

RBI, govt should resolve issues for the sake of the economy

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The meeting of the central board of the Reserve Bank of India (RBI) on Monday is a crucial one that may alter the course of government-RBI relations.

The bitterness between the government and RBI has reached a new high, with both camps at a standoff. Board members belonging to various parts of the industry are torn between these two camps. At stake is an economy that seems at last to be on the road to a recovery, but which also faces several headwinds.

Here are five issues that are likely to

dominate the board meeting and their implications for the economy:

RAID ON INSTITUTIONAL CREDIBILITY

The government has not just come after RBI's regulations, but also its balance sheet. RBI as an institution is perceived to have the intellectual capital

to determine the strength of its own balance sheet. Hence, the government should leave the

judgement to the technocrats of RBI. Global investors prefer political stability, but they value institutional credibility more. Respecting the institutional credibility of RBI would soothe

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global investors, who would soon face the uncertainty of national elections. The outflow of dollars could get worse if the central bank is portrayed as weakening.

CHOKING CREDIT OR AVOIDING CRISIS

The government is accusing the central bank of choking the banking system by needless regulation. Some board members seem to share this view. Easing Basel norms on

capital may buy the government time, but it would hardly help in reducing capital infusion. Public sector banks would need colossal capital infusion irrespective of whether their minimum capital adequacy ratio is 8% or 9% simply because bad loan provisioning will remain high.

BUILD BRIDGES, NOT BURN THEM

The government's demand that RBI provide support to non-bank lenders is not unreasonable. Non-bank lenders

have been a critical funding source for small business in terms of last-mile connectivity.

In the aftermath of tax reforms and demonetization, small business have suffered and to deny them credit because of exogenous factors is unfair.

The central bank, too, understands that non-bank lenders and banks are different and hence regulations need to be different. Giving leeway to non-banks would go a long way in improving the



Central bank watchers worry about the possibility of political motivations seeping into its functioning. ANIRUDDHA CHOWDHURY/MINT

fund flow to the economy without compromising on prudence.

ENTER THE POLITICIAN

The biggest worry among cen-

tral bank watchers is the possibility of political motivations seeping into the functioning of RBI. Indeed, a few members of the board are known to harbour specific political affiliations. Great care should be taken by the government and RBI that political compulsions, unless accompanied by sound economic logic, do not impinge upon the functioning of the central bank.

**ACCOUNTABILITY
GOOD, CREDIBILITY
BETTER**

Globally, the conduct of central banks has come under scrutiny after the global financial crisis. The need for central banks to be accountable is recognized and RBI is not above this.

To be fair, the central bank is answerable to the government and even Parliament. That said, it should have no hesitation in explaining why it does what it does in

front of its board members. RBI would only strengthen its credibility in front of them.

Giving leeway to non-banks would help improve the fund flow to the economy without compromising on prudence

If media reports are any indication, the government and RBI are aware of the dire consequences of a standoff between them.

It is time they bury the hatchet so that the economy can go surely on the path of growth.