CHAPTER I

STATEMENT OF THE PROBLEM

(1)

Credit and Credit Analysis

Definition of Credit:

The term credit has been variously used. It has been used as "purchasing power other than money", and has been equated with debt "differing from other debts only in the facilities allowed by the banker for transferring it to other creditors".

In this sense credit implies transfer of control as distinct from the ownership of resources. Thus an individual gets money on the basis of his stock of produce against which he gives the banker a promissory note or hundi. The banker can discount it, subject to legal requirements, with the Imperial Bank or the Reserve Bank of India, i.e. to transfer the paper to other creditors. The borrower comes, temporarily, in possession of money. After a certain period the man has to clear up his debt and thus reverse the transfer of resources. Such transactions do not effect any permanent distribution of resources, though they often help to increase the total productive resources, out of which increment a stipulated slice goes to the lender and after the deduction of tax dues the rest is retained by the borrower.

2. Hawtrey: Currency and Credit, p. 5, 1928
In this work credit will be used to denote not only means of payment - both deposits subject to cheques, and currency notes, but it will also be taken as meaning "an asset of all members of the community taking the form of potential rights over future goods and services which they may exchange for present goods and services".  

The first point which is emphasised in the above statement is that credit is not very distinct from the means of payments. This is because money in its modern form is highly abstract. It depends for its acceptability not upon goods and bullions in the coffer of a central bank, but upon a confidence in the stability and progressiveness of the economy. One may, therefore, legitimately call such a credit as "Social Credit".  

Credit is not, however, co-terminus with the means of payment. For, although money should not be increased without the corresponding actual or expected increase in the volume of goods and services, there is no guarantee that it will not. The first difficulty is, thus, in the purchasing capacity of a given volume of money. To determine this is an unsurmountable task - unless the velocity of the turnover of money is assumed constant. Secondly, the expected increase in the volume of goods and services is, after all, attendant with uncertainty which may render the supply of money, even after the lapse of a sufficiently long time, superfluous. Thirdly, the money creating capacity of a state is autonomous of its good creating "

1. Whitney: Experiments in General Credit Control, N.Y. 1934, p. 70
potentialities. And, although it is desirable to establish a nexus between these, there is no certainty that this will be done. The foregoing analysis is intended to show how credit and money may not coincide. There is, however, a greater urgency to realize the limitation of such an independence. The collapse of the German Mark in 1923, and of Chinese currency, in more recent years, besides the currency reforms that have been a regular feature of the Continental monetary reform movement are footnotes to the problem of autonomy. For, a stage comes when people will refuse to accept money as a means of payment, unless it is backed by adequate social credit.

Again, credit is also equated with the potential rights of all the members of the community that entitles any one of them "to extend his control as distinct from his ownership of resources". This would, however, involve a problem of conceding such rights after subjecting the assets of a particular member of the community to a process of credit analysis. From national perspective, as contrasted with a businessman's standpoint, an analytical credit should not restrict itself to an examination of the balance sheets, the inventory, the income and the property statement of the individuals, in order to find out the ultimate realizability of a loan. This would merely determine the liquidity of a loan. It would, however,

bypass, on the one hand, the consideration of the inter-relationships of such potential right and, on the other hand a neat definition of the relationship of such potential rights to the interest of the community as a whole. For, once the potential right of one member of the community is conceded, it would affect the potential rights of other members.

This is, firstly, because, the real goods represented by such means of payments are limited in quantity and secondly because their employments in one way would mean the relinquishment of the next best alternative. Indeed, in a community with much excess capacity, the reasoning that underlies our first point may not be very convincing. It is nonetheless true of an underdeveloped economy that has embarked upon a process of rapid industrialisation and expansion, an economy the price system of which can be no guide to the optimal distribution of its investment resources. As for the second point, it holds good both for a developed economy as well as for an underdeveloped economy, albeit the extent of its usefulness varies, directly, with distortions of prices. It also depends upon the ultimate choice of a government that bases its economic decisions on its own criterion of usefulness. Hence the interest of all the members of the community should be considered before a loan is granted to an individual member. In this study, however, such an interest is assumed to be reflected and to be amply represented in the scheme of priority that is envisaged by a planning body. This is, therefore, a case for selective credit control.

Our definition of the concept of credit would require and involve the manipulation of the means of payment on a general
plane, representing and stimulating an increase in the national wealth. It would also entail a selective control over the means of payments, intended to distribute such wealths according to a pre-determined pattern or to prevent their percolation in undesirable directions. How far this objective is achieved, in actuality, does not concern the theorist. It will, however, be our endeavour to examine the cases of close approximation to this ideal, in actual practice.

Another crucially important point is whether these two aspects of credit control - namely the general and the selective aspects are "irreductibles ou simplement complementaires? ... Plus exactement, l'un et l'autre controles peuvent-ils etre pratiques separement; l'un et l'autre doivent ils etre considerees comme necessairement intriques de par natures specifiques". The learned writer asks this question when he considers the quantitative and qualitative control of credit. For such a control a distinction is drawn between "vrais droit" and "fauz droit". The "vrais droit" finds its foundation, its legitimate and secure basis in an unequivocal reference to a quantity of good that is generally recognised as marketable, within a given range of its present value. The best example of this is the bill of exchange. In reality the appraisal of a credit as "vrait droit" is an attempt in probabilities. And a credit analyst, in this attempt has to synthesize many qualities that are as much numerous as they are various. For, there exists a "no man's land" a zone of indecision which makes

it difficult to analyse the constituent elements of creditworthiness. Whatever the difficulty, a banker attempts to ascertain the probable credit of his borrower. He will not give his money unless he can reasonably hope to recover it. He cannot act as a "philanthrope ou comme un candidat au suicide."

But even if the party to which credit is advanced has a "vrais droit" prima facie case should the money be advanced to him if the purpose of such a borrowing makes it a "faux droit". Money, for example, may be advanced by bankers in Bombay to Badliwalas who, in turn - albeit with adequate margin - give advances to brokers who may indulge in an orgy of speculation, so perilous to the stability of an economy. The Badliwala, in this case, is sure to honour his obligation to the bank. But the effects of such operations, under certain circumstances, are not desirable as they put undue premium on speculation.

It is felt by many eminent bankers that if the banks are obliged to maintain a fixed ratio between their deposits and their cash, the quantitative credit control would have the requisite repercussion on the qualitative evaluation of "vrais droit" and "faux droit". By eating into their holdings of cash, a monetary authority compels banks to scrutinise more closely the applications for loans. Apart from the feasibility of such variations in the reserve ratio of banks - whether effected directly or indirectly - the case of Badliwala is still left unanswered. Here comes the selective element in credit control which is more direct in its applicability.
That the general and the selective methods of credit control can be complementary is undoubted. In a completely planned economy, however, the general credit control loses its active role, in the transition period, and is generally replaced by the selective element which co-ordinates the financial plan with the material plan and devises the former as a check upon the execution of the latter.

In a mixed economy, everything depends upon the degree of mixedness and the growth of the economy in question. In England where stock exchanges are well-organised, the joint-stock banks are consolidated and centralised and where convention is enthroned in the seat of authority, indirect control of quantitative nature can, at times, prove very effective, while, in India, where such a growth is conspicuous by its non-existence, the selective element has to be more emphasised. That a form of selective control of credit was made inevitable, even to Great Britain, under the exigencies of war, shows its importance. The selective aspect was inherent in the continuance of the cheap money policy hedged about with stringent physical and capital investment control. In post-war Britain, the execution of certain priorities, under condition of shortages, necessitated the continuance of this form of selective control of investment and credit. How far, then, such a control is necessary to a planned economy afflicted with many shortages?
What is meant by credit analysis:

Credit investigation is likened to the rings that are relayed by a stone thrown into a pond of still water. The credit problem is where the stone pierces the water, and the waves that are created are elements that have bearings, either directly or remotely, upon the credit-risk. The credit man who is conscientious would try to analyse all these rings and find out the exact financial position of his customer. He would examine the balance sheet, the property statement of his customer, he would ask for information from other banks and would consult the national association of credit men. He does all these with an intent to ensure the final realisability and liquidity of his loan.

The credit analyst, however conscientious he may be, cannot but examine a fragment of the relevant evidence. In term of our earlier analogy, he can analyse, at the most, four or five rings. However, a credit that is granted may have far-reaching social consequences.

The Credit analysis and the underdeveloped economy:

Commercial banks that specialise in short-term advances for the marketing of crops, and supply the working capital of industries do this well, when they analyse the credit standing of their customers. In the agricultural sector, however, the facility for such an analysis is woefully lacking. Further, if a rapid progress is envisaged, short-term advances by the commercial banks is not and cannot be the only advances. The advances that have to be made are either for industrial
expansion, agricultural reconstruction or for the elimination and removal of certain retarditory factors that may be fraught with immense external economies, which economies accrue to and condition the growth of industries and firms or benefit the agricultural lands situated nearby.

It is clear, then that loans for such purposes cannot be of short-term character and may not easily lend themselves to credit analysis. In the following pages each one of these three cases is taken separately and is examined in greater details.

**Loans for Agricultural Reconstruction:**

The agricultural credit analyst, even in highly developed countries will have a difficult task before him. A rosy picture on the day the loan is made may be a dark one on the day the loan is due. Snow, storm, hail, flood, tornado, drought, blights, pests, grasshoppers etc. may damage the crops. Diseases, epidemics or accidents may strike down his livestock. Hence, the analyst cannot confine himself to the present, future is of much more relevance to him. Some of these hazards are, indeed, insurable. Yet the analyst has to depend upon such devices as price analysis and forcasting, taking them all in their historical perspective.

In an underdeveloped economy, apart from the non-existence of insurance, co-operative societies with widespread ramifications on a federal basis, and an all-inclusive net-work, and apart from the non-existence of scientific knowledge and chemical products to prevent plant or animal diseases, there
are other factors that a credit analyst has to take into account.

From a credit analyst point of view, the marginal analysis of farm lands is of utmost importance. Marginal analysis implies, firstly, the measurement of the increase or decrease of return on land, per unit of additional variable factors.

It, secondly, requires a land big enough to meet all the overhead and other costs and still leave a margin sufficiently large to defray all the debts and the interest charges.

For this an agricultural credit analyst has to examine the cost-price relationship and weigh the magnitude of the overhead cost, the latter reflecting the excessive fragmentation of agricultural holdings and also the extent of the pressure of population on land.

A) The Consideration of the Prime Cost:

Firstly, in an underdeveloped economy, the cost of cultivation or the prime cost, other than the overhead or supplementary cost, is generally very high. For, the technique of cultivation is antiquated and old. And this phenomenon has no relation to price variations. With an increase in prices, indeed, the cost of maintaining the bullocks and the price of other materials - besides the overhead cost - increases; and with a fall in prices a reversal in the trend is noticeable. But such variations, in cost, do not induce the illiterate farmer to rationalise his technique. This is chiefly because of the lack of technical know-how, education, the smallness of the agricultural holdings and the deficiency of credit. The social and religious aspects of the farmer's life, moreover, reinforces
these economic drawbacks. Higher castes arrogate a superiority complex, while those on the lower strata suffer from an inferiority complex. Both these aspects are detrimental to good farming. A Brahmin who does not cultivate his farm nor requisitions the services of his wife and children is a bad farmer compared with Kunbi or a traditional farmer. On the other hand, the lower castes and aborigines are steeped in ignorance and their technique of cultivation is antiquated and crude. They are further addicted to drinks and drugs.

These social and economic drawbacks make the farmer vulnerable, which have, in turn, far reaching economic significance. In a competitive market, the cheap agricultural commodities, produced by the application of modern technique, exert a downward pressure on the prices of such goods. That is to say the prices, in normal periods, will not be such as to cover the cost of the application of an undeveloped technique. This deficit, therefore, has its bearing upon rural indebtedness. Moreover, the impact of modern life, apart from having the least effect on rationalising a crude technique, has been very profound on the village economy. The self-sufficient villagers are becoming increasingly dependent upon a triangular system of exchange. The use of money however, needs circumspection and care which qualities are so grievously lacking in rural areas. Further, while a farmer's father used his bullocks, during the off-seasons to cart his crops, he is now using the more speedy means of transport. His wife in those days would grind the corn, while there is now a mill to replace this drudgery. All these are desirable changes, if an alternative
employment is provided for the displaced labour. This, however, is not the case. Thus there are additional burdens that a farmer has to bear, without, at the same time, being favourably affected by the modern method of cultivation.

The war years witnessed a rise in the price of all the commodities; and as the index numbers indicate such rise, in India, has been more pronounced in respect of agricultural commodities. The accuracy of the implication of such a statement as meaning a better condition for rural farmer cannot, in the absence of elaborate statistical data, be vouchsafed. This is because we do not possess the index number of commodities that are consumed by the agricultural labourers and secondly because we do not know how far the cost of cultivation has increased. This, however, should not debar us from arriving at certain tentative conclusions; in so far as the commodities consumed by the farmers are restricted, in range, and secondly in so far as the self-contained rural regions make the benefit from the increase in the cost of cultivation accrue to people living in the same area. The usual yardstick that is adopted for the measurement of this better agricultural condition is the variation in rural indebtedness.

Some attempts have been made to size up the extent of variations in the rural indebtedness. Dr. B. V. Narayanaswami Naidu, for example, gives us, in his Report on Rural Indebtedness, in Madras, the following figures.
**Table No. 1**

<table>
<thead>
<tr>
<th>Total debt of the Province</th>
<th>1939</th>
<th>1945</th>
<th>Percentage reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Debt</td>
<td>2,71,91,64,000</td>
<td>2,17,71,15,000</td>
<td></td>
</tr>
<tr>
<td>Per Family</td>
<td>318.8</td>
<td>255.5</td>
<td>19.9</td>
</tr>
<tr>
<td>Per Capita</td>
<td>51.0</td>
<td>40.8</td>
<td></td>
</tr>
</tbody>
</table>

Since 1942, according to the same Enquiry, there had been an additional debt to the tune of Rs. 27 crores, for the purchase of land and for other productive purposes. If this sum is taken into account and is deducted from the total debt outstanding, the gross reduction in debt would amount to eighty two crores of rupees.

Among other investigations, we have a survey by the Bombay Provincial Co-operative Societies in the Karnatak and Deccan regions of the Bombay province. According to this report, again there is a reduction in the rural indebtedness, between 1939-1944.

One can conclude that the agriculturists are, on the whole, benefited by the disparate rise in prices. Indeed, within the agricultural class there are numerous groups, which are not all benefited, to the same degree, and some of them, and in particular the agricultural labourers, have increased their debt, though the real burden, owing to the fall in the value of money, has been reduced for all. Here are some figures Naidu's report.

*Vide: page 35.*
**Table No. 2**

Position of different classes of agriculturists in Madras (\%age of fall (-) or rise (+) in 1947 as compared with the base year 1939)

<table>
<thead>
<tr>
<th>Big landlords 25 acres or more</th>
<th>Medium landlords (5-15)</th>
<th>Small landlords (bel.5)</th>
<th>Tenants</th>
<th>Landless Labourers</th>
</tr>
</thead>
<tbody>
<tr>
<td>- 39.9</td>
<td>- 24.6</td>
<td>- 12.3</td>
<td>+ 4.1</td>
<td>+ 45.6</td>
</tr>
</tbody>
</table>

The average fall in indebtedness for all groups, as is shown in the table, is 19.9 percent.

The perpetuation of such a trend is, indeed, dubious and already an opposite trend is noticeable. When prices fall, the deadweight of interest, rent and revenue is increased. In such times, again, the farmer finds himself in the throes of financial crisis.

It can, hence, be concluded that, in normal and depressionary time, we have a deficit agriculture. In inflationary period, the coverage of the agricultural cost, both the primary and the supplementary, is dependent upon the price differential between the agricultural goods and other goods which are either directly consumed by the farmer or are used for agricultural production.

B) The Overhead or Supplementary Cost considered:

The overhead cost may, now be subjected to careful scrutiny.

*Vide p. 42 (last col. of the 1st table in that page.*)
In a backward economy, this cost is of utmost significance. With population pressure on land and no alternative employment available, the supplementary cost cannot be pruned without reducing, further, the already low standard of living of the farmers. The extent of pressure on land, the degree of fragmentation of land and the sub-division of holdings are important points that give one an indication of the supplementary cost. Here are some figures showing the increasing pressure on land.

<table>
<thead>
<tr>
<th>Table No. 3</th>
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<tbody>
<tr>
<td><strong>Year</strong></td>
</tr>
<tr>
<td><strong>%age of population depending on land</strong></td>
</tr>
<tr>
<td><strong>Number of people depending on land (in million)</strong></td>
</tr>
<tr>
<td><strong>Number of people depending on non-agricultural occupation. (in million)</strong></td>
</tr>
<tr>
<td><strong>The total Population</strong></td>
</tr>
</tbody>
</table>

Source: Census Reports.

* There is hardly any increase over 1911 figures, owing to the influenza epidemic which seems to have affected the agricultural population most severely.


@ Population of India, Chandrasekar, 1950

# Census of India Paper No. 3, 1953.
Here we see that the pressure on land is increasing even though the percentage does not show a steep rise. The position after partition as compared with 1931 i.e. before the separation of Burma shows that, in absolute figure, the pressure on land, the size of which is reduced by the partition and by the separation of Burma, has increased to the tune of thirty million by 1951.

The increasing pressure on land would, therefore, lead to further fragmentation of land and the subdivision of holdings which has shown startling increases, in the past. The problem of fragmentation is different from that of sub-division of holdings. It refers to the scattered lands held by an individual, in plots separated by lands owned by other farmers. Fragmentation not only splits up lands into uneconomic holdings, but it also gives rise to the problem of distance. Sub-division, however, refers only to progressive diminution of land. Thus the two problems are inter-dependent, albeit distinct.

Apart from the pressure of population and the lack of alternative employment, laws and customs relating to inheritance of property which is compared with laws prevailing in the Russian Mir, "with strong emphasis on distributive justice" and which enforces the division, among the co-heirs, of all types of lands held by the testator; the lack of capital that

makes it difficult for one heir to purchase the entire land from his co-heirs; the social prestige that the possessor of land has - all these contribute to the sub-division and the fragmentation of holdings.

The effect of fragmentation, barring a few isolated exceptions, has invariably, been found to prevent the full-utilisation of land. The problem of distance is also to be solved. So long as it is there, time will be wasted and extra money will be required for the transfer of workers, draught animals and implements from place to place. Supervision over all these disjoint plots is rendered extremely difficult. The control of depredation by animals and birds is rendered difficult and more expensive. What is more serious is that improvement in land, even in a small way, becomes impracticable, especially when radical improvements such as soil conservation measures, mechanisation of agricultural operations and major irrigation and drainage schemes are being considered.

The following figures are illuminating:-
<table>
<thead>
<tr>
<th>Table No. 4</th>
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<tbody>
<tr>
<td><strong>Average Size of holdings (acres)</strong></td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>3.1 (4.9) $</td>
</tr>
<tr>
<td><strong>%age of No. of holding (bel. 5 acres)</strong></td>
</tr>
<tr>
<td><strong>%age of No. of holding under 10</strong></td>
</tr>
<tr>
<td><strong>%age of No. of holding under 15</strong></td>
</tr>
<tr>
<td><strong>%age of No. of holding under 25</strong></td>
</tr>
</tbody>
</table>

$ The Royal Commission on Agriculture in India, 1928
$ The Report of the Rural Banking Enquiry Committee, 1950
$ Figures for Orissa only, Report of the Land Revenue and Land Tenure Committee 1949. Appendix IX
$ Report of the Famine Inquiry Commission 1945
$ U.P. Zamindari, Abolition Committee Report, Vol.II.
If the holding of a size, falling below five acres is considered as uneconomical, most of the holdings in India, as table 4 shows are below five acres. Moreover, a recent survey undertaken by the Department of Research and Statistics, Reserve Bank of India, in connection with the study of land problems in India, show that almost 60 per cent of the holdings in Orissa and 66 per cent in Uttar Pradesh were below 3 acres, while in Madras almost 84 per cent of holdings were below five acres. In Punjab 60 per cent of holdings were below 5 acres while holdings below 15 acres constituted 88 per cent of the number of holdings. According to Captain S. P. Mohite, the number of holdings in Bombay State has increased from 1

We see, therefore, that the supplementary cost is not confined to mere additional maintenance charge. It has grave economic significance in as much as it causes the rapid subdivision and fragmentation of holdings which, according to the Famine Enquiry Commission, 1945, have increased, in Punjab from 43.4 per cent in 1928 (being the ratio of holdings below 3 acres to the total number of holdings) to 48.8 per cent., in 1939. Dr. Mann, in his survey of typical village in Poona district in Bombay State, has shown that the average holding shrunk from 40 acres in 1871 to 7 acres by 1914-1915. According to the Hyderabad Agrarian Reform

1. Co-operative Farming in Bombay Province, Published by the Government of India.
Committee, 1949, the average size of holdings decreased from 23 acres in 1880 to 14 acres by 1945-46. It is, therefore, clear that the prime cost of cultivation, if placed in conjunction with supplementary cost far exceeds, in the case of average farmer, his earnings from the land. A micro-credit analyst, in a backward economy cannot give loans to such farmers, with an expectation of getting his money back out of the income of the farm. The only alternative for the credit analyst is, therefore, to grant loan on the basis of the valuation of land, and in case of irredeemability to foreclose the land. The process of foreclosure is hastened by reason of over-valuation of land. Having no other channel to invest, people in backward regions, usually speculate on lands. The loan granted on such inflated values is in excess of the amount calculated on the basis of the capitalisation of earnings on land.

Another equally important point is that, in the absence of supervised credit, most of the loans is backward economies are used for unproductive purposes. They gradually become deadweights, impeding the progress of agriculture. Further, such supervised credits in the absence of warehousing facilities are not given by the ordinary commercial banks. It is, therefore, no wonder that the direct advances of the commercial banks for agricultural purposes other than for the purpose of marketing crops, has been very limited in amount. Such advances constituted, 2.3 per cent., in 1950,
2.2 per cent. in 1951 and 4.2 per cent. in 1952 of the total advances of all the Scheduled Banks in India.

2-Loans for Industrial Expansion:

Loans made for the expansion of an industrial concern, from the standpoint of a credit analyst leaves much to be desired. Such loans are necessarily long term in character and have to be preceded by technical investigation by expert agencies. In underdeveloped economies the feasibility of many schemes that need loans is limited.

The number of companies that have discontinued their business in India is an eye-opener to the real risk involved. The graph No. 1 puts the total number of companies, working at the end of respective years, the total paid up capital of all the registered companies working at the end of the year along with the total number of companies that have discontinued business. The red line indicative of the discontinuance of business is above the blue line. It only crosses the blue line in 1946 when a number of companies, with inadequate capital, were included in the list. The fact, however, remains that for every successful venture there is to be set more than one dismal failure.

The industrial investment in India, therefore, suffers from many deficiencies among the most significant of which the followings may be noted. There is, firstly, a need

1. Trend and Progress of Banking in India. More details are given in the fifth chapter.
for investment banks, issuing houses and investment trusts that would underwrite risk and associate themselves with technological investigations preceding the initiation of a scheme. There is secondly, a need for a discriminating public that is willing to avoid speculative ventures and shun the "get rich quick mentality". The chaotic conditions of stock exchanges, in India, with curb markets and independent dealers attached have aided and abetted this speculative trend. The importance of stock exchanges in India, in the absence of a capital market cannot be over-emphasised. It is because of certain warped structure - both of stock exchanges and of commodity markets - with inadequate machinery to control forward tradings that the works of the credit analyst is greatly complicated. In such a welter, the credit analyst may not get hold of any true criterion. Neither security quotations nor the actual production of a concern helps him much. If he relies upon market quotations unrelated to the profitability and productivity of a concern the method of evaluation may become easy but the risk of a debacle may not be easily safeguarded against. On the other hand to pin one's judgment upon profitability as a true criterion may mean an unexpected loss engendered by a liquidation caused by the alluring prospect of investment in commodities the prices of which happen to rise more rapidly. The genuine investor cannot go on without losing faith; and thus the speculative gambling by thwarting a true appraisal distorts the vision of a credit analyst. It is no wonder, therefore,
that the private sector has not, hitherto, been able to throw up any significant financial institutions with the exception of the now discredited managing agency system, in order to promote new industrial ventures and accelerate the process of industrialisation of the country.

1

The history of some of the industrial banks established in India, moreover, vindicates this conclusion. The failures of People's Bank of Lahore, the Bank of Burma and the Tata Industrial Bank are pointers to the same malady. The real shortcoming, some aver, is the inter-locking of authorities that tie down the safety of a bank to the financial standing of an industrial enterprise. This is more or less due to the paucity of business talent in the country, and cannot be overcome within the short compass of time. The suggestion sometimes made is the association of many banks with an issue as had been common, in Germany. This would lead, it is believed, to the diffusion of risks and the avoidance of interlocking of authorities. It has not, however, been noted how much funds the commercial banks can spare. For, their present short-term finance of trade, during busy seasons have, not unoften, to be supplemented with funds drawn from other quarters. Hence no permanent locking up of finance is conceivable without affecting trade or without compromising the soundness of such financial institutions.

1. Details are given in the fifth chapter.
The point that is to be conceded is that the risk factor in underdeveloped economies is greater than in other industrial countries. Apart from being subject to the "washtide" of cyclical waves that are primarily exogenous in their inceptions, such industries have to tug against many odds. The technical "know-how" is not widespread, the proper ethos for the growth of industry may not be present, there may not be a well-knit communication system, or cheap power or other ancillary firms and industries. Such industries have to bask under government's financial radiation and cannot be subjected to short-term credit analysis.

This is clearly brought out by the variation in the total paid up capital of registered companies. Most of the non-financial companies depend for their success upon their capital structure and the reserve that they can build by ploughing back their profits in the same or allied fields of production. If such a reserve is of quite a significant dimension, the inference is that the concern has been quite profitable. This induces similar ventures in the same field. Further, in India none of the industries are big enough to preclude the growth of other firms. Hence with the growth of new concerns in profitable fields we will have a proportional rise in the paid up capital of the companies working in the same field. This would furnish us with an index of the structural growth of capital determined by consumers' preferences and in some cases with producers' initiative in the field.
For the purpose of this study the strategic industries are grouped under three heads. Under the first category come all those industries that are autonomous of market conditions. The market condition is defined as the variation in the aggregate paid up capital of the registered companies working at the end of the year. As it is clear from graph No.1, jute, public services, engineering and estate, land and building companies come under this group. In the case of all these companies, save the engineering, the demand for their products and services is inelastic with a bias towards a shift in the demand curve. Water, gas, electricity are necessaries which cannot be dispensed with. Estate, Land and Building companies have also proved to be autonomous and that not because of inflexibility in supply and in jute India enjoys a semi-monopolistic position. In the case of engineering the supply is inelastic even when the demand shifts as is witnessed during the war. There is a slight rise in the total capital invested in the engineering industry, but the rise is by no means comparable with similar growth in other fields. This insensitivity may be attributed to the lack of technical "know-how" which has to be built up over a period of time. The trend is, perhaps, responsible for the "g-r-a-d-u-a-l rise" of the paid up capital of the industry as is depicted in the same graph.

The second group of industries are those that are moderately dependent upon market conditions. The movements of ship-
Graph No. 1.1

Paid-up capital of all the registered companies working at the end of the year (unit of measurement: Rs. 20 crores).

Paid-up capital of Cotton Mills (unit of measurement: Rs. 20 crores).
Paid-up capital of Jute Mills (unit of measurement: Rs. 20 crores).
Paid-up capital of basic services Cos. (unit Rs. 20 crores).
Paid-up capital of Estate, Land and Building Cos.
Paid-up capital of Steel, Iron and Shipbuilding Cos.
Paid-up capital of Engineering Cos.
Paid-up capital of railways, Metals, Coal, Stone, General.

Source: Ibid.
building, iron and steel and building materials are symmetrical. These industries, on the demand side, are dependent upon constructional activities. Such constructional activities are affected by cyclical changes, hence the sympathetic movement of the paid up capital of such companies.

The third group of industries are dependent on market conditions to a considerable extent. Cotton Mills furnish the best example. The dependence of Cotton Mills are not only shown by the lines in the graph but also by the susceptibility of the industry to mushroom growth under favourable conditions. Hence the flexibility or elasticity of supply. The demand being a function of general prosperity, the variation in demand is bound to be reflected in the supply. We have therefore, the great dependence of the industry on market conditions.

The degree to which the companies show sensitivity to the total variation in the paid up capital, measures, over a period of time, the degree of "unconscious priority" induced by the short-term consideration of profitability without adequate emphasis on national interest. We have, for example, the engineering, ship building, iron and steel industries making very insignificant improvement over a span of sixteen years (from 1921 to 1937). Nor has the paid up capital of building material companies improved till 1937. All these basic industries have to expand if other industries are to be built up rapidly. Credit analysis, as the past annals disclose, will not therefore result in much improvement, unless
undertaken on an aggregative plane by government.

3 - Finance for the Removal of Retarditory Factors:

The finance for projects that radiate much external economies without compensating advantages as regards their income-yielding potentialities to individual businessmen is not usually advanced by banking agencies and are not usually undertaken by private individuals. The risk involved, in such ventures, is great; the initial financial outlay considerable, and the subsidiary industries that have to spring up and bask under such external economies are not directly within the purview of the control exerciseable by private companies. Such financial concentrations, in the private sector of an economy is, moreover, rare and only a micro-credit analyst can recommend the schemes.

The size of the market is also important from this point of view. The smallness of the size of the market would require a synchronised application of capital to a wide range of different industries. This is due to the limited size of domestic market in a country with a low standard of living. If investment is concentrated in a single branch of industry, there is a strong possibility that the product of the industry will remain unsold. For, the domestic demand for the products being limited, an outlet has to be found in foreign markets. In the case of an infant industry this is an insuperable task, partly because the quality of the product of the industry

1. The position after 1946 is examined in the fifth chapter.
and its cost of production are not comparable with those of similar foreign products, and partly because the industry has to encounter stiff competition from well-connected foreign concerns. A synchronised application of capital by creating a domestic market for the product would, if not obviate, at least attenuate the difficulties. This happy culmination can result only, if there is a conscious planning for the industrial development of the country. A micro-credit analyst, confining his investigation, as he does, to a solitary field is not aware of all these intricate inter-relationships. And since he is aware of the lack of demand his counsel vouchsafes the abandonment of the scheme.

The credit analyst is, again oblivious of the importance of strategic and indivisible financial investments. Many maintain that the scale of investment, in underdeveloped economies, is bound to be concentrated. The credit analyst has little to contribute to this sphere. It is instructive to compare, in this connection, the per capita paid up capital of steling companies working in India but registered abroad, with the per capita paid up capital of similar Indian registered companies. If we take thirteen rupees for a pound, then in 1946-47 there had been nine foreign engineering companies working in India with an average of 590 lakhs of paid up capital as against 727 Indian engineering firms with just over one lakh of average paid up capital. In Iron, Steel, and Shipbuilding, again, the average per capita paid up capital
per sterling firm is twenty two lakhs as against three lakhs per Indian firm. In fact the mean average of paid up capital per company has been very low, in India, being just over two lakhs of rupees in 1946-47. The micro-credit analyst has not, at least, appreciated the necessity of such concentrated investments.

It is clear that obsession with the theory of liquidity and realisability of loans is one of the important factors that precludes from the compass of a micro-credit analyst (namely the private businessman) important cases with which a macro-credit analyst (namely the state) is mostly concerned. It is, therefore, important to analyse the relevance of the liquidity theory and see how far its stringent requirements can be waived in order to furnish the much needed funds.

What do we mean by Liquidity Theory:

The collection of loans and advances that are made by the financial institutions provides the student of banking with an interesting barometer which reflects the general economic trend of the country. With the appearance of sluggishness in the payment of loans, we may find increasing friction in the economy and a slackening in general prosperity. Such a slowness is equal to the ratio of past dues (i.e. of past dues in a given period of time) to the aggregate advances made within the same span of time.
i.e. The degree of slowness = Past dues (of that period)
    (in a given period) The aggregate advances of the period.

This formula indicates that an increase in the numerator accompanied by an equal or more than proportionate increase in the denominator is definitely not alarming.

The above formula can easily be converted into one that would test the liquidity of advances.

i.e. the degree of liquidity = The aggregate advances
    (in a given period) (of the period)
    The period's outstanding receivables.

This formula implies that a rise in the denominator, unaccompanied by a rise in the numerator reduces the liquidity of loans and hence our barometer oscillates round a perilous position. Liquidity is, on the other hand, infinite, if the denominator is zero. This means that all the loans made during the period is collected back and hence no permanent alteration in income-distribution has taken place.

Liquidity can, therefore, be defined as that quality of a loan which does not result in permanent alterations in the distribution of income.

The Relevance of the Liquidity Theory:

The lending tradition of the British and the American Banking system, as against that of the German's, has tended towards a reluctance in financing the long-term capital needs of industry and agriculture. This tradition is embedded in the belief that fixed capital goods and machinery lack, in exigent circumstances, that automatic liquidity with which the working capital and marketable consumers' goods are
invested. Hence investment in such self-liquidating assets is coveted by the commercial banks.

Such a tradition outlives its usefulness if it is stretched too far. We have, firstly, the growth of joint-stock corporations with limited liabilities and flexible ownership; and we have secondly a capital and bond market that invest the claim to illiquid equipments and fixed assets with a shiftability that is well-nigh tantamount to automatic liquidity. Marketability, therefore, is highly important from an individual bank's point of view. How far it ensures the liquidity of the banking system as a whole is a dilemma that is sought to be solved by making the central bank the shock-absorber of our economic system. This further gives a central bank an opportunity to set qualitative standards for the advances that are made.

Moreover, what is important is the increasing recognition that investment in short-term papers is not quite liquid, especially when, as a result of a host of unfavourable economic forces, the whole economic structure is torpedoed by a lapse in public confidence. Liquidity in this situation would involve the reinforcement of forces that are conducive to the intensification of depression. The following question and answer before the Indian Industrial Commission, 1916-18, on the question of bank failure is significant. "Q. - But you think that the banking system was good, although they were not even able to pay? - A. - I beg your pardon I did not say that. Q. - Except one or two banks? - A. - The
whole system was destroyed. How could you expect them to pay? The credit of no country can be converted into cash at a moment's notice. That is not possible."

This is chiefly because, usually, short-term loans are renewed. In India for example, the short-term funds are used for the supply of the working capital to industries and for marketing of the agricultural produce. Indeed, owing primarily to the hazards to which agriculture is subject and also because of the absence of storage facilities, the advances made by the commercial banks to agriculturists are very limited. However, most of the funds of commercial banks seep, indirectly, through traders, into the hands of cultivators. Such loans are primarily used for the short-term needs of the cultivator and for the marketing of their crops. These loans are renewed year after year. To suggest, therefore, that loans should be made liquid, on a vast scale, is to imply that industries should be left without working capital and trades without funds to market their agricultural produce. This, indeed, would lead to the virtual collapse of our economy.

Thus we see that the concept of total liquidity has not much to commend itself either to the advanced countries, where the stalling of the incubus of unemployment is the prime task of their governments; or to underdeveloped economies, where

the finance of agriculture and the development of industries, with much external economies, but with no immediate tangible return, is an axiom of their economic policy and of their monetary creed.

The Liquidity Theory, and the Qualitative Credit Control:

It is the contention of the advocates of the qualitative credit control that if all loans are made liquid the system can, with impunity, dispense with quantitative credit controls. Moreover, since the inanity of volumetric controls has been demonstrated in the Great Depression, it is said that we have to substitute the "conscious control of credit by man" with "automatic elasticity."

This would involve, firstly, a stricter definition of eligible papers, secondly, a decrease in the purchase of securities by the central banks, since the use to which the money is put by the public, after it is being released by a central bank, cannot be dictated by the monetary authority. Thirdly, it would also mean that the bill market should not be encouraged and should be allowed to stand on its own feet. This is because misuse, in practice, creeps in, when there is firstly, renewal of maturing drafts by new ones; when, secondly, such bills are used as collection instruments for

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1. e.g. Whitney says, "... Therefore, the limitation of banks loans to liquid loans, while diminishing the size of banks, would remove the necessity for the exercise of quantitative credit control - a form of control which has never been successfully applied." Vide "Experiments in Credit Control," N.York, 1934, p. 187.
unpaid accounts; and when, thirdly, insufficient credit analysis accompanies the drafting of bills. Finally, attempts should be made to expel government bonds from banking portfolio, otherwise the discount of such papers would give banks cash which might be made the basis of multifold creation of credit; it also provides them with a means to escape the rigours of central banking supervision.

If such attempts prove futile, there should be increasing supervision, by the monetary authority, over the lending operations of banks.

The criticism against this approach has been that such writers "set off idealistically conceived theories against those which have sustained the buffeting that experience always produces." Miss Whitney, however, in a comment states that individual banks which were tenaciously adhering to such a principle, did survive, without closing their doors, the worst crisis of the 'thirties; and that the experience of British banks is another supreme example which vindicates the same viewpoint.

Limitation of the Shiftability Theory:

When banks hold securities, the real danger is that the money that they release may not be used for the liquidation of some other type of loan and consequently the volume of a bank's liabilities, in the form of time and demand deposits,

and the volume of its assets, in the form of securities, increase. This increase enlarges the "area which is exposed to the risk of sudden pressure for liquidation". Such a liquidation need not necessarily mean economic collapse. It may only mean the cancellation of assets and liabilities of the banking system. What is serious, however, is the worsening in the quality of the assets of banks. In order to cancel the liabilities, the most liquid asset is dispensed with and thus the confidence of the public in the soundness of the banking system is shaken.

**India and the Shiftability Theory:**

In a future chapter the asset structure of the banking system is considered. It is, however, appropriate to examine the recent views, as it was given vent to, in the Report of the Committee on Finance for the Private Sector. Banks have maintained that "with their present resources, they cannot make advances to industries on a long-term basis." But they would be willing to do so, on a limited basis, if they are enabled to obtain loans from the Reserve Bank against such advances. The Committee, however, believes that it would not be desirable to encourage a tendency "on the part of banks to lean on the Reserve Bank for providing liquidity against these advances, which they make on their own judgement and initiative." The Committee feels, however, that indirect

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assistance within the same liquidity pattern of the commercial banking asset portfolio is possible. It, therefore, envisages the formation of a consortium under the leadership of the Imperial Bank of India, with the association of the insurance companies. The consortium has to underwrite or invest in new issues of shares and debentures of industrial companies, wherever it is satisfied of the soundness and the prospects of the schemes. It is felt that if banks earmark five per cent. of their deposits for investment in new issues of shares and debentures of industrial companies, no impairment of their liquidity position would result. This, however, would mean the availability of an additional thirty crores of rupees for long-term investments. These loans are not to be made shift-able. Further, the Committee recommends that in order to facilitate investments by banks, in the shares of the Industrial Finance Corporation of India and the various State Financial Corporations and the shares and bonds of State Transport Agencies which are guaranteed by the Central or the respective State Governments - in short, if they invest in trustee securities - such investments should be accepted for the purpose of advances granted under Section 17(4)(a) of the Reserve Bank of India Act. The Committee, however, recognises the right of the Reserve Bank to do otherwise, if the grant of the facility would militate against the credit policy of the Reserve Bank.

It is, moreover, felt that statutory restrictions placed on the amount of shares that could be held by different classes
of investors are not conducive to easing marketability of such shares. Such restrictions are, therefore, to be removed so far as the shares of the Finance Corporations are concerned.

It is rather paradoxical that the Shroff Committee while conceding the stagnant position of the banking system which makes the expansion of their short term credit to the tune of Rs.158 crores, as visualised by the Five Year Plan, an extremely unlikely proposition, suggests the consortium scheme discussed above, without making such investments eligible securities for the purpose of obtaining loans from the Reserve Bank of India, on the plea that banks make such advances on their own judgements and initiative. That the commercial banks have, hitherto, refrained from making such advances goes to show that they do not want to make such advances and they shall do this only if they are given adequate security. Moreover, it is difficult to understand why the investment portfolio of banks, in India, is compared with those obtaining in other countries. For, as foregoing pages attempted to show the risk factor is different in the two economies.

There is, therefore, an undercurrent of feeling that it would have been more appropriate if investment in certain industries or concerns were made eligible for long term advances. It is possible to pick up such firms, preferably from among those that have obtained licences under the Industries (Development and Regulation) Act, 1951, and which government considers investment in them, according to the criteria that the technological and other sections of the
Industrial Finance Corporation follow, as sound and desirable. In the context of an integrated approach as is suggested in the fifth and the sixth chapters, investments in the shares of a selected number of firms should be made eligible for long-term advances.

For this proposal the following merits can be claimed. Firstly, since such firms have to obtain special licences besides meeting the requirements of the Capital Issue Controller which is proposed to be made very scientific and since they are periodically inspected and special boards are instituted to expedite their development and expansion, at the same time to rectify their faulty operations, the risk factor is minimized and is conceded to be worth Shouldering. Secondly, by making such loans eligible as securities for the purpose of loans from the Reserve Bank or more appropriately from the Industrial Finance Corporation of India the objective of expanding the short-term credit to the tune of Rs. 158 crores is made more easily attainable. Further, such a step would establish a liaison between the Industrial Finance Corporation and the consortium which reinforces the integrated approach suggested in the fifth and the sixth chapters and makes for a true consistency in economic planning.

There are other proposals made by the Committee to assure liquidity and to impart flexibility. These include the schemes for enlarging the bill market, for liberalising the

1. Vide: Fifth Chapter.
remittance facilities.

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The Ambit of Credit Control

Credit control denotes a control over the total volume of money and its distribution, in other words a control over the cost, the availability and the volume of money. The volume of money means the amount of notes, coins and bank deposits held by the public. The availability of money depends on the willingness and ability of banks to create additional credit, which is incidentally an important point in analytical credit. The cost of money is the rate of interest charged.

This definition is, however, very narrow, in so far as no sharp line can be drawn between money and a variety of other liquid assets, especially the government securities. Moreover, a change in money supply produces counterbalancing or reinforcing effects, on other types of liquid assets. These effects will have to be taken into account when a certain monetary policy is being pursued. An increase in the economic activity can, for example, be achieved by the generation of additional reserve through open-market operation or it can be achieved by the borrowings of government from the public. In the former case, the money supply is increased, while in the latter case its supply remains stationary. It is, however, possible that the latter step would increase public's propensity to consume and to invest
more than in the former case. This is because of the guaranteed convertibility of government papers, at par, into cash. In the first case, however, an increase in the total cash supply would, pari passu, increase the liabilities of the public and would therefore, be less conducive to increased future propensity to consume and to invest.

It is clear, therefore, that the total liquid asset position of the public and the composition of such assets (whether government securities or other types of securities) are more important for many purposes than the total supply of money.

Credit control, therefore, encompasses, within its fold, a number of fiscal measures, other than the usual central bank credit policy. It includes, for example, the debt policy, the deficit or surplus finance and the lending policy of government agencies.

The Radius of Credit Control and the Central Bank:

Ideally speaking, in order that the monetary policy of a country should be effective, the range of the central banking control should be extended to all forms of credit. In reality, however, the radius of central banking control is restricted to banks only. There are other sources of non-bank credit which are not the direct offspring of the "credit-creating potential" of banks. These credits are directly drawn from capital and can, therefore, be called "Capital Credit".

Even among banks, the susceptibility to the central banking control is not uniform. Generally speaking, commercial banks are directly influenced by the operations of a central bank. In England, for example, the control exercised over the Big Five Banks is comparatively more direct, decisive and all-inclusive than in India. The commercial banks, in India, are heterogeneous in character and for the purpose of control are disintegrated and improperly organised. Among the organised commercial banks, apart from the exchange banks, we have the scheduled banks and most of the non-scheduled banks. The unorganised sector consists of indigenous bankers and the money lenders. How far this segment can be included in or precluded from the class that creates "capital credit" is a matter for speculation and conjecture. The reason that impels us to include them under this class stems from the possibility of bringing them within the fold of the organised sector. Such a scheme will be discussed in a latter chapter.

The segment that is generally less susceptible to central banking control includes agricultural co-operative credit societies, industrial banks, building societies, mortgage banks, insurance companies, trust companies, and other societies. Since, the policy of most of these banks and financial concerns are not seasonal and therefore, short term the control exercised over them should be in conformity with the long-term economic policy of a state. This segment of the banking sector may be subjected to the moral suasion of the central bank, and in India, all of them are subject both to
the overall control exercised over the capital market, as well as to specific statutes.

The "Capital Credit" and the credit generating capacity of the public, is not, however, under the direct influence of the central bank. To control this sector, it is necessary to control public opinion.

Hence we see the insuperable difficulties with which a central bank, in a truly uncontrolled enterprise economy, has to grapple. This difficulty becomes more acute as the instability and fluidity of the insensitive sector grows. This fluidity depends for its final shape upon the economic, political and psychological factors.

It is sometimes averred that the grant of credit should be related to the use to which it is put. But any attempt to determine the ultimate distribution of credit, without direct intervention, would prove futile. The immediate distribution of credit can, indeed, be brought under central banking control. But its ultimate use, once credit is released, is effected by the people. This latter cannot be brought within the radius of the control exercised by a central bank, without a complex system of economic controls.

To say this is not to state that, given a certain mechanism, the immediate distribution of credit is not possible. As the analyses of the fourth chapter demonstrate Konto Korrent Verbundung can, roughly determine the pattern of investment. It seems that such a Verbundung is desirable and possible in India, at least between a certain specified
class of banks participating in the formation of the consortium proposed by the Shroff Committee and the industries mentioned in the First Schedule to the Industries (Development and Regulation) Act, 1951. This has to be supplemented with the control of strategic materials, whenever the need for such a control is felt, and also the control of the capital market on a more scientific basis. This latter control can be entrusted to the "Corporate Investment and Administration Commission" proposed by the Bhabha Committee Report on the Company Law. Such a measure would not only establish a liaison between the planning commission, the Industrial Finance Corporation, the Corporate Investment and Administration Commission, the commercial banks that participate in the proposed consortium and the Reserve Bank of India; it also ensures a proper machinery for planning the distribution of funds. Thus the money supplied to the public might not be directly amenable to the control exercised by the central bank. But it is seen that through the operations of these various controls, financial resources do not percolate in directions which are considered, from economic point of view, as less desirable.

Besides these problems, there may be foreign exchange complications also. Money can be created by an untimely inflow of gold, as it has often happened in America. It is maintained by Plumpton that the internal elasticity of finance, in many dependent economies, is based on exchange position. Hence a plentiful or niggardly supply of such
resources affect the credit base of an economy. In the present thesis the assumption is that such ups and downs are controllable by such devices, as foreign exchange stabilisation account, the issue of special certificate modelled on the experience of Argentina, the Australian system of Special Account modified to suit the foreign exchange policy of the monetary authorities and the variable reserve ratio that may be confined to exchange banks - both Indian and foreign. Hence insulation is possible and apart from discussing some of these devices, it is not intended, while recognising the implications and the remedies, to complicate the general and selective consideration of credit with exogenous intrusions.

It can be seen, therefore, that a proper general and selective credit policy requires the co-ordination of fiscal, monetary and exchange policies, and also the co-operation of the public and government agencies.

Credit control and the operations of banks:

In the operation of banks two features stand out prominently. These are, firstly, the "roosting" of funds in the coffers of banks and secondly their multifold dispersal among those worthy of credit. Control in this work will, therefore, mean the attuning the tempo of both these operations, on the one hand, to the inflationary dangers latent in a developing economy, and on the other hand, to the investment pattern that is visualised by a planning body.

However, Goldenweiser, in his Monetary Management asserts,
"From the banks' viewpoint, deposits are a passive item, the banks receive them and pay them out at the customers' discretion. Loans and investment, on the other hand, are the active or dynamic side of the bank's operations .... Consequently, credit or monetary policy, which is intended to influence bank operations, must address itself largely to exerting an influence on the lending and the investing operations of the banks."

**Feeder and the Canal:**

Here it is proper to distinguish between banks that are primarily "feeders" and banks that are mainly "canals". The former term is, in a word, the character sketch of such banks that are concerned, above all, with the collection of deposits; while the latter term points at such banks that are primarily distributive channels, conveying faithfully, the impulses that are generated from the top to the different layers of economy. In earlier periods, the banking system, in advanced countries, had to evolve painfully from the position of a "feeder" to that of a "canal". Hence we have, at present, the passivity of their deposit and the dynamic character of their loans and investments.

In an underdeveloped economy, however, the liability side of banks is not well-developed. With the absence of adequate mechanism for the mobilisation, collection and utilisation of the savings of the people and a proper ethos for the growth of confidence in banking institutions, the deposit-side of a bank has a dynamic aspect. This is especially true of the rural finance. The Rural Banking Enquiry Committee e.g. avers: "It has been represented to us by several people that the problem of rural banking is primarily that of
devising a satisfactory machinery for the supply of rural credit. While we appreciate the importance of this problem .... the emphasis must, in the context of present economic situation be on facilities for mobilisation of rural savings."

It has, hitherto, been assumed that the rural saving is very limited and cannot be made available to the banking system of the country. The experience of the co-operative societies which depend for funds, mostly upon the urban supply, and the arguments of the preceding pages in assuming agriculture to be a deficit industry seem to give much weight to this line of reasoning. The earlier statement needs, however, modifications in so far as it does not take into consideration the stratification among the rural populace. The wealthier section of our rural people do save; sometimes they loan out this saving to others or invest in their own lands or hoard it in the form of precious metal.

In emphasising the dynamic character of the liability side of the banking portfolio, in a backward economy, a note of caution should also be struck. The practice of opening branches in the rural sector, with an intent to siphon off whatever fund is available to sectors already developed is naturally not desirable. This calls for a re-examination of the organisational framework of the agricultural finance which is proposed to be taken up as a part of a future chapter.
The "Dynamic Side" of the Banking Control:

The dynamic side of a bank's operation is by no means so dynamic, especially in a period of falling income and investment. Commercial banks in such periods prefer secure advances to investments, the onus of a loss in the former case being squarely on the borrower. It is, thus, evident that with a low marginal efficiency of investment, there will be a contraction both in the advances made by the commercial banks and also in the investments undertaken by them. The cumulative result of such contractions will be a rise in cash ratios of banks and a change in the structure of their assets and liabilities. Government securities may, under such circumstances, give the commercial banks the most attractive earning assets. It follows that in underdeveloped countries, where long term investment is at a discount, the banking institutions can serve as a siphoning mechanism for the finance of industries in which government is interested.

There is thus the dynamic problem of saving, which is a part of credit control. For credit means the transfer of control but not ownership. The dynamic side of this credit problem is primarily concerned with fostering such ethos that promote this transfer of control, increasingly, so that the people who cannot make use of their own resources may contribute in enabling other to do so.

In many advanced countries this transfer takes place with extreme ease. For, people have confidence in the soundness of financial institutions and the prospects of the public and
private companies. In a backward economy, however, such an ethos is to be zealously promoted.

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Scheme of the Present Thesis

Summary:

In viewing credit three definitions are synthesised. These definitions are representative of the viewpoints of creditors, the debtors and the nation.

The first definition speaks of credit as the transfer of control without the transfer of ownership. Thus people save and put their money in banks, or buy a policy, invest in securities and debentures in the hope of earning something on their savings.

From the point of view of a debtor "credit" is a potential right to obtain money - either because of the adequacy of collateral securities or because of the desirability of the scheme. The potential rights of the individual citizens, in this respect, need co-ordination in case financial resources are not adequate to meet all these sundry requirements.

Above all, such financial disbursements need co-ordination and integration with the objectives of a society, as is for the purpose of this study, outlined by the Planning Commission.

From the national point of view "credit" means an inherent right, on behalf of the citizens, to acquire money in ways other than taxation, in order to see through certain national schemes.
Control also has its three sidelights, corresponding to the above considerations.

The monetary writers of advanced countries view the mobilisation of saving as a rather passive function of the credit institutions. A more dynamic role is, however, attributed to investment, loans and advance policies. While not underestimating the importance of the so called "dynamic" side, recognition is due, in an underdeveloped economy, to the passive side. A chapter is, therefore, devoted to the study of the dynamics of saving, with special emphasis on saving as a problem of confidence. This is meant to meet the needed control from the creditors' standpoint.

Control of credit from the other remaining two points of view implies the imposition of a brake on credit facilities enjoyed by, or the grant of subsidized credit facilities to, the private sector, in general, or to any of its parts, in particular, in the interest of co-ordination, planning and the maximum utilisation of people's savings.

Credit control, grafted with the threefold objectives set down above, is exercised in the national interest over the prospective debtors' claims or over their claims for preferential treatments of which government's claim is but one. It also is an attempt to see that creditors' claims are not bypassed so far as the enforcement of such claims results in the mobilisation of the financial resources of the country in organised agencies which are susceptible to the control of a central authority.
Thus the term control is used in a broader sense. It not only deals with the imposition of restraint upon certain sector or relaxation of such a control in regard to another sector, but it also examines the consequence of such a relaxation in so far as it leads to greater credit facilities or otherwise to other sectors. Further, credit control is used in singular form signifying a unified control emanating from a "conscious will" or a coalition of such wills, in order to effect changes in accordance with a priority scheme.

Thus defined, the exercise of control over the debtors' claims can be either in a general or in a selective form. The two types of control are not, however, exclusive or incompatible. From our point of view, while general credit control aims at stability, the selective credit control aims at progress. It can, therefore, be said that the perspective of the present thesis is the development of a backward economy without resort to inflationary method.

Selectivity is viewed, however, primarily in a re-organised institutional setting which it inevitably entails. Thus, the establishment of specialised institutions for the purpose of directing funds to certain sectors or the control exercised over the use of funds in such particular sectors falls within the scope of the present thesis.

Selectivity, though involves preferential treatment, is viewed as one of the steps that would help in obliterating certain factors which go in making uneconomic holdings, whether agricultural or industrial. Thus the sequel to a
selective credit policy is not bad debts and hidden subsidies in order to conceal the real shortcomings. Selectivity is only one of the steps needed for fostering a balanced development.

**Chapter Scheme:**

In the first chapter an attempt is made to show how dependence on micro credit analysis and the free functioning of supply and demand mechanism in a backward economy prevents the flow of funds, in right quantity, in desirable channels. Analytical credit, in an underdeveloped economy is, then examined with particular emphasis on, the scope for investment in agriculture and in industry, and also on certain indivisible outlays. In this analysis, the outstanding fact is the vindication of the need for selective and, therefore, subsidized distribution of funds for certain distinct purposes.

The second chapter is the first part of an exploration in the recent annals of credit policies. It is mainly pre-occupied with such policies in advanced economies. The second part which constitutes the last chapter of the thesis views, in the light of previous analyses, the pursuit of credit policies in India. In the second chapter, however, the credit policies of a number of advanced countries are reviewed and recent reorientations, in the trend, are examined.

The third chapter deals with the mechanics of control. The various weapons used are discussed and their limitations are noted. It is seen that owing to a disintegrated banking system, in India, the general and selective weapons of credit
control are of limited applicability, as weapons of a central bank. Nor is it possible, in the absence of a centralised banking system, to build up such precedents which would make the selective control of credit democratic. The absence of centralisation - exemplified by America, is a significant warning. The moral suasion used in England for much of selective distribution of credit is a sufficient case for centralisation and integration of the various discordant elements.

The fourth chapter, therefore, examines the mechanism needed for the extension of the sphere of credit control in India and a great emphasis is laid on concentration and amalgamation of banking resources. Branch banking is also examined in order to see how far the field of organised sector amenable to control can be widened. Bill Market, the integration of indigenous banking, the remittance facilities are other important points that are examined in the chapter.

The fifth chapter deals with selectivity in the distribution of the investment resources. The imposition of control over the capital market is viewed in the perspective of the targets set down by the Planning Commission. Further, institutional organisation of the capital market is also viewed along with the statutory inhibitions and directions. The capital market, from this point, is divided into two parts, one providing primarily for the needs of the urban area and the other for rural requirements. Both the sectors are, further, classified according to the degree to which
they are susceptible to statutory controls. In the urban sector three classes are recognisable. These are: (a) specialised institutional organisations such as the I.F.Cs., and for the purpose of comprehensiveness the aids given under the States Aids to Industries Acts are also reviewed, side by side; (b) those financial institutions, the investment, loans and advance policy of which are subject to a great degree of control and (c) those institutions that are not subject to specific controls but which are or can be made subject to the overall and, therefore, the less direct control exercised over the capital market under the Capital Issue Control Act. In this last group are included the managing agents, their friends and associates; the investment trusts, and the public, through the intermediary of brokers. The control of the last group can be made more tractable by the proposed regulation of the stock markets.

Thus, while some of these constituents are subject to direct control all of them are within the ambit of the control vested in the hands of the Controller of the Capital Issue Market. As for the specialised institutions, the I.F.C. of India has the machinery for supervised distribution of credit. The state IFCs have still to develop such a machinery. Here, therefore, the scheduled banks can be of some help and the Reserve Bank being a member of all these IFCs, as well as the moving force behind the organised banking system, is a proper agency for bringing about a machinery that would channelise the funds of the IFCs on a supervised basis.
Indeed, the section on amalgamation and branch expansion of the fourth chapter is significant from this point of view. This is especially urgent in view of the fact that unlike the IFC of India the state bodies advance loans to medium and small scale industries scattered far and wide. This makes the task of supervision particularly difficult. In the second group, banks are under the statutory control of the Reserve Bank; and the "controlled fund" of Insurance Companies, again, leaves them almost no choice as to whether they should invest in the approved securities or not. The control that can be exercised over the third group can be divided into two. Under the first caption come those industries that require funds, above five lakhs of rupees which under the existing laws have to obtain the sanction of the Controller. Since the IFC of India also deals with such industries, its machinery may be utilised for the purpose of such a supervised control. If the control is extended to such requirements that are below five lakhs, the machinery suggested for the IFC of states may be utilised for the supervised distribution of investment in this field as well.

This organisational set up of the capital market viewed in the setting of a less turbulent and, therefore, a better regulated stock exchanges conjures up the possibility of establishing the needed mechanism for the planned distribution of resources which is the starting point of the selective control of long term credit.
As for rural credit, in the light of the analyses of the fourth chapter, on the question of branch expansion, amalgamation and the indigenous banking system and the examination of the purpose-wise distribution of the funds of the commercial banks, in the present chapter, it is clear that the institutional organisation needed for channelising funds for production purpose, in this sector - as contrasted with such organisational set-up needed for marketing purposes - cannot be the ordinary commercial banks and the non-sympathetic moneylenders. Thus, despite the failure of the co-operative movement, it is the only agency that can touch the lowest layer of the economy and bring to the fold of organised and supervised credit system the rural population of the country. Hence the need both for overhauling and strengthening the movement, under the aegis of the Government and the Reserve Bank of India. Among the agencies which have to be set up in order to expedite the movement, mention may be made of the State Bank of India, the National Co-operative Development and Warehousing Board, the All India Warehousing Corporation and the State Warehousing Companies. In this part, therefore, an attempt is made to analyse the record of the Reserve Bank of India and the Co-operatives, in the light of the preceding study and in the context of the aims and the objectives of the Five Year Plan. The credit facility needed for marketing of agricultural produce which can be increased by the development of licensed warehouses is a subject which is studied in the fourth chapter under the "Bill Market" and a flexible system of finance.
The sixth chapter deals with the "dynamics of saving" in an underdeveloped economy. It analyses saving as a problem of confidence. Thus the company law, the banking, the insurance laws are reviewed and some attention is also given to co-operative laws. Stock market and forward trading in commodities also are examined with a view to finding out what steps would be necessary to make variation in prices correspond as closely as possible to the discounted prospective yield of securities, thus doing away with bear raids, corners and manipulation, in order to foster the growth of permanent interest by the investors and establish the ideal condition for the diversion of funds into proper channels.

The seventh chapter is the concluding part of the second chapter. It views the credit policy, in India, in the light of the foregoing chapters and examines the scope of deficit financing and its 'de-selective' effects, if it is carried beyond the safe limits. This aspect assumes importance in view of the difficulty in regulating the stock and the commodity markets and also in the administrative problems involved in having an impeccable system of physical control. In the context of a few tables of economic indicators the chapter also analyses the credit policies pursued in India, since the establishment of the Reserve Bank of India.