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MANISH SABHARWAL WRITES, 'RBI'S JOB INVOLVES TRADE-OFFS, NOT CONFLICTS'

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

Amartya Sen once wrote in the Economic and Political Weekly that Alfred Tennyson's poem "The Charge Of The Light Brigade", which glorified charging ahead in nobility, "Theirs not to reason why/ Theirs but to do and die", was inappropriate inspiration for policy because "Good reform is the charge of the heavy brigade. The reason why is central to the task". A central bank like the RBI must replace intellectual certainty with continuous debate about Why because their job involves complex trade-offs — next quarter vs quarter century, growth vs stability, and mandates vs expectations. A global anthropological shock like COVID makes these trade-offs — they are not conflicts — even harder. The RBI must remember three things — acting prudently to balance the next quarter and quarter century, acting flexibly to blunt this economic cataclysm, and acting within their mandate to ensure institutional legitimacy and immunity.

First, acting prudently. If everybody believed that in the long run we are all dead, we would never sit under trees planted by people who had no chance of sitting under them. The coronavirus is a human tragedy but a central bank must not act like a commercial bank because that would compromise the balance between today and tomorrow. A narcissism — bordering on solipsism — already reflects in global debt levels that steal from our grandchildren. More importantly, India doesn't have the economic strength to copy the US Federal Reserve's $2.3 trillion offer to lend to businesses of all sizes and sorts, run anything close to this year's expected US fiscal deficit of 15 per cent of GDP, or sustain Japan's public debt levels at 240 per cent of GDP. We are all in the same storm but we are all not in the same boat.

Opinion | In Pakistan, religious leaders, not doctors, are setting Covid policy

Second, acting flexibly within mandate. Renaissance physician Paracelsus had important advice for central banks; the dose makes the poison. Anything powerful enough to help has the power to hurt; handling the inevitable tensions between the RBI's dual mandate of growth and stability requires continuous work. Our inflation targeting regime is a macroeconomic gift to India. But recognising that is hardly inconsistent with acknowledging that inflation's secular decline has many parents, some economic models are useful but all are incomplete, and the fog of war involves making second best choices as long as they are reversible, proportional, and accountable.

Central banks often undertake liquidity management while leaving policy rates unchanged; current actions are not a conspiracy to undermine the MPC or its interest rate corridor (between reverse repo rate and MSF rate with repo rate midpoint targeting and call rate operating target). They are a pragmatic encouragement for banks to lend to clients rather than lend Rs 7 lakh crore to the RBI. Other virus flexibility includes repayment moratoriums (with 10 per cent provisions), bad loan accounting forbearance (despite past experience of breaking the thermometer doing little for the fever) and bank windows for NBFC/Mutual Fund liquidity. Listening is hardly compromise. Especially if accompanied by a will to unwind liquidity, asymmetry and forbearance when the planet's gap year ends.

Third, acting within mandate. Central bank governance is a fine balance; they function best when they don't declare poorna swaraj from the government and they aren't considered a part of the finance ministry. The difficulty of balance isn't uniquely Indian; Wharton Professor Peter Conti-Brown asks: "Is the independence of the US Federal Reserve a precious public good to be

protected or a nefarious dodge of public accountability?" History suggests technocratic central banks run by unelected officials amplify institutional vulnerability by wading into democratic politics; the messy, slow and clunky process involving conciliation, compromise, and squeezing collective decisions out of conflicting demands described in Bernard Crick's wonderful 1963 book, In Defence of Politics. The RBI must build on its track record of wisely balancing the trade-offs between depositors vs borrowers, companies vs banks, and stability vs growth. And it must continue to stay out of the government's domain.

Opinion | It should inspire countries to recommit to principle of universal bio-deterrence

The central bank crisis role debate is skewed by the great book, Lords of Finance, by Liaquat Ahamed that shows how central bankers of the 1920s failed to fight the Great Depression. Historian Heraclitus suggested you can never step in the same river twice; the river is different, you are different, and the world is different. History matters but nobody knows if this is the beginning or ending of the virus. Yet the global central bank COVID toolbox has been substantial; buying corporate bonds, making corporate loans, cutting interest rates, conducting open market operations, and reducing reserve ratios. Additionally, banks have been permitted to grant loan moratoriums, hold less capital, restructure loans, pay lower deposit insurance premiums and delay bad loan recognition. The emergency authority under Section 13 of the US Federal Reserve Act being used — in my opinion, prematurely — also exists in Section 18 of the RBI Act. But emergency powers are a last resort. We are not there yet. The recovery being V-shaped, U-shaped, or Bathtub-shaped is only modellable after the lockdown.

Just like COVID is particularly painful for patients with pre-existing conditions, the RBI's COVID balm is constrained by pre-existing conditions in Indian banking; bad loans (peaked at Rs 14 lakh crore but still large), inadequate competition (scheduled commercial bank numbers have hovered between 90 and 100 since 1947), private bank governance (CEO so powerful that boards and shareholders are weak), public sector bank governance (shareholder so powerful that boards and CEOs are weak), and the RBI's own game (process, technology and human capital in regulation and supervision). All these must be tackled with urgency when normalcy returns.

The true antidote to fear is hope. Another fiscal package may come soon. But supplementing India's fiscal and monetary policy interventions by announcing two bold reform plans — 90-day flick-of-pen and one-year structural — that tackle overdue reforms in labour, education, cities, finance, compliance, and civil services, will catalyse hope among employers, employees, banks, and overseas investors. Creating a prosperous India needs many things. One of them is an independent, accountable, and boundaried central bank that listens.

This article appeared in the print edition of May 2, 2020, under the name 'Fear, hope and central bank'. The writer is co-founder, Teamlease Services

Opinion | Though stringent, lockdown was timely

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