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Always a fine balance : RBI-Centre Tussle

Why in News:-

- The break-down of communication lines between RBI and the Centre in recent times is worrying for the domestic economy.
- Recent RBI-Centre tussle is actually a series of smaller disputes that go beyond the classic interest rate debate and spill over into more contentious realm of policy-making and regulation.

Current Issues between RBI and Centre:-

- **Prompt Corrective Action (PCA) framework:** Currently 11 state-owned lender(PSB) are under restrictions
 - Centre wants state-owned banks to exit PCA, which might be fraught with risks to financial stability.
- **NPA Rules:** In RBI circular of February 12 which redefined NPAs and revised the framework for resolution. New rules asked all banks to initiate a resolution plan even if there was a single-day delay in repayment of dues by large corporate borrowers.
 - The centre is upset over redefined NPAs and revised the framework for resolution. It is also upset that the central bank is not doing enough to ease the ongoing liquidity squeeze through extraordinary measures.

- **Regulation of PSBs:** RBI Governor Urjit Patel advocates that RBI has a weak supervisory powers over PSBs. it lacks powers to replace managements or revoke licenses of PSBs, when questioned on regulatory gaps that led to bank NPAs and frauds. So, RBI needs more teeth with regard to government-owned banks.
- **Independent Payments Regulator:** Currently central bank manages all payment systems, some directly and some through NPCI and recent attempt (new ***Payment and Settlement System Bill***) by the Centre to set up an independent payments regulator, which the RBI sees as encroachment of its turf.
- **Easing credit to small firms:** Centre insisted on easing prudential norms for MUDRA and SME lending. With domestic banks just halfway through the process of resolving their mountain of NPAs from large corporates, it would be imprudent to increase SME loans without toning up their credit appraisal systems first.
- **RBI's reserves and surplus:** RBI's burgeoning reserves, a piece of which the Centre is eyeing to bridge its fiscal gap, while the RBI resents this.

Is RBI is Autonomous Institution?:-

- According to **Former RBI Governor, Dr. Y. V. Reddy**, RBI is independent, but within the limits set by the government.

- Dr. Reddy explains his understanding of this autonomy under three functions:
 - **Operational issues:** he believed, Here RBI is *in total freedom*;
 - **Policy matters:** he preferred *prior consultation* Centre;
 - **Structural reforms:** he worked in *“very close coordination”* with the government.
- Interactions of RBI Governor with the government as *“walking on a razor’s edge”* because the RBI Act allows the government ***to give written directives to the RBI in the public interest under Section 7 of RBI Act.*** Though it has never been used till now.
- So it is clear that the *RBI is autonomous but within the framework of the RBI Act.*
- The central bank *cannot claim absolute autonomy.* Because it is *not the technocrats and economists* who carry the can for the policies they frame Ultimately, it is the *elected representative* ruling the country who is *answerable to the citizen* every five years.
- In a democracy, it is unthinkable that we will have an institution that is so autonomous that it is not answerable to the people. The risk of such an institution is that it will impose its preferences on society against the latter’s will, which is undemocratic.
- So, ***RBI is autonomous and accountable to the people ultimately, through the government.***

Suggestion:-

- No regulator can work if its views are constantly questioned by the government in public.
- On issues of **operational autonomy**, the central government needs to lay off its pressure on the RBI.
- On macro issues such as exchange rate management and RBI's dividend policy, etc. **written agreements that clearly demarcate roles and responsibilities can be thrashed out.**
 - The **Monetary Policy Framework Agreement** and the **FRBM Act** are good illustrations of how a mutually agreed rule-based framework can broker peace between the central bank and the executive arm of government.
- If the issues are not resolved, the tussle will undermine investor confidence and strengthens fears about institutional erosion when India is already experiencing economic turmoil.

Conclusion:-

- The onus is thus on responsible behaviour by both sides.
- The Governor has to be conscious of the limits to his autonomy at all times, and the government has to consider the advice coming from RBI in all seriousness.
- The cleverness of the politician in Centre lies in negotiating with the RBI and having his way without ever

- threatening to unleash the brahmastra(Section 7 of RBI) the other side knows it exists anyway.
- So there is **need of mature handling of differences behind closed doors** by both Government and RBI, something that has been absent in the current tussle.

THANK YOU

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