Reserve Bank of India vs Government of India: an ugly, open public dispute

■ *Dr. T.K. Jayaraman*

An open public dispute is currently on

Normally, the differences between two institutions, one being the elected government whose political tenure is determined by periodical elections, as expected in a democracy and the other, a statutory institution, whose future is more certain, are settled across the table. No elected government would like to have its image tarnished by the acrimony between statutory bodies or constitutional institutions being exposed to the public.

Goal and instrument independence

The fiscal policy (public expenditure and revenuer including raising taxes and borrowing) is within the government's purview and the money matters (control of money supply and of interest rates through monetary policy formulation and implementation are assigned to monetary authorities in all democracies. The national objectives of economic growth and creation of jobs and employment and price stability are common. Within these parameters, good practices in governance are now well known.

There is an agreement between Government of India (GoI) and Reserve Bank of India (RBI) which lays down the price stability is the goal of RBI; and the RBI should aim at an inflation target of 4% (within range of 2%, plus or minus); and RBI's instrument independence is confined to fixing the policy interest rate and along with including regulatory powers in regard to payments system and the whole gamut of financial sector stability. Thus, the twin concepts of goal independence and instrument independence are well understood.

In the case of India, Reserve Bank of India (RBI) is a statutory body under RBI Act of 1935. Though not patterned after the fiercely independent similar institutions, India has been parading for some time until very recently that RBI's autonomy is well recognized as in other democracies. The Act has never been amended by any of the past governments to the disadvantage of RBI. Although there is a Section in the Act, hitting the headlines since last 15 days, which enables the government to give directions to RBI how it should act, it is to the credit of past governments of India that the Section 7 was never invoked.

A whipping boy

It should also be mentioned some of the past governments, which would have been frustrated by the then monetary authority standing firm, never went to the extreme. They were afraid of possible repercussions and certainly scared of being thrown out of power in the next election. However, there are instances of showing displeasure through veiled threats of amending the law when monetary authorities do not see eye to eyes with the government. Such threats were not unusual in the US. A former US Congressman Ron Paul of Texas, and an unsuccessful nominee as a Republican candidate for US Presidency, fought his campaign for the abolition of the US Federal Reserve Bank (the Fed). His book, End the Fed was number six on the New York Times Best Seller List. He accused the Fed for debasing the US currency through quantitative easing for getting out of the Great Recession ignited by the US financial crisis of 2007-08.

Not many in the US Congress agreed with Ron Paul. The legislators preferred the Fed to continue as it serves as "a whipping boy". When things went wrong, they can lay the blame on the US Fed.

Close to the election time, if the monetary authority refuses to toe the line of government (which likes to keep the borrowing cost low) or denies honoring government overdrafts for temporary financing of gaps between expenditures and revenues) or /and flatly says "no" to fiscal abuse of central bank (forcing central bank to print currency to bridge the annual fiscal deficit), the governments in Africa and Latin America do go to the extremes: we have seen ugly incidents of either the governor of the central bank in Zimbabwe being dismissed or resigned quietly as in Argentina.

Contentious issues

The current open public dispute centers around four issues, which are now fairly well known having been discussed in detail. Broadly they fall under the following:

- The GoI feels RBI's Prompt Corrective Action Programme in regard to dealing with bad loans of public sector banks (PSBs) is too strict and should be relaxed.
- The 11 PSBs which have been banned from any more lending should be allowed to give fresh loans.
- RBI should inject more liquidity to get over the crisis caused by the bankruptcy of IL&FS.
- RBI should dilute its February 12 circular and provide some leeway to the power sector borrowers.
- The GoI wants a separate payments regulator independent of RBI, which is opposed by RBI.
- GoI needs some resources from RBI's reserves (a total of two heads: ₹ 9.22 lakh crore; comprising Foreign currency and Gold Revaluation: ₹ 6.90 lakh crore; and Contingency Fund: ₹ 2.32 lakh crore).

Amongst all the above issues, the last one has received maximum attention.

The opposition leaders have a point: why does GoI want additional resources?

Is it for winning votes by handouts and freebies when the scheduled elections are just around the corner: just five months away? Only a few weeks ago GoI announced that GoI would forego the budgeted borrowing for ₹70,000 crore since they have achieved the targeted figure of 3.3% of GDP.

The former Deputy Governor of RBI Rakhesh Mohan wrote in the Business Standard that any such transfer would erode whatever confidence that exists in the government's intention to practice fiscal prudence. The Bloomberg reports Mohan saying RBI's assets are equal to 20% GDP for some time now, which is not very different from the balance sheet of the U.S. Federal Reserve at present, or the European Central Bank, the Bank of England and the Bank of Japan.

"It is a little surprising to see arguments that the RBI needs to transfer the capital to the government," Mohan told Bloomberg in an interview.

So the debate is now public.

The GoI should avoid it becoming ugly. ■

— Dr T.K. Jayaraman is an Adjunct Professor, Amrita School of Business, Bengaluru Campus

[The views expressed by the author in this article is his own.]