SUMMARY AND CONCLUSION
CHAPTER XII
SUMMARY AND CONCLUSION

This chapter presents a summary of the present study dealing with an analysis of monetary policy as pursued in the planned economy of India.

12.1 MONEY SUPPLY:

The trends in money supply indicated a rise in the liquidity of the economy over the plan periods. \( M_1 \) rose to Rs. 66,259 crores by 1988-89 from Rs. 7,321 crores in 1970-71. \( M_2 \) stood at Rs. 8,311 crores in 1970-71. It was Rs. 69,661 crores in 1988-89. \( M_3 \) rose from Rs. 10,958 crores in 1970-71 to Rs. 1,913,231 crores in 1988-89.

The compound growth rate of the various measures of money stock \( M_1 \), \( M_2 \), \( M_3 \) and \( M_4 \) during 1971-89 were respectively 12.29 percent, 11.8 percent, 16.24 percent and 15.95 percent per annum.

Reserve money, also referred to as high powered money increased from Rs. 4,814 crores in 1970-71 to Rs. 62,342 crores in 1988-89, growing at a compound rate of 14.4 percent per annum. Reserve money was highly correlated with \( M_1 (r = 0.987) \) and \( M_3 (r = 0.998) \) during 1961-84.

The growth of money supply \( (M_3) \) in various periods was found to be higher than the growth in output. Money supply \( (M_3) \)
had grown from 3.4 percent during the First Five year Plan Period (1951-52 to 1955-56) to 16.87 percent in the Sixth Plan (1980-81 to 1984-85). The growth of gross domestic product was very slow. It was only 5.5 percent even by the Sixth Plan. There was a tendency for inflation to catch up. The annual average growth rate of the prices of all commodities was 1.8 percent during 1950-61. It increased to 7.31 percent during 1980-81 to 1988-89.

The compound growth rate of the number employed in the public sector and non-agricultural establishments in the private sector employing 10-24 workers was 4.4 percent during 1960-61 to 1964-65. It declined to 1.4 percent during 1980-81 to 1984-85. Since data on the number of persons employed in agriculture could not be obtained, the data were not used in the study. This imposes a limitation of the study of Monetary Policy Vs. Employment.

The rise in money supply (\(M_3\)) relative to reserve money (H) is seen from the rising ratios of \(M_3/H\). The ratio increased from 1.54 in 1950-51 to 3.052 in 1987-88.

The income elasticity of \(M_3\) was declining. It was 3.995, in 1950-51. Its magnitude was 1.843 in 1986-87.

The effects of changes in high-powered money on income growth showed a certain degree of stability with an average of 6.9 and a coefficient of variation 12 percent during the period 1970-71 to 1986-87.
12.2 AGRICULTURAL CREDIT:

Monetary policy followed in the sphere of agricultural credit supplied was concerned with (i) changes in the institutional structure, (ii) changes in the nature of operations of the institutions and (iii) increased financial support to the institutions engaged in agricultural credit supply.

During the early plan periods, the rural credit supply took place under unorganised conditions. The All India Rural Credit Survey Committee appointed by the Reserve Bank of India in 1950-51, revealed that the institutional sources of agricultural credit covered less than 7 percent of rural credit requirements. The cooperative credit societies charged rates varying from state to state. The interest rate varied between 6 1/4 and 12 1/2 percent. The interest rate charged by the money lenders was 70 percent in Orissa, 49 percent in Tripura and 40 percent in Bihar. The money lenders adjusted their loaning procedures to suit the needs of rural borrowers but charged very high rates of interest. The central cooperative financing agencies which were started in various districts were not getting financial assistance from the Reserve Bank till 1943. The land development banks established from 1920 for providing long term loans to the agriculturists were disbursing credit largely for the redemption of the past debts, whereas the needs of productive capital formation became important in the context of the planned rural development efforts.

The Reserve Bank of India had an Agricultural Credit Department even from its inception in 1935. The cooperative
ideology influenced the Reserve Bank of India since the beginning of the plan period. The cooperative sources had been receiving encouragement till 1969. Later, the nationalised banking system became a powerful instrument of change in the rural credit system. Regional Rural Banks were also organised. For the weaker sections of the society and for the tribal areas special organisations-viz-viable primary agricultural credit societies, cooperative farmers service societies (1971), and large sized multipurpose societies (1971) came to be established. To provide extended remittance facilities for cooperative and to other banks, the Imperial Bank of India was nationalised and transformed into the State Bank of India in 1955. Based on the recommendations of the All India Rural Credit Review Committee Report (1969), Small Farmers Development Agency and Marginal Farmers and Agricultural Labourers Agencies were set up and merged with the Integrated Rural Development Programme in 1980. In this way, a multiagency approach for rural credit supply was ushered in. In all this, the Reserve Bank of India played a key role.

The credit economy of the rural areas had been shaped by the Reserve Bank of India, to stimulate growth in the agricultural sector. The short term credit provided by the Reserve Bank to the state cooperative banks for agricultural operations increased from Rs.339.20 lakhs in 1950-51 to Rs.1,77,830 lakhs in 1988-89. For the period 1969-1984, the crop yield was found to be highly correlated with the short term loans of (i) primary agricultural credit societies (r=0.89), (ii) state cooperative banks (r=0.87),
(iii) the central cooperative banks \(r=0.89\) and with the short
term loans of the Reserve Bank of India to state cooperative
banks \(r=0.84\).

The yield of foodgrains was also highly correlated with the
short term loans of (i) primary agricultural credit societies
\(r=0.62\), (ii) The Central Cooperative banks \(r=0.87\), (iii) the
state cooperative banks \(r=0.84\) and with the short term loans of
the Reserve Bank of India to state cooperative banks \(r=0.76\).

The area under cultivation of crops and also the area under
foodgrains were also highly correlated with the short term
agricultural credit provided by the credit societies (vide
Table V-1).

Rural credit supply received extensive refinance support
from the Reserve Bank. The Reserve Bank established the
Agricultural Refinance corporation in 1963 for providing
refinance facilities for minor irrigation and land development
programme. By the end of June 1982, the cumulative refinance
disbursed by the corporation was Rs.2,808 crores. Purpose wise,
minor irrigation schemes accounted for the major portion of
refinance availed of from the corporation.

Medium term loans were sanctioned by the Reserve Bank out of
its National Agricultural Credit (Long Term Operations) Fund
since the inception of the Fund in 1956. Concessive rates of
interest were charged on medium term loans to state cooperative
banks. The liberalised rules on the provision of medium term
loans enabled an increase in the amount of loans sanctioned by
the banks. The primary agricultural credit societies could raise
the medium term credit supply to farmers from Rs.970 lakhs in
1968-69 to Rs.9,440 lakhs in 1983-84.

During the period 1971-84, the irrigated area under
different crops was found to be highly correlated with the
medium term loans provided by (i) the primary agricultural credit
societies (r=0.95), (ii) the central cooperative banks (r=0.95),
(iii) the state cooperative banks (r=0.90) and with the medium
term loans provided by the Reserve Bank of India to state
cooperative banks for agricultural operations (r=0.77).

The National Agricultural credit (Stabilisation) Fund was
set up by the Reserve Bank in June 1956, to convert short term
overdue outstandings into medium term loans when the crops were
damaged due to natural calamities. These conversion loans were
sanctioned at a concessive rate of 3 percent below the Bank rate.
From 1977-78, the Reserve Bank restricted its assistance from the
Fund to 60 percent of the conversions effected by the central
cooperative banks. The state cooperative banks, the central
cooperative banks and the State Governments shoulder the balance
in the proportion of 10, 15 and 15 respectively from their
stabilization funds or own resources.

The land development banks were instructed by the Reserve
Bank to give not less than 90 percent of their advances for
productive purposes such as investments in minor irrigation and
farm mechanisation. Only 10 percent was allowed to be given for purchasing land or for redemption of old debts.

Agriculture was a priority sector to avail of bank credit. Concessive rates were applied by the Reserve Bank to the short term and medium term credit. In March 1980, the Reserve Bank directed the public sector banks to raise the proportion of their advances to the priority sectors from 33 1/3 percent to 40 percent by 1985. All the public sector banks had complied individually with the norms relating to the advances to the priority sector. The agricultural advances of the public sector banks increased from Rs.2,580 millions in December 1969 to Rs.81,740 millions in September 1985. Institutional sources of agricultural credit covered 40 percent of rural credit by 1983-84. The Reserve Bank of India had shifted the security oriented approach in rural lending practised by credit institutions to a purpose and production oriented approach. It established the Credit Guarantee Corporation in 1971 to provide guarantee to the lending institutions against the risk of lending to agricultural and other hitherto neglected sectors of the economy.

For the period 1971-72 to 1983-84, the public sector bank's advances to agriculture responded to (i) area under food grains ($r=0.64$), (ii) area under all crops ($r=0.66$), (iii) yield of foodgrains ($r=0.86$), (iv) yield of all crops ($r=0.87$) and (v) irrigated area under foodgrains ($r=0.92$).
The measures taken for improving the rural credit system could not remove the regional disparities in the working of the credit economy (vide Appendix V-5). Long term agricultural loans were found to be highly skewed infavour of medium and large farmers (Vide Appendix V-6).

Special programmes such as the Intensive Agricultural District Programme (1960-61), Intensive Agricultural Area Programme (1964-65), High yielding varieties programme were supported by the Reserve Bank of India paving the way for green revolution.

The National Bank for Agriculture and Rural Development established in 1982 took over the entire operations of the Agricultural Refinance and Development Corporations from the Reserve Bank and became the apex bank in regulating bank credit. The Reserve Bank gives advice or suitable directives to the National Bank for Agriculture And Rural Development to ensure that the policies of this apex bank are in consonance with the policies of the Government. By 1983-84, the institutional sources of rural credit went up by 40 percent.

Overdues in loan: recoveries arise from time to time and various measures are being implemented to deal with this problem. There were wide inter regional variations in the recovery of overdue loans.

The aggregate monetary resources responded to changes in the volume of agricultural production, the correlation between them being $r=0.89$ for the period 1961-84.
During the period 1972-1984, the changes in the levels of the Reserve Bank of India's credit refinance to cooperative sectors raised high powered money ($r=0.90$). The production levels in agriculture were highly related to agricultural credit ($r=0.93$) for the period 1972-84. The accumulation of overdue loans affect the recycling of funds in the banking system. The correlation between overdue loans and Agricultural credit volume was found to be 0.93 for the period 1972-84. The analysis showed how a sound credit economy had been essential for agricultural growth.

12.3 **INDUSTRIAL FINANCE:**

When the country embarked on planned development, the sources of institutional finance were very weak. The rates of investment and savings were only 10.00 percent and 10.20 percent of the gross domestic product respectively in 1950-51. The Reserve Bank fostered development banking in the country and encouraged the formation of term lending institutions to provide medium and long term credit to industries. The Reserve Bank of India helped in evolving norms and regulated the operations of the term lending institutions. There had been a number of them established at the initiative of the Reserve Bank and the Government.

The Reserve Bank helps the term lending institutions by extending resources to facilitate their operations. The Reserve Bank has its nominee in the Boards of Directors of these institutions. The Reserve Bank has been foregoing dividends
accruing on the shares held by it in the Industrial Finance Corporation of India. The Reserve Bank assisted the banks to extend liberal refinance facilities through Refinance Corporation of India. The Refinance Corporation was taken over by the Industrial Development Bank of India in 1964. The Industrial Development Bank of India was established in 1964. It then worked as an apex institution and was originally a wholly owned subsidiary of the Reserve Bank. It was delinked from the Reserve Bank from February 16, 1976. The Reserve Bank has supervisory functions over the term lending institutions until the Industrial Development Bank of India took over these functions in 1964. At present the Reserve Bank provides from its National Industrial Credit (Long term operations) Fund (1976) financial assistance exclusively to the Industrial Development Bank of India and Export-Import Bank of India.

With the active involvement of the Reserve Bank, The Unit Trust of India was established in 1964. One half of the initial capital of Rs.5 crores of the Unit Trust of India was provided by the Reserve Bank. The main function of the Unit Trust of India is to mobilise resources and to channel them into investments. The Unit Trust of India is gaining importance over the period. The amount raised under Unit Scheme 1971 increased from Rs.3 lakhs in 1971-72 to Rs.1,30,02 lakhs in 1988-89, growing at a compound rate of 59.2 percent per annum.

The Department of Industrial Finance (1957) of the Reserve Bank attends to the specialised problems of financing industries
and keeps itself in continuous touch with the activities of the Central and State Governments and various other agencies dealing with industrial finance.

With the nationalisation of the major commercial banks in 1969, the Reserve Bank of India was able to persuade the banks effectively to assist the industries in providing loans and assistance. The outstanding amount of scheduled commercial bank loans to large and medium industries rose from Rs.1,857 crores at the end of March 1968 to Rs.22,187 crores at the end of March 1987, an increase of about 12 times.

The Reserve Bank appointed the Tandon Committee (1975), the Chore Committee (1979) and the Marathe Committee (1983) to assess the working capital requirements of the industries. Based on the suggestions of these committees, the Reserve Bank evolved appropriate banking policy norms.

To supply credit to cottage and small scale industries and to grant a degree of protection to the lending institutions against possible losses, the Reserve Bank started the Credit Guarantee Scheme on July 1, 1960. The amount of outstanding guarantees under the scheme rose from Rs.1.75 crores in 1961 to Rs.3,289.1 crores in March 1980, increasing at a compound growth rate of 45.7 percent per annum. The Credit Guarantee Corporation of India set up by the Reserve Bank in 1971 to cater to the credit requirements of the weaker sections was merged with the Deposit Insurance and Credit Guarantee Corporation set up by the
Reserve Bank in 1981, to ensure a large measure of protection to the financing banks.

The priority status accorded to the small scale industries and the concessive interest rate policies were helpful in increasing the availability of bank credit to the small scale industries. The amount outstanding in the advances made by the commercial banks to the small scale enterprises rose from Rs.285.6 crores in June 1969 to Rs.10,818 crores in March 1988, growing at a compound rate of 19.9 percent per annum.

The Reserve Bank of India and the Government are both concerned in preventing the mortality and sickness of industrial units. The total number of sick industrial units increased nearly six times during 1980-86 and was 1,47,740 by the end of December 1986, with an outstanding bank credit of Rs.4,874.49 crores.

The Reserve Bank coordinates the efforts of banks and other financial institutions as well as Government agencies in the rehabilitation of sick industrial units. The Reserve Bank has given guidelines for defining sick units and for diagnosing and identifying industrial sickness at the incipient stage itself. The Reserve Bank closely monitors certain industries where sickness is more widespread by appointing standing committees.

The Reserve Bank evolved the rules for identification of viable and non-viable units to ensure coordinated approach between the banks and the term lending institutions for the removal of sickness.
The Reserve Bank gives an impetus to the active participation of the commercial banks in providing export credit to small and large industries through preshipment and postshipment credit and under the Duty Drawback Scheme (1976), and Export credit (Interest Subsidy) Scheme (1968). The Reserve Bank also provides refinance facility in export credit. The Reserve Bank makes loans and advances to the Export-Import Bank to enable it to purchase foreign exchange from the Reserve Bank for financing the import of capital goods or for such other purposes as may be approved by the Central Government.

The bank credit extended to the export sector by the Commercial banks increased from Rs.834.8 crores in April 1974 to Rs.3,910 crores in March 1988.

For the period 1974-1984, when exports was regressed on volume of export credit and industrial production, it was found that exports increased with the increased industrial production and export credit, though the latter was found to be insignificant in promoting export.

12.4 GROWTH IN THE GROSS DOMESTIC PRODUCT:

A liberal monetary policy is essential for gross domestic product growth in India because (i) more transactions need monetary support, (ii) larger balances are needed by the population and by the productive economic units, (iii) new areas are covered by the banking system which has to extend credit support to productive activities. The gross domestic product had grown from 3.4 percent per annum during the First Five Year Plan
(1951-52 to 1955-56) to 5.5 percent during the Sixth Five Year Plan (1980-81 to 1984-85). There were structural changes in the economy, which could take place with the monetary policy support extended to agricultural, industrial sectors. The percentage share of the public sector in gross domestic product increased from 8.5 percent during the First Five Year Plan to 24.5 in the third year of the Sixth Five Year Plan. The contribution of the primary sector to gross domestic product declined from 59.8 percent in the First Five Year Plan to 38.6 percent in the Sixth Five Year Plan. The secondary sector whose share was 14.25 percent of the gross domestic product in the First Year Plan was 24.96 percent in the Sixth Five Year Plan. The structural changes were followed by increased money supply. Money supply $M_3$ had grown from 3.4 percent per annum during the First Five Year Plan to 16.87 percent during the Sixth Five Year Plan.

The rise in the gross domestic product responded to increased agricultural and industrial production. Their interrelationships showed high correlations.

Six simultaneous equations were constructed with 10 variables for the period 1961-84 to bring out (i) how gross domestic product was rising with the volume of factory employment and (ii) how the inflation rate was rising even when gross domestic product was rising. The model has two parts. Stress was laid on industrialisation by introducing factory employment and industrial production. Gross domestic product (1980 prices), the inflation rate as defined by the GDP deflator (1980 prices) and factory employment were explained in the first part of the model.
The exogenous variables included in the first part of the model were electricity generated, index of share prices, government bond yield and high powered money. The model relationships were assumed to be linear. The gross domestic product and GDP deflator were estimated using the two stage least square method. The ordinary least square method was applied to estimate factory employment as a function of electricity generated, index of share prices and government bond yield.

The index of share prices was found to be weak in its influence on factory employment. The government bond yield indicative of the long term rate of interest and electricity generated were found to be significant in explaining factory employment.

Factory employment was significant in explaining the gross domestic product. But the government bond yield was insignificant in explaining the changes in the gross domestic product.

The inflation rates were found to be influenced by changes in the gross domestic product, high powered money and factory employment.

From the first part of the model, it was seen that the gross domestic product (1980 = 100) had been closely affected by factory employment. It was seen how the gross domestic product was rising with volume of factory employment and how the inflation rate was rising even when the gross domestic product was rising.
In the second part of the model, the computed values of factory employment, gross domestic product and GDP - deflator were considered to explain industrial production, government expenditure and the aggregate monetary resources. The ordinary least square method was applied. The computed levels of gross domestic product and of inflation rate together with the endogenous variable the index of industrial production explained the magnitude of the aggregate monetary resources.

The model equation for industrial production showed the impact made by the government expenditure and the estimated values of factory employment and GDP deflator.

The changes in government expenditure were affected by broad money and the estimated values of factory employment and gross domestic product.

The model equations bring out the interrelationship existing between the real variables factory employment, gross domestic product (constant prices) and industrial production with the monetary or financial variables viz. government expenditure, aggregate monetary resources and GDP deflator.

12.5 INTEREST RATES:

In India, the rates of interest were very high and showed lack of integration when unorganised money markets were dominant in the fifties. A structure of interest rates was however evolved with the active involvement of the Government and the Reserve Bank of India in evolving a credit structure suited for
Indian agriculture and industry. Though the interest rates had tended to increase, the justification of low rates had not ceased.

The Reserve Bank, over the plan periods, stipulated interest rates which aimed at directing bank credit flows to specific sectors intune with the plan objectives and specific plan programmes. Concessional interest rates are widely used signalling that certain target groups are assigned special prominence in availing bank credit. Agriculture, the weaker sections of the population and the export sector are for example eligible for bank credit at concessive rates.

The Bank rate policy caused a movement towards high rates. The recourse to the Bank rate was limited since '80s. There was a close harmony between the Bank rate and most important rates of the organised sector during 1961-84. A high correlation between the Bank rate and the money market rate \((r = 0.84)\) was revealed. The Bank rate was highly correlated with the long term government bond yields \((r = 0.93)\) and treasury bill rate \((r = 0.94)\). High correlation between the Bank rate and gross fixed capital formation was found \((r = 0.86)\). The Bank rate was found to have significant impact on changes in commercial and cooperative credit.

The commercial banks have been adhering to the directives of the Reserve Bank of India when fixing interest rates on the loans made by them. The banks fix different rates of interest on the
loans made by them according to the purpose of the loan, the nature of the creditor groups and the period of the loan.

With a high rate of inflation, the real interest rate declined. The real rate of interest was viewed as nominal rate of interest less the rate of inflation. To find the rate of inflation, the wholesale price index was used. $P_{t+1} - P_t / P_t$ was taken as the annual rate of inflation. When prices were kept relatively stable, real interest rates were positive. Under inflationary conditions, during the oil price hike of 1972-73 and 1979-80 the real interest rates became negative.

A dichotomy of interest rates has developed between borrowers at differential rates of interest and the others.

12.6 INFLATION:

An expansion in money supply is needed for income growth. But the expansion may lead to inflation. The control of inflationary pressures has been one of the major concerns of monetary policy. The Reserve Bank has been applying various instruments to contain inflation which is emerging in the economy. To restrict credit expansion, selective credit controls, cash reserve ratio, regulation, changes in statutory liquidity ratio, moral suasion, persuasion, prescribing norms on lending rates are resorted to by the Reserve Bank.

Inflation as measured by GDP deflator (1980 prices) revealed that the GDP deflator stood at 23.6 in 1960 and at 136.8 in 1984. Various types of cost and price inflation prevailed in the
planned economy. A high correlation \( r = 0.98 \) existed between gross domestic product and GDP deflator for the period 1961-84. The GDP deflator was found to be highly correlated with money stock \( M_3 \) \( (r = 0.97) \) and reserve money \( (r = 0.98) \) during the period 1961-84. The ratio \( GNP/M_3 \) declined from 3.531 in 1960-61 to 1.843 in 1986-87. GDP - deflator was found to be highly correlated with budgetary deficits \( (r = 0.94) \) and government expenditure \( (r = 0.97) \) during the period 1961-84.

The increasing claims of the banks on the private sector played an important role in the inflation that prevailed during 1961-84, but the increase in the industrial and agricultural production during the period contained the price level to some extent. These characteristics were noticed by linear regression analysis.

Selective credit control measures were adopted by the Reserve Bank during various plan periods and were intended to ration the supply of credit for productive purposes and to curb the less essential activities.

12.7 THE RESERVE BANK AND THE BANKING SYSTEM:

Planning necessitated the effective cooperation between the Reserve Bank and the Government in operating the credit economy for the benefit of productive activities so that planned goals could be realised.

Between June 1969 and June 1989 the total number of commercial bank offices rose from 8,321 to 57,698. The deposits
with the commercial banks rose from Rs.4,665 crores in June 1969 to Rs.1,41,823 crores in December 1988. The branch expansion programme introduced by the Reserve Bank of India enabled the mobilisation of savings by the banking system. The share of the financial savings of the household sector rose from 4.35 percent in 1951-52 to 28.4 during the First Plan. It was 44.3 percent in the Sixth Plan. Bank deposits assumed 48.7 percent of the financial savings of the household in 1986-87. During the period 1970-85, the interest elasticity of time deposits exceeded the interest elasticity of demand deposits. Credit support was provided to plan schemes. The advances made to the priority sectors by the public sector banks alone increased from Rs.6,590 millions to Rs.3,42,070 millions between December 1969 and March 1989. Within the priority sectors, advances to weaker sections aggregated Rs.8,459 crores constituting 11.1 percent of the total advances of these banks as against the target of 10 percent as at the end of June 1989.

Credit planning which was started in 1969, later on took the form of the Service Area Approach. Such an approach evolved by the Reserve Bank introduced a measure of decentralised planning.

The Reserve Bank took steps to activate the Indian money market. The Bill Market Scheme (1952), New Bill Market Scheme (1970), the issue of Participation Certificates (1970), the issue of Certificates of Deposits (1989), the setting up of the Discount and Finance House of India (1988), the issue of 182 days
Treasury bills are some of the measures introduced by the Reserve Bank to widen the money market instruments.

To regulate credit and to ensure orderly credit management the Reserve Bank introduced the Credit Authorisation Scheme in 1965.

To restrict credit expansion, the Reserve Bank has used the cash reserve ratio. Since mid 70's this instrument is used often indicating a restrictive monetary policy stance. During 60's the ratio remained at 3 percent. In 1989, it stood at 15 percent. Monetary inflation could be contained in this manner.

The statutory liquidity ratio requirement has evolved into an instrument for supporting the government market borrowing programme. The rise in the statutory liquidity ratio made the banks absorb more of government securities. During 1955-70, the compound growth rate of commercial banks' investment in government securities was 8 percent only. During 1970-89, the compound growth rate of commercial banks' investment in government securities was 18.77 percent.

The statutory liquidity ratio stood at 20 percent in 1964. In April 1990, it was 38.5 percent.

The efforts made by the banks to meet the statutory liquidity ratio, and the cash reserve ratio requirements under the directives of the Reserve Bank brought about many changes. Till the mid '70s the investment deposit ratio and cash deposit ratios of the banks were declining. They started increasing
thereafter. The investment deposit ratio was 23.3 percent in 1973-74. It increased to 39 percent in 1988-89.

The cash deposit ratio was 6.4 percent in 1975-76. It rose to 16.3 percent in 1988-89. Though cash earns no income, it is an important asset for banks.

The credit deposit ratio started declining from 1976. It was 80.8 percent in 1975-76. It declined to 60.5 percent in 1988-89. The fall in this ratio could lower the earnings of the banks. The Reserve Bank emphasized improvements in the credit deposit ratio in the rural areas. The credit-deposit ratio for the rural areas was 64.5 percent in March 1989, exceeding the target of 60 percent fixed for the year.

Because of the agricultural seasons, there was a pronounced seasonality in the demand for credit in the Indian economy. With the banks' widening their role of credit supply for diversified economic activities, in recent years, the difference between the credit ratio at the end of the slack season and that in the busy season has been on the decline.

Norms relating to credit deposit ratios, guidelines regarding priority sector advances, advances under the Differential Rate of Interest Scheme affect the profit of a bank. The earnings of the banks increased at a compound growth rate of 23 percent per annum during 1969-81. The expenses increased at a compound growth rate of 22.79 percent per annum during the same period. The profits were thus slow to grow.
12.8 EXCHANGE CONTROL:

In developing economies the central bank assumes great responsibility in managing the value of the currency. The Reserve Bank managed the value of Indian rupee first linking it with pound-sterling, then delinking it from pound sterling and shifting to a basket of currencies for strengthening the rupee in the international market.

The stability in the internal and external values of rupee would help improving the foreign trade sector. The years of the First Five Year Plan period witnessed a favourable balance of payments situation. Starting from the Second Five Year plan, India witnessed adverse balance of payments till 1980. Exchange control measures are being pursued by the Reserve Bank to regulate foreign exchange reserves and to mitigate balance of payments difficulties. The holdings of foreign currency assets which were Rs.185.8 crores at the end of 1960-61 rose to Rs.5,219.9 crores in 1978-79.

The Reserve Bank of India in concert with the Government is taking steps to mobilise the savings of the non resident Indians and to promote foreign investment in India. Various concessions in the form of tax relief, interest rates etc. are being provided to the non resident Indians. The deposits from non resident Indians which stood at Rs.1,091 crores in 1981 rose to Rs.14,154 crores in March 1989.

The volume of trade with United States and trade with the
countries which link their currency to dollar make the rupee value of the dollar an important factor to be considered. The volume of exports to U.S.A increased from Rs.207 crores in 1970-71 to Rs.1,752 crores in 1984-85. When the exchange rate of rupee per dollar and the volume of exports to U.S.A. were treated as regressors against foreign exchange reserves of India for the period 1971-85, it was found that with the increased exports to U.S.A, the foreign exchange reserves of India were increasing. The appreciation of the U.S. dollar was found to have an adverse effect on the foreign exchange reserves.

The relationship existing between exchange rate, total volume of exports and imports, foreign exchange reserves and rate of inflation for the period 1971-85 revealed the decline in foreign exchange reserves and the increase in the total volume of exports with the appreciation of rupee. The domestic value of rupee was not found to be significant in determining the external value of rupee.

12.9 THE RESERVE BANK OF INDIA AND THE GOVERNMENT:

The Reserve Bank of India acts as the banker to the Central and the State Governments. The Reserve Bank has been managing the public debt of the Government of India which covers the issue and retirement of rupee loans, interest payments on all such loans and all matters relating to debt certificates and to registration of debt holdings.

The Reserve Bank provides different denominations of currency. The issued currency notes have cent percent cover in
approved assets, with not less than 40 percent of the assets consisting of gold coins, bullion and foreign securities. During 1970-71 to 1987-88, the currency notes issued increased from Rs.4,62,038 lakhs in 1970-71 to Rs.21,29,625 lakhs in 1987-88, growing at a compound growth rate of 8.8 percent per annum.

The borrowing programme of the Central and the State Governments reveals the close relationship of the fiscal and monetary policies in India.

The market loans and bonds of the Central Government rose from Rs.1,438.46 crores in 1951 to Rs.48,041 crores in 1988.

The level of coupon rates for different maturities of government securities were below the maximum rate being offered by banks on term deposits of more than 5 year maturity or yields available on other comparable financial instruments.

The Reserve Bank of India was the largest holder of the Central Government securities till 1976. The Reserve Bank was holding Rs.2,256.6 crores of Central Government securities, constituting 31.8 percent of the total in 1976. Since 1977, the scheduled commercial banks were the largest holders of the Central Government securities. The commercial banks holdings of the Central Government securities was Rs.20,194 crores in 1987, constituting 50.4 percent of the total.

The Central Government and the State Governments float market loans separately through the Reserve Bank of India. To
secure the floatation of Government loans at reasonable rates of interest, the Reserve Bank coordinates the terms on which the direct loans are raised by the State Governments and those of loans raised by other institutions guaranteed by the State Governments. Since 1973, a perceptible shift could be seen in the composition of the maturity pattern of the Government of India Rupee Loans. The share of securities with a maturity of over 10 years showed an increase from 53.5 percent in 1972-73 to 81.8 percent in 1988-89. The share of securities with maturity of under 5 years showed a decline from 25.7 percent in 1972-73 to 9 percent in 1988-89.

For many years till 1974-75, in the total accepted subscription amount of new issues, the share of conversion was high. It was 53 percent in 1969-70. Since 1970-71 there was a decline in the conversion of loans. During 1988-89, of the total loans issued only 3.9 percent of the loans were subject to conversion.

Treasury bills are the main instrument of short term borrowing by the Government. The Reserve Bank attends to the sale of treasury bills as an agent of the Central Government. The major purchaser of treasury bills was mostly the Reserve Bank of India. During 1988-89, the Reserve Bank purchased 64 percent of treasury bills amounting to Rs.42,240 crores.

To make treasury bills as an active monetary instrument with flexible rates, the Reserve Bank of India introduced 182 days treasury bills in 1986 to be issued by auctions without
rediscounting facilities. The outstanding amount against 182 days treasury bills stood at Rs.382.9 crores at the end of June 1989.

The Government's dependence on external loans was Rs.49.8 crores in 1950-51. It increased to Rs.23,225 crores in March 1988.

Open market operations are pursued by the Reserve Bank of India as an active instrument of monetary regulation. The objective of open market operations is to affect the reserves of banks and in the process to create and maintain a desired pattern of yield on government securities. The Reserve Bank makes the purchase and sales of government securities through approved brokers. The net purchase of the government securities by the Reserve Bank stood at Rs.56.27 crores in 1950-51, the net sales increased from Rs.28 crores in 1955 to Rs.342 crores in 1981 and to Rs.1,251.1 crores in 1988-89. Switch transactions are also provided by the Reserve Bank in which the banks and the other financial institutions could purchase one security against another.

The Reserve Bank provides ways and means advances and overdraft facilities to the State Governments with concessive rates of interest.

The public sector has grown considerably in importance since 1951. The financing of the Five Year Plans has a link with the functioning of the monetary system in relation to the public sector.