The Big Picture - RBI's Surplus Fund

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The Reserve Bank of India has decided to **transfer Rs. 1.76 lakh crore** in dividend and surplus reserve to the government.

- This came after the RBI board accepted the recommendations of **Bimal Jalan committee** on transfer of excess reserve funds to the government.
- The total amount to be transferred by the RBI to the government includes Rs. 1,23,414 crore surplus for the year 2018-19 and Rs. 52,637 crore as excess provisions identified according to the revised economic capital framework (ECF).
- This transfer of record surplus funds from the RBI is expected to boost overall revenue for the government and meet its fiscal deficit target.

Why the RBI transfer funds to the Government?

- On an average, in the last decade or so, anyway between Rs. 40,000- 60,000 crores have been given away to the government as dividends by the RBI.
- Dividend is paid to the government as the government is a stakeholder in the RBI.
  The dividend is paid out of the earnings that the RBI makes.
- Every year, RBI calibrates as what are the expected incomes.
  - Income sources include **reserves,** which tantamount to about 430 billion dollars which are kept in overseas markets with different central banks in terms of gold, Special Drawing Rights (SDRs) and other deposits. The bank gets certain returns on the same.
  - The Bank also gives **loan to the commercial banks within the country,** whether in the private sector or public sector.
- The income/fund left with the Bank after giving the dividend, is referred to as **'Surplus Fund'.**
  - In companies, in general, this kind of surplus fund is kept as deposits or reserves for the purpose of growth or to handle the situation of emergency.
  - **Bimal Jalan Report says that the RBI should keep 5.5-6.5% of the surplus fund to meet any kind of emergency requirement. Rest of the fund can be given either to the government or can be used for some other purposes.**
- This time, apart from the Rs. 1.23 lakh crores worth of dividend, the RBI has given an additional amount of about Rs. 52,000 crores as surplus fund.
  The RBI has kept 5.5% (the lower limit) of the surplus fund with itself for any kind of emergency.

Does the RBI have enough reserves?

- The RBI's forex assets are not good enough.
  - If one looks at the foreign assets held by the Banking Department of the RBI, percentage of yearly import as end of June 2019 is 0.03%.
  - RBI's external liabilities including short term deposits and commodities are around 114% .
- The net worth (assets-liabilities) of India's Banking System is lower than most of the developed countries. In case of India, it is 0.52%, whereas in the case of UK, it is 6.97%, USA - 12% and Australia -7.2%.
- With respect to adequacy of the reserves, the RBI does not hold a very high percentage vis-a-vis other countries.
  The IMF has created a metric for assessing the adequacy of reserves of countries. Russia has 265% of the required reserves, Brazil-162% and India-159%, a lower percentage.
- The reserves transferred have not been built up on the current account surplus of the country.

- All the developed countries like USA can borrow in their own currency. India has still not not been able to borrow in its own currency in the international market.
- There are two ways the government can finance its spending:
    - Can utilise reserves from the RBI, as done presently
    - Can do deficit financing: i.e. it can take loan from the RBI or can go for monetization (printing of currency)
- The government would not be able to continue using the reserves to finance its fiscal deficit for a longer time.
    - Utilisation of reserves is a short term measure, as next year, the amount of transfer would depend on the income of the RBI.
    - Also, the government sticking to the fiscal deficit number of 3.3% is a matter of concern.
- There is a fear that the lower limit 5.5% can be brought down to 4.5%.

Counter Arguments

- Indian reserves are fairly good, 430 billion dollars for a 1.27 trillion dollar economy is fairly okay. The United Kingdom which is above 1.29 trillion dollar economy, has reserves of only about 100 billion dollars.
- The current surplus has come from the excess contingency. The Contingency Fund (CF) stood at 6.8% of the RBI's total assets, the Jalan panel has recommended that the CF be maintained within a range of 6.5% to 5.5% . Going by the lower limit, the RBI has transferred excess money to the government.
- The RBI, by transferring surplus funds to the government, did its own bid to help the government so that it can take care of the needs of the people of the country.
- The transfer of money will also encourage the RBI to look for its earnings.

How the Government should utilize the transferred amount?

- This money does give the elbow room to the government, however, as of now, there is no mention of how and where will the government spend the transferred money.
- The money should be used judiciously in terms of productive growth implements like roads, highways to yield positive results, thus creating basic infrastructure.
- The money can also be used for pumping some money into nodal agencies such as SIDBI, NABARD etc.
- MUDRA loans, as well as the banks that provide loans to the MSMEs can be refinanced.
- With the help of this money, stimulus package for auto or real estate or construction sector can be created.
- However, if it will be used just to finance the NPAs or dip in balance sheet of PSUs then it can result in fiscal deficit financing and would not yield good results.

Way Forward

- The government needs to continue with the measures which save fiscal spending. For example- restructuring of taxation framework (GST), a large number of controls for NPAs etc.
- The government should create a sovereign fund so that all the capital funds inflows can be invested and not expensed out like tax receipts.
- The government needs to develop a difference between recurring and non-recurring income and should also decide how they are to be deployed in the funding of the budget, to ensure efficiency in expenditure.
- While looking at the reserves of the central bank, the government should look at the entire health of the banking sector in the country. Also, the Central Bank having a very large profit is not an indication of better health of the economy.