CHAPTER - X

CONCLUSIONS & SUGGESTIONS
Democratic planning in India began in 1951. With the acceleration of planning efforts, exceptional stresses and strains developed in the economy which challenged the Reserve Bank to reformulate its monetary policy in a way which would curtail the flow of credit into undesirable channels without bringing about a contraction in the total quantum of credit. How well the RBI has met this challenge, has been discussed with particular reference to the foodgrains, sugar, Gur and Khandasari, oilseeds and oils, cotton and Kapas and raw-jute in Chapters IV to VIII, in particular, in relation to the selective credit control measures adopted by it. The RBI along with the co-operation and assistance of other Institutions/Bodies - Governments (Central and States), the Forward Market Commission, the Textile Commissioner, the IJMA and others - has been successful to a very great extent in controlling the trends in prices as well as in regulating the advances of scheduled commercial banks against the commodities under study.
However, the innumerable limitations have affected the effectiveness of these measures to a considerable extent. The limitations have been outlined first prior to the advancing of suggestions for making the qualitative methods of credit control more effective.

(a) **THE INTER-PLAY OF SPECULATIVE AND PRECAUTIONARY MOTIVES:**

The continuance of rising investment expenditure financed through Deficit Financing coupled with the inelasticities of supplies of the five commodities under study gave a free rise to the inter-play of speculative and precautionary motives which generated a trend in stock-piling and in raising of prices.

(b) **STATISTICAL INFORMATION:**

The short-term adjustments in credit policy, particularly selective credit control measures, on the price situation relied on the amount and quality of statistical information available regarding the out-turn of the crops and the supplies coming onto the markets. Accordingly, the trader, assisted by the bank credit, hoarded the necessary commodities or transferred them from an area of plenty to that of scarcity and earned a higher return. Improvement in regard to the availability, coverage and accuracy of statistical information, would help to enhance the effectiveness of selective credit control.
policy. All the commercial banks must regularly supply the RBI with the requisite statistical and descriptive data concerning their operations to help RBI in formulating the credit policy.

(c) **ADMINISTRATIVE LAGS**

There have been various 'lags' regarding the formulation, implementation and enforcement of RBI directives among the commercial banks, differing widely in the structure and organisation and spread over a very wide area. The various 'lags' have been - (i) the Recognition lag - the need for applying credit controls to be recognised; (ii) the administrative lag - after realising the need for applying credit controls the administrative exigencies necessitate some time for the RBI to proceed to formulate policy measures; (iii) the Impact lag - after applying the various selective credit control measures the RBI would have to wait for these measures to achieve the desired results to assess the effectiveness of the measures adopted by it and make desirable changes in them accordingly. The Governor of the RBI once admitted that "The administration of the selective credit control has not, in practice, proved an easy task. In practice, there are limitations to the ability of banks to exercise detailed controls over scores of branches located in widely separated parts of the country with divergent economic conditions and credit needs."¹ The larger the number of banks to be covered by selective credit control methods, the greater is

¹ Statement to the 12th Annual General Meeting of the IMF.
the likelihood of administrative difficulties, the possibilities of evasion increase particularly in an under-developed economy which is characterised by under-developed law-abiding habits. The success of selective credit control hinges on the co-operation of the banks. Regulation loses much of its significance in the absence of efficient administrative machinery for its implementation. Hence, it is necessary to have adequate machinery for administering the plan of banking regulations.

(d) **STRUCTURE OF MONEY MARKET**

The structure of the money market in India itself limits the effectiveness of the selective credit controls. The RBI had to operate in an institutional set-up of a mixed economy, the existence of a heavy public sector under a planned development programme, a highly organised and an unorganised money and banking sector, and, above all, the existence of a primitive barter economy. Any selective directive to scheduled banks shifted the credit from them to non-scheduled banks, co-operative banks and/or NBFIS. Recourse to indigenous bankers also cannot be prevented under the prevailing conditions. The effectiveness of monetary policy largely depends on the degree of integration in the economy and the extent to which the money market constituents operate in coordination.

(e) **THE PASSIVE ROLE OF THE RBI**

The regulation of money supply is not wholly, or even largely, under the RBI's control. It is considerably affected
by the budgetary operations of the Government over which the RBI has no control. Defence and development have always claimed priority over price stability. On account of this, the RBI had to pay a passive role under the dictates of the Fiscal Policy. This implies that the monetary policy and Fiscal policy in the country should be coordinated so that both can be effectively implemented in furtherance of the economic goals. The Central Board of Directors in their report observed "This underlines the necessity of maintaining harmony between monetary policy and fiscal policy... The impact of credit policy on price line is conditioned by the availability and cost of alternative source of finance for hoarding operations. The impact of fiscal operations on the overall monetary expansion has to be borne in mind especially in a period of large outlays on defence and development." ¹ The nature of the economic problem in the developing economies is such that it can be tackled only through simultaneous adoption of the monetary and fiscal policies along with other instruments of economic policy so as to form a 'package deal' approach to the whole problem.²

(f) HEAVY DEPENDENCE OF THE CO-OPERATIVE BANKS ON RBI:

The dependence of co-operative banking system on the RBI has been progressively increasing. The co-operative movement in India leans too heavily on the patronage of the Government. Nearly 80 per cent of its resources are obtained by

² The Per Jacobsson Foundation lecture, delivered by Dr. Deshmukh on October 1, 1965, Washington, D.C., p. 30.
way of loans or share capital from Government agencies like the RBI. This is against the basic concept of co-operation which desires progress through self-help. The movement can be self-sufficient at least to a considerable extent, if not wholly, if it concentrates on mobilisation of savings in the rural areas. The co-operative institutions should run their business strictly on commercial principles. In particular, they must watch their growing expenses of management which must never be out of tune with the expansion of the business. They should, and must, re-examine each item of expenditure and observe strict economy. The rate at which overdues are increasing is also alarming. Firmness in recovering these is very much desirable.

The RBI should lay down definite criteria with regard to reducing the dependence. Once a bank outgrows the stage of infancy or inability, the Reserve Bank should apply such measures as to discourage further borrowings from it. An ideal policy for these institutions in future would be to strengthen their resources in the form of owned funds and deposits rather than depend heavily on Reserve Bank funds.

(g) **LINKING OF INDIGENOUS BANKERS**

The RBI made two attempts in 1939 and 1941 to realise the above objective; but they were not effective. Of late, however, some of the indigenous bankers have converted themselves into joint-stock banking companies and the Banking Companies' Act of 1949 is applicable to them.
In spite of the various measures taken after independence, the indigenous bankers remain outside the control of the Reserve Bank; and the chances of bringing the indigenous bankers under the organised banking system do not yet appear to be bright. However, Dr. V. Krishnan observed, "a number of licensed warehousing Corporations have been established and that, when the commercial banks and indigenous bankers give advances against these warehouse receipts, Section 17(4)(b) of the Reserve Bank of India will begin to operate. A kind of direct linking between the Reserve Bank and the indigenous bankers can be brought about, if the Reserve Bank were to liberalise the rules in regard to the acquisition of assets under its open market operations."  

Earlier, the Banking Commission, in their report, had concluded that the best way to control the business of indigenous bankers would be through commercial banks. The strategy suggested for enforcing such control is the prescription of certain minimum requirements to be fulfilled by an indigenous banker to qualify for discounting facilities with commercial banks. Indigenous bankers seeking such facilities may be required to (a) keep off any trading activity, (b) put in 'own' capital of not less than Rs. 1 lakh (discounting facilities being fixed as a given multiple of 'owned funds'), (c) maintain regular books of accounts and get them duly audited, (d) furnish statement of business in a prescribed form annually to Reserve Bank, (e) not

1. Dr. V. Krishnan - Indigenous Banking in South India, pp.176-77 - The Bombay State Co-operative Union, Bombay, 1959.
to borrow from more than one bank, and (f) to become members of an association.¹

The future of indigenous banking seems to lie in linking it with the organised financial system and the commercial banks, in their dealings with indigenous bankers should encourage them to become corporate bodies.

(h) **CONTROL OVER NBFIS**

The Banking Commission had recommended certain steps in order to safeguard the interests of depositors as well as to ensure that the operations of these institutions do not weaken the effectiveness of the RBI's monetary policy. These are:

1. **NBFIS may be given inducements to form themselves into corporate bodies.**

2. **These institutions may be classified into two categories - 'approved' and 'non-approved'.** Those which satisfy certain prescribed requirements regarding size of capital and reserves, level of liquidity ratio, quality of management, etc., may be designated as 'approved' and they may be accorded a favourable treatment such as refinance facilities from banks and credit Guarantee and Deposit Insurance Cover.

3. **Hire-purchase finance institutions should be licensed compulsorily and the licensing authority may be given power to revoke licences where warranted.** The Commission

endorsed the recommendations of the NCC study Group, that banks should form a few hire-purchase finance companies particularly in eastern region and participate in its operation.

(iv) The setting up of new Unit Trusts and Investment Companies should be encouraged where market conditions justify.

(v) The Commission felt that the removal of chit funds without offering alternative, will create a gap. Hence measures should be taken to regulate them. There should be uniformity in legislation of Chit Funds and only public limited companies should be allowed to run them. The Chit Funds, if run by the commercial bank under safeguards of the RBI, shall be more useful.

(vi) The Commission, in view the familiarities of the 'finance corporations', recommended for their continuance. These should be licensed and follow certain discipline in the matter of ratio between their own funds and deposit liabilities, liquidity of assets, periodical inspections, ceiling on interest rates etc.

(vii) The administration of the Financial Institutions should be left to an Independent Agency which should be closely associated with RBI. This agency would comprise separate licensing/regulating authorities at the State level with an apex body at the all-India level, alternatively, RBI itself may be entrusted with the responsibility.¹

RECOMMENDATIONS OF THE STUDY GROUP:

After an examination of the recommendations of the Banking Commission in regard to NBFCs and bank views thereof, Government decided, \textit{inter alia} that statutory powers should be taken to prohibit acceptance of deposits by all unincorporated bodies, that the existing statute and directions issued by RBI may be tightened to plug the loopholes which are being taken advantage of, particularly by the private limited companies. Accordingly the RBI constituted, in June, 1974, the Study Group for examining in depth all aspects of the matter and make suitable recommendations for the Government decision. The Study Group submitted its report to the RBI on July 14, 1975, and necessary follow-up measures are being taken to implement the recommendations of the Government which have since been accepted by the Bank and the Government.

The broad approach of the Study Group has been that the acceptance of deposits may not be prohibited altogether. But measures should be designed to ensure the efficacy of monetary policy to avoid disruption and production process to safeguard the interest of the depositors. The ultimate object should be to discourage further growth of the deposits. The Study Group recommended that their activities be regulated broadly on the same lines as banks and these should be brought under the close surveillance of the RBI. The Group suggested a higher limit of ten times the net owned funds in case of Loan
Companies as their operations are analogous to those of the banks and as they depended basically on the margin between their deposit and advance rates.

In case of Hire-purchase Companies, which were at that time exempted from ceiling restrictions, a ceiling had been proposed.

The Group had not recommended any ceiling on deposits with Midhis which deal with their members only.

The minimum starting capital was also recommended. The directives styled as Non-banking Financial Companies (NB) Directions, 1977, and Miscellaneous Non-banking Companies Directive, 1977, were issued in supersession of the earlier directives and have become effective from July 1, 1977.

By these directives, the maximum amount which may be accepted by Hire-purchase Finance Companies by way of deposits was required not to exceed ten times of their net owned funds. The restriction on ceiling in case of Loan Companies were being retained, while in case of Investment Companies, the ceiling was to be progressively reduced in two stages, the reduction taking effect in April, 1978 and April, 1979. The maximum period for accepting deposits was prescribed as 36 months, and, in case of Housing Finance Companies as 60 months.

The Bill for banning the Prize Chits and Money Circulation Scheme was finalised and introduced in Parliament.
during 1976-77 Budget session. The Bill was passed by both the Houses of Parliament and came into force on December 12, 1978. The said Act - the Prize Chits and Money Circulation Scheme (Banning) Act, 1978 - extends to the whole of India except to the State of J & K. In terms of this Act, all the State Governments including Union Territories were required to frame rules in consultation with RBI for carrying out the provisions of the Act for winding up the existing business of Prize Chits for money circulation scheme.

A Bill entitled 'The Chit Funds Bill, 1979' to regulate the conduct of conventional Chit Fund business on uniform basis throughout the country was drawn up by the RBI. It was later examined by the Raj Study Group and introduced in Parliament on February 23, 1979.

The draft of the comprehensive legislation (to give effect to one of the recommendations of the Raj Study Group) for regulating the general conduct of business by other Non-banking Financial Companies was also being finalised by the RBI. However, this Bill lapsed consequent on the dissolution of the then Lok Sabha. Meanwhile, it was observed that the Bombay High Court had held that any amount due from a prized subscriber to the foreman conducting conventional chits was a 'debt' within the meaning of the provisions of the Maharashtra Debt Relief Act, 1973 and thus stood extinguished by reason of the provisions of that Act.
The draft of the comprehensive legislation for regulating the deposit acceptance and other business of Non-banking Financial Companies remains to be finalised by the RBI.

(1) **NECESSITY TO CONTROL INFLATIONARY PRESSURES**

The RBI has been caught in a vicious circle in the course of implementing the policy of 'controlled expansion', a synonym for the term 'growth with stability'. Money supply is expanded to meet the growing demands of productive sectors in a developing economy. This tends to create inflation which, in turn, raises the financial needs of the productive sectors. To meet the legitimate needs of these sectors, still more money is injected into the market, which in turn, produces more inflation. Once speculation is sought to be controlled through a tight money policy, the productive investors are also hurt because their need for funds is a rising function of inflation. Therefore, within the frame work of this policy there is no escape - production and prices escalate together but the latter stay ahead of the former.

It is likely that "black money" too has played an active part in accentuating inflation. Besides this, wasteful use of funds on unremunerative non-developmental and non-plan expenditure, which has been snow-balling since the beginning of the planning era, is also responsible for inflating inflation.
A drastic pruning of non-essential expenditure in order to reduce the strain of excess demands is necessary. The RBI would be failing in its responsibilities if it does not administer a stern warning against the continuance of deficit financing. It is the duty of Central Banker to caution the Government about the danger to economic efficiency and social injustice of inflationary planning. Again, to control the inflationary strains, the RBI applied, in varying degrees and frequency, all the monetary brakes in its possession. The success or failure of monetary policy, however, depends to a large extent not only upon the dexterity with which these brakes are applied, but also significantly upon the structural framework within which monetary policy functions.

(j) NEED FOR PUBLIC INTEREST AND CO-OPERATION:

Exclusive reliance upon monetary policy as a means of coping with inflation and also dealing with the problem of development of financial institutions is dangerously one-sided. The scope of monetary policy is larger than is generally supposed and that it is expanding. Steps have also to be taken by all sectors of the general public for it would be a profound mistake to think that the task of maintaining monetary stability is the task of RBI only. Discipline, hard work and integrity all around are necessary to bring down the prices.
In order to enable the Central Bank to feel the pulse of market correctly, a regular and continuous exchange of ideas and views between the Central Bank and commercial banks' representatives before hand is necessary instead of introducing improved monetary measures. The RBI must endeavour to enlarge the areas of participation, consultation and discussion with the banks. With continuous understanding and co-operation between the RBI and commercial banks, the task of regulation and control will be accomplished in an effective manner.

The effectiveness of credit control policy is derived from its proper timing. Proper timing can thwart a speculative boom from developing, slow down an increase in prices through selective controls or make the economic system more or less stable by influencing expectations one way or the other. There has been much vacillation by the Reserve Bank in taking appropriate action against inert and deliquent banks.

In respect of selective credit control, there is ample evidence to show that compliance on the part of the commercial banks with the Reserve Bank of India's directive has not been completed. Experience shows that certain commercial banks circumvented the weapons of credit control of the Reserve Bank. In some cases, there has been only partial compliance. Again,
on many occasions, many banks including the State Bank of India, have not complied with the provisions relating to reduction of the total advances to prescribed limits. Thus, the provisions of the directives of the Reserve Bank of India were honoured more in breach than in observance, and herein lies the problem of effective functioning of credit control. There is need for better compliance with RBI directives by the commercial banks so that the control over credit could be more effective.

(m) RBI BURDENED WITH TOO MANY FUNCTIONS:

It is also true that the RBI is at present saddled with too many functions and responsibilities. It not only discharges the traditional or orthodox functions of a Central Bank but is loaded with a variety of functions in regard to economic development, development of banking facilities, financing of industrial development, control over NBFIS and the co-operative banks etc. The question arises as to whether the RBI can exercise the very many functions entrusted to it efficiently and effectively or to consider seriously if the RBI is not biting more than it can chew. This problem needs proper enquiry and consideration so that the RBI might function efficiently with limited functions.

(n) THE CHOICE OF OBJECTIVES:

The monetary policy has been directed to achieve different objectives depending on the environment and the time factor. The problem is not one of choosing or setting one
objective, but ensuring coordination and consistency among different objectives. Various objectives of monetary policy require to be reconciled, coordinated and balanced in accordance with the nature of the economy and priorities of the plans. There is need to search for an optimum objective-mix. The RBI should coordinate the various credit instruments and employ them at the proper time for the right purpose but only to an extent that is, neither more nor less than needed.

(c) **NEED FOR TRAINED PERSONNEL**

So complex and delicate has become the working of a Central Bank that the operations cannot be performed successfully by means of mere legislation. The effective working depends more upon the MEN whose business should be to run the machine efficiently than to devise any legal formula. To minimise the possibilities of committing mistakes and face their repercussions, it is essential to have an efficient body of trained men who could run the whole show efficiently. Mr. B.T. Thakur pointed out some years back that there was "inadequacy of talented personnel manning the RBI. He felt that the Bank lacked in man power of the right quality." It is, therefore, suggested that the RBI should have a cadre of talented officers and men of a very high calibre, properly trained through NIEM and other higher institutions for better working of the RBI.

1. Article entitled Bureaucracy and Banks in Commerce; May 5, 1956, pp. 854-855.
Since independence, the RBI has been endowed with additional powers and there have been radical changes in the underlying economic and monetary situations since the commencement of planning in India. In view of the rising prices and massive investments, a probe into the monetary affairs would provide valuable data to guide the line of policy and action. Lessons in the management of money and banking would help to evolve short-term and long-term aspects of monetary policy. Systematic collection and analysis of data would help the monetary authorities in framing, adopting and implementing effectively a monetary policy for the country. No detailed enquiry has been made since 1930's. An enquiry by a high power body has been long overdue. The earlier it is done the better would it be.

Prof. Chandler's observation appears to be quite convincing that "an essential characteristic of satisfactory Central Banking' policy must be adjustability and flexibility of action." The monetary policy continued to be a double edged one 'The RBI had to ensure an adequate flow of credit to meet the genuine requirements of planned economy but at the same time check speculative excesses with their inflationary overtones.

The Reserve Bank of India has succeeded to a large extent in the credit rationing efforts and exercising of credit quality control of the commercial banks. It has to be admitted that "but for the selective controls the price situation might have been worse."¹