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FROM THE RINGSIDE

Foreign reserves are no magic wand

The proposal for a more productive use of our foreign exchange reserves has received mixed response. This is not surprising. Both sides are reasonably familiar with each others' arguments. It is said that what we profess is what we are expected to profess. Historically, the Planning Commission has believed that the Finance Ministry is short-sighted, niggardly, pre-occupied with fiscal fetish and what is important is high growth, which in the long run will also generate larger revenue streams. As long as public expenditure is targeted to capital-creating assets like strengthening infrastructure and we can build on the virtuous circles which growth creates, a temporary fiscal deterioration is acceptable. The Finance Ministry, on the other hand, believes that productivity of expenditure is difficult to measure much less monitor, there is irreversibility on expenditure commitments once made and fiscal deterioration, apart from crowding out private investments, makes macro-management more difficult. It also sends negative signals to multilateral institutions, credit-rating agencies and potential foreign investors. The truth perhaps lies somewhere in between.

It is ironic that successive deputy chairmen of the Planning Commission speak one language when they are in the Yojana Bhawan and another on becoming finance ministers. The inter-changeability has happened more than once involving distinguished personalities like N D Tiwari, Pranab Mukherjee, Jaswant Singh to name a few. The 'halo' any deputy chairman acquires in the Yojana Bhawan is related to his success in garnering as much resources as possible (popularly known as Gross Budgetary Support—GBS) and in getting prime ministers to overrule the niggardly Finance Ministry! The present Deputy Chairman, who knows both sides of the story, has done well in suggesting some clever financial engineering to increase the resource kitty of the Planning Commission and at the same time, persuade Chidambaram that this won't hurt his fiscal numbers as presented to Parliament. So what can be better if growth is fostered and fiscal deficit as a consequence does not deteriorate.

The proposal is to utilise US $5 billion per annum of reserves for the next two years to finance high import-intensive infrastructure projects with suitable calibration in import duty. The Government would be increasing its deficit through issuing securities, with the RBI monetising part of this deficit by picking up these Securities and the Rupee resources obtained by the Government being used to purchase foreign exchange of the equivalent amount and utilise them towards financing preferably 100 per cent imported infrastructure projects.

The key questions which arise are the following:

• **Is there need for greater public investment in infrastructure?**

It would be difficult to argue against the merits of doing so. The cost and quality of

Power remain exceptionally high; Port constraints make trade expensive; Airports need enlargements; Telecom requires rural connectivity; the National Highways and rural network need huge resources for timely completion; while the Railways need investments for safety, modernisation and faster trains on commercially viable corridors.

The following issues would however need to be addressed:

Is poor infrastructure a result of inadequate resources? We all know that each year finance ministers are able to show somewhat improved fiscal performance emanating from underutilisation of funds either from tardy defence purchases or inadequate Plan expenditure. Even during the current year, there is a utilisation slack in Ports, Power and other infrastructure areas. So the ability of the public sectors to efficiently spend resources poses endemic challenges in improving the quality of public services which have deteriorated in recent times.

The issue of public expenditure versus private expenditure or what has become fashionable public-private partnership needs to be addressed. If deregulation creates new space for private investment, then the sectors or segments which need continued public funding need delineation. Assuming, that private investment is still shy while infrastructure improvement can brook no delay, the issue of inadequate sector reforms looms large. Private investment in Power remains shy because power sector reforms notwithstanding, the Electricity Bill 2003 still needs credible implementation particularly by many state governments. Building new electricity projects by financially sick electricity boards or NTPC taking up more national projects without sector reforms is not sustainable. Similarly, strengthening the Railways Golden Quadrilateral, modernising and upgrading tracks is inescapable but cannot be a substitute for long-overdue Railway reforms. These inter-alia include a sunset clause for distortionary rail tariff between passenger and freight, depoliticisation of Railway tariff fixation, corporatisation of several activities on which experts agree. Montek has been a strong votary against entitlement-driven devolution with a preference for performance-based access. This principle can hardly be given a go-by in the present debate.

Since the foreign exchange reserve is essentially not government money against which it is proposed to issue Bonds, there are still several choices open to us. First, to temporarily extend the date by which the agreement with the RBI on the borrowing limit by the Government becomes fully operational. The full prohibition from subscribing to the Government's securities in the primary issue stage only clicks in 2007. This can yield low-cost finance for infrastructure projects. A temporary extension of this agreement may be preferable than an amendment of the Fiscal Responsibility Management Act itself whose enactment was not easy to achieve. The second option is along the lines of the Planning Commission's proposal by utilising the foreign exchange reserves and issue of securities with monetisation of the fiscal deficit. The third option is to recognise that the additionality of expenditure on infrastructure has a compelling economic and social case and accept an additional fiscal deficit of 0.5 per cent to 0.75 per cent per annum in larger interest. The fourth is for a year or two to concentrate on quality of public expenditure, complete ongoing sector reforms, rationalise public portfolios and reprioritise expenditure. In the public debate, these options and their implications need closer examination. The issue is as much about the modality of financing as about the quality of public expenditure, effectiveness of delivery system and the underpinning of sector reforms.

At the same time, while in the present climate, it may be fashionable to find clever ways to enhance public expenditure, this is no substitute for addressing the more endemic sector problems. Montek has the credit for raising a public debate on these issues since urgent infrastructure improvement has overwhelming multiplier benefit. The Prime Minister’s call for an early consensus on these options has struck the right chord. Foreign exchange plenty by itself is no magic wand to our economic ills.

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