved on issues relating to State finances. During 2003-04, the 12th and 13th conferences were held on August 1, 2003 and January 23, 2004, respectively. In the 12th Conference, the major issues deliberated upon were

Table 11.20: Outstanding Guarantees of the State Governments

End-March	Amount (Rs. Crore)	Proportion to GDP (per cent)
1	2	3
1992	40,159	6.1
1993	42,515	5.7
1994	48,866	5.7
1995	48,479	4.8
1996	52,631	4.4
1997	63,409	4.6
1998	73,751	4.8
1999	97,454	5.6
2000	1,32,029	6.8
2001	1,68,719	8.1
2002	1,65,386	7.2
2003 (P)	1,84,294	7.5

P : Provisional.

Note : Data on State Governments guarantees are based on information received from 17 State Governments.

- (i) defaults in servicing of guaranteed bonds;
(ii) market borrowings of the State Governments;
(iii) infrastructure financing; (iv) restructuring of State

level PSUs; and (v) one-time settlement of SEB dues. A one-day interactive workshop on cash management was also organised by the Reserve Bank on August 2, 2003 for the benefit of officials of the State Government. In the 13th conference held on January 23, 2004 the major issues discussed were (i) the Report of the Group to Study the Pension Liabilities of the State Governments; (ii) default on loans/bonds of State Governments, including guaranteed bonds issued by State Finance Corporations (SFCs); and (iii) market borrowings of the State Governments. Two Working Groups were constituted to examine issues relating to credit enhancement in infrastructure projects and uniform application of software for treasury operations. A workshop on "Restructuring and Disinvestment of State Public Sector Undertakings" was also organised on January 24, 2004 for the benefit of officials of the State Governments. In the 14th Conference held on August 13, 2004, important issues discussed related to (i) implications of higher market borrowings and other borrowings of the State Governments; (ii) enhancing the liquidity of the State Government

Box XI.3

Monitoring State Government Guaranteed Advances and Bonds

The Working Group on Information on State Government Guaranteed Advances and Bonds (Chairman: Shri G. Padmanabhan) underscored the need for consolidation and sharing of data with a view to ensuring its regular dissemination and recommended a central point or 'data warehouse' on all State government guaranteed loans and bonds. There are several gaps in the present reporting system in respect of State Government guaranteed bonds/advances from the side of investors/creditors. The only source of data is the off-site surveillance returns furnished by commercial banks, large non-banking financial companies (NBFCs) and select All India Financial Institutions (AIFIs) that are under the supervisory purview of the Reserve Bank. Data covering all NBFCs, co-operative banks, public financial institutions (excluding those supervised by the Reserve Bank) and provident funds that have a considerable exposure to State Government guaranteed bonds and advances are not available. Some information is available on a disaggregated basis across various financial sector regulators such as NABARD, NHB, SIDBI, IRDA, Ministry of Labour (in respect of Provident Fund Trusts) and the Ministry of Power (in respect of REC and PFC) though not in a structured form.

A centralised database is to be located in the Reserve Bank to meet the needs of various regulators as also to serve as a useful input for policy formulation. Data requirements in respect of guaranteed loans and advances cover State-wise, borrower-wise and sector-wise information and details of formal guarantees and letters of comfort (LCs) issued by the

State Governments. The sum of formal guarantees and LCs give the aggregate amount of explicit as well as implicit guarantees. A distinction is made between 'amount overdue and guarantee not invoked' and 'amount where guarantees have been invoked but not honoured'. In respect of guaranteed bonds, information requirements of the central database would cover issuer-wise and nomenclature-wise (*i.e.*, ISN identification number) total investments in guaranteed bonds, amount of overdue bonds (principal and interest) and amount of invoked guarantees not honoured. Inter-temporal changes in the default position would also be reported. The periodicity of reporting would be half-yearly with a lag of one month.

Transparency in information disclosure is crucial for enhancing market discipline. While the availability of information on defaults at a State-wise aggregated level (rather than at the level of the borrower) could sometimes go against the guarantor than would be the case if information was available on a more disaggregated (*i.e.*, project/borrower) basis, legal aspects relating to the publication of borrower-wise data on defaults would have to be taken into account. Subject to this limitation, (i) individual lender/investor-wise data (broken up into sectors) and (ii) State-wise data on guaranteed advances and investments (including defaults) could be disseminated through the Reserve Bank's publications and its website.

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securities; (iii) dimensions of debt sustainability of the States; and (iv) credit enhancement for infrastructure financing at the State level. The draft report of the Working Group on the model fiscal responsibility legislation at the State level was also discussed. Two Working Groups were constituted on (i) improving secondary market liquidity of the State Development Loans and (ii) methodology of compilation of data on various types of debt liabilities of the States.

Technical Advisory Committee

11.42 During 2003-04 and 2004-05 (up to August 14, 2004), the Technical Advisory Committee (TAC) held four meetings in June 2003, October 2003, March 2004 and May 2004. Issues discussed in the meeting in June 2003 related to (i) introduction of 'when issued market'; (ii) interest rate derivatives; (iii) report of the Internal Group on forward sale of securities acquired under OMO; (iv) capital indexed bonds; (v) introduction of 28-day Treasury Bills; and (vi) retailing of Government securities. Issues discussed in the October 2003 meeting included (i) relaxation of the existing norms on sale of Government securities/introduction of DvP-III mode of settlement and rollover of repos; (ii) exclusive access to primary dealers in Treasury Bill auctions; and (iii) settlement of Government securities transactions on a T+1 basis. The TAC was reconstituted and named as Technical Advisory Committee on Money, Government Securities and Forex Markets. In its first meeting held in March 2004, the newly constituted Committee discussed issues relating to (i) permitting PDs to invest in overseas markets; (ii) development of the repo market by allowing entry to corporates; and (iii) permission to banks to trade in exchange traded derivatives. As a follow-up of decisions taken in the TAC meeting held on March 29, 2004 a sub-group (Chairman: Dr. R.H. Patil) of the TAC was constituted to examine issues relating to diversification of business by primary dealers, including overseas investments. The report of the sub-group is expected to be submitted shortly. In the meeting of the TAC held in May 2004, various issues such as over-the-counter (OTC) derivatives, permission to banks to

trade in exchange traded derivatives, development of the term money market, improving secondary market liquidity of State Development Loans and extension of repo eligibility to corporates were deliberated.

Outlook

11.43 The lower market borrowings of the Central Government have provided some room for manoeuvre to the Reserve Bank and undertake innovative debt rescheduling /restructuring measures. These initiatives would be carried forward with a view to ensuring the sustainability of public debt. The Reserve Bank would also persevere with efforts towards development of financial markets, including new instruments and new participants, with an ongoing priority attached to modernising the technological infrastructure. These efforts, in turn, would help minimise debt servicing costs, transaction costs and volatility. The relaxation of regulations relating to sale of Government securities facilitating repo rollover, institution of delivery *versus* payment (DvP) III and the launching of screen based trading in Government securities would help in deepening the Government securities market and would facilitate the process of debt management. The reintroduction of capital indexed bonds (CIBs) would lower the cost of borrowings to the Government, while minimising the inflation risk to the investors. The lower cost of borrowing by way of CIBs would hinge on effective fiscal-monetary coordination. The enactment of Fiscal Responsibility and Budget Management Act, 2003 and the Fiscal Rules, 2004 effective July 5, 2004 would prohibit borrowings through subscription to primary issues of the Government by the Reserve Bank from April 1, 2006. This would impart greater flexibility and manoeuvrability in the conduct of monetary policy. The Reserve Bank would pursue the debt management policy consistent with objectives of minimisation of cost and rollover risk taking into account market conditions. The liquidity in State Government securities is an issue that would need to be addressed. Besides, the States would need to adopt a prudent fiscal policy, with enabling fiscal responsibility legislations for fiscal consolidation.