FOR FINANCIAL EXPRESS

“Global Turmoil, RBI Governor, and India”

July 13 2016-07-17 by S L Rao”

The British referendum voted to leave the European Union. Whether Britain goes or stays, the EU will change dramatically. The opaque bureaucracy, increasingly central decision making, ignoring national political considerations, and the dependence Russian supplies of oil and gas, are bringing a political transformation. NATO is not as relevant as it was and Europe, especially Britain cannot afford the present cost of contributing to it. The USA is increasingly involved with the Pacific Ocean countries in response to China’s attempt to grab oil rich islands in the Pacific. The Middle East is in economic jeopardy because of falling oil prices, and the decline in f American imports of oil as it refines its own shale oil and gas discoveries. The American interventions in Iraq, Libya, Afghansitan. Sysria, and its support to Pakistan and Saudi Arabia, have led to the emergence of a virulent fundamentalist ‘Islamic Caliphate’, terror groups like the Taliban and Al Quaeda, and a failed state like Pakistan with nuclear weapons that it exports and uses as threrat to India.

 This poiitical turmoil has economic consequences. Global free trade might become a casualty. Euro and pound sterling will be hit badly and subject to wide fluctuations. Poor economic growth in Europe and Japan will adversely affect trade. Very low interest rates might result in unviable lending and consequent weaker bank balance sheets. An easy money policy will enhance liquidity in these countries. Investment flows to apparently stronger econom,ies ( like India) will increase. China is and will for some years continue to undergo economic turmoil as it focuses on internal consumption, reducing corruption and correcting high debts of provinces and state owned undertakings. USA will remain relatively strong. The decline of the Euro as a globally accepted currency and the restructuring in China will further raise the status of the dollar as a reserve currency. Indian economic and monetary policies must extract maximum advantage for India from this situation.

 India is relatively better placed. It is the “fastest growing economy” (on trumped up figures but yet better than most), good macroeconomic parameters, but with jobless growth. Politically India has as legacy from decades of ‘non-alignment’, a relatively comfortable relationship (if not close with all) with most countries except Pakistan. Indeed, with its large and growing domestic market India will be more wooed by cash rich countries as a trade and investment destination. But the times are volatile and economic management has to be alert and responsive to changing global political, economic and financial conditions.

For three years India will till September have had an ideal economist to manage its central banking in Raghuram Rajan . He is hugely respected by academic and applied economists, heads of other central banks, international financial institutions, rating agencies, and even the informed public. He came to the RBI with an international reputation for economic brilliance and for foreseeing in 2005 the directions of the global capital and money markets which collapsed in 2008. The financial and monetary crisis he inherited in RBI was handled by him firmly and speedily to great effect. His reputation enabled him to demonstrate independence in thinking and expression. He could not be bullied. His policies were at times unacceptable to the new Indian government from 2014. The view was that he was not bigger than the government. There was little recognition for his succrssful steering which stabilized India’s foreign currency exchange. The Finance Minister more than once publicly disagreed with him, for example on bringing down interest rates which Rajan was determined to reduce when he was confident that inflation was under control for the future. Rajan’s public comments on actions to clean up the non-performing assets of nationalized banks must also have upset powerful industrialists with proximity to high levels in government. Surrogates to powerful Ministers attacked him, and Rajan was ultimately forced to announce his departure as Governor after the frst term (like some others before him). Only after that announcement did the Prime Minsiter praise him for his dervices.

 India is now in the middle of a long playing global economic drama as the world adjusts to the changes described earlier. The RBI has a key role to play in preserving currency stability, meeting inflation targets and thus assisting in continuing growth.

 The Modi government has announced its determination to bring down deficits and has kept them within targets. However the suspicion of many experts in India and abroad is that there has been jugglery in estimating the GDP so that it is shown as higher than it really is and results in the fiscal deficit percentage to GDP being lesser than if the GDP figure was lower.

 Government has announced measures to stimulate foreign direct investment and is trying to improve the ease of foing business. The Prime Minister through his many foreign visits negotiated significant infrastructure investments by governments of Japan, China and others. Private investment has been promised.

 The Mauritius (and other similar) routes which for decades enabled financial investments that did not have to payIndian capital gains taxes, were closed. Such flows were both from foreign investors and domestic ones. Domestic unaccounted moneys went to (say) Mauritius and were brought back for financial investments in India. These moneys were thus laundered whits. In this way India receved far mnore FII investment than FDI. Now the balance can be restored.

 Apart from announcing determination to control fiscal deficits, this government has introduced three measures. It now has an agreement on inflation targets with RBI, with the growth objective. This latter could pose a dilemma to the RBI since government and industry think growth requires lowering interest rates. It could weaken RBI’s ability to bring down inflation and keep it that way. With a growth objective added to inflation control, Rajan might have had difficulty in bringing down inflartion as he did.

 It can be questioned whether growth in agriculture, and industry-large, mediu, small and cottage- have been constrained by credit and interest rates or by droughts, poor irrigation, lack of storage, rigid labour laws, red tape, lack of demand, etc. Additional impediments to growth are the available infrastructure services to all-energy, water, roads, affordable housing for labour, etc. These require government action. Constraining the RBI will not acieve them. Growth in services also may not have been due to the availability or otherwise of these facilities.

 Public debt management will now be out of RBI purview and managed by a Public Debt Management Authority. (Presumably this will include state governments). PDMA will allow the government to issue as much debt as it wants. It can compel banks to buy bonds at an interest rate it wants to pay. SEBI and not RBI will now regulate the inter-bank bond market. This will take away a key monetary policy instrument now with RBI. It may also be bad timing since the priority that the RBI had was to make the bond market deeper and more liquid. But populist pressures on government are immense, unlike on a seemingly independent RBI.

 We must not place as much reliance on only the obvious solutions-easier funds supply at lower cost, and controlling money supply, to contain inflation. India needs coordinated government policies for faster growth of production and jobs. The RBI has a key role in keeping the exchange value of the Rupee stable, keeping money supply apace with production growth, and overseeing banks so that they do not allow funds to be stolen or misused by borrowers.

 It is the policies and their execution by governments that are most vital. They must encourage, indeed stimulate, investment and production.

It is sad that a man of Rajan’s brilliance and accomplishments as Governr was induced to go by insults and public disagreements. But he is one man and will be replaced. For the country’s sake, government and its mamy spokesmen must get back to removing the constraints that retard growth. The RBI is a necessary actor in economic policy formulation and execution. Governemnt must coordinate with it. The country must also treat the Governor of RBI as a necessarily independent actor and not constrain his independence in any way.

(1365)