India must regain investor trust

Second RBI chief quits amid autonomy clash with government

by Meghnad Desai in London

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Urjit Patel's resignation as governor of the Reserve Bank of India echoes what his predecessor, Raghuram Rajan, did a little more than two years ago. After being in office for three years (2013-16), Rajan announced he would not seek a second term. Patel resigned after two years, citing personal reasons. This was an act of courtesy – his departure was predictable. Shaktikanta Das, a career bureacrat, has today been appointed Patel's successor.

Prime Minister Narendra Modi's government is acquiring a reputation for invading the autonomy of institutions, harming India's standing as a haven for foreign investors. Traditionally, the RBI governor has been a senior bureaucrat from the finance ministry. Unusually, Rajan was named governor following stints in the US as an academic and at the International Monetary Fund. He was the first RBI chief in 20 years to decline a second term. With the somewhat flamboyant reputation of a 'rock star banker', he clashed with the institution's usual staid style of bureaucrats. Previous governors have disagreed with the government's wishes for loose fiscal policy and lax monetary policy; typically the RBI has advocated a balanced budget (or at least a pre-declared path of deficit reduction) and anti-inflationary monetary policy.

Throughout its more than 80 years, the RBI has never been truly independent. Governors have resigned following clashes with finance ministers. Others have complained – in memoirs penned after their retirement – of interference by finance ministers. Duvvuri Subbarao's Who Moved My Interest Rate?: Leading the Reserve Bank of India Through Five Turbulent Years is one example.

Patel disagreed with the Indian government on several points. The country's nationalised banks were burdened with non-performing assets and were fragile financially. The RBI wanted to restrict further lending. Patel, during his time as deputy governor under Rajan, helped set an anti-inflationary monetary policy as a legislative goal. He was reluctant to loosen lending rules.

The biggest sticking point concerned the size of the dividend which the RBI paid to the government. The most recent budget, presented last February, laid down a deficit target of 3.3%, which Finance Minister Arun Jaitley is unlikely to meet. The government had its eye on the RBI's excess reserves – which it estimated at Inr3tn – and accused the RBI of hoarding them under an overly risk-averse calculation. Patel was reluctant to give in.

As a result, New Delhi ramped up pressure on Patel and appointed new members to the RBI's board of directors according to their ideology, rather than their expertise. He was then forced to let the new board members assess the contentious issue of excess reserves. Moreover, in an unprecedented move, the government issued a public reminder that under Section 7 of the RBI Act, it can instruct the Bank to follow its guidance.

Patel refrained from making controversial statements and cited personal reasons for resigning, such as the stress of the job. However, no one is fooled by this. India will have to walk an extra mile to gain a reputation as a safe country in which to invest.

Lord (Meghnad) Desai is Emeritus Professor of Economics at the London School of Economics and Political Science, and Chair of the OMFIF Advisers Council. He recently joined Ellie Groves, OMFIF programmes manager for emerging markets, to discuss the political and economic implications of government pressure on the Reserve Bank of India. [Listen to the podcast.]