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## ROLE OF RBI IN INDIA'S ECONOMIC DEVELOPMENT

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### INTRODUCTION

The Reserve Bank of India (RBI), India's central bank, was established on April 1, 1935 under the Reserve Bank of India Act 1934. As the apex monetary institution, the RBI regulates, supervises and develops the country's financial system. Initially, the RBI's role was confined to controlling credit, but it has since evolved to encompass a broader range of functions.

The RBI manages the country's currency, regulating its supply and ensuring its integrity. It also regulates foreign exchange transactions, managing India's foreign exchange reserves. In addition, the RBI supervises and regulates commercial banks, cooperative banks, and other financial institutions, ensuring their stability and soundness.

The RBI's role has transformed significantly since 1992, particularly in banking supervision. The RBI has implemented various reforms aimed at strengthening the banking system and promoting financial stability. Today, the RBI plays a vital role in maintaining India's economic stability and growth, and its decisions have a significant impact on country's financial markets and economy.

### HISTORICAL OVERVIEW

The Reserve Bank of India was established to tackle the economic turmoil that occurred after World War I. The Reserve Bank of India owes its origin to the recommendations of Hilton Young Commission led by Lord John Hilton Young. John Hilton Young Commission 1926 was also

known as Royal Commission on Indian Currency and Finance.<sup>26</sup> Before the establishment of Reserve Bank of India in 1935 by The Reserve Bank of India Act, 1934 the Imperial Bank of India was conducting the Central Bank's functions such as management of government accounts and public debt. The existing currency offices at Bombay, Madras, Rangoon, Calcutta, Lahore, Karachi and Cawnpore (Kanpur) became branches of the issue department.<sup>27</sup>

Burma (Myanmar) seceded from the Indian Union in 1937 but the reserve bank continued to act as the central bank for Burma till Japanese occupation of Burma and later up to April 1947.<sup>28</sup> After the partition of India, the Reserve Bank served as the central bank of Pakistan until when the State Bank of Pakistan commenced operations from June 1948.<sup>29</sup>

It originally served as a shareholder's bank until post-independence the Reserve Bank (Transfer of Ownership) Act, 1948 was passed which

<sup>26</sup> <https://www.rbi.org.in>

<sup>27</sup> <https://jnp.org.in>

<sup>28</sup> <https://www.scribd.com>

<sup>29</sup> <https://www.rbi.org.in>

paved the way for nationalization. Effective January 1, 1949, the RBI transitioned into a state-owned central banking institution, with its central office headquartered in Mumbai.<sup>30</sup>

### PREAMBLE

“To regulate the issue of Bank notes and the 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”<sup>31</sup>

### RBI'S DEVELOPMENTAL FUNCTIONS

The Reserve Bank of India undertakes various developmental functions to stimulate economic growth. These developmental functions are as follows-

#### 1. SUPPORTING AGRICULTURAL GROWTH-

The RBI's Agricultural Credit Department tackles complex credit challenges, providing authoritative guidance to governments and cooperatives. The RBI Act mandates its pivotal role in providing institutional credit to agriculture, underscoring its commitment to robust agricultural sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and regional rural banks in India.

#### 2. INDUSTRIAL FINANCE EMPOWERMENT-

The RBI provides critical financial support for industrial development, recognizing that medium and long-term finance is vital for growth.

To address this the RBI has established:

- > IDBI
- > IFCI
- > SFC
- > Small Scale Industrial Development Corporations

These institutions empower industries to scale up, modernize and drive economic expansion.

#### 3. FINANCING INDIA'S EXPORT-

The RBI promotes export finance, providing refinance to

banks against export credit to encourage exports. To achieve this, the RBI offers various schemes such as:

- > The Bill Market Scheme
- > Export Bills Credit Schemes
- > Shipment Credit Scheme
- > Duty Drawback Credit Scheme

#### 4. PROMOTION OF BANKING-

The RBI has undertaken several initiatives to strengthen the country's banking system. Firstly, it has eliminated numerous weak, unsound, or poorly managed banks, thereby fortifying the banking structure. Additionally, banking facilities have been extended across the country, particularly in small towns and rural areas, enhancing geographical coverage. Furthermore, the functional coverage has been expanded to prioritize sectors such as agriculture and small-scale industries through the establishment of Regional Rural Banks. Lastly, the Deposit Insurance and Credit Guarantee Corporation ensures the security of deposits, safeguarding the interests of bank customers.<sup>32</sup>

#### 5. RESEARCH AND DATA ANALYSIS-

The RBI plays a crucial role in promoting informed decision making by conducting research and analysis on macroeconomic trends, financial stability, and monetary policy. Through its research initiatives, the RBI generates valuable economic data and disseminates information to policymakers, market participants, and other stakeholders. This contributes significantly to evidence-based policymaking, ultimately fostering a positive impact on India's economic development.

#### 6. PROMOTION OF EXPORT THROUGH REFINANCE-

The RBI plays a vital role in promoting India's foreign trade, particularly exports, by providing financing facilities. To achieve this, the RBI supports institutions like Export-Import Bank of India (EXIM Bank) and the Export Credit Guarantee Corporation of India (ECGC). The RBI provides refinancing facilities to these institutions, enabling them to lend to exporters at competitive rates. This refinancing support helps EXIM Bank and ECGC to provide

<sup>30</sup> <https://www.rbi.org.in>

<sup>31</sup> <https://www.indiacode.nic.in>

<sup>32</sup> <https://www.dspmuranchi.ac.in>

financing for export purposes, thereby boosting India's export growth and competitiveness in the global market.<sup>33</sup>

7. CAPACITY BUILDING INITIATIVES- The RBI has always been instrumental in fostering financial discipline and promoting banking habits in India. Through its various initiatives, the RBI has encouraged people to develop a savings culture and adopt formal banking practices. By establishing institutions such as the Deposit insurance corporation, Unit Trust of India, and National Bank for agriculture and rural development, the RBI has expanded the banking network and made financial services more accessible. These efforts have contributed significantly to promote banking habits and financial inclusion in India.<sup>34</sup>

8. TRANSPARENCY IN BANKING- The RBI provides transparency in banking by publishing periodic reports and data. These publications provide valuable insights into the country's economic and financial conditions, enabling stakeholders to make informed decisions. The RBI releases various reports, including the Annual Report, Monetary Policy Report, and Financial Stability Report, which cover topics such as macroeconomic trends, banking sector performance, and regulatory initiatives. By making this information publicly available, the RBI promotes accountability, transparency and good governance in the banking sector.<sup>35</sup>

#### KEY ROLES OF RBI IN FOSTERING ECONOMIC DEVELOPMENT

1. NATIONALIZATION OF BANKS- The nationalization of banks in India was a major step towards bringing the banking sector under government control. The RBI played a crucial role in this process.

**1969-** The government of India nationalized 14 major commercial banks, with the RBI providing the necessary support and guidance.

**1980-** The government nationalized 6 more banks with RBI's assistance.

The banking sector was given a significant boost towards achieving a more equitable distribution of resources and increasing financial inclusion.<sup>36</sup>

2. ACCOUNT AGGREGATOR 2021- The RBI acts as an account aggregator, enabling the sharing of financial information between banks and other financial institutions. As of 2022, the RBI has licensed around 8 account aggregators, which have collectively onboarded over 1,200 financial institutions including banks, NBFC's and fintech companies. This facilitates interoperability, with over 10 million customers having linked their accounts, and seamless sharing of financial data between banks and fintech companies, with over 100 million data consent request processed.<sup>37</sup>

3. LIBERALIZATION OF INDIAN ECONOMY- India's 1991 balance of payments crisis prompted a paradigmatic shift in the economic policy. The government initiated reforms to liberalize and open up the economy, with the RBI playing a pivotal role. Reforms including abolishing the License Raj, reducing import duties and facilitating foreign direct investment. As a result, India's international competitiveness increased in the sectors like auto components, software and pharmaceuticals. Foreign investment rose from \$132 million in 1991-1992 to \$5.3 billion in 1995-1996. Poverty rates declined from 36% to 26.1% between 1993-1994 and 1999-2000. These reforms transformed India's economy, fostering growth, job creation, and improved living standards.<sup>38</sup>

4. MINIMUM RESERVE SYSTEM- In 1957, the RBI adopted the Minimum Reserve System for issuing currency notes. As per this system, to issue money, the RBI maintains Gold and Foreign currency reserves of worth Rs.200 crores as a backup.<sup>39</sup>

5. TAMING INFLATION- Controlling inflation is a paramount objective for the Reserve Bank of India, which strives to maintain price stability while fostering economic growth. In accordance

<sup>33</sup> <https://www.acquire.fi>

<sup>34</sup> <https://www.iibf.org.in>

<sup>35</sup> <https://www.investopedia.com>

<sup>36</sup> <https://www.frontline.thehindu.com>

<sup>37</sup> <https://www.sahamati.org.in>

<sup>38</sup> <https://www.protium.co.in>

<sup>39</sup> <https://www.jagranjosh.com>

with the RBI Act of 1934, the central bank collaborates with the federal government to establish a suitable inflation target. As of April 2021, the RBI set up a target inflation rate of 4%, with an upper tolerance limit of 6% and a lower limit of 2%.<sup>40</sup>

6. DEMONETIZATION- The RBI played a crucial role in demonetization process initiated by the Indian government on November 8, 2016. The RBI recommended demonetization to combat counterfeiting, terrorism financing and black money subsequently printed and distributed new currency noted. It managed currency exchange, monitored financial stability and provided guidelines to banks and financial institutions to ensure a smooth transaction. The RBI's involvement was a crucial in executing the demonetization plan, minimizing disruption to financial system and maintaining public trust. The RBI also mentioned demonetization was meant to stop people from hoarding cash.<sup>41</sup>

#### INDIA'S ECONOMIC RANKING

India has the fifth-largest economy in the world according to the world bank. It comes after the economies of the United States, China, Japan and the Germany. India's GDP grew to 7% amounting to \$3.39 trillion in 2022.<sup>42</sup>

#### CONCLUSION

The Reserve Bank of India (RBI) has been a loyal institution in India's economic journey, having played a transformative role in shaping India's financial landscape. It has helped keep the prices stable, promoted financial stability, and encouraged economic growth. RBI has been a beacon of stability and a catalyst for change. Through its visionary monetary policy, robust regulatory oversight, and innovative development initiatives.

The RBI has successfully navigated the economy through various turbulent challenges, including inflation, economic crises and global shocks. The RBI's efforts have had a profound impact on the lives of millions of Indians,

improving their economic well-being, increasing access to financial services, and enhancing their overall quality of life. With its experience and expertise, the RBI is well equipped to address future challenges and ensure India's economic growth remains strong and sustainable.

In the years to come, the RBI will continue to play a vital role in promoting financial inclusion, deepening financial markets, and strengthening financial stability. As the Indian economy continues to grow and mature, the RBI will remain a steadfast institution, working tirelessly to promote the country's economic interests and improve the lives of its citizens.

<sup>40</sup> <https://www.ixambee.com>

<sup>41</sup> <https://www.rbi.org.in>

<sup>42</sup> <https://www.investopedia.com>