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## ROLE OF RESERVE BANK OF INDIA



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### ABSTRACT:

**H**aving taken up the subjects of money supply and the money market in the preceding chapter, we discuss in this chapter the central monetary authority of the country, namely, the Reserve Bank of India, and the monetary policy it pursues.



**Tale Sudhir  
Mahendra**

**KEY WORDS:** money supply , money market , central monetary authority .

### INTRODUCTION: FUNCTIONS AND WORKING

Since its inception in 1935 as a private shareholders' bank and its nationalization in 1949, functions and the working of the Reserve Bank have been expanded a lot. Besides, the functions of a traditional central bank of currency-credit regulation, it is engaged in building and improving the financial infrastructure for development. An enumeration of these functions and the way these are practiced can be spelt out in terms of its various activities.



### Issue of Currency

The Reserve Bank has the sole right of note issue. This authority is given because the Reserve Bank is charged with the responsibility of providing adequate supply of currency for facilitating transactions of the government and the exchange and remittance requirements of banks and the public. This covers currency notes of every denomination, other than one-rupee coins and notes and subsidiary coins which are issued by the Central Government. This function is performed through the Issue Department of the Bank. The issue of currency is backed by assets of different types. Under a system known as minimum reserve system, in operation since 1956 and modified in 1957, the Reserve Bank is required to ensure that in the different items of assets kept as backing, the value of gold coin and bullion should not be less than the value of ₹ 115 crores. The other minimum condition, which can be dispensed with during unforeseen contingencies, is that there should be foreign securities of the

minimum value of ₹. 85 crores, so that together with gold (coin and bullion) the minimum value of these assets is ₹200 crores.

Prior to the minimum reserve system a different system was prevalent. Under this the Bank was required to keep 40 per cent assets in the form of gold coin, gold bullion and foreign securities, subject to the condition that the value of gold (coin and bullion) should not be less than 40 crores. This system was a relic of the old international gold exchange standard and it placed rigid limitations on the central bank. As against this, the present minimum reserve system is less restrictive, and, therefore, provides a larger scope for the regulation of currency. The new system seems to provide for gold of a higher value, but this did not imply need for additional gold. It is because the value of the existing gold was revised upward in accordance with the new higher price.

### **BANKER TO GOVERNMENT**

The Reserve Bank acts as the banker to the Central Government as also to the governments of the constituent units of India's federal system. The bank has the obligation to transact the banking business of the Government of India and accordingly performs the following functions: accepts money on account of the government; makes payment on its behalf; and carries out exchange remittances and other banking operations, including the management of public debt. The Bank performs similar functions on behalf of the State Governments by virtue of agreements entered into with them.

Besides undertaking current financial transactions and management of public debt, the Reserve Bank of India plays an important part in financial government expenditure. This is done through its several services. One, it floats rupee loans in the form of stock certificates and promissory notes. Being a banker to both the Central and State Governments, it coordinates their borrowing programmes and thereby minimizes any risk of uneconomic competition. Again, in carrying out borrowing operations, the Bank endeavours on the one hand to minimize the effects of such operations on the money market and government securities markets, and on the other to obtain the best possible terms for governments concerned. Two, it sells treasury bills on behalf of the Central Government and thereby provides short term finance. Incidentally this operation also helps to absorb any excess liquidity in the money market. Similarly to provide short-term investment facilities to State Governments, semi-government departments and foreign central banks, the Bank issues on behalf of the Central Government ad hoc Treasury Bills. Three, the Bank makes short-term advances, known as Ways and Means Advances, which are repayable not later than three months from the date of making the advances to State Governments against the collateral of Central Government securities.

In addition to financial transactions, the Bank acts as the agent of the government in respect of India's membership of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). Besides, an important function is that of acting as an advisor to the government on banking and financial matters. The subjects on which Bank's advice is sought are many and varied such as floatation of new loans, investment of funds, agricultural credit, cooperation, industrial finance, legislation affecting banking credit, financial aspects of planning and development, etc.

### **BANKER'S BANK**

The Reserve Bank acts as a banker to other banks, Banks are required to maintain a certain percentage of their deposits with RBI. The minimum cash requirements can, however, be changed by the Reserve Bank to regulate credit. The Reserve Bank also provides finance to scheduled banks. They can borrow on the basis of eligible securities. Besides, financial accommodation is provided in times of

need or stringency in the money market. This help is rendered through rediscounting of bills of exchange. Since the Reserve Bank is always ready to come to the aid of banks, it also functions as the lender of the last resort. In other words, even when banks fail to get finances anywhere, they can look to the Reserve Bank and get it from there.

### CONTROLLER OF CREDIT

The Reserve Bank functions as the controller of credit. As such it regulates the quantity of credit and the rate at which it is made available. Thus it does through the use of general and selective controls. For general quantitative control, the instruments used are: Open Market Operations; Variable Reserve Requirements; and the Bank Rate. The selective control of credit is practiced through specifying the purposes for which credit is to be given and the margins to be maintained in respect of secured advances. In addition, the Reserve Bank has been relying on the method of moral suasion, i.e., persuading banks through letters, meetings, etc., about the need for following the course desired by the Reserve Bank.

Through the open market operations, the Reserve Bank changes the cash or reserve with banks, and thereby affects the credit capacity of banks. The sale of securities reduces reserves, while the purchase of securities increases them. In the former case, banks are forced to contract credit and in the latter case they get an opportunity to expand it. The changes in reserve to be kept under the method of Variable Reserve Requirements, the Reserve Bank directly affects the capacity of banks to create credit. By raising the reserves (as percentage of deposits with the banks) to be kept with the RBI, it reduces the capacity of the banks to create credit. And vice versa. Changes in the bank rate, i.e., the rate at which the Reserve Bank discounts bills of exchange, affects the cost of funds and through that the amount of credit. Higher interest makes keeping reserves a costly affair, and lower interest rate renders it less costly. In the former case banks are hesitant to seek help and in the latter case find it easy to get funds from the Reserve Bank. In addition to the control of credit in general, the method of "Selective Control" has been applied to allocate credit to certain lines, and to deny it to certain other uses, as also fixing the amounts of credit. In respect of "Moral Suasion", the Reserve Bank has been more effective in recent years, particularly after the nationalization of big banks.

**Custodian of Foreign Exchange Reserves and Exchange Management** One of the essential central banking functions of the Bank is that of maintaining the external value of the rupee. For this purpose it holds most of the nation's foreign exchange reserves. Primarily this' aim is achieved by appropriate monetary and fiscal policies, but for planning in India it is being done with trade policy bearing upon export and import, as also exchange management. The underlying principle is to regulate demand by the nationals for foreign exchange as also the disposal by them of the foreign exchange earned. For this purpose, all dealings of the public in foreign exchange are required to be transacted only through authorised dealers. In accordance with trade and exchange policies, the Reserve Bank is instrumental in carrying out operations relating to foreign exchange. Additionally, regulation is exercised to prevent the flight of capital and to make speculative or arbitrage operations in exchange impossible.

### DEVELOPMENT AND PROMOTIONAL FUNCTIONS

Besides performing the essential functions of a central bank, the Reserve Bank has been doing valuable work in aiding development, and promoting saving and banking habits. These tasks are performed through a variety of means by the Bank. For example, the Reserve Bank has helped in building up a financial such institutions as the Deposit Insurance Corporation, the Agriculture

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Refinance and Development Corporation (now taken over by the Bank for Agricultural and Rural Development), the Industrial Finance Corporation of India, State Finance Corporations, the Unit Trust of India, etc. Of special significance are its help, advice and training facilities for the furtherance of cooperative credit movement in agriculture. Again, through various institutions as also through the promotion of commercial banking the Reserve Bank is helping in mobilizing saving resources and encouraging banking habits among the people.

### CONCLUSION:

In the performance of its various functions, the Reserve Bank undertakes collection and dissemination of information, and conducts research in this field. As the banker's bank, banker to the government and the country's exchange authority, it issues Bank's weekly statements of accounts and the annual balance sheet. Besides, the Bank issues several periodical publications which attempt to explain and assess the significance of economic and financial developments in the country as also on the working of the Bank, and provide a wealth of factual data for the use of public. Yet again, special publication containing reports of ad hoc expert committees, monographs on certain problems such as rural credit, cooperation and balance of payments are issued from time to time. All these help in promoting a climate of rational thinking in the spheres of money and banking, From the description of the various activities of the Reserve Bank, it is clear that it is not a mere central bank but much more than that. Besides regulating currency and credit, it is performing functions which aid development and promote banking facilities in the country. As such the Reserve Bank is many things combined into one.

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