RBI to Transfer 99,122 crore to Government

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The Reserve Bank of India (RBI) will transfer ₹99,122 crore to the government from its profit, helping the Centre keep its fiscal deficit in check amid strained public finances because of the pandemic. The issue of transfer of surplus or profits has often been contentious. The government often pitches for a higher payout, arguing it needs to spend to deliver on promises and to keep the economic momentum going, while a conservative central bank, which has medium- and long-term perspectives, prefers to salt away a good portion of the profits for a rainy day.

In news: Reserve Bank to transfer ₹99,122 cr to government
Placing it in syllabus: Economy
Dimensions

- Recommendations of Bimal Jalan committee on Reserve Bank of India's (RBI) economic capital framework (ECF)
- How does RBI generate surplus?
- Why are these called transfers to the government, rather than dividends?
- Globally, what are the rules relating to payment of dividends by central banks?
- What is the difference in India now compared to the past?
- What are the potential issues relating to a higher payout?

Content:

- The Reserve Bank of India (RBI) transfers of ₹99,122 crore to the government from its profit amounts to 95% of the ₹1.04 trillion budgeted by the government as dividend from RBI and other state-owned banks and companies in the fiscal year.

- RBI had transferred ₹57,130 crore last year, but the numbers aren't comparable because of a change in the accounting year.
- The RBI does transfer its surplus annually to the government, the owner of the institution, after making adequate provisions for contingencies or potential losses.
- The profit that is distributed has varied, averaging over Rs 50,000 crore over the last few years.

Recommendations of Bimal Jalan committee on Reserve Bank of India's (RBI) Economic Capital Framework (ECF):

- In 2018, Reserve Bank of India (RBI) had constituted an "**Expert Committee to Review the Extant Economic Capital Framework of the RBI**" under the **Chairmanship of Dr. Bimal Jalan.**

Major recommendations of the Committee with regard to risk provisioning and surplus distribution are as follows:

RBI's economic capital:

- A clearer **distinction between** the two components of **economic capital (realized equity and revaluation balances)** was recommended.
- Realized equity could be used for meeting all risks/ losses as they were primarily built up from retained earnings.
- Revaluation balances could be reckoned only as risk buffers against market risks as they represented unrealized valuation gains and hence were not distributable.

Risk provisioning for market risk:

- It recommended the adoption of **Expected Shortfall (ES) methodology** under stressed conditions (in place of the extant Stressed-Value at Risk) for measuring the RBI's market risk.
- It also recommended the adoption of a **target of ES 99.5 % confidence level (CL)**.

Size of Realized Equity:

- **Contingent Risk Buffer (CRB)** – made primarily from retained earnings – has been recommended to be maintained within a range of 6.5 % to 5.5 % of the RBI's balance sheet, comprising 5.5 to 4.5 % for monetary and financial stability risks and 1.0 % for credit and operational risks.

Surplus Distribution Policy:

- It recommended a surplus distribution policy which targets the level of realized equity to be maintained by the RBI.
- Under it, only if realized equity is above its requirement, will the entire net income be transferable to the Government.
- It also suggested that the RBI's economic capital framework may be periodically reviewed after every five years.

Issue of transfer of surplus or profits:

- The level of surplus or profits the RBI pays to the government has been an issue of conflict two for long.
- Over the last decade or more, the government had sought higher payouts saying the RBI was maintaining reserves or capital buffers that were much higher than many other global central banks' buffers.
- The government has argued that such relatively lower transfers crimped public spending for infrastructure projects and social sector programmes, considering the

pressure to meet deficit targets and to provide space for private firms to borrow.
- With the government amplifying its demand for a higher transfer, the Jalan committee reviewed the capital structure, statutory provisions and other issues relating to the RBI balance sheet.

How does RBI generate surplus?

A significant part comes from RBI's operations in financial markets such as:

- when it intervenes for instance to buy or sell foreign exchange;
- Open Market operations, when it attempts to prevent the rupee from appreciating;
- as income from government securities it holds;
- as returns from its foreign currency assets that are investments in the bonds of foreign central banks or top-rated securities;
- from deposits with other central banks or the Bank for International Settlement or BIS;
- lending to banks for very short tenures and
- management commission on handling the borrowings of state governments and the central government.

RBI buys these financial assets against its fixed liabilities such as currency held by the public and deposits issued to commercial banks on which it does not pay interest.

The RBI's expenditure is mainly on printing of currency notes, on staff, besides commission to banks for undertaking transactions on behalf of the government and to primary dealers that include banks for underwriting some of these borrowings.

The central bank's total costs, which includes expenditure on printing and commissions forms, is only about 1/7th of its total net interest income.

Why are these called transfers to the government, rather than dividends?

- The RBI is not a commercial organisation like banks and other companies owned or controlled by the government to pay a dividend to the owner out of the profit generated.
- Though it was promoted as a private shareholders' bank in 1935 with a paid-up capital of Rs 5 crore, the government nationalised it in January 1949, making the sovereign the "owner".
- What the RBI does is transfer the surplus – excess of income over expenditure –to the government.
- Under Section 47 of the RBI Act, "after making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds and for all other matters for which provision is to be made by or under this Act or which are usually provided for by bankers, the balance of the profits shall be paid to the Central government".
- This is done in early August by the Central Board.

Globally, what are the rules relating to payment of dividends by central banks?

- Central Banks such as – US Federal Reserve, Bank of England, German Bundesbank, Bank of Japan– have clear laws about how profits have to be transferred to the government or the treasury.
- The amount of profits or percentage to be distributed is also specified in the laws.

What is the difference in India now compared to the past?

- The quantum was not fixed, but was discussed and decided between the government and RBI.

- In the past, this has been guided by policies set out internally. Example: A committee headed by Y H Malegam recommended distributing 100% of the profits made during Raghuram Rajan's time.
- The difference is that the Jalan committee's recommendation on a profit distribution policy has been endorsed by the Central Board.
- This means a **more transparent and rule-based payout** , as in many other central banks, which could help **narrow differences between the government and RBI**.

What are the potential issues relating to a higher payout?

- According to Former RBI Governor Raghuram Rajan, much of the surplus the RBI generates comes from the interest on government assets (securities or bonds) or from capital gains made off other market participants.
- When this is paid to the government, the RBI is putting back into the system the money it made from it; there is no additional money-printing or reserve creation involved.
- But when the RBI pays additional dividend, it has to create additional permanent reserves or, more colloquially, print money.
- So, to accommodate the special dividend, the RBI will have to withdraw an equivalent amount of money from the public by selling government bonds in its portfolio.

Low Buffers affect Credibility During Crisis:

- Especially after the global financial crisis when central banks had to resort to unconventional means to revive their economies, the approach has been to build adequate buffers in the form of higher capital, reserves and other funds as a potential insurance against future risks or losses.

- A higher buffer enhances the credibility of a central bank during a crisis and helps avoid approaching the government for fresh capital and thus maintain financial autonomy.

Mould your thought: Why is the issue of transfer of surplus or profits of RBI often contentious? How have Jalan Committee recommendations addressed these concerns?

Approach to the answer:

- Introduction
- Discuss the earlier system of transfer of surplus and global comparison
- Mention the issues with higher payouts of surplus
- Discuss how the Jalan Committee recommendations bridge these issues
- Conclusion