Reserve Bank of India

History

- The Reserve Bank of India was established on **April 1, 1935** in accordance with the provisions of the **Reserve Bank of India Act, 1934**.
- The Central Office of the Reserve Bank was initially established in Calcutta but was **permanently moved to Mumbai in 1937**. The Central Office is where the Governor sits and where policies are formulated.
- Though **originally privately owned,** since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

Preamble

- To regulate the **issue of Bank notes** and keeping of reserves with a view to **securing monetary stability** in India and generally to **operate the currency and credit system** of the country to its advantage.
- To have a modern monetary policy framework to meet the challenge of an increasingly complex economy.
- To **maintain price stability** while keeping in mind the objective of growth.

Structure

- The Reserve Bank's affairs are governed by **a central board of directors**. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.
- The directors are appointed/nominated for a period of four years.

Constitution

- **Official Directors (central board of directors)**
  - **Full-time:** Governor and not more than four Deputy Governors
- **Non-Official Directors**
  - **Nominated by Government:** ten Directors from various fields and two government Official
  - **Others:** four Directors - one each from four local boards (regional)

Main Functions

1. Monetary Authority:

- It implements and monitors the monetary policy and ensures price stability while keeping in mind the objective of growth.

An amendment to RBI Act, 1934, was made in May 2016, providing the statutory basis for the implementation of the **flexible inflation targeting framework.**

Section 45ZB of the amended RBI Act, 1934, also provides for an empowered six-member **Monetary**

Policy Committee (MPC) to be constituted by the Central Government by notification in the Official Gazette

Monetary Policy Committee

- It was created in 2016.
- It was created to bring transparency and accountability in deciding monetary policy.
- MPC determines the policy interest rate required to achieve the inflation target.
- Committee comprises of six members where Governor RBI acts as an ex-officio chairman. Three members are from RBI and three are selected by government.
- Inflation target is to be set once in a five year. It is set by the Government of India, in consultation with the Reserve Bank.

Current inflation target is pegged at 4% with -2/+2 tolerance till March 31, 2021.

2. Regulator and Supervisor of the Financial System:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions such as issuing licenses, branch expansion, liquidity of assets, amalgamation of banks etc.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services such as commercial banking, co-operative banking, to the public.

3. Manager of Foreign Exchange:

- Manages the Foreign Exchange reserves of India.
- It facilitates external trade and payment and promotes orderly development and maintenance of foreign exchange market in India.
- It also maintains external value of rupee.

4. Issuer of Currency:

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

5. Developmental Role:

- Performs a wide range of promotional functions to support national objectives such as making institutional arrangements for rural or agricultural finance.
- Commercial banks lend loans to small-scale industrial units as per the directives (Priority Sector Lending) issued by the Reserve Bank of India time to time.

6. Financial Inclusion:

- The Reserve Bank has selected a bank led model for financial inclusion in India. RBI has undertaken a series of policy measures. Some of the important ones are:
    - **No Frills Accounts –** account either with nil or very low minimum balance as well as charges that would make such accounts accessible to vast sections of population.
    - **Use of Technology –** devices such as ATMs, hand held devices to identify user accounts through a card and biometric identifier, Deposit taking machines and Internet banking and Mobile banking facility to provide the banking services to all sections of society with more ease.

7. Related Functions:

- Banker to the Government: performs merchant banking function for the central and the state governments.
- It is entrusted with central govt.’s money, remittances, exchange and manages its public debt as well.
- Banker to banks: maintains banking accounts of all scheduled banks. It also acts as lender of last resorts by providing fund to banks.

Independence of RBI

- Under section 7 of the RBI Act, the central government may from time to time give such directions to the RBI as it may, after consultation with the Governor of the Bank, consider necessary in the public interest. Moreover, there is no legal act mandating autonomy of the RBI.
- Yet, RBI has always been looked upon as an autonomous body which has under its umbrella all commercial banks, be it PSBs or private banks or foreign banks.
- It is not only vested with the powers to formulate the monetary policy but also to monitor the functioning of all banks.
- To play its role effectively, autonomy in its functioning is sine qua non for RBI.
- However, the independence of RBI has been challenged many times due to a continued tug of war for wresting more power between the bank and the govt.
- The main reasons for this have been:
    - RBI’s failure to check the growth of Non Performing Assets.
    - Reduced liquidity in the economy due to tight monetary policy followed by RBI.
    - Corrective measures taken by RBI to clean up the banking system which are not seen very positively by the government
    - Clash between short term populist agenda of the government and long term view for price stability taken by RBI.
    - Regulation of Public Sector Banks: One important limitation is that the Reserve Bank is statutorily limited in undertaking the full scope of actions against public sector banks (PSBs) – such as asset divestiture, replacement of management and Board, license revocation, and resolution actions such as mergers or sales –– all of which it can and does deploy effectively in case of private banks.
    - Erosion of statutory powers of the central bank through piece-meal legislative amendments that directly or indirectly eat at separation of the central bank from the government.

RBI’s Important Publication (half yearly)

- Financial Stability Report
- Monetary Policy Report
- Report on Financial Review