



The govt and central bank fighting openly will have serious impact on the economy: Ghosh

Latha Venkatesh
CNBC-TV18

Jaimini Bhagwati, RBI chair professor; Dr. Arvind Virmani, chairman, (EGROW) Foundation for Economic Growth and Welfare; Ananth Narayan, professor, SPJIMR; R. Gopalan, former finance secretary; T.T. Ram Mohan, professor, IIM Ahmedabad; Samir Ghosh, general secretary, AIRBEA; and Ashima Goyal, member, PMAEC, share their views on the rift between the Union government and the Reserve Bank of India (RBI). Edited excerpts:

The dissent is in public domain, whether it is for the payment regulator or whether it is the deputy governor's speech or the finance minister's statements. Is it looking like a point of no return?

Bhagwati: By definition, it cannot be a point of no return because this country has to continue, so does the RBI and the government. There is so much in the media now, particularly since Friday's speech by one of the deputy governors, I don't want to go over what the various differences are.

Let us take a step back as to what the RBI is doing. It is responsible for supervision and regulation of the banking sector in particular and also for the stability for the financial sector as a whole. So these are its two main tasks. It is also supposed to look at what is happening to the exchange rate of the rupee.

Taking this as a principal backdrop, where have the differences cropped up and why? To some extent, it is a question of a difference of opinion on whether our institutions are facing a liquidity or a solvency crisis. Let us take the issue of MSMEs (micro, small and medium enterprises) because there is a substantial difference within the board and, as you know, some recent appointments to the RBI's board are not people who are known in the market or in academia as people with very strong credentials, either in the field of finance or economics, but be that as it may, they might be just as good as somebody else who does and has a PhD.

However, having said that, my sense is that since the RBI is in the hot seat, you have to let it decide just how it wants to handle these issues of liquidity and solvency. One can make a suggestion and one would hope that these suggestions are made within closed doors, whether it is the issue of the board, or anything else. I find that too much is out in the public domain and whether it is a question of the government talking to RBI and vice versa. So my concern is that this is natural, this tension between a central bank and a duly elected government and the government is the one which appoints the RBI personnel right up to governor,

but having done the appointment, one needs to take a slightly hands-off approach, it is not something which I feel comfortable about as a taxpayer that a certain chief economic advisor is giving suggestions to the RBI about what should happen to interest rates. You can make your private, but not in a speech or in public, suggesting that the RBI tends to overestimate inflation



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Would you say that the appointment of almost a political person in the RBI may have rankled too much or could it be that there were threats to the RBI's capital and that perhaps took it to breaking point?

Bhagwati: Neither of them. I am absolutely sure. You are skirting around the principal issue, which is that several banks, including public sector banks, and some NBFCs have been lending irresponsibly. They might say they have no option because the government or somebody close to government or somebody high up in the political structure has forced them over the last 10 years to lend to corporates and to their projects which did not deserve to receive those funds. I am not going to get into the details of I&FS, but you know what I am alluding to.

Many of these things are known to the people whether it is in government or in the RBI or in the market. You go and ask anyone in the market, they knew about what was going on in I&FS for the last three-four-five years. I think there is a certain amount of exasperation creeping into our central bank in terms of asking it to not proceed with prompt corrective action. It's about beyond high time; water is well above our head. Therefore, that's where the real tension is coming from. Whatever you would call it, stigmatized capital, cronny capitalism, socialist capitalism, whatever you want to call our capitalism—there are people there who are exerting pressure on RBI through various channels and that is something which I am guessing is what is really getting under the RBI's skin.

On one hand you want the RBI to be a responsible regulator of the financial sector, maintain stability of the financial sector, maintain integrity of our financial markets, and on the other, you are trying to tie the one hand of the RBI as it tries to take action. I would go to the extent that even Supreme Court has stepped in and said that the

period that RBI has prescribed of six months—that needs to be relaxed. I do not know what is going on. So I can understand why somebody who just want to do his jobs in the RBI feels that they are being asked to do things which are not quite on the level.

Therefore, would you say that things are taken an unfortunate turn and the economy and the finan-



like we were cleaning up with a strong banking regulator. Now does it all get setback?

Bhagwati: It's a reflection of what the true situation as a country is. There are too many interests pushing for the same corporate who should never have got a loan in the first place. The RBI is trying to say that we have come up with some norms and please allow us to follow through all those norms. The government, if it knows more than the RBI about the vulnerabilities of some of these banks of which it is the principal shareholder, it should quietly give a paper to the RBI as to why it thinks the situation is not as dangerous as RBI feels.

I would think it should be a white paper which should be presented in parliament so that you and I, as taxpayers, also know what exactly the technical difference are between the approach taken by the RBI and the ministry of finance, rather than it becoming an issue of personalities in the media. I think we need to get to bottom of it or get to the substance of this issue. I remember some time back, one deputy governor was not given an extension. That became an issue between the then governor and the then finance minister. But those issues seem to get far more prominence than the substantive issue that where we as a country in terms of adequate probity in lending, and then follow-up an adequate independence of the banks be it private sector or public sector.

There, I completely disagree with the governor RBI. He has enough powers to be able to point out what is wrong. There is nothing preventing the RBI from putting out in his financial stability report, exactly what is wrong with the balance sheet and the loan portfolio of any bank.

However, if they choose not to do so because they do not want to destabilize the sector, that's fine too, but they should say in broad terms that we are not too happy about A, B and C, but we are taking action, and the financial sector should feel secure that we are adequately on top of both liquidity and solvency issues. But instead of that, we are getting this thing in the media that it's all question of personality.

Jaimini Bhagwati thinks issues of personality are not important. The fact that there is a political appointee in the board, all these are issues that perhaps are difficult for the RBI to digest. But the real problem is that they are being forced to do the rules governing public sector banks, both the prompt corrective action



mean by that. Without being personal, while I was in government, I was nominated to about 100 different committees that I functioned on and the reason was not just to have differences and divergences in professional and technical views and sometimes even political views of people. These were 100 government committees. However, I was also on many different RBI committees. So I am just giving that as an explanation.

You think on both sides people do not have spirit of cooperation, is that what you are saying?

Virmani: I think it is the objective. I think people are focusing on both sides. Perhaps the government with its political imperatives, perhaps the RBI with its ideology. Let us set up a committee with diverse representation, people who have different views and try to solve these out. That is why I mentioned all those committees. What I am feeling from all the discussion is that the approach seems to be more of argument and debate rather than discussion and solving a problem.

This government started with giving the RBI actually more freedom, in the sense that there is a monetary policy committee now. You cannot have a finance minister saying that I will walk alone if the government does not cooperate because it is the whole MPC. So, to some extent law was framed to give the RBI more independence, to give it a monetary target. So, technically, institutions and processes were built to give protection. While that piece may have worked, there are other pieces that may have riled the central bank too much. For instance, being constantly arm twisted on the prompt corrective action rules, constantly arm twisted to give more dividend. This is the first time we have had interim dividends from the RBI? So, do you think while there is no bullying on monetary policy there is bullying on other things?

Narayan: Clearly there are areas of differences and, as you mentioned, the speech by Dr. Viral Acharya was extremely strong in terms of language, so it is indicative of serious differences. There is also a list of differences which have been



ment is actually eyeing the reserves lying in the RBI balance sheet for the use, as well as for pumping up the bank balance sheets at this point in time, as a way of recapitalizing them. So, there seems to be a litany of issues, which unfortunately are bubbling over.

Could you give a reaction as a person who has known the markets very well. I don't know if people can still ease off from the positions they have taken both the RBI side and the North Block side. But if they don't and god forbid if things were to precipitate to a point where there are even resignations, will the financial markets react?

Today they seemed okay? So is the market not expecting things to get that bad or is that which will also be taken in the stride?

Narayan: I think nobody is expecting the nuclear option to be exercised. Nobody expects resignations, nobody expects

sacked, these are unthinkable and we should not be discussing this on air. I think the warning that Dr. Acharya gave was severe and right. If this was something which was to go absolutely out of whack, where somebody offers to resign or something, I think the reaction from global investors would be extremely sharp. We have seen what happened in Turkey, for instance, where the credibility of the central bank was actually brought into question. I am sure it will never come to that, I think the implications are way too onerous to even imagine such a thing. I am sure at some stage, the RBI and the government, if at all they have huge issues, will sit across the table and sort them out.

You have looked at all the sides, everything is in public domain now. The charge is that the RBI is being too academic and unaccommodative. I am not using the finance minister's words, he says that un-elected institutions are not accountable and, therefore, not adjusting to the political reality, so to speak. Would you agree to that charge, the RBI is not being realistic?

Gopalan: That is too difficult a question to answer but I can indicate from where the finance minister is coming from: this is only a guess. I would make. Today, in the market, liquidity is a big problem, both in MSME sector as



cient liquidity.

This is a debatable point, but ultimately the government has to see whether liquidity is available at the last level where it is required to be made available. If that is not available, the government has a viewpoint to say, yes, there is a problem, you will not be in a position to look at it. You should look at the roles of both the government and the RBI from these two viewpoints. Government reflects the growth concerns and what is happening at the field level, RBI is equally concerned, but it has a much bigger objective to look at. So when these two views are absolutely okay, how to marry these views, that is the tension that is arising at this point in time.

The RBI's argument would be that there is a liquidity issue, which is why they have announced nearly ₹40,000 crore of open market purchases both for October and in November. Liquidity availability does not mean that loans lent recklessly to builders should be forced upon public sector banks. PCA norms cannot be loosened simply because somebody wants to off-load their difficult loans. The RBI is perhaps correctly asking public sector banks to be careful, especially those who are anyway short on capital. Do you think the RBI is being ideological or idealist? How would you rate this ongoing problem on the two ways to tackle the debt issue?

Goyal: There are a number of very interesting issues this whole debate raises. First, it is true that RBI has a long-term view, while the government perhaps has a shorter-term view. However, the point is that the short term sets the long-term. They cannot be divided into watertight categories. So, if you do not take care of short-run problems, if they are genuine problems, it can set long-run also adversely. It is not that you need perfect systems in the short run and aim for perfect systems and neglect the short run.

The second thing is, in the Indian context you operate on very theoretical principals, which is based on an academic US literature, and you do not listen to the market. If you believe they are all lobbying, it will not quite work. Things are changing fast, they are so different here, so in many conditions you have to talk to the people and you have to learn a lot. If you refuse to do that and you work on principles which apply only in the long run,



to A and above A rated companies is perhaps in public interest. Goyal's Yes. Definitely they have to improve their lending standards, but you give them more freedom on the ground to make this decision. The other issue in India, the contextual issue that we are asking all these institutions, the banks, the public sector banks are in trouble. I&FS is in trouble because, basically, you are financing long-term assets through short-term borrowing, and we have not solved that problem. It is not only their fault, and you have to help them in refinancing because this is a national objective.

The RBI did allow greater lending and this is not something which the RBI has said in the public domain—but I would assume they would want to do asset quality review (AQR) and find out which NBFCs deserve help. There will be so many who would be reckless and you cannot expect the RBI to sit quiet, allow public sector banks to mop up the dangerous and bad loans, or potentially reckless loans, so they have to be careful. They cannot just allow a line of credit recklessly. How will you assess, do you think the RBI is right in being strict about PCA and, secondly, do you think that is what has led to the breaking point?

Ram Mohan: The argument about PCA has not been properly reported. It is not that the government doesn't want the PCA. All that the government is saying is that the Basel norms that apply internationally should also apply to Indian banks. Here, we have a requirement which is 1 percentage point above the Basel norms. So by all means enforce the PCA—one of the criteria used is capital adequacy.

But, all that the government is saying is you don't have to be ahead of the curve in terms of capital adequacy requirement just conform to the international requirement. Now you may or may not agree with this particular prescription, but I don't see anything wrong with the government prescribing this in the first place.

As to the point about liquidity requirements, I don't think anybody is saying that banks should start lending recklessly to the NBFCs. I don't think

the newspapers, we have seen the finance minister saying very clearly that nobody is above the country, everybody, all institutions or individuals, are subject to the interest of the country. Now the question is what is the interest of the country and how best it can be served; that is the issue. Now, Viral Acharya has raised certain points, very cogently I should say and very forcefully;

window to be opened for NBFCs, perhaps for the MSMEs. There could be other ways of helping people who have genuine liquidity problem.

How can you do that? How does the RBI lend to the NBFCs? The RBI under law can lend money only against government bonds.

Ram Mohan: I am not saying they should lend. There could be various measures that could be facilitated in order to improve the flow of funds into NBFCs and MSMEs. The only measure that is available is not bank credit. One can think of various other measures perhaps lending against particular kind of securities or whatever. These are all issues, which are perfectly legitimate to debate and I am not sure that the issues which have been flagged in the RBI deputy governor's speech warrant the level of controversy that we have.

This is a different set of issues from the central issue of the conduct of monetary policy, which is really what central bank independence is traditionally been all about. There, in respect of monetary policy, we have a statute in place, we have a framework in place and everything is chugging along nicely. These set of issues cannot be clubbed along with the broader issue of monetary policy independence.

But let me also say that since the FM has flagged this issue, there is a theoretical question of what are the conditions in which elected representatives

can delegate authority to unelected technocrats—that is the issue which the FM has posed and I think this question is very well answered by Paul Tucker of Bank of England in his book, 'Unelected Power'. He lays down basic conditions for such delegation to happen. The first is that objectives must be clearly defined. The second is that the instruments must be clearly defined and, thirdly, there must be proper framework of accountability in place.

You will note that all these three elements are in place in conduct of monetary policy but we don't have these conditions satisfied when it comes to bank regulation, liquidity or whatever. Therefore until these conditions are thought through, and put in place for the RBI to simply expect more independence to be given on a platter is both unrealistic and unfeasible.

You have been observing everyone speaking, what is your own view as an RBI insider? Do you think the RBI is getting a fair deal or do you think it is being hemmed in?

Ghosh: The government of the country and the central bank of the country fighting each other openly in public, has very serious repercussions for the economy, nationally, and also in global significance. And, I think it is a very bad thing to be seen. Today, in the newspapers, we have seen the finance minister saying very clearly that nobody is above the country, everybody, all institutions or individuals, are subject to the interest of the country. Now the question is what is the interest of the country and how best it can be served; that is the issue. Now, Viral Acharya has raised certain points, very cogently I should say and very forcefully;

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and, therefore, it is not bringing down interest rates. These suggestions should be made privately.

Haven't we had public debates on the public debt office that the G-Sec (government security) control should go out of Reserve Bank? We have had turf issues in the past as well and that has not led to a breaking point in the relationship.

cial system have been pushed back by some notches because of the way some things have evolved?

Bhagwati: Not at all. You would have noticed at least when I last looked at the stock market today it was 400 points up. So it has not only digested, it has marched on.

I mean more in a sense of financial sector evolution; we were looking

(PCA) and the 12 February circular. Do you think that is the real fight between the two sides?

Virmank: No. I do not quite agree with that. If I compare what is happening now, what my experience with dealing with the RBI and the government for 20 years or so, what I find is that there is a little bit of greater emphasis on blaming each other, rather than looking at a problem and trying to

building up over the past year – starting with the 12 February circular, Dr. Patel's speech talking of ownership-neutral regulatory powers, the whole PCA situation, interim dividend and now extra regulator coming in for payments and settlements. This whole issue of reserves, which seems to be a key feature of Dr. Acharya's speech, maybe (we can only speculate since we do not know the details), the govern-

well as with the unorganized sector, NBFCs, the liquidity is becoming a huge problem. There is a way of looking at how to make it available.

The second issue is are you within your prudential norms, are your monetary policy objectives are sub served by what you are taking a stance on, that you are call rate is between repo rate and reverse repo rate, and therefore, this indicates that there is suffi-

then you are not responding to real needs. The other thing is if the PCA criteria, again it is not, in the Indian context because of the sovereign warranty these banks continue to get deposits. However, they are not allowed to earn and they are being forced to be careful about their lending.

But their bad loans are huge, in some cases 15-25%. So, to tell them that you have to only lend

anybody has made a move to actually purchase the assets other than the SBI, which has announced the programme to buy 345,000 crore of NBFC assets. And you can be pretty sure that the SBI will be mindful of the attendant risk and all the usual controls that they have in place will apply.

What the government is looking at is measures other than direct bank lending, perhaps some kind of liquidity

in fact earlier also there have been spurts between RBI and the government of India. Now the point is that what the government is trying to do nowadays. As insiders from RBI, though I am not in any way speaking on behalf of the RBI my point is that RBI has been doing their jobs right from 1935 till now with really very significant achievements for the country.

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