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Heavy Government Hand Likely Forcing RBI Governor Out

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Summary

Dr Urjit Patel has become the fifth Governor of the Reserve Bank of India, in independent India, to have quit prior to the completion of his tenure. Although healthy tension between the fiscal authority (government) and the monetary authority (central bank) is nothing new, presently however, these differences seemed to have become unmanageable leading to the Governor's resignation. This is certainly not a reassuring move, especially when the financial sector needs deft handling.

Dr Urjit Patel, the Reserve Bank of India (RBI) Governor, announced his resignation on 10 December 2018, with immediate effect, citing personal reasons. His resignation comes nine months ahead of the expiry of his 3-year tenure, taking everyone, including the government, by surprise. In fact it has, to a certain degree, embarrassed the government. It is widely believed that Dr Patel resigned only a few days ahead of a crucial RBI Board meeting on 14 December 2018, wherein there was a likelihood of the Board attempting to establish its primacy over the Governor. Traditionally, the RBI Board has served only as a sounding board, where the primacy of the views of the Governor always prevailed. The Board is not considered to be mandated to drive policy decisions as it comprises corporate representatives who could have a conflict of interest. Former governors are credited with the view that the Governor has a predominant position and is not under any compulsion to conform to the views orchestrated by the board. RBI watchers believe that in recent months there has been a systematic tendency on the part of the government to dilute the powers of the Governor and establish its dominance on the belief that the monetary authority, though being autonomous, is subservient to the elected government.

Dr Patel has had a very tenuous stint as Governor of the central bank. Within a few weeks of his appointment, the demonetisation of Rs 1000 and Rs 500 denomination currency notes was announced by the government. How much consultation took place between the government and the central bank is not known but in the aftermath of the announcement, the credibility and competence of the RBI to manage currency availability in the country came up for huge criticism. It led to hardship for the common man and the blame for such poor liquidity mismanagement was laid at the door of the RBI. No sooner had the pains introduced by the demonetization died down, than the RBI decided to change the interest rates and bring 12 commercial banks, with stressed balanced sheets, under further corrective norms. These decisions were adversely viewed by government. However, the flashpoint in relations appears to have been the speech made by Dr Viral Acharya, RBI Deputy Governor, at the AD Shroff Memorial Lecture in Mumbai on 26 October 2018, in which he made no bones about the fact that the autonomy of the bank was being eroded and if the trend continued, there was a likelihood of adverse impact on the economy. This public airing of differing perceptions provoked sharp responses from the government. It is believed that the government retaliated by seeking consultations under a hitherto unutilized provision of the RBI Act, leading to sharp exchanges between the government and the Bank. Speculation was soon rife that Dr Patel, would step aside and not get into a turf battle with the government. However, after a marathon board meeting on 19 November 2018, it was generally believed that a truce had been reached. Even so, it was obvious that the RBI's autonomy had taken a major hit when the Board took a decision to constitute an expert panel to examine the Economic Capital Framework (ECF) of the RBI, a move that could prompt a rethink of what constitutes adequate capital reserves for the central bank, which was earlier considered to be totally within the mandate of the bank. Further, the RBI placing 12 commercial banks under Prompt Corrective Action (PCA) and restricting the flow of resources to the micro, small and medium enterprises (MSMEs), was causing disquiet in the government. The Board meeting had compelled a rethink on lending to MSMEs and required the prompt corrective framework to be examined by the Board for financial supervision. These decisions caused great discomfiture in the central bank as its remit on them had never before been challenged.

In the Board meeting scheduled for 14 December 2018, the membership of the expert panel to examine the ECF, was to be jointly decided by the Bank and the government. That was the crux. The membership would have determined which way the decision would go—in favour of lower capital resources that the Bank should keep, thereby implying greater surplus transfer to the government, or retain the present level, which would have implied lesser transfers to government. The Bank must have gotten insights into the constitution of the committee and found that the government was going to come in heavily on them. A Governor, who had already faced heavy criticism for having ceded substantial space to the government during the demonetisation imbroglio, must have seen this as one more giveaway, for which he would have had to carry the cross. This thought would have been very unsettling to him. Dr Patel was known to be a very reserved person and there were not many with whom he shared confidences. Hence, the real reason for his resignation will probably never become public. However, the timing can certainly be linked to pressures prior to the upcoming Board meeting.

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