

General Studies-2; Topic: Statutory, regulatory and constitutional bodies

Role of RBI in an Economy

1) Introduction

- Reserve Bank of India (RBI) is India's Central bank. It plays multi-facet role by executing multiple functions such as overseeing monetary policy, issuing currency, managing foreign exchange, working as a bank of government.
- RBI played a vital role in ensuring economic and financial stability.

2) RBI's Previous Functions

- Before inflation targeting was formally introduced in 2016, RBI was doing multiple roles.
- They were responsible for growth by managing liquidity as well as interest rates.
- They contributed in inflation management by adjusting liquidity and interest rates.
- They borrowed money on behalf of the government to keep them functioning.
- They also took care of the financial system's stability by supervising banks and NBFCs.
- Nobel laureate Joseph Stiglitz made a statement that if RBI Governor was the governor of the US Fed then the sub-prime crisis would not have occurred.

3) Role of Reserve Bank of India

- The central bank issues and regulates currency notes.
- It keeps reserves with a view to securing monetary stability and is called banker to banks.
- The RBI plays a vital role in economic growth of the country and maintaining price stability.
- **Monetary Policy of the Country**
 - a. The RBI has been tasked to have a monetary policy framework to meet the challenges of the economy and to maintain price stability while keeping in mind the objective of growth.
- **Inflation control**
 - a. The RBI has targeted to keep the mid-term inflation at 4 four per cent (+/- 2 per cent).
- **Decides benchmark interest rate**
 - a. A six-member Monetary Policy Committee, headed by RBI Governor, decides the benchmark repo rate.
- **Government's banker**
 - a. RBI acts as a banker for both the central as well as state governments.
 - b. It sells and purchase government securities on their behalf.
- **Regulator of Foreign Exchange**
 - a. Foreign Exchange Management Act ("FEMA") envisages that RBI will have a key role in management of foreign exchange.
- The central bank plays a key role in creating financial awareness among the masses.
- It also supervises if the banks and other financial institutions are doing the job assigned to them regarding financial inclusion.

4) RBI's Role to Manage Inflation

- Post 2016, RBI has been mandated to manage inflation and growth in that order of priority.
- We copied this idea from the developed economies where this idea has been put into cold storage when required.
- RBI was constitutionally mandated in 2016 to bring inflation around 4% with a leeway of 2 % on both sides.

- They have successfully brought down the menace of inflation.
- RBI has maintained tighter liquidity and higher real interest rates to control inflation.
- The collateral damage has been on growth as liquidity remained tight and the cost of liquidity remains high in the real sense.
- The disruption caused by the introduction of GST and demonetisation added to the complexity.

5) Urjit Patel Resignation

- The resignation of Urjit Patel as the RBI governor raise questions on transparency in appointing, removing and resignations of financial sector regulator heads.
- Even though RBI serve an extremely important role in the Indian economy, the board or head do not have any constitutional protection like the CAG or the CEC do for their appointments or removal.
- It is time that our financial regulatory architecture is strengthened.
- Removal of the regulatory heads once appointed for a fixed tenure should be made difficult on the lines of other constitutional functionaries.
- This will provide confidence to the institutions and allay the fears of politicisation of regulators.

6) Way Forward

- Some experts feel that what we require at this point of time is the old RBI that is an all-rounder rather than a specialist.
- They have to manage multiple roles.
- They have to manage issues like inflation, growth, rupee and financial system stability.
- Operational independence of central banks important for carrying out their responsibilities, says IMF
- In a democracy, the final responsibility of all policy decisions must lie with Government.
- Therefore there should be mutual cooperation and coordination between RBI and Government in large at public interests for an efficient and sustainable economy.

7) Facts for Prelims

- The RBI was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.
- Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.
- Key appointments in the RBI - Appointments Committee of the Cabinet headed by the Prime Minister appoints the governor and deputy governors.
- The RBI Act empowers the government to issue directions to the governor in public interest (Section 7 of the Act).
- Urjit Patel's resignation makes it the second time since 1992 that a RBI governor did not serve out a full term.
- The term of office typically runs for 3 years.
- Shaktikanta Das is the 25th governor of the Reserve Bank of India from 11 December 2018.