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:
  
  o monitors macro prudential supervision of the economy, including SIFI/FCs
  o addresses inter-regulatory coordination and financial sector development issues.
  o financial literacy and financial inclusion
## Financial stability Architecture

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

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

• 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 !