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Statement by Dr. C. Rangarajan, Governor, Reserve Bank of India, on the occasion of signing of agreement between the Government of India and RBI

Today's agreement signed between the Government of India and the Reserve Bank of India puts an end to the four-decade old system of ad hoc Treasury Bills to finance Central Government deficit. The ad hocs which found its way as an innocuous administrative arrangement for convenience, to enable the Government to maintain its cash balance to a required minimum level, assumed in course of time, a larger than life proportion posing a threat to monetary stability and curtailing the Reserve Bank's freedom of operating instruments of monetary policy for price stability.

The agreement is the culmination of continued efforts from RBI and the Government in the past few years. The earlier agreement of September 9, 1994 paved the way for phasing out ad hocs over the three-year period beginning 1994-95 by placing year-end and intra-year ceilings on net issue of ad hoc Treasury Bills. The year-end ceiling for 1994-95 was placed at Rs.6,000 crore and for the next two years at Rs.5,000 crore. The intra-year ceiling was placed at Rs.9,000 crore. The experience in this respect had been by and larger satisfactory. While in 1994-95, the net issues of ad hocs both at year-end and intra-year were within the ceilings, during 1995-96, there were prolonged periods when the intra-year limit was crossed. During the current year since August 1996, the level of net issues is well within limits.

A question often raised is whether the new scheme of Ways and Means Advances (WMA) is not old wine in new bottle. Far from it. While ad hocs were used to monetise budget deficits year after year in a cumulative way, WMA is not a source of financing deficit at all. That is the reason why the practice of showing budget deficit has been given up. WMA will purely be a mechanism for bridging the gap between Government's expenditure and receipts temporarily and WMA will be vacated from time to time. Like net issue of ad hocs, no net increase in WMA is contemplated in the budget. It may be noted that the budget for 1997-98 has provided for both receipts and discharges of WMA at Rs.1,00,000 crore in gross terms, implying a net amount of zero. Therefore, WMA is not a source of monetisation.

Secondly, WMA will be drawn at market related interest rates.

Thirdly, with improvements in cash management by the Government and techniques of debt management by RBI, the actual need for WMA is expected to get narrowed down during the transition period of two years up to March 1999. A Monitoring Group is being constituted with officials of Finance Ministry and RBI to activate this process. With overdrafts not being permitted beyond a period of ten consecutive working days, after March 1999, the scheme of WMA will culminate in an ideal position of fiscal balance being achieved.

RBI's support to Government at Rs.16,000 crore indicated in the budget for 1997-98 as the 'Monetised Deficit' has been a subject of misunderstanding and mis-interpretations. RBI, when it acquired Government securities during a period, either in the primary issues or in the secondary market, no doubt indirectly lends support to the market borrowing programme of the Government. This results in monetisation. Unlike lending support through ad hocs which remained almost automatic and without any limit, monetisation by RBI henceforth will be voluntary and in alignment with its goals of achieving monetary stability and exchange risk management. Thus, the actual level of monetisation by RBI will depend upon the level of real sector activity, inflationary trends and expectations, foreign exchange inflows and the consequential need to sterilise such inflows which are all reflected in RBI's aim of keeping monetary expansion within the targeted levels. The 'Monetised Deficit' of Rs.16,000 crore shown in the budget should therefore be taken purely as initial assumption and the actual level could turn out to be different due to the Reserve Bank's operations in the market.

During April 1996 to February 1997, the RBI's direct support to Government in primary issues of dated securities and treasury bills amounted to around Rs.12,000 crore whereas the net RBI credit to Central Government was only of the order of Rs.5,000 crore. This is primarily on account of the fact that RBI undertook active open market operations. The repos operations by RBI similarly resulted in sales of about Rs.1,500 crore at the end of this period.

Alpana Killawala
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