A study on Role of Monetary Policy in Economic Development of India

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Abstract

The monetary policy helps in the development of undersized countries by monitoring price fluctuations and general economic activities. This is done by making proper alteration between demand for money and the supply of money. As the economy develops, there is continuous increase in request for money. This paper emphasis on role of monetary policy in economic development of India. And it will also measure the impact of monetary policy on Indian economy.

Keywords: *Monetary Policy, Economic Development, Indian Economy*.

Introduction

In order to achieve high economic growth and maintain price stability the financial authority of India i.e. central bank manages the supply of cash within the economy by its control over interest rates. Reserve Bank of India (RBI) is the central monetary authority in India and price stability is maintained by RBI in India. RBI has stated the other objectives of monetary policy that are as follows:

- Price Stability
- Controlled Expansion of Bank Credit
- Promotion of Fixed Investment
- Restriction of Inventories and stocks
- To Promote Efficiency
- Reducing the Rigidity

- **Price Stability**

  The main focus of price stability is maintain reasonable price stability to ensure the development of projects to run rapidly for which favorable environment is facilitated.

- **Controlled Expansion of Bank Credit**

  RBI mainly work for controlled growth of bank credit and money supply where seasonal requirements are considered for credit without affecting the output.

- **Promotion of Fixed Investment**

  The objective is to limiting non-essential fixed investment to increase the productivity of investment.

- **Restriction of Inventories and stocks**

  This policy has been framed to evade over stocking & idle money in the organization. As additional stock available in the unit was becoming outdated and it was resulting in sickness of the unit.

- **To Promote Efficiency**

  Central Banks these day are way more careful with their systems and transactions with this practice the effectiveness of the bank was increased. With this practice now they are able to derestrict many functions of the bank like easing operational controls in the credit distribution system, introducing new money market instruments, etc. along with that they even tried to make some structural changes which would help them in the long run of their business.

- **Reducing the Rigidity**

  Reserve Bank of India helps the banks with a few flexibilities in operations which helps the bank to work independently. With these flexibilities it creates a competitive atmosphere and helps in expansion. It also helps to maintain control regularly to make sure that the discipline and cautiousness of the operations in the financial system is kept at the highest level.

Monetary policy committee

Amendments were made by the Finance Act, 2016 for The Reserve Bank of India Act, 1934 (RBI Act), the same was done to provide legal and long standing background for the Monetary Policy Committee. The objective of these changes was growth and pricing stability. The committee is a bench mark setter for the policy rate (repo rate) and is delegated to achieve a specific target level. The RBI Act makes it necessary to have three of the six members of RBI in the MPC and the other three will be allotted by the Central Government.

In discussion with RBI the Government of India, informed the 'Inflation Target' in the Gazette of India Extraordinary dated 5th August 2016 for the duration beginning from the publication date of the announcement and ending on 31st March 2021 as 4%. At the same time, tolerance levels were notified to be 2% and 6% respectively only.

Monetary operations

Monetary techniques are a part of the monetary operations which work on the monetary magnitudes like monetary supply, interest rates and credit limits, to maintain price stability, economic growthand healthy balance of payment, stable exchange rate and financial stability.

Instruments of monetary policy

The below mentioned instruments are used to regulate the money stream in the economy:

- Open Market Operations
- Cash Reserve Ratio (CRR)
- Statutory Liquidity Ratio (SLR)
- Bank Rate Policy
- Credit Ceiling
- Credit Authorization Scheme
- Moral Suasion
- Repo Rate and Reverse Repo Rate

Key indicators

As of 4 October 2019, the key indicators are

Indicator	Current Rate
Inflation	2.86%
MSF(Marginal Standing Facility) Rate	0.054
CRR	4.00%

SLR	18.75%
Bank rate	0.054
Reverse Repo Rate	0.049
Repo Rate	0.0515
GDP growth rate	0.061

Source: https://en.wikipedia.org/wiki/Monetary_policy_of_India#cite_note-16

Role of Monetary Policy in Economic Development of India

The Role of monetary policy in the economic development of a country are as follows:

- Appropriate Adjustment between Demand for and Supply of Money,
- Price Stability,
- Credit Control,
- Creation and Expansion of Financial Institutions,
- Suitable Interest Rate Structure,
- Debt Management.

- **Appropriate Adjustment between Demand and Supply of Money**

  Economic development can be measured by analyzing the rising demand for money. To carry out day-to-day transactions the demand for money increases if there is increase in population of country and rise in per capita income. And if monetary authority is supplying more money to the industries than its requirements this will hinder the growth of the country and will cause an inflation.

  The monetary authority should keep balance between demand and supply of money in order to prevent economic fluctuations and pave the ground for rapid development.

- **Price Stability**

  Price stability plays a vital role in economic growth of a country. It is very important to maintain the stability in exchanges rates and the domestic level of prices. If it is not done by the monetary authority it will lead to inflationary pressures in under developed countries.

- **Credit Control**

  Short term credits are provided to the businessmen and traders mainly and long term credits are provided to industries and manufacturing sectors for meeting their financial needs. Selective credit systems shall be adopted to inspire the design of investment and production by distinguishing between the costs and availability of credit in different sectors and industries.

- **Creation and Expansion of Financial Institutions**

  Special attention needs to be paid by the Central Bank for the problem of rural credit. A system of cooperative credit societies can go a long way in providing the credit requirements of the ruralites. Central Bank along with other financial corporations shall provide finance to business and industry. This will help to upsurge the rate of economic development of the country.

- **Suitable Interest Rate Structure**

  Interest rate serve as an anti-inflationary measure by limiting borrowing from the banks for suppositious purposes and undesirable investments. It will arouse savings and thus increase the supply of investible sources. It would secure the allocation of uncommon capital into most productive uses and avoid productive and wasteful use of resources. But these opinions do not carry much weight. The productive and efficient use of investible resources can be better secured by straight controls and control over capital issues. The developing countries, shall be more practical in their approach and must change such a differentiated interest rate policy which should restrain the unessential spending, contain the inflationary pressures, promote capital formation and sustain the investment activity at a level such that the leap of growth is not slowed down.

- **Debt Management**

The government has to derive on a large scale to implement the programmes of economic development and hence the responsibility of managing public liability effectively and efficiently so as to assist the requirements of economic growth. The main objective of debt management "is to create circumstances in which public borrowing can increase on a big scale without giving any surprise to the system. And this must be on lower rates to keep the burden of the liability low." It is clear that a sensible monetary policy can go a long way in motivating economic development.

Research Objectives

The objectives of the research are:

- To identify the role of Monetary Policy in Economic Development of India.
- To measure impact of Monetary Policy on Indian Economy.

Methodology

The study is based on secondary data and the data for the study was collected through journals, magazines, newspapers and internet.

Discussion and Implications

However, tight monetary policy for controlling inflation is not without its limitations. First, monetary transmission mechanism may be weak and raising of short-term interest rates by the RBI may not actually lead to the restriction of bank credit. This can happen when the banks may have surplus liquidity (i.e., cash reserves) with them and therefore they may not follow tight monetary policy and raise their lending rates. As a result, supply of credit by banks will not be restricted. If the economic environment will be in flourishing conditions will prevail in the economy and collective demand for products will be quite high, demand for credit may not be much affected by higher offering rates.
As emphasized by J.M. Keynes, investment is firm more by marginal efficiency of capital (that is, expected rate of return) rather than rate of interest. Thirdly, at present in India corporate firms are more easily able to borrow from foreign capital markets (i.e., external commercial borrowing, ECB) especially when rates of interest in the US, European zone and Japan are extremely low. Therefore, unless this debt-capital inflow (i.e., ECB) is checked RBI's monetary policy may not be effective to check the supply of credit to control inflation in the economy.

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