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CARE-TAKER GOVERNMENT AND POLICY CHANGES

A CARE-TAKER Government is not expected to initiate new policies or to undertake big changes. This is the British precedent. In some things we follow British precedents to the letter and even carry them to ridiculous lengths; in others, the more wholesome ones, we are neither sticklers for good form nor do we give evidence of good sense. Whoever heard of a Central Bank giving explanations for its actions in the way in which the Reserve Bank had issued its lame explanation for what it admits to be a belated decision? Whoever might have been responsible for this communique, it will certainly rank as one of the strangest documents in the annals of central banking, whereby a guardian of the money market renounces its rights, formally and openly, to engaged in open market operations. If the Reserve Bank wants to take the money market into its confidence, the approved method for doing it, never followed in the old civilian regime nor followed now, would be more informal and simpler. This is only a matter of form but it is also reveals where the real weakness lies. For lack of co-ordination in the money market follows from absence of co-operation and mutual trust.

The implications of the bank rate change have been discussed in a subsequent article from the point of view of the liquidity of the banking system, and its significance from the broader considerations of economic policy alone need concern us here. While the authorities did not feel up to taking this important step a year ago when the situation was ripe for it, why have they acted so belatedly? The usual time-lag in Delhi for important decisions like those relating to changes in export policy or export duties is usually between three to six months. This is accounted for by the normal time taken in inter-departmental consultations. When the Central Board of Revenue is also concerned, the time taken is naturally longer. But since busy seasons recur only once a yean the time-lag here is dictated by the calendar. There has been a school of thought which has consistently been in favour of this orthodox, though out-moded, remedy. There was a time when the bank rate used to be changed in Britain, the home of the bank rate policy, several times in a year. But that was before the years of the great depression. For those, who have not lost their faith in the efficacy of the bank rate, the proper time for its use would have been when the country was expecting or facing a marked export surplus, that is to say the threat of accentuated inflationary pressure. This was the situation at the threshold of the busy season a year ago. This year, the possibility of a big export surplus, in view of the known magnitude of food imports, must be remote. On the contrary, the Government may be forced to go back on their policy of curbing exports through the export duties and other means, a policy which has already produced good results in the shape of arresting price rises and may achieve much more, if the Government can convince the trading community that they will remain firm and will not yield to pressure at a later stage. This is another important aspect in which the present care-taker Government may hav to take important decisions and initiate important changes in policy

From the confused controversy over the bank rate, what emerges clearly is the lack of co-ordination in the. money market and its very great susceptibility to the foreign balance situation. The former also brings into relief an important source of weakness in the money market organisation as it has developed in recent years, namely, the absence of a short-term market for loans. Since a proper bill market never developed here, Treasury Bills at one time promised to fill this gap partially and served as an instrument which could be used to impart some elasticity, so that by changing the volume of Treasury Bills, the monetary authorities could influence the money market in whichever direction they wanted to, without subjecting it to severe jerks and jolts. 'The circumstances that led to swell the cash balances of the Government, put an untimely end to this experiment.

The authorities had thus to fall back upon directly operating on the long-term rates. In fact, in recent times a strange incongruity in monetary policy has been the attempt on the part of the Reserve Bank to support the structure of money rates at a few chosen points by offering to absorb only one or two selected gilt-edged securities. Thereby the structure of money rates was distorted. If support was intended, it should have been broader based for the entire structure can be either lifted up or brought down but the money market cannot stand a distortion of this structure without suffering obvious unfavourable eonsequences.

Assuming that a main inflationary factor can only arise from export surplus, in the absence of any marked investment actively within the country worth the name—indeed all evidence points to the absence of such activity in the private sector—the justification for the change in the bank rate on this particular score is difficult to find. On the contrary, expected disinflationary effects lack a basis in fact. Close observers may or may not agree with the contention of our stock exchange correspondent published elsewhere in this issue that speculative holding of stocks of commodities is today entirely absent. But if there is such speculative boarding of stocks, it is more likely to be financed out of black money, the existence of which is not denied but on which the bank rate can have no effect. Qualitative control of credit has been attempted by the Reserve Bank through directives to the scheduled banks from time to time but with what effects, it is difficult for outsiders to judge. Rationing by price, however, is least likely to be successful where speculative demand is involved, since the latter has its origin either in expected export demand or in the faltering export policy of the Government, as in the matter of grant of export quotas for oilseeds. In the absence of more convincing evidence of excessive investment in the private sector, the claim that the bank rate can possibly operate on the price level must be dismissed as unproven.

The circumstances that may force the Government to relax export restrictions are those that threaten at the moment to upset completely the. foreign exchange budget on the basis of which presumably the broad pattern of the control on foreign trade is devised.

More than the bank rate and the export policy, elections have been so timed that the same care-taker Government will have to present the next year's budget. The old Parliament will have to be recalled for the purpose. This is a grave breach of the precedent in the democratic countries for care-taker governments. But it has drawn little attention and aroused no resentment for the simple reason that the interest in the country in the forthcoming elections is itself lukewarm. Most people have taken it for granted that things will *go* on pretty much in the same way as they have done in the past, that the same set of people will run the administration, that food deficits will continue to recur with the cycle of the seasons. The pattern will never change. So why be excited?

The Bank Rate and Scheduled Banks

IN Britain, as well as in India, the motive behind the rise in the bank rate is to force the banking system and the money market to be " in " the Bank, In Britain the bank rate was not effective. In other words the money market was always able to secure funds at rates cheaper than the bank rate because the " special buyer " was always willing to take up Treasury bills at and and a half per cent. So the banking system never had any occasion to borrow from the. Bank at the bank rate of 2 per cent.

In India, too, the bank rate was not effective for two reasons. It was not as if the market were always able to receive credits at below the bank rate. During and since the last busy season, it has been paying 3 to 3¼ pr cent for short-term advances from the Imperial Bank against approved Government securities as collateral.

The reasons why the banks prefer to borrow from the Imperial Bank, now one of their competitors, at or even above the bank rate without seeking recommendation from the Reserve. Bank are rooted deep in the past. But the fact remains that banks are reluctant to seek aid from the Reserve Bank.

There is another reason why the bank rate in India has not been effective in the recent past. Instead of seeking loans from the Reserve Bank at its traditional lending rate, banks have preferred to replenish their cash resources through liquidation of investments in gilt-edged securities. The Bank has occasionally helped the scheduled banks by purchasing securities on offer. Until Thursday, for instance, the Reserve Bank was a willing buyer of, say, Conversion Loan at Rs. 92-12. This " freezed " rate has gradually been lowered. But the banks were always sure of procuring cash through sales of securities at rates at which the Reserve Bank was a buyer.

More than the rise in the bank rate, the incidental measures announced by the authorities in Britain, as well as in India, are more significant in their repercussions on the money market. In Britain, the Bank of England will hereafter provide financial aid to the money market only on its own terms. To avoid an unduly heavy floating load on the market, the authorities have announced a series of short-term funding loans for treasury bills. This will reduce the. load by a third, though the various methods of short-terrn borrowings by the Exchequer, such as Treasury Bills and Treasury Deposit Receipts, will continue.