RBI Surplus Transfer to the Government

The article is based on **Spelling out the government's RBI windfall** that was published in The Hindu on 31st August. It talks about the recent surplus transfer by the RBI to the Government and its implications.

Context

- The Central Board of the Reserve Bank of India (RBI) on 26th August decided to **transfer** a sum of ₹1,76,051 crore to the Government comprising of ₹1,23,414 crore of surplus for the year 2018-19 and ₹52,637 crore of excess provisions identified **as per the revised Economic Capital Framework (ECF)** adopted at the meeting of the Central Board.
- The Surplus Distribution Policy of RBI that was finalized is in line with the recommendations of the **Bimal Jalan committee** that was formed by the RBI, in consultation with the Government, to review the extant Economic Capital Framework of the RBI.
- The Committee's recommendations were based on the consideration of the role of central banks' financial resilience, cross-country practices, statutory provisions and the impact of the RBI's public policy mandate and operating environment on its balance sheet and the risks involved.
- In view of the RBI's function as a lender of last resort, it needs to maintain some **Contingent Risk Buffer (CRB)** to insure the economy against any tail risk of financial stability crisis.
- The Jalan Committee recommended that the CRB needs to be maintained at a range of 5.5% to 6.5% of the RBI's balance sheet.
- The surplus transfer policy is now formula based and thus transparent, which is an important departure from the past.
- The formula-based CRB will take care of the **risk provisioning** and the central board of RBI will decide on the level of risk provisioning.

Why this huge transfer

Overcapitalised RBI: The narrative that the RBI is an overcapitalised institution has been in discussions for some time.

- The **Economic Survey of 2016-17** found that the RBI is one of the most capitalised central banks in the world and noted, "There is no particular reason why this extra capital should be kept with the RBI".
- Some central banks around the world (like the US and UK) keep 13% to 14% of their assets as a reserve compared to RBI's 27% and some (like Russia) more than that.
- Economists in the past have argued for RBI releasing 'extra' capital that can be put to productive use by the government. **The Malegam Committee** estimated the excess (in 2013) at ₹1.49 lakh crore.

RBI Surplus Transfer: Why and How

- **RBI's Earning:**
  - **Returns earned on its foreign currency assets,** which could be in the form of bonds and treasury bills of other central banks or top-rated securities, and deposits with other central banks.
  - **Interest on its holdings of local rupee-denominated government bonds** or securities, and while lending to banks for very short tenures, such as overnight.
  - **Management commission** on handling the borrowings of state governments and the central government.
- **RBI's Expenditure:**

  Printing of currency notes and on staff, besides the commission it gives to banks for undertaking transactions on behalf of the government across the country, and to primary dealers, including banks, for underwriting some of these borrowings.

Surplus Transfer:

- RBI transfers the surplus – that is, the excess of income over expenditure – to the government, in accordance with **Section 47** (Allocation of Surplus Profits) of the **Reserve Bank of India Act, 1934.**
- A technical Committee of the RBI Board headed by **Y H Malegam (2013),** which reviewed the adequacy of reserves and surplus distribution policy, recommended a higher transfer to the government.
- By and large, with a few exceptions, the quantum of surplus transfer averages around 0.5% of the GDP.

Implications

- It would help the government to go for **bank recapitalisation** in a big way given the

economic slowdown, when channels of credit disbursements are choked because of a **lack of capital with the commercial banks.**
- The transfer of the additional surplus from the RBI could enable the government to pursue efforts towards **stimulating the economy while maintaining budget discipline.**
- The government, in the case of revenue shortages, would be able **to meet the fiscal deficit target without cutting expenditures** on important sectors.
- It would give the Government necessary **fiscal space to maneuver structural reforms** to boost economic growth.
- The surplus transfer from the RBI has implications for the central bank's balance sheet, government budget, financial market and, above all, monetary policy and debt management by the RBI.

Way Forward

- The decision of the RBI Board must be welcomed as it would help the government in combating the economic slowdown and to conform to the fiscal targets.
- It is hoped that the government will be prudent in using these funds.
- However, the RBI dividend transfer is not a panacea. India's economy needs sustained structural reforms to boost potential growth.

Drishti Input

"Critically analyse the implications of the recent surplus transfer by the RBI to the government. Will it be helpful in the recovery of the economy that is undergoing a slowdown?"