

FINANCIAL STABILITY AND MACRO ECONOMIC FISCAL POLICY

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Presentation Plan

- What is the Financial Stability Architecture(FSA) in India?
What about other countries?
- What are the basic tenets of Fiscal Policy(FP) of a Developing Economy ?
- Are FP and FS interlinked?
- What way? How critical is that?
- Does our Financial Stability Architecture amply recognise the inter- linkages?
- What more can be done?

Financial Stability Architecture in India

- FSDC to strengthen and institutionalize the mechanism for maintaining financial stability, enhance inter-regulatory coordination and promote financial sector development. FM Chairs
- Without prejudice to the autonomy of regulators:
 - monitors macro prudential supervision of the economy, including SIFI/FCs
 - addresses inter-regulatory coordination and financial sector development issues.
 - financial literacy and financial inclusion

Financial stability Architecture

| Country | Financial stability agency |
|----------------|--|
| USA | Financial Sector Oversight Council- Treasury, Fed ,SEC,CFTC etc. |
| UK | Financial Policy Committee within the BoE- Gov, Dy Gov, Treasury rep etc. |
| Australia | Council of Financial Regulators- RB, PRA, SIC, Treasury etc. |
| European Union | European Systemic Risk Board (ESRB) – European Central Banks, Fin supervisory authorities, Eco and Fin Committee etc. |
| Japan | Informal mechanism of meetings between the Ministry of Finance, Bank of Japan and Financial Supervisory Agency for cooperation and risk monitoring |
| Korea | Bank of Korea monitors the financial system and evaluates its stability. |

Financial stability Architecture

| Country | Financial stability agency |
|--------------|---|
| Brazil | Financial Stability Committee established by Central Bank of Brazil |
| Russia | Informal coordination between Central Bank of Russia and ministry of finance in time of crisis |
| China | China Banking Regulation Commission (CBRC) carries out systemic risk oversight |
| South Africa | The mandate of South African Reserve Bank revised to include ensuring financial stability- the bank has an internal Financial Stability Committee |
| Indonesia | Financial System Stability Forum (FSSF) |

Fiscal Policy - Basic Tenets

- Fiscal policy - tax & expenditure policy, investment or disinvestment strategies and debt management.
- Expenditure funding- taxation, seigniorage, borrowing, reserves and sale of fixed assets. $G > T$
- Conservative fiscal policy- FRBM Act
 - Inter generational equity in fiscal management
 - Ensuring long term macro-economic stability.
- Debate on fiscal consolidation- When? How?
- Fiscal sustainability- Fiscal Limits
- Austerity backlash

Fiscal Policy & Financial Stability Inter-linkages

- Policy does not operate in isolation: close macroeconomic linkages with Real /Monetary /External Sector
- Fiscal policy, a powerful tool for Financial Stability
- Fiscal legislation, both at Centre and State level is critical.
- Fiscal federalism & institutional reforms (GST)
- Formalization of the informal sector.

Fiscal Policy & Financial Stability Interlinkages

- Shocks and policy measures also affect the fiscal limit
- Focus on current debt and deficits is insufficient
- No “one-size-fits-all” number for debt to GDP ratio
- Fiscal policy - Volatility – Inflation-Welfare losses.
- Price stability supportive, but not sufficient for financial stability.

FS & FP Inter-linkages-Criticalities

- Instability, a burden on public finance.
- Loose fiscal policy – strains public finance
- Vicious cycle - of financial crisis & deteriorated fiscal position.
- Not to cross limits or else – default or loss of credibility
- Period of heightened uncertainty – Economic & Political crisis - limited options
- Sovereign credit rating down – Borrowing costs more

What is a successful policy?

- Certainty about policy regimes – weighing policy trade-offs
- Fiscal policy within safeguards essential
- Monetary policy to focus on price stability
- Financial Stability Policy
 - Macro prudential instruments
 - Financial Sector Reform
- Who to secure financial stability – Agents of fiscal policy or monetary policy?
- Our current policy to safeguard financial stability ensures fiscal policy and financial stability going hand in hand

Ensuring Financial Stability

- 12 meetings of FSDC under the chairmanship of Finance Minister have been held so far.
- A Sub-Committee of FSDC has been set up under the chairmanship of Governor, RBI- 15 meetings held
- Technical Groups/Working Groups :
 - Inter-Regulatory Technical Group
 - Inter-Regulatory Forum for Monitoring of Financial Conglomerates
 - Technical Group on Financial Inclusion and Financial Literacy
 - WG on Financial Resolution
 - Early Warning Group

Ensuring Financial Stability

- Development of Financial Markets
- Financial Reforms- FSLRC
- Assessing financial stability Risks- FSR, Resolution Regimes, Supervisory arrangements for Financial Conglomerates
- External Sector Vulnerabilities, CIS, CAD, Fiscal Cliff, FATCA, Currency volatility, bank asset quality/NPAs, and bank exposure to large corporates
- National Strategy on Financial Education, Regulation for Investment Advisors
- Coordination on implementing key financial sector reforms as part of G-20/FSB agenda.

Crisis Prevention & Management Framework

MoF collaborating with, and assisting, the Regulatory Authorities and the other stakeholders in:

- Identifying and mitigating the potential emerging threats to our financial and macroeconomic stability; and
- In the event of a crisis, taking all the necessary steps to be taken by Anchors to mitigate its impact on: (a) the financial markets; as well as (b) the real sector
- Macro Financial Monitoring Group

Managing FS & FP Inter-linkages

- Fiscal consolidation- sustainability, FRBM
- Broadening Tax base- formal sector
- Managing CAD
- Exchange rate and reserves
- Bank recapitalisation
- Subsidy/ Expenditure management
- Disinvestment targets
- Stability in Capital flows/FDI
- Stable and simple Regulatory Regime
- Regulatory Impact Analysis
- Real Sector Growth
- Financial Reforms including fiscal reforms

An Assessment

- Are the arrangements and steps taken enough ?
- What more needed?
- Statutory FSDC
- Consistent thrust on Fiscal Consolidation
- More Simplicity, clarity and certainty in regulatory regime,rules
- Institutional reforms to be a continuous process
- Contribution of States and all stakeholders- the Key !

THANKS !
