THE OBSERVER
OF BUSINESS AND POLITICS
MONDAY MAY 29, 1995

Robbing Peter to pay Paul

The government should keep its hands off the resources of commercial banks, says **Uttam Gupta**

BY announcing the setting up of the Rural Infrastructural Development Fund (RIDF), in the Union Budget for 1995-96, the government has apparently sought to promote rural development without committing Union resources. This sounds too good, particularly against the backdrop of huge sums having been spent on various development schemes in the past without any concrete results by way of adding to the stock of productive assets, increase in employment and improvement in the incomes and living standards of people.

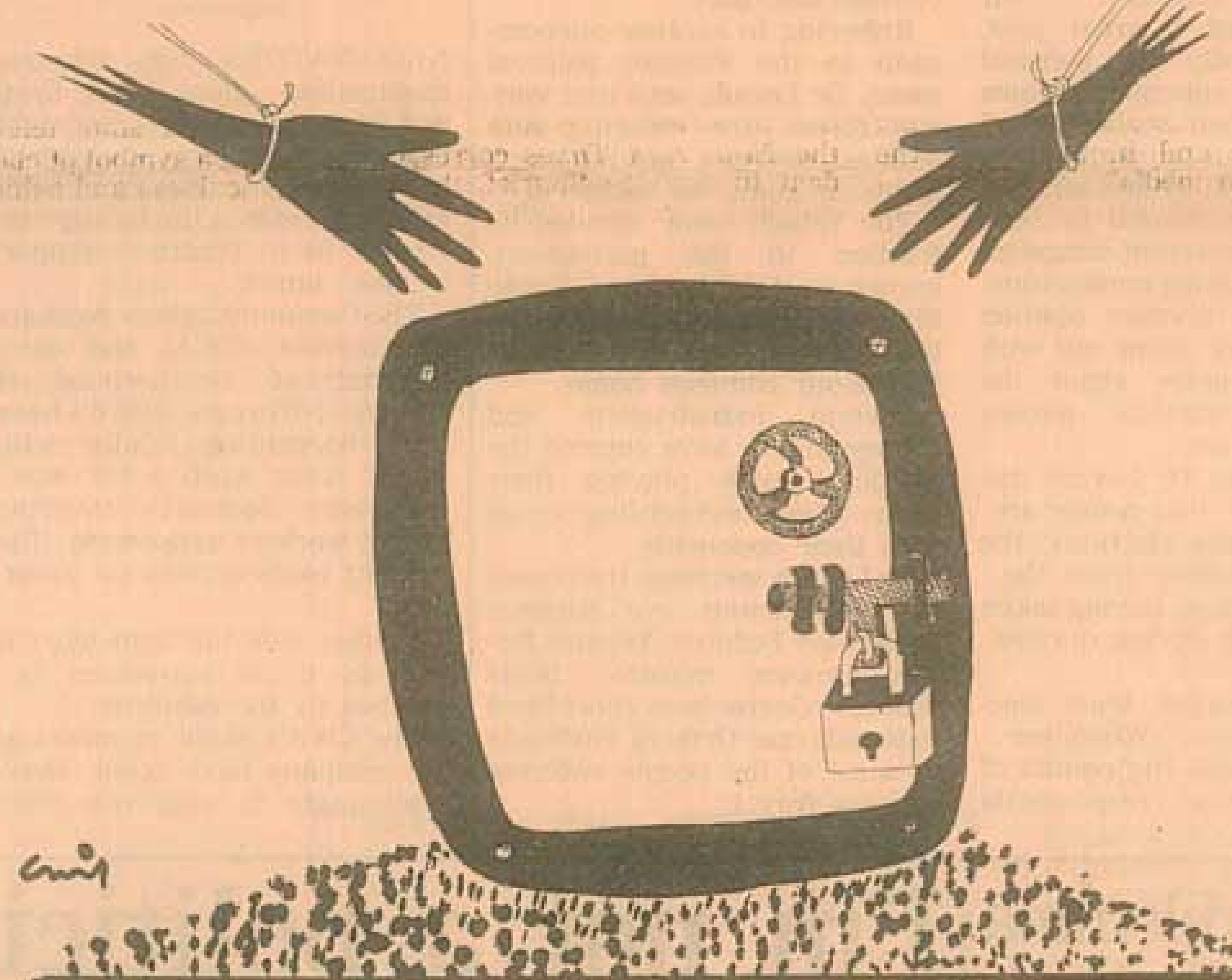
An innovative arrangement has been proposed to mobilise funds for the RIDF. Scheduled commercial banks are expected too direct 40 per cent of their total lending for agriculture, small scale industries, cottage industries and handicrafts under the priority sector lending programmes. The share for agriculture alone is 18 per cent. Since the actual lending by the banks to these sectors is short of the target, the shortfall is to be made available to the RIDF to be set up under NABARD.

RIDF will, in turn, release these resources for financing projects and schemes to be identified by the concerned state government. Besides, in the new credit policy recently announced by the RBI (April 1995), it is assumed that even after contributing to the RIDF, the banks would still not meet the 40 per cent target. The remainder will therefore be lent by the banks under consortium arrangements to the Khadi and Village Industries Commission (KVIC) for its lending operations to the small scale industries.

There are fallacies and contradictions inherent in the suggested approach. First, what makes the government take the view that banks will have surplus funds? Apart from the fact that the demand for non-food credit has increased enormously, consistent with the need for supporting industrial revival, the government itself has been borrowing heavily from the banks to support its ballooning revenue expenditure. In the current year, it proposes to borrow from commercial banks a whopping Rs 30,000 crore. This will eat up almost 50 per cent of the deposits mobilised by these banks.

Banks are also required to support the extra-budgetary resource mobilisation efforts of the central undertakings. The market borrowing target for the PSUs during 1995-96 has been fixed at Rs 7,500. The only option available to them are the banks. Add to that the expectation that the banks participate actively in revival and rehabilitation packages of sick undertakings.

With demand for funds far exceeding the money available with the banks and the government as the sole owner of the banks fully exercising its authority to decide who should get how much funds, the only way RIDF's requirements can be met is by denying funds to industry and trade.



Second, despite a funds crunch, the government is seeking to enforce, through a somewhat indirect route, the 40 per cent limit for priority sector lending. Only some time back, the government while declaring the need to give a commercial orientation to banks' activities, talked of doing away with the system of quantitative control on flow of bank credit.

Sudden and immediate discontinuation of the system of priority sector lending is not in the national interest and must be avoided at any cost. But, now through the RIDF, the government is moving to the other extreme by rigidly enforcing the 40 per cent limit.

The interest on funds so transferred — about Rs 2,000 crore to RIDF and Rs 1,000 crore to KVIC — will not be more than the maximum term deposit rate, which is presently 12 per cent after the recent hike announced by the RBI. No doubt the banks will not be incurring the costs associated with administering credit to borrowers.

However, given a choice, the banks would loan funds where returns are high. At a time when the emphasis is on profitability of the banks and making them viable without budgetary support, (More than Rs 10,000 crores was given away by the Centre in 1993-94 and 1994-95 to bail them out), any restriction on the choice of portfolio will be counter-productive.

In this case, the situation is much worse. If the difference between the lending rate and the borrowing rate is zero, who will pay for the overhead expenses? In the ultimate analysis, the other category of borrowers, mainly industry and trade, will be forced to bear the burden by way of a further hike in lending rates.

It has been argued in some quarters that transfer of funds, whether to RIDF or KVIC, bear zero risk as these are guaranteed by the government.

On the face of it, the money appears to be safe by virtue of the guarantee. But is the government actually in a position to meet all its liabilities in a manner consistent with sound fiscal management? It is well known that even for meeting its current consumption expenditure, it has to borrow heavily. And, now, there is guarantees galore for everything that comes up. Has the government ever bothered to work out where the resources will come from to redeem its obligations?

Moreover, the way commercial banking is evolving, safety of money or a fixed return is not the only consideration. A key feature of contemporary banking is active involvement of commercial banks in promoting industrialisation and even sharing in the prosperity of profit-making body corporates. To the extent funds are diverted to RIDF, they would be denied these opportunities.

State governments are expected to recommend to the RIDF projects/schemes for financing. They would also be associated in the monitoring of the project. Yet it has to be ascertained whether the states have the machinery to carry out these functions effectively and what has been their track record till date.

Moreover, considering that most state governments are financially crippled, the possibility of RIDF being diverted cannot be ruled out. In such eventualities, banks stand little chance of recovering their funds.

The government has to keep its hands off the resources of commercial banks and leave them free to decide on utilisation of funds. It should instead concentrate on ensuring effective utilisation of funds earmarked for various rural development, employment generation and poverty alleviation schemes. Apart from massive cumulative spending in the past, the budget for 1995-96 has also made substantial allocations for these. Through appropriate structuring of these programmes, even rural infrastructural development can take lace.

As for bank assistance in this endeavour, it should be recognised that already nearly 37 per cent of their total advances are going to the priority sector, including agriculture. The government can interact with banks for ensuring a reasonable share of these funds are redirected for building rural infrastructure. The government can also play a key role in improving recovery of outstandings.