RBI AUTONOMY and PERFORMANCE of MONETARY POLICY in the POST LIBERALIZATION PERIOD: A COMPARATIVE ANALYSIS of the REGIME of VENKITARAMAN and RANGARAJAN

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Abstract

In case of Central Bank Autonomy, the theory of public choice talks about financial independence of the central bank and stresses on the importance of constitutional amendment for a pre-specified stipulation on central bank credit to government. This paper aims to provide a comparative study of the degree of autonomy of the Reserve Bank of India (RBI) and the monetary policy due to the two Governors, S. Venkitaraman and C. Rangarajan, who chaired the central bank around the critical time of India’s economic reforms, most importantly in case of financing the Government’s large fiscal deficit. Rangarajan, contributed, among many other things, to the discontinuation of the automatic monetisation of central government deficits through the introduction of Ways and Means Advances (WMA) which is regarded as a major step towards the achievement of greater discretion of the RBI. The tenure of Rangarajan, who was not considered a government ally and whose tenure was longer, saw higher growth rate, appreciation in exchange rate and rise in stock prices as compared to Venkitaraman’s regime. Inflation rate was lower despite large fiscal deficit as the net RBI credit to the central government could be contained.

JEL classification: E52, E58, E62

Keywords: Central Bank Independence, Monetary Policy, Fiscal Policy, Transition Economies

1. INTRODUCTION

Central bank autonomy refers to the 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. Autonomy of central banks has become an article of faith in the industrial countries. The constitution setting up the European Central Bank has been written based on this belief. However, central bank autonomy goes with accountability and accountability in turn requires transparency in case of both objectives and strategies.

Economists and practitioners in the area of monetary policy generally believe that the degree of central bank independence or central bank autonomy affects the performance of monetary policy and through it, important macro-economic variables such as inflation, economic growth rate, etc. In recent years, considerable attention has been given to the possible benefits of central bank independence as an institutional mechanism to help control inflationary biases. There is a general agreement to give instrument independence to central banks among countries that have decided that the single objective of monetary policy is inflation control.
Generally, central bank independence relates to three areas viz. personnel independence, conduct of policy and financial aspects. Personnel independence refers to the extent to which the central bank is free from government influence in case of appointment, term of office and dismissal of top central bank officials and the members of the governing board. It also includes the extent and nature of representation of the Government in the governing body of the central bank.

Policy independence relates to the flexibility given to the central bank in the formulation and execution of monetary policy. A central bank is said to have goal independence, if it has complete discretion in setting the ultimate goals of monetary policy, like inflation, unemployment, or economic growth. European Central Bank exhibits this kind of independence. A central bank has instrument independence if it is free to choose and does not require government approval to use the policy instruments to achieve its goals. It is believed that partially independent central banks are accountable while too much independence can reduce democratic accountability. One way to bring about accountability in an independent central bank is to allow instrument but not goal independence whereby the government sets the social goal but the central bank is free to implement it using its professional know-how.

An aspect of central bank independence on which a high degree of consensus is growing is on financial independence i.e. the funding of the government by the central bank. Financial independence relates to the freedom of the central bank to decide the extent to which government expenditure is either directly or indirectly financed via central bank credits. Direct or automatic access of government to central bank credits imply that monetary policy is subordinated to fiscal policy. While statutory limits on credit to government can be got around quite clearly, direct funding of government, without limits by the central bank will come in the way of the efficient conduct of monetary policy. Still, many countries have placed legal constraints on central banks’ credit to government.

In transition economies like India also, the flexibility of monetary policy is constrained by a larger fiscal deficit, driven by politically motivated fiscal policy. This leads to monetisation of government’s fiscal deficit through seignorage which is an important source of inflation in such economies.

Three different theories, which are by no way mutually exclusive, have been advanced in support of autonomy of central banks, viz., dynamic or time inconsistency theory, theory of political business cycle and the theory of public choice. Time inconsistency arises when the best plan currently made for some future period is no longer optimal when that period actually starts. In the context of monetary policy, the time inconsistency problem arises because there are incentives for a politically motivated policymaker to try to exploit the short-run trade-off between employment and inflation. The political business cycle theory studies the interaction between economic policy decisions and political considerations whereby incumbent governments use restrictive policies early in their tenure by raising unemployment to reduce inflation, as the election approaches. As it takes time for the monetary policy to affect the economy, even if the central bank nullifies the fiscal stimulus through monetary tightening, its impact would typically be felt during the post-election period when the incumbents may happen to be back in power.

1 Domestic coalitions that put pressure on the government to cut budget deficit that results from politically motivated subsidies and large non-developmental expenditure.
Finally, economists talk about the theory of public choice. In recent years, the theory of public choice has received importance due to the fusion between politics and economics. In the context of reducing budget deficit, the primary solution offered in public choice theory is a constitutional amendment for a pre-specified stipulation on central bank credit to government.

It is important to study the performance of monetary policy in relation to the degree of central bank autonomy in transition economies due to the very unique nature of such economies. It has been pointed out by some experts that the RBI, though not formally independent, has enjoyed a high degree of operational autonomy during the post-reform period. In fact, during the recent period, the Reserve Bank of India (RBI) enjoys considerable instrument independence for attaining monetary policy objectives. Significant achievements in financial reforms including strengthening of the banking supervision capabilities of the RBI have enhanced its credibility and instrument independence. Moreover, the International Monetary Fund (IMF) applauded RBI’s recent policy measures to maintain macroeconomic and financial stability amid a challenging macroeconomic landscape to reduce external vulnerabilities, rebuild buffers, and revive investment. Despite slowing economic growth, the RBI has raised interest rates thrice by 25 basis points since September 2013, after Raghuram Rajan took over as the new governor of the central bank, stressing on the need to bring down rising prices. The RBI raised its key benchmark repo rate to 8 per cent from 7.75 per cent in January, 2014.

Also, as well conveyed by the former RBI governor, Dr. D. Subbarao, in recent times, there has been a need for greater independence of the Reserve Bank of India (RBI) as a prerequisite for implementing an effective monetary policy.

In the past, RBI governors have exhibited independence in their monetary policy decisions. Balachandran (1998) points out that in the mid-fifties, the then governor of the RBI, Rama Rau, who was interested in developing the bill market resigned because of pressures from the Finance Minister TT Krishnamachari who imposed a steep rise in the stamp duty of bills that effectively destroyed the bill market. In 1964-65 Finance Minister TT Krishnamachari even claimed for the Government the right to announce Bank rate changes when Parliament was in session. But P. C. Bhattacharyya was able to defend the RBI’s right to announce the Bank Rate, and was also able to raise rates. According to Balachandran (1998), such symbolic rights are also important for autonomy.

In case of financial independence of central banks, which has gained importance in recent years, some economists explicitly talk about the fiscal-monetary policy nexus. In India, monetary policy has been very much conditioned by the stance of fiscal policy. The basic philosophy behind the monetary-fiscal relationship during the pre-reform period was not in the Reserve Bank autonomy but the importance of the agreement to ensure that monetary and fiscal policies work in harmony and proceed in the same direction. Accordingly when the fiscal policy was dominant, the Reserve Bank’s monetary policy generally played an accommodative role to fiscal policy (RBI, 2006). The large size of the Government borrowings in the pre reforms period often posed problems for the monetary authority that could not raise the interest rates as the Government was averse to higher interest rates. This forced the RBI to adopt other measures without directly raising the cost of borrowing for the Government. Thus, faced with inflationary pressures, the RBI had to tighten its monetary policy by imposing an incremental CRR in 1960 although it wanted to raise the Bank Rate. This measure, however, could not restrain the expansion of bank credit as banks met this requirement by liquidating their holding of Government securities, thereby leading to a slump.
in the Government securities market. It was not until 1963 that the Reserve Bank could raise Bank Rate by 50 basis points. Thus, the Reserve Bank’s freedom to choose the monetary tool it wanted to employ was, to some extent, compromised.

Moreover, during the 1960s, the RBI’s Open Market Operations (OMOs) increasingly threatened to demoralize its monetary policy instead of coordinating with it. During 1960-66, the RBI raised its Bank Rate from 4 per cent to 6 per cent and initiated a series of measures to restrict monetary expansion. However, to stabilise market conditions, the RBI became a net purchaser of Government securities through its OMOs, thereby infusing liquidity into the system and causing inflation. The coordination between the two policies was present only when drastic monetary control measures were required.

One of the key reasons for the macroeconomic crisis of 1991 was the unrestrained monetary accommodation of the fiscal deficits and the resultant monetary expansion which in turn resulted in double digit inflation. The high fiscal deficits, particularly revenue deficits of the central government, had set up a ‘vicious circle of increased borrowing and attempts to force the banks to lend at below-market rates’ (RBI, 1992). Fiscal dominance restricted the conduct of monetary policy. One of them was that since the banking system’s resources fell short of the ever increasing requirement of the government, the RBI monetised the fiscal deficits with the ratio of monetisation to GDP nearly doubling from 1.1 per cent during the 1970s to 2.1 per cent in the 1980s. This led to inflation, which in turn, led to increasing government expenditure greater than its revenue mobilisation, thereby widening the fiscal deficit further.

The system of the scheme of ad hoc Treasury Bills facilitated monetisation of the fiscal deficit without limit and without prior approval. In the context of India’s economic reforms of 1991, the reformers were in favour of central bank autonomy not only because of their faith in monetary policy but also because they believed that once the government's access to cheap credit from the RBI was curtailed, government borrowing would be limited². Since the reformers considered the size of the fiscal deficit as India’s number one economic problem, they backed central bank autonomy as a solution to that problem. However, India is believed to be a country with weak constraints on Government’s access to central bank credit (RBI, 2006).

Specifically, this paper aims to provide a comparative study of the degree of autonomy exercised by the two Governors of RBI, S. Venkitaraman and C. Rangarajan, around the critical time of India’s economic reforms and their monetary policy decision, most importantly in case of financing the Government’s large fiscal deficit.

The study is expected to provide an understanding of the Governors of RBI, their policy decision and the influence on the performance of relevant macroeconomic variables and market parameters. The possibility that the role of the central bank’s governor changes in an emerging country like India may convey some sort of information relevant to the future conduct of monetary policy that can alter inflation and interest rate expectations has provided the impetus for the present study. The paper shows that Rangarajan, contributed, among many other things, in achieving a greater degree of RBI autonomy by way of the discontinuation of the automatic monetisation of central government deficits through the

² For two reasons- Firstly, excessive borrowing from the open market will push up interest rates, signaling the government of the impact of its behaviour on the cost and availability of credit; secondly, excessive borrowing will result in sharp increase in the interest burden on the government's budget, and act as a corrective against such borrowing.
introduction of ‘ways and means advances’ (WMA). Moreover, the tenure of Rangarajan, who was not considered a government ally and whose tenure was longer, saw higher growth rate, appreciation in exchange rate and rise in stock prices as compared to Venkitaraman’s regime. Inflation rate was lower despite large fiscal deficit as the net RBI credit to the central government could be contained.

The rest of the paper is organised as follows. Section 2 quickly reviews the literature related to central bank autonomy and its association with monetary policy performance taking into account the monetary-fiscal policy nexus. Section 3 gives a comparative analysis of the monetary policy decisions of the two RBI governors, S. Venkitaraman and C. Rangarajan, by considering certain characteristics viz. term of office, whether one was a government ally and the changes in key macroeconomic variables. This section also concludes the paper.

2. LITERATURE REVIEW

The rapidly expanding literature on the extant literature on the association between central bank autonomy and performance of monetary policy is concentrated more on the developed and industrialised countries. Most of the empirical studies have investigated the relationship between central bank autonomy and inflation and have concluded that degree of central bank autonomy and the level of inflation are negatively related. Bade and Parkin (1985) were the first to empirically conduct studies of this link and found that countries with high degree of policy independence had low inflation levels. Alesina (1988), Grilli, Masciandaro and Tabellini (1991) too found a negative relationship between central bank independence and the inflation rate.

The literature has found a relationship between some measures of central bank autonomy and macroeconomic outcomes viz. Inflation. However, if central banks have explanatory power, then the chairman or the governor may have power to exert influence on monetary policy and in turn macroeconomic outcomes. The extant literature also investigates whether the degree of central bank autonomy depends on the central bank governors. Cukierman (1992), Cukierman and Webb (1995), de Haan and Siermann (1996), Cukierman et al (2002), Neyapti (2003), Crowe and Meade (2007, 2008) find that turnover rate of central bank governors is positively related with inflation, particularly for developing countries. Cukierman et. al (1995) state that a sufficient high turnover rate make the tenure of the central bank governor shorter and thus makes the governor more susceptible to influence by the government and more discouraged from trying to implement longer term policies (). Romer and Romer (2003) found that different Federal Reserve chairs are associated with different monetary policies and different macroeconomic outcomes. Vasudevan (2007) points out that one of the measures suggested in the literature to increase independence is to delegate authority to a conservative central banker, who will then impose own preferences on the growth inflation trade-off.

Cukierman et.al (1992) and Cukierman (1992) found a significant negative association between the actual average term of office of the central bank governor (their proxy for central bank independence) and inflation across developing countries. The use of this proxy is based on the presumption that below some threshold a shorter term in office of the governors associated with lower for central bank independence. It should be noted here that the actual terms in office in developing counties are substantially lower than in industrial countries (Cukierman, 1994).
Kuttner and Posen (2007) have put forward a counter-argument to the above and have also looked into the possibility that central bank governor appointments may not contain any apparent information and thus may not lead to any market reaction. If all governors are selected from a relatively homogenous pool of candidates, then presumably any new appointee would be expected to pursue policies similar to those of his predecessor. Their results suggest that market reactions are not uni-directional which suggest that the reactions are based on the perceived characteristics of the specific appointees rather to a generic concern that all new governors are susceptible to inflationary bias.

The studies in the extant literature on CBI have taken into account the whether the central bank Governor is a government ally (Christoph and Axel, 2007 and Vuletin and Zhu, 2011). Government ally has been defined as someone who is, at the time, the highest official in any of these ministries, representing the clearest case of central bank capture. They found a very interesting fact that the newly appointed central bank governor is most likely to be an ally of the government if the previous governor had a premature exit. They have found that replacements of central bank governor classified as ally are present in India.

The theoretical studies of central bank independence and economic performance also stress on the conflict between the monetary and fiscal policy. Some of the studies concerning the central bank independence, more importantly, investigate the interaction between the government and the central bank in financing fiscal deficits. Sargent and Wallace (1981) in their seminal paper on this issue showed that if the government continuously issue bonds to finance their fiscal deficit, the central bank might eventually be forced to inflate to fund the deficits. This in turn will lead the public to expect inflation rates to increase which may cause inflation to increase. This is a case of Stackelberg game where the government is able to set its policies and the central bank merely reacts to this.

The motivation for discussing this issue in many studies is due to the belief that independent central banks should be better able to resist government efforts to have them monetize deficits. Accordingly, governments who realize that there may be some limit on their ability to borrow continuously from the central bank to finance deficits may have to decide to limit deficit financing and in turn this may curb inflation. Parkin (1987) and later Masciandaro and Tabellini (1988) investigated this issue for a sample of countries and found that there was a negative relationship between central bank independence and government deficits. Grilli, Masciandaro and Tabellini (1991) used an economic measure of inflation where the economic factors considered were the ability of the government to determine the conditions under which it can borrow from the central bank and the monetary instruments under the control of the central bank. They found that economic independence was negatively related to inflation. However, Grilli, Masciandaro and Tabellini (1991) concluded that an independent central bank does not discourage the government from running fiscal deficits. Loungani and Sheets (1995) point out that an independent central bank is believed to resist giving cheap deficit finance and hence put pressure on government to limit the size of the deficit or to invent non-inflationary sources of fiscal financing.

In the context of India, study of the autonomy of the Reserve Bank of India is almost absent except for those by Goyal (2002, 2007 and 2010) and Chandavarkar (2005). Goyal (2002, 2007) suggests that a democratically accountable governor in a developing democracy would anyway keep inflation low, so if stricter rules control fiscal policy decisions the central bank can focus less on inflation and more on growth. Study by Goyal (2010) reveal that monetary policy has differed in the tenures of various Reserve Bank governors and as a result there have been variations in performance parameters like inflation and economic growth. This
suggests strong evidence that economic performance variables respond to central bank governor changes in India. Independence depends also on personalities. Goyal’s (2010) study suggests that a good deal depends on history and tradition and a fair amount even on the personalities involved.

Chandavarkar (2005) indicates that in the case for an independent RBI, an important governance issue is the security of tenure for the governor. The study states that RBI autonomy is inconceivable without security of tenure for the governor which should be defined by statute specifying the terms and conditions of office and the qualifications for the job.

As pointed out by Ramachandran (2000), the RBI has historically confronting a major impediment in taking an independent monetary policy stance and that is the growing fiscal-monetary policy nexus, which can be measured by the amount of net RBI credit to the government. The net RBI credit to the government constituted around 96 per cent of the reserve money in the 1980s and exceeded the total amount of the reserve money in 1990-91.

However, investigation on this important issue of autonomy of the Reserve Bank of India and its link with the policy decisions of subsequent RBI Governors and also with the monetary and fiscal policy coordination has been almost absent.

This paper aims to provide a strong case for more central bank independence in India by providing a comparative analysis of two Governors of the Reserve Bank of India (RBI) around the critical period of economic reforms, their policy decision and the influence on the economy.

3. RBI AUTONOMY AND MONETARY POLICY POST 1991

3.1. VENKITARAMAN’S REGIME:

S. Venkitaraman was the eighteenth RBI Governor, who had previously worked as Finance Secretary for the Government of India. He served as RBI Governor for two years from December 22, 1990 to December 2, 1992. The country faced difficulties related to the external sector during his tenure. His short tenure saw the country tide over the balance of payments crisis. His term also saw India adopt the IMF’s stabilisation programme where the rupee underwent devaluation and the launch of the programme of economic reforms. During his tenure, the interest rate rose from 10 per cent to 12 per cent, the rupee weakened from 17.50 to 22.69 and the GDP growth dipped from 5.29 per cent to 1.43 per cent. Moreover, the annual inflation (WPI) moved up from 10.30 per cent to 13.70 cent. Due to his short tenure in office, not much has been documented regarding his contribution.

3.2. RANGARAJAN’S REGIME:

C. Rangarajan succeeded S. Venkitaraman as the nineteenth RBI Governor from December 22, 1992 to November 21 1997. Prior to his appointment as the Governor, he held charge as RBI's Deputy Governor for over a decade. He was also a member of the Planning Commission and a member of the Tenth Finance Commission.

In the early nineties, prior to Rangarajan’s appointment as the RBI Governor, the stagnation in the economy, rising government indebtedness, and scarcity of foreign exchange precipitated a balance of payment crisis. More openness was regarded as a solution. But more
openness required more credible institutions. Poor fiscal finances had precipitated many outflows and currency crises in emerging markets and the same was the case in India. For the government, there were immense challenges on the fiscal front while RBI’s job was to ensure monetary stability and inflation control.

Rangarajan’s tenure as RBI Governor saw an era of fairly revolutionary changes in the Indian financial system. During the five years that he served as RBI governor, Rangarajan devised a monetary policy which would facilitate growth and ensure price stability. Most of the measures such as simplification and deregulation of interest rate structure, reorientation of reserve requirements with a view to improve banks’ lendable resources, an improved supervision system, upgradation of information technologies and imparting a greater element of competition in the financial system contributed to lay down the foundation of a monetary policy to further strengthen India’s new economic environment.

In view of the dangerous effect of the growing fiscal-monetary policy nexus on the flexibility of monetary policy, in December 1982, the then RBI Governor Manmohan Singh appointed the Sukhamoy Chakravarty Committee “to review the working of the monetary system”. The Chakravarty Committee recognised the danger that could be brought about by the monetary-fiscal policy nexus and strongly recommended a fundamental restructuring of the monetary system. The Committee argued that price stability should be the dominant objective of monetary policy and inflation control was perceived as the joint responsibility of the Government and the Reserve Bank”.

One of its major recommendations was to regulate money supply consistent with the expected growth rate in real income and a tolerable level of inflation. The Committee recognised the fact that Government borrowing from the Reserve Bank had been a major factor contributing to the increase in reserve money and therefore, money supply and in turn high inflation rates. The Committee wanted an agreement for a coordination between the Central Government and the Reserve Bank on the extent of monetisation of the fiscal deficit to contain monetary expansion within the limits set by expected increase in output which otherwise could become impossible. According to Chakravarty, Rangarajan who was a monetary economist among Indian policy makers and an influential member of that Committee had been the driving force and main author of the influential report the Committee came to submit in April 1985. Even though it could take a concrete shape only in the Nineties, this recommendation of the Committee was accepted in principle which was a successful effort in the part of Rangarajan in restoring some kind of monetary policy in the country for the first time since the 1930s.

In some sense, this was also the Rangarajan era in RBI as barring a small stint at Planning Commission, Rangarajan was with RBI between February 1982 and November 1997, first as a deputy governor and then as governor. The Rangarajan committee on balance of payments recommended the introduction of a liberalized exchange rate management—a transitional system with a dual rate with the objective of moving towards convertibility on current account transactions. It might be argued that under Rangarajan, the central bank gained substantial freedom to conduct monetary policy primarily by getting the government to agree to pay market rates of interest for its borrowings and also by reducing its right to monetise deficits at will. Accordingly, since 1995-96, the net issue of ad hoc bills and tap treasury bills were subjected to a cap and subsequently replaced with the WMA. The WMA is an overdraft facility from the RBI. The facility is available for 10 days. The interest rate on WMA and overdraft are linked to the repo rate.
WMA the RBI provides facilities for temporary accommodation of the financial needs of the government up to a ceiling (or limited amount) fixed in advance. In subsequent years, the entire requirement is being met through the WMA system and market borrowing. The disincontinuation of the automatic monetisation of central government deficits was a giant step towards fiscal correction as well as giving the RBI functional autonomy in the conduct of monetary policy and in turn the RBI’s balance-sheets appear much cleaner today as a result.

It is no coincidence that a majority of the RBI governors have been ex-finance secretaries. This was true for S Venkitaraman. Under Rangarajan (who was never in the ministry) the RBI may have made the biggest headway on the autonomy issue so far. Rangarajan rightly observed that emergence of an autonomous bank enables the central bank to pursue a consistent monetary policy over a long time without being influenced by short-term pressures to deviate from its path. Autonomy in any case is not unrestrained. In a democratic set-up it can always be the subject of policy directives either from the Government or the legislature.

Apart from the effect of RBI governors on the trend in fiscal deficit as a percentage of GDP, the change in governors and their individual monetary policy decisions also affects macroeconomic variables.

Table 1. Governors and macroeconomic variables (wpi and real gdp growth rate aggregate for the tenure)

<table>
<thead>
<tr>
<th>Governor</th>
<th>Tenure period</th>
<th>Wpi</th>
<th>Real GDP growth rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>S. Venkatiramanan</td>
<td>1991-92 to 1992-93</td>
<td>11.9</td>
<td>3.2</td>
</tr>
<tr>
<td>C. Rangarajan</td>
<td>1993-94 to 1997-98</td>
<td>7.6</td>
<td>6.62*</td>
</tr>
</tbody>
</table>

Source: Goyal (2010)
Note: 1. * refer to the New Series of the CSO, with base 1993-94, prior to that the base was 1980-81.
2. WPI- Wholesale Price Index; GDP-Gross Domestic Product

Table 2. Governors and Macroeconomic Variables (year-wise)

<table>
<thead>
<tr>
<th>Year</th>
<th>Governor</th>
<th>Reserve Money (growth rate)</th>
<th>Fiscal Deficit as a percentage to GDP</th>
<th>RBI’S net credit to central government as percentage to GDP</th>
<th>Inflation rate (WPI)</th>
<th>Exchange rate</th>
<th>Stock price (BSE Sensex; Base: 1978-79=100)</th>
<th>GDP (growth rate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>S. Venkatiramanan</td>
<td>13.13</td>
<td>7.61</td>
<td>2.52</td>
<td>10.3</td>
<td>17.94</td>
<td>1049.53</td>
<td>5.29</td>
</tr>
<tr>
<td>1991-92</td>
<td>S. Venkatiramanan</td>
<td>13.36</td>
<td>5.39</td>
<td>0.82</td>
<td>13.7</td>
<td>24.47</td>
<td>1879.51</td>
<td>1.43</td>
</tr>
<tr>
<td>1992-93</td>
<td>C. Rangarajan</td>
<td>11.33</td>
<td>5.37</td>
<td>0.55</td>
<td>10.1</td>
<td>30.64</td>
<td>2895.67</td>
<td>5.36</td>
</tr>
<tr>
<td>1993-94</td>
<td>C. Rangarajan</td>
<td>25.18</td>
<td>7.01</td>
<td>0.03</td>
<td>8.4</td>
<td>31.36</td>
<td>2898.69</td>
<td>5.68</td>
</tr>
<tr>
<td>1994-95</td>
<td>C. Rangarajan</td>
<td>22.07</td>
<td>5.75</td>
<td>0.2</td>
<td>12.6 @</td>
<td>31.39</td>
<td>3974.91</td>
<td>6.39</td>
</tr>
<tr>
<td>1995-96</td>
<td>C. Rangarajan</td>
<td>14.87</td>
<td>5.16</td>
<td>1.62</td>
<td>8</td>
<td>33.44</td>
<td>3288.68</td>
<td>7.29</td>
</tr>
<tr>
<td>1996-97</td>
<td>C. Rangarajan</td>
<td>2.84</td>
<td>4.88</td>
<td>0.14</td>
<td>4.6</td>
<td>35.49</td>
<td>3469.24</td>
<td>7.97</td>
</tr>
</tbody>
</table>

Notes: 1. The inflation series are derived from the Wholesale Price Index; before @ the base year is 1981-82; after it is 1993-94
2. Exchange rate of INR vis-à-vis USD (Financial Year-Annual Average
Table 1 and 2 show that macroeconomic variables such as growth, inflation, exchange rates and bond prices have differed in the tenures of the two RBI governors under study. The overall direction may have been dictated by the preferences of the elected government, given lack of constitutional autonomy but the Governor has been able to make a difference. The divergence in performance in the regimes of the two governors suggests that their preferences affected growth rates. Rangarajan’s regime which saw higher growth rate also saw lower inflation, appreciation in exchange rate and rise in stock prices. By the end of the fiscal year 1994-95, the WPI was in double digits at 12 per cent. Several factors contributed to this high inflation rate, including the sharp increase in reserve money fuelled by the build up of net foreign assets, the cumulative effect of earlier increases in procurement prices for foodgrains, the upward revision of administered prices of foodgrains, sugar and petroleum in the final quarter of 1993-94 and the generally buoyant economic conditions. It should be mentioned here that the large fiscal slippage in 1993-94 would also have contributed to monetary growth and price rise but for adroit management by the RBI of large sales of government securities, as a consequence of which there was hardly any increase in net RBI credit to the Central Government for the year as a whole. The clear differences in regimes suggest that governors whose policies discouraged recovery in growth ended up with higher inflation also as in the case of Venkitaraman (Goyal, 2007).

From the above two profiles, it is seen that Venkitaraman held important government position before becoming RBI Governor which makes him government ally. Moreover, Venkitaraman had a considerably shorter tenure as RBI Governor which saw a rise in inflation rate from 10.3 per cent to 13.7 per cent. The four years tenure of Rangarajan as the Governor saw the annual inflation rate moving down sharply from 13.7 per cent to 4.6 per cent.

3.3. CONCLUSION

The theory of public choice as well as financial independence aspect of central bank autonomy stresses on the presence of the fiscal monetary policy nexus and the importance of constitutional amendment for a pre-specified stipulation on central bank credit to government. Keeping in mind that the flexibility of monetary policy is constrained by a larger fiscal deficit in a transition economy like India, this paper aims to study if the RBI had some degree of financial autonomy due to the two RBI Governors policy decisions under study, S. Venkitaraman and C. Rangarajan, around the critical time of India’s economic reforms, most importantly in case of financing the Government’s large fiscal deficit.

Under Rangarajan, the central bank gained substantial freedom to conduct monetary policy primarily by getting the government to agree to pay market rates of interest for its borrowings and also by reducing its right to monetise deficits at will. Rangarajan’s appointment as the RBI governor saw the discontinuation of the automatic monetisation of central government deficits through the introduction of Ways and Means Advances (WMA) which is regarded as a major step towards the achievement of greater discretion of the RBI. Compared to Venkitaraman’s tenure, the tenure of Rangarajan, who was not considered a government ally and whose tenure was longer, saw higher growth rate, appreciation in exchange rate and rise in stock prices. Inflation rate was lower despite large fiscal deficit as the net RBI credit to the central government could be contained. The RBI has greater flexibility in the choice of its assets which, in turn, provide it larger expertise over management of liquidity in the system.
However, the above-mentioned trends in macroeconomic variables can be brought about by exogeneous factors and external shocks also. Thus, it becomes imperative for future studies to investigate the role of individual Governors macroeconomic variables via monetary policy decisions taking into account other factors like external shocks too.

REFERENCES


