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Spirited Central Banking versus Democratic Politics

Ammu Kishore
Mahatma Gandhi University
(ammukishoreak91@gmail.com)

Abstract
The conscience of seizing the economic power of regulation from the Reserve Bank of India impacts the complex financial system of our country in a wider arena than we expect. While the regulator is being regulated, the motives and objectives behind it should be analysed and thoroughly observed. Hence, this paper examines the changes in the decision-making process of the Central Bank after the formulation of Monetary Policy Committee which has the sole responsibility of determining the policy interest rate required to achieve the inflation target. How far the Monetary Policy Committee changed the complexities of decision making in the monetary policy practices in our country is to be analysed in a two-way perspective. Firstly, it should be studied in the point view of investors and key shareholders who were earlier accustomed with the independent decision-making policies of the Central Bank and secondly, with the point view of academicians and practitioners of monetary policy. Also, this paper investigates on how much the Monetary Policy Committee revamps the Central Bank's accountability in a democratic system like ours.

Key words: *Monetary Policy Committee; transparency; accountability; independent; Central Bank, etc.*

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I. Introduction

Independence, which had been obsolete for more than sixty years, has been peeping through the passage of endless controversies over the RBI's Monetary Policy Committee. The conscience of seizing the economic power of regulation from the Reserve Bank of India impacts the complex financial system of our country in a wider arena than we expect. What RBI does so far and what it should do hereafter is very much different. While the regulator is being regulated, the motives and objectives behind it should be analysed and thoroughly observed. Greater care and effort should be needed for fixing the policy rates since the country straggles in the forecasted growth rates of International Institutions. The traditional powers of inflation targets and policy rates of the Central Bank had been in question after the global financial crisis. The prospects of proper and well-managed monetary-fiscal coordination came to be the need of the hour. The political independence seems to have no correlation with the outcomes of the inflation propaganda. Hence, political independence becomes more emphatic than the operational independence for choosing appropriate instruments for achieving inflation targets.

This paper examines the changes in the decision-making process of the Central Bank after the formulation of Monetary Policy Committee which has the sole responsibility of determining the policy interest rate required to achieve the inflation target. The six-membered committee has been constituted as per the section 45ZB of the amended RBI Act of 1934. The Monetary Policy Committee replaced the Technical Advisory Committee on monetary policy with experts from monetary economics, central banking and financial economics. The Monetary Policy Committee is assisted by the Monetary Policy Department for framing the monetary policy. Perspectives of the major collaborators of the economy and the diagnostic exertions of the RBI involves in the decision-making process of the monetary policies. This paper also investigates on how much the Monetary Policy Committee revamps the Central Bank's accountability in a democratic system like ours. How far the Monetary Policy Committee changed the complexities of decision making in the monetary policy practices in our country is to be analysed in a two-way perspective. Firstly, it should be studied in the point view of investors and key shareholders who were earlier accustomed with the independent decision-making policies of the Central Bank and secondly, with the point view of academicians and practitioners of monetary policy.

II. Methodology

The study resorts to comparative analysis of the decision-making process of the Central Bank before and after the inception of the Monetary Policy Committee. The study thus critically examines the institutional accountability issues of the RBI prior to the implementation of Monetary Policy Committee and how the transparency enhanced subsequent to the execution of the same through a qualitative juxtaposition. The study analyses the monetary policy practices in two different dimensions. The investors and major players in the market are the one who were predominantly affected by the operational independence of the Central Bank. Hence, what they feel about the changes over the decision-making process of the RBI on the policy rates is very vital. On the other way, the practitioners of the monetary policy and the academicians who were mostly concerned with the futuristic concerns of these changes can have a different outlook. Thus, this paper enquires the perceptions of the market and the concerns of the academic realm.

III. Monetary Policy Committee

Monetary Policy Committee (MPC) is one of the radical consequences on the idea of better monetary transmission in India. To validate the Monetary Policy Committee, the RBI was amended in 2016 and it states as, the "primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth". The Monetary Policy Committee is framed to attain the medium-term inflation rate of 4 percent with a band of +/- 2 bands. The Monetary Policy Committee put back the system where the Chief of the Central Bank with the technical advisory committee solely decides the policy repo rates and adheres to the obligation of price stability through inflation targeting.

Background

The propositions of having a committee-based approach on the smooth functioning of the monetary and fiscal coordination in India traces back its history in the Y. V. Reddy Committee (2002). Subsequent suggestions were made by Tarapore Committee (2007) and further by Raghuram Rajan Committee (2009). In 2013, the report of the Financial Sector Legislative Reforms Commission as well as the Dr. Urijit Patel Committee emphasized the same. As per the Dr. Urijit Patel Committee, "Heightened public interest and scrutiny of monetary policy decisions and outcomes has propelled a worldwide movement towards a committee-based approach to decision making with a view to bringing in greater transparency and accountability in India." Hence, on 20 February 2015, the government of India and RBI signed a monetary policy framework agreement after considerable discussions and therefore, formally adopted flexible inflation targeting in India. Under this framework, monetary policy committee was adopted and met for the first time in October 3 and 4, 2016.

Constitution

The relevance of price stability is not something new to the monetary policy spectrum. Economic giants like United States have been using the notion of inflation targeting as a monetary policy stratagem for a long time since it is more predictable and transparent. Under the monetary policy framework agreement, the key objective of maintaining price stability with the growth objective aims to restrain the inflation targets at 4 percent with a standard deviation of 2 percent for all subsequent years.

The responsibility of RBI for the objective of flexible inflation targeting had been affixed by the amended preamble of the RBI act, 1934.

> "…. [AND WHEREAS it is essential to have a modern monetary policy framework to meet the challenge of an increasingly complex economy;
> AND WHEREAS the primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth;
> AND WHEREAS the monetary policy framework in India shall be operated by the Reserve Bank of India;]"

The new chapter IIIF with the section 45Z now describes and legalises the institutional arrangement of RBI for the operation of inflation targeting for keeping the prices stable. The major institutional arrangement to implement the same is through the Monetary Policy Committee. The section 45ZB, hence reads as,

> "(1) The Central Government may, by notification in the Official Gazette, constitute a Committee to be called the Monetary Policy Committee of the Bank.
> 2) The Monetary Policy Committee shall consist of the following Members, namely: — (a) the Governor of the Bank—Chairperson, ex officio; (b) Deputy Governor of the Bank, in charge of Monetary Policy—Member, ex officio; (c) one officer of the Bank to be nominated by the Central Board—Member, ex officio; and (d) three persons to be appointed by the Central Government—Members.
> (3) The Monetary Policy Committee shall determine the Policy Rate required to achieve the inflation target.
> (4) The decision of the Monetary Policy Committee shall be binding on the Bank."

Again, in 45ZI provides that the bank shall organise at least four meetings of the Monetary Policy Committee in a year. Also, it should implement the decisions during the meeting of the committee and publish it on the fourteenth day of every meeting of the committee about the proceedings which includes; the resolution adopted, the vote of each member and the statement of each member. Furthermore, the amended act emphatically stands for a monetary policy report once in every six months, and says as,

> "(1) The Bank shall, once in every six months, publish a document to be called the Monetary Policy Report, explaining—
> (a) the sources of inflation; and
> (b) the forecasts of inflation for the period between six to eighteen months from the date of publication of the document.
> (2) The form and contents of the Monetary Policy Report shall be such as may be specified by the regulations made by the Central Board."

Metamorphosis

The perilous days of inflation targeting in India finally attaches to a framework which is very much collective in its policy rate decisions. The committee-based approach involves newer non- conventional and broadened responsibilities for the Central Bank for enhancing monetary stability. The deviations from the individualistic approach give more importance to the public disclosure of the policy decisions and its formulation. This further adds on to better policy speculations on future policy changes by the financial markets. The collective decision making accumulates multiple outlooks and proceeds on a modest decision with reduced informational asymmetry. Hence, on the decisions on the degree of activity- whether hawkish or dovish- relates to more moderate collective choice rather than flamboyant single-handed decisions. Even though there existed a TAC (Technical Advisory Committee) prior to the formation of MPC, its role was very limited and the monetary policy making was very much autonomous in every dimension.

Global Scenario

The revolutionary formulation and the committee based collective decision-making paradigm can potentially affect the operational and political independence of the working of the Central Banks across the countries is relatively quiet and manifested itself in its global panorama only after the post-crisis economic scenario. In the pre-crisis era, there is no crossroads in the decision-making process of monetary policy and Central Banking. The fear of political capture, for short term political gains, ostensibly granted autonomy to the central banks. But after the crisis, the consensuses changed dramatically. For reducing the incidents of banking instability and economic breakdown, reshaping the nature and soul of central banking came as a primary solution worldwide. Even though the pattern of committee-based approach is varying across the countries, the ethos of this modus operandi is somewhat relatable. The major evidences can be witnessed through the US Federal Reserve's Federal Open Market Committee (FMOC), the Governing Council of European Central Bank (ECB), Bank of England's MPC and People's Bank of China's (advisory) MPC. Most among these are advisory in character and others encompass different ways of preference aggregation through voting patterns.

IV. Discussion

So far, we have discussed the structural nuances of Monetary Policy Committee in India and its genesis. It's an action, where we seek to find the epitome of policy coping in monetary distress. But every action, there should be a reaction. Here, the major reactions come from two diverse entities. One is from the key players in the financial markets including investors, shareholders etc. The other spectrum is the professional policy analysts who rely on scientific revelations for their predictions and assessments. Their intention differs in a wide manner, but their reactions are vital since it guides and transforms the public interest.

Investor Sentiments

Every macroeconomic activity is affected by the market expectations which derive from a sequence of economic beliefs and market fluctuations. In the recent times, macroeconomic literature recognizes the origin of fluctuations other than the fundamental concepts regarding animal spirits. The central bank communication itself is one of the most evident gamechangers of our times. The transparency slogans stand over the ambiguity of monetary policy dissipation. Hence, most of the prime central banks like Federal Reserve, Bank of England and ECB adhere to the policy of forward guidance. The Indian scenario is not divergent from the global counterparts. Through the setting up of Monetary Policy Committee, India too adopts to this mercurial change from furtiveness to transparency. While transforming the institutional set up and adding more professionalism and expertise on policy decisions, investors believes to have a much more investor safe environment. They normally expect expansions rather than contractions. Since, the RBI follows a simple majority model for voting, the emphasis is given to the median voter the expectations on positive expansions are relatively high.

The investor further believes that having a panel of experts is much better than having an unescorted chief. This belief therefore makes them to assume that it helps to reduce the bias and subsequent lobbying. The conflicting opinions on the rate cuts, for example, lower rate cuts for bankers whereas high rates for pensioners can be smoothed out through the majority vote. They observe the debate carried over the policy decisions by the expert committee enhances professionalism. Also, the public disclosure of this debate can give those investors a fine understanding of the policy decisions. It reduces the informational asymmetry as well as the whims and fancies of the investor community.

Theoretical Inquests

There are appreciable lot of theoretical analyses on the study of decision-making process in the central banks. Every monetary policy committee exists today is an aggregation of theoretical anatomization and historical traditions. Hence, we cannot infer that every monetary policy committee is working the same way. Major factor which causes these differences includes the voting pattern, institutional design, regional bias, the role of the Chairman and the degree of political influence.Eijffinger et al. (2015) rendered a valuable study on the range of preference disagreement within these monetary policy committees. This preference heterogeneity has been a key area of concern for the pioneering works of Belden (1989), Gildea (1990), Havrilesky and Schweitzer (1990). Others estimated the reaction functions for every committee member and the preference of outside members.

Again, Riboni and Ruge-Murcia (2010) analysed different ways of accumulating preferences through voting which includes a consensus model, an agenda setting model, a simple majority model and dictator model. The interesting factor they revealed is that when the members of the committee vote, they don't always take the right policy choice instead focusses on their reputation since their prowess matters the most and their reputation should be safeguarded.The central banks effectiveness lies on the intensity of impact that it can make to the market expectations. The interest rates in future become more detrimental than the current rates. Hence, the communication of the central banks with the mainstream market seems to worth a king's ransom. This was further stressed by the articles of Cukierman and Meltzer (1986). Therefore, transparency is the need of the hour. Thus, the concept of transparency was hence defined as, "how easily the public can know and understand the central bank strategy just from observables". (Masciandro and Romelli)

The institutional design was put in question by Capie et al. (1994), Elgie and Thompson (2002), Wood (2005). The global financial was one of the most provoking moment for the theorists where the existing systems of central banking seems to be inadequate. They further on explored the issues of accountability and measured the current level of transparency in various central banks. The fear of the part of fundamental policy makers over the issues of political influence in the monetary policy making was a growing concern before the crisis era. But the effects of political influence can be subsided through a well-executed game plan for the functioning of the central banks is found by the post crisis era policymakers. For Fischer (1995) and Lastra (2006), greater accountability returned with greater central bank independence and furthermore enhanced its credibility and reputation.

V. Conclusion

The paper discussed the instances of regulating the central banking system of our country in recent times. The independent nature of the functioning of the Reserve Bank of India was affected to great extent through the implementation of the Monetary Policy Committee. This entirely changed the monetary policy decision making in India. The study hence focussed the different perspectives on the implementation of the Monetary Policy Committee. The major reactions from the investors as well as the theorists were assessed. The inflation targeting on the post-demonetization days was extremely challenging which requires more professionalism and expertise from the part of the RBI. The forward guidance formula with a team of experts was the solution we proceeded with. The subsequent years will test the solution since it is not appreciable, to conclude the impacts and incidence of the committee based collective decision making whether will strive the country forward or not, without an appropriate timeframe.

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