

CENTRE-RBI TUSSLE: BALANCE OF POWER, IN THE BALANCE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The role of the Board of Directors of the Reserve Bank of India (RBI) and its powers *vis-à-vis* the RBI Governor have come into focus in the ongoing tussle between the Centre and the central bank. The Centre has hinted that it is examining the option of using the powers of the RBI Board to override the Governor.

There are several questions that arise from this unprecedented attempt by the Centre to use powers under the Reserve Bank of India Act, 1934. The most important of these is: Where does the balance of power lie between the Governor and the board? What is the legal position of the board in relation to the Governor? Does the latter draw his powers from the board as in a corporate set-up? Can the board give directions to the Governor on issues of policy and management of the central bank?

Government may not issue directions to RBI under section 7

Before we get to answering these, let's get this out of the way first. The relationship between the board and the Governor is not comparable to a corporate set-up where the managing director (the corporate equivalent of the Governor) reports to the board and draws his powers from it.

While a managing director is an agent of the board in a company, in the RBI, the Governor is not. He draws his powers from the RBI Act and not from the Board of Directors. He is appointed by the Prime Minister in consultation with the Finance Minister. The RBI Board has no say whatsoever in his appointment. In a company, the board of directors chooses one of its own to be appointed as the managing director. In the RBI, the Governor secures board membership only after he is appointed to the post. It is, thus, wrong to compare a corporate board to the RBI's and suggest that the Governor is subservient to it.

But what is the constitution of the RBI board like? As per the RBI Act, the board is made up of the following members: the Governor and four Deputy Governors, four directors (one each from the four regional boards of the RBI), 10 directors to be nominated by the Centre, and one government official who is also to be nominated by the Centre.

The present board is made up of 18 members, which is the Governor and four Deputy Governors, four regional board members and nine nominees from the Centre who include two officials, the Economic Affairs Secretary and the Secretary, Department of Financial Services.

So, where does the balance of power lie between the Governor and the board? The sections in the RBI Act dealing with this subject are rather vaguely worded. Eminent past Governors have interpreted Section 7, the relevant one, to mean that the powers of the board and that of the Governor are concurrent. The Governor draws his powers from Section 7(3) of the Act. He can exercise all powers and do all things that may be exercised and done by the RBI.

This is subject to a caveat though. The board, under Section 58, can make regulations that will give it the powers to override those of the Governor's. But this is subject to two important conditions. First, the regulations have to be *consistent* with the provisions of the RBI Act, which essentially means that the board has to act within the framework of the Act. Second, these regulations have to go through an elaborate approval process before they become law (Section

58(4)). The board has to forward the regulations to the Centre, which will have to table them in both Houses of Parliament. Members have a period of 30 days within which they can either suggest modifications to the regulations or annul them.

And then, there is the brahmastra of Section 7(1) which confers powers on the Centre to issue directions to the RBI “from time to time” in the public interest after consultations with the Governor. All bets will be off if this section is invoked as it will become untenable for the Governor to continue in his position.

This is the framework of the law but what has been the convention till now? The RBI Board has always functioned in an advisory role with the understanding that the Governor would consider its advice while making policy decisions. In other words, there was mutual respect between the board and the Governor, with both operating in a spirit of accommodation.

The fact is that neither Section 7(1) nor Section 7(3) has been unleashed in the 83-year existence of the RBI. Not even when the RBI was privately owned between 1935 and 1949.

It is not as if there have not been any disagreements between RBI Governors and governments before this. You only have to read the memoirs of the former Governors, Y.V. Reddy and Duvvuri Subbarao, to understand the extent of meddling by the Centre in the RBI’s affairs. Yet, things did not reach the brink and were sorted out quietly behind the scenes.

Another former Governor, C. Rangarajan, has spoken about how the RBI, under Governor R.N. Malhotra, was forced by the Centre to withdraw a circular freeing short-term rates of banks. Yet, there was no chatter of invocation of Section 7 or of the board arming itself with governance powers.

What’s the difference between then and now? The short answer is that the spirit of accommodation, which flows out of mutual respect and understanding of each other’s compulsions between the RBI and the Centre, and which was evident then, is absent now. And the blame for this has to be shared by the players involved in the current tussle.

It may not be very difficult for the Centre to have its way by using the board’s powers to frame regulations overriding the Governor but this will necessarily come with a price. Such a move will not only set a bad precedent but also lead to several ticklish situations.

The RBI Board has several representatives from industry. The present board includes N. Chandrasekaran, Chairman of Tata Sons, Dilip Shanghvi, MD of Sun Pharma, and Manish Sabharwal, founder of Teamlease. There will be a conflict of interest if industrialists are members of committees that run the affairs of the monetary authority of the country (and we are not for a moment suggesting that they will behave in any manner favourable to their interests).

Second, there is a good reason why the RBI has been kept at arm’s length from the Centre and bestowed with a certain independence. That is because the Centre is the spender and the RBI is the creator of money, and there has to be a natural separation between the two. The Centre arming itself with powers to run the RBI runs afoul of this precept.

Whichever way we look at it, such a move by the Centre would be ill-advised and will take its relations with the monetary authority into uncharted territory. There will be no winners in this dangerous game.

Enough dirty linen has been washed in public in the past month and it is time for the Centre and the RBI to behave like the mature entities that they are, uphold time-tested conventions, and act

with mutual respect and a spirit of accommodation.

The board meeting today, November 19, will set a crucial precedent in the economic history of India, and one can only hope that it will be the right one.

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