



The RBI concedes a vital principle

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The RBI concedes a vital principle-Its openness to the board discussing all policy decisions may well be a paradigm shift

- Every one of the four decisions taken by the Reserve Bank of India (RBI) in press note issued after the meeting of its board of directors, including three decisions related to regulation, was ascribed to the board.
- The note also mentions that the constitution of a committee to examine the economic capital framework of the RBI, which was one of the decisions taken, will be jointly determined by the RBI and the Government of India.
- These announcements constitute a significant departure from what has appeared to be the position of the RBI thus far: policy decisions, especially those relating to regulation, are the exclusive province of RBI management.
- Any departure from this position amounts to an infringement of the RBI's autonomy.
- The government and some of the current nominee directors on the RBI board have contended that all policy decisions must be deliberated by the board.
- The outcomes of the November 19 meeting suggest that the RBI has conceded this vital principle.
- This augurs well for the relationship between the government and the RBI management hereafter.
- Indeed, it may well constitute a paradigm shift in the functioning of the RBI.

A grey area

- The precise relationship between the RBI board and the RBI management is something of a grey area.
- Various experts have made the point that the RBI Act vests all powers in the board and, concurrently, it vests those very powers in the RBI Governor.

- Whether the board can issue directions to the RBI Governor in the event of a difference of opinion between the two is not clear; some experts reject the suggestion outright.
- The RBI management may or may not accept the inputs of the board but the board must have its say.
- This is elementary corporate governance.
- In accepting this principle, the November 19 meeting of the RBI board marks a big step forward.

Raiding the reserves?

- The government's position is that the RBI's reserves are in excess of reserves typically held by central banks elsewhere.
- Some commentators have described the government's position as an attempt to 'raid the reserves' of the RBI to fund its fiscal deficit.
- The suggestion seems to be that the RBI has cash which the government wants to steal for its own purposes.
- The RBI's reserves fall into two categories: revaluation reserves (which have mostly to do with the change in the rupee value of the RBI's holdings of gold and foreign currencies) and contingent reserves (which represent plough back of a portion of the surplus earned by the RBI every year, the remaining portion being transferred to government as dividend).
- Contingent reserves are intended for risks related to the RBI's balance sheet.

Flow of bank credit

- The other outcomes at the RBI board meeting have to do with increasing the flow of bank credit and easing the problems of borrowers, especially small and medium enterprises (SMEs).
- Banks are subject to capital adequacy requirements — that is, they have to hold a minimum of capital against every rupee of loans they make.
- The RBI's requirement of capital adequacy is one percentage point higher than that of the internationally accepted Basel norms laid down by the Bank for International Settlements.
- The government would like to align Indian banks' requirements with the Basel norms as that would reduce the demands for capital made on it by public sector banks (PSBs).
- The RBI did not yield on this point at the recent meeting.
- The RBI has also agreed to consider the government's suggestion for

easing the norms for Prompt Corrective Action (PCA) for banks.

- A relaxation in PCA norms, by translating into higher credit flows, could relieve stress in the broader economy.
- The strident demand to enhance flows to non-banking financial companies (NBFCs), which was heard ahead of the meeting, finds no mention in the press note.
- As a public institution whose actions have enormous welfare implications, the RBI management cannot rule by fiat.
- Its actions must flow from a consultative process.

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