Role of Monetary Policy in Promoting Economic Growth

There is no denying the fact that monetary policy plays a key role to promote the rate of economic growth in underdeveloped countries.

According to Meier and Baldwin, “Monetary Policy May also play some part in accelerating development by influencing the supply and uses of credit combating inflation and maintaining balance of payments equilibrium.

After development gains momentum, effective monetary policy is also necessary to provide an elastic credit supply which can parallel the expansion in trade and population.”

In this way, the main role of monetary policy lies in its capacity to promote economic growth by influencing the cost and supply of credit, by controlling inflation and by maintaining balance of payments equilibrium in less developed countries.

In order to accelerate the pace of economic development, we need improvement in technology. The growth rate of capital formation has also to be increased. When we find acceleration in capital formation, there would be improvement in technology also. Capital formation itself is also significant in the process of economic development. For this purpose, cheaper monetary policy has to be followed.

Besides it, in order to increase capital formation, investment should be raised. Further methods to control credit should be followed to direct investment in right direction. Further savings have to be raised with a view to raise investment; savings can be mobilized if there is wide spread net of financial institutions.

Monetary policy can influence growth by helping to create favorable environment for saving and investment. By following a cheap money policy, it can help in the mobilization of resources for capital formation by creating suitable financial institutions. Through a policy of cautions and controlled deficit financing additional resources can be created for development programmes.

It creates suitable environment for additional investment by controlling inflationary pressure in the economy. Monetary policy can be the most effective instrument of shaping the character of investment in the economy. In the underdeveloped countries monetary policy can also help in facing the situation of continued balance of payments disequilibrium. Therefore, monetary policy is a tool to bring economic development.

According to Prof. Witlenshy, monetary policy is a growth-oriented factor, that is, to accelerate the rate of economic growth is one of the main objectives of monetary policy. In the words of Edward Shaw and Ronald Mackinon, “Monetary policies have important implications both for the accessibility of domestic savings to domestic investors and for the efficiency with which these savings are allocated to competing investment purposes". According to these economists, "Monetary policy can have potent effects on development and growth. These days monetary policy is also called financial policy".

Monetary policy significantly contributes to economic development in the following manner:

i. Monetary policy creates congenial atmosphere for saving and investment and -thereby help in capital formation.

ii. Cheap Monetary Policy, reduces the cost of credit and thus encourages investment.

iii. Monetary policy by setting up appropriate financial institutions can mobilize resources for capital formation.

iv. By controlled deficit financing it can provide additional resources for developmental investment by the government.

v. Monetary policy can help in making investment in the desired direction by controlling the use of credit through selective credit control or differential rate of interest.

vi. Monetary policy can establish equilibrium between demand for and supply of money according to the supply of goods and services.

vii. By controlling inflationary pressure in the economy, monetary policy can create appropriate climate for additional investment.

viii. Monetary policy influences favorable investment tendency for economic development.

ix. In under developed countries, monetary policy proves helpful in achieving exchange stability.

x. Monetary policy can also help an economy to achieve full monetization.

In the end, we agree with the views of Dr. D. Bright Singh who says, "The long term objective of promoting economic growth represents the positive aspect of monetary policy in underdeveloped countries. From the point of view of long term growth monetary policy should aim at providing means to better mobilize and canalize financial resources for investment. It should also have the objective of promoting the development of banking and financial institutions and fostering the banking habit in the community."