CHAPTER - I

INDIA'S MONETARY EXPERIENCE [1970-71 TO 1989-90]

The inflationary pressure witnessed during the seventies clearly point out the importance of devising policies for implementing the Five Year Plans in an environment of reasonable price stability. The Sixth Five Year Plan recognised that, "A major task of economic policy in the Sixth Plan is to create the necessary conditons for the mobilisation of resources for development in a non-inflationary manner. The control of inflation and generation of stable price expectations are crucial for a successful implementation of the plan. However, anti-inflationary policies must be so devised as to facilitate basic structural changes which are essential for a progressive increase in the countries productive potential .... A greater deal of ingenuity will be needed to devise effective economic policies to cope with inflationary pressures".[1]

Although the price rise is caused by a number of factors operating at different levels and in various sectors, the supply of money stock in the last two decades has the inherent potential for causing spiralling prices in India.

Extracting enough from first three Five Year Plans and the three Annual plans, we started our Fourth Five Year Plan [1969-74] with major changes in monetary and credit policy in order to attain desired policy goals. The major changes were natioanlisation of 14 major commercial banks [1969], increase in interest rate on deposit with a view to mobilise savings, bank rate was raised from 5% to 6% and tight credit control measures were followed in order to control inflation. The net effect was that, though we could enhance the rate of savings from 12% to 14% per annum, the rate of growth of national income was hardly 3% per annum on an average. The alarming feature during this period was the rate of inflation of 9% annual average.

During Fifth Plan period [1974-79], [through the plan was terminated by the Janta Government in 1977-78] Planners started feeling that our economy has reached a stage where the supply of the necessary wage-goods and crucial raw-material is reasonably elastic, therefore, they stressed the need for a set of measures, monetary and fiscal in character which can help the process of development to be carried out in a non-inflationary manner. To achieve this the RBI announced a general hike in interest rate structure in July 1974. Bank rate was raised from 7% to 9%. Minimum lending rates on banks' advances were raised from 11 to 12.5%. Rate of interest on advances against commodities covered under selective credit control was raised by 2%. Deposit rates were also raised. During 1976-77 the RBI took steps to rationalise the banks' interest rate structure. A significant change a was two-way classification of savings, the interest rate on saving deposits with cheque facilities was lowered to 3% while that on saving deposit without cheque facility continued at 5%. The monetary and credit policy throughout the year was, "directed towards restraining the inflationary potential of monetary expansion but at the same time endeavouring to help promote investment and increase production".[2]

The net result was that economy registered a growth rate of 4.1% per annum on an average but still it was not enough to contain the accelerating trend in inflation.

The Sixth Five Year Plan [1978-83] which later on extnded to cover the period of 1980-85, had enough experience from the earlier plans, so stated, "It is necessary, therefore, to monitor the balance between the aggregate demand for goods and aggregate supply and to relate the growth of money supply to the growth of the NDP".[3]

The continuing inflationary pressure made the planners believe that there is a "need for caution in determining the permissible rate of growth of money supply".[4]

The final Sixth Plan document states : "Co-ordination of fiscal, monetary and credit policies so that deficits financing by the government, credit to public agencies or agencies designated by government for purchase of food grains and other commodites as well as credit to commercial sector taken together do not lead to excessive increase in money supply".[5]

During the Sixth Plan, to restrict the excess money supply, the bank rate was raised from 9% to 10%. SLR was raised in two phases 34% to 35% in 1981 and further to 36% in 1984. CRR was raised from 6% to 7.25%. Lending and deposit rates were readjusted.

The collective out-come was satisfactory, economy could achieve a real growth rate of 5.5% per annum on an average, though it was not enough to curb the rate of inflation which still continued at 6% per annum, but, certainly it was less than that of the earlier plans.

More recently the Seventh Plan [1985-90] document pertaining to monetary policy states: "Monetary policy relates to the regulation of the volume, cost and allocation of credit. But monetary and fiscal policies are interrelated, because fiscal policy almost always brings about changes in money supply through the budget deficit. A fiscal policy that keeps the budget deficit down would give greater scope for autonomy to monetary policy. An excessive budget deficit, on the other hand, would shift the burden of control of inflation to monetary policy".[6]

During the Seventh Plan, to restrict the quantum of credit creation, tight monetary policy was followed by way of increasing the bank rate from 10% to 11%. There was a further rise in SLR upto 38.5% [of net DTL] and higher CRR upto 15%. With all this, we still fail to check the fiscal deficit, which was as high as 8% of GDP. Though during this period the economy grew at the rate of 5.5% in real terms [1980-81 price], which was insufficient to meet the excess money supply and hence resulted into a net inflation at the rate of 9% per annum once again.

From the experience of the Indian economy for last two decades it is clear that the most proximate goal of the monetary management should be to contain the inflationary forces. It is a well known fact that price spiral has been distorting the pattern of economic growth and social equity. The fall in purchasing power of rupee has caused considerable social and economic anguish and misery. The vice of corruption and crime in the country is deeply related to the price malady. This is the considered view of the various bodies and authorities also. The Chakravarty Committee had observed :

"In the short run, the single most important contribution which monetary regulation measures can make towards the achievement of the goal of Social Justice is the maintenance of price stability. The vast majority of those with low income need to be assured even when they remain untouched by developmental activities in the short run, that their incomes, such as they are, will at least be protected from erosion in value due to rising prices".[7]

From the above analysis it becomes very clear that for both Monetary & Fiscal authorities, maintaining relative price stability [particularly since 1971] has remained a strugle without much success. In our opinion failure of these authorities lies in their misdirected efforts in restricting credit and inability to identify root cause of price instability. It is a well known fact that banks credit merely results from "reserve money" they held. Hence, what is more crucial is to identify the sources of change in reserve money and operate on them rather than endeavoring to restrict the volume of credit through Monetary and Fiscal Policy measures for price stability. In our opinion there is a strong case for undertaking further study of the soruces/factors, influencing what is popularly called "monetary base" - a prime source of money supply explosion in India.

SUMMARY OF MONETARY AND CREDIT POLICY AND PRICES

[1970-71 TO 1989-90]

ERIOD	POLICY CHANGE	PRICE & OTHER VARIABLES
70-71 to 73-74	Tight Credit control measures in view of high inflation Cash reserve ratio was raised from 3% to 7% Interest rates on deposits raised S.L.R. raised from 25% to 31%. Bank rate raised from 5% to 6%	Price increased by 40% Real National Product increased by 3% M3 increased by 60%
974-75 to 979-80	The RBI announced a general hike in interest rate structure in July 1974 Bank rate was raised from 7% to 9% Minimum lending rates on bank advances were raised from 11% to 12.5% Deposit rates were also raissed by 0.5% in case of short term and by 2% in case of long term deposits of over 5 years S.L.R. raised to 34% Lending a minimum 1/5 of the resources to priority sector Six more private banks were nationalised C.R.R. was lowered to 6%	Prices --- 50% RNNP --- 14% M3 --- 104%
980-81 to 984-85	Bank rate raised from 9% to 10% S.L.R. raised from 34 to 36% C.R.R. raised from 6% to 9% in phased manner Lending and deposits rates readjusted	Price --- 46% RNNP --- 25% M3 --- 90%
985-86 to 989-90	Bank rate raised from 10% to 11% S.L.R. 38.5% of net demand and time liability C.R.R. raised to 15%	Price --- 35% RNNP --- 26% M3 --- 88%

Source : Publications of RBI Plan documents and Economic Survey.

NOTES

1. Planning Commission : Sixth Five Year Plan [1978-83], P.76
2. RBI : Annual Report - 1976-77, P.4.
3. Planning Commission : op.cit. P16.
4. Ibid
5. Planning Commission : Sixth Five Year Plan [1980-85]
6. ----- : Seventh Five Year Plan [1985-90]
7. RBI : Report of the Committee to Review the Working of the Monetary System P. 228.