MSW MANAGEMENT -Multidisciplinary, Scientific Work and Management Journal
ISSN: 1053-7899
Vol. 34 Issue 2, July-Dec 2024, Pages: 380-397

Monetary Policy Through the Ages: Global Trends and India's Path to Stability.

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Abstract

This research paper explores the evolution of monetary policy on a global scale, with a specific focus on the Indian context. It begins by tracing the historical development of monetary policy, starting from the classical gold standard to the Keynesian approach during the Great Depression, which emphasised demand management. The rise of monetarism in the 1970s introduced the notion of controlling the money supply to manage inflation, culminating in the widespread adoption of Inflation Targeting (IT) in the 1990s. This framework has been pivotal in enhancing economic stability and transparency among central banks worldwide. In India, the transition from a pre-reform era characterised by strict regulatory controls to the implementation of the Multiple Indicator Approach (MIA) in 1998 marked a significant change. The adoption of inflation-targeting (IT) in 2015 represented a major shift in monetary policy, with the Reserve Bank of India (RBI) explicitly setting inflation targets to guide policy decisions. This paper highlights the interplay between domestic economic challenges and global influences that have shaped monetary policy in India, illustrating the importance of flexibility and responsiveness in policymaking. By examining these developments, the research aims to provide insights into the future trajectory of monetary policy in India and its implications for economic growth and stability.

Key Words: Monetary Policy, Multiple Indicator Approach, Exchange Rate Targeting andInflation Targeting.

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1. Introduction

Monetary policy is the cornerstone of economic management, pivotal in stabilising economies, controlling inflation, and fostering sustainable growth. It encompassesa range of strategies and tools central banks employ to influence money supply, interest rates, and economic credit conditions. The evolution of monetary policy has been influenced by historical events, economic theories, and changing global dynamics, resulting in diverse approaches tailored to specific economic contexts.

Historically, the development of monetary policy has mirrored the economic landscape of various nations, reflecting the unique challenges and opportunities they face. In India, the monetary policy landscape has undergone significant transformations, particularly following the economic reforms of the early 1990s. The transition from the Multiple Indicator Approach (MIA) to Inflation Targeting (IT) marks a critical juncture in India's monetary policy approach, reflecting broader global trends. This paper aims to provide a comprehensive overview of monetary policy evolution, both globally and in India, highlighting key developments, challenges, and implications for economic growth and stability.

2. Evolution of Monetary Policy: A Global Perspective

The evolution of monetary policy on a global scale has undergone significant transformations, driven by changing economic conditions, theoretical advancements, and lessons learned from financial crises. Initially, monetary policy was dominated by the classical gold standard, which aimed to stabilise currencies by pegging them to gold. This system facilitated international trade but limited the flexibility of monetary authorities. The collapse of the gold standard during the Great Depression in the 1930s prompted a shift towards more discretionary policies, allowing central banks greater autonomy to respond to economic fluctuations.

In the post-World War II era, the Bretton Woods system established fixed exchange rates, further embedding the role of monetary policy in managing inflation and promoting economic stability. However, abandoning the Bretton Woods framework in the early 1970s marked a pivotal moment as countries transitioned to floating exchange rates. This shift emphasised the importance of monetary policy in stabilising domestic economies amid external shocks.

Macroeconomic policies, including monetary and fiscal policies, play a crucial role in the modern welfare state's efforts to achieve desired changes in the size and composition of a country's income and employment. By the closing years of the 20th century, market-oriented reforms became prevalent, supplanting the previously state-dominated controlled approach in many global economies. The responsibility for an economy's prosperity and growth was primarily entrusted to the mechanisms of free markets. By implementing monetary, fiscal, and trade policies, governments sought to ensure prosperity and economic development in these market-driven systems. Of these policies, monetary policy gained significant popularity and is frequently utilised by governments to regulate economic activity. Unlike fiscal policy, which is less proactive to changes in the market, monetary policy possesses greater flexibility to influence the real economy.

From the time of Adam Smith until the present, macroeconomic stability has been a significant concern for economists and policymakers. Macroeconomic stability involves maintaining an acceptable inflation rate, achieving optimum output growth, preserving the value of the currency, and fostering a favourable balance of payments (Majumdar, 2004). Price stability holds utmost significance among the various dimensions of macroeconomic stability, making it a core focus of monetary policy due to its strong connection to economic health.

By the end of the 20th century, a growing consensus emerged among central bankers and policymakers that inflation control and price stability should serve as the primary long-term goal of monetary policy (Mishkin, 1997). This consensus was driven by economic research and real-world events dating back to the 1960s. Mishkin highlighted that the rationale for prioritising price stability rests on two key propositions. First, adopting the activist monetary policy to reduce short-term unemployment could prove undesirable, as it may lead to higher inflation without effectively lowering unemployment. Second, price stability fosters greater economic output and facilitates faster economic growth in the long run. During the 1960s and 1970s, activist monetary policy gained substantial support as policymakers sought to reduce unemployment through expansionary monetary measures whenever unemployment surpassed full-employment levels (Mishkin, 1997).

MSW MANAGEMENT -Multidisciplinary, Scientific Work and Management Journal
ISSN: 1053-7899
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However, a series of criticisms emerged against activist monetary policy. The first argument against such activism was articulated by monetarists led by Milton Friedman, who pointed to flaws in Keynesian macro-econometric models and the uncertain nature of macroeconomic policy effects. Friedman (1960) contended that economic policy, particularly monetary policy, affects the economy with "long and variable lags," rendering activist policies counterproductive. This argument posits that while monetary activism may appear effective, the myopic focus of politicians on immediate outcomes often leads to over-manipulation of policy levers. For instance, policymakers may apply expansionary monetary measures to address high unemployment, but the inherent lags in policy implementation may result in an overheated economy, leading to inflation or further instability.

The second criticism, also advanced by Friedman during his renowned presidential address to the American Economic Association in 1967, challenged the validity of the Phillips Curve, which suggested a trade-off between inflation and unemployment. Friedman argued that while higher inflation might temporarily stimulate the economy and reduce unemployment, it ultimately disregards the role of inflation expectations. As workers adjust their expectations and demand higher wages, firms' profit margins normalise, leading to a return of output and unemployment to their natural rates. This gave rise to the "expectations-augmented Phillips curve," indicating that, in the long run, the unemployment rate stabilises at its natural rate, rendering any trade-off with inflation non-existent.

The third critique arose from the works of economists such as Kydland and Prescott (1977), Calvo (1978), and Barro and Gordon (1983), who introduced the "time inconsistency" problem in monetary policy. This issue stems from the notion that policies optimal in the past may not be viewed as such in the present, leading to a lack of implementation. Policymakers often assume that expectations remain fixed when making decisions, underestimating the influence of future policy expectations on economic behaviour. Consequently, when policymakers seek to stimulate output through expansionary measures, economic agents adjust their expectations accordingly, resulting in higher inflation without substantial gains in output. This "inflation bias" reveals the shortcomings of monetary policy aimed at achieving real output goals.

These analyses suggest that pursuing real output goals through monetary policy can have undesirable consequences, leading to a recognition that price stability is the appropriate long-term objective for monetary policy. Price stability enhances the efficient functioning of the economic system (Mishkin, 1997). When inflation is unchecked, it can create various economic costs, including uncertainty surrounding price levels, complicating production and expenditure decisions. Additionally, inflation undermines the productive utilisation of resources, impeding economic growth. As criticisms of monetary policy activism mount and the benefits of price stability in reducing uncertainty become evident, the consensus grows that price stability should remain the primary long-term goal of monetary policy.

The 2008 Global Financial Crisis underscored the limitations of traditional monetary policy frameworks and prompted central banks to adopt unconventional measures, such as quantitative easing and zero interest rate policies, to stimulate economies. These developments have since shaped the contemporary monetary policy landscape, prompting ongoing debates about the balance between targeting inflation and fostering economic growth. As global economies face new challenges, including rising inequality and climate change, the future of monetary policy will likely require an integrated approach that addresses both traditional and emerging economic concerns. Today, the evolution of monetary policy reflects a complex interplay of strategies and objectives, highlighting the necessity for adaptability in addressing the dynamic nature of global economic systems.

3. The Vital Role of Nominal Anchors in Monetary Policy

Monetary policy is a crucial macroeconomic tool a country's monetary authority employs to regulate interest rates, credit availability, and the money supply, aiming to achieve specific economic objectives such as price stability and employment (Mankiw, 2016). At its core, optimal monetary policy seeks to maximise a welfare function that reflects these dual objectives. Price stability entails minimising deviations of inflation from a predetermined target, while output stability aims to reduce fluctuations around potential output levels. Therefore, monetary policy can be seen as a sequential process that begins with setting objectives, establishing intermediate targets and specifying operational approaches, including the optimal choice of policy instruments directly controlled by the central bank.

Economists and central bankers agree that maintaining stable and low inflation is essential for promoting economic efficiency and long-term growth. Consequently, price stability is widely regarded as the primary long-term goal of monetary policy. The concept of a "nominal anchor" is critical to achieve this. A nominal anchor is essentially a constraint on the value of domestic currency, helping to align monetary policy with long-term price stability (Mishkin, 1999). It mitigates the time inconsistency problem and curtails political pressures that could lead to overly expansionary and inconsistent monetary policies. In essence, a nominal anchor serves as a reference point for the central bank's policy, shaping the expectations of private entities regarding the nominal price level and the actions the central bank might undertake to maintain that level.

Nominal anchors can take various forms in different monetary policy frameworks, including exchange rate targets, monetary targets, inflation targets, and policies that operate without an explicit nominal anchor. Each of these frameworks has its own advantages and disadvantages, influencing their effectiveness in achieving desired economic outcomes. The table 1 gives a detailed outline about the adavantages and disadvantages of different monetary frameworks.

Table 1 : Different Monetary Policy Regimes

Approach	**Advantages**	**Disadvantages**
Exchange Rate Targeting	• Provides a nominal anchor for monetary policy. • Fixes the inflation rate for internationally traded goods, helping to control inflation. • Automatic policy adjustments based on exchange rate movements. • Simplifies monetary policy for the public. • Inherits credibility from the anchor country's policy. • Effective with strong commitment (e.g., Currency Board).	• Loss of independent monetary policy. • Vulnerable to speculative attacks on the currency. • Direct transmission of shocks from the anchor country. • Risk of financial crises in emerging markets. • Lack of transparency through exchange rate fluctuations.
Monetary	• Allows central banks to	• Success depends on a stable

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Targeting	respond to domestic shocks. • Provides immediate signals about policy stance. • Promotes accountability and reduces time inconsistency.	relationship between targeted aggregates and desired outcomes. • Requires firm control over monetary aggregates. • Risk of overly tight monetary policy.
Inflation Targeting	• Clearly defined numerical target for inflation. • Institutional commitment to price stability. • Enhanced transparency and communication with the public. • Improved central bank accountability. • Incorporates other economic goals like output and employment.	• Adjustment of inflation expectations involves long lags. • Uncertain impact on the real economy. • Limited reduction in output loss during disinflation. • Critics argue for insufficient policy discretion. • Complex mechanism requiring careful analysis of information.
Monetary Policy with an Implicit Nominal Anchor	• Successful in controlling inflation in the US. • A forward-looking and pre-emptive approach. • No explicit nominal anchor is required. • Resembles features of inflation targeting regime.	• Lack of transparency leads to volatility in financial markets. • Uncertainty among producers and the public about future inflation and output. • Difficulty in managing medium-term effects of supply shocks. • Dependency on central bank representatives' preferences and skills.

Source: Mishkin (1997)

4. Significance of Inflation Targeting

Among the various monetary regimes, inflation targeting has emerged as a particularly effective framework for managing inflation expectations and achieving price stability. This approach, pioneered by New Zealand in 1990, involves a formal commitment by the central bank to maintain inflation within a specific range, providing clarity and transparency to the public (Green, 1996). The key components of inflation targeting include a clearly defined mandate for the central bank focused on price stability, explicit public inflation targets, accountability for achieving these targets, and a policy formulation process grounded in prospective assessments of inflationary pressures (Bernanke & Mishkin, 1997; Mishkin, 2004; Heenan et al., 2006).

Inflation targeting's advantages include improved transparency, which enhances the central bank's credibility and reduces the pressure for inflationary policies. Additionally, this framework accommodates short-term stabilisation goals related to output and employment fluctuations, making it adaptable to changing economic conditions. Inflation targeting has shown success in various countries, where targeted inflation rates and expectations have been effectively managed, contributing to lower inflation rates overall.

However, inflation targeting also has its drawbacks, including the potential for time lags in adjusting inflation expectations and uncertainty regarding its impact on the real economy. The framework's complexity necessitates that central banks analyse a wide range of information to formulate effective monetary policy. Despite these challenges, inflation targeting remains a vital nominal anchor, demonstrating its significance in promoting economic stability and growth.

5. Monetary Policy in India: Transition and Developments

In line with global trends, India's monetary policy shares several core objectives and strategies with other major economies while adapting them to its unique economic landscape. To comprehend the evolution of India's monetary policy, it is important to discuss four distinct eras: development planning, monetary targeting, multiple indicator approach, and inflation targeting. The table 2 describes the main attributes of monetary policy in India.

Table 2 : Attributes of Monetary Policy in India

Attribute	**1951-52 to 1984-85**	**1985-86 to 1997-98**	**1998-99 to 2014-15**	**Since 2015**
Objective(s)	1)To enhance economic growth and investment rates	1)Price Stability 2)Ensuring adequate flow of Credit to productive sectors of the Economy 3) Reduce fiscal dominance and come out of financial repression.	1)Price Stability 2)Ensuring adequate flow of credit to productive sectors of the economy	1)Price Stability 2) To anchor inflation expectations and re-establish the credibility of monetary policy 3)To keep deviation from inflation target minimum
Transmission Mechanism (or intermediate target)	Era of Development Planning	Monetary targeting with annual growth in broad money (M3) as intermediate target.	Multiple Indicator approach with rate of returns in different markets (namely money, capital, currency, external, etc.) as intermediate target.	Inflation Targeting with combined headline CPI as an intermediate target.
Operating Procedure (Instruments)	Bank Rate/ Controlled expansion of money supply.	Direct instruments namely interest rate regulations, selective credit control and Cash Reserve Ratio (CRR).	Indirect instruments, namely repo operations under Liquidity Management Facility (LAF) and Open Market Operations(OMO).	The policy instrument used to meet this inflation target is the general repo rate or interest rates.

5.1.The period of Development Planning (1951-52 to 1984-85)

Following the end of colonial rule, India's early post-independence period relied on an exchange rate anchor enforced through a proportional reserve system under the RBI Act of

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1934. This system mandated that a minimum of 40% of currency in circulation be backed by gold bullion and sterling reserves. However, in 1957, this structure shifted to the minimum reserve system, introducing credit aggregates as the nominal anchor guiding monetary policy (RBI, 2014). India commenced its path of development planning in 1951 with the introduction of the first Five-Year Plan shortly after gaining independence. These Five-Year Plans subsequently became central to India's developmental strategy. A critical question arose regarding the integration of monetary policy within this extensive development planning framework, as monetary policy was primarily subordinate to the objectives of these plans.

Under the development planning approach, fiscal policy and planning were the primary tools for spurring economic growth and enhancing investment rates. In contrast, monetary policy was expected to align with the economy's evolving financial needs. Often viewed as auxiliary to fiscal policy, monetary policy appeared to function within its shadow. Thus, the Reserve Bank of India (RBI) was expected to aid budgetary deficit financing through monetary expansion. During this time, India aspired to elevate its investment rate for accelerated economic growth; however, limited domestic savings posed a challenge in funding such investments. Foreign aid partially supplemented this savings shortfall, while the RBI's role in money creation supported deficit financing. Consequently, India's initial monetary policy framework was one of "controlled expansion" of the money supply, shaped by fiscal policies to address substantial budget deficits.

This development planning phase yielded significant successes, notably in economic growth and establishing a diversified industrial base. Yet, the limitations of this strategy became increasingly evident by the late 1960s, as inflation surged to high levels, bringing economic difficulties similar to the Western stagflation crisis of the 1970s, which combined stagnant growth with rising inflation. The severe inflation of the 1970s, coupled with fiscal dominance over monetary policy, ultimately stimulated a rethinking of India's monetary approach, heralding the rise of monetarism in the country.

5.2.The period of Monetary Targeting (1985-86 to 1997-98)

Before the mid-1980s, India's monetary policy was principally defined as "credit planning" (Mohan & Ray, 2018), a system focused on channelling credit at controlled, affordable rates to fuel economic development, with public sector banks serving as essential intermediaries in this process. However, a significant shift occurred in the mid-1980s when monetary targeting was introduced. This strategy sought to control monetary growth specifically to support projected nominal GDP expansion, with inflation maintained within permissible limits. By the late 1980s, the Chakravarty Committee's recommendations increasingly influenced monetary policy formulation, shaping a structured framework for pre-reform policy. This framework underscored two key goals: price stability and adequate credit provision to productive sectors while systematically setting broad money supply (M3) targets to match annual increases in expected inflation and output growth.

In 1985, the Chakravarty Committee proposed a new approach to monetary policy based on monetary targeting with feedback informed by empirical evidence suggesting stability in the money demand function. Following this approach, monetary projections were designed to support anticipated real GDP growth while controlling inflation at acceptable levels. Additionally, the Committee recommended limiting monetary expansion by establishing an agreement between the Reserve Bank and the government to curb fiscal deficit monetisation. Broad money (M3) was thus adopted as the intermediate target, while reserve money became the primary operational tool to manage M3 growth.

During the period of monetarism, the focus shifted to managing inflation, reducing fiscal dominance, and moving away from financial repression (Adil & Rajadhyaksha, 2021). Although the RBI introduced new money market instruments and deregulated interest rates in the late 1980s, these changes had limited effects. The absence of a fully functional money market and the government's dependence on RBI credit as a financing source meant that the cash reserve ratio (CRR) became the main instrument for monetary control, used to mitigate inflationary pressures while ensuring adequate credit to the commercial sector (Mohan & Ray, 2018). The monetary targeting framework allowed considerable adaptability through various feedback mechanisms (Mohanty, 2010). In the early 1980s, however, the challenge of managing high liquidity growth (M3) alongside an undesirable increase in wholesale prices persisted (Mohanty & Mitra, 1999). A significant constraint on monetary targeting was the RBI's limited control over credit provided to the central government, which was the primary source of reserve money creation. The onset of economic reforms in 1991 further complicated monetary management as capital flows became more volatile.

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Initially effective as nominal anchors, monetary aggregates began to lose stability, encountering obstacles as money demand grew unstable due to financial innovations, external shocks, capital flow fluctuations, exchange rate volatility, and global economic cycles. These factors made monetary aggregates increasingly unreliable, reducing the credibility of monetary policy and complicating communication, mainly when targets were unmet.

Thus, India's monetarist period, spanning roughly a decade, marked a decisive shift from the previous development planning model. This period aligned with broader economic reforms, including interest rate liberalisation, the establishment of a market-based exchange rate, and gradual steps toward account convertibility (Ramachandran, 2004). As international capital flows gained importance, the effectiveness of monetarism began to wane, both domestically and globally, eventually giving rise to a new phase in Indian monetary policy around 1998. This phase, defined by a multiple-indicator approach, marked a pivotal turning point in India's approach to monetary policy.

5.3. The period of Multiple Indicator Approach (1998-99 to 2014-15)

Following the severe balance of payments crisis of 1991, India embarked on an ambitious series of economic reforms that reshaped its policy landscape, institutional framework, and strategic outlook during the early 1990s. These reforms fundamentally altered the country's economic policy environment, challenging India's monetary policy to address traditional issues and contend with new complexities arising from a transformed economic context. The rapid pace of financial market deregulation and liberalisation that intensified in the late 1990s prompted a reassessment of the efficacy of relying solely on money as the intermediate target for monetary policy. In this context of evolving economic dynamics, India's monetary policy framework underwent a significant shift in April 1998, transitioning from a "pure monetary targeting strategy" to a "multiple indicator approach." This approach marked a pivotal shift, emphasising interest rate channels as primary instruments for policy formulation and implementation and reducing dependence on quantity-based measures.

Consequently, abandoning the monetary targeting framework led to removing broad money (M3) as the nominal anchor. However, the Reserve Bank of India (RBI) has not distinctly identified an alternative nominal anchor within this new framework. Instead, broad money remains relevant as an informative variable, complemented by a broad spectrum of both quantity and rate variables (Mohan, 2008). The quantity variables encompass measures such as money, credit, output, trade, capital flows, and fiscal position. In contrast, rate variables include aspects like market rates of return, inflation, and exchange rates, each rigorously evaluated to shape monetary policy perspectives.

The transition from a sole focus on money supply to a multifaceted multiple-indicator approach entailed considering a range of economic factors, including inflation, money supply, interest rates, exchange rates, credit growth, fiscal deficits, and capital inflows—factors whose significance surged after the economic reforms of 1991(Shaji et al., 2024). Before 1991, the RBI exerted tight control over money market interest rates, and the exchange rate was fixed. Post-1991, however, India's money market evolved to be market-driven, and the exchange rate became a critical variable in economic policymaking as India advanced toward full current account convertibility. Moreover, until the economic reforms, substantial capital inflows were absent; this changed in 1991 when foreign direct investment (FDI) began flowing into India's stock market. This broader focus on indicators,shifting from the money supply to a range of parameters such as inflation, exchange rates, credit growth, interest rates, and capital flows, epitomises the core transformation from a monetarist approach to an inclusive multiple indicator framework for economic policy formulation. A landmark development during this period was the historic agreement between the government and RBI to phase out ad-hoc treasury bills, effectively ending the automatic monetisation of the budget deficit. This shift enhanced the independence of monetary policy and elevated the central bank's credibility. Although the primary aims of monetary policy, including price stability and the provision of credit to productive sectors, remained consistent, there were profound changes in the operational approach.

The multiple-indicator era introduced significant innovations, with the launch of the Liquidity Adjustment Facility (LAF) in 2000, incorporating the repo and reverse repo mechanisms, standing as a critical advancement. The multiple indicator approach demonstrated efficacy from 1998–99 to 2008–09, evidenced by an average real GDP growth rate of 7.1% alongside an average inflation rate of roughly 5.5%. However, two prominent trends emerged during this period. First, the coexistence of persistently high inflation with weakening economic growth raised concerns. Second, beginning in the late 1980s, numerous advanced and emerging economies globally started adopting inflation as the central target of monetary

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policy, grounded in robust theoretical and empirical evidence indicating that low, stable inflation is essential for sustainable high growth (RBI, 2014).

5.4.The period of Inflation Targeting (Since 2015)

The onset of the 2008 Global Financial Crisis sparked substantial criticism of India's multiple-indicator approach, as economic commentators questioned its adequacy for managing heightened inflationary risks. During this period, India experienced an influx of net capital, reaching nearly 10% of GDP in 2007-08, spurred by reductions in the US Federal Reserve's interest rates. Despite the Reserve Bank of India's (RBI) interventions to mitigate liquidity impacts from considerable foreign exchange acquisitions, inflationary pressures persisted, fueled by strong domestic demand and surging global commodity prices. Consequently, attention increasingly shifted toward addressing elevated inflation levels, generating momentum for a gradual transition toward an inflation-targeting framework, paralleling the strategies adopted by other emerging economies (Rajan, 2008). Critics of the multiple-indicator approach argued that its broad scope hindered its effectiveness, emphasising the need for a more explicit, singular focus to anchor monetary policy—such as inflation, exchange rates, money supply, or nominal domestic GDP—all considered reliable nominal anchors for shaping private sector expectations (Adil and Rajadhyaksha, 2021). This period marked a global shift, with advanced and subsequently emerging market economies moving towards inflation-targeting frameworks, reflecting an evolving perspective that central banks should not only target inflation but also aim to stabilise long-term inflation expectations.

The GFC revealed challenges in the RBI's ability to communicate its multifaceted objectives clearly to the financial sector and the broader public, which hindered its capacity to anchor inflation expectations effectively. From 2007 onwards, several high-profile committees in India called for a shift to inflation targeting, asserting that the RBI should adopt this approach over the multiple-indicator framework. Notable among these were the Percy S. Mistry-led High Powered Expert Committee Report on Creating an International Financial Centre in 2007, the Raghuram G. Rajan-led Committee on Financial Sector Reforms Report in 2009, and the Financial Sector Legislative Reforms Commission (FSLRC) report in 2013, chaired by BN Srikrishna. These committees collectively advocated for transitioning to a single nominal anchor, with inflation as the preferred target.

The RBI, however, maintained reservations about abandoning the multiple-indicator approach, citing India's complex economic landscape, which required a more adaptable framework. Several factors contributed to the RBI's initial reluctance to embrace inflation targeting. For instance, India had traditionally maintained low inflation rates, with double-digit inflation episodes remaining relatively rare and socially intolerable. Unlike nations with a history of high inflation, which often benefit most from adopting inflation targeting, India's lowinflation history reduced the perceived necessity for such a framework. Additionally, effective inflation targeting depends on efficient monetary transmission, supported by well-developed financial markets with minimal distortions. While India's financial markets had made significant strides, the continued prevalence of administered interest rates and areas needing further development posed constraints.

Further complicating this issue were inflation drivers, such as energy and food prices, which are mainly external. The relevance of targeting "core inflation"—an index that excludes these volatile components—was limited in a lower-income economy like India. Moreover, until recently, India lacked a comprehensive national CPI, adding to the challenges.

The first formal endorsement of inflation targeting in India emerged with the Committee on Financial Sector Reforms (CFSR) Report, set up by the Indian government's Planning Commission and led by then-RBI Governor Raghuram Rajan. This Committee underscored that the RBI's most influential contribution to economic growth would be through a sustained focus on inflation control, recommending that inflation be treated as a single objective within a specified range over the medium term, achieved via adjustments to short-term interest rates, namely the repo and reverse repo rates. This recommendation was officially documented in a 2007 Government of India report, and it was later echoed in the FSLRC report of March 2013, which suggested establishing a Monetary Policy Committee (MPC). By 2013, while many government bodies and economists increasingly favoured inflation targeting, the RBI's stance remained cautious, prioritising the practical limitations noted earlier. The multiple-indicator approach has yielded stable inflation rates in the mid-single digits for around 15 years since the mid-1990s. Still, between 2009 and 2013, inflation crept into double digits, fueling support for a pivot to inflation targeting.

In 2015, under the leadership of then-Governor Dr Raghuram Rajan, the RBI formally adopted a "flexible inflation targeting" framework, reshaping its monetary policy approach

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based on the recommendations from the 2014 Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework, chaired by Dr Urjit Patel. Within this revised framework, inflation was instituted as the primary nominal anchor, as advocated by the Patel Committee, which argued that inflation should be declared as the central focus of monetary policy in official statements. To achieve this objective, the RBI's policies aligned monetary policy conduct with sustainable growth objectives while maintaining financial stability (RBI, 2014).

India's adoption of inflation targeting was formalised by signing the Monetary Policy Framework Agreement (MPFA) on February 20, 2015, which anchored inflation as the primary policy focus. This agreement obligated the RBI to uphold a dual mandate, balancing price stability with economic growth. A crucial development in 2011 was the introduction of a new consumer price index (CPI) , the all-India CPI-Combined (incorporating CPI-Rural and CPI-Urban), designated as the inflation metric under the MPFA. Accordingly, the monetary policy committee's mandate centred on maintaining headline inflation within a range of 2-6%, with a specific target set at 4% and upper and lower bounds set at 6% and 2%, respectively. To achieve this target, the MPC, a six-member body, wields policy instruments like the repo rate, adjusting interest rates to manage inflationary pressures. This flexible inflation targeting, characterised by a "point with tolerance" target, contrasts with fixed-target regimes in some other nations, allowing for short-term growth considerations.

The fundamental task of a central bank under an inflation-targeting regime is to meet the inflation target set by the government. Technically, this goal is often framed as a quadratic loss function, wherein the squared deviations of actual inflation from the target are weighted alongside deviations of economic output from its potential. The central bank's objective is to minimise this loss function through its monetary policy choices, responding to the gaps in inflation and growth relative to their targets. The Urjit Patel Committee's report emphasised the importance of anchoring inflation expectations, both rational and adaptive, as critical for sustained price stability, positing that transparent and credible policy actions would prevent prolonged deviations from target inflation. This anchoring mechanism would, in turn, provide a unified expectation framework for economic agents, influencing aggregate demand accordingly.

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The inflation targeting regime aims to secure stable inflation expectations, restore policy credibility, minimise inflationary deviations, and align the expectations of all economic participants with monetary policy goals, ultimately shaping aggregate demand(Shaji et al., 2024). The transition to inflation targeting has fundamentally redefined India's monetary policy landscape, progressing from development planning to monetary targeting in the mid-1980s, to a multiple-indicator approach in the late 1990s, and finally, to the current inflation-targeting framework since 2015.

6. CONCLUSION

In conclusion, the evolution of monetary policy reflects the dynamic interplay between theoretical advancements, economic challenges, and global influences. From the classical gold standard to Keynesian interventions, monetarism, and the emergence of inflation targeting, global monetary policy has consistently adapted to meet the evolving needs of economies worldwide. India's journey, mirrored by these global shifts, highlights the progressive nature of its monetary policy. The transition from the pre-reform era of strict controls to the Multiple Indicator Approach (MIA) and, more recently, to Inflation Targeting (IT) in 2015 underscores India's commitment to stability, transparency, and growth.

India's adoption of inflation targeting has aligned its monetary policy with international best practices, bringing greater predictability and resilience to its economy while navigating domestic challenges. The Reserve Bank of India's responsiveness to global standards, balanced with the unique needs of the Indian economy, demonstrates the importance of a flexible and adaptive policy framework. As India's economic landscape continues to evolve, this research suggests that further refinement of monetary policy, mindful of global trends and national priorities, will be crucial to achieving sustainable growth and long-term economic stability. The insights drawn from the global and Indian experiences emphasise the role of monetary policy as a tool for inflation control and a foundation for economic resilience and prosperity.

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