RBI-Centre Tussle

What is the issue?

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The break-down of communication lines between RBI and the Centre in recent times is worrying for the domestic economy.

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What are the conflicting areas?

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- There are multiple flashpoints between the RBI and the Centre that seem to have precipitated this outburst.
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- Disagreements between RBI and the centre over setting benchmark interest rates have been common over the years.
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- But the disagreements appear to be over regulation in itself this time.
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- **Concerns of RBI** - There are three issues on which the Centre seems to have irked the RBI.
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- It has refused to accept Governor Urjit Patel's point that the RBI is hobbled by lack of adequate powers in regulating public sector banks.
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- The second is the tussle over the RBI's burgeoning reserves, a piece of which the Centre is eyeing to bridge its fiscal gap, while the RBI resents this.
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- The last is the attempt by the Centre to set up an independent payments regulator, which the RBI sees as encroachment of its turf.
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- Also, the centre insisted on easing prudential norms for MUDRA and SME lending.
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- 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.

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- Centre has also demanded to relax Prompt Corrective Action rules for public sector banks, which might be fraught with risks to financial stability.
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- **Concerns of centre** - The centre is upset over an RBI circular of February 12 which redefined NPAs and revised the framework for resolution.
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- It is also upset that the central bank is not doing enough to ease the ongoing liquidity squeeze through extraordinary measures.
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- However, the RBI argues that it lacks powers to replace managements or revoke licenses of PSBs, when questioned on regulatory gaps that led to bank NPAs and frauds.
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- But it has effectively used its existing supervisory powers to plug process gaps in banks or head off ever greening of loans in recent times.
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- The centre finds RBI guilty of not detecting the bad loans of banks in time or figuring out the IL&FS mess despite it being a systemically important NBFC.
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- However, much of this applies to the government as well.
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- As the owner of PSU banks, it needed to know what was happening and that is why it had its directors on these banks.
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- As for IL&FS, apart from RBI, others were members of the Financial Stability and Development Council which is headed by the finance minister and the top shareholders of IL&FS include LIC, SBI and Central Bank of India.
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- The government is also concerned with raising repo rates, since it is projected to rise its borrowings from the market in the future.
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- There is an estimation of Rs 1.7 lakh crore of 'extra budgetary resources' to be raised in FY19, which will correspondingly involve higher interest payments in future if interest rates are raised.
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What should be done?

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- The Centre and the RBI should waste no further time in public sparring, and get back to the negotiating table.

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- No regulator can work if its views are constantly questioned by the government in public.
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- A better way to sort out these differences and to come to a conclusion is to have a larger debate with technical experts weighing in.
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- On issues of operational autonomy, the central government needs to lay off its pressure on the RBI.
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- On macro issues such as exchange rate management and RBI's dividend policy, written agreements that clearly demarcate roles and responsibilities can be thrashed out.
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- 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.
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- 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.
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- Thus the Centre and the central bank must talk behind closed doors and resolve their differences as mature entities, as they have done so many times in the past.
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Source: Business Line

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