

THE BOOK REVIEW

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Ravi Bhoothalingam

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Central Bank and the Government: Providing Primacy to an Important Debate

TCA Ranganathan

QUEST FOR RESTORING FINANCIAL STABILITY IN INDIA

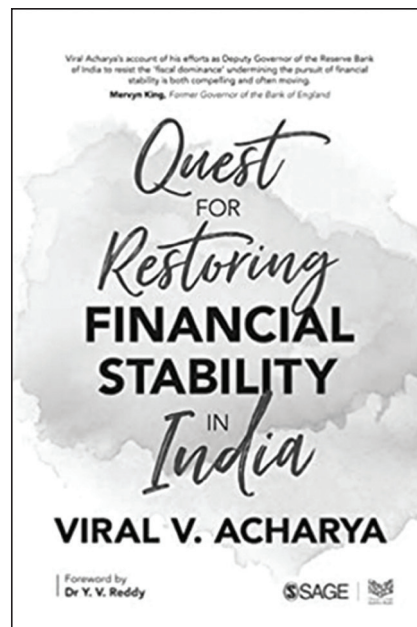
By Viral V. Acharya

Sage Publications, New Delhi, 2020, pp. 396, ₹695.00

This book intrigues. It comes heavily recommended. It was released, in a high-powered function graced by two former RBI Governors (YV Reddy and Duvvuri Subbarao) as speakers and a galaxy of present and former RBI officials, Deputy Governors and so on. The book carries a blurb by Mervyn King (former Governor, Bank of England) apart from endorsements by Raghuram Rajan, C Rangarajan (both former RBI Governors in addition to being holders of other prestigious positions) and several other financial sector doyens. In terms of contents, at one level, it is a collection of seventeen speeches/reports targeting a variety of audiences, ranging from the FICCI's Ladies Organisation, Mumbai chapter, to high level RBI/IBA conferences/summarizing Monetary Policy Committee deliberations. They are thus of various lengths and complexity ranging from 'light and frothy' to being intensely academic with pages of equations and derived tables and graphs.

Why would a book consisting mainly of public speeches arouse so much interest? In a feisty and eminently readable foreword, Dr Reddy brings out that the practice of Deputy Governors making public speeches goes back to the days of Dr Rangarajan who was the first Deputy Governor to deliver well prepared speeches containing elements and communications we normally attribute to Central Bankers to create public opinion. He brings out that the most influential was the Kutty Memorial Lecture which had made out a case for ending the system of automatic monetization. The impact was such that it led to a memorandum of understanding between the Government and the RBI, well before it was incorporated as a law. The practice of Deputy Governors delivering prepared speeches was continued by SS Tarapore and all subsequent successors.

The author, Viral V Acharya is the



C.V. Starr Professor of Economics in the Department of Finance at New York University Stern School of Business. He had completed the Bachelor of Technology Degree in Computer Science and Engineering from Indian Institute of Technology, Mumbai in 1995 and Ph.D. in Finance from NYU-Stern in 2001. His primary research interest is in theoretical and empirical analysis of systemic risk of the financial sector, its regulation and its genesis in government-induced distortions; an inquiry that cuts across several other strands of research—credit risk and liquidity risk, their interactions and agency—theoretic foundations, as well as their general equilibrium consequences. He has authored/co-authored several books earlier, on an array of Wall Street/US Financial governance related issues. He additionally has several publications and prize-winning works in many eminent journals. He was Deputy Governor at the Reserve Bank of India (RBI) from 23rd January 2017 to 23rd July 2019, in charge of Monetary Policy, Financial Markets, Financial Stability, and Research.

The speeches/essays are grouped by the author under six themes: Bank Non Performing Assets, Need for Public Credit Registries, Financial Cycles, Monetary Policy transmission, Developing Viable Capital Markets and External Resilience, Enhancing the autonomy of the Central Bank, Markets, and the Real Economy. As with all RBI speeches they are extremely well documented, and data-linked and are thus valuable aids to any researcher exploring any of these themes. They are tied together by a detailed preface entitled 'Fiscal Dominance: A Theory of Everything in India' wherein the author sketches out how and why a directional coherence exists in speeches, which were seemingly superficially crafted to suit different audience categories.

The central argument can be summarized in the author's own words: 'Financial stability is perhaps the most important prerequisite for stable growth. It is surprisingly also the most compromised one. Post-1991 reforms, India undertook an upward and onward march in economic progress for close to two decades. Since then, the lack of financial stability has emerged as its Achilles' heel. My objective in putting together the book has been that it stirs up this important debate, gives it the primacy it deserves and provides some useful inputs, so together we can implement the much needed long-lasting solutions to restore financial stability in India.'

In his preface, Acharya argues that decision making in all matters of state policy relating to banking regulation, debt management, timely disclosures of defaults, market regulation, capital flow measures and RBI profit transfer have been dictated and governed principally by the concern regarding their fiscal implications and naught else. The book does admit that progressive steps limiting fiscal dominance were undertaken in the post-liberalization period. In those initial years, high economic growth, and a rise in household financial savings had facilitated an environment of consolidating government debt and fiscal deficit trajectories. But the author laments that fiscal dominance has once again taken hold of the Indian economy as these conducive factors have gradually reversed. Concerns voiced by him, illustratively are:

*Bank recapitalization and regulation: There is pressure from the government for regulatory forbearance, not only for public sector banks but also for private sector banks, as the prudential norms are ownership neutral. This is because imposing prudential regulatory norms required for financial stability could lead to a huge need for the government to capitalize the public sector banks and thereby stress the fiscal deficit.

*Timely disclosure of defaults: There was resistance to RBI tightening default disclosure directives on one-day bank loan defaults to markets, presumably because downward rating migrations would imply larger provisions and more demands on the budget for recapitalization and thus fiscal stress.

*Rate setting: Interest rate cuts are sought by the government not for Monetary Policy needs but because they result in treasury gains for banks resulting in a lowered demand for Capital apart from a lowered cost of rolling over government debt. Likewise, rate hikes are resisted as this would imply larger provisions for fixed income securities and a consequential impact

“Why would a book consisting mainly of public speeches arouse so much interest? In a feisty and eminently readable foreword, Dr Reddy brings out that the practice of Deputy Governors making public speeches goes back to the days of Dr Rangarajan who was the first Deputy Governor to deliver well prepared speeches containing elements and communications we normally attribute to Central Bankers to create public opinion.”

on capital. The book goes on to say, ‘In fact, once sufficiently fiscally dominated, the liquidity policy can control most of the government bond yield curve and prices, rendering the rate-setting process of monetary policy authority effectively irrelevant.’

*Market regulation: Asymmetric mark-to-market accounting treatment of government bonds: Treasury gains are transferred for the most part as soon as bond prices rally; in striking contrast, treasury losses are allowed to be recognized over several quarters. The end result is another form of deep interference of fiscal deficit pressures on the accounting treatment of banking balance sheets. ‘Public sector banks and other government-owned entities in the financial sector can be, and are, required—through moral suasion—to buy up entire issue amounts in individual auctions at above-market prices.’

*Capital-flow measures: It is indicated that continuous fiscal deficits have resulted in increased reliance on external finance creating a continuous pressure to relax controls over capital inflows to meet the shorter-term objective of financing government borrowing, and this can go counter to financial stability.

*RBI balance sheet: The demands made on the Central Bank to transfer what are considered excess reserves in its balance sheet to the government are driven by the fiscal imperative. ‘Given India’s external sector vulnerabilities, it is paramount that the Central Bank balance sheet be perched on

the highest hill; it should remain untouched and unperturbed in the midst of almost any macroeconomic storm.’ It is argued that erosion of the RBI capital through high dividend pay-outs leads to increasing compromise of the severity of stress scenarios it can withstand in future, especially when the sovereign rating is not of the highest quality.

The solutions offered are based on the author’s firm conviction that the Central Bank must at all times ensure that financial stability is not compromised, especially in the face of imminent government pressures driven by a shorter time horizon. As a banking regulator, the Central Bank has to ensure the safety of bank deposits; and as a monetary authority, price stability and managing the currency’s excessive volatility are part of its long-term mandate. The solutions offered are many, and policymakers would do well to have a closer look at the fairly long list provided in the various chapters of the book. These range from principles for the RBI’s governance and appointments, upholding Basel capital and liquidity norms in letter and spirit, forbearances (if at all) to be subject to a ‘sunset clause’ of no longer than six months, a strong PCA framework, timely default disclosure for even one-day, setting up of a public credit registry, annual asset quality review for banks and NBFCs, resolution of large NPAs, etc. This conviction is well placed and deservedly receives sympathetic resonance elsewhere if the post launch book related events and expert-speak is any guide.

While the author’s commitment and passion come through this entire erudite intellectual discourse, discussions on the behavioural mores of the RBI and the state cannot be viewed in isolation. The famous Hungarian philosopher, Arthur Koestler in his book *The Ghost in the Machine* (1967) had taken recourse to a Greek word, Holon, to define organizations or hierarchies which are simultaneously both a ‘whole’ and a ‘part’. Holons exist simultaneously as self-contained wholes in relation to their subordinate parts, and as dependent parts when considered from the inverse direction. While originally, this was in relation to biological systems and hierarchies, it has since been found to be a useful practical device to assess functioning of hierarchies in social and/or economic systems. A debate regarding Central Banking functioning/independence falls in this category.

Viewed from this perspective of the RBI communicating as a regulator, a noteworthy aspect about the NPA issues is that despite extensive references to Asset

Quality Reviews etc., very little analytically relevant information about the sectoral and geographical structure of these NPAs has ever been put into the public domain thereby resulting in a vague understanding about causes and suggested remedies. Such a discussion would not have violated any banking secrecy commitment. A scholarly book like this, concerned about NPA problems, could have filled the gap. Then again, while references to the importance of adhering to Global Best Practices are scattered across the book, the specifics are missing. Illustratively, the specifics of Global Best Practices for financing PPP projects or Bank Loan concentration norms or Loan loss provisioning methodology have not been brought into the debate diluting the quality of contribution. It will freely be accepted that the current Covid related lockdown will continue to add to the NPA problem of banks, thus renewing the debate about regulatory forbearance and restructuring of bank loans to Covid impacted businesses. At the same time, most observers also recognize that it is extremely important that credit support be provided for resuming operations and economic activity. It is when the contradictions between NPA management and Restart management come into play and opinions start to diverge that specific consciousness of Global Best Practices assist thought.

The debate on the RBI’s Balance sheet and net worth and dividend payment obligations also intrigues. To an outsider, the quality of the Sovereign rating and extent of Foreign Currency reserves would matter more than a Central Bank’s net worth in a stress scenario. After all, in a currency crisis, currency depreciation can well create capital gains to a Central Bank unless they try to defend the indefensible, while domestic crises would only require decisions regarding NPA recognition with the resultant fund related heavy lifting being thereafter done by the banks or the Sovereign. Readers would therefore have benefited if Global Best Practices regarding relationship between Central Bank net worth and balance sheet size had been brought into play in support of the debate with possible illustrations of how exactly this net worth comes handy.

Then again, while the author has well discussed how increased dependence on external finance and consequent relaxations in controls over capital inflows can go counter to financial stability, a discussion on why the regulator did not or could not take counter moves to relax controls in the outward direction would have improved understanding. A relatively simple counter

balancing could have been to allow resident Indians access to multi-currency banking facilities from their local banks within the existing LERMs (Liberalised Exchange Rate Management) entitlements. Such facilities are quite common in most parts of the globe.

Also, while it is entirely plausible that interest rate setting decisions can impact bank profitability, the dilemma of a fiscally strapped government relying on inward capital flows to balance budgets should have merited a somewhat more detailed discussion. Interest rate cuts do boost bank profits, but also reduce India's attractiveness (by way of reduced earnings) to a foreign investor thereby impacting inward flow volume. On the other hand, interest rate hikes though damaging bank balance sheets, ought theoretically to improve investor returns and thereby attracting higher capital flows. Readers would thus have benefitted if a more detailed discussion had been provided.

Having said this, there is no doubt that the book has brought some of the core issues involved in the relationship between the Central Bank and the government into sharp focus. While one may have a difference of opinion on some of the arguments relating to debt management or market regulation, etc. or on the completeness of the discussion, the book does represent a valuable addition to the extant literature. It is also extremely readable and is therefore, a must read for students of finance and banking, academics, market participants, policymakers and the informed citizen.

TCA Ranganathan, former CMD of Export Import Bank of India and former Non Executive Chairman of Indian Overseas Bank, is the co-author of *All the Wrong Turns: Perspectives on the Indian Economy* (Westland, 2019).

Book News Book News

Overdraft: Saving the Indian Saver by Urjit Patel, a former Governor of the Reserve Bank of India, explains how after centuries of ruinous experiences, some governments learnt, others haven't, to control themselves, create self-governing Central banks and let them manage money and regulate banks. The problem of unsustainable bad debts (non-performing assets or NPAs) in the Indian banking sector landed on the table of the author who, based on thirty years of macroeconomic experience, worked out the '9R' strategy which would save our savings, rescue our banks and protect them from unscrupulous racketeers.

Harper India, 2020, pp. 248, ₹599.00

Changing Profiles

Zinnia Ray Chaudhuri

FROM OBEROI TO OYO: BEHIND THE SCENES WITH THE MOVERS AND SHAKERS OF INDIA'S HOTEL INDUSTRY

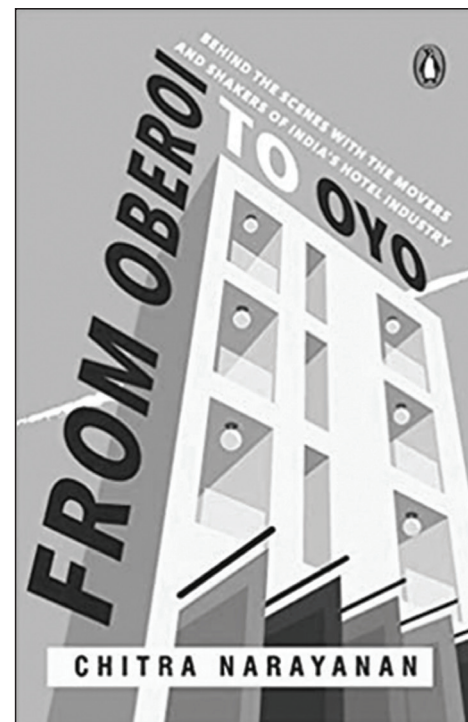
By Chitra Narayanan

Penguin Random House, India, 2020, pp. 319, ₹399.00

Most of us still peruse a list of hotels that pop up on various aggregators like we do a menu at an expensive restaurant—with one eye on the prices on the right. We are usually looking for a hotel or a homestay within our budget which will meet our basic requirements of, as Chitra Narayanan puts it, the four Bs—bed, bath, breakfast and broadband.

Narayanan, a Delhi-based journalist, has spent years observing the hotel industry. While the average traveller looks at a hotel through the twin lens of basic amenities and budget, Narayanan looks at the pricing methods, consumer behaviour, history of the brand and the innovations and technology being employed to attract customers. In her book, *From Oberoi to OYO: Behind the Scenes with the Movers and Shakers of India's Hotel Industry*, Narayanan not only charts the history of hospitality in India, but also its evolution, while making educated predictions about its future (which, unfortunately, Covid has now rendered precarious).

The story of hotels and hotel chains in India is not purely one of business; there is sentimentality involved. There is nostalgia for the colonial aesthetic and, more importantly, the service and treatment one got during the British Raj era—servers in crisp white and smart turbans ensuring that the tea is poured just so in a tea room where no entry is allowed to those who dare to show up in open-toed sandals. 'One often visits hotels just to recall the good old days and get charmed by the legends and stories, provided the hotels are smart enough to play them up,' writes Narayanan. She gives the example of hotels like The Imperial in Delhi, The Savoy in Mussoorie and the Great Eastern in Kolkata—each patronized by some of history's greatest political and cultural figures. The graceful Imperial is where Jawaharlal Nehru, Mahatma Gandhi, Muhammad Ali Jinnah and Lord Mountbatten met to discuss the Partition; The Great Eastern served as a muse to celebrated Bengali author Sankar for his book *Chowringhee*; and a mysterious, unsolved murder of an English woman at



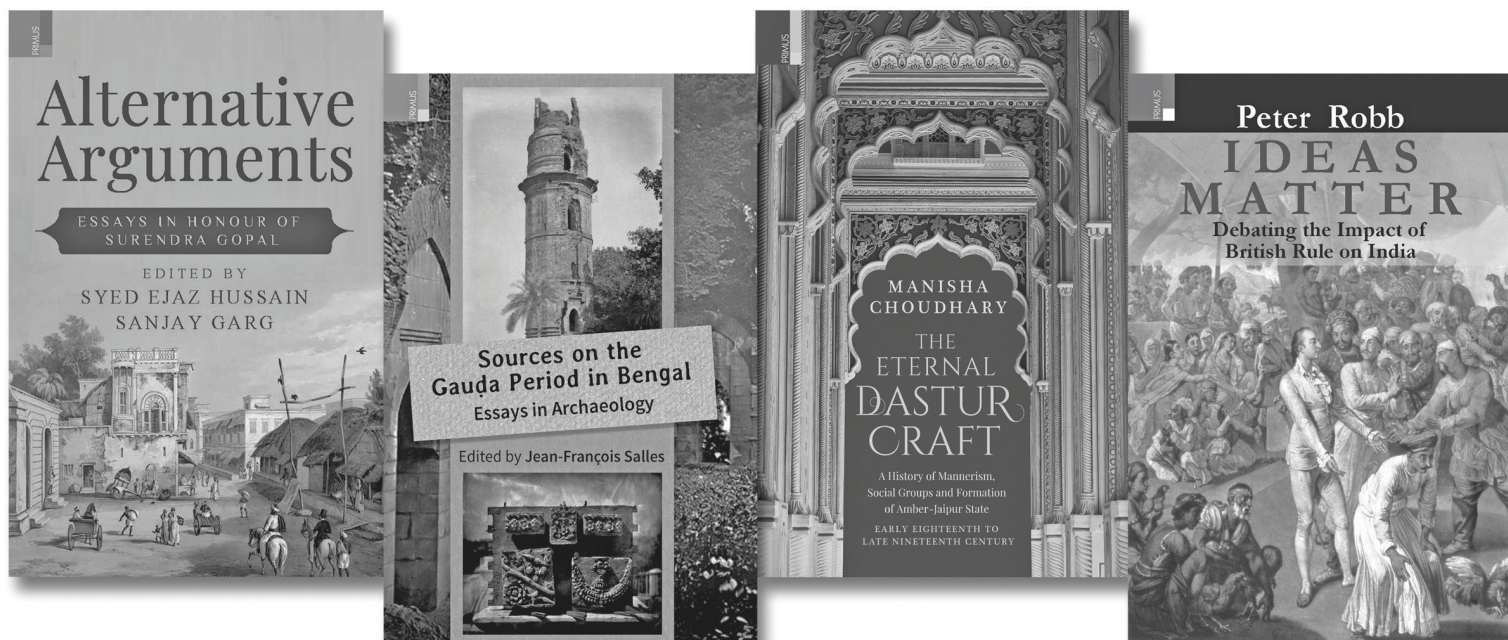
The Savoy in 1911 inspired Agatha Christie to write her very first novel—*The Mysterious Affair at Styles*.

Narayanan, though, after dedicating a detailed chapter to the industry's 'History and Evolution', moves on quickly to the late 90s and the noughties when the industry started seeing big changes. There is obviously much space given to the holy triumvirate of the Taj, the ITC and the Oberoi—the three players who for long dominated the hospitality scene and have maintained a strong presence despite the entry of numerous other names.

An especially significant chapter in Narayanan's insightful book focuses on hotel chains run by women. 'Just stay at two Indian chains that are owned by women, and you can immediately perceive how they stand out. More so, if you're a woman guest,' she writes. She is referring to The Lalit and The Park chains. Jyotsana Suri of Bharat Hotels which runs the Lalit, and Priya Paul of The Park are trendsetters and success stories within the industry. Between the two, they have demonstrated the myriad ways in which a hotel chain can be imbued with an inclusive and non-stuffy personality. Suri and Paul have also served as inspiration to many women to enter the business in leadership roles.

The book meanders through the various trends the industry has witnessed—the entry of foreign players (which has not been without its own set of dramas); the introduction of heritage hotels for a touch of royal treatment; the creation of the mid-market hotel targeted at the middle class, who would otherwise prefer to stay at a relative's home in a different city rather than spend a week's salary on a room at the Taj;

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