

UNITED FORUM OF RESERVE BANK OFFICERS & EMPLOYEES

Proposed separation of management of public debt from Reserve Bank of India

The Government of India have decided to establish a Debt Management Office (DMO) to manage the public borrowings of Central and State Governments and enact for that purpose National Treasury Management Act (NTMA) which would divest RBI of this function. This would have been operationalised by this time but for the global economic melt down which plunged many a countries into serious economic crisis, and RBI's note of caution in view of huge borrowing programme of the Government of India of more than Rs. 4.5 lakh crore in this fiscal.

But the issue is very much alive. This might be revived any time and pushed through. We, the representatives of RBI staff and officers, would like to place the factual position so that there might be informed discussions at national level to arrive at a national consensus on this vital matter.

The issue is of utmost national importance. The total public debt of the Government of India and State Governments is currently to the tune of Rs.36 lakh crore, about 60% of the country's GDP. Public debt is an important component of Government finance, both Central and State Governments, and are essential for country's developmental needs. This is particularly true for developing countries like India. Whether this huge public borrowing of the Government as also new borrowings will continue to be serviced by RBI or a separate agency to be created, either as part of the Ministry or independent, to look after the same, is the issue in question.

The protagonists of the separation comprising various committees set up by the Government and other agencies and a section of economists associated mostly with various international fora have argued on "conflict of interest" if RBI look after both the monetary policy as also Government debt. Strangely, this is being raised increasingly stridently notwithstanding the fact that RBI have been looking after both the functions well and in a balanced way for several decades, which has earned appreciations from all quarters.

They contend that as manager of public debt RBI would arrange to sell the Government bonds cheap i.e. at a low rate of interest to ease the interest burden on the Governments, whereas its monetary stance might be to tighten the interest rate to contain inflation. Hence a conflict would arise. They suggest that RBI should exclusively focus on inflation targetting and price stability whereas under DMO, pricing of Government bonds would be market oriented and market determined. Otherwise, they say, there would be distortions in the money market, it will remain artificially suppressed, which they term as "financial repression", and stand in the way of financial liberalisation.

Such logic to distinguish the monetary policy from debt management is erroneous, at best tenuous. According to eminent Nobel laureate US economist James Tobin, "There is no neat way to distinguish monetary policy from debt management, the province of the Federal Reserve from that of the Treasury. Both agencies are

engaged in debt management in the broadest sense and both have power to influence the whole spectrum of debt..... 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." This clearly refutes the so-called "conflict theory", substantiates rather the confluence of interest in favour of keeping the debt management with the Central Bank.

In fact leaving huge public borrowings of the Government which is increasing apace for obvious reasons, to the turbulence of market mechanism will put severe strain on monetary policy and make management of interest rates by RBI an almost impossibility. 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 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 have to offer higher rates of interest on their loan to persuade the investors, which on the one hand will strain their finance further and the state-wise 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, have 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 timely payment, which guarantee will not be there if DMO takes over, for DMO cannot act as banker to the State Government and issue overdrafts. This will definitely dissuade the investors from investing in Government bonds on risk of default. Weaker is a state Government financially, risk perception will be 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 due to growing economic divergence for non-availability of fund for development.

This perceived withdrawal of guaranteed payment will make state Government bonds, in particular, less investment-worthy, creating a space for corporate bonds to make inroads. Perhaps that is the main reason for advocacy for RBI's withdrawal from the Government debt management and the hue and cry on absence of "level playing field" for corporate bonds.

The allegation that the Government bonds are under priced as RBI decides the interest rate "capriciously" does not hold good, as for last couple of years the stocks are being auctioned in the market, bids are invited and accordingly interest rate(s) are decided. Hence market definitely plays a role, albeit within a range. It is also known that of late, sale of some bonds were withheld as bids were not accepted by RBI.

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, Iceland, Iraq, Srilanka, Tanzania, Germany, Japan, China, Italy etc. Incidentally, Denmark and Iceland which had a different system earlier came back to the central bank management of their public debt in 1991 and 2007 respectively.

In some other countries, some Government agencies do the jobs, somewhere some independent outfits. There is no reason, therefore, that our country should follow a path different from what we have been doing for last so many decades, if there is no worthwhile and pressing reasons for that. Our policy should suit needs of our country and our people and must not follow blindly some others. Reserve Bank of India is an important national institution. Its role and sagacity have been internationally acclaimed during the current global economic crisis when Indian financial system came out more or less unaffected, while huge banks and insurance companies in advanced economies like the US, Europe, Japan etc. collapsed miserably. To dispense with such an institution from management of country's crucial public debt system requires an in-depth analysis, lest the economy and equitable development of the country are not seriously impaired. Hence a national discourse and debate is absolutely necessary to arrive at a national consensus, we very strongly feel.


The Public Debt Office (PDO) of RBI in almost all state capitals monitor the work of issue and administration of public debt efficiently with state-of-the-art technology and skilled work force. The efficiency of existing system of RBI has been highly praised by all concerned. To dismantle the existing net work and create a new agency with appropriate technology, infrastructure, and skill will be an up-hill task, and unduly costly. While RBI will be further emaciated (it is already skeletal) and its expertise wasted, the new agency will be floated, adding to the national cost, which going by what has been stated above, is absolutely unnecessary.

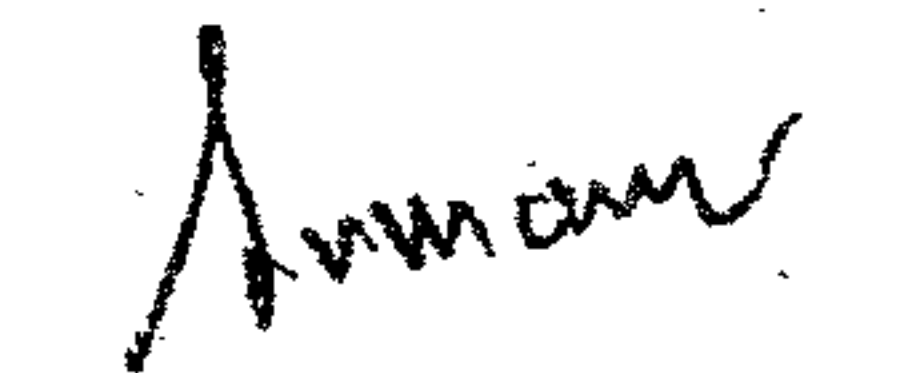
We request you, sir/madam, to consider the issue in national interest, in the interest of the states and the people and advise the Government of India, Ministry of Finance and RBI accordingly, if you please deem fit.

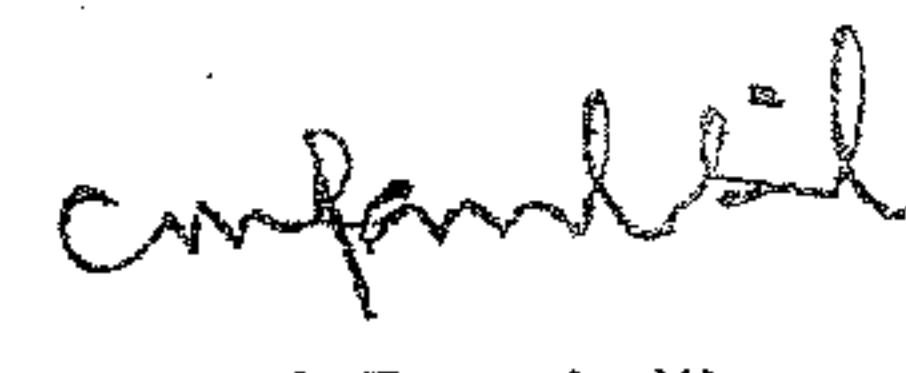
We will be extremely grateful if a copy of your communication to the above authorities is kindly forwarded for our information and record.

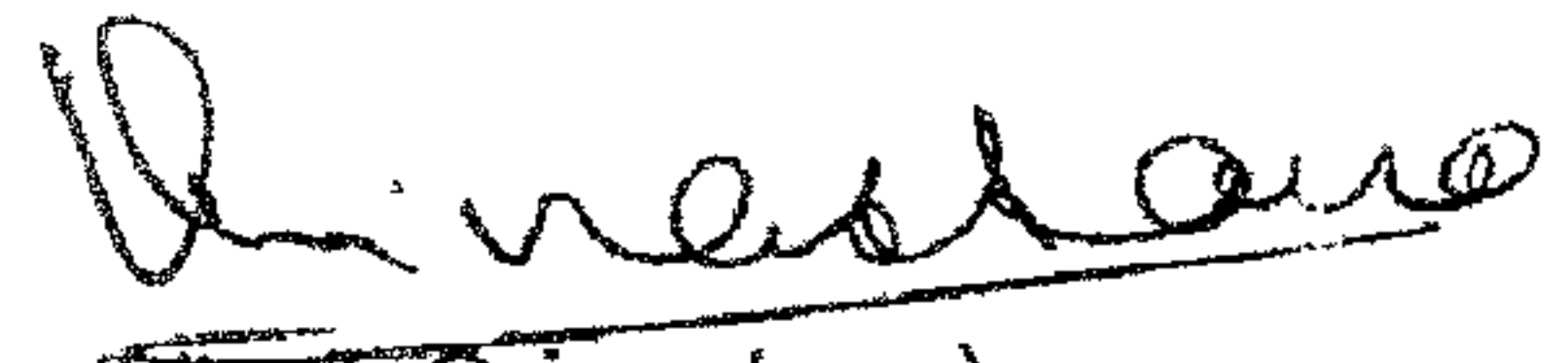
With regards,

Yours faithfully


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