Chapter V

THE GROWTH OF MONEY IN INDIA, 1951-52 to 1970-71

This chapter deals with the examination and analysis of another important aspect of financial development, namely, the growth of money in India during the period 1951-52 to 1970-71. In Section I we have discussed the demand for money as a financial asset.[1] In Section II we have presented the contours of monetary development in India. Particularly, we have examined the growth of money in relation to the growth of national income and the hypothesis of rising money-income ratio in a growing economy.

Section I

Demand for Money Balances

In the barter economy transactions are carried on in kind. Thus, there is no use of money in the barter economy. The diseconomies of the barter economy induce monetization i.e. the use of money in the transactions. Therefore,

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[1] Much of the text of section I is based on a part of the text from John G. Gurley and Edward S. Shaw, "The Growth of Debt and Money in the United States, 1800-1950: A suggested interpretation." The Review of Economics and Statistics, August, 1957.

price of primary securities, thesurplus spending units would like to absorb a smaller proportion (e) of primary securities and they would prefer to take a rising proportion (I-e) of their increment of portfolio assets in the form of indirect financial assets. If the money is only indirect assets the incremental diversification demand for money at given terms of lending can be expressed as $(I-e)(ay-t\Delta y)$. Thus, this is the amount of primary securities the monetary system must purchase and the amount of money it must create to satisfy incremental demand for money. In addition the money system must purchase to the extent of $t\Delta y)$ to satisfy the incremental transactions demand for money. Thus, the total primary securities that monetary system must purchase are equal to $(I-e)(ay-t\Delta y) + t\Delta y$.

Furthermore, money is competitive to some extent, in satisfying demand for portfolio assets with the indirect assets created by the non-monetary intermediaries. If the periodic increment in demand for non-monetary indirect financial assets is (by), some portion (w) of (by) displaces demand for money. Allowing this substitution of as for example, savings and loan shares in portfolio assets, the total incremental demand for money is $(I-e)(ay-t\Delta y) + t\Delta y - wby$. At an equilibrium level of income and at terms of lending appropriate to that income level, the incremental demand for money will fall as the demand for non-monetary indirect assets rises, this demand depending upon on the level of income, the fraction of income that non-monetary indirect assets, and the degree to which these assets are substituted for money in portfolio assets. If non-monetary indirect assets are substituted only for primary securities, then (w) is zero and the incremental demand for money is unaffected by the growth of non-monetary indirect intermediaries.

Section II

Monetary Development in India

In this section we have examined and analysed the stock of money in relation to national income and debt during the process of economic development. It seems as a general rule that the money-income ratio will rise in the earlier stage of the economic development, the money-income ratio tends to be stabilized. Another important aspect of monetary expansion is that as the debt-income ratio is stabilized at a plateau stage of the economic development, the money income ratio also tends to be stabilized.. At this stage money-debt ratio will also be stabilized.[2] This has been the monetary

[2] Ibid., pp.253-259. See, the simplified model of monetary expansion prepared by John G. Gurley and Edward S. Shaw, and theeemperical evidences of monetary expansion and experience in the United States of America which was fairly closer to the predictions of the hypothetical model of the monetary expansion.

experience of the United States of America. The ratio of money to gross national product was only 7 per cent in 1805. It doubled in 1850 and again it doubled in 1900. And thereafter, the money-income ratio has shown no strong upward or downward trend, and it has remained around 30 per cent.[3] Such was the monetary experience of the United States of America. Thus, our objective is to examine the hypothesis of rising money-income ratio and to what extent it is borne out in the context of monetary expansion and experience in India during the period from 1951-52 to 1970-71.

Growth of Stock of Money and Composition of Money:

The absolute growth of stock of money and composition of money in India is presented in Table V-1 and Table V-2 respectively for the period 1951-52 to 1970-71.

From Table V-1, column 2, we observe that there has been rapid growth in the stock of money in absolute amount during the period. The stock of money increased from Rs.1,828,85 lakhs in 1951-52 to Rs.2,184,45 lakhs in 1955-56. It further recorded increase from Rs.2,868,61 lakhs in 1960-61 to Rs.4,529,39 lakhs in 1965-66, and the stock of money reached the level of Rs.7,139,97 lakhs in 1970-71. This shows the continuous expansion in the stock of money during the period.

[3] John G. Gurley and Edward S. Shaw, "Financial Structure and Economic Development", Economic Development and Cultural Change, April, 1967, p.259.

Table V-1: Stock of Money and Composition of Money in India, 1951-52 to 1970-71.

(Rs. in lakhs)

Year	Stock of Money	Currency with the public	Deposit Money with the public
1	2 (3+4)	3	4
1951-52	1,828,85	1,216,57	612,28
1952-53	1,784,56	1,199,25	585,31
1953-54	1,856,56	1,229,43	627,13
1954-55	1,980,90	1,311,77	669,13
1955-56	2,184,45	1,505,22	679,23
1956-57	2,312,88	1,556,49	756,39
1957-58	2,389,35	1,607,13	782,22
1958-59	2,499,59	1,725,36	774,23
1959-60	2,703,13	1,862,72	840,41
1960-61	2,868,61	2,098,05	770,56
1961-62	3,045,82	2,201,16	844,66
1962-63	3,309,98	2,379,47	930,51
1963-64	3,752,12	2,605,56	1,146,56
1964-65	4,080,28	2,769,05	1,311,26
1965-66	4,529,39	3,034,28	1,495,10
1966-67	4,949,96	3,196,80	1,753,16
1967-68	5,350,07	3,376,08	1,973,99
1968-69	5,779,25	3,681,95	2,097,30
1969-70	6,386,54	4,010,34	2,376,20
1970-71	7,139,97	4,383,32	2,756,65

Source: Statement on "Money Supply with the Public", Report on Currency and Finance, (RFC), Reserve Bank of India, Bombay. The figures for the years from 1951-52 to 1954-55 are obtained from annual report of 1954-55, RCF, for 1955-56 to 1959-60 from annual report of 1960-61, for 1960-61 to 1968-69 from annual Report of 1968-69, RCF, and for the years 1969-70 and 1970-71 are obtained from annual report of 1972-73, RCF.

The stockof money increased nearly four times in 1970-71 as compared to the stock of money in 1951-52. Over the twenty years period the growth in the stock of money in India has been at a linear average per annum of Rs.265,56 lakhs.

The percentage composition of stock of money is given in Table V-2, for the period 1951-52 to 1970-71. Table V-2, columns 3 and 4 give percentage share of the currency with the public and of the deposit money with thepublic respectively. From Table V-2, columns 3 and 4, it is seen that the percentage share of the currency with public accounted for not less than 61 per cent, and of deposits with the public did not exceed 39 per cent during the period. The percentage share of the currency with the public averaged 67 per cent per annum and deposits with the public averaged 33 per cent per annum during the period. This shows that major constituent of the stock of money in India is the currency with the public. This is in contrast to the composition of the stock of money in mature and advance economy where major constituent is the deposit money with the public. From Table V-2, columns 3 and 4, it is seen that the currency with the public declined from 66.52 per cent in 1951-52 to 61.39 per cent in 1970-71, whereas deposit money with the public increased 33.48 per cent to 38.61 per cent during the same period.

Table V-2: Percentage Composition of Stock of Money in India, 1951-52 to 1970-71.

(in percentage)

Year	Stock of Money	Currency withthe public	Deposit Money with the public
1	2 (3+4)	3	4
1951-52	100.00	66.52	33.48
1952-53	100.00	67.20	32.80
1953-54	100.00	66.22	33.78
1954-55	100.00	66.22	33.78
1955-56	100.00	68.90	31.10
1956-57	100.00	67.30	32.70
1957-58	100.00	67.26	32.74
1958-59	100.00	69.03	30.97
1959-60	100.00	68.91	31.09
1960-61	100.00	73.14	26.86
1961-62	100.00	72.27	27.73
1962-63	100.00	71.89	28.11
1963-64	100.00	69.44	30.56
1964-65	100.00	67.86	32.14
1965-66	100.00	66.99	33.01
1966-67	100.00	64.58	35.42
1967-68	100.00	63.10	36.90
1968-69	100.00	63.71	36.29
1969-70	100.00	62.79	37.21
1970-71	100.00	61.39	38.61

Source: Table V-1.

Thus, there is a marginal change in the composition of money, but this change has not altered the composition of money redically. Thus, by and large the composition of stock of money has remained the same and currency with the public has remained the major constituent of the stock of money during the period.

Stock of Money and National Income:

Here we have examined the stock of money in relation to national income in India for the period 1951-52 to 1970-71. We have already mentioned that our purpose is to examine the hypothesis of rising money-income ratio during the process of economic development. Table V-3, presents the stock of money in relation to national income in the form of money-

Table V-3: Stock of Money and National Income in India, 1951-52 to 1970-71. (Rs. in lakhs)

Year	Stock of money	National Income	Money-income Ratio
1	2	3	4 (2÷3)
1951-52	1,828,85	9,146,00	0.20
1955-56	2,184,45	9,176,00	0.24
1960-61	2,868,61	13,263,00	0.21
1965-66	4,529,39	20,637,00	0.22
1970-71	7,139,97	34,462,00	0.21

Source: Col. 2: Column 2, Table V-1.
Col. 3: Column 2, Table II-1
Col. 4: Column 2 ÷ Column 3.

income ratio during the period 1951-52 to 1970-71. Table V-3 column 4, gives money-income ratio. From Table V-3, column 4, we observe that the money-income ratio has strikingly remained around 0;20 to0.22 during the period. It also means that it has not shown upward tendency but it has remained steady at a higher level around 0.20 to 0.22 during the period. The steadiness of the money-income ratio at a higher level does not lend support to the hypothesis. But it also does not disprove the hypothesis, if we examine the hypothesis from different angle. The money-income ratio rises in the earlier stage of economic development and the ratio tends to be stabilized at the mature stage of economic development. Underlying the hypothesis is that the ratio tends to rise from the lower to higher level during the process of economic development. This is evidenced in the United States of America. As we have mentioned earlier that in the United States of America the ratio of money to gross national product has risen just from 7 per cent in 1805 to 14 per cent in 1850 and reached to 28 per cent in 1900 and thereafter the money-income ratio remained around 30 per cent. If we examine the ratio from the broader perspective, then the money-income ratio observed during the period in India seems to be consistent with the hypothesis. The observed money-income ratio during the period in India is around 0.20 to 0.22 (or 20 to 22 per cent) which can be considered higher one and the ratio would have increased from low level in the earliest stage of country's development during the pre-independence period. However we have no data to support the contention, as the data on national income though available, are not so reliable for the pre-independence period. Thus to conclude the money-income ratio has not shown upward tendency during the period understudy in India, but the observed ratio seems tobe overall good fit with the hypothesis.

Here it should be pointed out that the steadiness of the money-income ratio during the period, does not mean that the money-income ratio has stabilized (i.e. no strong upward or downward tendency), or the ratio has reached its peak level, as the money-income ratio gets stabilized at the mature and advanced stage of country's economic development, the stage which India has yet to attain.

Stock of Money and Primary Securities Outstanding:

Another important aspect of monetary growthis the money-debt ratio. The money-debt ratio would show the proportion of money held as a financial asset in the portfolio of the financial assets of the non-financial spending units.

The demand for money to hold as financial assets depends in part on the transaction demand for money balance.

Secondly, the demand for money balances also depend on the diversification in the asset portfolio of the non-financial spending units. The non-financial spending units would like to diversity their assets portfolio, because there are some general and specific risks of holding the assets. Thus, the diversification demand for money depends on the advantages there may be in substituting money for primary securities and for non-monetary indirect financial assets, this is because the assets in the portfolio can be held in the form of money, non-monetary indirect financial assets, or primary securities. It is from this angle we have analysed the money debt ratio.

Table V-4, column 4, presents the money-debt ratio for the period 1951-52 to 1970-71, Table V-4. From the table, V-4 column 4, it is seen that the money-debt ratio has declined during the period from 0.29 in 1951-52 to 0.19 in 1970-71. The ratio has rapidly declined from 0.29 to 0.20 between 1951-52 to 1960-61. And between 1960-61 to 1970-71 the ratio has remained around 0.18 to 0.20. Thus, the money-debt ratio during the period understudy has declined. What does this indicate? Does it indicate that non-monetary indirect assets, or primary securities are substituted for money?

Table V-4: Stock of Money and Outstanding Primary Securities in India, 1951-52 to 1970-71.

(Rs. in lakhs)

Year	Stock of money	Primary securities out-standing	Money-debt Ratio
1	2	3	4 (2 ÷ 3)
1951-52	1,828,85	6,227,94	0.29
1955-56	2,184,45	8,103,66	0.27
1960-61	2,868,61	14,358,05	0.20
1965-66	4,529,39	24,427,25	0.18
1970-71	7,139,97	37,818,62	0.19

Source: Col. 2: Column 2, Table V-1.
Col. 3: Column 2, Table II-3.
Col. 4: Column 2 ÷ Column 3.

If the non-monetary financial assets have been substituted for money in the assets portfolio of the non-financial spending units, then it would have been reflected in the proportion of primary securities outstanding held by the monetary and non-monetary intermediaries. In that case, the proportion of primary securities by the non-monetary intermediaries would have increased relatively and to that of monetary intermediaries declined. But our findings of the financial intermediation by the type of financial intermediaries suggest that non-monetary indirect assets have not been substituted for money. While examining the financial intermediation by the type of financial intermediaries we have brought out that it is the monetary intermediaries dominate the purchases of primary securities, and secondly the proportion of net primary issues securities purchased by the monetary intermediaries has remained more or less the same during the period, in spite of the fact that the proportion of net issues primary securities purchased by the non-monetary intermediaries has marginally increased during the period. Thus, marginal increase in the purchase of the primary securities of the non-financial spending units by the non-monetary financial intermediaries does not explain sizable decline in the proportion of money in the assets portfolio of the non-financial spending units. This shows that non-monetary indirect assets have not been substituted for money, precisely because the proportion of primary securities outstanding held by the monetary intermediaries has remained more or less the same during the period. Therefore, this leads us to a fact that the proportion of primary securities must have increased in the assets portfolio of the non-financial spending units, and consequently it has resulted in the decline of the proportion of money in the assets portfolio of the non-financial spending units. Here one may expect that an increase in favour of primary securities probably might have come by displacing the money. If increase in the primary securities would have come by displacing the money, then it would be reflected in the money-income ratio and consequently money-income ratio might decline. But the money-income ratio has remained constant around 0.20 to 0.22 during the period. Secondly, in that case we would also expect decline in the proportion of primary securities outstanding purchased or held by the monetary intermediaries. We have already noted that the proportion of primary securities outstanding held by the monetary intermediaries has remained more or less the same during the period. Thus, we can reasonably conclude that increase in favour of primary securities in the assets portfolio of the non-financial spending units, as it seems that it has not come by displacing the money nor it has displaced the growth of money. It is simply that primary securities have gained more weightage in the assets portfolio of the non-financial spending units due to the growth of primary securities by itself. Thus, it is this that explains the increase in primary securities in the assets portfolio of the non-financial spending units, and consequently, the decline in the proportion of money in the assets portfolio of the non-financial spending units.

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