

## 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 -
  - i. interest it earns on its holdings of local rupee-denominated government bonds or securities
  - ii. management commission on handling the borrowings of state governments and the central government
- The RBI buys these financial assets against its -
  - i. fixed liabilities such as currency held by the public
  - ii. deposits issued to commercial banks
- **Expenditure** - A central bank's expenditure is mainly on the printing of currency notes.
- Other components include the expenditures -
  - i. on staff
  - ii. on commissions to banks for undertaking transactions on behalf of the government across the country
  - iii. 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**

