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The extravagance continues

There is a pressing need for a statutory cap on borrowings from RBI, says Uttam Gupta

SEVERAL issues of government paper/treasury bills during the current financial year, so far, have met with fiasco, forcing devolvement on the RBI to the extent of the unsubscribed amounts. This has been so despite the government offering progressively higher return.

Apparently this reflects tight conditions in the money market and the possibility of commercial banks/financial institutions earning much higher on loans to industry and trade. But, more important, it is a vindication of the market forces which largely determine who will get how much funds and, at what price, unlike in the past when the government could garner any amount at prices dictated by it.

Moreover, considering that lending to the government is now at market-determined rates, this will enable commercial banks/FIs to improve their profitability.

These developments also send a strong message to the government that it must improve its finances, tighten budgetary controls and bring down its borrowing requirements to levels which are not only consistent with norms of sound debt management, but also, can be accommodated in the market without serious problems.

But, the million dollar question is whether government is picking up the signal. The answer is a categorical "no". In this context, it is important to recall that on September 9, 1994, the government had signed a MoU with the RBI to limit central government borrowings by issuing ad hoc treasury bills. The ceiling was fixed at Rs 6,000 crore which was also the projected budget deficit for 1994-95.

In his budget speech for 1994-95, the finance minister had even gone to the extent of proclaiming government's resolve to completely do away with borrowings from the RBI by the year 1997-98. Needless to say, Dr Manmohan Singh received resounding acclaim for this both within and outside Parliament. Unfortunately, in less than one year's time, the government is not only slipping, but has even taken a U-turn.

Already, during the current year, borrowings from RBI through issue of ad hoc treasury bills crossed the Rs 17,000 crore mark by July 21, 1995. This has since increased further to about Rs 21,000 crore by the third

week of August. In view of these trends, it is unlikely that the government would be able to live up to its commitment of restricting borrowings from RBI to the projected budget deficit for 1995-96.

The 1994-95 discipline package was dividend in two parts. Apart from the Rs 6,000 crore ceiling for the year as a whole,

borrowings through ad hoc would not exceed Rs 9,000 crore for more than 10 consecutive working days at any time. The latter was, in fact, a precondition to achieve the former. For the current year, although, in-

go, political compulsions of impending general elections has forced it to untie the knot sooner than expected. The Prime Minister has announced four social assistance schemes on Independence Day which will cost the exchequer a whopping Rs 5,000 crore.

The government knows that all these doles are impossible to fund

borrowings from the RBI. And, since an MoU would have come in the way, why have it at all?

In short, we are back to square one with the government taking recourse to deficit financing on an unprece-

Here also, like a bull in the China shop, it left its scars on the economy by pre-empting the limited resources available in the market. The government's borrowings have crowded out private sector investment, thus adversely affecting industry, agriculture, trade and commerce. Besides, the resultant increase in interest rate made working capital and project finance expensive, aggravating inflationary pressures on the supply side.

In sourcing its funds, the government has even thrown all norms of competitive behaviour to the winds. Or else, in market borrowings, where is the question of non-competitive bids. It is no secret that substantial sums have been mobilised by accepting bids in this category which could be from sources none other than commercial banks/FIs owned and controlled by the government itself. More recently, it even made mandatory for the PF and pension funds to invest 30 per cent of their corpus in government's dated securities.

That despite these widespread debilitating effects the demand for funds has remained unsatisfied, and in the process, forced it into the evil of deficit financing as well, is a matter of grave concern. If allowed to continue unabated, it has the potential of devastating the economy.

There are no magic solutions. The problem starts with excessive revenue spending and must be tackled at that level only. The government has been making promises and breaking them. The MoU with RBI should ensure that there is some deterrent to overspending. While the MoU is no guarantee that discipline will be strictly observed, having no MoU at all will lead to a chaotic situation.

There is no statutory provision for a ceiling on borrowings from RBI. However, there is an urgent need to statutorily put a cap. Enforcement may pose practical problems, but can be overcome. Necessary safeguards may, however, be built in to allow for authorisation beyond the ceiling to meet clearly defined emergencies like war or national calamities.

Meanwhile, the RBI should assert its independence and get into the habit of saying 'no'. True, this might lead to a payment crisis for some time. But, that is good in a way, as it would help in forcing public opinion to focus on the imperatives of fiscal discipline.



initially, the government was contemplating a 10-day ceiling at Rs 12,000 crore, it finally decided not to have the MoU at all.

This is a dangerous precedent even as it smacks of double standards. After all, does it not expect state governments not to knock at the doors of the RBI for overdraft? Or public sector enterprises to achieve the targets stipulated in MoUs they sign with the government (now, even loss-making PSUs are expected to sign MOUs)? Or commercial banks to work for what they have agreed to in the MoUs with the RBI. Why should, then, the government seek a special dispensation for itself at will?

While the government was uncomfortable with the MoU from the word

denoted scale and its attendant devastating consequences in terms of aggravating money supply and inflation rate. The argument that since the inflation rate has been low for some time and, therefore, the government can afford to take some chances, is frivolous.

The crux of the problem continues to be spending by the government in excess of its revenue earnings. The gap has increased during the reform years. So long as the trend continues, money will be needed to bridge the gap. All along in the past, the government resorted to deficit financing and, in the process, eroded its credibility. To get over this, in recent years, it shifted focus to borrowings from the market.