Transfer some forex reserves to states for covid expenses

Vivek Moorthy Tuesday, 11 May 2021

A grant of $200 per person to each state will help them spend on vaccines and other urgent medical needs

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Very recently, I wrote, "Within India, as for taxes, if states were allotted some reserves, many more people would have been vaccinated by now." ('Of poor nations rich enough to have imported vaccines', 11 May, Mint). Building on that conjecture, this follow-up article makes a concrete suggestion.

As the covid death toll mounted fiercely, there has been a tectonic shift in policy. Since mid-April, India has dismantled its vaccine licence raj, just as it dismantled the sprawling socialist licence raj starting 1991. Finding it impossible to manage the purchase and allocation of vaccines, the Centre has told states to 'do it yourself'. At the time this was written, about 10 states had floated global tenders for importing vaccines.

Now that states are free to import or buy vaccines domestically, the question is can they afford to? If goods and services tax (GST) revenues are too low, they will crumble fiscally. Travel has again fallen due to lockdowns. So, sales of petrol and diesel, and thus non-GST fuel taxes, will fall sharply. Therefore, despite their freedom to buy, states may not be able to afford vaccines.

Fortunately, there is a way out, since India has built up a huge stock of foreign exchange reserves. These reserves can be used for much-needed covid imports and various other expenditures of state governments.

The obvious starting question is what has prevented India from booking vaccines with so much foreign exchange? The short answer is the Make-in-India policy focus, which is well-meaning but very unsuitable for a medical emergency. There are other reasons too worth discussing, but beyond the space limits of this article. Further, the Indian policy discussion has largely been corporate-focused, not people-focused. Using foreign exchange reserves to build infrastructure was first proposed in late 2004. Its use for investment was again broadly discussed in this February's Economic Survey. However, there was no discussion of using the reserves to import vaccines.

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The more pressing question to ask is what policy change will facilitate the speedy purchase, not just of vaccines, but all needed medical items, from oxygen cylinders to pills and beds? In my opinion, it is the immediate transfer as a grant of foreign exchange reserves, now held solely by the Reserve Bank of India (RBI), to states for their medical and other expenditures.

At present, the Finance Commission decides on states' share of total taxes collected, based on various criteria and formulae. However, the Finance Commission is too slow-moving a mechanism for a speedy transfer of foreign exchange reserves. Even more so after the advent of the GST regime in 2017, which has greatly complicated Centre-State fiscal transfers.

Instead, Parliament can legislate, amending the RBI Act, that some foreign exchange reserves be transferred from the Centre to states for covid and other expenditures. As of end December 2020, our benchmark date, reserves stood at $579 billion, an estimated $419 per person. The simplest and quickest policy would be to transfer, say, $200 per person to each state based on their populations. This could perhaps be done in tranches. For an estimated population of 1,379 million for 2020, that comes to $ 276 billion worth of reserves to be given to states. That would still have left RBI with $303 billion in reserves as of December 2020, and another $6 billion as of end-April 2021.

Two rules of thumb are used to assess whether a country's foreign exchange reserves are adequate. The first long-standing rule is that it should be enough to cover three months of imports. The second one, more recent, is the Greenspan Guidotti rule: a country should keep enough reserves to pay back its short-term external debt, based on residual maturity. To meet these criteria, RBI roughly needed $120 billion and $106 billion of reserves, respectively, at the end of 2020. After the suggested transfer to states, leaving RBI with $303 billion, both criteria are very amply met. Since this is a medical emergency, even these rules should be flouted if need be.

The covid needs of states are obviously not population-based. Medically, a better criterion would be to give foreign exchange based on the number of active cases or proportion vaccinated. But covid hotspots have changed and will change rapidly, rendering a medical criterion unsuitable. Any criterion other than population will be seen as unfair and lead to conflict among states.

In this fast-changing situation, states may hesitate to import vaccines that will take too long to arrive. They may prefer to buy from Indian companies that are ramping up production quickly. Further, Made-in-India vaccines may be medically better suited to battle the B.1.1617 'double mutation' variant or possible future ones. In which case, states with surplus foreign exchange can sell it back to RBI or to the public, and get rupees for their domestic expenditures. This is far better than waiting for uncertain tax revenues, in a shrinking economy, or borrowing funds from the Centre at a rate of close to 7%, or higher now.

Purchases by the Centre for states, as the EU did for its members, will facilitate a bulk volume bid and so a better price deal. But it is perhaps too late for that. Besides, states can pool their bids. Pricing mechanisms and distribution within states will have to be worked out. At this point, speedy delivery matters the most. Being alive, even if ripped off, beats dying while bargaining or waiting for a lower price.

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