Chapter 5
India's Experience with Cash Management

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5.1 Introduction

Government cash management may be defined as "the strategy and associated processes for managing cost-effectively the government's short-term cash flows and cash balances, both within the government and between government and other sectors" (Williams 2004).

The primary objectives of government cash management must be to fund its expenditures in a timely manner and meet its obligations as they fall due. But cost-effectiveness, risk reduction and efficiency are additional objectives. A sound cash management system must provide assurance of timely availability of funds to meet the obligations as they arise.

There is a general understanding of what constitutes good practice in government cash management. These are summarized as follows:

- Centralization of government cash balances and establishment of a Treasury Single Account (TSA).
- Modern Systems: an adequate transaction processing and accounting framework, modern banking, payment and settlement systems.
- Ability to make accurate projections of short-term cash inflows and outflows.
- Strong institutional interaction, covering in particular:

The views are personal.

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  - Information sharing between cash managers, revenue-collecting agencies and spending ministries;
  - Strong coordination of debt and cash management;
  - Formal agreements between the Ministry of Finance/Treasury and the central bank on information flows and respective responsibilities.

- Use of short-term instruments (Treasury bills, repo and reverse repo, term deposits, etc.) to help manage cash balances and timing of mismatches between receipts and expenditures.

This paper discusses the historical facts and developments in cash management system in the country in Sect. 5.2. Section 5.3 follows up with the recent developments and changes in the way the government and central bank deals with deficits and cash surplus. Section 5.4 gives the assessment of current Indian cash management system. Finally, conclusions are presented in Sect. 5.5.

5.2 Historical Facts and Developments

According to the agreement made on 5 April 1935, Reserve Bank is required to transact the general banking business of the Central Government. The agreement was supplemented by exchanges of letters from time to time to bring in matters like minimum balances, provision of financial accommodations and modifications to the original agreement. The balances were usually maintained at not less than Rs. 50 crore. Whenever the balance in the account of the Central Government fell below Rs. 50 crore, the account was replenished by the creation of Treasury bills, generally in multiples of Rs. 5 crore, in favour of the RBI. These Treasury bills, which were also called ad hoc, were held in the Issue Department of the RBI. This arrangement continued for a long time and was commonly understood to facilitate automatic monetization of government's fiscal deficit.

The fiscal architecture began to change after the beginning of economic reforms in early 1990s. The first initiatives in the area of cash management in the Central Government were taken in 1997, consequent to the decision to phase out automatic monetization of budget deficit in 1994 and move to fund government's borrowing requirements at market-related rates. The old arrangement involving issue of ad hoc Treasury bills was replaced by a system of ways and means advances (WMA) with effect from 1 April 1997 through a memorandum of understanding (MoU) signed between the Central Government and RBI. Therefore, for the first time, Central Government was no longer assured of automatic monetization of debt through the discontinued system of ad hoc Treasury bills. This provided impetus for improvement in fiscal discipline and ensured greater independence for monetary policy. It also paved the way for designing institutional arrangements which would allow debt management to be increasingly separated from monetary policy.

Historically, WMA are temporary advances made to the government by its bankers to bridge the interval between expenditure and the flow of receipts of revenue. These advances are meant to provide for marginal and unanticipated but purely temporary difficulties, on account of a shortfall in revenue or other receipts for meeting the liabilities of the government. In terms of Section 17(5) of the RBI Act, the Reserve Bank is authorized to make, to the Central and state governments, WMA, which are repayable not later than three months from the date of making the advance. There are no statutory provisions as regards either the maximum amount of the advance or the rate of interest to be charged. Besides, it also arranges for investments of surplus cash balances of the governments as a portfolio manager. All the state governments are required to maintain a minimum balance with the RBI, which varies from state to state depending on the relative size of the state budget and economic activity. The WMA scheme for the state governments has provision for Special and Normal WMA. The Special WMA is extended against the collateral of the government securities held by the state government. After the exhaustion of the special WMA limit, the state government is provided a normal WMA. The normal WMA limits are based on three-year average of actual revenue and capital expenditure of the state. The withdrawal above the WMA limit is considered an overdraft (OD). A state government account can be in overdraft for a maximum of 14 consecutive working days with a limit of 36 days in a quarter. The rate of interest on WMA is linked to the Repo Rate. Surplus balances of state governments are invested in the Government of India 14-day Intermediate Treasury bills in accordance with the instructions of the state governments.

The current cash management operations of the Central Government take place via a two-tier system, with commercial banks acting as the first tier and the RBI forming the second tier of the system. The arrangement works through a system of accredited commercial banks with which different departments/ministries of the Central Government maintain their accounts. All receipts of the department/ministry pass through the accredited bank to the TSA of the Government of India maintained at Central Accounts Section RBI, Nagpur.

As per the 1997 agreement, if the cash balance of the government falls below the minimum cash balance level that it is required to be maintained, a short-term advance is automatically extended by the RBI to the Central Government under its WMA facility, up to a pre-announced limit to restore the cash balance to the minimum stipulated level.

These advances under the WMA system are extended at a mutually agreed rate of interest, currently at the Repo Rate, and have to be repaid in full by the government within three months. The RBI also provides an OD facility to the Central Government under which additional advances, over and above the WMA limit, are made available at a higher interest rate, which is currently at the Repo Rate plus 2 % points. The Central Government is not allowed to be in OD at a stretch for more than 10 consecutive working days.

In order to implement the rudimentary cash management system in the Central Government, a Monitoring Group on Cash and Debt Management of the Central Government (hereinafter referred to as Monitoring Group) was constituted. The terms of reference (TOR), in essence, encapsulate the motivation and objectives of cash management in India and are: (i) to estimate the monthly fiscal deficit and associated borrowing requirement at the beginning of the year and to update the estimates of monthly deficit and borrowing every month in the course of year; (ii) to review the cash position of the Central Government on an ongoing basis and to suggest measures to correct mismatches in receipts and expenditure from time to time; (iii) to work out a system for monitoring projections of receipts and expenditure on both monthly and quarterly basis; (iv) to suggest measures for building up a database for advance estimation of monthly revenues, especially for income tax, corporation tax, excise duties, service tax and customs duties; and (v) to review investments of surplus cash balances of the Central Government.

The need for better cash management system became more imperative after the introduction of half-yearly calendar for market borrowings by Central Government, in April 2002, as part of measures to develop government securities market. The initial half-yearly calendars were drawn up on the basis of "core market borrowing requirements" that was assessed taking into account expenditure relating to repayment of debt, interest payments, monthly expenditure on salary, wages and pensions and devolution of share of taxes and duties to state governments. However, projections based on such limited coverage of expenditure and backward-looking methodology were found to be inadequate to correctly assess the intra-year phasing of the market borrowing.

The growing emphasis on fiscal responsibility concerns was reflected in the enactment of Fiscal Responsibility and Budget Management Act, 2003 (FRBM) and notification of the Fiscal Responsibility and Budget Management Rules, 2004 (5 July 2004). There was greater focus on issues of expenditure management, including reduction in the mismatch between receipts and expenditure, rush of expenditure in the last quarter of financial year and possible parking of funds outside the Consolidated Fund of India (CFI). There was stricter and more frequent monitoring of fiscal position of the Central Government by various stakeholders, including the credit rating agencies.

In the meanwhile, the Union Budget (2003–2004) had announced the proposal to initiate cash management scheme, on a pilot basis, in some major spending ministries, releasing budgetary allocations in a time-sliced manner to permit convergence with available resources within the year. It envisaged prescription of monthly or quarterly cash limits, based on actual requirements of the ministries. The scheme was expected to avoid mismatches between receipts and expenditure, and associated possible waste of resources in the last quarter.

The Pilot Scheme of Cash Management was implemented in nine major spending Departments of the Central Government with effect from 1 April 2003. The scheme envisaged that the concerned departments would make Quarterly Expenditure Projections, which would be finalized by Ministry of Finance, upon consultation with the concerned Ministry, if need be, and then formally communicated to concerned department. The departments were expected to adhere to the mutually agreed quarterly ceiling while issuing cheques. However, these ceilings were not envisaged to be in nature of exchequer control—they were decided through mutual consultation and there were no penalties for breaching the same. The actual quarterly expenditures were to be communicated to the Ministry of Finance by the departments by the 10th of the month following the quarter. However, it was provided that unutilized funds during the quarter would not lapse and would be available for automatic carry-forward for expenditure in the subsequent quarters.

The working of the Pilot Scheme was examined by a Sub-Group on Cash Management of Government of India, which submitted its report in January 2005. The Sub-Group presented its recommendations under the following sub-heads: (a) inflow reporting; (b) outflow reporting; and (c) administrative arrangements. The Sub-Group had recommended, inter alia, introduction of exchequer control in phased manner to cover all departments.

5.3 Recent Developments

The financial year 2006–2007 was a landmark year in the area of debt management, with significant implications for the cash management system. FRBM Act, 2003, contained provisions that prohibited participation of RBI in the primary government securities market with effect from 1 April 2006, except under exceptional circumstances. With the statutorily mandated withdrawal of RBI from the primary government securities market, the two options of private placement of government securities with the RBI and devolvement to RBI in the event of inadequate bidding response or an bidding at rates not in alignment with market rates of interest, were no longer available to the government to meet its debt and cash requirements. In effect, for the first time, the Central Government was subjected to "hard budget constraint". It was in this backdrop that, based on the recommendations of the Sub-Group, Central Government introduced modified cash management system, including exchequer control-based expenditure management in 14 departments, with effect from financial year 2006–2007.

The cash management system currently operational in the Central Government is a modified version of the scheme recommended of the Sub-Group. The details of the Scheme are provided in Budget Division Office Memorandums dated 27 December 2006; 2 November 2011; 30 July 2012; and 3 July 2013. The July 2013 Memorandum reiterates the objective of the modified exchequer control-based expenditure management as follows:

- Obtain greater evenness in the budgeted expenditure within the financial year, especially in respect of items entailing large sums of advance releases and transfers to corpus funds.
- Reduce rush of expenditure during the last quarter, especially the last month of the financial year.
- Reduce tendency of parking of funds.

- Effectively monitor the expenditure pattern.
- Better planning of Indicative Market Borrowing Calendar of the Central Government.

The modified exchequer control-based cash management system presently covers 46 “High Spending Demands for Grants”, as recommended in the 14th Report of the Second Administrative Reforms Commission titled “Strengthening Financial Management Systems”. It entails formulation of monthly expenditure plans (MEP) that are to be included in the Detailed Demand for Grants presented to the Parliament. The exchequer control is applicable at Quarterly Expenditure Allocation (QEA), i.e., quarterly level. Automatic carry-forward of quarterly savings is no longer permitted without revalidation from Cash Management Cell in the Ministry of Finance. The Report of the Sub-Group had concluded that the provision for automatic carry-forward of the quarterly savings was a major factor limiting the efficient working of the Pilot Scheme. However, in order to provide comfort to line ministries against possibility of delay by MoF, it has been provided that revalidation would be “deemed” in case of non-response from MoF within 15 days.

Thereafter, based on the recommendation of 51st Report of the Standing Committee of Finance on Demands for Grants (2012–2013), Budget Division in July 2012 advised that all the Demands for Grants irrespective of whether they are covered under Cash Management System or not are required to prepare and send their MEP and QEA for better monitoring and compliance of the guidelines of MoF regarding expenditure management. Thus, departments/ministries, other than those 46 covered by the cash management system, also prepare and send their MEP and QEA to the Budget Division.

One of the important components of the cash management scheme has been the restrictions it places on rush of expenditure during the last quarter, particularly in the last month, of the financial year. The Scheme provides that while formulating the MEP, departments concerned should limit the QEA for 4th quarter to 33 % of Budget Estimate (BE) and MEP for the month of March, i.e., the last month of the financial year, should not exceed 15 % of BE. This restriction has been envisaged on the premise that such rush of expenditure towards the end of the financial year results in parking of funds outside the CFI. However, a spending department may approach Finance Ministry for exemption from the said restriction along with reasons (thereof), in case the situation so requires.

Up to (2003–2004), whenever there was surplus government fund, the excess amount was automatically invested in Central Government dated securities provided by the RBI from its own portfolio. But this can cause distortion between cash management and liquidity management if the RBI does not have adequate securities. Due to the reduction in government securities from the RBI’s portfolio because of the sterilization operations, RBI in consultation with the government placed a limit on the investment of the surplus. The limit depends on the availability of securities after meeting the requirement of securities for the Bank’s monetary policy operations. The surplus balance exceeding the limit is kept as idle cash balance at CAS, Nagpur, and does not earn any interest.

The Government of India's Internal Working Group on Debt Management (2008) (WGDM; Chairman: Dr. Jahangir Aziz) had emphasized that the Treasury bills as instrument for cash management were observed to be a potential source of volatility in short-term interest rates and interfered with the signalling impact of monetary policy. During this period, a relatively higher volatility in cash flows of the Central Government was observed. Therefore, during the month of May 2010, the Central Government introduced Cash Management Bills (CMBs) to meet cash requirements to cover for temporary deficit in cash flows, apart from using Treasury bills for this purpose. CMBs are flexible maturity instruments with all generic characteristics of Treasury bills, but are expected to be issued as and when necessary, purely as cash management instruments.

The WGDM had also observed that the cash management in India was largely passive due to "a lack of end-day balance management, presence of surplus funds in the form of idle balances, and delay in the remit of cash balance information to the Budget Division". The WGDM had suggested that "given the impact that government cash balances have on liquidity management, there is a need for closer co-ordination between the RBI and the fiscal authority".

The issue of auctioning of government cash balances has been under consideration of the government and the central bank. The Working Group on Operating Procedure of Monetary Policy (2011) (Chairman: Shri Deepak Mohanty) has recommended a scheme of auctioning of government surplus cash balances at the discretion of the RBI. It is obvious that this arrangement will require a very intensive coordination between the government and the RBI.

5.4 Assessment of the Indian Cash Management System

The Government of India maintains a TSA with the RBI, which is *a sine qua non* for effective cash management system. The TSA system involves the consolidation of all government cash balances into a single account, usually and preferably at the central bank.

In India, the Constitution provides for the Central Government accounts to be constituted into three separate accounts—Consolidated Fund, Public Account and Contingency Fund. However, at the back of the said three separate accounts, there is a common cash balance for the three, which is maintained by the RBI, Central Accounts Section, Nagpur. This feature has a very significant implication, besides the cash management challenges—correspondence between fiscal deficit of government plus the repayment liability and gross borrowing requirement is effectively broken.

Over the years, Central Government has taken certain measures to discontinue Public Account transactions not directly related to the government. For example, earlier there was a scheme that mandated public sector enterprises (PSEs) to park their surplus cash in Public Account through a deposit scheme. Since the scheme made the cash management efforts of the government, as indeed the PSEs, more cumbersome and complex, the same was discontinued in 2005–2006.

It is important to mention that state governments in India also have their separate Single Treasury Accounts with the RBI and the cash balances of the Central and States TSA are linked through the mechanism of 14-day Treasury bills. The extant mechanism provides for automatic parking of surplus cash of the state governments in 14-day intermediate Treasury bills of the Central Government. Thus, the surplus cash balances of state governments become automatic short-term debt for the Central Government. It has been noted that the state governments taken together have been maintaining surplus cash balances for about last 10 years and the opening annual cash balance has been generally increasing overtime. This persistence of state government surplus cash balances has presented a challenge to the cash management policy for quite some time now.

A significant objective of the cash management system has been to reduce the mismatch between the receipts and expenditure of the Central Government. In order to understand the challenges relating to this, let us look at the broad features of Central Government's intra-year tax receipts and expenditure patterns.

There are five major components of the tax revenues of the Central Government, namely (a) corporation tax, (b) personal income tax, (c) central excise duties, (d) service tax and (e) customs duties: the first two being direct taxes and the remaining three being indirect taxes. Since the beginning of economic reforms in early 1990s, a significant trend has been observed. Share of direct taxes has increased and that of indirect taxes has declined (Table 5.1). At the individual tax level, which is significant from cash management point of view, share of customs duties has declined the most and that of corporation tax and service tax has increased significantly.

Taxwise pattern of quarterly receipt of these major taxes during 2013–2014 is given in Table 5.2.

Thus, it is noted that the receipts under each of the five major taxes are back-loaded, with customs duties showing the most even inflow pattern. The intra-year inflow patterns are influenced mainly by the statutory provisions relating to discharge of tax liabilities. It may also be mentioned that the component with most even pattern of collection, i.e., customs duties, has declined most significantly since the beginning of reform period.

The intra-year pattern of expenditure during the year 2012–2013, taken as representative year, is given in Table 5.3.

Table 5.1 Share of direct and indirect taxes (in per cent)

Year	Direct taxes	Indirect taxes
1990–1991	22.6	77.4
1995–1996	30.2	69.8
2000–2001	36.3	63.7
2005–2006	45.3	54.7
2013–2014	55.1	44.9

Source RBI and GOI

Table 5.2 Break-up of central tax receipts (as percentage of actual total collection)

	Corporation tax	Personal income tax	Customs	Central excise	Service tax
First quarter	12.9 (13.1)	16.9 (12.6)	23.6 (22.7)	12.5 (13.7)	14.4 (14.3)
Second quarter	26.1 (23.9)	24.2 (20.9)	24.6 (24.0)	24.1 (22.7)	22.5 (21.5)
Third quarter	27.0 (30.9)	23.5 (29.2)	23.7 (25.6)	23.5 (24.8)	25.8 (25.5)
Fourth quarter	34.0 (32.1)	35.4 (37.3)	28.0 (27.6)	40.0 (38.8)	37.3 (38.8)

Figures within brackets are for 2007–2008
Source GOI

Table 5.3 Share of plan and non-plan expenditure (as percentage of actual total expenditure)

	Plan expenditure	Non-Plan expenditure	Total expenditure
First quarter	20.1	22.6	21.6
Second quarter	28.2	26.7	27.1
Third quarter	21.5	20.5	21.1
Fourth quarter	30.2	30.2	30.2

Some figures have been rounded off
Source GOI

The above tables are intended to convey the broad trends in government's cash flows, while for effective cash management system, more granular data are required and used. However, broadly speaking, both the tax receipts and the expenditure of the government are back-loaded, receipts more than the expenditure. This is to say that more tax receipts flow in and expenditure flows out in the second half of the year than in the first half. And highest quarterly tax inflows and expenditures take place in the last quarter and specifically last month of the financial year. This has obvious implications for the intra-year fiscal deficit and borrowing programme of the Central Government, which has to be, therefore, necessarily front-loaded. The persistence of such front-loaded borrowing programme has resulted in skewing the interest payment and debt repayment schedule as well. The challenges to cash management of the Central Government are, therefore, significant. One of the issues that the Central Government and RBI have to manage is regarding the bunching of redemptions of government securities in first half of next few financial years. It is being handled through switching of maturing securities so as to elongate the maturity profile.

One important result of the introduction of cash management system has been that there is increased evenness in the pattern of expenditure and rush of expenditure in last quarter and parking of funds has been significantly curbed. The frequency of release of funds to implementing has increased, and it has resulted in lower idling of funds. However, general level of unspent balances and idling of funds with implementing agencies, with accounts outside the CFI, continue to be a problem.

Implementation of effective cash management system involves effective coordination between Central Government, the fiscal authority and RBI, the monetary and debt management authority. This coordination is achieved principally through the mechanism of Cash and Debt Management Committee of the Central Government, with representations from Central Government and RBI. The mechanism and extent of coordination is robust and has delivered meaningful results. The proposal of the Central Government to set up an independent Debt Management Office will insert a new entity that would need to greatly coordinate with the Central Government and the RBI.

5.5 Conclusion

In conclusion, it may be mentioned that Central Government has a robust cash management system, which incorporates many of the recommended features of a modern system. However, the Indian expenditure management system, including the cash management system, is still a long way from obtaining a system that delivers "more bang for the buck". It is towards this endeavour that the government has announced constitution of an Expenditure Management Commission (EMC) in Budget 2014–2015. One of the terms of reference of the EMC relates to cash management system in the Central Government.

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