We have made an attempt in the foregoing chapters to examine the impact of monetary management on India's balance of payments during 1960-61 to 1985-86. The analysis of the foregoing pages shows that the role of monetary policy during the period of our study has been two fold promotional and restrictive. The Reserve Bank of India endeavoured to moderate the expansion of credit and money supply in such a way as to ensure the legitimate requirements of industry and trade and curb the use of credit for speculative and inflationary activities. In the sphere of monetary control the Reserve Bank of India has used both quantitative and qualitative techniques.

During the Third Five Year Plan period (1961-62 to 1965-66) money supply (M1) rose at an annual average rate of 9.59 per cent and M3 rose at the rate of 9.11 per cent as against growth in real national income (Y1) of 2.41 per cent and an annual rise in the wholesale price index of the order of 5.65 per cent. Under such circumstances a relatively tight monetary policy was opted. The Reserve Bank of India raised the Bank Rate to 4.5 per cent in January 1963 to 5 per cent in October 1964 and to 6 per cent in March 1965. The Statutory Liquidity Ratio (SLR) was raised from 20 per cent to 25 per cent in September 1964. Credit Authorisation Scheme was also introduced in November 1965 with a view to regulate the credit flows to the different borrowers. Despite the various restrictive credit policy measures adopted by the Reserve Bank of India inflationary pressures could not be contained during the Third Plan period. During this period annual average
exports amounted to Rs. 1178 crores and imports valued at Rs. 1950 crores which resulted in an adverse trade balance of Rs. 772 crores. The balance of payments deficit amounted to Rs. 1972 crores. Measures related to control and regulation of imports and promotion of exports were adopted to correct the disequilibrium in the balance of payments. The devaluation of rupee in June 1966 by 36.5 per cent improved India’s trade balance substantially by 1968-69. The Indian exports started moving up while imports registered a continuous decline.

During the Three Annual Plans (1966-67, 1967-68 and 1968-69) average annual increase in M1 was 8.46 per cent and M3 rose at the rate of 10.63 per cent. National Income at constant prices rose at an annual average of 3.74 per cent and prices rose by 8.86 per cent per annum on the average. The average annual imports during this period amounted to Rs. 1991 crores and the exports totalled by Rs. 1247 crores which resulted in the annual average adverse trade balance of Rs. 744 crores.

During the Fourth Five Year Plan period (1969-70 to 1973-74) M1 rose at the average rate of 14.11 per cent per annum and M3 rose at the average rate of 16.18 per cent, while the real national income grew at 3.29 per cent and prices rose at 7.69 per cent. During this period Reserve Bank of India followed restrictive credit control measures in the form of a rise in the Net Liquidity Ratio from 31 per cent to 40 per cent in eight stages between February 1970 and September 1973. The Bank Rate was raised from 6 per cent to 7 per cent in May 1973 and the Cash Reserve Ratio was raised from 3 per cent to 7 per cent in September 1973. The Statutory Liquidity Ratio was raised from 25 per cent to 32 per cent in six stages between February 1970 to December 1973. During this period as a whole
there was a surplus of Rs. 100 crores in India's balance of payments.

During the Fifth Five Year Plan (1974-75 to 1978-79) period as a whole M1 rose at an annual average of 9.53 per cent and M3 rose at 17.89 per cent while national income rose at the average rate of 5 per cent per annum and the rise in prices averaged 7.54 per cent per annum. In order to check spiralling inflation Reserve Bank of India increased the Bank Rate from 7 per cent to 9 per cent in July 1974. Statutory Liquidity Ratio was raised from 33 per cent to 34 per cent in December 1978. The Cash Reserve Ratio was adjusted five times between June 1974 and November 1976.

The first oil price hike in 1973-74 and resultant strain owing to the heavy import bill caused some pressure on India's balance of payments. During the Fifth Plan period average annual imports amounted to Rs. 5479 crores and exports valued at Rs. 4698 crores. But due to increase in earnings from invisibles the current account position for the period as a whole turned into a surplus of Rs. 3082 crores.

During the Sixth Five Year Plan (1980-81 to 1984-85) period as a whole M1 rose by 17.96 per cent, M3 by 16.87 per cent, national income by 4.93 per cent and prices by 10.28 per cent on an average annual basis.

The balance of payments problem became acute during the Sixth Plan. The trade deficit averaged Rs 6091.2 crores per annum over this period. The current account deficit also increased sharply to an average of Rs. 2276.8 crores per annum. The pressure on balance of payments during this period was largely attributed to the second oil price shock of 1979. As it created
a massive escalation in foreign exchange expenditure on oil import as well as heavy debt burden on the country which in turn imposed a severe pressure on the balance of payments of India. However, the foreign exchange reserve which fell from the peak of RS. 5820.67 crores in 1978-79 to Rs. 4023.56 crores in 1981-82, steadily rose in the next three years, and stood at Rs. 7243.06 crores in 1984-85.

To remove the deficit in the balance of payments, India negotiated an Extended Fund Facility (EFE) of SDR 5 billion with the IMF in November 1981. This lead to a severe debate and controversy regarding the conditionality of the loan versus the economic sovereignty of the country.

With effect from September 25, 1975, India opted for a managed floating exchange rate policy based on a weighted basket of currencies. The objective of exchange rate management is to maintain the relationship of the rupee with the value of the basket of currencies within a wider band of ±5 per cent. The experience of early eighties indicates that the rupee has depreciated in terms of SDR, US dollar, Yen and Deutsche Mark (DM). It appreciated against the pound sterling. Trade balance of India persistently deteriorated in this period.

The analysis reveals that India's experience with her balance of payments in the period of our study has been a mixed one: A difficult payments situation in the sixties, a comfortable situation in the seventies, and again a difficult one in the early eighties.

India's experience shows that the Bank Rate, which is considered as the pace setter for the entire interest rate structure, has not been a flexible instrument particularly due
to the underdeveloped money market. Open Market Operations have not been quite effective because the market in government securities is not well developed. The scope of the refinance facility to commercial banks by Reserve Bank of India is also limited because the refinance is mainly oriented towards assisting banks to provide credit to certain preferred sectors. Statutory liquidity Ratio has also lack of desired effectiveness. The analysis of all the major monetary control techniques during the period of our study discloses that there was heavy reliance on changes in the Cash Reserve Ratio (CRR). It has been frequently used for checking rapid growth of liquidity in the economy and subsequently for controlling inflation.

The analysis reveals that the monetary policy which has been followed in India has resulted in an upward pressure on the growth of money supply. This has resulted in the rapid rise in the price level.

As mentioned earlier, we have estimated a large number of equations with numerous combinations of variables included in the specification. The following major findings emerged from them at different stages of our exercise.

The major conclusions regarding the price function from Chapter II emerging out of the regression analysis are.

(i) The coefficient of the explanatory variable price with one year lag (P-1) is found to be statistically significant with positive sign. The variable explained 97.6 per cent of the variation in the function.

(ii) The explanatory variable Money Supply with one year lag (M1-1) explained 96.9 per cent of the variation in
the function. The coefficient of the variable is statistically significant and has positive sign.

(iii) The explanatory variable Net National Product (Y1) explained 96.5 per cent of the variation in the function. The coefficient of the variable is statistically significant and has positive sign.

(iv) The coefficient of the explanatory variable Money Supply (M1) without any lag is found to be statistically significant with positive sign. The variable explained 96.4 per cent of the variation in the function.

(v) The two explanatory variables, viz. M1 and P-1 together explained 98.3 per cent of the variation in the function. The coefficients of the variables are statistically significant and both have positive signs.

(vi) There is a slight decrease in the explanatory power of the function to 98.1 per cent, when the variable Y1 is considered instead of P-1, along with the variable M1. The coefficients of both the variables are statistically significant and have positive sign.

(vii) The overall results show that the lagged variables have larger explanatory power than the variables without any lag.

Chapter IV, in which an econometric model of India's balance of payments is presented, the major conclusions emerging out of the regression analysis are:

(viii) Among the various explanatory variables considered in the import function real income is the only explanatory variable which explain the emergence of a large proportion of total imports. It is also found that the
value of income elasticity of demand for imports is higher than the price elasticity of demand for imports.

(ix) Estimated results of the export demand equations suggest that a major portion of growth in export volume is due to the growth in world real income.

(x) Estimated results reveal that merchandise imports and external debt outstanding are the two main determinants of the import of services.

(xi) World real income and the ratio of consumer price index in India to the world are the two main determinants of the export of services.

(xii) Growth in net foreign exchange assets is found to be a significant factor in explaining net long-term capital flow.

(xiii) Estimated results show that the aggregate imports into India have a high income elasticity while the demand elasticity for exports of Indian goods with respect to world real income is low.

From Chapter V the major conclusions emerging out of the regression analysis are:

(xiv) Changes in the price level (P) and the 12 months time deposit rate of commercial bank (R₁₂) do not explain the variation in demand for real money balances, while the change in real national income (Y₁) does effect to demand for real balances.

(xv) Results reveal that the income elasticity of real demand for money is more than unity, indicating that the real demand for money rises more than proportionally as income rises.
The overall results of the estimated reserve flow equations show that the value of the offset coefficient is approximately -1 and it is statistically highly significant. This confirms the proposition of the monetary approach to the balance of payments theory that the changes in the domestic component of the reserve money (D) will cause opposite and equal changes in the international reserve (R).

The overall results of the estimated sterilisation equations show that the value of the sterilisation coefficient is very near to -1 and statistically significant. While for monetary approach to the balance of payments validity it should be zero. Therefore monetary approach to the balance of payments is not an appropriate model for explaining movements in net foreign assets in the Indian case.

On the basis of general observations and regression results we can conclude that there is a strong confirmation of the hypothesis that the course of monetary management significantly affect the India's balance of payments. But monetary mismanagement cannot be identified as the sole cause of balance of payments disequilibrium. Monetarist variables have been more dominating in aggravating deficit in India's balance of payments after first oil shock of 1973-74 and onwards which is much reflected from the behaviour of price rise and exchange rate distortions. The slow rate of growth in exports together with deterioration in terms of trade had made India's export earnings inadequate to meet the country's growing import bills. A massive escalation in foreign exchange expenditure on oil import and steady increase in the interest payments on foreign loans and credit have added fuel to the fire of balance of payments disequilibrium.