

# Reserved Bank of India

Demonetisation showed India's central bank is too opaque. Its decision-making must be open to scrutiny



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THE RBI BOARD'S decision to recommend withdrawal of legal tender of high denomination notes after a short board meeting is seen as a loss of independence of the RBI. The recommendation was based on advice by the government that the RBI Central Board should consider such a decision. The RBI board was within its powers to turn it down. It could have directed the management to give it a report on the costs and benefits involved and taken a considered decision in its next meeting. Why did it not do so? Why could the government take the RBI board for granted?

To figure this out, we need to look at how the RBI Central Board normally makes decisions. As an example, we consider how the RBI Central Board decides the annual expenses of the RBI; a relatively important decision about spending public money. The RBI annual report shows the RBI's annual expenses in 2014-15 were Rs 13,356 crore. These are comparable to the annual expenditure of many states in India, and many times bigger than that of most central banks and regulators in India and abroad. Nearly a third, or more than Rs 4,000 crore, is spent on RBI staff salaries, superannuation, housing, maintenance, directors' fee and board meeting expenses. Such a large use of public money requires adequate scrutiny.

The board would discuss and approve the expenses and fulfill its role of controlling excessive expenditure by the management. However, there is no evidence available that the board even discusses this enormous annual spend of the RBI. Further, there is no evidence that the board looks after the public's interest in the event that there may be a conflict with the interests of the management. This is something the Board would have been expected to do. The decision seems to be taken mainly by the management — without the scrutiny of the Board.

How could such an arrangement be possible in today's India? The answer lies in the text of the RBI Act. In 1934, India's British rulers did not see a role for defending public interest which could be in conflict with the interests of the RBI management — the sections of the Act relating to the functioning of

For decades, the RBI board has functioned in a manner in which it did not deliberate on the most important decisions of the functioning of the RBI. This suited the management, which did not have public accountability in this unusual set-up. The management's functioning has consequently become a black box with no scrutiny. The board functions in a manner that would not be acceptable even for a private company as it would violate company law. Today, Parliament may find fault with the demonetisation decision and blame the RBI for not asserting its powers. But if the board continues to function in this manner, the problem will remain.

the Board have not been amended even after Independence. Through regulations made by the Board (Regulation 15 of the RBI General Regulations), the board created a "Committee of the Central Board" to which it delegated all its powers. The management may invite a couple of directors to meetings of the Committee, based on whichever directors happen to be in Mumbai at the time. This Committee can meet often and take all decisions that are then approved by the Board — in effect, the RBI Central Board has abdicated its responsibilities to the people they were supposed to have oversight over, that is, the management.

A normal governance practice is to create committees of a board with specific mandates and come back to the board for decisions, rather than take decisions. All decisions are taken by the board. In the case of the RBI, all the general powers of the Central Board have been delegated to the Committee of the Central Board — the Committee of the Central Board virtually can do everything that the Central Board can, under the RBI Act. This defeats the spirit of collective decision-making at the Central Board-level and circumvents the necessity of obtaining votes of the majority of members of the Central Board. The minutes of the Committee are placed before the Central Board; this serves little purpose as decisions are already taken and members did not participate in them. The Central Board effectively becomes responsible for all decisions of the Committee without deliberations — while the Committee has no accountability on how it discharges its duties.

The regulation that empowered this Committee to transact all the business of the Central Board was made in 1949. For decades, the RBI board has functioned in a manner in which it did not deliberate on the most important decisions of the functioning of the RBI. This suited the management, which did not have public accountability in this unusual set-up. The management's functioning has consequently become a black box with no scrutiny. The Board functions in a manner that would not be acceptable even for a private company as it would violate

company law. Today, Parliament may find fault with the demonetisation decision and blame the RBI for not asserting its powers or the governor for not doing his job properly. But if the Board continues to function in this manner, the problem will remain.

A related issue is that of transparency. The RBI does not make the Board agenda or minutes public. This lack of transparency is not just about this episode, when an RTI enquiry about Board minutes was turned down. Even the minutes of Board meetings held five years ago are not made public. If the Board was required to make its proceedings public, would it have continued to behave in this manner or would public scrutiny have prevented such functioning?

This takes us to the question of what is gained by transparency. Why are the agenda and minutes for board meetings of regulators or central banks in India and abroad made public? In the minutes, only a few specific decisions, such as those related to specific companies or trade secrets that the law prevents regulators from revealing, are held back. The answer lies in the understanding that along with transparency comes autonomy. When participants know that discussions of the meeting will be made public, they, as well as those who may be sending letters or advice to the Board, behave more responsibly. This reduces the chances of the Board being pressured or taking hasty or irresponsible decisions.

Parliament must examine in detail the functioning of the RBI Central Board. The RBI must be required to make public minutes of all past meetings of the Central Board. The agenda of every meeting should henceforth be public. If there are to be any exceptions based on national security, it is Parliament that should decide. The Board must not be allowed to abdicate its responsibility. Unless Parliament amends the law and enforces a well-functioning Board, the RBI will continue to be a weak institution — and fertile ground for further mistakes.

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