Decline and fall

A combination of weak political control leading to unchecked bureaucratic hubris, weak analytical capacity and avoidance of reality has created a deep institutional vacuum and consequent incoherence in Indian macro policy-making.

The governor of a central bank must be trusted to act in good faith by the government of the day. It would appear that this was not the case in 2015. Journalist Somesh Jha, in a three-part investigation, (*www.reporters-collective.in/projects/rbi-papers*) reports a noting on file by then finance secretary Rajiv Mehrishi that, in effect, accuses then governor Raghuram Rajan of acting in bad faith — keeping interest rates high to help wealthy foreign businesses.

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To express such bad faith in the actions of the governor of the Reserve Bank of India (RBI) on file reflects poor administrative judgement and an inexcusably casual approach to extremely sensitive matters of macroeconomic management, besides being boorish. That the then finance minister merely "desired a discussion" and did not immediately relieve either the finance secretary (who was clearly out of line in expressing in writing and without evidence such bad faith in the governor) or the governor (if accusations did indeed have a concrete basis) reflects poor political control and an indifference to the responsibility of ministerial office.

This attempt to undermine the autonomy of the RBI was compounded by attempts in 2017 to pressurise the newly set up Monetary Policy Committee (MPC) to cut interest rates. The MPC, as an autonomous body, is designed to be firewalled from the Government of India, the media and private stakeholders. It does not meet stakeholders or listen to their advocacy. But the Ministry of finance sought a formal meeting on the subject of interest rates with the MPC that, quite correctly, refused.

The ministry had the prerogative of presenting its views in writing to the MPC. It did not do so because the government, quite simply, had no coherent economic arguments to put to the MPC. And so, it resorted to an informal and institutionally deeply damaging course of verbal pressure, led by the economic affairs secretary — who was appointed the governor of the Reserve Bank the following year. Unlike governors Venugopal Reddy and Duvvuri Subbarao, both IAS officers with economics PhDs and demonstrable policy experience as professional economists, the new governor lacked the expertise and credentials to provide the analytical leadership required to navigate the macroeconomic situation.

The next step in this dismal saga was that the RBI, aided by the finance ministry, failed to take responsibility for missing the inflation target. It claimed that the official inflation estimates were "unrealistic" and artificially overestimated by the government's own statisticians! Other central banks accepted their official data as it was, even with the limitations of the calculus imposed by the Covid situation; India's macroeconomic authorities chose to live in denial. We now know that they were culpably wrong, but it is too late.

Refusing to acknowledge the data that points to an adverse situation signals a weak and ineffective government. This government has an abysmal track record on data denial, be it on hunger, poverty or employment estimates. Now, it appears, this disease has spread to price data, and the government is inclined, when it is convenient, to challenge its own consumer price index. Data denial at this scale lowers government credibility to an extent that no amount of bombast in the future tense can remedy.

An incoherent approach to macroeconomic policy is the inevitable result of incompetence, data denial, and the hollowing out of economic policy expertise. So it has now come to pass. The observations of the members of the MPC have, with the notable exception of Prof Jayanth Varma, been marked by analytical incoherence. The governor, in his public statements, keeps saying that the RBI is "prioritising economic growth". This is baffling. The theoretical logic underlying an inflation target is to achieve that inflation target. There is no trade-off with economic growth in that analytical framework. This is why, faced with similar challenges, central banks that buy into this theory, and therefore have an MPC, have been raising interest rates worldwide.

If the intention is to prioritise growth, then the government can give the central bank a higher inflation target. But it does not do this because the Ministry of Finance, like the governor, is analytically confused. Lacking a medium-term fiscal strategy and producing ad hoc annual budgets, it is unable to craft a credible medium-term growth-inflation pathway. A Central government faced with increasing debt servicing costs, bereft of a medium-term vision, sees low interest rates as useful to keep debt interest costs down in a fiscal crisis. There is no political bandwidth to appreciate the short- and long-term trade-offs because neither the Ministry of Finance nor the Niti Aayog has the capacity to craft medium-term economic policy, instead preferring to do optically attractive things that are peripheral to serious macro policymaking.

Economic tradecraft is a serious business; optics, rhetoric, bombast and bullying may serve well in coercive ministries and to win popular approval — the economy and the public finances are harder taskmasters. It is a great pity that at this delicate economic juncture, we have a political and executive leadership that is unable to discern the difference.

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