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Bank ratio, Repo rate, Liquidity Adjustment Facili
Interest Rate Policy, Prime lending rate, Treas
management.

1. INTRODUCTION :

- In India the need for a central bank was felt as early as 17
when Warren Hastings recommended the establishment of a Cen
Bank of Bengal and Bihar. In 1921, the Imperial Bank was set
and it performed certain central banking functions. But the Imper
Bank could not succeed in its central banking functions. In 1925 t
Hilton Young Commission strongly recommended the establishme
of a Central Bank in the country. In 1927 a bill was introduced in t
Indian Legislative Assembly, to establish a gold standard curren
for British India and constitute a Reserve Bank of India. Thereafte
various attempts were made and thus, the Reserve Bank of Indi
Act was passed in 1934 and the bank began functioning from 1s
April 1935. Later it was decided to nationalise the bank and the
Reserve Bank of India (transfer to public ownership) Act was passed
in September 1948 under which the ownership of the bank was passed

into the hands of the Government of India with effect from 1st January 1949.

2. NEED FOR THE RESERVE BANK:

1. **To secure monetary stability:** The preamble to the Reserve Bank of India Act states that it was expedient to constitute a Reserve Bank for India "to regulate the issue of bank notes and the keeping of reserves with a view to secure monetary stability in India and generally to operate the currency and credit system of the country to its advantage".
2. **Separation of the functions:** Before the establishment of the Reserve Bank, currency was issued by the Government of India and Credit was regulated by the Imperial Bank of India. The separation of these two functions was found to be defective from the point of view of economic development of the country. Hence the need was felt for the establishment of a Central Bank performing both these functions.
3. **To maintain the internal and external value of the rupee:** The establishment of a Central Bank was found to be necessary to maintain the internal and external value of the rupee. A Central bank has the means of securing monetary stability because it has the sole right of note issue and the power to adopt an appropriate credit policy.
4. **Transfer of responsibilities:** The white paper on Constitutional Reforms made it a condition that a Central Bank should be established, if the responsibilities were to be transferred from the British to the Indians. It stated that, "no room should be left for doubts as the ability of India to maintain her financial stability and credit, both at home and abroad".
5. **To remove the structural instability:** A Central Bank was found to be necessary to remove the structural instability of the banking system. In the absence of a Central Bank, each Commercial bank will have to ensure liquidity of its assets and must maintain adequate reserves. This multiple reserve system is highly disadvantageous as compared with the single reserve system under which the various Commercial Bank's reserves are pooled at the Central Bank. A single reserve system is efficient, economical, mobile and elastic.

...they are however not members of Central...

3. FUNCTIONS OF RESERVE BANK OF INDIA:

The RBI performs large number of functions. The functions of RBI can be conveniently classified as A, Traditional B. Promotional and C. Supervisory Functions.

Table 3.1 : Functions of Reserve Bank of India

A) Traditional Functions	B) Promotional Functions	C) Supervisory Functions
1. Monopoly of note issue.	1. Promotional of banking habit and expansion of banking systems.	1. Granting licence to banks.
2. Banker to the Government. determine	2. Provides refinance for export promotion.	2. Inspect and make enquiry or position in respect of matters under various sections of RBI and Banking Regulation Act.
3. Agent and adviser to the Government.	3. Expansion of facilities for the provision of agricultural credit through NABARD.	3. Implementation of Deposit Insurance scheme.

4. Banker to the Banks.	4. Extension of facilities for the small scale industries.	4. Periodical review of the work of commercial banks.
5. Acts as the clearing house of the country.	5. Helping the co-operative sector.	5. Giving directives to commercial banks.
6. Lender of last resort.	6. Prescription of minimum statutory requirements.	6. Control the non-banking finance corporations.
7. Controller of credit and forex.	7. Innovations in banking business.	7. Ensuring the health of financial system through on-site and off-site verifications.
8. Custodian of foreign exchange reserves.		
9. Maintaining the external value of domestic currency.		
10. Ensures the internal value of currency.		
11. Publishers the Economics statistics and other infromation.		
12. Rights again...		

A) Traditional Functions :

The RBI functions on the traditional lines are as follows:

1. **Monopoly of Note Issue:** In terms of Section 22 of t Reserve Bank of India Act, the RBI has been given the statuto function of note issue on a monopoly basis. The note issue India was originally based upon "Proportional Reserve System When it became difficult to maintain the reserve proportionately it was replaced by "Minimum Reserve System". According t the RBI Amendment Act of 1957, the bank should now maintai a minimum reserve of Rs.200 crores worth of gold coins, gold bullion and foreign securities, of which the value of gold should be not less than Rs. 115 crores. The Government of India issues rupee coins in the denomination of Rs. 1, 2 and 10 public. These coins are required to be circulated to public only through Reserve Bank under Section 38 of the RBI Act. The RBI presently issues notes of denominations Rs. 10 and above. RBI manages circulation of money through currency chests. Originally, RBI issued currency notes of Rs.2 and above. However, due to higher cost of printing small denomination notes these denominations are now coinised and issued by Government.

2. **Banker to the Government :** The RBI acts as banker to the Government under Section 20 of RBI Act. Section 21 provides that Government should entrust its money remittance, exchange and banking transactions in India to RBI. Under Section 21A RBI has to conduct similar transactions on State Governments also. RBI earns no income by conducting those functions but earns commissions for managing the governments public debt. Where RBI has no branch, SBI or its subsidiaries are appointed as agents and sub-agents under Section 45 of the RBI Act. Agency Banks receive commission on all transactions conducted on turnover basis. The RBI extends' ways and means' advances to Central and State Governments.

Ways and Means Advances (WMA) : It is a ...

3. **Adviser to Government :** It also acts as adviser to Government on economic and financial matters. In brief. banker to the Government the f.BI renders the following functions

   a) Collects taxes and makes payments on behalf of the Government.

   b) Accepts deposits from the Government.

   c) Advises governments on their borrowing programmes.

   d) Keep the accounts of various Government Department.

   e) Collects cheques and drafts deposited in the Government accounts.

   f) Provides short-term loans to the Government.

   g) Provides foreign exchange resources to the Government.

   h) Maintains currency chests in treasuries at some importance places for the convenience of the government.

   i) Maintains and operates Central Government's IMF accounts.

4. **Agent and Adviser to the Government :** The RBI acts as the financial agent and adviser to the Government. It renders the following functions :

   a) As an agent to the Government, it accepts loans and manage public debts on behalf of the Government.

   b) It issues Government bonds, treasury bills, etc.

   c) Acts as the financial adviser to the Government in all important economic and financial matters.

5. **Banker's Bank :** The RBI acts as banker to all scheduled banks. Commercial banks including foreign banks, co-operative banks and Regional Rural Banks (RRBs) are eligible to be

... public interest.

6. **Acts as National Clearing House :** RBI acts as the clearing house for settlement of banking transactions. This function of clearing house enables the other banks to settle their inter bank claims easily. Further it facilitates the settlement economically. Where the RBI has no offices of its own, the function of clearing house is carried out in the premises of the State Bank of India. The entire clearing house operations carried on by RBI are computerised. The inter-bank cheque clearing settlement is done twice a day. There is a separate route for clearing high value cheques of Rs. 1.00 lakh and above. Cheques drawn on banks in metropolitan cities are cleared on the same day. The RBI carries out this function through a cell known as National Clearing Cell.

7. **Lender of Last Resort :** The RBI acts as a lender of last resort. As such, if the commercial banks are not able to get financial assistance from any other sources, then as a last resort, they can approach the RBI for the necessary financial assistance. In such situations, the RBI provides credit facilities to the commercial banks on eligible securities including genuine trade bills which are usually made available at Bank Rate. RBI rediscounts bills under Section 17(2) and 17(3) and grants advances against securities under Section 17 (4) of RBI Act. The RBI now mainly provides refinance facilities as direct assistance. Rediscounting of bills fall under the following categories :

   i) Commercial Bill.
   ii) Bills for Financing Agricultural operations.
   iii) Bills for Financing Cottage and Small Scale Industries.
   iv) Bill for holding or trading in Government securities.
   v) Foreign bills.

   As lender of last resort the RBI facilitates the following:

   (a) Provides financial assistance to commercial banks at the time of financial needs.
   (b) It helps the commercial banks in maintaining liquidity of their financial resources.
   (c) Enables the commercial banks to carry out their activities with minimum cash reserves.
   (d) As a lender of last resort, the RBI can exercise full control over the commercial banks.

8. **Credit Control :** The RBI controls the credit creation by commercial banks. For this, the RBI uses both quantitative and qualitative methods.

   a) **Quantitative Methods :**
      i) Bank Rate Policy
      ii) Open Market Operations
      iii) Variation of Cash Reserve Ratio

b) Qualitative Methods :

i) Fixing Margin Requirements

ii) Regulation of consumers credit

iii) Rationing of credit

iv) Moral Suasion

v) Issue of Directives

vi) Publicity'

vii) Direct Action.

9. **Custodian of Foreign Exchange Reserves:** The RBI acts as the custodian of foreign exchange reserves. An adequate reserves may help maintain foreign exchange rates. In order to minimise the undue fluctuations in the rates it may buy and sell foreign currencies depending upon the situations. It may buy the foreign currency to build up adequate reserves or to arrest unwarranted rise in the value of rupee which may be due to sudden inflow of foreign currencies into India. It may also buy and sell foreign currencies in international market to switch the portfolio of investments denominated in different international currencies depending upon circumstances and needs. The value of foreign currency assets of RBI, which form the largest portion in India's Foreign Currency reserves is subject to changes even on daily basis depending upon ruling exchange rates, inflow and outflow of currencies, intervention policy of the RBI, etc.

10. **Foreign Exchange Control:** When a country faces Balance of Payment problems it controls the whole gamut of forex (foreign exchange) transactions and regulates payment system for its advantage. Ever since the beginning of Second World War in 1939 India faced shortage of forex for its development and growth. A Foreign Exchange Regulation Act was originally put in operation from March 1947 and later a new act known as Foreign Exchange Regulation Act (FERA) 1973 was introduced from 11 January 1974. Under this Act, RBI is empowered to regulate foreign exchange out go and inflow, for example, we cannot buy everything we need from abroad

11. **Maintaining the Value of Currency:** The RBI by its operation of credit control and price stability, maintains the internal value of domestic currency and ensures its stability.

12. **External Value of Rupee:** As per the RBI Act, the Bank is also required to maintain external, value of the Rupee. It, however, depends upon many factors like inflation levels, interest rates balance of payments situation, etc., ruling in different countries on which RBI does not have control. Earlier, till 1993 the RBI use to prescribe the Exchange Rate of Rupee. The external value of rupee is now determined by market forces. RBI by virtue of its position as the Central Bank of the country and custodian of large forex reserves can influence the level of External Value in the short run.

13. **Publishes the Economic Statistics and Other Information:** The RBI collects statistics on economic and financial matters. It publishes periodically an analytical account of the operations of joint stock and co-operative banks. It presents the online financial position of the government and companies. The publications like the report on currency and finance, the report on the trend and progress of banking in India, lite review of co-operative movement present a critical account and a balanced review of Banking developments commercial, economic and financial conditions of the country.

implementation

B) Promotional Functions :

These are non-monetary functions of RBI . They are as follo

1. **Promotion of Banking Habits :** In order to promote bank habits among the people the RBI has set up Deposit Insura Corporation in 1962, Unit Trust of India in 1964, the IDBI 1964, the Agricultural Refinance Corporation in 1963, Indust Reconstruction Corporation of India in 1972, NABARD in 19 and the National Housing Bank in 1988, etc. It has helped bring into existence several industrial finance corporations su as Industrial Finance Corporation of India, Industrial Cre and Investment Corporation of India for industrialisation of th country.

2. **Provides Refinance for Export Promotion :** The RBI takes the initiative for widening facilities for the provision of financ for foreign trade particularly of exports.

   The Export Credit and Guarantee Corporation (ECG) and Exim Banks render useful services in this regard. To encourage exports the RBI is providing refinance facilities for export credit given by commercial banks. Further the low rate of interest on export credits are be levied by RBI. EXIM Bank extends long term finance to project exporters and foreign currency credit for promotion of Indian exports.

3. **Financial Facilities for Agriculture :** The RBI extends indirect financial facilities to agriculture through NABARD. It provides short-term and long-term financial facilities to agriculture and allied activities. Indian agriculture would have starved of a cheap credit but for the institutionalisation of rural credit by RBI.

extent to empl...
Keeping this in view, RBI has directed commercial banks to open specialised 551 bank branches to provide adequate financial and technical assistance to 551 branches.

5. **Helps Co-operative Sector:** RBI helps to State Co-operative Banks by connecting the cooperative sector with the main banking system of the country. The finance is mostly routed through NABARD. This way the financial needs of agricultural sector is taken care of by RBI.

6. **Prescription of Minimum Statutory Requirements for Banks:** The RBI prescribes the minimum statutory requirement such as, paid up capital, reserves, cash reserves, liquid assets, etc. RBI prescribes reserves requirements both under Banking Regulation Act and RBI Act to ensure different objectives. For example, SLR prescription is done to ensure liquidity position of the bank. eRR prescription is done to have effective monetary control and money supply. Statutory Reserves Appropriation is done to ensure sound banking system, etc. It also asks banks to set aside provisions against possible bad loans. With these functions, it exercises control over the monetary and banking systems of the country to ensure growth, price stability and sound banking practices.

price stability and sound banking practices.

C) Supervisory Functions:

By supervisory functions RBI controls and administers the entire financial and banking systems of the country.

1. **Granting Licence to Banks:** Licences are required to open new branches or closure of branches. The RBI grants licence to the banks, which like to commence their business in India. With this power RBI can ensure avoidance of unnecessary competitions among banks in particular location evenly growth of banks in different regions, adequate banking facility to various

regions etc. This power also help RBI to weed out undesirable people from starting banking business.

2. **Function of Inspection and Enquiry :** RBI inspects and makes enquiry in respect of various matters covered under Banking Regulations Act and RBI Act. The inspection of commercial banks and financial institutions are conducted in terms of the provisions contained in Banking Regulation Act. These refer to their banking, operations like loans and advances, deposits, investment functions and other banking services. Under such inspection RBI ensures that the banks and financial institutions carry on their operations in a prudential manner, without taking undue risk but aiming at profit maximisation within the existing rules and regulations. This type of inspection is carried on periodically once a year or two covering all branches of banks. Banks are obliged to take remedial measures on the lapses / deficiencies pointed out during inspection.
3. **Implementing the Deposit Insurance Scheme :** RBI Implements the Deposit Insurance Scheme for the benefit of bank depositors. Under this system, deposits up to Rs. 1.00 lakh with the bank branch is guaranteed for payment: Deposits with the banking system alone is covered under the scheme. For this purpose banking system include accounts maintained with commercial banks, co- operative banks and RRBs.
4. **Periodical Review of the Working of the Commercial Banks:** The RBI periodically reviews the work done by commercial banks. It takes suitable steps to enhance the efficiency of the banks and make various policy changes and implement programmes for the well-being of the nation and for improving the banking system as a whole.
5. **Controls the Non-Banking Financial Corporations (NBFC) :** RBI issues necessary directions to the NBFC. It conducts inspections through which it exercises control over such institutions. NBFCs require a permission from RBI for their operations.)