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## RBI asserting independence

BY [T.K. JAYARAMAN](#) ON [10/12/2016](#)

Everyone knows why the previous governor of RBI had to leave. Urjit Patel understands the circumstances under which he assumed charge but has still risen to the occasion.



RBI governor Urjit Patel. Credit: Reuters

The Reserve Bank of India (RBI)'s decision on December 8 [stunned](#) the markets. There were high expectations that in a cash starved economy, brought literally to a standstill by

demonetising 86% of the currency held by the public and devastated by declining consumption and investor confidence, the central bank would rescue the economy through a cut in its policy interest rate.

These expectations did not materialise and there was disappointment all around.

Although the chief economic adviser (CEA) to the government lauded the RBI decision to stick to its policy rate of 6.25%, “as bold and brilliant”, it was obvious to many that there was no option in his choice of adjectives. Maybe he did not expect it. The CEA did not say in as many words: “We recognise and appreciate the independent discretion of the central bank.”

Certainly, as a distinguished economist he knows the value of central bank independence. Does it mean the central bank really wanted to assert its independence by not responding to the general expectations of the public, markets and policy makers? Everyone knows why the previous governor of RBI had to leave. He was too independent. He was more worried about inflation. The new governor knows the circumstances under which he has entered his new office.

It is now testing time for the new governor. He rose to the occasion.

### **Black clouds**

There are already black clouds gathering, threatening the world economy. In the context of world commodity prices including petroleum crude and the wobbling eurozone, RBI has to be worried about the long-term prospects of growth and stability unlike the government of the day.

Governments all over the world have a myopic view and are often worried about the next quarter, the next election. The RBI also fears that the US Fed’s impending interest rise would affect the external value of the rupee. Any depreciation of the rupee as a result of capital outflows would only worsen the balance of payments, aside from feeding inflation due to rise in prices of imported commodities. Inflationary expectations are real, as there has been a continued firmness in food prices as well posing a threat to domestic price stability and external value of rupee.

The RBI governor announced at the press conference on Dec 7 that the RBI monetary policy committee (MPC) decision was unanimous.

“The MPC was of the view, given a reduction of 25 bps rate in October, which cumulatively adds up to a reduction of 175 bps since January 2015 – a further reduction in the policy rate is not warranted at this juncture.”

### **Removal of 100% CRR**

The RBI also announced removal of the 100% cash reserve ratio, which was imposed on incremental deposits of the banks due to the surrender of the demonetised notes of Rs 500 and Rs 1000. The money will now be with the banks once again. Under the market stabilisation scheme

(MSS), whose ceiling has been raised on December 2 to Rs 6 lakh crore from Rs 30,000 crore, RBI auctioned the 28-day cash management bills (CMB) for Rs 20,000 crore.

The RBI feels confident. It can control liquidity with the increased ceiling under MSS. It is confident that there is adequate liquidity in the system with the removal of 100% CRR on incremental deposits gathered after demonetisation.

It is now left to the banks to take advantage of the cuts already offered and facilitate transmission mechanism of easy monetary policy stance since January 2015.

### **No dividend to government from demonetisation**

In the press conference on December 8 it was clarified that there is no dividend from reduced liabilities of RBI due to reduction in currency holdings following the surrender of old notes.

RBI's dividend is the surplus income over expenditure at the end of the accounting year: July-June. Surplus income is the difference between the net incomes earned by RBI on government bonds held and net income earned from its open market operations, purchase and sale of government securities and from forward currency operations, and the usual operating expenditures. It is too early to determine what will be the surplus given the obvious fact that RBI's expenditures now until end of June next year would be higher than in the past.

Reduced liabilities do not increase the income of RBI or dividend to government.

### **Additional tax revenue**

All demonetised notes were legal tender when surrendered. They are deposits from the public.

If tax officials start their investigations into the bank transactions on and after Nov 8 and if they find the money deposited into a new account opened by a depositor for the first time, exceeded the taxable threshold, they would identify him as tax dodger. If a person is already a tax payer and has all along suppressed excess incomes and he had to deposit under the changed circumstances of demonetisation, it would also receive the attention of the tax collector; and the dodged tax revenue would also be collected.

The Lok Sabha passed the amendment bill on Nov. 29, which would enable levying a tax of 30 percent of income declared, an additional surcharge of 33% of the tax amount and a penalty of 10% of the declared income. The total liability would be 50%. Further, 25% of the declared income will have to be held as interest-free deposit for four years.

In the case of the undeclared income, when eventually found out by tax officials, the unexplained amount will be taxed at 60%, a surcharge of 25% of the tax amount and a penalty of 10%, in all 85%.

## **Governance matters now**

So if there is any bonanza that will arise out of demonetisation it will be as a result of diligent work put in by India's tax machinery. If the tax machinery fails, the bonanza would not materialise. We have seen how corrupt bank officials, both in the public and private sector, have let down the public by helping unscrupulous black money holders in the conversion of black money into white.

Additional resources, mobilised by incorruptible tax officials, have to be efficiently spent. Fiscal policy will have to play a more dominant role. Appropriate and quick yielding public investment projects will help the recovery.

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