S.S.e.13. PAULSON CHUNKAPURA–A Critical appraisal of the Techniques of Monetrary Control and the efficacy of Monetary Policy in India–1988–Dr. K.C. Shankaranarayanan

Introduction

This study is a modest attempt to analyse systematically the techniques of monetary control and to find out their effectiveness in the Indian context. The formulation and execution of monetary policy requires a thorough understanding of the working of the monetary system and the instruments of monetary control. Hence, a major part of the present study is concerned with discussions of these concrete issues.

Objectives of the Study

The basic objectives of the study are:

(i) to examine critically the existing instruments of monetary control and the efficacy of monetary policy in India during 1970-85 period;

(ii) to assess the role of monetary policy in achieving the objective of price stability in India;

(iii) to provide some insight into the complicated problems of monetary management;

(iv) to focus light on the constraints and limitations under which the monetary policy of the RBI has to work at present;

(v) to study and analyse the new trends of monetary management introduced by the RBI during the recent years;

(vi) to explore how the RBI is drifting steadily from its orthodoxies to bolder policies of monetary administration in order to suit the structural requirements of a planned economy like that of India; and

(vii) to suggest some alternative measures for reforming and reorganising the monetary policy in order to suit the Indian condition.

Hypotheses:

The present study proposes to test the following hypotheses:

(i) The efficiency of the instruments of monetary policy are rather limited in a country like India where both public and private sectors co-exist.

(ii) Administered prices are directly responsible for price increase in India rather than monetary factors.

(iii) A major cause of the substantial growth in money supply and inflation since 1970 has been the rise in the RBI credit to Government.

(iv) There must be proper integration of fiscal and monetary policies to control inflation.

Methodology:

The data for the study are collected from secondary sources. The major source of data is the Reserve Bank itself—the monthly bulletins published by the RBI, the Reports of various Committees, occassional papers, Annual Reports on Currency and Finance etc. They are supplemented from other sources such as the planning commission, Central Statistical Organisation, the Reports of the

Committees appointed by the Government of India, Ministry of Finance, International Monetary Fund and World Bank, authoritative books and journals, Research reports of individual scholars etc.

Plan of the Study

For the purpose of analysis the study is divided into two parts. The first part comprises of three chapters. They discuss the theory relating to monetary policy and the important tools and techniques used to achieve the aims of monetary policy. Various aspects of monetary policy like basic notions, theoretical framework and its implications, objectives, importance and limitations of monetary policy are explained.

The second part includes four chapters which deal with the Indian experience. Attempts are made to evaluate the use and efficacy of monetary control techniques in India in attaining the goal of price stability during the past one and half decades.

Conclusions and Recommendations

1. The findings of the study proves the hypotheses of the study.
2. The strong inflationary pressures witnessed in the Seventies and early Eighties have focused attention on the urgent need to pursue developmental strategies in a frame-work of price stability. Hence, price stability should be the foremost objective of monetary policy in India.
3. The single most important factor influencing the conduct of monetary policy in India since 1970 is the remarkable increase in reserve money.
4. The system of administered prices is mostly responsible for 'cost push inflation'.
5. The monetary policy and measures have failed to deal effectively with the price situation due to its own constraints and targeted flow of credit to the priority sectors and net credit to the Government creating reserve money.
6. The fiscal policy measures in most of the years since 1970 has not been conducive to the effectiveness of monetary policy. In fact, the fiscal policy has been an important factor in increasing prices. Similarly, the repeated fiscal action of marking-up of the administered prices for the purpose of raising revenue has materially contributed to the inflationary pressures in the economy. Moreover, the management of Government finances has reduced the effectiveness of monetary policy.
7. During 1974-76 period when drastic monetary control measures were the need of the hour both the Reserve Bank and the Government have closely co-ordinated their actions and have thereby achieved the desired results. Instances of such co-ordination have demonstrated the powerful impact of such concerted action by the Reserve Bank and the Government and serve to stress the importance of close consultation between them. Hence, what is needed is a cordial and symbiotic relationship between monetary policy and fiscal policy, in which the monetary policy performs its tasks as an equal partner and not as subordinator, and there is continuous coordination, integration, concommittance, and compatibility betwen the two policies so that their functioning becomes mutually rebounding. For a proper blending betwen the two, fiscal policy should aim at providing a background in which monetary policy can actively operate. This kind of co-ordination will make the goal of price stability feasible and possible. However, it is upto the Government to make such a relationship a reality.

8. A close coordination and proper combination of monetary and fiscal policies can be made through 'monetary budget' which has a specific aim of holding growth of money supply to a level consistant wih price stability.

9. The present policy of 'administering' interest rates should be discarded, and inteest rates must be raised to a much higher level.
10. The regulation of reserve money and money supply should be undertaken in a framework of monetary targeting in terms of a range, with feedback and with necessary support from an appropriate interest rate policy, which in turn can help in restraining the uncontrolled flow of money.
11. The techniques of monetary control should be used more frequently, more actively and more vigorously and there should be strict coordination between them for the purpose of economic stabilisation.
12. An important anti-inflationary factor in the long run can be an increase in production/output achieved through increased productivity and better technology in the economy.
13. Monetary policy needs reorientation and reform in a developing country like India because the RBI faces problems different from those in developed capitalist or socialist economies. The reorientation is also necessary because the importance of the monetary system has considerably increased in recent years and its spectrum is widening with a rapid growth of banking and non-banking financial intermediaries.
14. An important measure for redesigning our monetary policy would be indexing of money supply to the real growth rate of the economy.
15. An integrated monetary policy and planning will go a long way in improving the efficacy of monetary policy in India.