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National Treasury Management Agency Proposals: Implications for India's Financial Policies

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The Reserve Bank of India (RBI) manages the borrowings of the Indian government. In almost all the years since independence, the government has not had a fiscal surplus, and it has had to borrow from the market to meet capital requirements for planned schemes. In fact, the argument among the financial managers of the government was that there was no harm in running up a fiscal deficit if the funds were used for capital expenditure. By the 1980s, the government was borrowing for its current expenditure as well, and the resultant growth of debt threatened to take the country into a financial crisis. The RBI has managed these substantial borrowings from the market. It has managed government borrowing in a manner that the targets are fulfilled, without affecting credit flows to the rest of the economy. The RBI decides on tranches of government borrowing at different times of the year, the periodicity and the coupon rate, and 'persuades' the state-owned banks to pick up the bonds, which are then counted as part of their statutory lending ratio. Apart from this, the RBI manages the borrowings of the state governments as well, taking into account their needs and their capacities. In fact, the RBI has been the debt and treasury manager of the government.

There have been some problems with this. First, in order to be an effective bonds manager, it would like to keep interest rates low. However, this constrains its monetary policy freedom of setting short-term interest rates. Second, these bonds are illiquid, with trading taking place only between different public sector banks that hold these documents and, hence, it is non-transparent. It has also constrained the development of a bond market where the public could buy and sell government bonds. It has also prevented corporates from accessing market for debt financing, as long-term bonds have not developed in the secondary markets. Finally, with a limited number of high credit rated companies, there was little opportunity for the others to access the market, except at very high interest rates.

In the last decade, the situation has changed significantly. The equity markets have become world class and there has not been a single day, even in the current crisis, that the markets have not functioned and settlements not taken place. The markets have developed considerable depth, with a large number of companies being able to raise equity in the country, and equity as well as debt overseas. State government borrowings have been made

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independent of the central government's oversight on planned expenditure, after the Twelfth Finance Commission recommendations, and they can now borrow according to their credit worthiness, as needed.

It was against the backdrop to create a smooth, independent bond market that the government announced in the 2007-08 Budget that the monetary and the debt management aspects of the RBI would be separated. On 21 November 2008, the government released a draft bill to create a statutory corporate body called the National Treasury Management Agency (NTMA) to carry out debt and cash management, and the management of contingent and other liabilities of the Centre and the states. The NTMA would help them to manage their debt so as to meet their financing needs. It would, over time, be able to extend the portfolio of debt instruments to include rupee-denominated bonds, foreign currency-denominated bonds and inflation-indexed bonds. This is a welcomed move and will help create a vibrant bonds market, and greater strength and depth to the financial markets.

At the same time, there are some moral hazards as well. First, the role of the RBI, which it has been ably executing for the last 60 years, is being curtailed. The NTMA, as the investment banker to the government, would work with the budget division of the Ministry of Finance, without oversight from the RBI. The NTMA would be an investment banker without any regulatory oversight. In the past, there have been several state governments which have been remarkably indiscreet in their borrowings, primarily to pay for subsidies and dole outs. In the early part of this decade, the worsening of state finances was due to this profligacy. With the RBI in control, and the states needing overdraft and 'Ways and Means' facilities, the RBI was able to provide an effective oversight to the management of state finances. There have been several instances where the RBI has bailed out the states, through proactive advice and assistance. With the proposed NTMA, this role will cease to exist. There is no evidence to suggest that the states, and indeed even the central government (this financial year is a good example), have been able to rise above politics to manage their finances in an objective and prudent manner. The NTMA will be unable to prevent indiscreet borrowings by the states for it is slated to be an investment manager and not a fiscal regulator.

Second, the draft bill envisages that these government bonds would be available for sale in India and abroad. This would mean that, for the first time since independence, India would be offering sovereign bonds to overseas investors. Earlier Finance Ministers and governments have shied away from this, for committing a sovereign to a debt that can be called outside the country, has been a very sensitive and emotional issue. This was the reason that, even at the height of the foreign exchange crisis, Resurgent India Bonds were in fact issued by the State Bank of India and not by the debt. It has been the principle so far that the sovereign, the State, would not issue debt overseas.

The worry is that the mere creation of the Debt Management Office in the Finance Ministry, without taking a holistic view of the problem, is likely to exacerbate the fiscal pressures that are being faced by the states and, eventually, the central government. Institutions need to be reformed as much as processes and it would have been better if both issues had been addressed simultaneously.

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