● TRANSGRESSING AUTONOMY

IF, INDEED, BANKING SUPERVISION AND REGULATION IS IN THE REMIT OF RBI, IS IT APPROPRIATE FOR THE OWNERS OF BAD BANKS TO PRESSURISE RBI TO RELAX CONDITIONS FOR THESE BANKS?

Is the government right to question RBI?

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Views are personal

MUCH DUST HAS been raised on the RBI-GOI standoff in the aftermath of the AD Shroff Memorial Lecture delivered by Viral Acharya, deputy governor of RBI. Of course, everyone, including RBI, knows that it does not have absolute autonomy and has to function within the parameters set by the government. The purport of the speech by the deputy governor is to remind that it should be allowed to perform unhindered in the field of its remit. When there are continuous attempts to transgress its regulatory role, he has chosen to remind the government, as well as the public at large, of the dangers involved in transgressing even the limited autonomy.

There have been simmering differences between the government and RBI for long. The government wants RBI to relax rules and move ahead rather than undertaking the much needed reforms in the banking sector. Apart from infusing funds for recapitalisation, which actually increased the stake of the government in PSBs, nothing has been done do far to improve the governance or build capacity in these banks. RBI, for its part, has found the challenges created by the government formidable and has wanted a clear control over the regulatory turf. The Governor aired his frustration quite some time ago in not being able to regulate the PSBs, unlike in the case of private banks. While we all cherish democratic values, it is important also to realise that benevolent governments hardly exist. Unlike in the case of market failures, government failures have to be dealt with by institutions to create checks and balances. Electoral accountability of the governments, if it exists at all, comes with a long time lag. Elections in countries like India are hardly fought on the issues of economic policy. If the government is the custodian of public interest, we would not have faced these problems today.

The uneasiness in RBI seems to have been simmering for long. While the demonetisation decision was forced on it without considering the logistical problems, the blame for the difficulties in the aftermath were squarely placed in the door of RBI. As the public sector banks lent money recklessly at political heist, bad debts mounted and RBI had to ask the banks to make provisions in the interest of the public at large. Unlike the private sector banks, RBI was also severely constrained in its effort to discipline the public sector banks as it could not enforce actions such as asset divesture, replacement of management and board and could also not undertake measures such as mergers and sales. Cutting short the tenure of board members who are respected and have enormous experience and appointing another on considerations other than expertise is not a way to empower RBI. The attempt to pressurise RBI to relax the 180 days limit as set in the February 12 circular to resolve loans and immediately initiate insolvency proceedings upon the expiry date has not helped matters. The lenders have to take a call and cannot go on negotiating forever. The attempt to pressurise RBI to dilute the norms for recognising stressed assets and make provisions impinges on the role of RBI as a regulator. Asking RBI to transfer the reserves is to basically cover the government's ability to undertake the required fiscal corrections. Pressuring RBI to relax lending norms to MSMEs and ensure greater liquidity to NBFCs in the aftermath of demonetisation, implementation of a complicated GST system and the IL&FS crisis only added to the problem. Finally, trying to create a separate regulator for payments systems added to RBI's discomfiture. After all, RBI has the responsibility for financial stability.

> **What action has been taken against govt-nominated board members for allowing banks to lend to unviable projects?**

The message of the lecture seemed to be the manifestation of accumulated concerns. Perhaps the finance minister could have diffused it by having a meeting over a cup of tea with the regulator instead of allowing the bureaucrats to deal with it.

There is a separate and, of course, important question of whether RBI should have so many tasks assigned to it and this has been partly discussed in the FSLRC report. Calibrating monetary policy, banking regulation, foreign exchange management, public debt management are specialised tasks and with many hybrid products coming to the markets and to avoid regulatory arbitrage and conflicts, we need specialised regulators. Therefore, in countries like Australia, the RBA voluntarily surrendered the regulatory function in favour of a specialised regulator—Australian Prudential Regulatory Authority (APRA). In India, too, there was a suggestion put forward by Rangarajan when he was the Governor of RBI that public debt management should be done by a specialised independent agency, but there was severe opposition to the proposal by some later Governors. The fact of the matter is that RBI faces serious conflicts of interest in conducting banking regulation, monetary policy management and public debt management. In any case, in the given situation, one cannot fault RBI for asking for unbridled authority in carrying its functions.

Unfortunately, much of the discussion so far on the standoff does not recognise the basic conflict of interest in the government. To be sure, the government is the owner of PSBs and, as an owner, should it interfere with regulation? Where did the "public interest" figure when the banks were allowed to lend indiscriminately to the politically connected? What were the government nominees in the boards of these banks doing? What action has been taken against them for allowing the banks to lend to unviable projects and evergreening the loans? Does the government compensate the banks for the social obligations they are forced to carry out? The matter does not stop at banks; it pervades in NBFCs too. How much voice can "independent" directors in the boards of these entities, who are appointees of the government and look forward to the patronage of reappointments, exercise in such decisions? If indeed, banking supervision and regulation is in the remit of RBI, is it appropriate for the owners of the bad banks to pressurise RBI to relax conditions for the banks under PCA or be lenient in lending to the SMSEs and provide funds to bail out NBFCs?

It is not surprising that the mandarins in the North Block, irrespective of which party is in power, are always looking for easy funds to meet their deficit targets. In fact, the budget numbers have lost much of their credibility. The report of the Comptroller and Auditor General on the compliance of FRBM Act by the Union government states that deferred liabilities in 2015-16 amounted to ₹1.87 lakh crore. It appears the government wants to reduce fiscal adjustment to a numbering exercise by postponing the payments, asking one public sector company to buy another and raiding RBI's reserves. Hope better counsel will prevail in public interest!

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