RBI-Government Tussle

Recently, deputy governor of Reserve Bank of India(RBI) in a public speech warned against government interference in Reserve Bank's working.

- The Ministry of Finance recently started consultation with RBI governor on issues such as easing the PCA (Prompt Corrective Action) framework and providing more credit to small units.
- This is prior to issuing the directions to RBI under Section 7 of RBI Act of 1934, such directives under this section has never been issued in past since 1934.

Prompt Corrective Action (PCA)

- PCA norms allow the **RBI to place certain restrictions such as halting branch expansion and stopping dividend payment.** It can even cap a bank's lending limit to one entity or sector.
- Other corrective actions that can be imposed on banks include special audit, restructuring operations and activation of the recovery plan. Banks' promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA.
- The provisions of the revised PCA framework became effective from April 1, 2017, based on the financials of the banks for the year ended on March 31, 2017. The framework will be reviewed after three years.
- When is PCA invoked?

    The PCA is invoked when banks breach certain regulatory requirement like minimum capital, return on asset and quantum of non-performing assets.

Issues between RBI and Government

- **Easing Norms of Prompt Corrective Action**
    - The government has asked the RBI to give exemption to power companies under the PCA framework.
    - The government wants RBI to ease lending rules under PCA, as it could help reduce pressure on MSME through credit availability.
    - RBI has said that such move will jeopardize all efforts of dealing with country's Non-Performing Asset (NPA) Crisis.
- **Section 7 of RBI Act of 1934**
    - The government which is a stakeholder in 21 public sector bank is issuing the direction to RBI, the regulator of banks.
    - This section empowers the **government to issue directions to RBI in public interest.**
    - The section states that directions must be issued after consultation with RBI governor.
- **RBI Surpluses**
    - Every year RBI earns interests from the domestic and foreign bonds it holds. This income is used in running the operation of RBI and rest is accrued as surplus. Out of this surplus, RBI holds some amount to itself as equity capital to maintain its creditworthiness and pays the rest to the government.
    - In 2015 RBI's risk analysis showed that its equity position of around Rs 10 lakh crore was adequate, the Bank decided to transfer its entire surplus to the government (around Rs 65,876 crore for 2015-16).
    - The government is of the opinion that RBI should pay more dividend reasons being that the building up of buffers such as the Contingency Fund and Asset Reserve by the RBI has been far in excess of what is required to maintain creditworthiness.
    - RBI, on the other hand, says that increasing the dividend payment to the government can prove to be inflationary as there will be more money in the market and may harm the RBI's major task of macroeconomic stability.
    - The surplus is also meant to cover a situation where the rupee appreciates against one or more of the currencies or if there is a decline in the rupee value of gold.

Way Forward

- The tussle between RBI and government can impact the image of India as a stable market as investors require long-term policy consistency, such interference in the working of RBI can impact investment in the Indian economy. Thus it is necessary that the government should respect the mandate given to RBI as a regulator of the banks.

- On the other hand, it must also be understood that constitutionally RBI is not independent, it is a part of the government, thus accountable to people. The independence of the central bank is maintained as it has positive externalities on the economy. The autonomy must also come with accountability. Thus it can be said that by invoking section 7 of RBI Act 1934, the government is acting within power given to it under the act.

More on Independence of RBI