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## Mains Practice Questions

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**Q.** In light of recent tussle between RBI and government, critically examine the need to ensure central bank's autonomy in globally changing economic scenario. (150 words)

10 Dec, 2018 GS Paper 3 Economy

### **APPROACH**

- Briefly mention the issue
- Give arguments in favour of ensuring RBI's Autonomy
- Give reasons why government intervention is required in view of changing economic demands
- Give a way forward balancing both the arguments and suggestions for better management between the two.

### **INTRODUCTION**

#### **Why the tussle?**

- The latest tussle between the RBI and the government is actually a series of smaller disputes regarding RBI's stance on PCA- Prompt Corrective Action, NPA (Non performing assets), lowering of interest rates, setting up of an independent payments regulator, etc.
- Even though RBI is a autonomous institution, it is still accountable to the government and government plays a role in RBI's functioning through MPC (monetary policy committee) appointments, section 7 of the RBI act, and also appoints governor and deputy governors.
- RBI also works for the government as a Banker to the Government, regulating inflation and ensuring macroeconomic stability of the country, promoting economic growth etc.

### **BODY**

#### **Arguments in favour of RBI's Autonomy?**

- RBI is a particularly important regulator of the economy, with responsibilities that matter for the fundamentals of the health of the economy.
- Central bank autonomy ensures freedom of monetary policymakers from direct political or governmental influence in the conduct of policy. It implies discretion to central banks to decide on the timing and nature of monetary policy intervention.
- Governments driven by electoral calculations, are prone to take economic decisions catering to popular demands and short term interests, such as lowering of interest rates just before elections, debt waivers, easing of strict regulations, plugging fiscal deficits through reserves etc. In such cases RBI's autonomy is crucial for check and balance.

- RBI has accumulated expertise and domain knowledge over time which should be used for making monetary decisions and has managed its functions and role credibly, as evident from strong macroeconomics of the country and non-invocation of Section 7 of the RBI Act in RBI's 83-year history.
- Around the world, the central bank is set up as an institution separate from the government to ensure protection from political interferences.
- When government interventions dilute the central bank's policies and effectively coercing the central bank into such dilutions, banks and private sector spend more time lobbying for policies that suit them individually, at the cost of collective good, thus exposing economy to corruption, crony capitalism, shadow banking etc.

### **Arguments in favour of government intervention:**

- Central bank's autonomy goes with accountability and RBI is accountable to the government which it ensures by enforcing section 7(1) in the RBI Act which justifies that the government is acting within power given to it under the act. (Section 7 section empowers the government to issue directions in public interest to the central bank, which otherwise does not take orders from the government.)
- In the current changing economic scenario, changes are needed in RBI's functioning to meet the contemporary demands through governments' intervention, such as the introduction of MPC (Monetary Policy Committee) for restructuring decision making in monetary policy decisions and making it more inclusive and accountable, proposal for an independent payments regulator in wake of rising digital transactions etc.
- Inclusive economic and political institutions involve plurality in decision-making which help guarantee the rule of law and transparency.

### **WAY FORWARD**

- The tussle between RBI and government can impact the image of India as a stable market as investors require long-term policy consistency; such interference in the working of RBI can impact investment in the Indian economy. Thus, there is a need for amicable and sustainable resolution of disputes.
- Independence of central banks is in the interest of the government as the central bank taking independent decisions sends the right signal - helping maintain macroeconomic stability.
- Therefore, it is advisable for the government to avoid forcing decisions that could be seen as undermining the central bank.
- At the same time, the central bank also should be amenable to changes in lieu of changing economic scenarios and take government and public at large on board so that issues can be debated more widely and amicably.