INTRODUCTION
CHAPTER I

INTRODUCTION

1.1 NATURE OF THE STUDY

In India, the monetary system in operation sought to answer the needs imposed by the aims of a centrally planned economic system. The Reserve Bank of India which formed the central bank of the country was established in 1935. It was nationalised in 1949. The monetary and financial organisation of the country was taking shape under conditions of a planned economy since 1951. Changes in economic conditions since then led to various postures of monetary policy. The methods and the instruments used varied from time to time. The efforts made to coordinate the activities of the Reserve Bank with the implementation of the Five Year Plans is a significant field of study. The plans and the functions of the Reserve Bank might in a way be described as organising the transmission mechanism that relates the monetary sector with the real sector. The impulses generated in any of the sectors have a bearing upon the other. Under the planned regime their interaction is significant for overall development. In the course of development planning, structural changes were contemplated for the Indian economy in a way that emphasized agricultural productivity growth, industrialisation and the service sectors. Though structural changes have been slow to come about, the role of monetary policy and the impact of financial organisation could be seen in all these directions. This study is concerned with the manner in which the central banking
institution viz, the Reserve Bank of India pulled the economy round during the years of planning.

1.2 OBJECTIVES OF THE STUDY:

The objectives of the study are:

i) to find out how structural changes in the economy and money mutually influenced each other,

ii) to assess the efforts of the Reserve Bank of India to transform the rural credit structure in support of agricultural growth,

iii) to analyse how monetary policy measures were designed to help industrial financing so that large and small industry and exports received credit support,

iv) to study the impact made by the instruments of monetary policy on the economy particularly in the context of inflationary conditions,

v) to delineate the role played by the Reserve Bank of India in managing the external value of the rupee and in mitigating the balance of payment problems and

vi) to analyse the role played by the Reserve Bank in the patterns of development administration that had evolved in the country.

1.3 HYPOTHESES:

In this context, the following hypotheses were explored.
i) The role played by the Reserve Bank in inducing changes in the credit structure reduced the rural rates of interest which had been at high levels at the beginning of the plan period.

ii) Inflation had arisen from changes in the money stock, and the reserve money.

iii) The regulation of the credit economy moved in step with the cropped area, the volume of production in the agricultural sector and with the agricultural yields.

iv) The need for mobilisation of savings, and the investments made under the plans for increasing the capital formation led to changes in the method of operations of the credit institutions. The interest rates that had emerged in that context become interrelated unlike in the old days when the interest rates were heterogeneous lacking in harmony as between the organised and unorganised markets though low rates had been pursued as a matter of policy in certain spheres.

v) The role of the Reserve Bank of India in the context of the mixed economy patterns followed in India had led to more and more of administrative impacts made by the Reserve Bank of India.

1.4 DATA SOURCES AND METHODOLOGY:

The statistical data for the study were drawn from various sources. The Reserve Bank and the Government of India published
numerous statistics. The Central Statistical Organisation is a rich source of data. The National Sample Survey Organisation brings out many important forms of data useful for the study of the Indian economy, particularly with regard to rural areas in which in fact the evolution of institutional finance has been the most significant over the years. The Directorate of Economics and Statistics and the Controller of Capital Issues also publish valuable information. The annual reports of financial institutions such as the Industrial Development Bank of India, the International Financial Statistics published by the International Monetary Fund have also been of much use to the study.

The comparability of the data available from time to time had arisen in the course of the study. There had been changes in the way data were defined, collected and presented at different points of time. Till 1967-68, the Reserve Bank of India used to publish only a single measure of money supply defined as the sum of currency and deposits both held by the public. From 1967-68, the Reserve Bank of India started publishing a broader measure of money supply called 'aggregate monetary resources'. From April 1977, the Reserve Bank of India has been publishing data on four alternative measures of money supply in the place of the earlier two. The data on national income, savings and capital formation published by the Central Statistical Organisation are available with 1970-71 prices for the period 1950-51 to 1979-80. Since 1980s data are constructed with 1980-81 prices. Projections on different base years indicated significant differences in
magnitudes. Data on the number employed in the private and public sector were based on Standard Industrial Classification (1960) prior to March 1975 and on National Industrial Classification (1970) from 1st April 1975.

To bring out the relationship between the variables, linear regression methods were used. Wherever found necessary simple correlation analysis was applied. At several places to find the growth rates, the compound growth rate equation \( P_t = P_o (1+r)^n \) was used on the assumption that the underlying growth was continuous. The annual growth rate was computed from \( \frac{P_{t+1}}{P_t} \) which gives a difference equation of the form \( P_{t+1} = (1+a)P_t \). The Durbin-Watson statistics were calculated, while estimating regression in time series data in many cases. Lags were not discussed in the study. This was indeed a limitation. Treatment of expectations was another aspect lacking in the study. Graphs, percentages and ratios were made use of for comparison. Linear, quadratic and logarithmic equations were estimated in finding trends in some cases.

1.5 **PLAN OF WORK:**

In Chapter one the nature and scope of the present study are indicated.

The second chapter gives an account of the goals of monetary policy as defined by various writers. The monetary policy suitable to India is also brought out. A discussion on the various issues the Reserve Bank had to face under the planned economic regime is also made.
In the years since 1951, many institutions were set up with a view to imparting impulses of growth to the economy. Thus organisations for supply of seed, fertilisers, improved irrigation, water management, soil technology were set up. They had a slow and steady impact on the agricultural sector. The industrial sector was also receiving aid and assistance from many institutions some of which were nonfinancial. The structural change of the Indian economy, evident from the data to be presented later was receiving a significant impact from monetary and financial institutions. In Chapter III, the structural changes in the economy in terms of agriculture and industry and the public and private sectors are discussed.

In the course of planning, several macro variables undergo changes. Some such variables are gross domestic product, price levels, employment, money supply and government expenditure. Chapter IV pays attention to some of the important relationships between selected macro economic variables. In analysing these aspects particular stress was laid on factory employment, taking into consideration the fact that industrial development has been of great concern in the Five Year Plans. The important contributions to modelling of the Indian economy on the basis of monetary expansion are also stated.

The changes in the financial structure supporting agriculture and credit policies followed in the country under the guidance of the Reserve Bank of India form the subject matter of Chapter V.
At the time when the country embarked on planned development, the institutional finance was very week. The Indian capital market was not active. In this connection, the role of the Reserve Bank in improving term credit supplies that help capital formation for industrial development is studied in Chapter VI. The role played by the Reserve Bank in rehabilitating sick industrial units is also studied.

Chapter VII is devoted for a detailed discussion on the main features of the developments in money and commercial banking in the country. The trends in money stock, the behavioural pattern of deposits form part of this chapter. Credit planning and Service Area Approach are also discussed. A reference is made to money multiplier and velocity of circulation of money.

In India, the rates of interest were very high and showed lack of integration when unorganised money markets were dominant in the fifties. A structure of rates however emerged when an organised institutional structure was developed. Both the Government and the Reserve Bank of India were deeply involved in this problem during the plan periods. Though the rates have tended to increase in general, the justification of low rates has not ceased. Chapter VIII makes an attempt of how interest rates can be raised at times and also lowered at other times to suit economic needs in the mixed economy pattern of inducing economic development. The Bank rate and the deposit and loan rates of the commercial banks are studied. The selective credit controls are referred.
The promotion of exports has been a goal of economic policy in India. Chapter IX brings out the support of monetary policy in the active participation of the commercial banks in providing export credit to small and large industries.

The Reserve Bank of India maintains the external value of the rupee. Chapter X discusses the changes in the value of money, the regulation of foreign exchange reserves, the measures followed by the Reserve Bank of India in relation to non-resident Indians and exchange control as well as the encouragement offered to foreign investment aiming at mitigating balance of payments difficulties.

In Chapter XI, the close cooperation between the Reserve Bank and the Government is brought out. The open market operations of the Reserve Bank, the growing importance of the public sectors are also stated.

A summary and the conclusions emerging from the various aspects of the present study are presented in Chapter XII.

Thus the behaviour of the economic system in response to the development strategies implemented and the role played by monetary policy in that context are the nature of the subject covered in this study.