



## Dispute Between Government and RBI

**For Prelims:** [Reserve Bank of India \(RBI\)](#), RBI Governor, [Repo Rate](#), [Reverse Repo Rate](#), CRR

**For Mains:** Working of RBI, Key Reasons for Tussle between RBI and Central Government

[Source: IE](#)

### Why in News?

Recently, the tenure of [Reserve Bank of India \(RBI\) Governor Shaktikanta Das](#) concluded in December 2024, characterized by some friction with the government towards the end of his second term.

- The disagreement between the **RBI and the government** arose from the central bank's decision to **refrain from cutting policy rates**, despite the economic slowdown and the government's appeal for steps to boost **GDP growth**.

**Note:** The **Appointments Committee of the Cabinet** has approved the **appointment of 56-year-old Sanjay Malhotra**, currently serving as Revenue Secretary in the Finance Ministry, as the **26<sup>th</sup> Governor of the Reserve Bank of India**.

### What are the Key Issues Between RBI and the Central Government?

- **Easing Norms of Prompt Corrective Action (PCA):** The government urged RBI to exempt power companies and ease lending rules under [PCA](#) to boost credit for MSMEs, but the RBI has often opposed such measures.
  - Arguing that relaxing norms under PCA could undermine the efforts to address the **Non-Performing Asset (NPA) crisis**, which had become a significant challenge for the **Indian banking system**.
- **Section 7 of RBI Act, 1934:** The government, under **Section 7 of the RBI Act**, can direct the RBI in public interest, but its rare invocation has raised concerns about undermining RBI's autonomy.
  - While the government prioritizes short-term growth through measures like [lowering interest rates](#), the RBI focuses on [inflation control](#), [price stability](#), and long-term financial stability, leading to occasional policy tensions.
- **RBI Surpluses:** RBI earns income from **bonds and retains part of the surplus** for buffers like the **Contingency Fund and Asset Reserve**.
  - It is seen that the government often demands higher dividends, arguing excess reserves, while the RBI warns of inflation risks and threats to macroeconomic stability.
  - Surpluses also act as a safeguard against currency value fluctuations and gold depreciation.
- **Regulatory Authority and Institutional Turf:** The creation of bodies like the [Financial Stability](#)

[and Development Council \(FSDC\)](#) has raised concerns within the RBI about its **diminishing role in financial regulation**.

- Moreover, there is conflict over the issue of government influence in the appointment of key RBI officials, with the central bank expressing concerns that such **interference challenges its independence**.
- **Issue over Forex:** The RBI has resisted the government's calls to use [foreign exchange reserves](#) for [fiscal deficits](#) or loan write-offs, fearing it could undermine **financial stability** and weaken the rupee, leading to disagreements on reserve management.
  - RBI opposes this demand by citing risks to **financial stability and the rupee's strength**. Additionally, the government's push for [financial inclusion](#) and [priority sector lending](#) often conflicts with RBI's focus on maintaining overall financial stability.

## What Were the Previous Conflicts Between RBI Governors and the Government?

- **RBI governor YV Reddy (2003-2008):** He had differences with the then Finance Minister (FM) **over rate cuts** and [financial market development](#). He opposed proposals for writing off farmer loans and using foreign exchange reserves without guarantees.
- **D Subbarao (2008-2013):** His tenure saw **conflicts over anti-inflation policies**, with government officials pushing for lower rates despite high inflation.
- **Raghuram Rajan (2013-2016):** He also faced challenges when the government sought to regulate money markets through the [Securities and Exchange Board of India \(SEBI\)](#) without consulting the RBI. He raised concerns about the **potential costs and benefits of demonetization**, which the government pursued without his endorsement.
- **Urjit Patel (2016-2018):** His tenure was marked by significant **disagreements over surplus transfers and lending norms**. The government invoked [Section 7 of the RBI Act](#) to engage in discussions about the RBI's policies.
  - He resigned amid escalating tensions, particularly regarding the government's attempts to access the RBI's capital reserves.

## Way Forward

- **Strengthening RBI-Government Dynamics:** Independent oversight mechanisms can ensure merit-based appointments and shield RBI from undue political influence.
  - A clear delineation of roles is essential, with the government focusing on fiscal policies and growth, while RBI prioritizes [monetary policy](#) and financial stability.
- **Strengthening the RBI's Autonomy:** The government should build consensus with the RBI to implement short-term measures that compromise long-term financial stability.
  - **Clear legal and institutional frameworks** can reinforce the RBI's autonomy, ensuring it can carry out its mandate without external interference.
- **Enhancing Transparency and Accountability:** Greater **transparency in decision-making** by both the RBI and the government is needed to reduce misunderstandings and build mutual trust. Instances like **demonetization (2016)**, **PCA norms**, **surplus transfer disagreements**, and monetary policy conflicts highlight the need for transparent decision-making to align RBI-government priorities and build mutual trust.
- **Clear Fiscal-Monetary Policy Coordination:** The government should aim for **better coordination between fiscal and monetary policies**, acknowledging the limits of fiscal expansion and the RBI's concerns regarding inflation control.
  - This could involve **formal mechanisms for policy alignment**, ensuring that both institutions work towards a **common economic goal**.

**UPSC Civil Services Examination, Previous Year Questions (PYQs)**

**Prelims**

**Q. Which of the following statements is/are correct regarding the Monetary Policy Committee (MPC)? (2017)**

1. It decides the RBI's benchmark interest rates.
2. It is a 12-member body including the Governor of RBI and is reconstituted every year.
3. It functions under the chairmanship of the Union Finance Minister.

**Select the correct answer using the code given below:**

- (a) 1 only
- (b) 1 and 2 only
- (c) 3 only
- (d) 2 and 3 only

**Ans: A**

**Q. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)**

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

**Select the correct answer using the code given below:**

- (a) 1 and 2 only
- (b) 2 only
- (c) 1 and 3 only
- (d) 1, 2 and 3

**Ans: B**

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