Monetary apartheid

Why in news?

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RBI Governor Urjit Patel has highlighted that the system of currency swaps was unfavourable for the emerging economies.

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What is the currency swap system for?

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- The currency swap lines have emerged since the global financial crisis.
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- This is an important tool in stabilizing the financial system of a country in times of funding squeeze.
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- The swap lines allow the central bank to funnel foreign currencies to banks in the home country.
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- Access to dollars is crucial to this global network, and emerging markets have largely been excluded from this global network.
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What are the concerns?

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- Speaking at a seminar organised by the G-30, Patel has described the situation led by currency swaps as a virtual apartheid (discrimination on certain unfair grounds).
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- This is in line with how the central banks of developed-countries are self-interested and protecting themselves.
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- Differences exist in access to dollars between the central banks in developed and developing economies.

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- Many swap lines exist between the US Federal Reserve (responsible for the supply of dollars) and its counterparts in the developed-world.
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- However, swap lines are relatively less accessible to the emerging economies.
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What does it imply?

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- **Reserves** - The difference simply means that developed countries would rarely have to worry about the stock of dollars in their reserves.
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- On the other hand, emerging markets such as India constantly have to keep a check on their dollar reserve status.
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- This is especially crucial at times, like that in 2013, when the current account deficit had turned adverse in India.
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- Under such circumstances, only a large stock of dollars saved before can provide security to the economy and prevent a crisis.
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- **Monetary Policy** - This type of "virtual apartheid" in the provision of foreign currencies hampers efforts to fight financial instability.
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- As, preserving the stock of dollars complicates the monetary policy decisions and also has a real economic cost.
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- Preceding Governor Raghuram Rajan had earlier warned of indifference of the developed-world central banks towards the spillover effects of their monetary policy on smaller economies.
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- Patel has now pointed out that these effects are magnified by the failure to make swap lines accessible to emerging-markets.
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- **Current trend** - Central-banks in many advanced economies have begun taking steps to withdraw some of the monetary stimulus provided after the 2009 recession.
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- Consequently, the rising interest rates in advanced economies can pull capital out of the emerging markets.

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- The remarks thus gains significance at a time when emerging markets are trying to cope with the changing central-bank policy in developed economies.
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What is to be done?

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- Major central banks have to extend their network of currency swap lines deep into the emerging markets.
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- It is essential that the executive leadership responsible for India's economic diplomacy pay heeds to these concerns.
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- They must take steps to raise the issue with their counterparts in the developed world.
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- Access to swap lines would demonstrate the maturity of Indian institutions.
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- This would also allow the Reserve Bank of India to free up some of its reserves to more productive activity in the economy.
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Quick fact

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G-30

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- The Group of 30 or G-30 is a private group of prominent central bankers, financiers, regulators and academics.
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- It was founded in 1978, to examine issues in relation with foreign exchange, capital markets, central banks and macroeconomic issues.
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- It aims to deepen the understanding of and explore the repercussions of international economic and financial decisions.
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Source: Business Standard

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