RBI's Interim Dividend to the Government

Why in news?

The RBI recently approved an interim dividend (surplus transfer) payout of Rs 28,000 crore to the government.

How does the RBI generate surplus?

- **Income** - A central bank's income comes largely from the returns it earns on its foreign currency assets.
- This could be in the form of bonds and treasury bills of other central banks or top-rated securities, deposits with other central banks.
- Other sources include the -
    1. interest it earns on its holdings of local rupee-denominated government bonds or securities
    2. management commission on handling the borrowings of state governments and the central government
- The RBI buys these financial assets against its -
    1. fixed liabilities such as currency held by the public
    2. deposits issued to commercial banks
- **Expenditure** - A central bank's expenditure is mainly on the printing of currency notes.
- Other components include the expenditures -
    1. on staff
    2. on commissions to banks for undertaking transactions on behalf of the government across the country
    3. on commissions to primary dealers, including banks, for underwriting some of the borrowings
- **Surplus** - Generally, the central bank's total expenditure is only about a seventh of its total net interest income.
- This implies that it certainly generates a large surplus out of the excess of income over expenditure.

What is an interim dividend?

- The surplus transfer is generally done in early August, after the completion of the bank's July-June accounting year.
- The RBI had thus already transferred Rs 40,000 crore to the government in August 2018.
- So the current one is an interim transfer, in addition to the usual one.
- With this, the government will get a total of Rs 68,000 crore from the central bank in the current fiscal.

Why is it transferred to the government?

- The central bank transfers its surplus to the government under the provisions of Section 47 of the Reserve Bank of India Act, 1934.
- The Government of India is the sole owner of India's central bank, the RBI.
- So the government can make a legitimate claim to this surplus.
- Also, by virtue of its role as the manager of the country's currency, the RBI generates more surplus than the entire public sector put together.
- So this surplus, in effect, belongs entirely to the country's citizens.
- Given this, the RBI pays the remaining surplus after setting aside what is needed to be retained as equity capital to maintain its creditworthiness.

Is giving extra dividends a problem?

- Much of the surplus that the RBI generates comes from the interest on government assets, or from the capital gains through other market participants.
- When this is paid to the government as dividend, the RBI is actually putting back into the system the money it has made from it.
- Logically, there is no additional money-printing or reserve-creation involved.
- But when the RBI pays an additional dividend to the government, it has to create additional permanent reserves i.e. it has to print money.
- Instead, to compensate for the special dividend, the RBI would have to withdraw an equivalent amount of money from the public.
- The RBI does this by selling government bonds in its portfolio.
- Besides, all central banks worry that large payouts could limit their ability to create buffers to make up for the impact of a crisis.

What does surplus transfer say about government finances?

- This is the second year running that the RBI has paid an interim dividend to the government.
- Last year, the RBI paid out an interim dividend of Rs 10,000 crore.
- Notably, during periods of high growth as seen during the last decade, the government does not make demands on RBI's surplus.

- But the government has asked for an interim surplus for the financial year 2018-19 as well as the amount retained by the RBI from surpluses of the previous two years.
- So surplus transfer from the RBI does indicate that the government finances are under pressure.
- The current transfer is expected to help keep the fiscal deficit at the projected 3.4% of GDP for 2018-19.

How is it elsewhere?

- Almost all central banks, the US Federal Reserve, Bank of England, Reserve Bank of Australia and Germany's Bundesbank are owned by their respective governments.
- They have to transfer their surplus or profits to the Treasury, or the equivalent of India's Finance Ministry.
- The UK has a formal Memorandum of Understanding on the financial relationship between the Treasury and the Bank of England.
- It lays down a clear framework for passing on 100% of net profits to the government.
- The US Fed too, transfers all its net earnings to the Treasury.

Source: Indian Express, Economic Times