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Money Supply System: A Tool to Accelerate the Rate of Economic Growth of Developing Countries Like India

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Abstract:

In order to achieve successful direction of economic activities in a country requires well-planned money supply. Money supply is an important technique for development in a developing economy like India. A well- planned money supply system will accelerate the rate of economic growth with stability. Generally, money supply in a country is regulated and controlled by the Central Bank (RBI in India). Money supply comprises of the system of issuing money, system of note issue, need of money and problems relating to note issue etc. Besides, the foreign value of money, exchange rate system etc. are also part of money supply. The fluctuations in exchange rate, favourable and unfavourable balance of payments, and fluctuations in trade and industrial world also affect money supply in country. Therefore, the present study is aimed to study the, measures of money supply, minimum reserve system of note issue and the factors affecting the velocity of circulation of money.

Purpose of the Study:

The primary purpose of the study is to prove that money supply is an important factor not only for acceleration of the process of economic development but also for the achievement of price stability in the economy.

Keywords: Money supply, Money stock, M0, M1, M2, M3, M4,

Introduction:

The term Money Supply (Money Stock) is the total value, of monetary assets available in an economy at a specific time. There is strong empirical evidence of a direct relation between money supply growth and long term price inflation, at least for rapid increase in the amount of money in the economy. In other word, money supply refers 'to the total sum of money available to the public in the economy at a point of time. That is, money supply is a stock concept in sharp contrast to the national income which is a flow representing the value of goods and services produced per unit of time, usually taken as a year.

The proper analysis and evaluation of the money supply help the economist and policy makers to frame the policy or to alter the existing policy of increasing or reducing the supply of money. The valuation is important as it ultimately affects the business cycle and thereby affects the economy. Periodically, every country's Central Bank publishes the money supply data based on the monetary aggregates set by them. In India, the Reserve Bank of India follows M0, M1, M2, M3 and M4 monetary aggregates. The circulating money involves the currency, printed notes, money in the deposit accounts and in the form of other liquid assets. If any nation wants to

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achieve the objective of development with stability then there must be controlled expansion of money supply.

Objectives of the Study:

The present study has the following objectives-

1. To know measures of money supply.
2. To know minimum reserve system of note issue.
3. To know the factors affecting the velocity of circulation of money.

Limitations of the Study:

Several factors are available to accelerate the growth of economy like smooth functioning of Capital Market, Money Market, Banking Sector, NBFCs etc. but only Money Supply system is included under the present study.

Data Collection:

This study is done with the maximum usage of secondary data. Secondary information has been made available from published sources like, library books, journals, newspapers, magazines, government publications etc.

Findings of the Study:

Measures of Money Supply:

The total stock of money in circulation among the public at a particular point of time is called money supply. The measures of money supply in India are classified into four categories M1, M2, M3, and M4 along with M0. This classification was introduced in April 1977 by Reserve Bank of India. These measures are discussed as below-

Reserve Money (M0): It is also known as High-powered Money, monetary base, base money etc. M0= Currency in Circulation +Banker's Deposits with RBI+ Other deposits with RBI. Actually it is the monetary base of India.

Narrow Money (M1): M1= Currency with public+ Demand deposits with the Banking system (Current account, Saving account) + Other deposits with RBI

M2: M2= M1+ Savings deposits of post office savings banks.

Broad Money (M3): M3= M1 + Time deposits with the banking system

M4: M4= M3 + All deposits with the post office savings banks.

- **Liquidity of Measures of Money Supply:**

The liquidity means how fast an instrument can be converted into cash. The liquidity of these measures is in the order of M1>M2>M3>M4 i.e. M1 is most liquid and M4 is least liquid.

- **Money Multiplier:**

It is the relationship between monetary base and money supply in economy. The amount of money that banks generates with each unit (Rs in case of India) of money. It is the ratio of deposits to the reserves in the banking system.

$$\textbf{Money Multiplier} = \frac{1}{\textbf{Reserve Ratio}}$$

For example the total deposit in banking system is Rs 100 and reserve ratio requirement is 10%. The banks can lend 90% of deposit i.e. Rs 90. This Rs 90 that banks will lend to its customers will ultimately be deposited in another bank which can further lend 90% of that i.e. Rs 81 and cycle continues.

Minimum Reserve System of Note Issue:

We have adopted the minimum reserve system of note issue since 1956. Under this system, the law prescribes the minimum metallic and foreign securities reserve against note issue. These reserves must be maintained irrespective of the amount of note issue. Beyond this limit, notes may be issued without increasing the reserves. At present, the Government of India can issue unlimited amount of paper notes by keeping minimum reserve of Rs. 200 crores. In the minimum reserve of Rs. 200 crores, gold reserves should not be less than Rs. 115 crores and the balance of Rs. 85 corores can be kept in foreign securities. Thus, the system which governs the note issue in India is called as the Minimum Reserve System.

With an amendment of 1957, the Reserve Bank of India has been empowered not to keep foreign exchange provided it is able to get approval of the Government of India for the purpose.

- **Merits of Minimum Reserve System:**

The Minimum Reserve System of Note Issue has the following merits-

1. **Economical:**

The note issue under this system is economical because the currency is not backed by cent per cent metallic reserve. Gold or silver in any form of metallic reserve is not kept.

2. **Flexibility:**

The system of note issue is flexible as the monetary authorities are free to issue as much currency as required after keeping a minimum of gold and foreign securities.

3. **Wider Suitability:**

The minimum reserve system of note issue has wider suitability for all the countries irrespective of their level of economic development and requirement of currency in circulation. Poor countries have more suitability in adopting this system due to need for developmental finance.

- **Demerits of Minimum Reserve System:**

The minimum Reserve System of Note Issue in India has the following demerits or limitations:

1. **Fear of Inflation:**

The main demerit of the system is the fear of inflation because government can issue unlimited quantity of paper notes in circulation. There will be a gap between the currency and volume of goods and services which will lead to inflationary rise in prices as no additional reserves are kept.

2. **Lack of Public Confidence:**

The country's people do not have confidence in the currency issued under this system of note issue. Inflationary situation leads to increase in the prices of goods and services and thereby the value of money goes down. Hence, public confidence is shaken.

3. **Inconvertible:**

The currency issued by the central bank is backed up by the minimum reserve of Rs. 200 crores and currency is not exchanged either with gold or with foreign exchange but it is exchanged with currency only.

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4. **Decreasing Internal Value:**

The system has failed to provide stability in the internal value of the rupee. The internal price level is constantly on the rise and the value of rupee is going down year after year. The Indian rupee has been devalued several times since independence.

1. **Factors affecting the velocity of circulation of money:**

The velocity of circulation of money affects the supply of money in an economy. The velocity of circulation of money is affected by several factors as given below-

1. **Quantity of Money:**

The velocity of circulation of money depends upon the supply of money in an economy. Money is needed to conduct exchange operations in an economy. If the supply of money in an economy is less than its requirements, the velocity of circulation goes up. Contrary to it when supply of money exceeds the requirements of the economy, the velocity of circulation goes down.

2. **Frequency of Cash Transactions:**

The velocity of circulation of money will increase with the frequency in cash transactions in the economy. The lesser the frequency of cash transactions, the lower shall be the velocity of circulation and vice versa.

3. **Credit Facilities:**

If more credit facilities are given to the people, they will not keep idle cash balances with them and the velocity of circulation will go up and less the credit facilities, lower will be the velocity of circulation in the economy.

4. **System of Wage Payment:**

The velocity of circulation of money depends upon the system of wage payment in the economy. If wages are paid to workers at long intervals, they will keep larger cash balances with them to meet their daily requirements and consequently the velocity of circulation will go down. Thus, Shorter the duration of wage payment higher will be the velocity of circulation and vice versa.

5. **Regularity or Irregularity of Income:**

If income is received by people at regular intervals, they will spend the money more freely and consequently the velocity of circulation will go up. Contrary to it, irregularity of income will force people to hold more cash balances to meet future uncertainty and thereby the velocity of circulation will go down.

6. **Propensity to Consume:**

Higher the propensity to consume in a country, higher shall be the velocity of circulation of money in that country. Lower the propensity to consume lower will be the velocity of circulation of money. People will save more and spend less in such a country. It brings down the velocity of circulation of money.

7. **Distribution of Income and Wealth:**

If distribution of income and wealth is unequal, the major parts are held by the richer section, and then the velocity of circulation of money shall be low because of low propensity to save. Contrary to it, in case of equitable distribution of income and wealth, the velocity of circulation of money shall be high because in that case the propensity to consume of the people will go up.

8. Liquidity Preference of the People:

The liquidity preference of the people also affects the velocity of circulation of money. If ordinary people as well as businessmen and traders keep large cash balances to meet their requirements, the velocity of circulation of money will go down. Thus, if small parts of cash balances are kept by the people, higher will be the velocity of circulation of money.

9. Future Expectation of Prices:

The velocity of circulation of money is also influenced by the future expectation of prices by people. If people think that prices are going to increase in future, they will purchase more goods in the present and the velocity of circulation of money will go up. If people think of circulation of money will go up. If people think that prices will fall in future, they will not purchase goods in the present and the velocity of circulation of money will fall.

Conclusion:

An Increase in the supply of money works both through lowering interest rates, which spurs investment, and through putting more money in the hands of consumers, making them feel wealthier, and thus stimulating spending. Business firms respond to increased sales by ordering more raw materials and increasing production. If the money supply increase was distributed to everyone evenly, it would have no effect at all, since the increase in the prices would adjust perfectly to the fact that everyone now has more money. The present minimum reserve system of regulating note issue has been criticized from various quarters. It has been argued that greater degree of elasticity has resulted in undue expansion of money supply which would reduce the confidence and prestige of Indian rupee both within and outside the country.

The increase in money supply affects vitally the rate of economic growth. In fact, it is now regarded as a legitimate instrument of economic growth. Kept within proper limits it can accelerate economic growth but exceeding of the limits will retard it. Thus, management of money supply is essential in the interest of steady economic growth or we can say that effective money supply system is a tool to accelerate the rate of economic growth of developing countries like India.

Abbreviations:

1. **NBFC's** : Non Banking Financial Companies
2. **RBI** : Reserve Bank of India

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