

## Viral Acharya warns of market wrath, bats for more independence for RBI

Dy Governor says central bank must have more powers to supervise PSBs, keep its balance sheet strong and have adequate regulatory scope

Advait Rao Palepu & Abhijit Lele | Mumbai October 26, 2018 Last Updated at 22:10 IST



Making a strong case for granting more independence to the Reserve Bank of India (RBI), Deputy Governor Viral Acharya on Friday said the central bank must have more powers to supervise public sector banks and keep its balance sheet strong, and have adequate regulatory scope. This independence, he said, was necessary to secure greater financial and macroeconomic stability.

Delivering a hard-hitting speech in Mumbai, Acharya said the governments that did not respect their central bank's independence would sooner or later incur the wrath of financial markets, ignite economic fire, and come to rue the day they undermined the regulatory institution.

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He said the governments that invested in central bank independence would enjoy lower costs of borrowing, the love of international investors, and longer life spans. Such endeavour would be a true inclusive reform for the Indian economy's future, Acharya said, delivering the speech on "Ongoing

As many parts of the world today await greater government respect for central bank independence, independent central bankers would remain undeterred, he said.

Acharya said, “We have made good progress in earning the RBI’s independence, most notably in the monetary policy framework, along with the Insolvency and Bankruptcy Code and the goods and services tax.” These were considered crucial structural reforms by Moody’s in upgrading India’s sovereign rating eleven months back.

Yet, a few important pockets of persistent weakness remain in maintaining the independence of the RBI. Some of these areas identified were included in the 2017 Financial Sector Assessment Programme of India report.

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This report was by the International Monetary Fund and the World Bank.

One important limitation the central bank faces is that it is statutorily limited in undertaking the full scope of actions against public sector banks (PSBs) – such as asset divestiture, replacement of management and board, license revocation, and resolution actions such as mergers and sales. The apex bank exercises these powers effectively in the case of private banks.

Significant implications of this limitation were highlighted in detail by RBI Governor Urjit Patel in a speech in March.

Referring to the RBI’s balance sheet strength, Acharya said the independence of any institution depended on having adequate reserves to bear any losses that arise from central bank operations and having appropriate rules to allocate profits. This includes setting rules to govern the accumulation of capital and reserves, which is considered an important part of central bank’s independence from the government.

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An ongoing issue on this front has been the rules concerning the transfer of surplus (dividends) from the RBI to the government.

Finally, Acharya asserted that the independence of the central bank in regulatory matters is being tested by the government’s attempt to bypass RBI’s powers over the payment and settlement systems, through the creation of a separate payments regulator.

The Reserve Bank has published its dissent note against this recommendation on October 19, 2018.

### **How govts undermine central banks**

- Govts appoint officials rather than technocrats to key positions
- Pursue steady attrition and erosion of statutory powers of central banks

- Block rule-based policies, favour joint decision-making
- Set up parallel regulatory agencies with weaker statutory powers

**Source:** Viral Acharya's speech at the A D Shroff Memorial Lecture