



Padmabibhushan Dr. C. Rangarajan, former Governor, RBI, former Chairman, Prime Minister's Economic Advisory Council delivering the inaugural speech

Some Aspects of the Current Economic Scene

It gives me great pleasure to be with you all this evening and to inaugurate the 32nd Conference of All India Reserve Bank Employees Association. I recall with pleasure my contacts with the Association from the days I was at RBI. I must say we maintained a cordial relationship even when we differed on some issues. I continued to be in touch with Mr. Samir Ghosh and others even after my formal relationship with RBI ceased.

Changing Contours of Central Banking

RBI is an august Institution. It has weathered many storms. It has steered the Economy through many crises. It has provided the needed directional change. All of us must take pride in having been associated with this institution. The quality of service by any Institution depends on the people who are part of it. This is true particularly of a service organization like RBI. Employers and employees are the two wheels of the organizational cart. Both must move synchronously and with the same speed. As an employees union, you have to look at the interests of the employees and improve their conditions of service. At the same time, you must recognize the unique nature of the institution that RBI is. Its profits are not similar to the profits of commercial entities. They arise as a consequence of the role it performs as the monetary authority.

Central Banking is evolving as the circumstances change. There were certain original functions associated with central banks. Most of them continue. But some have lost their original importance. The financial system has become more complex. New types of financial institutions and new financial products have emerged. Several of the financial derivative products that we talk about today were not heard of thirty years ago. The RBI which has to manage the financial system must be well equipped intellectually to handle these problems. As they say, we cannot fight the problems of today with the tools of yesterday. The employees must therefore recognize the changing nature of the financial landscape and must be in tune with them. In this context, I must say that the attitude

of Bank Unions in the late nineteen eighties in resisting computerization was a misreading of the future. Similarly in looking at the functions of RBI, some will have to be shed. At the same time, some new ones will come such as Payments Regulation Board. RBI has accumulated a large amount of expertise and it should not be lost. It should be utilized even if some activities are palmed off. The financial system is on the threshold of another quantum jump. NBFCs will grow and RBI will have to find a suitable system to regulate them. Regulation may have also to be decentralized. Bank accounts will increase enormously with direct bank transfers in the case of various subsidy schemes. The launching of various digital payments and transfer system will also expand the links with banks. Thus there will be a quantitative and qualitative change in the financial system and the tasks of RBI will raise manifold and the ability of RBI to handle these issues will depend on your skills, commitment and dedication.

Quality of Credit

The Banking system in India is currently passing through a difficult phase. The launching of the banking reforms in early 1990s was an important landmark in the development of Indian Banking System. The introduction of prudential norms was meant to improve the safety and soundness of banks. The prescription of capital adequacy norms, criteria for income recognition, classification of assets into performing and non-performing and a host of other measures have gone to strengthen the banking system. The ratio of nonperforming loans increased initially but later came down substantially. However over the last few years, there has been a sharp decline in the quality of bank assets. According to the Financial Stability Report of December 2016, the gross non-performing advances ratio of SCBs increased to 9.1% in September 2016 from 7.8 per cent in March 2016. The overall stressed advances ratio has increased to 12.3 percent from 11.3 per cent. These are high levels. Since 2011-12, growth has slowed down from the hefty rate at which it was growing at 8 to 9% between 2005-06 and 2010-11. The slowdown in growth itself causes distress. The original optimistic projections turn sour. As the saying goes, "Bad loans are sown in good times". A hard look at the nature and cause of nonperforming loans is required to draw appropriate lessons for the banking system and the Reserve Bank. Non-performing loans need to be classified into those affected by external factors and those by other factors. Even actions are taken to curb the emergence of non-performing loans, there is need to get the banking system moving in terms of credit growth.

Demonetization

Demonetization has been discussed threadbare. Demonetization has always been regarded as one of the possible instruments to neutralize the black money or unaccounted income held in the form of cash. Obviously, demonetization cannot be a standalone measure. It does not address the issue of how to prevent further accumulation of unaccounted income. It aims at neutralizing only the existing stock and that too held only in the form of cash. In fact, to prevent further accumulation would need measures such as improved transparency in governance, revised tax structure, improved tax administration and last but the least electoral reforms and changes in funding of political parties. The demonetization measure this time is far deeper than what was done on two earlier occasions. The measure has no doubt sent shivers down the spine of some. However because of the shortage of new currency to replace the old, many have suffered. Small business retail trade, vegetable vendors, fishermen, small businessmen and daily wage earners have suffered. All this will have an immediate effect on the economy which will be adverse. The long term gains are in terms of reduction in the proportion of pure cash transactions, and a shift to digital mode of payment leading to recording of all transactions and thereby helping to widen the tax net. Some of the cash driven sectors like real estate will undergo a change. All these are not automatic and depend upon further actions. The immediate pain is real and tangible and sooner the phase comes to an end, the better for the economy. In short much of the controversy over demonetization could have been

avoided, had the authorities been better prepared. It is the inadequate supply of new currency to replace old that has caused much of the storm.

Issues of Autonomy

The issue of autonomy has also been raised. Autonomy is a complicated issue. The independence of central banks has been discussed not only in India but elsewhere. In UK, Montagu Norman who was Governor of Bank of England for almost twenty four years compared the Bank of England to that of a 'nagging wife'. In the U.S., there has been a section which has steadily opposed complete autonomy to Federal Reserve System. For example, the Democratic floor leader at the American Senate while introducing the Balanced Monetary Policy Act of 1988 said, "It is time for congress to wrest control of monetary policy from the hands of a tiny band of monetary ideologues in the White House, the Administration and the Federal Reserve. It is time for basic economy policy once more to be set by elected officials who must bear the final responsibility. It is time to restore commonsense, balance and stability to monetary policy."

Even more recently a bill was moved in the Congress called Federal Reserve Accountability and Transparency Act that wanted that Fed should use a formal rule to guide monetary policy. Those legislations have not been passed. In the U.S., Fed is not subject to control by the President. It is accountable only to congress.

When RBI was set up, the fear of the nationalists was that the Bank could come under the control of the government. That is why they wanted even physically the Bank to be located away from Delhi. In parliamentary democracies, the issue of autonomy gets complicated. The Reserve Bank of India Act contains Section 7 which provides the directions to be given to RBI by the central government. Mercifully, this section was never used, even though the intention was clear. In fact, Jawaharlal Nehru made some strong remarks at the time of the conflict between Governor Rama Rau and the then Finance Minister. Even in the Western countries, it is only in the last two decades or more that the independence of the central banks came to be stressed with inflation control as the primary objective of central banks. Some countries adopted formally inflation targeting as the objective. even others which did not formally adopt it, operated as if price stability was the main objective. This has come to be known as 'instrument independence' as distinguished from 'target independence'. For a long time in India too, the compulsions of planning guided not only government's policies but also monetary policy. The system of issue of ad hoc treasury bills to replenish cash almost amounted to automatic monetization of fiscal deficit, even though it may not be its intentions. Thus fiscal dominance was perfect. With frequent bouts of inflation, price stability became increasingly the concern of RBI also. However to fulfill this function, institutional changes were required and that is why one of the earliest decisions during the liberalization programme launched in 1991 was to phase out the system of issue of ad hoc treasury bills. This was followed up later by FRBM Act and the recently concluded monetary policy framework. These are significant achievements as far as autonomy of monetary policy goes. The central bank in our country performs multiple functions such as regulator of banking system and exchange rate management. Exchange rate management is closely aligned to monetary policy. Historically exchange rate stability was itself an objective of monetary policy. As regulator of the banking system, it needs the same autonomy as other regulators. However, financial stability as an objective transcends mere regulation of banks, even though it is an important part of it. Accountability goes with autonomy and accountability requires clear enunciation of objectives or the mandate. Institutional arrangements must be such as to enable the autonomous institutions to function independently.

To sum up, autonomous institution with specific mandates are an integral part of democracy. RBI is one such institution in India. Its ability to perform its functions must not be compromised. Eternal vigilance is the price of autonomy.

Universal Basic Income

In many ways the coming decade will be crucial for India. If India grows at 8 to 9 per cent per annum, it is estimated that per capita GDP will increase from the current level of US\$ 1,600 to US\$ 8,000 by 2030. Then India will transit from being a low income to a truly middle income country. We need to overcome the low growth phase as quickly as possible, as growth is the answer to many of our socio-economic problems.

Development has many dimensions. It has to be inclusive, it must be poverty reducing, and it must be environment-friendly. We need to incorporate all these elements in the growth process. A strong and balanced growth will enable the economy to achieve multiple goals including reducing poverty. India has to follow a twofold path of accelerating growth and addressing directly through various schemes the vulnerable and poor groups.

The concept of Universal Basic Income mooted in the Economic Survey is a welcome idea. The idea is however not new. The thought behind the idea is to provide everyone a certain minimum income. Thus it is universal in nature accruing to everyone. Second, a certain minimum income can be related to the poverty line estimated by various committees. If Rs. 1000 per month per person is taken as the minimum, a household of 5 will get Rs. 5000 per month and Rs. 60,000 per annum. To reduce the financial burden, if we were to compromise with universality, we will face up to the problem of identifying beneficiaries based on some criterion. To some extent the financial burden can be reduced by phasing out some subsidies. But there can be a hue and cry, if any of the major subsidies is touched. This is an idea which must be thought through and a consensus built up before introduction.

Conclusion

The economy has slowed down. It is imperative to get the economy moving on a fast lane. The investment rate has shown a sharp decline. Jobs will come only out of growth spurred by new investment. There is need to work assiduously towards creating a favourable investment climate. More than ever, non-economic factors will play a key role here. Policy makers need to be conscious of this and keep the focus on growth and away from divisive and detracting issues. I wish the Conference all success.
