

## **UNIT -1**

### **Introduction**

A central bank is a public financial institution that manages a country's currency, money supply, and interest rates to ensure price stability and economic stability. It acts as the apex supervising commercial banks and implementing monetary policy to achieve macroeconomic goals like full employment and sustainable growth. The central bank is not a commercial bank and operates as the "banker's bank," providing financial services to the government and other commercial banks.

**Objectives of the establishment of the Reserve Bank of India (RBI)**, as stated in the RBI Act, 1934 and understood from its foundational purpose:

#### **1. Regulate the issue of banknotes**

To maintain control over the currency system in India and ensure an adequate supply of clean and genuine notes.

#### **2. Maintain monetary stability**

To ensure price stability while keeping in mind the objective of economic growth.

#### **3. Operate as the banker to the government**

RBI manages banking transactions, public debt, and financial advising for both the Central and State Governments.

#### **4. Act as the banker's bank**

To regulate and supervise commercial banks, provide financial accommodation, and maintain overall banking stability.

#### **5. Promote the development of a sound financial system**

To ensure a safe, stable, and efficient financial and payment system.

#### **6. Control credit and money supply**

To use tools like CRR, SLR, bank rate, OMO, etc., for controlling liquidity and credit in the economy.

#### **7. Protect depositors' interests**

Through regulation and supervision of banks and NBFCs, and maintaining public confidence in the financial system.

## 8. Promote economic development

To support national goals such as financial inclusion, rural credit, and institutional development.

## Organisation and Management of RBI

The Reserve Bank of India (RBI) is governed according to the **RBI Act, 1934**. Its organisational structure ensures smooth functioning of monetary, financial, and supervisory responsibilities.

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### 1. Central Board of Directors (Highest Decision-Making Body)

The affairs of RBI are managed by the **Central Board of Directors**.

#### Composition

1. **Governor** – Chief executive of RBI
2. **Deputy Governors (Maximum 4)**
3. **Directors nominated by Government**
  - 4 Directors (one each from the four local boards)
  - 10 Directors representing various sectors
4. **One Government Official** (usually from Finance Ministry), nominated by the Central Government

#### Functions of the Central Board

- Formulates policies related to currency, credit, banking, and investment
  - Approves budget, accounts, and internal rules
  - Oversees the overall management of RBI
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### 2. Governor and Deputy Governors

#### Governor

- Head of RBI and responsible for its day-to-day operations
- Appointed by the Central Government
- Tenure: Usually 3 years (extendable)

#### Deputy Governors

- Up to 4 Deputy Governors
  - Assist the Governor in managing various departments
  - Usually includes:
    - One from RBI cadre
    - One from commercial banks
    - One economist
    - One from financial sector/regulation background
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### 3. Local Boards

RBI has **four Local Boards** located at:

- Kolkata
- Mumbai
- Chennai
- New Delhi

#### Composition

Each Local Board has:

- 5 members appointed by the Government for 4 years

#### Functions

- Advise the Central Board on regional matters
  - Provide feedback on local banking and financial issues
  - Help in implementation of RBI policies in their respective zones
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### 4. RBI Departments

RBI has many specialised departments such as:

- Monetary Policy Department (MPD)
- Department of Banking Regulation (DBR)
- Department of Banking Supervision (DBS)
- Currency Management Department
- Financial Markets Department
- Consumer Education and Protection Department
- Foreign Exchange Department (FED)

- Payment and Settlement Systems Department

Each department is headed by an Executive Director or Chief General Manager.

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## 5. Committees of the RBI

To ensure efficient policy-making, RBI constitutes various committees such as:

- **Monetary Policy Committee (MPC)**
- Committee of the Central Board
- Board for Financial Supervision (BFS)
- Board for Payment and Settlement Systems (BPSS)

## Major Departments of RBI

### 1. Monetary Policy Department (MPD)

Frames and implements monetary policy.

### 2. Financial Markets Operations Department (FMOD)

Manages liquidity, conducts open market operations (OMO).

### 3. Financial Markets Regulation Department (FMRD)

Regulates money, government securities, forex markets.

### 4. Department of Regulation (DoR)

Frames regulations for banks and NBFCs.

### 5. Department of Supervision (DoS)

Supervises and inspects banks, NBFCs, and cooperative banks.

### 6. Financial Inclusion and Development Department (FIDD)

Promotes rural credit, priority sector lending, and inclusion.

### 7. Currency Management Department (CMD)

Handles printing, distribution, withdrawal, and management of currency notes and coins.

## **8. Department of Payment and Settlement Systems (DPSS)**

Regulates digital payments—UPI, NEFT, RTGS, etc.

## **9. Foreign Exchange Department (FED)**

Implements FEMA, manages foreign exchange transactions.

## **10. Internal Debt Management Department (IDMD)**

Manages government borrowings and public debt.

## **11. Department of Economic and Policy Research (DEPR)**

Conducts economic research and publishes RBI reports.

## **12. Department of Statistics and Information Management (DSIM)**

Handles data collection, statistical analysis, and forecasts.

## **13. Consumer Education and Protection Department (CEPD)**

Handles customer grievances and consumer protection.

## **14. Financial Stability Unit (FSU)**

Monitors risks to financial stability and prepares FSR.

## **15. Enforcement Department**

Handles regulatory violations and enforcement actions.

## **16. Human Resource Management Department (HRMD)**

Manages recruitment and staff training.

## **17. Inspection Department**

Inspects banks and ensures compliance.

## **18. Information Technology Department (ITD)**

Manages RBI's IT systems and cybersecurity.

## 19. Legal Department

Handles legal affairs and legislative matters.

## 20. Corporate Strategy and Budget Department (CSBD)

Budgeting, planning, and internal governance.

## Functions of RBI

### 1. Monetary Authority

- Formulates and implements **monetary policy**.
  - Controls money supply, credit, and interest rates.
  - Ensures **price stability** with economic growth.
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### 2. Issuer of Currency

- Has the **sole authority to issue banknotes** in India (except ₹1 coin/note issued by Ministry of Finance).
  - Ensures adequate supply of clean notes.
  - Manages currency circulation and withdrawal of fake/soiled notes.
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### 3. Banker and Agent to the Government

- Manages banking transactions of Central and State Governments.
  - Manages **public debt**.
  - Advises government on financial and economic matters.
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### 4. Banker's Bank

- Regulates and supervises commercial banks.
  - Maintains their CRR and SLR.
  - Provides loans and advances to banks.
  - Acts as a lender of last resort.
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## 5. Supervisor and Regulator of the Financial System

- Regulates banks, NBFCs, payment systems.
  - Ensures financial stability through risk monitoring.
  - Protects consumer interests.
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## 6. Manager of Foreign Exchange

- Regulates foreign exchange through **FEMA**.
  - Manages **foreign exchange reserves**.
  - Promotes orderly development of the forex market.
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## 7. Controller of Credit

- Uses tools like:
    - Bank Rate
    - Open Market Operations
    - CRR, SLR
    - Repo & Reverse repo rates
  - Controls credit flow to stabilize economy.
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## 8. Promoter of Financial Inclusion

- Supports rural credit, priority sector lending.
  - Develops institutions like NABARD, EXIM Bank, etc.
  - Promotes digital payments and financial literacy.
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## 9. Developmental and Promotional Functions

- Develops banking habits and payment systems.
  - Encourages modernization of banking technology.
  - Supports national development programs.
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## 10. Data Collection and Research

- Collects and publishes data on money, finance, and economic conditions.
- Releases important publications such as:
  - Annual Report
  - Financial Stability Report
  - Monetary Policy Report

## Key Features OF MINIMUM RESERVE SYSTEM

### 1. Minimum Reserve Requirement

Under the MRS, the RBI must maintain:

- **₹200 crore** as minimum reserves
  - **₹115 crore in gold**
  - **₹85 crore in foreign securities**

These reserves act as a backing for the currency issued.

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### 2. Purpose

- To ensure **public confidence** in currency
  - To maintain the **stability** of the Indian monetary system
  - To give RBI flexibility to issue more currency when needed
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### 3. Replacement of Proportional Reserve System

Before 1957, RBI followed the **Proportional Reserve System**, which required maintaining a fixed proportion of gold and foreign securities.

The MRS replaced it to allow **greater elasticity** in currency supply.

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## Advantages of Minimum Reserve System

- Provides flexibility for issuing more currency
- Requires only a **small fixed reserve**, making operations easier
- Helps in economic growth by allowing expansion of money supply



## CREDIT CONTROL METHODS OF RBI

Credit control means **regulating the availability, cost, and direction of credit** in the economy. RBI uses **two types of methods**:

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### A. QUANTITATIVE (General) Methods

These methods control **overall volume of credit** in the economy.

#### 1. Bank Rate Policy

- Bank Rate  $\uparrow$   $\rightarrow$  Loans become costlier  $\rightarrow$  Credit decreases
- Bank Rate  $\downarrow$   $\rightarrow$  Loans become cheaper  $\rightarrow$  Credit increases

#### 2. Open Market Operations (OMO)

- RBI **sells** government securities  $\rightarrow$  reduces liquidity
- RBI **buys** government securities  $\rightarrow$  increases liquidity

#### 3. Cash Reserve Ratio (CRR)

- CRR  $\uparrow$   $\rightarrow$  Banks keep more cash with RBI  $\rightarrow$  Less credit
- CRR  $\downarrow$   $\rightarrow$  Banks lend more  $\rightarrow$  More credit

#### 4. Statutory Liquidity Ratio (SLR)

- SLR  $\uparrow$   $\rightarrow$  Banks hold more liquid assets  $\rightarrow$  Less credit
- SLR  $\downarrow$   $\rightarrow$  More funds available to lend

#### 5. Repo and Reverse Repo Rates

- **Repo Rate**  $\uparrow$   $\rightarrow$  Borrowing from RBI becomes costly  $\rightarrow$  Credit falls
  - **Reverse Repo**  $\uparrow$   $\rightarrow$  Banks keep money with RBI  $\rightarrow$  Credit reduces
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### B. QUALITATIVE (Selective) Methods

These methods control **the direction of credit** (i.e., who gets credit and for what purpose).

#### 1. Margin Requirements

- RBI changes margin on loans against securities.  
Higher margin → Lower loan amount → Less credit.

## **2. Credit Rationing**

- RBI limits the amount of credit banks can lend to certain sectors.

## **3. Moral Suasion**

- RBI persuades and advises banks to regulate credit responsibly.

## **4. Direct Action**

- RBI can penalize or restrict banks for not following guidelines.

## **5. Regulation of Consumer Credit**

- Controls credit for durable goods like vehicles, appliances.

## **6. Selective Credit Control (SCC)**

- Restricts credit for speculative activities in specific commodities (e.g., food grains, cotton).

# **ROLE OF RBI IN THE ECONOMIC DEVELOPMENT OF INDIA**

The Reserve Bank of India (RBI) plays a crucial role in strengthening India's economy through its monetary, financial, and developmental functions. Its actions help promote stability, growth, and inclusive development.

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## **1. Monetary Stability**

- RBI controls inflation through monetary policy.
  - Maintains price stability which is essential for economic growth.
  - Regulates money supply and interest rates to support investment.
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## 2. Financial Stability

- Regulates banks, NBFCs, and payment systems.
  - Prevents bank failures and maintains public confidence.
  - Oversees risks in the financial system through supervision.
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## 3. Development of Financial Institutions

RBI promotes and supports institutions such as:

- NABARD (agriculture and rural credit)
  - EXIM Bank (export promotion)
  - SIDBI (small industries)
  - NHB (housing finance)
- These institutions contribute directly to development.
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## 4. Promotion of Agricultural and Rural Development

- Ensures adequate credit to agriculture via priority sector lending.
  - Supports rural cooperatives and regional rural banks (RRBs).
  - Facilitates schemes for farmers, rural SMEs, and microfinance.
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## 5. Industrial Growth

- Encourages credit to industry and MSMEs.
  - Provides refinance facilities to banks for industrial financing.
  - Helps in modernization of industry by regulating interest rates.
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## 6. Promotion of Financial Inclusion

- Expands banking services to rural and backward areas.
- Encourages Jan Dhan Yojana, digital payments, and no-frills accounts.
- Supports development of UPI, Aadhaar-enabled payments, and mobile banking.

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## **7. Development of Financial Markets**

- Regulates money market, government securities market, and forex market.
  - Ensures efficient payment and settlement systems.
  - Encourages innovation in digital finance.
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## **8. Management of Foreign Exchange**

- Stabilizes the exchange rate through forex management.
  - Ensures smooth and safe foreign trade through FEMA regulations.
  - Maintains adequate foreign exchange reserves.
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## **9. Control of Credit**

- Uses CRR, SLR, repo rate, OMO, etc., to control availability of credit.
  - Supports economic expansion during recession and controls inflation during boom.
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## **10. Consumer Protection and Financial Literacy**

- Protects customers through grievance redressal (Ombudsman).
- Promotes financial education and awareness programs.
- Ensures transparency in banking services.

## **FUNCTIONS OF NABARD (National Bank for Agriculture and Rural Development)**

NABARD, established in **1982**, is India's apex institution for **agriculture and rural development**. It coordinates, supervises, and provides financial assistance to rural financial institutions.

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### **1. Financial Functions**

#### **a) Refinance to Banks**

- Provides **refinance** to Cooperative Banks, RRBs, Commercial Banks, and other institutions for:
  - Agriculture
  - Rural industries
  - Small enterprises
  - Self-help groups (SHGs)

#### **b) Direct Finance**

- Gives direct loans to State Governments for rural infrastructure projects under **RIDF (Rural Infrastructure Development Fund)**.
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### **2. Developmental Functions**

#### **a) Promoting Rural Development**

- Supports projects like irrigation, soil conservation, watershed management, dairy, poultry, fisheries, etc.

#### **b) Strengthening Rural Credit Institutions**

- Provides training, guidance, and financial support to cooperatives, RRBs, and rural banks.

#### **c) Promoting SHG–Bank Linkage Programme**

- NABARD promotes microfinance through the **Self-Help Group movement**, helping women's empowerment and rural savings.
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### 3. Supervisory Functions

- Inspects cooperative banks and RRBs.
  - Monitors their financial health, management, and performance.
  - Ensures proper use of refinance and development funds.
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### 4. Regulatory Functions

- Frames policies for rural credit institutions.
  - Sets rules for cooperative banks and RRBs regarding lending and recovery.
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### 5. Promotional Functions

- Encourages innovations in agriculture and rural development.
  - Supports:
    - Farmer Producer Organizations (FPOs)
    - Rural entrepreneurship
    - Skill development
    - Digital banking in rural areas
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### 6. Rural Infrastructure Development

- Manages **RIDF** which finances rural roads, bridges, irrigation, markets, and storage facilities.
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## **7. Research and Development**

- Conducts research on agriculture, rural industries, microfinance, and financial inclusion.
- Publishes reports and promotes new models for rural development.