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Unmaking of a good policy

Issues that necessitated restrictions on repatriation of Euro-issue proceeds retain their relevance, says **Uttam Gupta**

WHEN in October 1994 the government prohibited repatriation of the proceeds of Euro-issues by Indian companies, the objective was primarily two fold. The first was to prevent the destabilising effect of incoming dollars on the domestic economy through expansion of money supply and, in turn, aggravation of inflationary pressures.

The second was to prevent misuse of these funds and to ensure that these were utilised primarily for the purpose for which these were mobilised, namely, for setting up of new projects or financing expansion/modernisation of existing plants. In fact, the guidelines issued then even indicated the broad categories — such as, import of capital goods, procurement of indigenous plant and machinery — to which the Euro proceeds could be put to use.

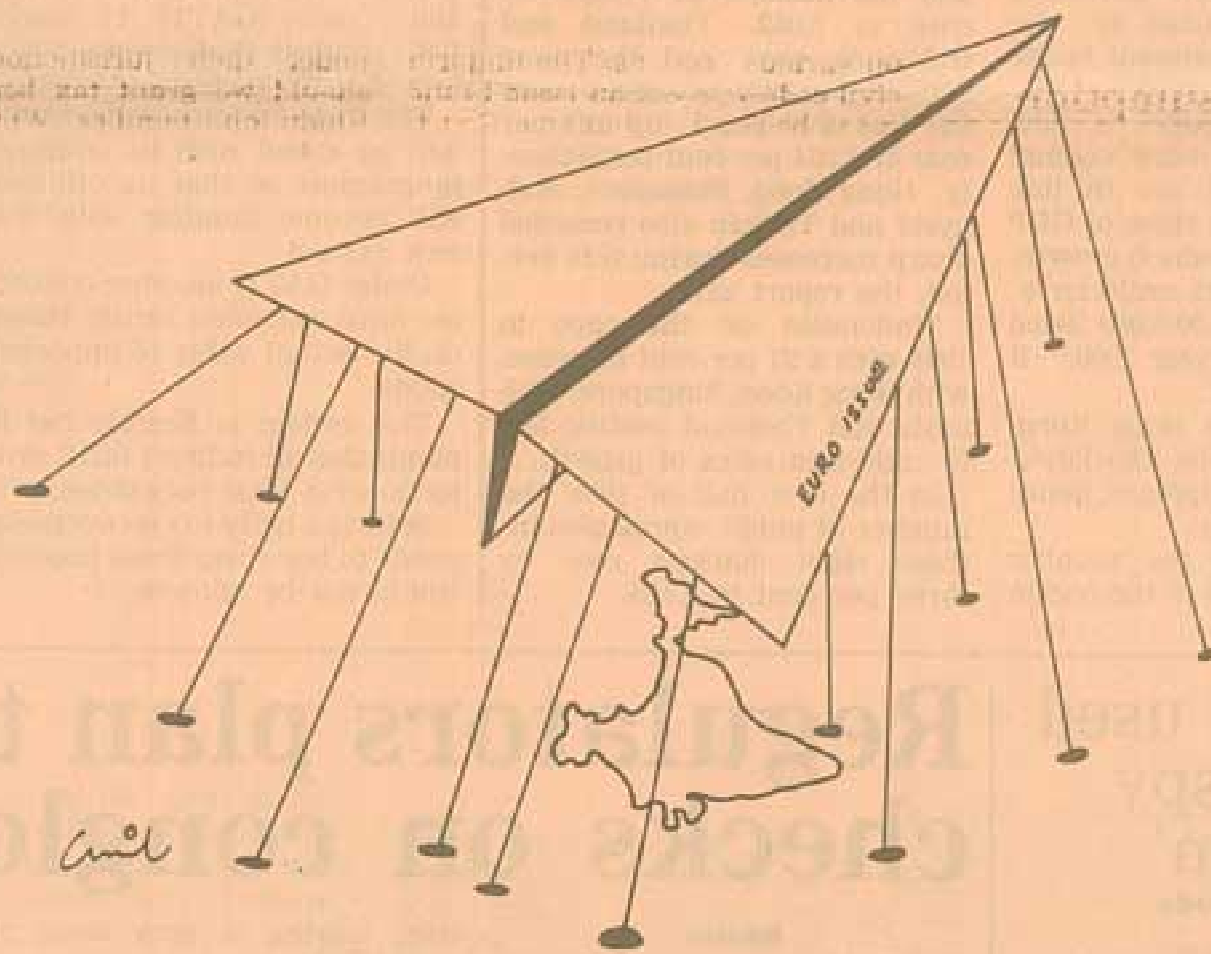
These restrictions were imposed keeping in mind the earlier experience of Euro proceeds being used largely for buying shares and debentures in the Indian stock market. In some cases, the funds were reported to have been deployed for purchase of real estate and land etc. Some corporates even used the funds for dressing up their balance-sheets by returning high cost borrowings from financial institutions.

In less than a year, the government has reportedly decided to lift the ban. Why this sudden U-turn now? Have the underlying factors become irrelevant? Or, have new concerns come up necessitating reversal of the approach?

Let us consider the inflation factor first. No doubt, the inflation index has been keeping low for a couple of weeks. But, the underlying fundamentals carry the potential of an accelerating trend in the course of the year. The issue of net ad hoc treasury bills during the first quarter of the year of well over Rs 13,000 crores is indicative of the magnitude of high powered money being pumped in. The reported move to say 'good bye' to the MoU with RBI also shows that the government is in no mood to accept any restrictions when it comes to monetisation of its budget deficit. That the deficit itself is set to rise beyond the budgeted level is evidenced by the announcement of a spate of supplementaries not provided for in the budget. Together with the unprecedented liquidity overhang in the system and a possible rise in the minimum support prices of kharif crops soon, the further expansion in money supply will have catastrophic consequences in terms of exacerbating inflationary pressures.

Against this backdrop, allowing Euro proceeds to freely come in will only precipitate matters.

The second main consideration was misuse of funds. While justifying its decision to remove the ban, the finance ministry has reportedly argued that this is necessary to give a boost to the sagging capital market. It has even gone to the extend of arguing that crisis in the stock market was triggered off in the first instance by non-availability of funds from Euro proceeds consequent to the ban. This is preposterous.



GDR funds are not meant for use in the capital market. For the government to encourage such use is not only totally unwarranted, it also undermines the very philosophy of selling a Euro-issue abroad, that is, to involve the foreign investors as partners in the development of Indian industries. It goes without saying that the former decided to put their money in buying Indian equity primarily to ensure that they gain by way of good dividend income and capital appreciation. The Indian company issuing the GDR should endeavour to redeem this implicit faith, which is possible only if the funds are used for building up the productive capabilities of the company and improving its fundamentals.

If, on the contrary, these funds are now sought to be frittered away in propping up the Indian capital market, the very objective gets frustrated. It would be tantamount to a breach of trust and would damage our credibility amongst international investors. Already, with most of the Euro GDRs quoting at a discount, the level of international confidence is at an all time low. The situation will worsen with the government itself giving wrong signals and encouraging practices which are pregnant with possibilities of corporates losing funds or of erosion in values (locking funds in artificially propped up premium issues carries enormous risk).

Allowing repatriation of Euro proceeds unrelated to project needs has a significant cost push effect as well. If the company surrenders the foreign exchange now and subsequently buys when the project needs arise, that will have to be at the higher rate of exchange then prevailing (quite likely in view of impending deterioration in the overall BoP position). In turn, this would necessarily raise the cost of the project and affect its viability.

In the context of the policy reversal, the finance ministry has cited availability of foreign exchange as another problem area. Repatriation of Euro proceeds may provide temporary respite for financing general import needs and that too, to a limited extent. However, this is far from being a substitute for the wholesome efforts that are required to put the BoP on a sound footing. Drawing upon funds which are otherwise committed in nature will present a false picture of the fronts where we need to act.

The ad hocism that mars the government's present approach must stop forthwith. The ban on repatriation of Euro-issue proceeds was guided by a sound philosophy and must therefore, stay. Depression in the capital market and inadequate foreign exchange availability are no doubt problems. But, the best way to address these is to improve the economic fundamentals through fiscal consolidation, macroeconomic stability, public sector restructuring etc. That alone will help in controlling inflation and improving export competitiveness.

Buoyancy should return to the capital market, but through the right means. The market suffered primarily because issues with weak economic fundamentals were allowed to come in. With ruling market prices substantially lower than the issue price, the investors have been put to a substantial loss. Even in regard to dividend income, although on the face of it the rates may look impressive, the effective yield to the investors is low. Clearly, there is a crisis of credibility.

The government, Sebi and body corporates need to seriously address these basic maladies. Specifically, Sebi should endeavour to ensure that the issues are generally at par and that, whenever a premium issue is permitted, the quantum of premium is reasonable.

A close watch on the track record of companies hitting the market with issues, checking the veracity of various disclosures made, prevention of price rigging etc, are too important to be taken casually. It must be recognised that there is no short cut to resurrecting the capital market. The issues that the finance ministry has raised now in the context of removing the ban on repatriation of Euro proceeds are not even remotely connected to this.