Unit-I

Lecture-15

The Reserve Bank of India

The RBI was first established on the 1st of April 1935 and nationalized in 1949. The governing of the RBI is done in accord to the RBI Act by the government. Its day to day affairs are take care of the Board of Directors who are chosen by the government.

From time to time, we read and watch news about the Reserve Bank of India (RBI) implementing some policies, increasing or decreasing some complex sounding rates, the RBI Governor talking about how inflation is rising, etc. Occasionally we might also hear a friend from finance background talk about how the latest act of RBI is going to make a difference in our daily lives and all we do is stand there nodding our heads in oblivion.

For an average Indian, all of these news articles seem to be coming straight out of the complex world of finance and economics. But have you ever wondered what does the RBI actually do and what role does it play in the Indian economy? Well, that's a natural question to ask and you're probably not alone wondering about it. So let's understand what does the RBI do.

Who is the RBI?

RBI is India's Central Bank. Every country has its own Central Bank. The US has Federal Reserve Bank (FED) and England has Bank of England (BOE) while the whole of Europe has European Central Bank (ECB). Simply put the role of a Central Bank is to monitor a country's economy and stabilize it by using its various policies. A Central Bank acts like an adviser to the Government on issues related to the economy. As opposed to popular belief, the RBI is NOT controlled by the Government but instead it works as an independent institution.

Structure of the RBI

The RBI was founded in 1935 to tackle the economic difficulties arising in British ruled India after the First World War. Since then it has undergone a lot of changes in its organizational structure. Currently, the RBI consists of a central board of directors that overlooks its functioning.

The board of directors is formed of 21 members:

Governor – appointed by the Government for a 4 year term

Deputy Governors – up to 4

Executive Directors – nominated from various fields and regions and also 2 directors nominated by the Government from the Ministry of Finance.

Role of RBI

1. Issuer of Currency

The RBI has the sole right to issue new currency notes and coins, exchanges or destroy currency not fit for circulation.

Objective: To give the public adequate quantity of supplies of currency notes and coins and in good quality.

2. Monetary Authority

RBI formulates, implements and monitors the monetary policy. This policy is the most important tool that the RBI has. Using this policy RBI manages the interest rates offered by banks on loans and deposits and which affects the inflation and deflation in the country. In simple words, lower rates give rise to higher inflation and vice versa.

Objective: To maintain price stability while keeping in mind the objective of growth.

3. Manager of Foreign Exchange

RBI also manages the flow of foreign currency in Indian economy by enforcing the Foreign Exchange Management Act, 1999. As part of this function, the RBI makes sure that the exchange rate value of Indian National Rupee is maintained in the international markets.

Objective: To facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

4. Regulator and Supervisor of the Financial System

RBI prescribes broad parameters of banking operations within which the country's banking and financial system functions. It makes sure that the banks are following the issued guidelines by overlooking their financial operations and in cases of banking failures, RBI comes ahead to safeguard the depositors' money by bailing out the distressed bank.

Objective: To maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

5. Regulator and Supervisor of Payment and Settlement Systems

RBI introduces and upgrades safe and efficient modes of payment systems in the country to meet the requirements of the public at large. This includes implementing various advanced technologies like the NEFT, RTGS or the latest Unified Payment

Interface (UPI) or overlooking the operations of National Financial Switch (NFS) which is necessary for ATMs.

Objective: To maintain public confidence in payment and settlement system

6. Related Functions

Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker. This includes dealing with financial securities issued by the Government like treasury bills, infrastructure bonds, etc.

Banker to the banks: To maintains banking accounts of all scheduled banks. This includes managing the minimum reserve capital balance required to be held by the banks with the RBI.

7. Developmental Role

Performs a wide range of promotional functions to support national objectives. This includes work like providing timely credit to the productive sectors of the economy, creating institutions to build financial infrastructure like UPI, NEFT, etc., expanding access to affordable financial services and working on financial inclusion of all classes of the society.