Y V Reddy: Autonomy of the central bank - changing contours in India

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The references for the speech can be found on the Reserve Bank of India's website.

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Dear Dr. Saxena, distinguished faculty, respected visitors, and young friends,

I am grateful to the organisers for giving me this opportunity to be here with you today to deliver the Second Foundation Day Lecture. The IIM, Indore has acquired a great standing and high stature within a short span of four years and the entire credit should go to the support rendered by all, and in particular, the devotion and dedication displayed by the faculty and students to academic excellence.

It is not easy to select a topic for today's lecture; a topic that would interest the best and brightest of young persons, that would be of contemporary relevance and one on which something forward looking can be explored. After some deliberation, the subject "*Autonomy of the Central Bank: Changing Contours in India"* has been chosen.

During the ten years of economic reform, Reserve Bank of India (RBI) has emerged as a respected and significant institution in public policy and its changing role as a central bank deserves to be appreciated. In fact, a historic agreement in 1997 between Government of India and the RBI on the termination of the system of automatic monetisation and introduction of a system of Ways and Means Advances constitutes a watershed in public policy governing their mutual relationship. Amendments to the legislation relating to the RBI and banking announced by Finance Minister in the budget speech for 2000-2001 and subsequent submission of draft legislations by the RBI are indicative of the evolving institutional changes. The issues of transparency and accountability governing their operations with each other have been addressed by Advisory Groups on *Transparency in Monetary and Financial Policies* headed by the former RBI Governor, Mr. M. Narasimham (September 2000) and on *Fiscal Transparency* by former Finance Secretary, Mr. M.S. Ahluwalia (June 2001). There have also been some deliberations on the issue of appropriate provisions relating to the RBI, in the context of ongoing review of Constitution of India by the Commission appointed for the purpose a year ago. Hence, there is merit in taking a view on the broader issue of independence of the central bank in India, so that the process of change is negotiated smoothly and in a consistent form, thus avoiding the danger of what may be termed as "disjointed incrementalism" in reform through ill-defined goals.

The lecture will be in three parts. The first one defines central banking, and its independence, while providing theoretical and empirical evidence for and against independence or autonomy (both words are used interchangeably in this lecture though autonomy and independence could have slightly different connotations) and explaining difficulties in its measurement. The second part reviews the Indian experience through recourse to periodisation and makes an assessment of the current situation. The third section focusses on the emerging issues in India and concludes with some random thoughts on the autonomy of central banks.

What is central banking?

The central banking functions typically include not only creation of money or more broadly monetary management, but, also often, management of public debt of Government, regulation and supervision of banking entities, financing of developmental activities and other associated functions.

While discussing the issue of autonomy, it is necessary to recognise that the function of debt management is essentially performed by a central bank as an agent of Government and the issue of autonomy does not arise. In fact, this function could be in conflict with autonomy in the conduct of monetary policy.

As regards the function of regulation and supervision, the argument for involvement of a central bank emerges from the role of lender of last resort and the obligation to smoothly operate the payments system. In this regard, the autonomy that the central bank exercises is no different from autonomy of any regulator in the financial system.

As far as the developmental role is concerned, close coordination with Government necessarily arises, which in some ways impinges on autonomy as it is in a way linked to money creation.

What is uniquely relevant for a central bank's independence is its exercise of the power to modulate the creation of money and the price of money, which impacts on the value of money, both domestic and external. In this context, the critical issue relates to the degrees of freedom the central bank has in deciding whether or not to fund the Government's expenditure out of created money.

The view that central banks should be largely independent of political power and that the central bank credit to government should be formally limited is generally believed to have emerged only in 20^{th} century. It would, however, be inappropriate to conclude that the importance of central bank's independence was recognised only as recently as 20^{th} century since Napoleon Bonaparte is reported to have commented in 1806, on Bank of France; "I want the bank to be in the hands of the Government, but not too much".

As a result of monetary consequences of deficit financing that had afflicted many countries during the First World War, the international financial community, in a series of Conferences organised by League of Nations recognised such independence as contributing to price stability. The recent revival of interest in the subject is attributable to several factors viz. the reforms in centrally planned economies, the establishment of new European Central Banking arrangements and importance of price stability in a world characterised by large cross border financial flows.

What is central bank independence?

Central bank independence generally relates to three areas viz. personnel matters; financial aspects; and conduct of policy. Personnel independence refers to the extent to which the Government distances itself from appointment, term of office and dismissal procedures of top central bank officials and the governing board. It also includes the extent and nature of representation of the Government in the governing body of 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 would naturally imply that monetary policy is subordinated to fiscal policy. Finally, policy independence is related to the flexibility given to the central bank in the formulation and execution of monetary policy.

Recent literature has stressed the difference between *goal* independence and *instrument* independence. Goal independence refers to a situation where the central bank itself can choose the policy priorities of stabilising output or prices at any given point of time, thus setting the goal of monetary policy. Instrument independence implies that the central bank is only free to choose the means to achieve the objective set by the Government. In a recent survey (Fry. M, *et al* 1999) of central banks, 40 of the total 56 central banks across a broad range of economies defined independence predominantly in terms of instrument independence. Of the remaining 16 responses, many highlighted factors that had implications for the relationship between the Government and the central bank.

Pros and cons in theory

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.

First, the most prominent argument for central bank independence is based on the time inconsistency problem. 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. Expansionary monetary policy may produce higher growth and employment in the short run, and, therefore, policymakers may be tempted to pursue this policy, even in the short run although there is no guarantee that there would be a favourable output impact. In the long run, however, such an expansionary monetary policy will necessarily lead to higher inflation with deleterious consequences for the economy. In order to solve the time inconsistency problem, two distinct approaches have been advanced. The 'conservative central banker approach' postulates the appointment of a conservative central banker whose aversion to inflation is well known which would result in low inflation because of the economic agents' belief in the reputation of the central banker. The 'optimal contract approach' postulates the existence of an optimal contract between the central banker and the Government. The central banker's tenure in office is conditional upon his performance of achieving low inflation, failure of which would lead to the repudiation of the contract of tenure. Historically, there are successful examples of both types of models of central bank independence – while US is often seen as an example of conservative Central Bank, New Zealand is characterised as a follower of optimal contract approach.

Second, the political business cycle theory studies the interaction between economic policy decisions and political considerations. The best known prediction of the theory is that the business cycle mirrors the timetable of the election cycle. Incumbent governments, in general, will use restrictive policies early in their elected tenure raising unemployment to reduce inflation, as the election approaches. The theory highlights the tendencies of incumbent governments to generate pre-election booms through expansionary fiscal policies. Once the incumbents get re-elected, the policy priorities could change towards inflation control rather than employment generation. In this respect, the theory in a way highlights the time inconsistency behaviour of governments. As monetary policy affects the economy with long and variable lags, 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.

Finally, the fusion of politics and economics over the last thirty years has resulted in the theory of public choice, establishing itself as an important proponent of central bank independence. 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. Nevertheless, in recent years, as a secondary solution to the deficit problem, some public choice theorists put forward the case of an independent central bank. The basic contentions of these economists are: unless there are constitutional or institutional constraints to the contrary, a democracy contains a bias towards deficit finance; thus they operate within the premise that politicians do not necessarily pursue public interest but are more concerned with their personal or political agenda. In this context, some economists explicitly talk about central bank independence by providing a solution which will ensure not only low inflation but also act as an effective institutional constraint.

While the above arguments build up a strong case for central bank independence, the issue has not been decisively settled and there are powerful forces aligned against according such independence to central banks.

First, detractors of autonomy argue that an independent central bank lacks democratic legitimacy. Curiously, such detractors derive strength from Milton Friedman’s statement that money is too important an issue to be left to the whims of central bankers.

Secondly, independence may lead to frictions between the fiscal and the monetary authorities and the resulting costs of these frictions between monetary and fiscal policy may be somewhat costly for society, thus inhibiting the development process.

Thirdly, there may be significant divergence in the preference pattern of independent central banks and the society at large. A strong central bank may impose its outlook on society resulting in a sub-optimal state in terms of economic welfare. Adequate sources of accountability can, however, counteract and circumvent these problems. In fact, the opinions in this context differ widely on the relative importance between growth *vis-à-vis* inflation as objectives of monetary policy.

At a pragmatic level, the basic issue is one of reconciling adequate independence with appropriate accountability to ensure that central banks are responsive to societal concerns.

Measures of central bank independence

It is difficult to measure the degree of independence of various central banks. It has pointed out that actual, as opposed to formal independence, hinges not only on legislation but also on several factors such as informal arrangements with governments, the quality of the personnel in the bank as well as Government and the personal characteristics of key individuals. Obviously, some other factors are virtually impossible to quantify. Existing research has, therefore, generally focused primarily on legal independence, mostly in the industrialised countries. Legal independence measures may be a better proxy for actual independence in some countries where informal relations are not dominant. Thus, various proxies may be useful to get a complete picture, since they capture different aspects of independence.

In quantifying the degree of independence, economists typically assign scorecards on different aspects of central banking. The final degree of independence is measured as the weighted sum of 'marks' obtained under different heads such as indices of political and economic independence; index aggregated from a number of basic legal characteristics of central bank charters; index based on issues relating to composition of board members, frequency of transfers of central bank governors, etc. Recent attempts made to construct measures of central bank independence using different criteria and examine correlations among them reveal that the factors that affect central bank independence are highly diverse and the importance of each of these factors may have weights that vary markedly across countries, time and circumstances.

The existing indices of central bank independence are clearly incomplete and at best noisy indicators of actual independence, though this does not mean that they are uninformative. In brief, it is possible to differentiate between legal independence, informal independence and contextual independence of central banks.

Central bank independence and economic performance

An inverse relationship between central bank independence and the level of inflation is supported by most empirical studies during the post Bretton-Woods period. The proponents for central bank independence generally cite empirical evidences of negative cross-country correlation between average inflation and the degree of central bank independence. It is, however, possible to question the veracity of this relationship. As already mentioned, there are significant measurement problems relating to central bank independence. Furthermore, researchers argue that the causal relationship observed between central bank independence and low and stable inflation might be influenced by some other common factors such as the extent of inflation averseness and the credibility that the central bank enjoys. While many Latin American countries changed the legal and operational framework, the change was prompted by people's aversion to high and chronic inflation. The causality between the rate of inflation and the degree of independence of the central bank may be viewed as bi-directional, since it would be argued that persistent high inflation led to changes in the operational framework in many countries.

It needs to be emphasised that central bank, independence by itself cannot ensure monetary policy credibility, which, to an extent, depends on the overall credibility of Government policy as a whole. Central bank independence is a means, the end being an appropriate division of responsibility between the monetary and the fiscal authority and policy coordination. There is a need to articulate the division of responsibility and policy priorities to the economic agents. Such articulation reduces uncertainties often inherent in economic decisions. If an institutional structure is not in place, there is a chance that policy coordination would depend entirely upon the personal equations among policymakers and the risk of it breaking down subsequently with changes in the persons at top can not be ruled out.

Indian situation: a review

The evolving relationship between the Government and the RBI can be broadly divided into four distinct phases.

The legislation to set up the RBI was first introduced in January 1927. The enactment, however, was made after seven years in March 1934. The RBI was set up as a privately owned and managed entity. The preamble of the Act focused on monetary stability and operations on currency and credit system in India. During this phase, which may be called infancy and uncertainty, the RBI was virtually subservient to the dictates of the Government and measures were taken to curb its capacity for independent actions. In fact, threats were issued to supersede the Bank's Board should it recommend monetary and exchange rate policies incompatible with the Government's scheme of actions. No doubt, the outbreak of war also added to the uncertainties.

Shortly after India's independence in 1947, the RBI was nationalised in 1948. The early years were characterised by a good degree of fiscal rectitude and harmony in monetary and fiscal policy with areas of potential conflict being minimal. The fact that the rate of inflation was modest compared to other developing countries during this period is indicative of the success of macro-policy management and facilitated the task of the RBI in pursuing other developmental activities. During this period, the

RBI was vigorously involved in promoting the institutionalisation of credit to agriculture and industry in pursuant to the overall objectives of the respective Five-Year Plans. Apart from helping to channelise credit to agriculture and industry, an important objective of the RBI was the promotion and mobilisation of savings by reinforcing the foundations of the banking system. This, however, does not mean that differences between the RBI and the Government over economic policies were totally absent. For example, the RBI did not approve of the substitution of financial planning by a kind of ‘physical planning’. Once it awoke to the consequences of physical targeting during the course of the Second Plan, the RBI strove to trim the size of the subsequent Plans to match visible resources. Another illustration of differences between the Government and RBI culminating in the resignation of Governor Rama Rau in 1957 is well documented (Balachandran G, 1998).

Another major area of discord between the RBI and the Government in the late 1950s related to the financing of the cooperatives and the pattern of organisation of the lending agencies. Interestingly, during the early 1960s, Governor Iengar identified four areas of potential conflict between the Bank and the central government. These were interest rate policy, deficit financing, cooperative credit policies and management of sub-standard banks. It may be of interest to note that currently, in the year 2001, these four areas are still on the top of RBI’s concerns.

This phase, from nationalisation of the RBI in 1948 till nationalisation of major commercial banks in 1969, may be considered as maturing of the RBI into a full-fledged professionally managed central bank, perhaps one of the foremost in developing countries. The mid-fifties, however, did see the beginnings of serious erosion of autonomy in the monetary policy function due to the emergence of the system of *ad hoc* Treasury Bills and automatic monetisation. It was agreed that RBI would replenish Government’s cash balances by creation of *ad hoc* Treasury Bills in favour of the RBI. The *ad hoc* Treasury Bills, which were meant to be temporary, gained a permanent as well as a cumulative character. Indeed, it became an attractive source of financing Government expenditures since it was available at an interest rate pegged at 4.6 percent per annum since 1974, i.e., actually at a negative real interest rate.

The third phase that changed the contour of this relationship started with the nationalisation of major banks in 1969. While the problems experienced earlier by the RBI persisted to some extent, the change brought about a curious situation where the Government became owner of a number of banks, but the supervision of these banks was, in turn, conducted by the RBI which was also owned by the Government. The situation, however, was not unique to India and was somewhat similar to that of France. The fundamental factor affecting the relationship was the combined effect of Government’s ownership of major commercial banks and the persistence of high fiscal deficits, which posed serious problems for prudent monetary management. For easy access of market borrowing, the interest rates were administered and the Statutory Liquidity Ratio (SLR) requirements of the banking sector were periodically hiked. In this regard, the nationalisation of banks and transfer of ownership to Government provided a captive market for the government. Simultaneously, recourse to the RBI credit was also high, leading to high levels of monetisation. To neutralise the effect of monetisation on the price level, the RBI, in turn, had to intermittently increase the Cash Reserve Ratio (CRR) requirements of the banking sector. This phase was charaterised by several features to indicate considerable influence or dominance of Government over the RBI.

On the basis of one of the criteria (Cukierman, 1992) to measure the degree of independence of various central banks during the ‘eighties, the RBI was ranked marginally below the median level of a list of about seventy countries (including twenty-one industrialised countries). This represented a limited degree of statutory autonomy because in general, central banks in developing countries enjoyed little independence from the Government at this time. As such, the measurements seem to reflect the intent of the 1948 nationalisation of the RBI, which was to ensure a greater coordination of monetary, economic and financial policies.

The fourth phase or the reforming phase in the changing contour of this relationship approximately starts from 1990-91. Major changes in the monetary policy framework took place in many countries around this time. While people in many developed countries were tired of persistent and high inflation during the earlier years, the journey of the centrally planned economies towards a market determined system also began around this time. As a result, the relationship between the central bank and the government took a new turn in many countries, resulting in the genesis of inflation targeting framework in a number of economies.

While radical changes were taking place worldwide, the Indian economy during 1990-91 experienced a severe balance of payments crisis. The crisis was clearly a fallout of the fiscal profligacy during the

Eighties. During the post-reform period, the relationship between the central bank and the Government took a new turn through a welcome development in the supplemental agreement between the Government and the RBI in September 1994 on the abolition of the *ad hoc* treasury bills to be made effective from April 1997. The measure eliminated the automatic monetisation of Government deficits and resulted in considerable moderation of the monetised deficit in the latter half of the Nineties. At the same time, with gradual opening up of the economy and development of domestic financial markets, the operational framework of the RBI also changed considerably with clearer articulation of policy goals and more and more public dissemination of vast amount of data relating to its operations.

Partly as a result of such institutional changes in recent years, inflation in India has been moderate relative to other developing countries despite high fiscal deficit, and most inflationary episodes have been caused by exogenous supply-side factors. As far as public finances are concerned, the Government generally relied on domestic sources to finance the deficit. 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 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.

Current status

In terms of redefining the functions of the RBI, enabling a movement towards meaningful autonomy, Governor Jalan’s statement on Monetary and Credit Policy on April 19, 2001 is a landmark event. First, it was decided to divest RBI of all the ownership functions in commercial banking, development finance and securities trading entities. Secondly, a beginning was made in recommending divestiture of RBI’s supervisory functions in regard to cooperative banks, which would presumably be extended to non-banking financial companies and later to all commercial banks. Thirdly, the RBI signalled initiation of steps for separation of Government debt management function from monetary policy. These measures would enable the RBI to primarily focus on its role as monetary authority and enhance the possibility of a move towards greater autonomy.

Three other developments in recent years are expected to have far reaching ramifications in the operational framework of monetary policy in India. The first was the tabling of the Fiscal Responsibility and Budget Management Legislation, which aims at the medium-term management of the fiscal deficit. The objective of the legislation is to impose fiscal discipline on Government spending and ensure a transparent and accountable fiscal system.

The second development was the coordinated endeavour of the Government of India and the RBI to consider the implementation of International Financial Standards and Codes. Among the ten Advisory Groups constituted for this purpose, the Advisory Group on Fiscal Transparency (Chairman : Mr. M.S. Ahluwalia) and the Advisory Group on Transparency in Monetary and Financial Policies (Chairman : Shri M. Narasimham) have suggested some important changes in the operational conduct of monetary and fiscal policies and highlighted the need for better coordination between them.

The third relates to the budget speech in February 2000, wherein the Finance Minister had noted that in the fast changing world of modern finance, it has become necessary to accord greater operational flexibility to the RBI for the conduct of monetary policy and regulation of the financial system and that accordingly, he intends to bring to Parliament proposals for amending the relevant legislation.

In this regard, the RBI constituted an Internal Committee to review the existing legal provisions in both the Reserve Bank of India Act and the Banking Regulation Act so as to bring about suitable amendments in them to provide sufficient operational flexibility to the RBI for conducting monetary policy, guiding the development of the financial sector and securing the stability of the financial system as a whole. The Committee made a host of recommendations that include providing the RBI the flexibility in respect of monetary policy instruments, supervisory effectiveness, prudential deregulation and governance of financial markets. It has also recommended further strengthening of institutions in the light of structural changes due to ongoing reforms and encourage transparency and integrity of operations. Furthermore, in a liberalised environment, maintaining financial stability is an important additional objective of policy and the RBI should have the operational maneuverability to manage and limit the damage on account of volatility/contagion transmitted *via* the international economy.

Emerging issues

The emerging issues relating to autonomy of RBI can be addressed at several levels.

First, at the level of the Constitution, the RBI finds a place in Entry 38 of List 1 of Schedule VII of the Constitution of India “subjecting the Bank’s policies to the wisdom of the executive and legislative wings of the Union” (Prasad. R, 2001). There are only a few instances of references to autonomy of central bank in the Constitution and obviously such a reference is neither a necessary nor a sufficient condition for ensuring appropriate level of autonomy. Yet there is an influential view such as that expressed by Dr. N.L. Mitra, formerly Director, National Institute of Law in favour of an appropriate provision in the Indian Constitution.

Second, at the level of legislative framework, several suggestions have been made to ensure appropriate autonomy and many of them are under consideration. In particular, proposed Fiscal Responsibility and Budget Management Bill and other amendments to Reserve Bank of India Act would cover significant ground. Several other suggestions relating to legal framework, particularly those relating to defining the objectives of and imparting transparency in monetary policy as recommended by the Advisory Groups are yet to be taken up.

Third, at the policy level, there are three important constraints on the operational autonomy even within the existing legal framework. One, the continued fiscal dominance, including large temporary mismatches between receipts and expenditures of Government warranting large involuntary financing of credit needs of Government by the RBI. Two, the predominance of publicly owned financial intermediaries and non-financial public enterprises, which has created a blurring of the demarcation between funding of and by Government vis-à-vis public sector as a whole. Three, the relatively underdeveloped state of financial markets partly due to legal and institutional constraints, which blunts the effectiveness of instruments of monetary policy. These issues need to be resolved to enhance genuine autonomy.

Fourth, at the operational and procedural level, there is a problem of “old habits die hard”. In a deregulated environment, there is considerable scope to reduce micro-management issues in the relations between the Government and the RBI.

Fifth, at the level of degree of transparency, there is a temptation to continue, what has been termed as the “joint-family approach”. The approach ignores basic tenets of accounting principles in regard to transactions between RBI and Government. It gives satisfaction to all participants that all of them are working together for growth and stability. In the process, however, the integrity of the respective balance sheets of Government and RBI gets eroded making both autonomy and accountability difficult to assess.

Random thoughts

In the light of theory, practice and the Indian experience I would like to share with you some of my thoughts on the subject. These are structured around emerging new realities, issues of coordination, transparency, accountability and credibility.

Generally, independence of central bank is discussed in terms of independence, or in a broader sense, from political, executive and legislative power. With emergence of powerful economic interests in the form of multinationals or dominant domestic corporates and their large stakes in capital markets, in the larger context of powerful influences outside of the executive wing of Government, it may be necessary to also ensure independence of central bank operations.

While price stability and availability of credit to meet the needs of the growing economy continue to be the twin objectives on a year to year basis, as a longer term and primary responsibility, the RBI concerns itself with price stability. There is, however, need to recognise the criticality of financial sector stability, especially of financial markets for which the RBI is assuming increasing responsibility and should exercise its independence from governmental priorities in that direction, whenever warranted. In other words, while the issue of the central bank’s independence and accountability were debated in the past in the context of price stability and money creation, the emerging issues warrant a broader view of exercise of independence from several sources to meet emerging challenges like financial sector and markets stability while enlarging the concept of accountability through greater recourse to transparency.

With the possible emergence of digital money, significant questions would arise in regard to the power that central banks would continue to exercise in future and hence the whole issue of its role in creation of money and consequently its independence may need to be revisited.

In view of the trends towards globalisation of capital flows and consequent emphasis on internal financial stability, standards, codes, etc., the central banks may gain independence from their respective governments but in practice may tend to be circumscribed by the compulsions of international financial community.

The traditional argument, at a philosophical level, in favour of an independent central bank is that the power to spend money should be separated from the power to create money. Given the complexities in separating the two too rigidly and given the advantages of co-ordination, a minimum requirement should be that their relationships and transactions be reported as transparently as possible, and the integrity of the two separate balance sheets be maintained.

At an operational level, it is possible to ensure co-ordination between fiscal and monetary policies while maintaining operational autonomy if interaction and consultation is ensured in three important areas namely (i) evolving macro-economic objectives; (ii) likely consequences of various options available for fiscal and monetary actions to realise the evolving objectives; and (iii) sharing and use of the respective forecasts of the likely state of the economy in the absence of policy interventions under consideration. Indeed, this interaction calls for a reasonable degree of intellectual integrity, professional competence and mutual respect in both the central bank and the Government.

Accountability can be narrowly defined or approached in a broader as well as longer term perspective. In a narrow sense, it can be argued that a central bank is accountable to the Ministry or to the Parliament through the Ministry. In a broader sense, it can be argued that central bank, as a significant public institution should be accountable to the public at large, unless there is a constitutional or legal hurdle. In this sense of broader accountability, in a way transcending political cycles, a central bank has to be not only transparent but should also effectively articulate its policy. It must be recognised that such a broader approach to accountability will depend on the public awareness of economic issues and the priority that political leadership accords to public articulation of issues as compared to closed door consideration of such issues.

Liberalised and developed financial markets, certainly, contribute to greater public-awareness and in this regard efforts to promote financial markets also contribute to greater accountability. In the final analysis, accountability is a basic principle of democracy.

At a pragmatic level there are two important arguments in favour of autonomy in addition to transparency. First, if superior technical competence is demonstrable, there is merit in according operational autonomy to the central bank. Furthermore, to the extent a central bank is likely to carry greater credibility with the public opinion when it makes a commitment, there is merit in entrusting it with autonomy. In the years to come, the sheer need to improve the efficiency of operations will thrust upon the RBI a greater degree of autonomy and, therefore, a greater degree of accountability. In such a milieu it is essential that the setting of goals and the policy processes will need to evolve in a transparent manner. For the central bank, these will be difficult times but also exhilarating times.

Thank you!