



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 **26th 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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