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RESERVE BANK OF INDIA AND ITS FUNCTIONS

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Abstract

The Reserve Bank of India (RBI) is India's central bank. The Reserve Bank of India (RBI) is central banking institution of India and it controls all the monetary policy of the Indian rupee. RBI has to perform various promotional functions to support national objectives. The Reserve Bank of India Act of 1934 established the Reserve Bank and set in motion in 1935. Firstly the Reserve Bank of India was started as a private entity in 1935 but after that it was nationalised in 1949, then it is fully governed by the government of India. The central office of the Reserve Bank of India was initially established in Kolkata but it was permanently transferred to Mumbai in the year 1937.

The RBI looks after all the level of price changes and controls inflation and deflation by conducting monetary policy. Since the Reserve Bank's functions have undergone through a numerous changes, as the nature of the Indian economy and financial sector have changed. Reserve Bank of India performs important monetary functions from issue of currency note to maintenance of monetary stability in the country. The main purpose of the Reserve Bank of India is to conduct consolidated supervision of the financial sector in India.

The RBI is governed by the Central Board of Directors appointed by the GOI (Government of India) . Reserve Bank of India has played an important role in economic development and monetary stability in the country. The Reserve Bank of India acts as a regulator and supervisor of the overall financial system. This paper briefly explains about Reserve Bank of India, its establishment, objectives, policies and its various functions. This paper also explains about different acts administered by Reserve Bank of India.

Keywords: RBI, Economy, Development, administration, finance.

Introduction

The RBI was established in accordance with the Reserve Bank of India Act in the year 1935. The Reserve Bank of India is the central bank of India. Reserve Bank of India is the back bone of all Indian banking operations that is why it is also called as the Banker's Bank. Reserve Bank of India has massive role to control and monetary a currency operations. All currency operations instructed to the commercial banks through various quality and quantitative techniques made by the Reserve Bank of India.

All commercial banks must obey the guidelines provided by the Reserve Bank of India. Reserve Bank of India is managed by central board of directors appointed by the national government. The government always appointed the RBI's directors and that has been the case since the bank became fully owned by the government of India as outlined by the Reserve Bank of India Act. The Reserve Bank of India has 4 local boards at Mumbai, New Delhi, Kolkata and Chennai. The members of the local boards of Reserve Bank of India are appointed by the Central Government for four years.

Reserve Bank of India controls cash flows, bank rates, foreign exchange, reserves management, debt management, financial regulation and supervision. The Reserve Bank of India plays multidisciplinary nature of its functions. Reserve Bank is fully operated and owned by the Government of India. The main objective of the RBI is to do supervision of the financial sector in India which is made up of commercial banks, financial institutions and non-banking finance firms[1] . Firstly the Reserve Bank of India formulates, monitors and implements India's monetary policy. The Reserve Bank of India's main objective of is to maintain price stability and ensure that credit is flowing to productive economic sectors.

Reserve Bank of India manages all foreign exchange under the Foreign Management Act 1999. The Foreign Management Act allows the Reserve Bank of India to facilitate external trade and payments to promote the development the foreign exchange market in India. Reserve Bank of India act as a supervisor and regulator of the overall financial system and it injects public confidence into the national financial system, provides positive banking alternatives to the public and protects interest rates. Finally Reserve Bank of India act as the issuer of national currency which means that the currency is issued or destroyed depending situation as if it's fit for current circulation. It provides the Indian public with a supply of currency in the form of dependable notes and coins, which is a remaining issue in India. The role of Reserve Bank of India has undergone through various changes over long period of time. Earlier it was a cocommo perception that the role of Reserve Bank of India is to credit control by changing different key policy rates depending on the economic environment of the national and international level[2].

The Reserve Bank's operations are governed by the central board of directors. Reserve Bank of India is operated with 21 members of central board of directors appointed by the government of India in accordance with the Reserve Bank of India Act.

CHAPTER 1

Establishment of Reserve Bank of India

The Reserve Bank of India was formed on the recommendations of the Hilton Young Commission. Reserve Bank of India was established on 1st of April, 1935 in accordance with the provision of the Reserve Bank of India Act 1934. The Reserve Bank of India was originally set up as a private entity in 1935 but it was nationalized in 1949. The central office of RBI was initially established in Kolkata but it was permanently moved to Mumbai in 1937. The central office is the place where the governor sits and where the policies are formulated.

Objectives of the Reserve Bank of India[3]

The primary objectives of Reserve Bank of India according to the preamble are:

- To secure monetary stability in the country.

[1] James chen , Reserve Bank of India , Investopedia, (Mar 15, 10:50 PM) , https://www.investopedia.com/terms/r/rbi.asp

[2] Sujoy Dhar, The Changing Role of Reserve Bank Of India, SSRN, (Mar 15, 10: 55 PM), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2600379

[3] Health, What are the main objectives of monetary policy? , Easierwithpractice, (Mar 16 , 10 :15 AM) https://easierwithpractice.com/what-are-the-main-objectives-of-monetary-policy/

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- To meet the economic challenges by modernising the monetary policy framework.
- To regulate the issue of bank notes.

The primary focus of the Reserve Bank of India is to supervise and undertake initiative on behalf of financial sector. The financial sector consists of financial institutions, commercial banks, non-banking financial companies. Few critical efforts of the Reserve Bank of India are to restructure bank inspections and fortifying the role of statutory auditors in the banking system.

RBI Policies

Repo Rate: Repo rate is the interest rate at which the Reserve Bank of India lends money to all other commercial banks for a short period of time. When the repo rate increases the borrowing from Reserve Bank of India becomes expensive so the customers or the public bears the outcome of high-interest rate.

Reverse Repo Rate: Reverse Repo Rate is the borrowing rate at which the Reserve Bank of India borrows money from the other commercial banks for the short period of time. The Reserve Bank of India use reverse repo rate method to reduce inflation when there is excess money in the banking system.
Cash Reserve Ratio: Cash Reserve Ratio is the particular share of any bank's total deposit that is mandatory to be maintained with the Reserve Bank of India in the form of liquid cash.

Statutory Liquidity Ratio: Banks are required to maintain liquid assets in the form of gold and approved securities leaving aside the cash reserve ratio. A higher statutory liquidity ratio disables the banks to grant more loans.

CHAPTER 2
Legal Framework

Acts administered by Reserve Bank of India

- **Reserve Bank of India Act, 1934:** It is the legislative act under which the Reserve Bank of India was formed. Reserve Bank of India Act along with the Companies Act was amended in 1936 which were meant to provide framework for the supervision of banking firms in India.

- **Banking Regulation Act, 1949**: The Banking Regulation Act, 1949 is a legislative that regulates all banking firms in India. The Act was passed as the Banking Companies Act 1949, it came into force from 16 March 1949, and further on 1 March 1966 it changed to Banking Regulation Act 1949. Initially this law was only applicable to the banking companies but on 1965 the law was amended just to make it applicable to all cooperative banks and the other changes were introduced. It was amended on 2020 to bring the cooperative banks under the supervision of the Reserve Bank of India.

- **Foreign Exchange Management Act, 1999:** The Foreign Exchange Management Act, 1999 is an Act of the parliament of India. The Act was passed on the 29th December 1999 in parliament and it replaced the Foreign Exchange Regulation Act. This is an act to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India[4].

- **Government Securities Act, 2006:** The Government Securities Act, 2006 is a legislation of the Parliament of India. The Act aims to introduced various improvement in the government securities market and the government securities is managed by the Reserve Bank of India.

- **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002:** The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 is also known as the SARFAESI Act and it is an Indian law. This act allows banks and other financial institution to auction residential or commercial properties of defaulters to recover loans.

- **Credit Information Companies (Regulation) Act, 2005:** The Credit Information Companies (Regulation) Act 2005 is a legislation enacted by the government of India. This is an act to regulate the actions of credit information companies in India and to facilitate efficient distribution of credit as well as for matters connected to the same. The Reserve Bank of India and the government of India have enacted the Credit Information Companies Regulations 2006 and the Credit Information Companies Rules 2006 issued under the Act, respectively.

- **Payment and Settlement Systems Act, 2007:** Payment and settlement systems in India are used for financial transactions and they are covered by the Payment and Settlement Act, 2007. This act is legislated in December 2007 and regulated by the Reserve Bank of India and the Board for Regulation and Supervision of Payment and Settlement Systems.

- **Factoring Regulation Act, 2011:** The Factoring Regulation Act of 2011 is an Act of the Parliament of India. The goal of this Act is to tackle the payment delays and liquidity issues that small and medium sized business encounter and to also establish a framework that will allow for easy accessibility to working capital financing. This Act also remove the stamp duty on factory transactions in order to stimulate more transactions by eliminating the burden of excessive duties that otherwise would have applied to moveable property transfers[5].

CHAPTER 3

Functions of Reserve Bank of India

RBI introduced various policies in banking sector to maintain close and continuous collaboration between government. Some important functions of Reserve Bank of India in banking sector and economy are:

1. **Banker's Bank**
The Reserve Bank of India also called as central bank and banker's bank. It is the relationship between commercial bank, central bank and major part of the business. Reserve Bank of India holds a part of cash reserve of banks, lends them funds for short

[4] Functions of RBI - Reserve Bank Of India, Insuregrams, (Mar 16, 12:05 PM), https://insuregrams.com/functions-of-rbi-reserve-bank-of-india/

[5] Bhaviyak Jain, An overview of the Factoring Regulation Act, 2011, iPleaders, (Mar 17, 09:15 pm), https://blog.ipleaders.in/overview-factoring-regulation-act-2011/?amp=1

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period of time and provides them with centralised clearing and cheap and quick remittance facilities. In the stage of the development of central banking, the banks used to keep some of their cash reserves voluntarily with a leading bank which gradually took over the role of the central bank of the country.

2. **Banker to the government**
The Reserve Bank of India acts as a banker to the government the central as well as state government. Reserve Bank of India provides government all banking services such as acceptance of deposits, withdrawal, cheques, making payment as well as receipts and collection of payments. The Reserve Bank of India transacts all banking business of the government, which involves the receipt and payment of money on behalf of the government and carrying out of its exchange, remittance and other banking operations. In return, the government of India keep their cash balances on current account deposit with the Reserve Bank of India.

3. **Controller of banks**
The Reserve Bank of India controls central and co-operative bank. Reserve Bank of India acts as controller of banks in India in 2nd schedule of the act. Reserve Bank of India issues loans and currency. Reserve Bank of India issues directions towards inspection and monetary control.

4. **Statutory reserves**
Reserve Bank of India maintains certain percentage of the assets in liquid cash. Statutory liquidity ratio and cash reserve ratio are two instruments of credit control. The cash reserve ratio refers to the cash which banks have maintain with the Reserve Bank of India as a certain percentage of their demand and time liabilities since 1962 separate CRR was fixed in respect of demand liabilities and time liabilities.

5. **Monetary policy of the Reserve Bank of India**
Monetary policy defined as policy and central supply of money as instrument for achieving the objectives of general economic policy, monetary economic growth, price stability, maintain exchange rate stability, balance of payments, full employment. Monetary policy measures have two types qualitative measures and quantitative measures.

6. **Right to issue bank note**
Reserve Bank of India has the right to issue bank note in India. The bank notes are the legal tender guaranteed by the central government of India. The central government on the suggestion of central board specifies denomination of bank notes which includes discontinuation of bank notes. The central government approves design, materials and form of bank notes on consideration and recommendation of the central board.

7. **Lender of the last resort**
The lender of the last resort is an institution usually the central bank that is Reserve Bank of India offers loans to banks and other eligible institutions that are experiencing financial difficulty or are considered highly risky or near collapse. The commercial banks approach to the central bank that is Reserve Bank of India in the time of emergency to tide over financial difficulties and the Reserve Bank comes for their rescue though it might charge a higher rate of interest.

8. **Controller of Credit**
The Reserve Bank of India has the responsibility of controlling credit created by the commercial banks. The credit is

controlled by the Reserve Bank of India in accordance with the economic priorities of the government. The credit money forms the most important part in supply of money and the supply of money has important implications for economic stability so, the importance of control of credit has become obvious. When the Reserve Bank of India observes that the economy has sufficient money supply and it may cause an inflation in the country then the Reserve Bank of India squeezes the money supply through its tight monetary policy and vice versa. The Reserve Bank of India uses quantitative and qualitative methods to control and regulate the credit flow in the country.

9. **Formulates banking policy**
The Reserve Bank of India is empowered to formulate banking policy in the interest of the pubic and depositors. The banking policy in relation to advances and provide direction on the purpose of the advances and margins to be maintained in a secured advances. The maximum number of advances may be made, the rate of interest, terms and conditions for advances or guarantees may be given.

10. **Central clearance and accounts settlement**
The clearing of accounts has become an essential function of the Reserve Bank of India. The commercial bank have their surplus cash reserve deposited in the Reserve Bank of India so, it is easier to deal with each other and settle the claim of each other through book keeping entries in the books of the Reserve Bank of India[6].

The preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

"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." [7]

Conclusion

The Reserve Bank of India has done a commendable job as a monetary authority and regulator of the financial system of India. The Reserve Bank of India plays an important role in achieving economic growth and development of the country. The Reserve Bank of India is responsible for the issue and supply of the Indian rupee and the regulation of the Indian banking system. Reserve Bank of India is an autonomous body promoted by the government of India. The Reserve Bank of India operates the government mints that produce currency and coins.

The Reserve Bank of India has been one of the successful central banks around the world in preventing the effects of the subprime crisis to the Indian economy, mainly in its banks. Further a large proportion of Indian population is affected by inflation it was necessary for the Reserve Bank to think about the majority of the population of the country and Reserve Bank of India is the authority to control inflation by through monetary

[6] BANKING & INSURANCE OPERATIONS MBA 927, (Mar 16 , 10 : 15 PM) https://www.cbsmohali.org/course_material/fourth_semester/BANKING&INSURANCE_MODULE.pdf

[7] About Us , Reserve Bank Of India, (Mar 18 , 10: 15 AM) https://www.rbi.org.in/Scripts/AboutUsDisplay.aspx

policies. The Reserve Bank of India keeps an eye on the levels of price changes and controls the inflation and deflation by conducting monetary policy. The Reserve Bank of India helps in attaining full employment of resources, in overcoming balance of payment disequilibrium and in stabilizing exchange rates.

Reserve Bank of India has been given wide range of power under the Banking Regulation Act. All the role and functions of Reserve Bank of India such as monetary, non-monetary, promotional and supervisory are equally significant in context of the Indian economy. The working of the commercial banks has greatly improved under the supervision of Reserve Bank of India. Reserve Bank of India is responsible for strong financial support to industrial and agriculture development in the country.

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