Monetary Policy

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An appropriate monetary policy should have such objectives as mentioned below:

i) Maintaining internal and external stability
ii) High employment
iii) Economic growth
iv) Fiscal objectives
v) Social objectives

i) **Maintaining internal and external stability:** By price stability, we mean both internal and external stability in price level. Both inflation and depression must be controlled so that the benefits of economic development are enjoyed.

ii) **High employment:** It is difficult to give a precise definition of full employment. Monetary policy during 1930s was aimed at achieving and maintaining full employment. Full employment, while theoretically possible, is difficult to attain in market driven economies.

iii) **Economic growth:** Growth should be the predominant aim of monetary policy. By economic growth we mean, per capita increase in output. There are various ways of raising the aggregate savings rate. A high rate of interest is conducive to higher saving propensities. However, a high rate of interest discourages investment. Further, a high rate of interest may encourage inflation. But a monetary policy can boost aggregate savings rate by expanding banking facilities in underbanked and unbanked areas. Commercial banks can mobilize savings of the people in such a way that savings rate of the people are channelized into productive investment. For productive investment, bank funds are invested in government securities so that the government can finance its planned investment programmes. However, generation of savings and investment is not enough for boosting economic growth. What is needed is the allocation of funds in the proper direction. Monetary policy has to be designed in such a way that scarce resources are invested only in productive lives.

Since monetary policy can influence the rate of interest, in investment and the availability of credit, it can directly affect supply of money:

a) Reducing the interest rate and consequently reducing the bank rate, money supply can be increased. This will help to increase money supply in the market.
b) Reducing the variable reserve ratio also, money supply can be increased.
c) Reducing the assets will also help to increase supply in the market.

These are the three ways by which money supply can be increased.

So at last, interest rate will come to a minimum level, increasing the money supply.

iv) **Fiscal Objectives:** The most important fiscal objective which monetary policy has to pursue is that of facilitating government borrowing and the management of public debt.

v) **Social Objectives:** Monetary policy is often used to attain some social ends or social welfare. By raising or lowering price level, monetary policy can produce far reaching social effects of redistribution of wealth.

Limitations of Monetary Policy:

i) Faced with an excess cash-reserve, banks need not reduce their cash-ratios to the minimum.

ii) Because of restrictive monetary policy applied by the central bank, some sort of disintermediation - which is subject to control – takes place and currency from one of their overseas branches then converts the currency into Rupees.

iii) Monetary policy is a long way to go before an efficient policy can be designed.

iv) One of the important problems of monetary policy is that it does not produce immediate effects in policy making and implementation of lags.

v) Further, policymakers are rather cautious in changing policy. The impact of the policy is felt much later than the time at which the policy is made.

Conclusion:

In order to stabilize the economy, the government can use either monetary policy or fiscal policy. But neither monetary policy nor fiscal policy should be considered as a precise means of controlling aggregate demand. Each policy has strengths and weaknesses. In view of this, both monetary and fiscal policies are simultaneously employed in every economy.