The many nuances of regulatory autonomy

GN Bajpai Updated on January 21, 2019

A central bank-government equation is essentially about discovering the fine balance between autonomy and accountability

Since the much-hyped battle of authority and autonomy between Reserve Bank of India and the Centre seems to have settled down, and also that a new Governor has since assumed charge, it might be worthwhile to take an objective look at the philosophy of autonomy.

Liberalisation, globalisation and free play of entrepreneurship has given rise to independent regulatory bodies. Regulators have are a very strange creation of law. They have powers to legislate like Parliament in the shape of subordinate legislation, are authorised to execute those (subordinate) legislation like the political executive and also become the judge of their own actions — the judiciary.

In fact, regulators are a combination of legislature, executive and judiciary and are often termed as the 'regulatory state'.

Regulators objectively discharging their duties in the interests of all stake holders, while maintaining the efficacy of markets is termed as 'regulatory craft'.

However, the regulatory state works within the ambit of the nation-state, which has the overall responsibility of the governance of the state. It is therefore important that the 'regulatory state' works harmoniously within the broader framework of the nation state and promotes the state's objectives.

The creation of a level playing field and eliminating subjectivity in the supervision of markets has made independence and autonomy to the regulators necessary. Accordingly, legislations have been enacted outlining the broad framework of the authority and autonomy but with a clear provision for intervention by the state in case of a disharmony.

Among the three factors of production — land, labour and capital, the significance of capital cannot be overemphasised.

Capital is closely linked with currency which must be of stable value.

. Since the demand for money is influenced significantly by the fiscal policies and supply by the monetary policies, there must be segregation of powers between the authorities controlling fiscal policies and monetary policies. Close coordination between the two authorities is vital in the pursuit of respective goals.

Since governments are entrusted with the economic welfare of people, globally fiscal management is with the government and monetary management in the hands of an independent (Regulatory) authority called the central bank.

Since banks and shadow banks play a significant role in the creation of money and its transmission; they are under the supervision of the central bank. The policy framework underpinning both the authorities are growth of the economy and employment and thereby welfare of the people. And maintaining macroeconomic stability is essential to promote growth and employment. However, for the monetary policy, ensuring stability is an element and not an end in itself. The expected outcome is growth and employment.

The rapid changes in the macro as well micro-environment along with interdependence of nation-states with the global order has brought about new challenges. Economics has evolved significantly over the years giving rise to new tools, techniques and policy frameworks for directing monetary policies more suited for the changing environment. However, sometimes even the established tools and techniques become ineffective.

Unconventional policies

So deal with with the aftermath of the global financial meltdown during 2007-08, central banks had use unconventional methods of opening up the floodgates of money.

The monetary authorities relied more on the financial and economic data rather than on the predictive models. Academics yielded space to pragmatism. As some economies are slowly recovering, central banks have slowly started rolling back these policies. Different economies are using different tools and techniques. While using these unconventional approaches, central banks have worked in close coordination with the fiscal authorities.

This article focuses on only one issue of dissonance between the Centre and the RBI.

The Indian economy continues to suffer from the pangs of twin balance sheet issues and SMEs and MSMEs have become the drivers of growth.

If one institution fails to honour its commitments due to balance sheet pressures, that results in a liquidity squeeze for another sector (NBFC, HFCs), which ends up impacting the funding of SMEs amd MSMEs.

The tools that have so far being used to clean up public sector bank balance sheets haven’t brought significant improvement and the freeze on their core activity of lending has led to a scarcity of credit.

The monetary authorities’ use of conventional tools in dealing with the problems is beginning to hurt the economy.

The fiscal authorities on the other hand want the monetary authorities toenhance the supply of money. This dissonance between the fiscal and monetary authorities was magnified by the media and the economic and political pundits christened it as a war between the two authorities.

It is common for the monetary and fiscal authorities to have disagreements and that should not raise eyebrows. If the state which has the power under the legislation to direct, urges the other party to come to the discussion table why should it be perceived as a battle for superiority? In fact, the dynamic tension with a strong underpinning of achieving the enshrined objectives is good and prevents excesses.

The accountability factor

Governments are ultimately accountable to the people. Regulators too are accountable but while pulling them up for lack of accountability, governments have to make sure the regulators' autonomy is not eroded. The protective umbrella often used is of 'autonomy' and 'independence'.

Accountability of public office is reckoned broadly from the four elements — expressing reasons for a decision, exposure to public scrutiny independent review and defining economics of the initiatives. Accountability extends even to explanatory procedure and delivery of intended outcome.

If some regulators are being needlessly hide-bound, the state has the authority to intervene and undertake a course correction. This should not necessarily be perceived as an attack on the autonomy of the regulators.

In the Indian context, the controversy has fortunately blown over. There has to be a broader understanding and agreement on the tools and techniques to be used to achieve the ultimate common objective of welfare and promoting prosperity. The craft applied by the regulators ought to deliver the expected outcomes.

The writer is former Chairman of SEBI and LIC

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