SIGNIFICANCE, POLICIES AND FACTORS DETERMING THE MONETARY POLICYIN INDIA

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Abstract
Policy in India is a part of economic policy. It is the management of money supply and interest rates by Central bank to influence prices and growth. Monetary works through expansion or contraction of investment and consumption expenditure. The three primary objectives of economic policy in India have been Growth, Social Justice, and Price Stability. Reserve Bank of India is the monetary authority in the country. The Reserve Bank of India operates in an atmosphere of democracy, and hence due preference is given to political control. The monetary policy pursued by the Reserve Bank of India has been characterized as a controlled monetary expansion. It refers to a policy of adequate financing for activities that promote economic growth with reasonable price stability. India is Monetary considered inflation-resistant, and so keeping a low rate of inflation has been a crucial objective of monetary policy. It aims at controlling inflation by restraining the secondary expansion of credit and regulating the supply of money in order to meet the requirements of different sectors of the economy to accelerate the pace of economic growth.

Key words :
Monetary Policy, Market Stabilisation Scheme Etc.

Introduction

The financial sector reforms were initiated in the year 1991 on the recommendations of the Financial Sector Reforms Committee. The committee suggested measures that would promote the efficiency and profitability of the financial system. The emphasis was on improving the depth of the system and the introduction of new financial instruments that would allow leverage and freedom for the monetary authority to achieve its objective of "Controlled Expansion." The first phase of reform included a reduction of Statutory Liquidity Ratio (SLR), Cash Reserve Ratio (CRR), and deregulation in deposit interest rates. These reforms were based on the evolving nature of the Indian economy due to the overall economic reform policy introduced in 1991. The money market plays a very significant role in the conduct of monetary policy. Reforms in the Indian money market were aimed at improving monetary policy transmission through the interest rate channel. It is also indicated that the communication channel also emerged as a significant monetary policy instrument in India. Financial innovation is another significant development in money and foreign exchange markets in the post-reform period that influenced the monetary policy. So, monetary policy in the post reform period by the central bank has been formulated by using a new set of instruments, approaches, and policies for achieving the goals of Price Stability, Economic growth, and Social Justice. As a result, the central bank started giving less priority to the cash reserve ratio (CRR) and the bank rate. Central Bank introduced many new indirect monetary control instruments of which the repo and reverse repos are essential.

Money supply in India

Reserve Bank of India has been collecting and publishing monetary statistics, since July 1935. Due to the new economic environment that the Indian economy is experiencing as well as the developments that are taking place in the monetary sector in India, various working groups were set up from time to time to refine and review the monetary aggregates. To date, three working groups have been established by the Reserve Bank of India. In the year 1961, the First Working Group on Money Supply (FWG), in the year 1977, the Second Working Group (SWG) and in the year 1998, the "Working Group on Money Supply: Analytics and Methodology of Compilation" (WGMS) under Dr. Y.V.

Reddy. Data obtained from the banking sector and postal authorities are used for compiling monetary statistics on a balance sheet framework. The reasoning and the logical foundations behind the drawing together of monetary aggregates have been made available to the general public through different reports, primarily through working group reports. The Reserve Bank of India publishes monetary aggregates regularly through major publications of Reserve Bank of India, Reports on Currency and Finance, Annual reports, RBI Bulletin, Weekly Statistical Supplement, and Handbook of Statistics. There is no distinctive definition of the term 'money,' either as an economic concept or in practice. Money is a means of payment and facilitates the exchange of goods and services. Money acts as a store of value and also a unit of account. However, in the real world, money provides monetary services along with tangible compensation. Money can, therefore, be as the set of liquid financial assets, the changes in the stock of which could affect the aggregate economic activity. Money, as a statistical concept, could include certain liquid liabilities of a specific set of financial intermediaries.[1]

Factors determining money supply in India during the post reform period:

Money supply is of interest not exclusively to the Central financiers and for money makers and for the academicians too. At whatever point there is the investigation of any financial framework, there is a proceeding with debate on the relative significance of money supply. Although having various belief systems concerning the money supply, the monetarist's reason that the alone money issues and every single other resource, i.e., real and financial, are close substitutes for money. Then again, extraordinary Neo-Keynesianism lays on the premise that money does not matter, and the adjustments in financial assets of the specific scope of money related resources alone are significant. The money supply is one of the significant components responsible for the progressions in the macroeconomic factors in the economy and has critical significance in the monetary order. The discussion on the role of money supply in the assurance of value level is since ages but still has its significance even in the present day. As per the amount hypothesis of money, inflation is consistently and wherever a financial phenomenon, delivered in the primary example by an unduly quick development in the amount of money. Friedman's declaration does not reserve that an increase in the money supply development rate is the sole reason for growth since quite a while ago. However, it is merely the most significant reason.

Objectives of monetary policy in India

The Central banks of developed economies pursue a monetary policy with the objective of stabilization and maintenance of proper equilibrium in the economy. When the US Congress established monetary policy with the statutory objectives of maximum employment, stable prices, and moderate long-term interest rates and incorporated them in the Federal Reserve Act. In the case of developing countries like India, the monetary policy pursued by the central banks has to be more dynamic by keeping in mind the requirements of a high growth economy by creating suitable conditions for economic progress. Presently, monetary policy is recognized as one of the powerful tools available for economic transformation.

1) price stability: It is a well-known fact that each instrument of economic policy is found useful for achieving a specific objective. In the same manner, monetary policy is found suitable for maintaining price stability. In simple words, monetary policy is considered to be one of the most significant policies for controlling inflation in the economy. In the words of C. Rangarajan, former Governor of RBI, "Faced with multiple objectives that are equally relevant and desirable, there is always the problem of assigning to each instrument the most appropriate target or objective. Of the various objectives, price stability is perhaps the one that can be pursued most effectively by monetary policy. In a developing country like ours, the acceleration of investment activity in the context of supply shocks in the agricultural sector tends to be accompanied by pressures on prices, and therefore, monetary policy has much to contribute in the short-run management." Hence, stabilization of prices has been one of the most critical objectives of monetary policy pursued by RBI in India.

[1] Arby, M. F., and M. N. Hanif (2010): "Monetary and fiscal policies coordination - Pakistan's experience," MPRA Paper 24160, University Library of Munich, Germany

2) Promotion of Economic Development: In developing countries like India, the monetary policy has a significant objective of promoting or accelerating the growth of economic development. The policy needs to channelise the resources to various sectors according to planned objectives. The shortfall of savings and investment, improper allocation of scarce resources, absorption of resources in non-priority sectors have all been fundamentally responsible for complicating the resource situation. Underdeveloped money and capital market and the duality of financial and money structure (i.e. organised and unorganised) have also been responsible for irregularities and abnormalities in the process of development. The monetary policy has to consider these problems and has to resolve various inter-related issues with particular reference to resource mobilisation and allocation of credit as per national importance. The objective of the promotion of economic development can be achieved by maximum mobilisation and planned allocation of resources from all sources. The objective of accelerated growth requires resource mobilisation, and it stands out as the most significant objective of monetary policy. Along with taking steps to increase mobilisation of resources, the functioning of the financial markets needs to improved to hasten up the investment process. Serious efforts are required to be taken for the development of money market too. Hence, it is imperative for an emerging economy like India; the highest priority of monetary policy is to increase the mobilisation of deposits from the public[2].

3) social justice: Social justice and equality of income and wealth are also considered as one of the objectives of monetary policy. While formulating monetary policy, sectoral deployment of credit and rate of interest are to be considered with a stronger viewpoint on equity. Our planned model of economic development has considered "credit policy must be formulated to meet the needs of poorer and weaker sections of he society increasingly in order to increase their productive capacity." In India, the monetary policy pursued by the central bank is an evidence that sufficient importance has been given to the assistance to poorer and weaker sections of the community for increasing their employment opportunities and their productive capacity. Social transformation and monetary policy are primarily inter-linked in India. In India, monetary policy is not insulated from socio-economic forces and the trend of thinking in economic planning. Monetary policy has to give significant importance to social justice and fighting vigorously against inequality, injustice and exploitation

4) Promotion of Employment Opportunities: Monetary policy in developing economies must also give importance to the generation of employment opportunities. The generation of employment opportunities depends on the deployment of credit and monetary resources to different sectors in the economy. The inclusion of micro and small enterprises in the priority sector financing in India has been under consideration for a long time. It is because of the higher labour-intensive nature of these enterprises and significant unemployment of labour available in this country. The concessional credit provided to self-employed businessmen and also financial assistance to scheduled castes and scheduled tribes for more employment opportunities is given the highest priority and promotes the concept of growth with equity. Acceleration of growth would generate adequate employment opportunities has been proved doubtful. In many developed countries, it has been observed that with the concentration of 40 capital-intensive nature of production process resulted in rising in output without contribution towards the generation of employment opportunities. All these factors have been responsible for considering the generation of employment as one of the significant objectives of monetary policy in India. Deployment of credit and resources should consider the objectives of growth and equity[3].

Determinants of money supply

Researchers have detailed that there were two significant ways to deal with the money supply assurance in India; balance sheet approach or structural approach and money multiplier approach. The money multiplier approach centers the connection between the money stock and reserve money, while the structural approach favors examination of specific things to be determined sheet of the solidified

[2] Ball, L. M. (1999): "Policy Rules for Open Economies," in Monetary Policy Rules, NBER Chapters, pp. 127–156. National Bureau of Economic Research, Inc.

[3] Bohn, H. (1998): "The Behavior Of U.S. Public Debt And Deficits," The Quarterly Journal of Economics, 113(3), 949–963.

money related division in clarifying the variety in money stock. The money multiplier approach developed emphatically as a critic of the balance sheet approach, and as a result, it prompted a significant discussion in the mid-1980s. The analytical distinction in the two may have all the signs of being kept to be two unique purposes of departure. The distinction to a degree, in any case, additionally mirrors the more profound division among monetarists and non-monetarists. It was particularly Gupta, who, in his article, fervently examines the way wherein RBI examines money supply in India. Gupta contends that the RBI's investigation is repetitious, and the entire examination by RBI, which is just an accounting examination, is observational without significance, and thus there is a need for complete methodological modification.

Monetary policy – developed and developing countries

Monetary policy plays a very significant role in developed and developing countries. Over a period of time, there has been a shift in the monetary policy as it has happened in terms of economic policy over a period of time. It is challenging to outline the differences in the monetary policy pursued by developed and developing countries. Nevertheless, developments that have taken place in recent times, these marked differences can be observed. Control of inflation has been given an essential place in the economic policy in developed countries. In the case of developed countries, there has been a shift in the process of achievement of full employment to control inflation. In the case of developing countries, this was not of much significance in developing countries. In the case of developing countries, control of inflation has been more or less of the permanent objective. The problem of unemployment has always been considered to be the objective of the economic policy in developing countries. In the case of developing countries and developed countries, whenever there was an option of either controlling inflation and promotion of economic growth, both the objectives are considered to be mutual amongst each other. In the case of developed countries, the importance of long-term growth has been of more significance rather than short-term economic management. Developed countries have started giving importance to supply-side economics rather than demand-side management. It is considered that sacrificing growth to achieve efficiency in the allocation of resources is not correct. Supplyside economics considers and promotes economic growth. Supply-side economics lay more emphasis on problems of economic development, removing structural problems, and inbuilt weaknesses in the economy. Maintain a proper work environment, promotion of savings, promotion of investment, and achievement of economic efficiency[4].

Monetary policy and its implementation in India

It is very significant to know how does the Reserve Bank of India implement monetary policy. Nevertheless, before answering that question, it is imperative to understand the objectives and framework of monetary policy, as they have developed over some time.

Objectives and framework of monetary policy in India

In India, the main objectives of monetary policy are maintaining stability in prices and ensuring that productive sectors of the economy get adequate and timely credit. As a result of the liberalization and globalization of the Indian economy, maintaining stable conditions in the financial markets also emerged as an additional objective. Hence, India's monetary policy attempts to maintain a careful balance between stability in prices, promotion of economic growth, and stability in financial markets.

Monetary policy operations – an Indian experience

Along with updating and modification of the objectives of monetary policy and monetary policy framework, monetary policy operating procedure has also undergone significant changes. The choice of targets, tools, and operating procedures were confined to a greater extent by the nature of financial markets and institutional arrangements. During the period 1992-1998, M3 growth was considered as the base, but reserve money was considered to be the operating target. More importantly, the Cash

[4] Bullard, J., and K. Mitra (2002): "Learning about monetary policy rules," Journal of Monetary Economics, 49(6), 1105–1129.

Reserve Ratio (CRR) was used as the principal operating instrument of monetary policy. The Reserve Bank of India also used interest rate regulations and selective credit control methods during the pre-reform period (before 1991). These instruments were applied to nullify the influence of large budget deficits, which were being partly monetized. The regulated or administered interest rate regime kept the interest rate of the government securities artificially low. The demand for government securities was created through periodic increases in the Statutory Liquidity Ratio (SLR). Developing financial markets and preparing the ground for indirect operations was considered the significant task of the Reserve Bank of India. During the year 1992-93, a landmark decision of selling the government securities (market borrowing program) through the auction process was introduced. This was supported by the progressive deregulation of lending rates in the credit market. The Statutory Liquid Ratio (SLR) was brought down to 25% by the Reserve Bank of India by October 1997. The Cash Reserve Ratio (CRR) was brought down to 9.5% by the Reserve Bank of India by November 1997. The automatic monetization of fiscal deficit was phased out totally by April 1997. All these measures resulted in the reduction of resources in the banking system from 63% to 35% during the period 1992 to 1997, respectively[5].

Market stabilisation scheme (mss)

Large and continuous capital inflows over and above the absorbing capacity of the Indian economy and their management proved the enormity of liquid management operations during the 2000s. Initially, the liquidity impact of enormous capital inflows was controlled through the Liquidity Adjustment Facility (LAF) and Open Market Operations (OMO). Nevertheless, given the limited stock of government securities with the central bank's portfolio and legal obligations on the issuance of its paper, it was mandatory for the introduction of additional and new instruments that were required to contain liquidity of a more permanent nature. Due to this, the Reserve Bank of India introduced the Market Stabilisation Scheme (MSS) in April 2004. Under Market Stabilisation Scheme (MSS), the Reserve Bank of India issues short-term government securities, and the amount remains held with the central bank for sterilization purposes. Interestingly, during recent testing times, as India experienced capital outflows, MSS helped to ease liquidity conditions through the loosening of sterilized liquidity. Due to the measures taken by the Reserve Bank of India to develop the money market, the turnover increased significantly in different market segments. All these measures have led to a marked improvement in liquidity management operations by the Reserve Bank of India. It can be observed from the stability in call money markets. It helped in the integration of different segments of money markets and, thereby, active transmission signals. Overall progress in monetary management was possible due to factors like easing of fiscal dominance and rule-based fiscal policy followed under the Fiscal Responsibility and Budget Management (FRBM) Act. Although the Reserve Bank of India bought many such improvements, the transmission of the policy signals to banks lending rates of interest has been rather slow due to rigidities in the system, particularly the preference for a fixed rate of interest on time deposits. With abundant liquidity in the banking system in recent times, banks have reduced their deposit rates, and the effective lending rates have further moderated.[6]

Information dissemination and policy communication

More substantial information dissemination and policy communication, better is the monetary policy outcome. There is still no clarity to what extent such information dissemination and policy communication would result in achieving monetary policy objectives. For instance, since 1994, the US Federal Reserve has been providing forward guidance, whereas the ECB follows the tradition of markets informed rather than guiding them. Nevertheless, in India, the Reserve Bank of India follows a middle path by sharing both information and analysis. The monetary policy measures are analyzed and published in various statutory and non-statutory publications, speeches, and press releases. The

[5] Cekin, S. E. (2013): "Monetary and Fiscal Policy Interactions in Turkey: A Markov Switching Approach," Working papers, Department of Economics, Texas Tech University.

[6] Davig, T., E. M. Leeper, and H. Chung (2004): "Monetary and Fiscal Policy Switching," Working Paper 10362, National Bureau of Economic Research

Reserve Bank of India releases data related to the economy, banking, and financial sector with strict guidelines of quality and timeliness.

Conclusion

Conclusion: Determination of money supply through the procedure of money multiplier prompts the conclusion that the two significant factors mostly dictate money supply, one is behavioral, and the other is policy-oriented (H). Be that as it may, the significant inquiry is what are the elements which decide these two factors and what is the nature of those elements. In this procedure, we endeavor and found the nature of the elements deciding the "m" alleged ‘proximate determinants’ c, t, r. It is discovered that in the post-reform period, the idea of proximate determinants has changed fundamentally if not of all the three. The noteworthy change like t (time-deposit ratio) as its job in deciding m (money multiplier) has altogether expanded due to previously mentioned reasons, and the other two have likewise changed their character if, however, not primarily. Likewise, factors (sources) answerable for the adjustment in base money (H) have additionally changed their characters primarily in light of arrangement interventions as examined before, if anyway not every one of the sources. Be that as it may, the critical move has been found in net RBI credit to government and net outside trade resources of the RBI. These sensational moves at last significantly affect the idea of money supply, and subsequently, the nature of the effect of money supply on the macroeconomic factors may change permanently. So there is a need to investigate how this changing nature has influenced the macroeconomic factors. There ought to be a strategic move in considering the nature and example of determinants of money supply, so that have we may have control over the macroeconomic approach system in the economy.

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