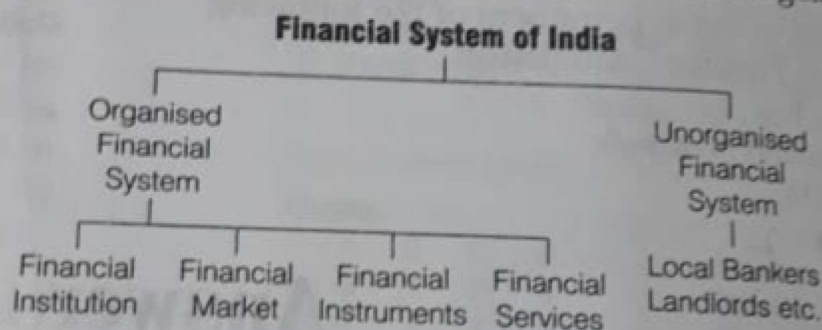
The Financial System *of* India

The financial system of India can be broadly classified into the organised and unorganised financial system. The organised financial system comes under the purview of the Ministry **of Finance**, the **Reserve Bank of India**, the **Securities and Exchange Board of India**, **Insurance Regulatory and Development Authority** and other regulatory bodies.



The unorganised financial systems are not regulated in a systematic manner by the government or any authorised regulators. The unregulated unorganised financial system comprises of relatively less controlled moneylenders non-bank financial intemediaries and the indegenous bankers. Individual moneylenders such as neighbours, relative local bankers, landlords etc are main parts of unorganised financial systems.

Financial institutions are intermediaries that mobilise savings and facilitate the allocation of funds in an efficient manner. Financial institutions can be classified as banking and non-banking financial institution. Financial markets are a mechanism enabling participants to deal in financial claims. The financial markets also provide a facility in which their demands and requirements interact to set a price for such claims. The main organised financial markets are the money market and the capital markets in India.

Financial instruments are legal documents that embody monetary value. Financial instruments represent paper wealth share, debentures, bonds and notes. Financial services refer to services provided by the finance industry. The finance industry encompasses a broad range of organisations that deal with the management of money.

Money

Money is historically an emergent market phenomenon establishing a commodity money, but nearly all contemporary money systems are based on Fiat money *i.e.,* like any check or note debt, it is without intrinsic value as a use of a physical commodity. It derives its value by being declared by a government to be legal tender, that is, it must be accepted as a form of payment within the boundaries of the country for 'All debts public and private'. Such laws in practice cause fiat money to acquire the value of any of the goods and services that it may be traded for within the nation that issues it.

The money supply of a country consists currency (bank notes and coins) and bank money (the balance held in checking accounts and savings accounts). Bank money, which consists only of records (mostly computerised in modern banking), forms by far the largest part of the money supply in developed nations.

Components of Money Supply

Money supply is the stock of liquid assets held by the public which can be freely exchanged for goods and services at a particular point of time. RBI calculates four concepts of money supply. These are known as measures of monetary aggregates or money stock measures.

The most important components of money supply laid down by Reserve Bank of India are given below

M_1

M_1 = Currency + Net Demand Deposits with Bank + Other Deposits with RBI
= C + DD + OD.

Where,

C = Currency includes paper money and metallic coins of all denominations,

DD = Net demand deposits includes the savings deposits with the bank and

OD = Other deposits with RBI includes the deposits with RBI of quasi-governments institutions such as Industrial Finance Corporation of India, State Finance Corporations, Industrial Development Bank of India, Agricultural Refinance and Development Bank of India, Agricultural Refinance and Development Corporation, deposits of International Monetary Fund (IMF) in account no. 2, deposits of Foreign Governments and Foreign Central Banks and Deposits of RBIs employees cooperative credit societies.

It must be noted that other deposits with the RBI here do not form the part of deposits of government, Commercial Banks and deposits of IMF in account no. 1.

M_1 as a measure of money supply has been found highly useful by the monetarists in their theoretical analysis of income, price level and money supply. According to many economists, time deposits should not be included in money supply due to their non-uniform maturities and their resemblance with non-money financial assets.

M_2

M_2 = M_1 + Saving deposits with post office savings of public.

This components of money supply is devised to include post office savings deposits in the M_2 component of money supply. Note that the time deposits remain excluded even from M_2 making it a narrow measure of money supply. In order of liquidity, M_2 ranks next to M_1.

M_3

M_3 = M_1 + Time deposits of public with banking system.

M_3 is the sum of M_1 and the time deposits of public with banking system. Hence, it represents a broader measure of money supply and is known as the Aggregate Monetary Resource (AMR).

M_3 as a measure of money supply is shown preference not only by RBI, but also by economists, even Chakravarty Committee favoured M_3 to M_1 as a measure of money supply. The intention of RBI might be to impart a high level of liquidity to the time deposits. M_3 ranks below M_1 and M_2 in liquidity.

M_4

M_4 = M_3 + total deposits with post office (excluding national certificates).

M_4 is the sum of M_3 and all deposits with post office (excluding national certificates). M_4 is an extension of M_3. RBI provides estimates of money supply on regular basis in terms of M_1, M_2, M_3 and M_4 to indicate fluctuating degree of liquidity of different components of money supply. While M_1 and M_2 provide the precarious measures of money supply, M_3 and M_4 provide it expansive measures.

RBI working group on money supply headed by YY Reddy recommended for dropping of post office saving deposits. Accordingly, there are now only three monetary aggregates, *viz* ,M_1, M_2 and M_3.

Monetary Aggregates

M_1 = Currency with the public + demand deposits with the banking system + other deposits with the RBI

Currency with the public + current deposits with the banking system + demand liabilities portion of savings Deposits with the banking system + Other deposits with the RBI.

M_2 = M_1 + Time liabilities portion of savings deposits with the banking system + certificates of deposit issued by Banks + Term deposits (excluding FCNR(B) deposits) with a contractual maturity of up to and including one year with the banking system = currency with the public + Current Deposits with the banking system + Term deposits (excluding FCNR(B) deposits) with a contractual maturity up to and including one year with the banking system.

M_3 = M_2 +Term deposits (excluding L_2 = FCNR(B) Deposits with a contractual maturity of over one year with the banking system + Call borrowing from 'Non-depository' Financial · Corporations by banking system.