

UNITED FORUM OF RESERVE BANK OFFICERS & EMPLOYEES

The Hon'ble Members of Parliament
Parliament of India
New Delhi.

Date: 13 April 2015

Respected Madam / Sir,

Finance Bill 2015 – An appeal to the Hon'ble MPs

We, the representatives of the entirety of officers and employees of the Reserve Bank of India, crave indulgence to draw your kind and immediate attention to certain provisions of this year's Finance Bill presented before the Parliament by Sri Arun Jaitleyji, Hon'ble Finance Minister on February 28, 2015, which, if implemented, will seriously impact the functioning, authority, jurisdiction and effectiveness of the country's central bank, Reserve Bank of India, and will have a deleterious effect on the national economy, both short term and long term. The changes sought to be ushered in through these provisions are sweeping and hasty, as it appears to us, without proper application of mind and without creating a national consensus which is so much needed in such case. These will clip the wings of RBI, shackle it and make it utterly incapable to conduct monetary policy, ensure financial stability and confining inflation within a narrow band which RBI is mandated to perform in national interest. As law makers of the country and guides of the country's destiny we beseech your kind attention to the following aspects as the country's central bank, set up in the year 1935 under an Act of Parliament, and which has served the nation for long 80 years now, earning repeated plaudits, both nationally and internationally, for its perspicacity and nation-oriented policies which has successfully steered Indian economy and its life line, the banking system, the financial market etc. through many turbulent periods, has been targetted, most unfortunately. A creation of the country's Parliament should not be strangulated by the same Parliament, we appeal.

A few days ago, on 2nd April 2015, RBI observed its 80th Anniversary, where the Hon'ble Prime Minister and the Finance Minister both highly appreciated RBI for its activities and unparalleled achievements in many areas and wished it to continue as such, which was quite factual and encouraging. In this context, the move to cripple RBI through the proposed changes is highly conflicting and defies logic. On the occasion, RBI Governor, Dr. Raghuram Rajan said, inter alia, **"Strong national institutions are difficult to build. Therefore, existing ones should be nurtured from the outside and constantly rejuvenated from the inside, for there are precious few of them."** We hope that you will kindly agree and acknowledge that RBI is one of these "precious few", which should be strengthened and not weakened.

Our such apprehension has been strongly supported by the country's Press, some of whose editorial comments are "Don't weaken RBI" (The Financial Express, March 10, 2015). "No room for surreptitious, illogical regulatory changes" (Business Standard, New Delhi, March 11, 2015) and such others.

Madam / Sir, RBI's role came into much prominence recently in the time of global financial crisis, when the entire banking system of the developed nations was on a crash course but India's banking system survived, which earned acclaim from world renowned economists like Joseph Stiglitz, Paul Krugman etc., for which RBI played commendable role.

We draw your kind attention to some of the proposals of the Finance Bill 2015. It has been proposed to amend the RBI Act 1934, repeal the Government Securities Act 2006, amend the Securities Contract (Regulation) Act. 1956, Foreign Exchange Management Act (FEMA) 1999, DICGC Act 1961 etc

The Finance Bill 2015 proposes for eventually repealing the Government Securities Act, 2006, and create a new agency called Public Debt Management Agency (PDMA), thereby taking over the debt management function from RBI; in addition regulatory and depository functions in relation to the Government securities is also proposed to be shifted to SEBI / PDMA. While this is a far reaching change, which requires a national consensus, this has been brought through Finance Bill thus practically ruling out effective intervention by the Hon'ble Members of Rajya Sabha even, who may discuss but not change, amend or rescind any of the provisions even if they deem this inappropriate and detrimental to national interest. To preclude thus an important section of national opinion, the Upper House of the Parliament, from asserting itself on such a vital national issue is highly undesirable, to say the least.

Madam / Sir, Reserve Bank is the debt manager of the Government of India since 1935 and has excellent track record in Public Debt Management. Even as the Government's borrowing had gone up substantially over time, (For 2015-16, the budgeted target for borrowing in current fiscal is Rs.6,00,000 crore), RBI has managed to complete the borrowing programme in an efficient manner at low cost without any risk to the Government. RBI has also taken several steps to develop the Government securities market resulting in reduction of cost of borrowing for government. These steps include introducing new instruments like floating rate bonds, inflation-indexed bonds, cost management bills, latest being 40 Year Government of India Security etc.; expanding the investor base and attracting foreign investors; strengthening market infrastructure by providing trading platform, safe real-time settlement mechanism etc. RBI have thus created world class trading and settlement infrastructure, reasonably deep and liquid market, stable domestic investor base and keen foreign investor interest. **Our system for trading, payment and settlement of government securities is world class and has become benchmark for several emerging market economies; even it has earned encomia from some advanced countries.** Notwithstanding all these, RBI is sought to be divested of this sensitive function, it is difficult to understand why?.

Madam / Sir, separating Government Debt Management from RBI has been in the air for quite some time. The proposal of a separate Debt Management Office (DMO) has been in the agenda of the Government since 2007 – 08 on the specious argument of “conflict of interest”- the argument being that RBI as the regulator of monetary policy as well as manager of Public Debt would have two conflicting roles simultaneously which would “repress” financial market. This argument is hardly relevant in Indian context with enormous public borrowing by the Government, escalating by leaps and bounds. And that is why this was opposed by successive RBI Governors like Dr. C. Rangarajan who strongly advocated for a “cautious, calibrated” approach, Dr. Y. V. Reddy and Dr. D. Subba Rao, who said explicitly in an interview given to Wall Street Journal on February 13, 2013, **“I believe there is a quite a bit of synergy for the RBI to be doing the debt management, because raising resources of the size the government does in India, is not just a matter of raising resources, it has implications for interest rates, for liquidity, for credit flow and for the macro economic situation”**.

Such logic to distinguish the monetary policy, which has been the exclusive domain of RBI, from debt management, is erroneous. According to eminent Nobel Laureate US economist James Tobin “.... **debt management is not a task that is divisible in two provinces, monetary control on the one hand and management of interest-bearing debt on the other. The programme is a unit, and it is anomalous to attempt to split it into administrative packagesThere is no neat way to distinguish monetary policy from debt management..... it is not merely that monetary action and debt management interact..... They are one and indivisible; debt management lies at the heart of monetary control.**”

Debt management can impact the entire economy as it influences interest rate movements and availability of funds in financial markets and banks. An autonomous Debt Management Agency, as proposed, which is likely to be only concerned about its own functions may not be able to manage this complex function and would create problems by increasing risky debt. This was proved during the financial crisis in Euro Zone (especially Greece, Portugal and Ireland) where independent Debt Management Offices (DMOs) issued short term / foreign debt in a disproportionate manner and exposed governments to great risks.

Madam / Sir, the modality of Government Debt Management have historically evolved in various countries. There is no universal pattern, rather this has been country specific. As far as our information goes, besides India, in the following countries the government debt management is done by the central banks viz., Singapore, Taiwan, Hongkong, Denmark, Chile, Uruguay, Ireland, Iraq, Sri Lanka, Tanzania, Germany, Japan, China, Italy etc. Denmark and Ireland which had different system earlier came to the central bank management of their public debt in 1991 and 2007 respectively. In fact, after global financial crisis, scholars / academics have started thinking in favour of debt management by central bank. Renowned scholar like Prof. Charles Goodhart, former member of Bank of England's Monetary Policy Committee and Emeritus Professor of London School of Economics has strongly argued that **responsibility of debt management be restored to Central Bank. So, when the world is restoring debt management to the central banks, we need to rethink whether it is right to shift debt management out of RBI.**

Having debt management within RBI has helped the country in several ways. It also made RBI functioning more effective due to synergy. For example, in a situation of large external capital flows, Market Stabilisation Scheme (MSS) were issued as part of debt management operations which helped the economy to stabilize. Holding of Government securities by the central bank in a developing economy is always advantageous. In fact the substantial stock of Government of India securities held by the RBI, enabled it to sterilize the monetary impact of capital flows during the 1990's by selling the securities thus containing inflation. RBI could effectively do it as it functioned as the depository of Government securities and had securities ready at hand to intervene in the market. In absence of RBI acting as the depository of Government of India securities, which will be handled by other agency(ies) as proposed, RBI will be simply helpless to stabilize the money market or target inflation, as the nation would expect from it. It is to be clearly understood that most of the Government of India securities are being held by the public sector banks, of which RBI is the regulator and supervisor. A well coordinated effort for monetary policy, public debt and RBI regulation of Government securities market is *sine qua non* for securing financial stability. RBI acts as depository of around Rs.40,00,000 crore Government of India securities.

Apart from what is stated above regarding RBI's meaningful intervention in the money market with the Government of India securities, the other aspect is Government will have to incur huge costs if such enormous amount of securities are transferred to NSDL (National Securities Depository Limited) etc., as RBI do not charge anything for its depository function, while NSDL or any other agency will, as these are profit-oriented companies. **We wonder if the cost benefit analysis was at all done by the Ministry before proposing this aspect.**

Debt management of State Governments -

Madam / Sir, in our Parliamentary system of democracy you might have been elected from various political parties, but you primarily represent the people of your State(s) and constituencies. You are the spokespersons in the Parliament from your state(s) too. . We request you to please query from the Hon'ble Finance Minister whether before placing his aforesaid proposals in the highest constitutional body of the country, State Governments have been consulted and their views obtained, or is it a unilateral move, in which case it impinges on Article 252 of the Constitution of India because State Debt Management is very much involved. As per Clause 21A(b) of RBI Act 1934. "The RBI may by agreement with the Government of any State undertake the management of the public debt of and the issue of any new loans by that State."

All the States in the Republic of India barring the Government of Jammu & Kashmir have entered into such agreements with RBI by virtue of which RBI is their debt manager too. The proposed amendment of Government Securities Act 2006, by virtue of which the Central Government debt will be shifted to another agency, as proposed, the State Governments are not covered. PDMA is entrusted with responsibility of only Central Government debt management as per Chapter VII of the Finance Bill. If Government Securities Act amendments are passed, issuance and servicing of State Government securities by RBI would become impossible. Who will look after them, then? Did the Finance Ministry consult with the States about this vital aspect, or in their hurry to somehow take away debt management function from RBI as quickly as possible, they did not bother about that and leave them in the lurch?

More importantly, are the State Governments eager to entrust debt management to a central government agency or an "autonomous body" by name only but for all practical purposes, a wing of the Government of India. It is important to see that State borrowings are done efficiently by the Reserve Bank by co-ordinating with centre's borrowings. As RBI manage Central and State debt, coordination is presently possible. Any change in the system could pose problems for the States. This would definitely go against the spirit of fiscal federalism. To quote Dr. Y. V. Reddy, former Governor of RBI and the Chairman of 14th Finance Commission, "..... **you would agree that the discussion that is going on in regard to the independent debt agency of the Centre has serious implications for the management of public debt by all the States and very serious implications for Centre-State fiscal relations.**" (Economic Times, Dr. Reddy's Interview, 12 March 2015)

Again, with RBI off the picture as the authority of issue and management of public debt, the States in particular, floating their bonds will have to fend for themselves, as RBI's gentle nudge to potential investors, mainly banks, will be lacking. Then going by the market logic, the investors would opt for those State Government Bonds which are in better financial shape to service their debt, than those whose economic position might not be so sound. These State Governments will perforce have to offer higher rates of interest on their loans to persuade the investors, which on the one hand will strain their finance further and the state-wise disparity or regional disparity, too glaring now, will further aggravate while on the other hand RBI's interest rate management will go awry with various State Governments coming to the market with widely varying interest rates.

There is, in addition, another worrisome dimension. RBI, as the debt manager of both Central and State Governments, has been servicing their debt including payment of interest and principal. If some State Governments were in financial straits, RBI as their banker would come to their rescue, as lender of the last resort, so that the investors were absolutely assured of their payments, which guarantee will not be there once PDMA takes over as PDMA cannot act as banker to the State Government and issue overdrafts. This will definitely dissuade the investors from investing in State Government Bonds on risk of default. Weaker is a State Government financially, risk perception is more. Such State Government bonds in particular, if not as a general feature, will remain under-subscribed much to their detriment, and much at the cost of country's Federal polity.

In this regard, what Dr. Reddy says is significant. **"At what rate you (State Governments) are positioned to borrow will be influenced by the credit rating (of the states) which is also influenced by the fact that RBI is a debt manager. If RBI is not debt manager, credit rating will also be influenced. Then, that will influence the cost"**.

Dr. Reddy's caution is significant.

Madam / Sir, kindly consult your State Governments and place their views also in the Parliamentary forum.

Dr. Reddy has sounded another very pertinent caution. He says, **"Then, there is another issue. It is external debt. The new debt office combines the domestic debt and the external debt. In other words, it is quite tempting for the government to have the debt programme, the borrowing programme, to increase the external debt."**

The important lesson is that if government securities are designated in foreign currency and / or are held by non-residents, it is a source of instability, particularly for emerging economies. So, risk is enhanced by combining the two because it is very tempting to substitute the two.it is a risk for the fiscal management for centre and is a greater risk for public debt management of the States....." In such a situation Government's borrowings could be hostage to foreign investment bankers, which is definitely risky, as following any development either in their home countries or globally, the FIIs may dump Indian securities and run away with their investments, which exactly happened in South-East Asian economic crisis in late 1990s.

Madam / Sir, we beseech you to kindly go through this aspect seriously as it would greatly endanger our economy and make it vulnerable to manipulation in global market.

In this context is to be viewed the purported amendment of Foreign Exchange Management Act (FEMA) which whittles down RBI's powers in respect of administration of FEMA. Forex market regulation is being done by RBI mainly for securing exchange rate stability. If RBI do not know or RBI cannot control how and how much the capital inflows are likely, it will not be possible for RBI to secure exchange rate stability and thus monetary stability.

Madam/sir, the Finance Bill proposes to bring the terms "repo" and "reverse repo" under the purview of Securities Contract Regulation Act 1956. If so, RBI loses its vital instruments to control the money market, by setting the interest rate. Since these are instruments of monetary policy, removal of regulatory power over them has the potential to interfere with both the monetary policy and banking regulation functions of the RBI. Along with losing its depository function and the mechanism of repo and reverse repo taken away from RBI, it will be rendered a helpless spectator when the financial market goes into a swing. Is it desirable? Will it serve nation's and common peoples' interest? Please ponder.

Under the Finance Act 2015, the monetary policy shall be determined by a Monetary Policy Committee (MPC) constituted by the Government of India. Vital decisions such as interest rate, etc. shall be decided by it. The constitution of the MPC is yet to be decided upon, but if the Government has its way in deciding the constitution of the Committee, it can well be presumed that the MPC will be packed with members who will toe the Government's line and this will virtually strip the RBI of its power and independence to make monetary policy. All over the world, the Central Banks are being given autonomy but the Reserve Bank, as a central bank, is being pushed to a situation of 1940's & 50's when the Govts. used to control the Central Banks. Any curtailment of autonomy of the RBI may sow the seeds of chaos in the whole financial system.

Deposit Insurance & Credit Guarantee Corporation (DICGC), in its present form, is likely to be wound up and a Resolution Corporation is planned to be set up to take care of winding up of all banks and other institutions in the financial sector. In this quest for forming a large organisation the basic insurance of money of an individual/depositor will be lost somewhere and eventually small depositors will become the poor victims, we seriously apprehend.

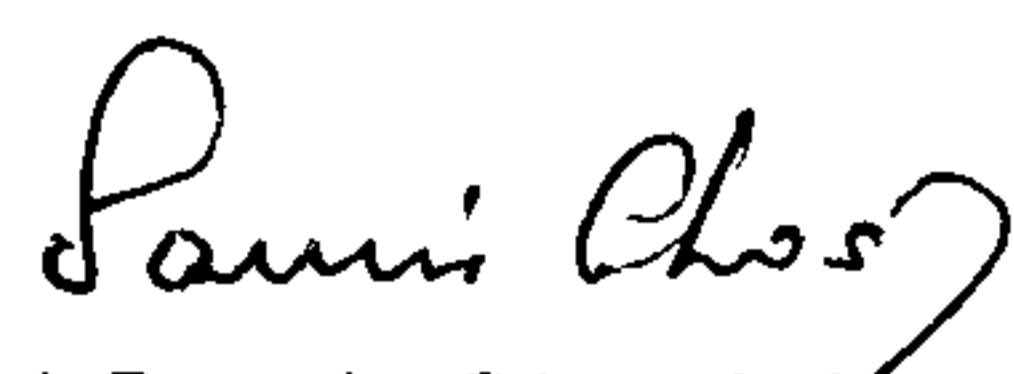
The all-important question that arises is - why all such important amendments are being done through the Finance Bill rather than by way of a separate bill which could have attracted a lot of public debate as well as full-fledged parliamentary deliberation? Is it intended to avoid public debate on such vital issues?

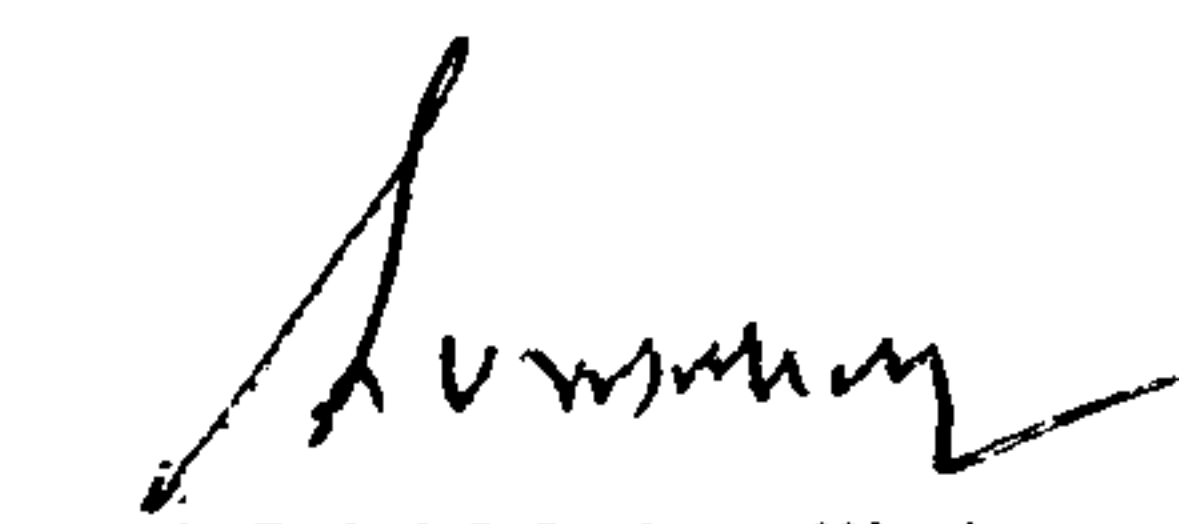
We request you to take up these in the interest of the country and insist that the amendments to the RBI Act 1934, Govt. Securities Act 2006, Public Debt Act 1944, Foreign Exchange Management Act 1999, DICGC Act 1961 and setting up of the Public Debt Management Agency may be dropped from the Finance Bill 2015 and be brought up for threadbare discussion in the Parliament at a later date.

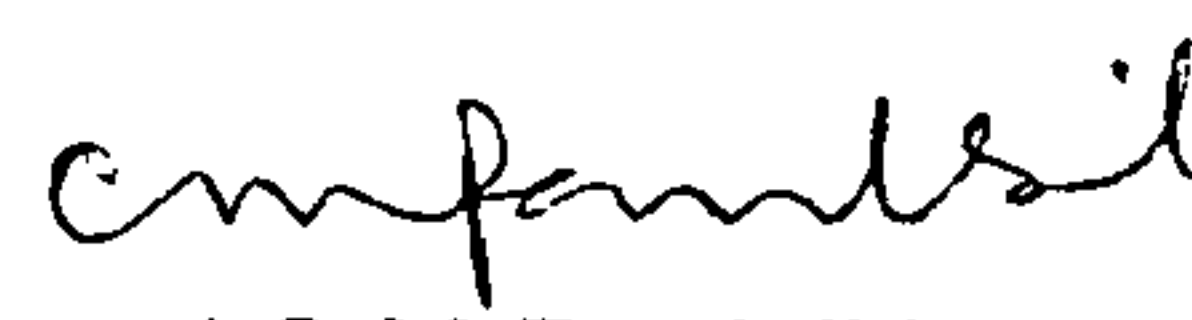
Meanwhile let a national consensus emerge in the country's best possible interest instead of pushing things in a hurry.

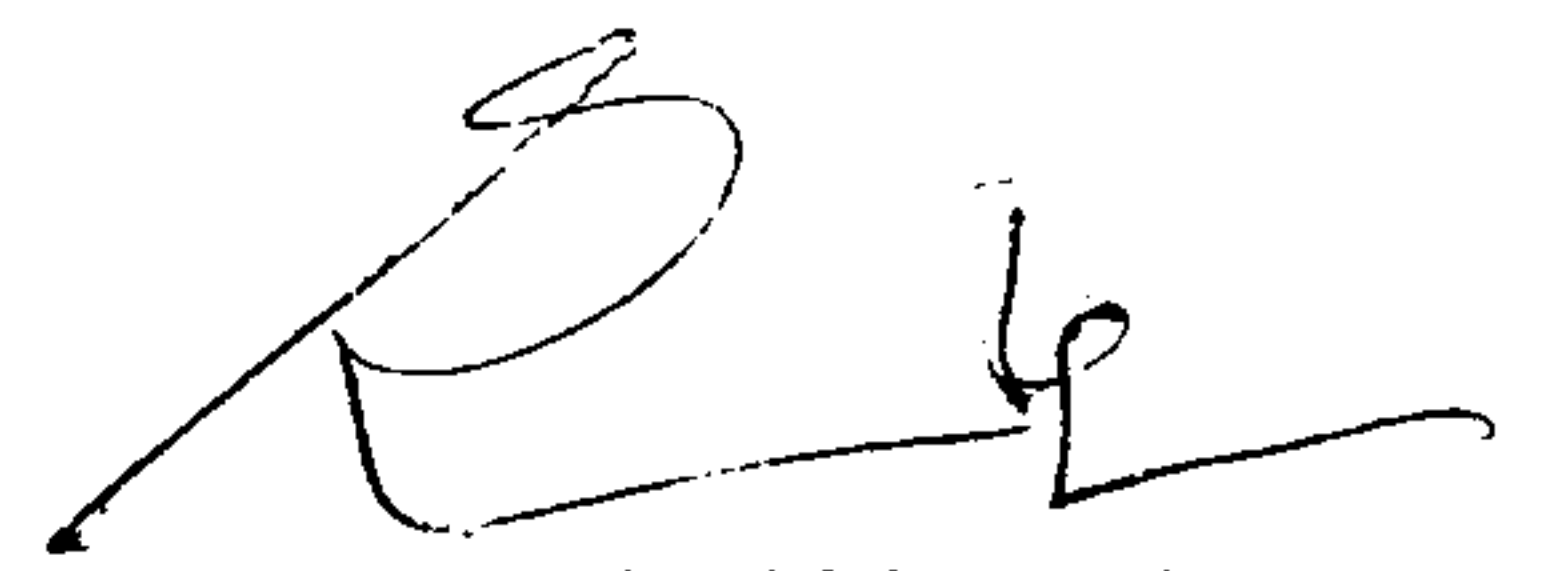
With regards,

Yours faithfully,


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