Effectiveness of Indian Monetary Policy in Present Context

An analytical appraisal

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ABSTRACT

In the content of developing economy like India the main motive of monetary policy is to stablize and fulfilling the infied balancing process. For this, R.B.I. has time to time used and tested various quality controls for the use of currency. These controls can vary according to circumstances. In other words the quantitative and selective approaches has always changed due to changing scenarios because India has its own limitations for finance and economy. These limitations are on the one hand due to the characteristics of developing economy and on the other hand due to the present state of economy. In the present context, the Indian monetary policy runs under the various limitations such as nature, structure, parallel economy and currency market etc. Other than these limitations the effectiveness of financial equipments are minimised by certain other forces like public expenses, taxes, agricultural policies, foreign business and investment policies etc.

Though a developing country has very limited area of monetary policy for its development, but it does not mean that it has no roll in developing countries. It is true that the huge problem of economic growth can't be rectified by economic respecffling because the economic growth depends on man power, capital, land and other such resources. But the monetary policy can help to a great extent in the conomic growth by supply of credit and minimisation the inflation that's why the monetary policy is considered as the base for economic growth.

By analysing the Indian monetary policy we can conclude that it has a very strong fundamental back ground but when it is practically applied various problems are generated that are given in the above analysis. This is the reason that monetary policy can't achieve more success in its goals.

The central bank of the country has been made responsible to manage the Indian currency in the present days. Generally currency policy is decided with a view to control the quantum and cost expenditure which affects the sources in addition to the other sources in respect of the economy to the other sources in respect of the economy of the country. In various countries currency policies is implemented to achieve the different objects and purposes. However, in the developed countries economic development is essential but of course currency policy is not affected due to some special reason. Firstly, in spite of the sufficient development, there is anti-currency area with Barker System in such countries. Due to this reason the area of currency remains limited as interest rate does not change in financial activities. Secondary in developed countries insufficient organised structure is found in the currency market. Hence, economy of the country remains unaffected due to bank rates, changes in the bank deposits and in the process of open market. due to cash transactions in banking, increase in the

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minimum cash credit limits by the central bank could not be saturated in the developed countries. Thirdly one of the main reasons for the above is that the current credit system is considered important in place of credit currency system in the developed countries. Therefore, central bank does not succeed in proper currency control. Bank interest structure is not found uniform *vis*. there is lot of difference in bank rates, rate of interest in the market and deficit rates.

There are other main reasons of limited effect of currency policy in the developed countries -

(a) Less co-ordination between the member bank and central bank .

(b) Fiscal policy works effectively under free process.

(c) Most of the banking systems are beyond control by the central bank.

(d) In spite of effective monetary policy sometimes the effect comes after a long time when other factors and conditions are changed.

The developing economies are planned in which the government itself invest money and regulates the conditions of investment in the private sector. In these above conditions effective monetary policy is not expected.

In the content of developing economy like India the main motive of monetary policy is economic development along with price stability so that the fluctuation in prices may not disturb the economic growth of the country. Any fiscal policy that can stabilize the prices and can increase the employment opportunity will definitely create a sufficient platform for economic growth.

From a long time (1950-1990) the fiscal policy of RBI has two main objectives.

1. Controlled flow of currency so that the currency can be supplied evenly for production and business.
2. To control the increase in the currency so that the economy may not be under pressure of inflation. In this way we can say the Reserve Bank has adopted the controlled credit expansion policy.

In the nineties, though the main motive of fiscal policy was economic development but now days the main objective is to control the currency inflation.

The prohibitory policy is forced to control the increasing currency rate. Therefore, the inflation is reduced from double digit to single digit. It was 17% in 1991 which is now proposed at 6.8% in the 8th 5 year plan. Along with various objectives the tenth 5 yr. plan has also included the fiscal control. In 2004-2005 annual report, the inflation rate was proposed at 5%. During this period keeping in view several events the RBI has increased the inflation rate from 5% to 6.5% during half yearly analysis on 26th Oct. 2004. In this way fulfilling various other objecting the main goal of Indian monetary policy is to stabilize and fulfilling the infied balancing process. For this purpose, RBI has applied and tested various quality controls for the use of currency. These controls can vary according to circumstances. In other words the quantitative and selective approaches have always changed due to changing

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scenarios because India has its own limitations for finance and economy.

These limitations are on the one hand due to the characteristics of developing economy and on the other hand due to the present state of economy. In the present context the Indian monetary policy runs under the following limitations.

1. THE NATURE

The monetary policy is of restrictive nature in this way the financial problems of the country can't be solved only by monetary policies, every financial crisis should be analysed from all aspects related to business and a solution is given accordingly e.g. the 'Inflatory pressure' is not only controlled by control on finance because this is not a pure event and not only financial conditions are responsible for it. Other factors like 'Cost effective factors' and 'Structural factors' are also responsible and must be analysed. In this reference, Mr. I.G. Patel is absolutely right saying that *"the monetary policy plays a very limited role in controlling the money inflation in a country*". It is only affective when it is wide policy in which the foreign exchange policy and treasury policies are also included. The Red Cliff is also of the opinion that "*the financial policies are not only to develop a new policy but to make a several financial policy which has the treasury policy the direct controls are same of the elements*."

2. STRUCTURE

The main reason of low affect of fiscal policy in Indian economy is the major portion of cash currency in the total currency supply of the country. This fact is viewed from credit earning capacity of the commercial banks because the Reserve Bank operates and controls the currency flow only by the loans given to the citizens. That is why, its capacity is reduced. The cash currency has a major part in the total currency supply due to which, when the banks wants to increase the goodwill a major portion of cash currency goes to general public in forms of loans and advances.

Due to old fashion and customs and also due to, underdeveloped banking systems people are using cash currency more in place of cheques. That results into reduced stock of cash currency in the bank and they are incapable of giving loans. To curve this problem.

Dr. Rangrajan (Governor of the reserve bank) has emphasized such policy and system in which the use of cash currency is minimised.

3. PARALLEL ECONOMY

The problem of black money is also responsible for the failure of monetary policy generally it is said that the flow of black money is like the parallel economy in the country. Due to this black money the Reserve bank is incapable of maintaining the balance between the Demand and supply of currency. This major part (black money) is always beyond control of Reserve bank thus the fiscal policy's goal is not achieved.

4. CURRENCY MARKET

One more hindrance in the success of fiscal policy is the underdevelopment of Indian currency pool. Monetary / currency pool is considered as the base for effective fiscal policy. Under this short term capitals, loans and other financial, assets are purchased and sold. The independently working monetary market is a sensitive barometer for the current state of markets. Unfortunately, the Indian monetary market is divided into two parts - Organised and unorganised. In the united sector the reserve bank, state bank, foreign banks and other Indian banks are operational. And the monetary policy is more effective in this sector. In the unorganised sector, the local banks, chit fund companies and money lenders are working and all have their own working attitudes. Non demarcation can be made between long term and short term loans under this sector. Indian currency has two faces due to the different operational attitudes of these two sectors.

In the absence of the unified policies the working of unorganised sector is faulty. The interest rate is also different in the absence of liaison between these two sectors. The fiscal policy proved to be unaffected on the unorganised sector but, due to the constant increase and development of united sector the local banks are now merging with the reserve bank. In order to control the non-united sector of money market state governments have passed resolutions and are making policies and as a result of this, the fiscal policy is getting an increased affect and unorganised sector is continuously decreasing.

5. THE ANALYSIS OF THE POLICY

In India the effectiveness of monetary policy is more complicated because an independent policy is not followed for all financial activities. The RBI is acting like an ordinary government bank because it is doing various financial activities. It has to work under the lines drawn by the government. For example most of the interest rates are predefined and some important sector like exports food processing and in this way the interest rate policy is failed. In the same way the monetary policy is used to compensate the financial loss and even on the compensatory interest rates in order to minimize the burden of the government. As a result of this are inflatory presence is there on the economy making the economic structure weak, increasing the interest rates and cost of investment is increased. The commercial banks are restricted to use their own financial resources because the ‘legal liquidity ratio’ and the ‘reserve ratio’ are both way high so that, the government can accommodate more financial resources under its control. This has been continuously minimised and the condition is getting well day by day.

Other than these limitations the effectiveness of financial equipments are minimised by certain other forces like public expenses, taxes and the disbursement of income between credit management policies and savings.

Agricultural policies foreign business and investment policies, the contractual between management and labour the distribution of income of different years in the economy, problems and peace and war, customers expectations, about fore coming prizes etc.

Analysing the above points it can be said that the monetary policy always fails in developing countries for increasing the economic growth rate.

Though a developing country has very less economies space and resources but it is not like these have no roll in these countries. It is true that the huge problem of economic growth can't be rectified by economic respecffling because the economic growth depends on man power, capital, land and other such resources. But the monetary policy can help to a great extent in the economic growth by fulfilling the goodwill and minimizing the inflation that is why the fiscal policy is considered as the base for economic growth.

By analysing the Indian fiscal policy we can conclude in the way that it has a very strong fundamental back ground but when it is practically applied various problems are generated that are given in the above analysis. This is the only reason that the monetary policy can't achieve mare success in its goals.

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