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TOPIC- ROLE OF RBI

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RESERVE BANK OF INDIA

Establishment:

The Reserve Bank of India was established in ***1935*** under the provisions of the Reserve Bank of India Act, 1934 in Calcutta, eventually moved permanently to ***Mumbai***. Though originally privately owned, was nationalized in 1949.

Organization and Management:

The Reserve Bank”s affairs are governed by a *central board of directors*. The board is appointed by the Government of India for a period of **four years,** under the Reserve Bank of India Act.

Full-time officials : **Governor** and *not more than four Deputy Governors.*

There are 3 **Deputy Governors** presently .

Nominated by Government: ten Directors from various fields and two government Officials

Others: four Directors – one each from four local boards

Role and functions of RBI

Traditional functions.

Traditional role and functions of RBI refer to those functions which every Central Bank of a country has to perform all over the world. Traditional functions are mainly the basic and fundamental functions of RBI.

Issue currency notes: RBI has the sole authority to issue currency notes in India. Earlier all currency notes except one rupee note and coins of smaller denomination were issued by RBI. However, Reserve Bank of India in New Mahatma Gandhi series has issued notes in the denominations of Rs 10 and above. Reserve Bank of India has been given these exclusive powers under the provisions of section 22 of Reserve Bank of India Act, 1934. This system of issuing currency notes is known as minimum reserve system. The currency notes issued by RBI is a legal tender throughout the territory of India without any limitations. It issues these currency notes against the security of gold bullion, gold coins, promissory notes, exchange bills and government of India bonds etc.

Banker to other banks: Reserve Bank of India is the apex monetary body in the country and it controls the volume of bank reserves. It helps and regulates other banks to create credit in the right proportion. It has obligatory powers to regulate, guide, help and direct other banks of the country, and hence it acts as the guardian of commercial banks in India. Every commercial bank has to maintain a certain part of the Reserves with RBI. Reserve Bank of India acts as the lender of last resort and banks can approach RBI when they need funds. Under the Banking Regulation Act, 1949 RBI has extensive powers to supervise and control the banking system of the country.

Banker, agent and financial advisor of the government: under section 20 of Reserve Bank of India act, it acts as the banker and agent to the government. Section 21 and 21A gives powers to RBI to conduct transactions of Central and state governments. It has the duty to make payments, taxes, and deposits on behalf of the government. It represents Government of India at International levels. It gives financial advice to the government and maintains government accounts. It has a responsibility to manage public debt and maintain the foreign exchange reserves. It provides overdraft facilities to Central and state governments.

Exchange rate management and the custodian of Foreign Exchange Reserves: Reserve Bank of India has the responsibility to stabilize the external value of Indian currency. It keeps gold bullions and foreign currency reserves etc. against currency note issue and has the responsibility to meet the adverse balance of payment with other nations. RBI has the responsibility to maintain exchange rate stability and for this, it has to bring demand and supply of foreign currency (usually US Dollar) to similar levels. It maintains this stability through buying and selling of foreign currency etc.

RBI as the bank of Central clearance, settlement, and transfer: RBI provides the facility of clearing house for settling banking transactions. This allows other banks to settle their interbank claims smoothly and economically. At places where RBI does not have its own office, this function is carried out in the premises of State Bank of India. This facility is provided by Reserve Bank of India through a cell called as the National Clearing Cell.

Credit control function: RBI tries to maintain price stability in the country which is essential for economic development. It regulates money supply in the economy according to the changing circumstances of the economy. It uses various measures such as qualitative and quantitative techniques to regulate credit in the economy. It uses quantitative controls such as bank rate policy, cash reserve ratio, open market operations etc. Qualitative controls include selective credit control, rationing of credit etc.

Promotional and developmental Role and Functions of RBI

Every Central Bank has to perform numerous promotional and development functions which vary from country to country. This is truer in a developing country like India were RBI has been performing the functions of the promoter of financial system along with several special functions and non-monetary functions.

Promotion of Banking habits and expansion of banking system: It performs several functions to promote banking habits among different sections of the society and promotes the territorial and functional expansion of banking system. For this purpose, RBI has set several Institutions such as Deposit and Insurance Corporation 1962, the agricultural refinance Corporation in 1963, the IDBI in 1964, the UTI in 1964, the Investment Corporation of India in 1972, the NABARD in 1982, and national housing Bank in 1988 etc.

Export promotion through refinance facility: RBI promotes export through the Export Credit and Guarantee Corporation (ECGC) and EXIM Bank. It provides refinance facility for export credit given by the scheduled commercial banks. The interest rate charged for this purpose is comparatively lower. ECGC provides insurance on export receivables whereas EXIM banks provide long-term finance to project exporters etc.

Development of financial system: RBI promotes and encourages the development of Financial Institutions, financial markets and the financial instruments which is necessary for the faster economic development of the country. It encourages all the banking and non-banking financial institutions to maintain a sound and healthy financial system.

Support for Industrial finance: RBI supports industrial development and has taken several initiatives for its promotion. It has played an important role in the establishment of industrial finance institutions such as ICICI Limited, IDBI, SIDBI etc. It supports small scale industries by ensuring increased credit supply. Reserve Bank of India directed the commercial banks to provide adequate financial and technical assistance through specialised Small Scale Industries (SSI) branches.

Support to the Cooperative sector: RBI supports the Cooperative sector by extending indirect finance to the state cooperative banks. It routes this finance mostly via the NABARD.

Support for the agricultural sector: RBI provides financial facilities to the agricultural sector through NABARD and regional rural banks. NABARD provides short term and long term credit facilities to the agricultural sector. RBI provides indirect financial assistance to NABARD by providing large amount of money through General Line of Credit at lower rates.

Training provision to banking staff: RBI provides training to the staff of banking industry by setting up banker s training college at many places. Institutes like National Institute of Bank management (NIBM), Bank Staff College (BSC) etc. provide training to the Banking staff.

Data collection and publication of reports: RBI collects data about interest rates, inflation, deflation, savings, investment etc. which is very helpful for researchers and policymakers. It publishes data on different sectors of the economy through its Publication division. It publishes weekly reports, annual reports, reports on trend and progress of commercial bank etc.

Supervisory Role and Functions of RBI

RBI performs certain non-monetary functions for the supervision of banks and promotion of sound banking system in India. Supervisory functions ensure improvement in the methods of operation of Banking in India. It controls and administers the entire financial and banking system of India through these functions.

Giving licence to banks: RBI has the authority to grant licence to the banks for carrying out business. It provides licence for the opening of new branches, opening extension counters, and also for closing down existing branches. Reserve Bank of India through this power avoids unnecessary competition among different banks at any particular location. It helps RBI to remove undesirable people from entering into the banking business.

Bank inspection and enquiry: RBI has the power to inspect and enquire banks in various matters under the Banking Regulation Act, and the Reserve Bank of India act. It can inspect loans and advances, deposits, investment functions etc. which helps to ensure that financial Institutions and banks carry out their operations in a proper manner. It carries out periodical inspection once or twice a year and banks have to take remedial measures pointed out during an inspection. It also asks for periodical information regarding certain Assets and liabilities of banks.

Implementation of deposit Insurance Scheme: RBI has the responsibility to implement the deposit Insurance Scheme to ensure the protection of deposits of small depositors. Under this scheme, deposits below Rs 1 lakh are insured with the Deposit Insurance Guarantee Corporation set up by Reserve Bank of India. It implements the deposit Insurance Scheme in case of failure of any Bank. Deposits made in the accounts of commercial banks, cooperative banks and RRBs are covered under this scheme. The fixed deposits with Institutions such as ICICI, IDBI etc are not covered under this scheme.

Control over Non-Banking Financial Institutions: The monetary policy of RBI does not influence the Non-Banking Financial Institutions. However, it gives directions to the Non-Banking Financial Institutions and also conducts enquiry and inspection to exercise control over these institutions. For example, it requires permission from the Reserve Bank of India for deposit-taking operations by Non-Banking Financial Institutions.

Periodic review of the working of commercial banks: the supervisory functions of RBI also includes periodic review of the working of commercial banks. It takes necessary steps to increase the efficiency of the commercial banks, and for the implementation of policy changes and schemes for the improvement of the banking system.

Prohibitory Role and Functions of RBI

1.RBI cannot purchase the shares of any industrial undertaking or even its own share.

2,It cannot provide direct monetary or financial assistance to any commercial undertaking or trade etc.

3.RBI does not have the power to buy any immovable property.

4.RBI does not have the authority to give loans on the security of property or shares

Instruments of monetary policy of RBI

Quantitative measures:

It refers to those measures of RBI in which affects the overall money supply in the economy. Various instruments of quantitative measures are:

Bank rate: it is the interest rate at which RBI provides long term loan to commercial banks. The present bank rate is 6.5%. It controls the money supply in long term lending through this instrument. When RBI increases bank rate the interest rate charged by commercial banks also increases. This, in turn, reduces demand for credit in the economy. The reverse happens when RBI reduces the bank rate.

Liquidity adjustment facility: it allows banks to adjust their daily liquidity mismatches. It includes a Repo and reverse repo operations.

Repo rate: Repo repurchase agreement rate is the interest rate at which the Reserve Bank provides short term loans to commercial banks against securities. At present, the repo rate is 6.25%.

Reverse repo rate: It is the opposite of Repo, in which banks lend money to RBI by purchasing government securities and earn interest on that amount. Presently the reverse repo rate is 6%.

Marginal Standing Facility (MSF): It was introduced in 2011-12 through which the commercial banks can borrow money from RBI by pledging government securities which are within the limits of the statutory liquidity ratio (SLR). Presently the Marginal Standing Facility rate is 6.5%.

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