1. Spelling Out the Government's RBI Windfall

Context:

- Reserve Bank of India (RBI) has approved the transfer of record Rs 1.76 lakh crore dividend and surplus reserves to the Government.

Introduction:

- The transfer of Reserve Bank of India (RBI) surplus to the government is a routine matter. Every year after the finalization of the accounts of the RBI its surplus is transferred to the Central government sometime in end-August; this augments the non-tax revenue of the Central government.
- Normally, an estimate of such a transfer is decided informally between the RBI and the Central government by January and finds a place in the Budget estimate, typically announced in early February. But this year is an exception.
- The excess reserve transfer is in line with the recommendation of former RBI governor Bimal Jalan-led panel constituted to decide size of capital reserves that the central bank should hold.

What is Economic Capital Framework?

- Economic capital framework refers to the risk capital required by the central bank while taking into account different risks.
- The economic capital framework reflects the capital that an institution requires or needs to hold as a counter against unforeseen risks or events or losses in the future.

Bimal Jalan Committee:

- The RBI, in consultation with the Government of India, constituted a Committee headed by Bimal Jalan to assess the quantum of economic capital of the RBI.
- The committee submitted its report and the RBI's Central Board accepted all the recommendations of the committee.
- Accordingly, it finalized its accounts for 2018-19 using the revised framework.
- As per the accounts, the RBI has ended with an overall surplus of ₹1,759.87 billion in 2018-19 as against ₹500 billion in 2017-18, representing an increase of more than 250%.

Bimal Jalan committee Recommendations:

- The surplus from the central bank comprised two components-Rs 1.23 lakh crore of surplus for the year 2018-19 and an additional Rs 52,637 crore of excess provisions that was made available as per the revised economic capital framework recommended by the Bimal Jalan committee.
- Of the Rs 1.23 lakh crore, the RBI has already transferred Rs 28,000 crore to the government in the previous fiscal, which will reflect in RBI's upcoming annual report.
- It suggested that the framework may be periodically reviewed after every five years.
- It recommended to align the central bank's accounting year with the financial year, which could reduce the need for paying interim dividend.
- The panel recommended clear distinction between the two components of economic capital, realised equity and revaluation balances. This is because of the volatile nature of the revaluation reserves.

Other reports regarding RBI surplus:

The narrative that the RBI is an overcapitalized institution has been in currency for some time.

1. The Economic Survey of 2016-17 found that the RBI is one of the most capitalized central banks in the world and noted, "There is no particular reason why this extra capital should be kept with the RBI".
2. Later, the former Chief Economic has caricatured the syndrome of treating the government's capital at the RBI by RBI officials as "prudence or paranoia".
3. Folklore estimates of excess capital of the RBI in the range of ₹4.5 lakh crore to ₹7 lakh crore seemed to have been blowing in the wind.
4. The issue became all the more controversial after the resignation of Mr. Patel in December 2018 citing personal reasons.

Constituents of RBI's Excess Capital:

- There are two distinct types of items under it.
- ✓ While "Contingency Fund (CF) and Asset Development Fund (ADF) represent provisions made for unforeseen contingencies and amount set aside for investment in subsidiaries and internal capital expenditure respectively".
- ✓ Currency and Gold Revaluation Account (CGRA), Investment Revaluation Account (IRA) and Foreign Exchange Forward Contracts Valuation Account (FCVA), represent unrealised marked to market gains/losses".

Narratives regarding the transfer of surplus:

- There are perhaps two caricatured folklore narratives about this increased transfer of RBI surplus.

1. First narrative- Arm-twisting the RBI

- The government, facing a resource crunch, has arm-twisted the RBI to transfer some of its reserves, which is almost in the nature of family silver. This is not good for the economy. As when and if the economy faces a crisis, the RBI may not have adequate money to protect it.

2. Second Narrative -Effective Utilization of Surplus

- Indian central bank is a unique institution which is backed by the faith reposed on it by the Central government, and therefore, a huge amount of reserves with the central bank is in the nature of idle cash which could have been utilized more productively in the economy.
- This year, the Central government has done precisely this. The RBI decided to transfer this increased surplus after following due process and after accepting the recommendations of the Jalan Committee.

Why RBI needs excess Reserves?

- The RBI needs adequate capital reserves for monetary policy operations, currency fluctuations, possible fall in value of bonds, sterilization costs related to open-market operations, credit risks arising from the lender of last resort function and other risks from unexpected increase in its expenditure.
- The RBI has maintained the view that it needs to have a stronger balance sheet to deal with a possible crisis and external shocks.

Positives of such a move:

- The Jalan committee does not seem to have compromised on arriving at the economic capital framework of the RBI and has calculated the extent of excess capital of the RBI under a set of fairly standard and conservative assumptions.

1. Contingent Risk Buffer (CRB):

- The Surplus Distribution Policy of RBI that was finalized is in line with the recommendations of the Bimal Jalan committee.
- The Jalan committee has given a range of 5.5-6.5% of RBI's balance sheet for Contingent Risk Buffer.
- Adhering to the recommendations, the RBI has decided to set the CBR level at 5.5% of the balance sheet, while transferring the remaining excess reserves worth ₹52,637 crore to the government.

- If CBR is below the lower bound of requirement, risk provisioning will be made to the extent necessary and only the residual net income (if any) transferred to the Government.
- However, keeping CBR at a lower range of 5.5%, will reduce RBI's space to manoeuvre monetary policy.

2. Scope for Bank Recapitalization:

- At this juncture of the Indian economy, when the spectre of a slowdown is looming large and when channels of credit disbursements are choked because of a lack of capital.
- A transfer of such additional money to the government could enable the government to go in for bank recapitalization in a big way and would be good for the economy.

3. Stimulation to the Economy:

- The transfer of the additional surplus from the RBI could enable the government to pursue efforts towards stimulating the economy while maintaining budget discipline.
- Of course, the final impact of such actions on the independence of the RBI would crucially depend upon the future course of such transfers.

Conclusion:

- It might sound better to make use of the RBI's surplus. But the government's attempt to arm twist the RBI and interfering with RBI's autonomy denotes an erosion of the RBI's independence.
- This assumes credence in view of the perceived difference of opinion between the RBI and the Central government, that has been highlighted in recent media reports, as well as the resignation of the former RBI Governor.
- So, the govt should exercise due restraint in very action which overlaps with other institution's autonomy, where autonomy and independence of the institutions are the bedrock of the democracy.
- Of course, the final impact of such actions on the independence of the RBI would crucially depend upon the future course of such transfers. After all, we all know the story of the goose that laid the golden eggs.