Autonomy of RBI

How did RBI originate?

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- A need was felt to ‘regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability’.
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- However, in 1929, the world had been hit by an unprecedented economic crisis — the Great Depression.
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- No one was sure what kind of monetary system would be suitable for India.
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- Hence, it was decided to make a ‘temporary provision’ and that temporary provision was the **Reserve Bank of India Act, 1934**.
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What are the objectives?

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The RBI’s main objectives in 1934 and now are the same:

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- to issue bank notes; and
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- to keep the reserves.
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What are the roles of RBI?

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- Under the Act and through numerous amendments, vast powers were conferred on the RBI.
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- The word ‘autonomous’ does not occur in the Act but, over the years, the principle of Central Bank autonomy has been raised to the level of an immutable law.
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- Under Section 7 of the Act, the Central government may give such directions to the RBI as it may consider necessary in the public interest, but the power has never been exercised in the 83 years of the Act.
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- Since November 8, 2016, the role of the RBI as the issuer of bank notes has come into prominence. **The RBI has the sole right to issue bank notes (Section 22).**
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- The RBI shall recommend the denominational values of the notes as well as the discontinuance of issue of notes (Section 24).
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- Further, it is on the recommendation of the RBI that the Central government may declare that any series of bank notes shall cease to be legal tender (Section 26).
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How was the relationship between central government and RBI?

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- There have been times when the RBI and the Central government had a tussle. One governor resigned in protest. One governor was forced to step down.
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- Overall, however, the RBI and the Central government respected each other’s jurisdiction and learnt to work with each other.
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In the current exercise of demonetisation, how did the RBI set free itself?

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- The government has claimed that demonetisation was announced on the recommendation of the RBI.
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- But the Prime Minister’s speech on November 8 made no reference to the RBI’s recommendation.

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- On the contrary, the government’s and the BJP’s spokespersons boasted that it was entirely Mr Narendra Modi’s brainchild.
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- The decision-making process at the RBI was opaque. The RBI’s Board of Directors should have 10 directors regarded as independent.
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- Seven vacancies in that category have not been filled by the NDA government.
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- Dr Urjit Patel, the Governor, justified demonetisation as a policy action to ‘turn around’ the economy.
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- **None of the governors before him since 1978 had advocated demonetisation even when the economy faced grave challenges.**
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- Dr Patel embraced the idea, barely 65 days after he took office, when the economy was growing, reportedly, at about 7 per cent.
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- The RBI is believed to have told a parliamentary committee that the Central government had recommended to the RBI (on November 7) that high denomination notes may be demonetised.
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- Acting in haste, the RBI recommended to the government (on November 8) that high denomination notes may be demonetised! It was an unusual role reversal.
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How RBI’s credibility was dented?

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- **The RBI was unprepared to manage the fallout of demonetisation.**
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- It did not have sufficient quantities of lower denomination notes. It had printed only Rs 2,000 notes that were not easily exchangeable.
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- Besides, the new note did not fit into ATMs. The RBI started printing Rs 500 and lower denomination notes only much later.
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- A terrible idea caused more pain through terrible implementation.
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- The RBI has a Monetary Policy Committee (MPC) that was constituted

recently after years of deliberation.
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- Money supply is an integral aspect of monetary policy. The MPC was totally excluded from the decision-making process.
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- In his speech on December 31, Mr Modi ventured into territory where no prime minister or finance minister before him had gone.
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- He directed banks to increase the credit limit for small industry from 20 per cent to 25 per cent of turnover and the working capital limit from 20 per cent to 30 per cent of turnover.
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- He directed banks to provide 8 per cent interest on 10-year fixed deposits of senior citizens.
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- Every announcement by the Prime Minister scuttled the independence and credibility of the RBI.
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