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Old wine in new bottle

The government cannot do away with RBI support unless the fundamental issues are tackled, says Uttam Gupta

THE decision announced in the Union budget for 1997-98 to abolish the system of ad hoc treasury bills to finance the government's deficit has been described as historic and revolutionary. The finance minister's argument is primarily two-fold. First, it will put an end to automatic/uncontrolled monetisation of the deficit. Second, it will restore to the RBI the autonomy to freely pursue the monetary policy.

In regard to the first, the bloated emphasis on the mechanics — controlled vs uncontrolled — camouflages the substantive question whether or not the government has made any dent on monetisation of the deficit per se. The answer is a categorical 'no'. This is in view of the budget providing for the monetised deficit (RBI support to the government's borrowings) of Rs 16,000 crore during 1997-98.

In the 90s, the net RBI credit to the government for financing its budget deficit was Rs 14,745 crore in 1990-91, Rs 5,508 crore in 1991-92, Rs 4,257 crore in 1992-93, Rs 260 crore in 1993-94, Rs 2,130 crore in 1994-95 and Rs 19,855 crore during 1995-96. Thus, barring 1995-96, in the remaining five years, the support was lower than provided for during 1997-98.

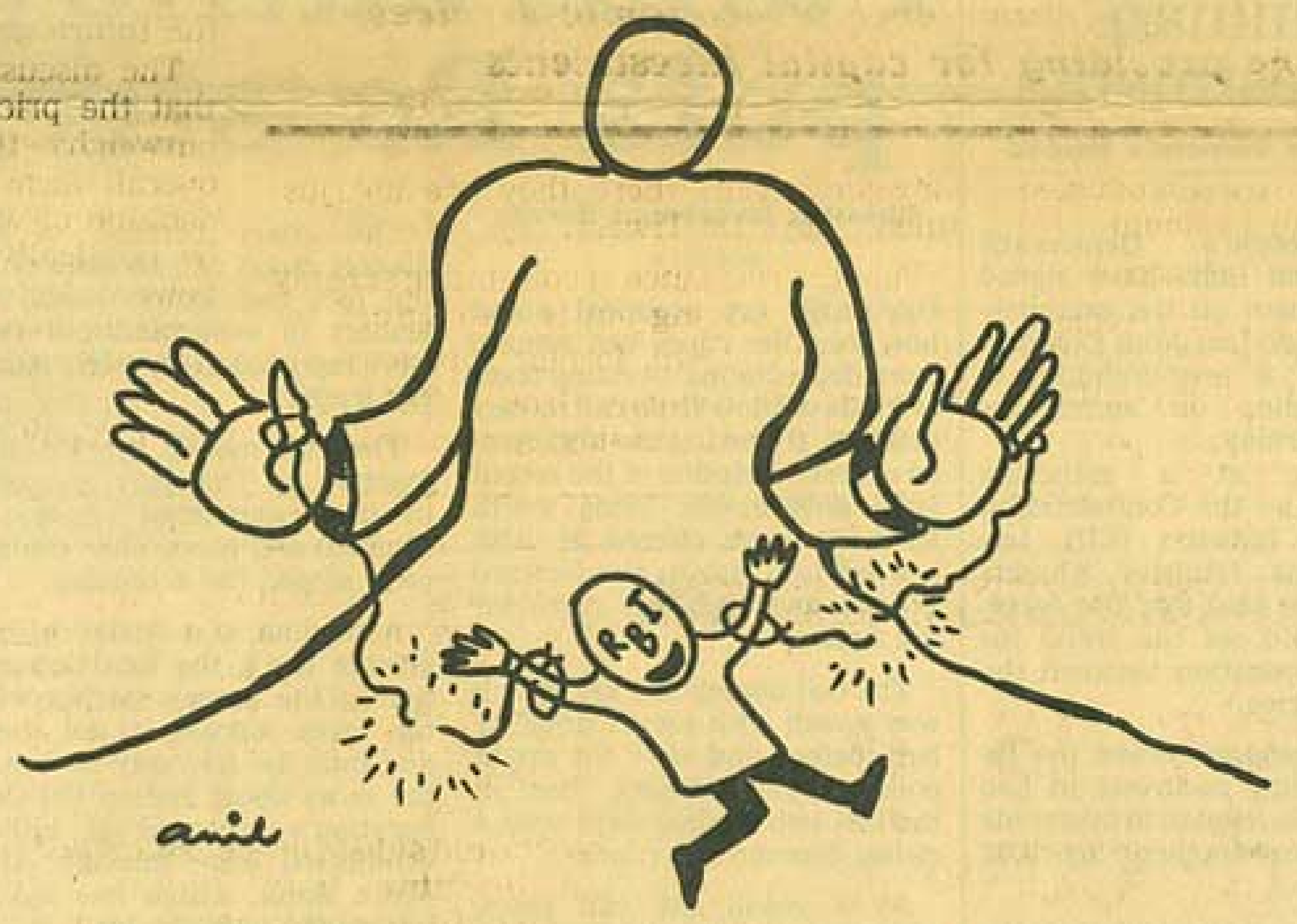
Clearly, there is not only no breakaway from the past practice, this is sought to be pursued even more vigorously. Only the manner of creating money has slightly changed. Whereas earlier, it was through issue of ad hoc treasury bills, now, the RBI will subscribe to the primary issue of the government securities.

As regards the second, will the RBI be really free to take decisions? Freedom means that it should have the powers and courage to say 'no' to the government in case the support desired by the latter clashes with its prime objective of maintaining price stability. All along in the past, the RBI has been acquiesced into doing what the government wanted from it. There is little reason to believe that from now onwards it would behave differently.

The March 26 agreement between the RBI and GoI in regard to abolition of ad hocs and its replacement by a system of ways and means advances (WMA) has been crafted in a manner as to fully subserve continued profligacy of the latter and leave little elbow room for the former to assert itself for applying necessary checks. Under this, the government can resort to WMA up to a maximum of Rs 12,000 crore at any point of time during April-September, 1997 and Rs 8,000 crore during October 1997-March 1998.

The agreement also provides for overdraft exceeding the WMA limits. During 1997-98 and 1998-99, this facility will be available for an unlimited period within the year. Only after March 1999, such overdrafts will not be permitted for more than 10 consecutive working days.

An earlier agreement in September 1994, between the GoI and RBI, also prescribed certain limits on the issue of ad hoc treasury bills. It was proposed that these will not be allowed to exceed Rs 9,000 crore for more than 10 consecutive working days at any point of time during the year. The agreement was observed more in breach.



The present agreement is even worse inasmuch as it virtually provides for breaking the ceiling by providing for the overdraft facility for an unlimited period. Under a similar scheme for WMAs to the state governments, the RBI has the powers to stop this facility. This is not available in respect of the proposed overdraft to the GoI.

The provision that the overdraft will be discontinued from the fiscal 1999-2000 makes little practical sense. Having allowed unbridled use of this facility for two consecutive years, how can the government suddenly gear itself for a situation whereby it will not ask for its continuation?

That the government will have to pay the so-called market determined interest on WMA, is no deterrent. This is because unlike any other borrower who has to pay a minimum of 15 per cent, the rate at which WMAs are proposed to be extended will work out to a meagre 4.5 per cent for the WMA during April-June, 1997 quarter (three per cent lower than the average yield on 91 days government securities during January-March 1997). On overdraft, this will be 6.5 per cent.

The new system has also been hailed for its role in disciplining government's finances. In this context, budget provision for monetised fiscal deficit at a whopping Rs 16,000 crore makes a mockery of this tall claim. In the years ahead, depending on the political compulsions, the deficit could be even more.

So far, the government has perceived fiscal discipline only as a number game involving fixation of targets for overall borrowings including the support from the RBI. But, it has not made any credible effort to reduce the need for borrowings. In fact, because of this, despite Dr Manmohan Singh's, the then finance minister, proclaimed commitment in 1994-95 budget to eventually do away with dependence on RBI to finance government's deficit, the support is still needed on an increasing scale.

The present government may have stopped using the terms budget deficit or ad hocs — like subsidies perhaps, these are dirty phrases. However, it is also in no position to say that "we do not need RBI support." And, it will not get into this situation unless the fundamental causes leading to mismatches between its revenue and expenditure are tackled.

In some quarters, it is even suggested that there should be a statutory ceiling on the government borrowings. That any move to cross the ceiling should be mandated by the Parliament voting with two-third majority. Even this is unlikely to work as on financial matters, invariably, the Parliamentarians — cutting across party lines — are prompt in giving approvals to the relevant proposals.

The excessive pre-occupation with the game of numbers should give way to adoption of credible measures which help in improving budgetary balances. Although the rate of corporate tax, besides custom and excise duties, has been reduced, significant increase in revenue is unlikely in view of the prevailing serious constraints on growth.

The government has virtually given up development of the infrastructure. This is mainly because it does not have funds which in turn, is due to profligacy on the non-plan side. Moreover, excessive borrowings from the market — largely to support non-plan expenditure — lead to shortfall in availability of credit and high interest rates. Resultant slackening of growth may thus even lead to reduced tax collections.

On the personal tax front, laxity in administration is a major problem. There was a time when income earners were scared of paying tax because the rates were too high. Over the years, they have got used to evasion, a habit that has taken deep roots primarily because the evaders are rarely punished. Against this backdrop, despite reduction in the rates, collections are unlikely to improve unless the administration is suitably geared.