MONETARY POLICY CORRUPTION AND OTHER PARAMETERS SPECIFIC TO INDIA

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Abstract: *The objectives of Monetary Policy in India have been growth, social justice and equity and price stability. Of late, objectives of the Policy have been restricted to growth and price stability. In a recent working paper of IMF, India's monetary policies have been analysed from a historical perspective. Different economic tools ranging from rationing of credit; exchange control, monetary targeting and interest rate and banking ratios have been used by the Reserve Bank of India at different stages of development policies of government. Since late nineties, the main instrument of the Policy has been interest rate variations. The above study observes that aggregate demand reacts to interest rate changes with a lag of at least three quarters, with inflation taking seven quarters to respond. Inflation is inertial and persistent when it sets in, irrespective of the source. Mujumdar (1989) had observed that Monetary Policy in India does not take into account economic phenomena specific to the Indian scenario and thus the policy prescriptions remained academic. Mujumdar, while describing the specifics, omitted to include corruption in his list of specifics. The effect of corruption has been over riding on the monetary policies and fiscal policies as studied by Ourania Dimabun (2008). The level of corruption in India is enormous and quantum is indeterminate. Econometricians have not developed a satisfactory model which would capture specific and hitherto unquantified parameters in the formulation and analysis of monetary policies and hence there is gap between the stated and achieved objectives. Further composition of Board of Governors of RBI is heavily biased in favour of Industry sector. The structure of the Board be either more representative or be only of core professionals who take on board views of different competing sectors through consultations without including any dominant sector in the final decision-making.*

N.A. Mujumdar (1989),[1] has quoted C. Rangarajan, to state the objectives of monetary policy as growth, equity and social justice, and price stability. In his address at the 93rd Annual Conference of the Indian Economic Association, 27–29 December 2010 at Chandigarh, Rangarajan stated that the broad objectives of monetary policy in India have been: *(1)* to maintain reasonable degree of price stability and *(2)* to help accelerate the rate of economic growth. The objective of equity and social justice was omitted from his address at Chandigarh. However, in the Indian polity, as it is constituted, the objective of growth with equity and social justice would remain implicit.

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1 Economic and Political Weekly, p. 1959–62,

Michael Debabrata Patra and Muneesh Kapur[2] have analysed India's monetary policy from a historical perspective. The paper divides India's monetary policy framework in three phases. Phase 1 was upto 1970s, when Keynesian thoughts ruled. In this phase RBI was into credit rationing and exchange controls. Monetary policy was subordinate to fiscal policy—monetary policy did not matter. The pursuit of low unemployment (read as faster growth) allowed inflation to drift upwards until it became unconscionable.

In phase 2 beginning in mid-1980s, monetary targeting with feedback became the *raison d'etre* of the conduct of monetary policy in India. In the 3rd phase beginning in 1990s, radical changes occurred in the institutional setting for monetary policy. Notable among them were the phased emergence out of fiscal dominance, a market based exchange rate regime, the progressive roll back of exchange control, and financial sector reforms resulting in the deregulation of interest rates and the activation of various segments of the financial market continuum. In the late 1990s, the interest rates progressively became the main instrument of monetary policy, supported by indirect instruments such as open market operations and reserve requirements. The centrepiece in the operating framework of monetary policy became the Liquidity Adjustment Facility (LAF). Repo and Reverse repo rates essentially began to provide a corridor for market interest rates to evolve.

Patra and Kapur observed that aggregate demand reacts to interest rate changes with a lag of at least three quarters, with inflation taking seven quarters to respond. Inflation is inertial and persistent when it sets in, irrespective of the source. Exchange rate pas through to domestic inflation is low. Inflation turns out to be the dominant focus of monetary policy, accompanied by a strong commitment to stabilization of output. Recent policy actions have raised the effective policy rates, but the estimated neutral policy rate suggests some further lightening to normalize the policy stance.

The above observations reflect that institutional mechanisms to give effect to the desired directions are beset with delays and price stability therefore is a casualty and the growth rates remain threatened. This means that the objectives of monetary policy remain unfulfilled.

[2] Patra, Michael Debabrata and Muneesh Kapur (2010), "A Monetary Policy Model without Money for India," IMF Working Paper, WP/10/183, August.

N.A. Mujumdar (1989), has laid stress on understanding the Indian milieu for monetary analysis and policy and integrating the prevalent phenomenon into monetary models designed to prescribe an appropriate monetary policy suiting the unique Indian milieu. He goes on to observe that unless the institutional framework and the behavioural characteristics of the specific phenomenon which characterize the Indian monetary scenario are built into monetary models, the models would remain largely academic.

Mujumdar identified a number of significant phenomena which would impact money supply flow and consequences thereof remain excluded while devising monetary policies resulting in non fulfillment of the objectives of the policy. For the sake of continuity, it would be in order if the phenomena referred to above are recalled, in brief. These are: *(1)* one should not be content with only the data relating to the quantity of money supply expansion: it is essential to take into account the quality of money supply expansion. This is because different sources of money supply expansion exert varying degrees of pressure on aggregate demand; *(2)* Public Sector Procurement and distribution of food grains and scale thereof result into a crucial variable in the determination of currency expansion in a given year. Import of sizeable proportion of food items, fertilizers and fuel have also large impact on currency expansion. Such impacts are not built into standard models; *(3)* Flow of cash takes place constantly between the formal and informal sectors. This results in dishoarding and hoarding of currency and have impact on monetary phenomenon. The impact is not taken into account in policy formulation exercise; *(4)* The impact of increase in credit would be sector dependant in which the increase is channelized. A disaggregated credit target would add to precision in the monetary policy.

The above phenomena are not easily subject to econometric discipline and do not get integrated into the models relating to monetary policies with resultant divergences of targets of the policy. Mujumdar omitted to include in the canvas of Indian milieu around the monetary analysis, the prevalence of widespread corruption. Dynamic interaction between fiscal and monetary policies under different levels of bureaucratic corruption has been studied by Ourania Dimabun (2008), School of Economics, Mathematics and Statistics, Biskbeck College, University of London. According to this study, all policy outcomes depend on the size of corruption the economy is faced with. The purpose of delegation of monetary policy to an independent Central Bank, like the Reserve Bank of India, would truly be served if there is no bureaucratic corruption. Because of bureaucratic corruption, the tax revenue would fall short of the true potential, and the government would be incentivised to increase debt forcing the Central Bank to pursue expansionary monetary policy, despite independence of RBI. The forced increase in the size of debt would be dependent on the spread and intensity of corruption and would proportionately pose difficulties on the achievement of both price stability and a balanced debt process.

Apart from bureaucratic corruption of the nature included in the above study, there are other types of corruption both within the government and outside. Large scale prevalence of which would result in siphoning off currency to an indeterminate level and would be released in the market at the convenience of the hoarder and thus there would be distortions in management of supply and demand hurting the objective of monetary policy.

Claire Benlinski (2009) in his paper titled "The Dark Figure of Corruption" terms corruption as—encompassing such practices on bribery, fraud, embezzlement, kickbacks, cronyism, and extortions. Like all crimes, the phenomenon of corruption in all its manifestations is difficult to study and quantify as those who indulge in such activities are not motivated to subject themselves to the study. The data gets buried and those who go out to dig data, they themselves get buried. Benlinski avers that if the objective of monetary and fiscal policies is towards the welfare of the people, the enunciation and impact of these polices would remain an academic exercise when the problem of corruption remains unaddressed and unresolved. Borrowing a phrase from the works of Belgium mathematician and sociologist Adolph Quetlet, he terms the extent of prevailing corruption in quantitative term as the dark figure of corruption. The exact measure of this figure would be hard to arrive at as corruption is indulged into and encouraged by governments that are charged with the maintaining the figures. No solution has so far been worked out towards quantifying corruption. Unless a model is worked out to bridge this gap in studies, the efforts to assess the reasons for the collapsing and non performing economies will be incomplete and conclusions drawn would remain defective.

Corruption has always remained an issue in India through all its phases and has obviously been affecting and undermining policies including the monetary policies. This scenario of corruption would also get added to the matrix of specific issues governing the economic interactions in India as enunciated by Mujumdar and pose further challenges to the academics who would engage themselves in developing an appropriate model for a meaningful monetary policy.

Monetary Policy, with imperfection in the model adopted, is administered by an autonomous institution like RBI which is administered by a 20-member Board of Governors. About 1/3rd of the members are industry representatives and there is hardly a representative from Agni Rural Sector and Social Sector. All sectors of economy are touched by monetary policies devised by RBI. Representation on the Board should be truly representative of all major sectors. If RBI is to maintain its professionalism and independence, it should be a compact body of sector neutral persons. Concern of the individual sectors can be addressed through the mechanism of wider consultations of all sector representatives rather than placing a particular sector at an advantageous position by making it part of the final decision-making.