

The Economy

Further Rise in the Treasury Bill Limit

On July 8, 1981 the ceiling on Treasury bill issue was raised once more, for the fifth time in the past one and half years. The new limit has been set at Rs. 13 billion which represents an increase of 30 per cent from the limit set in December, 1980; and an increase of 117 per cent from the limit set over a year ago (that is July, 1980). As seen in Table I below, the increase in the Treasury bill ceiling during the decade of the 1960's was only Rs. 850 million (an increase of 130 per cent), and in the 1970's the increase was Rs. 1,500 million (an increase of almost 100 per cent). In the first one and half years of the 1980's, the limit has sharply jumped by Rs. 10,000 million, an unprecedented increase of 333 per cent.

Whenever the government sought the approval of Parliament, in recent years, to raise the Treasury bill ceiling, opposition spokesmen have used the occasion for a critical appraisal of government's economic and financial policies and to focus on the "inflationary situation" in general and possible "inflationary effects" of increased borrowing through Treasury bills. The subject has often roused hot debate and strong opposition charges were made once again on this occasion. Another issue brought up in this regard, is not so much how high the ceiling is being raised, but whether the ceiling is being used for temporary accommodation purposes or as a means of continuous accommodation to finance budgetary gaps for which no revenues are available. A closer look, however, at the role that Treasury

bills can play in government finance will provide a fairer answer to these questions.

The Treasury bill is the principal instrument that the government uses for short term finance. It is meant as a method of meeting government expenditures pending the receipt of normal government revenues through taxation, loans and other sources. Revenue flows do not exactly tally with expenditure flows leads and lags are inevitable. When revenue lags behind expenditures, the gap is financed by the issue of treasury bills which mature in a short period of three months. Treasury bills are retired in periods of cash surplus. Borrowing by treasury bills, especially when they are purchased by the banking sector, is expansionary in its effects. But when they are retired, with the realization of the anticipated government revenues, the expansionary effect is withdrawn. Hence, when treasury bills are used for temporary accommodation only, they serve a useful purpose and the inflationary impact (even when purchased by banks) is kept at a minimum.

Why did the government have to raise the ceiling by 333 per cent over the past one and half years? One explanation is that over the past few years some substantial changes have occurred in the magnitudes of government revenue and expenditure. During 1977-81 the government revenue has increased by

Table 2. Treasury Bill Ceiling as Percentage of Government Revenue and Expenditure

	As % of Govt. Revenue	As % of Govt. Expenditure
1972	76	54
1973	62	46
1974	52	39
1975	49	32
1976	52	32
1977	45	31
1978	26	16
1979	24	14
1980	73	34
1981	84	47

133 per cent and government expenditure has risen by 180 per cent. It has been argued that borrowing limits need to have a bearing to the new magnitudes of government finance. The treasury bill limits as percentages of government revenue and expenditure for the past one decade are given in Table 2 above. This table, however, does not reveal any stable pattern or ratio between treasury bill limits and government finances. The limit as a percentage of the government revenue which was as high as 76 per cent in 1972 had fallen in the subsequent years and reached its lowest at 24 per cent in 1979. Similarly, the limit as a percentage of government expenditure which was 54 per cent in 1972 has continuously fallen in the subsequent years to reach a bottom of 14 per cent in 1979. In 1980, both ratios have risen sharply, and the new limit set on July 8, this year works out to 84 per cent of the estimated government revenue and 47 per cent of the estimated government expenditure for 1981.

Rather, it appears that the major underlying factor in the sharp and successive increases in the Treasury bill limits was to raise resources to finance the growing and unanticipated budgetary deficits caused by the inflationary rise in costs particularly of capital projects. The budget deficit in 1980 amounted to Rs. 15.3 billion as against Rs. 8.9 billion in the original estimates. Resources from external sources and domestic non-bank sources were available to finance only 59 percent of this deficit, thereby necessitating consi-

Table I. Changes in Treasury Bill Ceiling.

Month and Year of Revision	Percentage Increase	Increased Amount, (Rs. million)	New Limit (Rs. Million)
1960 Jan.	—	—	650
1961 Sept.	15.4	100	750
1963 March	33.3	250	1000
1963 Dec.	15.0	150	1150
1964 Aug.	8.7	100	1250
1968 Jan.	20.0	250	1500
1970 Aug.	30.0	450	1950
1970 Sept.	5.1	100	2050
1972 July	22.0	450	2500
1976 Nov.	20.0	500	3000
1980 March	33.3	1000	4000
1980 July	50.0	2000	6000
1980 Oct.	33.3	2000	8000
1980 Dec.	25.0	2000	10000
1981 July	30.0	3000	13000

derable bank financing. The Treasury bill was the principal instrument used for this purpose, and the principal subscriber to treasury bills was the Central Bank. As the Central Bank Report for 1980 commented:

"In the absence of any significant subscription from non-bank sources, the Central Bank was called upon to subscribe to successive issues of Treasury bills and the Central Bank's contribution to the total issue of Treasury bills as at the end of the year (1980) was Rs. 9604 million or 98 percent". "The effect on the economy of government's inflationary deficit financing was to raise money supply and to swell the level of aggregate demand in the economy". "In so far as the budget is concerned, a closer balance of government revenue and government expenditure would be a helpful step in overall demand management. There is a strong case to re-examine the revenue base so as to make it more responsive to income increases. Mobilization of savings is another useful move in limiting bank borrowings".

As for 1981, the government has attempted to reduce the overall budgetary gap by imposing a cut on government spending, and a virtual embargo on supplementary estimates. Even with these measures an unfinanced gap of around Rs. 3,000 million is expected to show in the 1981 budget. As the Deputy Minister of Finance announced in Parliament:

"I do not wish to hide the fact that the Government may have to resort to bank borrowing to the tune of Rs. 3,000 million during the course of this year".

He further added:

"We have reached an understanding with the International Monetary Fund as regards this level of deficit financing. We have secured extended fund facilities from the IMF for the foreign exchange support in order to meet the excess demand for goods in the form of imports when the incomes expand as a consequence of the expansionary impact of government spending".

Increase in the aggregate demand over the past few years has "overheated" the economy and fiscal discipline has to play a central role in reducing the level of demand in the economy.