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GOVT. NEEDS TO BE PRUDENT IN USING RBI'S TRANSFER

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

With the acceptance of the Bimal Jalan committee's report by the Reserve Bank of India (RBI), the stand-off between the RBI and the Ministry of Finance seems to have ended for now. The report has also helped to clarify the volume of reserves required for risk provisioning to counter a financial stability crisis if it were to arise.

Though the RBI belongs entirely to the government, the integrity of its balance sheet is important to ensure financial stability and to combat market risks. The committee made its recommendations after taking into account the role of RBI in financial salience; cross-country practices; statutory requirements; and impact of its public policy mandate and operating environment. Based on these factors, it decided on the volume of reserves required to support the financial system in times of crisis and concluded that the provisioning has to be more stringent than in developed countries to ensure the perception of safety, particularly as India has low sovereign rating and the Indian rupee does not have reserve currency status.

The revised economic capital framework recommended by the committee makes a distinction in the economic capital of the RBI between 'revaluation reserves' and 'realised equity'. Revaluation reserves, it held, are a risk buffer against market risks and not available for transfer. The committee used the Expected Shortfall (ES) method to measure the market risk and adopted a more stringent confidence level of 99.5% as against the practice by other central banks at 99%.

The revised framework would allow the economic capital to be in the range of 24.5% to 20% of the balance sheet. As regards realised equity, the committee recommended the required range to be between 6.5 to 5.5% of the balance sheet.

The RBI Board in its meeting on August 26 accepted these recommendations and decided to transfer 1,76,051 crore to the government. As the economic capital of the RBI, at 23.3% in June 2019, was within the prescribed range, it decided to transfer the entire surplus of 1,23,414 crore earned during 2018-19. As the RBI had already transferred 28,000 crore as interim dividend in February 2019, the remaining amount will be transferred in the current fiscal. The government will get an amount of 58,081 crore over the budgeted dividend of 90,000 crore for the current fiscal. The large surplus in 2018-2019 was mainly due to the revenues earned from open market operations, amounting to 3 lakh crore, to shore up liquidity and therefore, the coming years may not see such large dividends.

The additional fund transfer from the RBI provides much-needed relief and manoeuvrability to the beleaguered government. An analysis of the budget presented in July shows that the tax revenue projections are far too optimistic. In fact, the actual net tax revenue collection of the centre in 2018-2019 was 15.9 lakh crore and to achieve the budgeted target of 19.78 lakh crore in 2019-2020, the net tax revenue will have to increase by almost 25% and correspondingly, gross tax revenue will have to grow by 26.5%. The expected shortfall in tax revenue for the Central government, if the past trend is taken (after devolution to the States), is likely to be about 70,000 crore.

With the economy slowing down and the Goods and Services Tax (GST) not kicking in the expected buoyancy, the shortfall may even be higher. The infusion of additional funds, thus, will help the government to substantially overcome this shortfall and achieve the fiscal deficit target

without having to axe allocations to social sector and poverty alleviation.

However, while the Central government will overcome the shortfall in tax collections, the States will have to suffer the consequence of lower-than-budgeted revenue realisations. They have presented their budgets taking into account the tax devolution based on Central budget forecast and shortfall in collections will adversely impact their expenditure allocations to various sectors.

If, on the other hand, the tax revenue growth picks up, then the government can use the additional money to clear the dues of the Food Corporation of India and fertiliser companies to minimise spillover of deficits to the next year. The additional funds can also be used to spend on much-needed capital expenditure.

The decision of the RBI Board must be welcomed as it has not come a day sooner and should help the government in combating the economic slowdown and to conform to the fiscal targets. It is hoped that the government will be prudent in using these funds.

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