

Importance in Maintaining Trade and Banking Finance in India

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Abstract

Author in this paper looks at the money e minutes basic role as medium of exchange and its importance in maintaining trade and public finance in India. World trade has expanded rapidly over the past decades. An important factor contributing to the growth in trade has been the periodic rounds of successful multilateral trade negotiations which have led to a considerable reduction in tariffs on goods crossing national borders. India has entered into trading agreements with various countries of the world with the objective of boosting its external trade. Foreign Trade Policy of India has always focused on substantially increasing the country's share of global merchandise trade. Accordingly the Government of India has been taking various steps towards boosting its trade with the rest of the world by adopting policies and procedures which would help to increase and facilitate both exports and imports with the other countries of the world. To facilitate and thereby increase external trade activities with the rest of the world, the Department of Commerce, Government of India has developed this web portal. Fiscal measures are important and the government is working on a package of measures. The finance minister has gone on record on this. The government has taken measures to contain expenditure, like freeze on its employees' dearness allowance; at the same time, the government has announced a relief package to support the vulnerable and disadvantaged sections. Through measures like in-kind support (food grains), cash support, DBT (Direct Benefit Transfer) support or depositing money in PMJDY (PM Jan Dhan Yojana) accounts, government has committed to spend 0.8% of GDP. So, therefore, meeting the fiscal deficit target of 3.5% this year is going to be very challenging, and going beyond it becomes unavoidable.

Also, because of the lockdown, GST collections are going to be significantly impacted, and impact on direct taxes cannot be ruled out. While deciding on the size of the fiscal package, it would be very important to prioritise the support measures and interventions. All measures should be well targeted to optimise the outcome. Equally important is to have an exit strategy of fiscal interventions. In other words, fiscal measures under the package should contain specific sunset provisions. This would be in line with the recommendations of the FRBM Committee. In terms of exceeding the fiscal deficit, two straight replies, one is the 3.5% fiscal deficit target for this year will be very challenging to meet. As regards, how much it will exceed and how much the government will spend, that will depend on the view taken by the government, with regard to how much they can exceed the deficit number, and what kind of support measures can be taken that produce maximum impact.

Keywords— FRBM Committee, India, exit strategy, fiscal deficit, fiscal interventions

Introduction

In other words, it has to be a judicious and balanced call keeping in mind the need to support the economy on one hand and the sustainable level of fiscal deficit that is consistent with macroeconomic and financial stability. The pace at which policy rates are transmitted to financial markets determines the effectiveness of monetary policy signals. The transmission of policy rate changes to financial markets is sensitive to liquidity conditions and, therefore, the impact of policy rate changes is conditioned to a large extent by the liquidity management operations of the central bank. Under the framework where the interest rate channel has emerged as the key transmission channel for central banks, managing liquidity actively to steer the target rate in the desired trajectory has become a standard operating framework. An appraisal of the liquidity demand of the banking system becomes critical for the success of liquidity management operations.

For an efficient transmission of monetary policy, the central bank aims to align its overnight operating target rate close to its policy rate to guide the longer-term interest rates in the economy by way of liquidity provisions ranging from overnight window to medium-term horizon. Persistent deviation of the central bank's target interest rate from its policy rate may trigger active liquidity absorption or injection because such deviations and consequent rise in volatility may heighten market uncertainties and make the transmission process that much weaker. Thus, liquidity management is considered to be crucial for the first leg of monetary transmission, i.e. transmission of policy rate changes to overnight money market rate. In an emerging market economy, where financial markets are not fully developed and there are numerous frictions operating in the financial system (e.g. regulated interest rates in some segments, lack of complete market integration and prevalence of sectoral credit dispensation), the efficacy of the interest rate channel of monetary policy transmission is impeded.

Further, the efficacy of the transmission process to financial markets is also impeded by the prevalence of liquidity frictions, which may not be conducive for complete transmission of the policy rate changes. The operating framework of a monetary policy that has evolved across most advanced economies (AEs) and emerging market economies (EMEs) comprises mainly of an operating target interest rate of the central bank and instrument(s) to achieve the target rate. In the Indian context, the Reserve Bank of India (RBI, 2014) has suggested that liquidity management operations should be consistent with the stance of monetary policy, i.e. an increase in the policy rate to convey an anti-inflation policy should be accompanied by tightening of liquidity conditions, whereas accommodative liquidity conditions should characterise the easing of the policy standpoint. Thus, the transmission of monetary policy to interest rates at the short end of the yield curve is responsive to liquidity conditions prevailing during the policy rate change and subsequent periods. The central bank responds to various liquidity shocks in the banking system by deploying an array of liquidity management instruments. The basic operating framework of any monetary policy aims to align the weighted average call rate (WACR), i.e. the operating target, with the policy rate by proactively managing liquidity.

The revised liquidity framework instituted by the Reserve Bank of India (RBI) in September 2014 aimed to make liquidity management operations flexible, transparent and predictable. Subsequently, the liquidity management framework was fine-tuned to progressively lower the average ex ante liquidity deficit to a situation closer to neutrality. The objective is to meet the requirements of durable liquidity and then use the central bank's operations to ensure that short-term liquidity conditions are congruent with the monetary policy stance. Furthermore, the policy rate corridor around the repo rate was narrowed from +/-100 basis points to +/- 50 basis points. The prime motivation of this paper is to identify the unanticipated liquidity shocks that explain movements in call money rate and the pattern of its volatility. Thus, this paper seeks to answer the following question: How do various frictional and structural liquidity shocks shape the monetary transmission process towards the short- end and the nature of

volatility in call money rates? An understanding of these issues may help improve our insight into the transmission process which faces challenges emanating from various structural constraints. Abstracting from the usual approaches to explaining money market volatility in terms of market microstructure issues, an attempt is made to identify and quantify the nature and impact of various liquidity shocks on the target interest rate of the central bank and thus offer some new insights into the transmission process.

Objective:

This paper studies the role of money e in in maintaining international trade and public finance of Indian government

Banking and money value in international trade

The best measure of the liquidity demand of the banking system is central bank liquidity because any surplus/deficit in the banking system liquidity is ultimately reflected in the liquidity adjustment facility (LAF) balances. RBI (2014) proposed a monetary policy operating framework during the transitional phase with liquidity assessment based on frictional and structural drivers. The magnitude and persistence of the impact of a shock on the call money rate may differ significantly depending on the state of liquidity in the domestic financial system. It could be possible that a frictional liquidity shock may have longer lags and higher magnitude of impact on call money rates during deficit liquidity compared with surplus liquidity conditions. The role of the LAF window is to overcome frictional liquidity deficit/ surplus, whereas the durable liquidity is to be managed with other instruments.

The functional framework of the monetary policy in India comprises a single policy rate (repo rate) to indicate the monetary policy stance and operates within a corridor established by the RBI. In order to maintain its operating target (i.e. weighted average call money rate) close to its policy rate, the RBI deploys liquidity management instruments at its disposal.⁶ The operating objective is to contain this rate around the repo rate within the corridor. While instruments such as cash reserve ratio (CRR) and OMO are more appropriate to overcome durable or structural liquidity mismatches, overnight repo auctions are intended to tackle frictional liquidity mismatches. RBI (2019) underscored the fact that while overnight operations (or weekly/fortnightly operations followed by overnight operations) should address the liquidity needs of the banking system, unanticipated shocks could still lead to liquidity build-up that could result in actual liquidity being different from the desired level. In the case of persistent shocks, it would be essential to take the liquidity in the system back to the desired level, which could be achieved through OMOs or, where outright operations are not desirable, by deploying different tools to attain the required impact on durable liquidity. Against this backdrop, an empirical assessment of the various shocks affecting liquidity level, and hence call money rates and volatility in call rates assumes importance

Public finance export bills

(i) An exporter who has not been able to realize the outstanding export dues despite best efforts, may either self-write off or approach the AD Category – I banks, who had handled the relevant shipping documents, with appropriate supporting documentary evidence. The limits prescribed for write-offs of

(ii) The above limits will be related to total export proceeds realized during the previous calendar year and will be cumulatively available in a year.

(iii) The above write-off will be subject to conditions that the relevant amount has remained outstanding for more than one year, satisfactory documentary evidence is furnished in support of the exporter having made all efforts to realize the dues, and the case falls under any of the undernoted categories:

The overseas buyer has been declared insolvent and a certificate from the official liquidator indicating that there is no possibility of recovery of export proceeds has been produced.

The overseas buyer is not traceable over a reasonably long period of time.

The goods exported have been auctioned or destroyed by the Port / Customs / Health authorities in the importing country.

International Trade and Public finance

The unrealized amount represents the balance due in a case settled through the intervention of the Indian Embassy, Foreign Chamber of Commerce or similar Organization;

The unrealized amount represents the undrawn balance of an export bill (not exceeding 10% of the invoice value) remaining outstanding and turned out to be unrealizable despite all efforts made by the exporter;

The cost of resorting to legal action would be disproportionate to the unrealized amount of the export bill or where the exporter even after winning the Court case against the overseas buyer could not execute the Court decree due to reasons beyond his control;

Bills were drawn for the difference between the letter of credit value and actual export value or between the provisional and the actual freight charges but the amounts have remained unrealized consequent on dishonor of the bills by the overseas buyer and there are no prospects of realization.

(iv) The exporter has surrendered proportionate export incentives if any, availed of in respect of the relative shipments. The AD Category – I banks should obtain documents evidencing surrender of export incentives availed of before permitting the relevant bills to be written off.

(v) In case of self-write-off, the exporter should submit to the concerned AD bank, a Chartered Accountant's certificate, indicating the export realization in the preceding calendar year and also the amount of write-off already availed of during the year, if any, the relevant EDF to be written off, Bill No., invoice value, commodity exported, country of export. The CA certificate may also indicate that the export benefits, if any, availed of by the exporter have been surrendered.

(vi) However, the following would not qualify for the write off facility:

Exports made to countries with externalization problem i.e. where the overseas buyer has deposited the value of export in local currency but the amount has not been allowed to be repatriated by the central banking authorities of the country.

EDF which are under investigation by agencies like, Enforcement Directorate, Directorate of Revenue Intelligence, Central Bureau of Investigation, etc. as also the outstanding bills which are subject matter of civil / criminal suit.

vii) AD banks should report write off of export bills through EDPMS to the Reserve Bank.

viii) AD banks are advised to put in place a system under which their internal inspectors or auditors (including external auditors appointed by authorised dealers) should carry out random sample check / percentage check of write-off outstanding export bills.

ix) Cases not covered by the above instructions / beyond the above limits, may be referred to the concerned Regional Office of Reserve Bank of India.

Export claims and Trade

(i) AD Category – I banks may remit export claims on application, provided the relative export proceeds have already been realized and repatriated to India and the exporter is not on the caution list of the Reserve Bank.

(ii) In all such cases of remittances, the exporter should be advised to surrender proportionate export incentives, if any, received by him

Write off in cases of payment of claims by ECGC and private insurance companies regulated by Insurance Regulatory and Development Authority (IRDA)

(i) AD Category – I banks shall, on an application received from the exporter supported by documentary evidence from the ECGC and private insurance companies regulated by IRDA confirming that the claim in respect of the outstanding bills has been settled by them, write off the relative export bills 17in EDPMS.

(ii) Such write-off will not be restricted to the limit of 10 per cent indicated above.

(iii) Surrender of incentives, if any, in such cases will be as provided in the Foreign Trade Policy.

(iv) The claims settled in rupees by ECGC and private insurance companies regulated by IRDA should not be construed as export realization in foreign exchange.

Write-off – relaxation

As announced in the Foreign Trade Policy (FTP), 2015-20, realization of export proceeds shall not be insisted upon under any of the Export Promotion Schemes under the said FTP, subject to the following conditions:

The write off on the basis of merits is allowed by the Reserve Bank or by AD Category – I bank on behalf of the Reserve Bank, as per extant guidelines;

The exporter produces a certificate from the Foreign Mission of India concerned, about the fact of non-recovery of export proceeds from the buyer; and

This would not be applicable in self write off cases.

Exporters' Caution List

Caution Listing/ de-caution Listing of exporters is automated in EDPMS. The updated list of caution listed exporters can be accessed through EDPMS on a daily basis. Criteria laid down for cautioning/ de-cautioning of exporters in EDPMS are as under:

The exporters would be caution listed if any shipping bill against them remains open for more than two years in EDPMS provided no extension is granted by AD Category –I bank / RBI. Date of shipment will be considered for reckoning the realisation period.

Once related bills are realised and closed or extension for realisation is granted, the exporter will automatically be de-caution listed.

The exporters can also be caution listed even before the expiry of two years period based on the recommendation of AD banks. The recommendation may be based on cases where exporter has come to adverse notice of the Enforcement Directorate (ED)/ Central Bureau of Investigation (CBI)/ Directorate of Revenue Intelligence (DRI)/ any such other law enforcement agency or the case where exporter is not traceable or not making any serious efforts for realisation of export proceeds. In such cases, AD may forward its findings to the concerned regional office of RBI recommending inclusion of the name of the exporter in the caution list.

Reserve Bank caution / de-caution the exporters

AD Category – I banks should follow the procedure mentioned below while handling shipping documents in respect of caution listed exporters:

(a) They will intimate the exporters about their caution listing, giving the details of outstanding shipping bills. When caution listed exporters submit shipping documents for negotiation / purchase/ discount/ collection, etc. the AD Category – I bank may accept the documents subject to following conditions:-

The exporters concerned should produce evidence of having received advance payment or an irrevocable letter of credit in their favour covering the full value of the proposed exports;

In case of usance bills, the relative letter of credit should cover full export value and also permit such drawings. Besides, the usance bills should also mature within prescribed realisation period reckoned from date of shipment.

Except under the above mentioned conditions given in 2 (a) (i) and (ii), AD banks should not handle the shipping documents of caution listed exporters.

(b) AD Category – I banks should obtain prior approval of the Reserve Bank for issuing guarantees for caution-listed exporters.

(i) AD Category – I banks may allow payment of commission, either by remittance or by deduction from invoice value, on application submitted by the exporter. The remittance on agency commission may be allowed subject to conditions as under:

Amount of commission has been declared on EDF/SOFTEX form and accepted by the Customs authorities or Ministry of Information Technology, Government of India / EPZ authorities as the case may be. In cases where the commission has not been declared on EDF/SOFTEX form, remittance may be allowed after satisfying the reasons adduced by the exporter for not declaring commission on Export Declaration Form, provided a valid agreement/written understanding between the exporters and/or beneficiary for payment of commission exists.

The relative shipment has already been made.

(ii) AD Category – I banks may allow payment of commission by Indian exporters, in respect of their exports covered under counter trade arrangement through Escrow Accounts designated in US Dollar, subject to the following conditions:

The payment of commission satisfies the conditions as at (a) and (b) stipulated in paragraph (i) above.

The commission is not payable to Escrow Account holders themselves.

The commission should not be allowed by deduction from the invoice value.

(iii) Payment of commission is prohibited on exports made by Indian Partners towards equity participation in an overseas joint venture / wholly owned subsidiary as also exports under Rupee Credit Route except commission up to 10 per cent of invoice value of exports of tea & tobacco.

Conclusion

Among the key exogenous liquidity shocks impacting call money rates in India, there is strong evidence of currency demand, forex inflows and movements in government's cash balances with the RBI as principal drivers. While tax revenues are predictable, expenditures are lumpy, causing unanticipated liquidity demand/supply and hence higher volatility in the movement of call money rates. Given the significant currency-GDP ratio in India, movements in currency demand result in sudden changes in money market liquidity, which in turn impacts call money rates. Forex inflows, particularly led by portfolio inflows, are more volatile in nature as these are strongly influenced by foreign investors' expectations and risk-taking behaviour.

A key structural driver of liquidity demand in money markets is the wedge between the credit and deposit growth of the banking system. There is also a compelling evidence of this variable influencing the movement in call money rates. Future expectations of interest rates are also found to significantly influence call money rates. Among the key components of central bank operations—while changes in central bank policy rate (i.e. repo rate) strongly influence the call money rates in India—OMO sales/purchases, which absorb/inject durable liquidity in the money market, emerge as a key policy instrument influencing the call money rate. OMO purchases by the central bank from the banking system lead to the injection of durable liquidity in the financial system, resulting in a strong moderating impact on money market rates.

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