Weekly Notes

Revolving Fund Stagnant

THE revolving fund set up by the Export Credit Guarantee Corporation live months back for extending foreign exchange credits to manufacturer-exporters has not got off the ground. As against the foreign exchange resources available to the fund so far, which amount to Rs 15 crores, only two applications for a total sum of Rs 3 lakhs have been received. Under the scheme, any commercial bank licensed to deal in foreign exchange can arrange for a line of credit from its correspondents or principals abroad. It can then lend for a maximum of 18 months at one per cent above the bank rate of the country of origin to finance imports of raw materials, components and spare parts on condition that these imports are embodied in export of commodities within the loan period. ECGC guarantees fulfilment of the export obligation (there is a rupee penalty in event of non-fulfilment) and the Reserve Bank releases the necessary foreign exchange if the requisite exports fail to materialise.

Non-utilisation of this assistance clearly indicates — if any further proof were required — that the ubiquitous clamour for imported components and materials arises almosi wholly from the pressures of home demand. The revolving fund was set up on the recommendation of the Mudaliar Committee and Mathrani Group, both of which were inundated with complaints that export of many non-traditional commodities was inhibited by non-availability of relatively small imported elements. Imports financed by the revolving fund can be used only for exports and cannot be sold away or used for sale of finished products at home. Since the imports precede the exports, the latter do not qualify for import entitlements except insofar as the exporter qualifies, after fulfilling his export obligation, for another slice of the foreign exchange credit.

True, the scheme has not been in operation long enough to be appraised fully and is obviously out-rivalled by more attractive alternative schemes. The suggestion that inadequate publicity is responsible for its lack of progress is, however, absurd. Had it been really attractive, by itself or in conjunction with allied schemes, manufacturers would have smelled it from afar, without the benefit of any publicity. How to make the scheme more attractive? So long as freely transferable import entitlements continue in their present form, and the penalty for non-fulfilment of export, obligations is kept at as much as 50 per cent, there can be little hope. What kind of exports after all are covered by the revolving fund? Cotton and jute exports are left out because their imports of materials come under other arrangements; tea does not need this assistance; iron ore, manganese and oilseeds cannot qualify. That leaves only non-traditional exports and these, by and large, get the plums already in the form of import entitlements ranging from 40 to 70 per cent of exports. Besides, thanks to the proliferation of foreign collaborations, our demand for materials, components and spares has become highly fragmented and specific to certain countries; even if the domestic cost barrier is surmounted — an achievement in itself — it is not always possible to match demands against available lines of credit.

The remedy is not to make imports under the scheme negotiable, though some relaxations could be effected there, but to make exports more attractive, for instance, by tying up the scheme with the new tax credit certificates proposed in the Budget.

Failure of Monetary Policy

THE ineffectiveness of monetary policy in India has been explained by reference to fiscal policy and government spending, or more particularly, deficit financing, which swell money supply and over which the monetary authority—strictly defined to mean the Reserve Bank of India—has no control. From this it follows that the main objective of monetary policy is to maintain stability in the supply of money by preventing it from rising at a faster rate than required by the rate of growth in national income. At least, this is how the Reserve Bank appears to view its own task. In two lectures delivered this month at the Kerala University, Professor K N Raj of the Delhi School of Economics has examined this view of monetary policy and analysed its relevance in terms of the requirements of planned development.

The preoccupation with the quantity of money, Dr Raj points out, ignores the role of velocity *of* circulation of money. The fact that velocity can increase—and it is wrong to attribute any stability or even an "upper limit" to this phenomenon—implies that the effect of a credit squeeze could be nullified. This, in fact, is what has happened in India in recent years with current deposits declining as a proportion of national income on the one hand and their velocity rising—al approximately 5 to 6 per cent per annum — on the other.

Since it has no control over the quantum of credit extended to Government, the efficacy of the Reserve Bank's policy has to be judged from its success in curbing credit to the private sector. And it is Dr Raj's judgment that "in spite of the massive, sophisticated and discriminating use of all techniques of control, the Reserve Bank cannot be said to have had any conspicuous success in its attempt to restrict expansion in bank credit when and where such iestriction was really most needed". In support of this he points out that the increase in scheduled bank credit in the period 1950-56, when the Reserve Bank had *not* followed an active policy of restriction, was of a much smaller order than the expansion in subsequent years. The reasons for this are many, but most of them stem from the basic weakness of the "lender of the last, resort" function, through which the Reserve Bank has sought. to influence the cost and availability of credit. Banks have been able to keep down borrowings from the Reserve Bank by reducing their cash icserves and liquidating securities (both *found* possible despite the increase in the statutory liquidity ratio) and by inter-bank borrowing. Equally, the profitability of banking operations has made banks in general insensitive to the higher cost of Reserve Bank credit.

The failure of monetary policy has a qualitative aspect as well. Dr Raj's conclusion is that the scale and terms *on* which bank credit has been made available to manufacturing industry have not exerted any pressure towards inventory control—or, in popular parlance, reduction in hoarding. Selective credit controls have failed because evasion is easy and, at best, what is altered is the location of the hoards and not the quantity hoarded.

It is again on the qualitative aspect

that the "alternative approach" to banking organisation and monetary control outlined by Dr Raj tests. The true purpose of monetary policy is not the control of the cost and total availability of credit—as now interpreted — but the optimal allocation of credit. This purpose, of importance even in a system uncommitted to centralised planning, is vital to an under-developed economy committed to planning and to certain social objectives. Private commercial banking, operating according to "sound" lending practices, tends to perpetuate and increase market imperfections, which tendency cannot be counter-balanced by supervision and control by the monetary authorities. The nationalisation of the Imperial Bank of India and the creation of various specialised financial institutions, all bear witness to this fact. It is this kind of promotional activity, according to Dr Raj, that has "saved monetary management in India from getting reduced to what might otherwise have been a series of sterile and ineffective, and in cases even unhelpful, operations.' Only a nationalised banking system, discriminating between end-uses of credit and unhampered by the operational concepts of private banking, can achieve optimal allocation of credit, he concludes.

Life Insurance Rebate

I S Gulati writes:

APROPOS the editorial, 'Lost Opportunity', in the issue of March 6, 1965, I may be allowed to explain what lies behind the move to replace the existing system of rebate on turns paid as life insurance premia, provident fund contributions and cumulative time deposits by an outright deduction of 50 per cent of the qualifying amount—of such payments. The qualifying amount was and is 25 per cent of the total income of the assessee subject to the maximum limit of Rs 12,000 for individuals and Rs 25,000 for Hindu Undivided Families. {Incidentally, the Memorandum Explaining the Provisions of the Finance Bill states that the qualifying amount is limited to 10 per cent of total income but a reference to the relevant provision in the Bill shows that the limit is still 25 per cent, and not: 10 per cent. The error needs to be rectified to correct any misunderstanding.).

Before the Finance Act, 1964 came into force, the rebate was restricted to a maximum of 25 per cent of the qualifying amount. In other words, an individual with income attracting the highest rate of income-cum-super tax was eligible for a maximum income tax rebate of 25 per cent of the qualifying amount, i e, Rs 10,000 or one-fourth of the total income whichever was less. Thus, on a salary income of Rs 70,000, an individual was liable to pay Rs 33,600 by way of tax (i e, at the average rate of approximately 48 per cent). But the qualifying amount on which rebate was admissible could not exceed Rs 10,000 even though the individual concerned had made such rebate-worthy payments exceeding Rs 10,000. And on this maximum of Rs 10,000 he got an income tax rebate of Rs 2,500. That is, he would be liable to pay Rs 31,100 (Rs 33,600 minus Rs 2,500) by way of tax.

In the Finance Act, 1964 the limit on rebate was raised from 25 per cent to 50 per cent but that on the qualifying amount was allowed to remain unaltered. The result of this change was that the individual in the above illustration was able to claim by way of rebate Rs 4,800 instead of Rs 2,500 as before (at the 1963-64 rates). The change effected through last year's Budget was clearly calculated to benefit income tax payers whose effective tax liability (and not just the marginal rate of income-cum-super tax) exceeded 25 per cent. It was, therefore, a clearly regressive step.

In the Finance Bill, 1965 what is proposed is to allow the reduction of taxable income by 50 per cent of the qualifying amount. Thus under the new scheme, rebate is allowed not at the average or effective rate applying to the total income but at half the marginal rate applying to the highest slice of income before the above reduction. Of course, the monetary limit of the qualifying amount has also been raised in the Finance Bill.

Thus, the individual in the above illustration who got a rebate of Rs 4,800 at the 1963-64 rates and of Rs 3,800 at the 1964-65 rates (payment by way of annuity deposit did not qualify for rebate), would, at the 1965-66 rates, get a rebate of Rs 3,900. All along we have so far assumed that the entire income is wholly earned. Since on unearned income the rate of tax/is higher, the rebate earned on life insurance and other payments is correspondingly higher.

It will be observed that the really retrograde measure (insofar as one regards'a regressive tax concession as such) was adopted in the year 1964. By raising the ceiling on rebate from the previous 25 per cent to 50 per cent of the qualifying amount, the Finance Minister was clearly benefiting the upper-income groups, the groups who paid tax at the average rate exceeding 25 per cent, i e, with an annual income exceeding Rs 25,000-28,000.

It has not been disclosed what exactly was the revenue loss as a result of change effected in the 1964-65 Budget. Let us hope some alert member of Parliament will persuade the Finance Minister to indicate the estimated loss. Assuming that (a) the rebate-worthy payments are currently running at around Rs 125 crores a year (this should, if anything, be an under-estimate for the total of life insurance premia payments, employees' contributions to provident funds and cumulative time deposits), and (b) the average rate of rebate admissible on these payments will be higher than the average rate of tax payable by non-corporate non-hrm assessees, the total amount allowed currently by way of rebate should have gone up from around Rs 20-25 crores in 1963-64 to Rs 35-40 crores in 1964-65. This is by no means a small gift to the high-income groups.

Capital View

AS Capital View was received late, it appears on page 575.

Gradual Animal Husbandry!

AVOIDING conflict may be a laudable objective, but often it just cloaks the lack of a will to face issues squarely. Has one not heard enough the plea for a "balanced approach" and the "middle course" when the choice is clear and unequivocal? To Food Minister Subramaniam's appeal at. the All-India Gosamvardhan Sammelan that "in the development: of cattle, prejudice, sentiment and tradition had to be shed" and that in tackling the problem of the unchecked growth of cattle "the choice between science and sentiment" had to be made now, Prime Minister Shastri replied that compromises were necessary. In India, said the Prime Minister, any conflict between science and tradition and logic and sentiment would have to be resolved by striking a balance. He wanted a "middle path" between "extreme modernism" and sentiment.