The Evaluation of Monetary Policy in India

Dr. Rajbir Singh*

* Associate professor and head, Department of Economics, Kisan Post Graduate College, Bahraich U.P.

Introduction :

Monetary policy is an arm of public policy. It is a process by which the monetary authority manages the supply of money or trading in foreign exchange markets. It rests on the relationship between the rates of interest in an economy (the price at which money can be borrowed) and the total supply of money. It has set objectives and priorities, which are derived from the respective mandates of central banks. It ranges from single objectives of price stability considered to be the dominant objective of monetary policy, to the multiple objectives that also include growth and financial stability.

Monetary policy is an important aspect of overall economic policy. An appropriate policy contributes to economic growth by adjusting money supply to the need of growth, by directing the flow of funds in the required channels and by providing institutional facilities for credit in specific fields of economic activities. In this way monetary policy helps a healthy growth of the economy. Monetary policy consists of the measures taken by the central banking authority to regulate the cost and availability of credit. Monetary and credit policy operate through five factors :-

1) The availability of credit.
2) The value of money.
3) The cost of borrowing.
4) The prices of capital assets and
5) The general liquidity of the money.

One of the fundamental tasks of monetary authority is the growth which includes the creation of conditions for the effective mobilization of the supply of actual and potential savings through the promotion of financial intermediaries and the creation of a spectrum of financial assets on the one hand and on the other the effective investment of these resources through the adaptation of the credit structure to sub-serve the needs of development.

<u>Definition of monetary policy</u>

Monetary policy has been defined differently by various economists. According to **Paul Finzig,**"Monetary Policy includes all monetary decisions and measures irrespective of whether their aims are monetary or non-monetary and all non-monetary decisions and measures that aim at affecting the monetary system."

Harry Jahnson (1963) define monetary policy as "Policy employing control banks central of the supply of money as an instrument for achieving the objectives of general economic policy".

According **D. Jha,** "Monetary Policy is one important segment of an overall financial policy which has to be operated in the overall milieu prevailing in the country."

Reserve Bank of India Considers monetary Policy as an instrument influencing the level of aggregate demand for goods and services. The various instruments of monetary policy that the Reserve Bank of India has at its disposal are as follows :- 1. Open Market Operations, 2. Bank rate, 3. Variable reserve requirement, 4. Liquidity adjustment facility and 5. More suassion.

The History of Monetary Policy :

Monetary Policy is as old as monetary system or as money itself. It has a long and chequered history since the days of mercantilism. Evidence proves the existence of monetary management in Greece. But before 1914, the whole thinking about monetary policy was based upon the idea of automatic gold exchange system. After World War I, the gold exchange standard collapsed and it is then when the modern genesis of Monetary Policy took place. The 1920's is inflation in Germany and the two international conferences, one in Brussels in 1920 and the other one in Geneva in 1922, Compelled the thinking about a new monetary system. The depression of the 1930s provided further stimulus to the thinking of reforms in the field of monetary management. The Horizon of Monetary Policy has greatly widened in the recent past.

The origin of monetary management in India can be traced back to time immemorial. The reference about the Panis, the money lenders of southern India, in Rig Veda is an evidence of the developed state of banking or credit system in the Vedic age, although the date of the origin of the coins and credit instruments is lost in the midst of antiquity. In the Mauryan era, the system of currency, credit and coinage was fully developed. Kautilya devotes a chapter in his classical book "The Arthashastra" on rules for mining and credit.

The history of monetary management and policy in terms of central banking practices in India can be traced to as far back as January 1773, when **Lord William Bentick the then Governor and later on the** first governor general of British India, placed before the Board of Revenue his plan for General Bank in Bengal and Bihar. The Royal commission of

Indian finance and currency also known as the chamberlain commission setup in 1913 with J.M. keynes as one of the member who prepared a blueprint for the establishment of an Imperial Bank of India. The bank came into existence on January 1921 by amalgamating the three presidency banks – Bank of Bengal, Bank of Bombay, Bank of Madras in to one commercial bank with functions as those of the central bank which later on came to be called as State Bank of India after Independent. In August 1925, the Royal commission on Indian currency and finance also referred as the Hilton young commission was appointed. The commission observed that India was the only big trading country in which the currency and note issues were under direct government control. In 1926, it recommended that establishment of Central Bank of India which was to be called Reserve Bank of India and several measures to reform the monetary system. The Indian Central Banking Enquiry committee (1931), revised the establishment of the Reserve Bank of India which was established later under the Reserve Bank of India Act 1934.

Objectives of Monetary Policy :

The Monetary Policy in developed economies has to serve the functions of stabilizing and maintaining proper equilibrium in the economic system. But in case of underdeveloped countries, the Monetary Policy has to be more dynamic so as to meet the requirement of an expanding economy by creating suitable conditions for economic progress. Monetary policy is now widely as a tool of economic transformation.

As the objective of monetary policy varied from country to country and from time to time, a brief description of the same is as follows :

1. Neutrality of money.
2. Stability of exchange rates.
3. Price stability.
4. Full employment.
5. Economic growth.
6. Equilibrium in the balance of payments.

Research Methodology :

1. The study is based on secondary sources of data.
2. These sources include the official website of the Reserve Bank of India, Central Statistical Organization, National Stock Exchange and times of India archives of the property rates.

Instruments of monetary policy in India :

There are several direct and indirect instruments that are used in the implementation of Monetary Policy which are follows :

1. **Cash Reserve Ratio (CRR) :** The share of net demand and time liabilities deposits that banks must reserves with the Reserve Bank of India.
2. **Statutory Liquidity Ratio (SLR) :** The share of net demand and time liabilities deposits that banks must maintain in safe and liquid assets such as, government securities, cash and gold before providing credit to the customers.
3. **Term Repo :** They are used to infect liquidity over a period that is longer than overnight. The term repos was introduced by the RBI in October 2013 with the aim to help develop inter-bank money market.
4. **Liquidity Adjustment Facility (LAF) :** It's a tool that consists of overnight and term repo/reverse repo which allows bank of borrow money. The RBI has progressively increased the proportion of liquidity injected in the LAF through term-repos.
5. **Marginal Standing Facility (MSF) :** A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank against the approved Government Securities.
6. **Open Market Operations (OMOs) :** These include both outright purchase or sale of government securities for injection/absorption of liquidity.
7. **Bank Rate :** It is the rate at which the RBI lends money to Commercial Bank or rediscount bills of exchange or other commercial papers of commercial banks. This rate has been aligned to the MSF rate and therefore changes automatically as and when the MSF rate changes alongside policy repo rate changes.
8. **Market Stabilization Scheme (MSS) :** The instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury Bills. The mobilised cash is held in a separate government account with the RBI. the instrument thus has features of both SLR and CRR.

The Reserve Bank of India seeks to influence monetary conditions through management of liquidity by operating in varied instruments. Since 1991, the market environment has been deregulated and liberalised where as the interest rates are largely determined by the market forces. The trends in the instrument of monetary policy are shown in the table-1 :

Movement in Key Policy Rates and Reserve Requirements in India (%)

Effective Since	Bank Rate	Reverse Repo Rate	Repo rate	Cash Reserve	Statutory Liquidity Ratio
1990-91	10.00	-	-	15.00	38.50
2000-01	7.00	6.00	10.00	8.00	25.00
2010-11	6.00	3.25	4.75	5.50	25.00

Conclusion :

In our endeavour to understand the role of monetary policy and monetary framework it has been observed that monetary policy in India so far had largely been discretionary. The discretionary policies at least during the 1990s, were unavoidable due to the immense structural changes that were required to transform a Command and Control economy to a market-based one. However, consistent with international trends during the 1990s, the motivations that led to such discretionary practices in India had generally been explained to economic agents in detail. Despite crucial differences in a few areas, the monetary policy framework in India has assimilated many of the best international practices. The RBI's overall performance in transparency and data dissemination were also satisfactory. Its performance in assessing the outlook - in full view of public knowledge - has helped to guide expectations of economic agents along the desired trajectory. Together these features indicate the adoption of a soft, informal and flexible version of the IT framework similar to that practiced by many economies before their formal switch to IT. The Indian experience, therefore, further strengthens the observation of **Mishkin in 1999** that rather than the formal adoption of a target, 'the devil is in the details in achieving transparency and accountability'. While monetary policy played an important role in reducing the rate of inflation in India, the paper argues that this achievement was due to combinations of monetary, fiscal, competition and administrative policies. It may be noted that some of these policies, by enhancing efficiency and competition, usher shifts in the aggregate supply curve. As a result, to isolate the likely contribution of monetary policy in reducing the rate of inflation becomes a difficult task, especially in a situation where the relevant statistics pertaining to aggregate supply situations are an available. The paper, however, tries to highlight the importance of monetary policy in India-played and its contribution important role. It facilitated the increase in efficiency and competitiveness in the overall economy by sharply focusing its attention on efficiency and competitiveness in the financial sector. A defining feature of the Indian approach to financial sector reforms is gradualism. This is in sharp contrast to some of the emerging market economies that adopted shock therapy. To quote Reddy, "policy makers in India had been engaged in the development of sound and efficient financial intermediaries and markets so as to provide solid foundations for effective transmission of monetary policy". Common sense suggests that for financial stability, the set of measures should be speedy, but a juxtaposition of the Indian experience to other emerging market economies seems to suggest the undue haste in initiating structural changes. It is this last observation that highlights the importance of perspectives in reviewing Indian performance. Here it is worth mentioning the striking contrast in perspectives of two Economists. In describing the Indian experience, Reddy does deny 'an element of luck', but opines that investment in institution building was an “exercise of sound judgment and enhancement of skills at all levels". At the other extreme, **Balakrishnan** perceives the same experience as a "less than imaginative support to growth”, “a failure to show acceleration” and a “bizarre case of a missing monetary policy”, with a grudging approval that "this does not warrant the conclusion that the reforms failed". Thus, like the proverbial story of the Indian elephant which would look different to different people, the actions of Indian policymakers would perhaps attract different adjectives from different persons or organizations.

REFERENCES :

1. Friedman, Milton (1969) ; The quantity theory of money : A Restatement, Macmillan, Landon pp 51-68.
2. Mohanty Deepak (2011) : Changing of monetary policy in India", Speech delivered at the Royal Authority of Bhutan, Thimpu, December, p.1
3. Jacobson, Per (1958): Some Monetary problems, International and National, Oxford University Press, p.13.
4. Desai, V.R. Muthalik (1969) : Monetary Policy and Central Banking in India, Bombay Popular Prakashan First Ed. P-145

5. Bhattacharya, P.C. (1966) : "Monetary Policy and Economic Development, in 50 Years of Central Banking", Governors Speak, Mumbai, Reserve Bank of India, 1997, p.2.

6. Einzing, Paul (1964): Monetary Policy - Ends and Means Penguin Books Ltd. Harmonds Worth Middlesex, England. p.432.

7. Johnson, Harry G. (1963) : "Recent Developments in Monetary Theory", Indian Economic Review: Feb. Vol. 6, No:3, p.29-69

8. Sharma, K.K. (1968) : Indian Monetary Policy, Meenakshi Prakashan, Meerut, India, pl.7.

9. Reserve Bank of India, RBI Publications, Various years (1991-2010).

10. Vijayaragavan, Iyengar. G (2007) : Introduction to Banking, Excel Books, New Delhi, Chapter 1,2,3.

11. Keynes John Maynard (1937) : "The Ex-Ante Theory of the Rate of Interest", Economic Journal, p.663-679.

12. Burner Karl (1961), "Some Major Problems in Monetary Theory", American Economic Association, Papers and Proceedings, Vol. 51(b), p.47-56.

13. https://rbi.org.in/scripts/FS-verview.aspx.

14. RBI, Annual Reports.