MONETARY POLICY AND PLANNING
CHAPTER II

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Planning in India began in 1951. With the acceleration of the planning efforts, the Reserve Bank was expected to reformulate its monetary policy to perform regulatory, promotional and developmental roles. This chapter tries to point out the goals of monetary policy in a planned regime and the issues that the Reserve Bank of India had to face under planning.

2.1 MONETARY POLICY AND ITS GOALS:

Monetary policy actually deals with the actions of the central bank regulating the supply of money and money substitutes and the demand for money in the economy. The Radcliffe Committee's remarks (1959) on the objectives of monetary policy have been of interest to India too though the planners' views are of substantial importance here and the monetary authorities have to lean on the side of the government in implementing plan programmes and policies. Generally speaking, the plans proceeded with monetary policies allied to them. Otherwise there could be gaps in economic coordination needed for planning. Lack of coordination could cause differences between planners' aims and the actual performance of the economy. The Reserve Bank has been offering advice to Government on various methods of implementation of plan programmes and policies, and has secured for itself a place of importance in the development administration inaugurated by the plan machinery since 1951. Paul Einzig (1949) referred to the attitudes of the political
authority towards the monetary system as constituting monetary policy.¹

Harry Johnson (1967) however referred to monetary policy as the policy employing the central bank's control of supply of money as an instrument for achieving the objectives of general economic policy². Holtrop (1963) emphasized macro variables such as national expenditure, the time element and the creation of liquidity when he wrote

Monetary Policy consists of essentially exerting an influence on the present and future volume of total national expenditure by controlling the internal creation of liquidity, i.e. the creation of money (primary liquidity) and of near money.³

The Report of the Commission on Money and Credit (1958) described monetary policy as

One of the techniques which the government and the central bank deploy to achieve the general objectives of country's economic policy such as growth, employment, price stability and balance of payments.⁴

Geoffrey Crowther (1963) defined monetary policy as "a step or a number of steps taken by the monetary authority to promote the economic welfare of the economy as social sense".⁵ In India, ideas of this nature led to social banking or mass banking described at a later stage in this thesis.
The conditions faced by the Indian economy in the context of
development planning also led to a number of views on the nature
and scope of monetary policy. Alak Ghosh (1970) expressed the
view, "Monetary policy is the process of synchronising the rate
of growth of credit creating capacity of the banking system with
the rates of growth of output and income".  

Patel (1954) stated that in the narrow sense "Monetary
policy may be defined as the policy designed to regulate bank
credit"  

Manmohan Singh (1982) said, "viewed in the context of
planning, monetary policy has to facilitate speedy removal of
poverty and achievement of self-reliance".  

It is well known that the Macmillan Committee and Radcliffe
Committee exerted their influence in defining the goals of
monetary policy in India. The Macmillan Committee (1931) dealt
with various objectives of monetary policy. The objectives spelt
out by this committee were as follows.

i) maintaining the parity of the foreign exchange without
unnecessary disturbance to domestic business,

ii) the stability of the price level and

iii) the stability of output and employment at a high level.  

The Committee also referred to the avoidance of credit
cycles. The movements of the credit volume in India had been
taking place under a centrally planned economy. Planning was
actually leading to a mixed economy which was ushered in with the
close cooperation of the political and monetary authorities.
The Radcliffe Committee (1959) felt that monetary policy should help in maintaining,

i) a high and stable level of employment,

ii) reasonable stability in the internal purchasing power of money and

iii) stable economic growth and improved standard of living and a margin in the balance of payments to make some contribution to the development of other countries and to strengthen the reserves.  

2.2 ISSUES BEFORE THE RESERVE BANK:

The functioning of the monetary system must necessarily be in consonance with the national developmental strategy as articulated in the successive Five Year Plans. The Reserve Bank of India had to face various issues in the planned economy of India.

The First Five Year Plan (1951) stated, 

Central Banking in a planned economy can hardly be confined to the regulation of the overall supply of credit... . It would have .... to create the machinery needed for financing developmental activities all over the country and .... in ensuring that the finance available flows in the directions needed.

The role the Reserve Bank could play in the planned economy of India became obvious from the three dimensional task of financial development thus envisaged by the planners. During
the First Five Year Plan and later on monetary policy had to cope with problems of price stability. The necessity to pursue development goals with stable price levels has been aimed at by the planners. But success has not always been within reach. However, the issue of price stability has been one of the important concerns of monetary policy and planning throughout. The Reserve Bank's approach to agricultural credit supply had been influenced by the rationalisation of the cooperative approach during the First and Second Plan periods. Measures for increasing agricultural production based on farm credit supply and multipurpose activities by cooperatives have been taken up by the Reserve Bank of India.

The Second Five Year Plan (1956-57 to 1960-61) went into details of the development strategy in terms of rapid industrialisation with particular emphasis laid on basic and heavy industries and on employment opportunities. By this time the Imperial Bank of India was nationalised. The industrial financing institutions that had been already set into operation in the First Plan Period received a fillip. Term lending was emphasized as an important method for improving capital formation both in industry and agriculture. The land development banks and the central cooperative banks at the district level were marked out for special assistance to be extended in the course of their efforts to spread out and improve their performance. During this period, the Reserve Bank also armed itself with greater power for controlled expansion of bank credit. In fact the Reserve Bank of India Act was amended in 1956 for this purpose.
The Third Five Year Plan (1961-62 to 1965-66) shifted the economic focus towards self-sustaining growth in India. During this period monetary policy confronted problems arising from the needs of technological advances in agriculture, war financing and needs of external borrowing. Monetary Policy pursued during this plan period was complementary to the policies of the government in meeting 'Defence plus Development' programmes.

The Three Annual Plan period (1966-67 to 1968-69) witnessed how technological diffusion in the farm sector had to be supported by credit expansion. The distribution of high yielding seeds, the use of fertilisers, the creation of irrigation potential, soil conservation were important tasks in agriculture. The institutional structures raised during the earlier plans were in need of support in the form of refinance. The refinance facilities were made to commercial banks in January 1968 for advances to agricultural sector. While the legislation of 1956 set the economy on the path of controlled expansion of money supply, the events in the succeeding period pointed the way towards social control over banks. The events showed how large resource owners in farming or non-farming activity, could appropriate more than their just share of resources.

The Fourth Five Year Plan (1969-70 to 1973-74) aimed at "rapid economic development accompanied by continuous progress towards equality and social justice". During this period priorities of different sectors of the economy were fixed giving the utmost importance to agriculture. The Reserve Bank had a
vital role in this process and took positive steps for the nationalisation of the major commercial banks which took place in July 19, 1969.

The Fifth Five Year Plan (1974-75 to 1978-79) stressed the poverty problem. Self reliance was also a major goal of the plan. This plan stressed the adoption of a coordinated and integrated approach between fiscal and monetary policy to deal with inflation which was apparent at the time of the energy crisis.

The Fifth Five Year Plan pointed out that an attempt should be made to ensure that excessive increase in money supply caused by the fiscal operations of the government is neutralised to the extent possible by corresponding changes in the level of bank credit extended to the private sector. A closer harmonisation must be brought about between the monetary and fiscal policies of the government. 13

The plan also stated,

Monetary policy will have to be synchronized with the fiscal policy in order to check undue expansion of aggregate monetary demand. It is becoming more and more clear that alongside planning of investment outlays, there has to be concurrent planning of credit, so that it is more purposefully regulated and kept within strict limits consistent with the requirements of increasing production. 14
Thus credit planning became an auxiliary and central economic planning during the Fifth Plan Period.

Monetary policy during the Sixth Plan Period (1980-81 to 1984-85) was poised to assist the government in the task of alleviating rural poverty through Integrated Rural Development Programme. The Sixth Five Year Plan reported "Credit policy is being reoriented to meet increasingly the needs of the poorer and weaker sections of the community in order to increase their productive capacity". The Seventh Five Year Plan (1985-86 to 1989-90) emphasized policies which would accelerate the growth in foodgrains production, increase employment opportunities and raise productivity. Monetary policy during this period directed credit planning to start from the base level comprising block or villages. The Service Area Approach became operational during this period. Further the Seventh Five Year Plan envisaged a major effort to bring housing investment within the framework of the organised credit system.

The part which the central bank had thus to play in the context of the Five Year Plans was concerned with the regulation of money supply of financial organisation. It was to be controlled expansion under central planning instead of expansion left to the uncontrolled market forces. The flow of finance had to be directed towards needed areas, activities and population groups. The institutions necessary for the purpose had to be created and fostered. It was important to coordinate monetary policy with the general economy policy. The form of credit
planning which the Reserve Bank had to take up in recent years was decentralised up to the district level in spite of the centralised approaches of the Five Year Plans. Such decentralisation was also inevitable in weaker sections and poverty groups. The anti-poverty stance of the plans to some extent brought a decentralised approach to enable district level or block level authorities to cope with problems of development.
REFERENCES


12 "First Five Year Plan", Planning Commission, Government of India, New Delhi 8,1951, p38.

