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NEEDED: A NEW RELATIONSHIP CONTRACT BETWEEN RBI AND GOVT

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Archaic provisions of the RBI Act and its powers to appoint senior functionaries have given the finance ministry adequate levers to control the central bank

Two recent books, one by former Reserve Bank of India (RBI) governor, Urjit Patel, and the other by former RBI deputy governor, Viral Acharya, have reignited the debate on central bank autonomy in India. Patel and Acharya resigned from their respective posts before their terms ended. Acharya has claimed that both paid the price for resisting undue interference from the Union finance ministry.

The tussle between India’s treasury and its central bank is as old as the central bank itself. The concept of an independent central bank for India “on a level of authority with the treasury" was first spelled out by one of the greatest economists of the world, John Maynard Keynes, during the British Raj. Keynes’ proposal was shot down by the then Bank of England chief, Montagu Norman, who proclaimed “a Hindoo marriage" between the Bank of England (the dominant spouse) and RBI (the subservient wife).

“Norman’s graphic simile is… expressive of the RBI’s real status after its creation," wrote the former RBI economist Anand Chandavarkar in a 2005 Economic and Political Weekly article. Among the pioneering economists who built up RBI’s research prowess in the post-independence era, Chandavarkar considered RBI to have been more independent during the British Raj than in independent India. As RBI assumed quasi-fiscal mandates in order to fulfil plan targets set by the powerful Planning Commission, it became an “emasculated fiscal agency", in his words.

Throughout history, the Union government has deployed three levers to control the RBI. The first lever is the colonial-era RBI Act, which provides sweeping powers to the government. Section 30 of the RBI Act for instance, allows the government to “supersede" the RBI central board. Section 58 circumscribes the powers of the central board to make regulations only with the “previous sanction" of the central government. Section 7 (1) says that the Union government can “from time to time give such directions to the (central) bank as it may, after consultation with the governor of the bank, considered necessary in the public interest".

These provisions aren’t invoked as a matter of routine but can be used when needed. Towards the end of Patel’s tenure in 2018, it was section 7 that was invoked to make RBI toe the finance ministry's line on a range of contentious issues.

The second lever of control lies in the choice of governors and deputy governors to run RBI. Since independence, seven out of every ten RBI governors have been former finance ministry officials, an analysis of RBI’s annual reports shows. Some such as Y.V. Reddy joined as deputy governors before becoming governor. Others such as D. Subbarao or Raghuram Rajan were directly appointed as governors after their stints at the finance ministry.

Over the past three decades, 62% of RBI’s top management --- governors and deputy governors --- have been outsiders. All were men. Three women who made it as deputy governors during this period - K.J. Udeshi, Usha Thorat and Shyamala Gopinath - were all insiders. The last and only time an insider took up the top post was when M. Narasimham, a contemporary of

Chandavarkar, became the governor in 1977.

The share of RBI governors from North Block has been higher in the post-liberalization era. Patel was one of the rare exceptions, who except for a brief stint as a consultant, did not spend much time in North Block before becoming RBI governor. The lack of any finance ministry veteran in RBI's top rungs during Patel's tenure could have accentuated the ministry-RBI tussle. Unsurprisingly, the government turned to Shaktikanta Das, a finance ministry veteran, to take charge of RBI after Patel's resignation.

Patel himself has however been a beneficiary of the RBI-ministry tussle. His appointment as the deputy governor came at a time when tensions between the then governor, Subbarao and the then finance minister, P. Chidambaram were at their height. Chidambaram believed that even the outsiders sent to RBI had become hostage to the RBI technocrats and wanted to bring in 'fresh thinking' in the institution, wrote Subbarao in his memoirs. So instead of extending the term of Subir Gokarn, as recommended by Subbarao, Chidambaram appointed Patel, a known critic of Subbarao's policies, as deputy governor.

The third lever of government control lies in the composition and staffing of RBI's central board, RBI's highest decision-making body. Under the RBI Act, the central board is designed to consist of 21 members: the governor and four deputy governors [under Sec 8(1)a], four directors from the four regional boards of the RBI [under Sec 8(1)b] who are elected by their respective local board members, 10 directors nominated by the Union government who are usually experts in their respective fields [under Sec 8(1)c], and two government appointed officials (usually from the finance ministry) [under Sec 8(1)d].

By not filling up board positions, the government can ensure that the ex-officio members hold sway over the board, as was the case during demonetisation, when RBI's central board was at its weakest level in history.

The minutes of that fateful board meeting held on 8 November 2016 suggest that the board members were not convinced about the government's economic logic behind the decision to demonetize high-value notes. But government officials seem to have persuaded others to approve the plan, despite their reservations. It is tempting to ask whether the outcome would have been different if the board were staffed with more independent members.

Some of the board vacancies were subsequently filled up but the appointments attracted controversy because of the political background of the appointees: S. Gurumurthy and Satish Marathe. Both have been associated with affiliates of the ruling Bharatiya Janata Party (BJP) for long years. Political appointments have been common in RBI's regional boards but less so in the central board. The previous political appointees were Rajeev Gowda of the Congress in 2012, Gopala Ramanujam, the co-founder of the Indian National Trade Union Congress (INTUC) in 1994, and Erasu Ayyapu Reddy of the Telugu Desam Party in 1993.

Typically, Union government appointees to the board tend to be academics, bureaucrats (or former bureaucrats), industrialists, and finance professionals. The share of bureaucrats has gone up in the past couple of years even as the share of academics has stagnated.

In the 1990s, RBI's central board was relatively balanced in terms of the professional expertise of its board members. Between 2000 and 2010, industrialists and corporate professionals dominated the board. Their share declined in the 2010-2015 period as the strength of the board fell, and it came to be dominated largely by ex-officio members. The share of women on the board has also steadily declined over the past two decades.

While central board staffing has begun receiving some attention of late, the high number of vacancies in the local or regional boards often elude attention. Over the past five years, the northern board has been vacant for three years, while others have had a maximum of two members.

For some regions, there have been no representatives on the central board, and this means board decisions may not have fully factored in their regional implications. As Chandavarkar argued, the impact of monetary policy and regulations can be vastly different in different regions, which are at different stages of development.

Chandavarkar had advocated a high-powered commission to help legislate a ‘constitutionally independent federal’ RBI. The last time the role and functioning of RBI was examined threadbare was in 1931, when the Indian Central Banking Inquiry Committee was set up to help establish a central bank. That report and the RBI Act of 1934 continues to influence how RBI functions in the twenty-first century.

As we near the centenary of that inquiry committee report, it is perhaps time to re-examine the functioning and autonomy of RBI once again.

This is the first of a two-part series on the Reserve Bank of India.

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