

RBI Should not Focus Only on Prices, say Jalan, Reddy

Former central bank governors advise caution over full autonomy for the regulator

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India's former central bank chiefs don't quite favour the Reserve Bank of India (RBI) adopting a purely inflation-targeting approach and prefer caution when it comes to legislating full autonomy of the central bank.

The RBI had come under fire for not being able to tamp down on inflation which has been at elevated levels for over five years and Congress party chief Sonia Gandhi had attributed high prices as one of the reasons for the recent defeat of the ruling UPA government in state elections. However, both Bimal Jalan and YV Reddy indicated that they were not in favour of an inflation-targeting central bank in India.

Jalan, who was governor during the East Asian crisis in 1997-98 said that it did not make sense in an emerging economy such as India, where the consumer price index has a strong weightage for food articles.

Reddy, now chairman of the 14th Finance Commission which recommends sharing of taxes and resources between the Centre and states said that the point is that in India, polls are won or lost because of inflation. But would that mean that the RBI has not delivered on its mandate.



PAST MASTERS (From left) Former RBI governors Bimal Jalan, YV Reddy and D Subbarao

countable for inflation management. And if the RBI were to be mandated explicitly for this and if the RBI failed on that count, it could well impact credibility of the institution, he reckons.

The former central bank governors also discussed the issue of independence or autonomy for the RBI—on which there is an ongoing debate, especially after what is perceived as strained ties between the government and the central bank towards the fag end of Subbarao's tenure as governor.

According to Bimal Jalan who supports a consultative approach between the two, the issue of autonomy for the central bank was overstretched. "There is no question of autonomy when there is turmoil and it is important to take a view shared by both," he said, while citing his experience of handling pressures in battling the currency during the Asian crisis in 1997-98.

Reddy said that once there is instability, the fiscal policy-makers have to step in. And given the experience of 2004, when there were polls, it may be better for professionals to manage such a situation, he feels.

Subbarao said that monetary policy independence is a challenge. "It's difficult as the government has a different perspective."

Reddy said that one should be

mindful of both granting autonomy or independence to a central bank in public interest in form, but not substance. A case in point being that even after law makers put in place rules to bind the government to lowering the fiscal deficit, but targets have been breached—a sign that mandating by law is no guarantee. It is also worse if the central bank is given independence but is afraid of losing it, he said.

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YV REDDY

Jalan, who was critical of the current role of multi-lateral institutions such as the World Bank and the IMF said that the traditional thinking of central banks was not outdated.

"What you need now is a Bretton Woods II," he said.

The CAFRAL conference to discuss the emerging challenges on capital account management and macro prudential regulation featured top economists and global policy-makers such as Joseph

Stiglitz, former chief of UK regulator FSA Lord Turner, IMF deputy managing director Nemat Shafik, former Bank of England governor John Gieve and former Hong Kong Securities and Futures Commission chairman Andrew Sheng and Central Bank of Malaysia deputy governor Sukhdave Singh.

The learnings, after the crisis and the latest deliberations here, were that sound macro fundamentals aside, there is a need to have buffers to cushion against risks and the need to look at capital management tools, said former RBI deputy governor and CAFRAL director Usha Thorat.

Earlier, finance minister P Chidambaram said at the conference that contrary to public perception, the government and the RBI worked together closely during the 2008 crisis.

"There is a need to improve the mechanism to deal with systemic risk. These experiences have motivated much soul-searching on the subject of systemic risks. We need to strengthen our bond currency derivative markets to deal with such systemic risk," he said. The government, he said, was strengthening data bases and technical capabilities of the FSDC to make it a full-grown systemic risk agency, he said.

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BIMAL JALAN

"What is the purpose of inflation-targeting. Is it to say that the government is not responsible and the RBI is responsible," he said. Reddy, who was governor for five years between 2003 and 2008, said at a conference organised by the Centre for Advanced Financial Research and Learning (CAFRAL), promoted by the RBI that globally, those who practise the current approach to inflation-targeting now have second thoughts. Reddy said the question to be asked is whether it would be possible to convince people in India that the RBI was responsible for controlling inflation rather than the government.

This could pose problems when people look to a politically elected government to be ac-