CHAPTER 9

CONCLUSION

The foregoing study may now be broadly concluded. Since the summary is made at the end of each stage and conclusions drawn at the end of each chapter, we put up only the broad observations below:

4.1 Conclusions in general:-

(1) It is found that RBI had attempted to influence and regulate level of credit to some specific sector even prior to 1956 on quite a few occasions. It had also tried to help development of sound banking practices and money market. This shows that even prior to second plan period the seeds of qualitative monetary policy were sown. Even the concept of development with stability as an objective of monetary policy seems to have taken firm shape prior to 1956. In fact, prior to the change in bank rate in 1951, some of the actions taken by RBI can be termed as qualitative actions.

(2) The quantitative tools employed, during and after the second five year plan period have been given in most of the cases some qualitative colour. This was but a natural outcome to achieve the objective of the development with stability. Although overall regulation in monetary expansion is necessary for achieving the above goal,
preventing undue price rise of essential commodities by credit management can also be helpful. Thus rather than having monetary management RBI has managed credit. Even in the field of credit management, it is credit to the private sector only that is regulated (1). This shows that the credit policy of the RBI is qualitative in a way. Even while managing cost and availability of total credit, it had taken care to see that certain priority sectors such as small scale industries, export, agriculture etc., are not only given enough credit but are given credit at a preferential rate. Credit given to credit distribution agencies such as FCI was exempted from net liquidity ratio calculations. Even when tightened credit policy aiming at general price stability was followed, exceptions and certain preferential treatments continued. Of course, these have reduced the effectiveness of tight policy in controlling the price rise. It may be noted that net bank credit to the government sector seems to be the main factor influencing the total money supply and this has remained outside the control of Reserve Bank of India. 

(1) A. Rao is of the opinion that monetary policy has not been successful in controlling credit expansion mainly because of advances to priority sectors, credit to public sector for stock holding, credit to sick mills and changes in foreign reserves. For details please see
Qualitative monetary controls in most of the cases were employed with the objective of restraining price rise of various commodities resulting from hoarding with the help of bank finance. It seems prices have continued to rise, despite the regulation. One could argue that in the absence of such regulation, price situation could have been worse. Prices could not be controlled partly because bank credit played a very minor role in the total finance. Regression exercises indicate that in most of the cases, market arrival, current as well as past and income current as well as past and the trend factor have played major roles in price determination. In a few cases, credit as a variable has appeared as a demand pull factor in a regression exercise, but this factor generally disappear in the following period indicating that RBI must have succeeded in credit regulation. Moreover, in a few cases, regulations were not tight enough to reduce the effect of credit on prices. In those cases where credit as a variable is not present as a demand factor in the exercises, RBI can probably say that it has succeeded in preventing credit level from influencing the prices.

S. K. Rao, 'on Some Aspects of Monetary Policy in India: A Note' in Recent Development in Monetary Theory and Policy - RBI Publication, 1978, pp. 69-75. This may be important even for the period covered by our study.
Another objective of the qualitative monetary control was that of providing sufficient credit for genuine trading purposes. However, after 1959, helping state governments in their procurement programmes has become a major objective. After the establishment of the Food Corporation of India, the entire credit needs of this institution were taken care of. RBI itself has accepted that private traders' share is virtually negligible. So the second objective of providing credit for genuine trading requirement can be said to have not been realised.

As a part of the objective of price regulation, RBI has aimed at preventing hoarding financed by bank credit. By and large this objective is fulfilled, but this does not mean that hoarding has not taken place. Traders might have switched over to alternative channels such as non-bank financial intermediaries, own funds and unaccounted money etc. Such hoarding could have been undertaken is also supported by the fact that government issues repeated warnings and legislation is also provided. So commercial banks do not seem to have financed hoarding but hoarding might have been financed by other channels. Costlier these alternate channels, worse would be its effect on prices due to increasing cost.

It is observed that generally these regulations
were effective in influencing the level of credit. There are instances of absence of any effect in the beginning or rather of late effect but generally they are effective in controlling the level of credit. The reason for its being not effective in the beginning may be that advances are already committed.(3).

(7) It is also found that these controls are more effective when undertaken with other qualitative tool, namely the margin. In this sense, it is observed that in cases where margin and ceiling both are employed together they are more effective rather than where only one tool is employed.

(8) It is also found that these tools are more effective when employed with other quantitative tools and this is confirmed by ROI also.(4).

(9) On a number of occasions, ROI did not apply the regulations even though the credit level was high as compared to the level of market arrival probably because prices were falling. On a few occasions, ROI failed to apply regulations in time even though credit and prices were rising and some times it withdrew regulations earlier than necessary as for example in case of rice on 14 November 1936.
(10) It is also found that credit regulation has checked the growth of credit yet its level remained very high in a few cases. This may indicate that I could not have judged the required level of credit.

(11) Partly in order to plug the loopholes and partly to prevent hoarding, regulations were extended to other commodities also. This is the reason why other food-grains and other oilseeds were brought under the control. Regulating clean advances is an attempt to control by-passing specific regulations.

(12) In order to control credit availability from other channels, cooperative banks were also brought under the control frame. However, it could not prevent traders from getting funds from other sources.

(13) Tools employed for the purposes of qualitative regulations are mainly margin, ceiling over advances to individual and ceiling on advances against a particular security. After January 1970, rate of interest is also added as a tool of qualitative control. Ceiling over individual advances was withdrawn for a few years, but after the 1971, it is the main tool. RBI has inserted great flexibility to its policy. It has been always ready to adjust to the changing situation and generally operated the controls keeping in view the crises and market arrival.
 RBI has changed regulations to help specific sectors, regions or activity. Also it has employed both the tools, margin and ceiling with great differentiation. It has also learned from its own experience and changed the ceiling period from weekly basis to monthly basis and then to two month basis and so on. Sometimes regulations were maintained just for precautionary purposes, and sometimes regulations were more restrictive than necessary.

(14) One notable feature of the policy is that it has attempted to pursue a number of objectives simultaneously with the qualitative tools of margin and ceiling. This was sought to be achieved by control on the one hand and exemption on the other hand. As pointed out earlier, this policy cannot be successful. Our experience shows that the basic objective of price stability is not realized. On the one hand RBI has fully not the credit requirements of the public distribution system, while credit need of genuine traders have not been met. It is also felt that the objective of price stability and that of helping development of warehouses are contradictory as hoarding of foodgrains may take place in warehouses. This is the reason why warehouse concessions were withdrawn and subsequently modified. Again concessions aimed at helping a particular region could be viewed for hoarding activity. This is the reason why exemptions given to six border districts of Punjab were withdrawn.
(15) It is noted that P.A.I. had followed a number of objectives simultaneously. Out of these objectives, the objective of helping development of warehouses, branch banking and cooperative marketing may be termed an objective to change the institutional and structural set up of the economy. P.A.I. has provided exceptions to achieve this objective. Available data on warehousing activity indicate that the goal might not have been realised. It seems such structural transformation depend upon a number of other factors and credit alone can do little in this area.

(15) Regression exercises indicate that in a few exceptional cases, price model does not work satisfactorily. However, in general the results are satisfactory, except arrival, income and trend price of previous quarter are the main explanatory variables. Credit of current quarter or that of previous quarter can also explain in a few cases. As far as credit model is concerned, market arrival of previous quarter is the main explanatory variable. As inflation gathers momentum price expectations enter as an explanatory variable in a few cases. Where credit is determined by public distribution agencies, independent of the level of market arrival, credit model gives poor results. It may be noted that influence of \( \Delta_t \) over seasonal \( P_t \) is more than that of \( \Delta_{t-1} \) while influence of \( \Delta_{t-1} \) over seasonal \( C_t \) is more than that of
Thus prices are instantaneously affected by market arrivals, while credit level is affected by market arrival with a quarter's lag.

Regulations employed in USA to control consumer instalment credit were successful while qualitative credit control in India have not been quite successful. This may be because of the fact that the Indian authorities have pursued a number of objectives simultaneously while the U.S. authority did not. Moreover, alternative channels of credit supply are not plugged in India, which were plugged in USA.

9.2 Limitations of the study

Some limitations of the foregoing study might be pointed out.

1) The study does not take into consideration foreign trade sector. The extent to which, this sector plays a role, the results must be modified. For example, foreign trade in groundnut, cotton and wheat might be important enough.

2) The study does not take into consideration attempts made by the RBI to channelise the credit to a particular sector, as for example, small scale industry etc. These measures are rightly a part of the qualitative
controls. But this is not included in the scope of our study.

3) Price model has not provided satisfactory results in a few exceptional cases like cotton. In such a case, a more complicated relationship might be existing which can be studied by future researchers.

4) The method employed here is that of partial analysis in which advances against one commodity is taken at a time ignoring the effect of regulations on advances against other commodities. Some writers have noted that as advances against paddy and rice were controlled, advances against other foodgrains increased. Similarly, as advances against groundnuts were controlled, advances against other oilseeds were increased. Some is the case with increase in advances by way of clean loans. Extension of the RBI regulations to other foodgrain, other oilseeds and clean loans are attempts to plug these loopholes. But these are hot studied here.

5) RBI has attempted to help the development of branch banking and cooperative marketing etc. How far it has succeeded is also not studied here.

6) Selective credit controls are applied against number of commodities out of which we have undertaken the study of only five commodities.
9.3 Suggestions and policy implications

(1) RBI has aimed at more objectives than it can achieve considering the tools at its disposal. There are two alternatives. One is to forge new tools and the other is to scale down the list of objectives. We would recommend the second. Thus the objective of helping development of branch banking, cooperative, warehouses etc. by providing exemptions should be dropped. Efforts to refine present tools or alternatives to forge out new tools may not be very successful in the development of these sectors, it seems, depend upon a number of fundamental factors about which credit policy can do little.

(2) RBI has attempted to adopt credit policy for private sector only. In fact for the purpose of price stability and achieving the goals of planning these in now need to have national monetary plan. Total monetary management, including credit to government sector should be planned. Sectorwise supply of credit to be more available should also be planned. It should again be sectorwise and must have roots at the block level. Such a plan should take into consideration seasonal fluctuations. This may not be an impossible task with 85% of commercial banking under government control.

(3) As the controls have been continued over long
period traders etc. have adjusted to them. No old tax is no tax, old regulation is also no regulation. It seems therefore that RBI should withdraw regulation and allow bank credit to genuine traders etc. as required. That will increase the proportion of bank finance in the total finance. It is better to use regulations when needed rather than to have permanent regulations.

(4) It is not clear how RBI fixes up the ceiling level; against either the individual advances, or against advances to a specific sector. It seems most of the time, fixation is ad hoc and always aiming at the safe side i.e. providing less credit than required.

(5) The most important reason for limited success of credit policy in regulating price is the availability of non-bank finance. This is beyond the control of RBI. Therefore, it has to operate on a very narrow base. If highly restrictive measures are taken on such a narrow base, even genuine productive needs are not met. Therefore, RBI or government should find out ways and means to bring other financial intermediaries under its net of control. This may require new legislation and increase in powers of the RBI.

(6) RBI is not publishing data that it receives by way of S.S.R. 3. This should be published in the RBI
(7) O.S.R. I should be further modified so as to show clearly public sector and private sector credit security-wise.

(8) Food Corporation of India is a major borrower, beside government, of the commercial bank credit. Advances given to FCI and its agents, state governments and their agents for procurement purposes etc. should be published commodity-wise and state-wise. At present, there is a mystery about all these, and the general public and academicians do not know how much resources are locked up in these activities and what cost the society bears.

9.4 Further areas of research:-

Before we conclude, a few further areas of research might be pointed out:

1) Thorough investigation into the rest of the commodities not studied here, can be one aspect of further enquiry.

2) Qualitative controls are used to boost up production of certain sectors such as agriculture, small-scale industry etc. These attempts are made for more than a decade. It is now high time to evaluate the role of
credit policy in the development of the priority sectors.

3) Since the beginning of this decade, direct attack on poverty is being undertaken. This is the reason why self-employed people, private road transport operators, rickshaw-walas, people with some skill etc. are provided with finance even by changing the norms of lending. How far credit policy has helped in the development of these neglected sectors can be a further area of research.

4) And lastly, selective credit controls have virtually eliminated the private traders in getting finance from the commercial banks. They are financing their business with the help of own funds, non-bank financial intermediaries, and unaccounted money. So the effect of qualitative controls on traders can be studied. If they have been successful in getting funds, the objectives of the qualitative controls are not realised. And if they get funds which is costlier, then probably, selective credit control might be aggravating the price rise. A thorough investigation can be undertaken in this aspect.

REFERENCES

1. Shabatosh Patna observed "The only element subject to direct selective control is the bank credit to the private sector, but there are compulsions in that sector also, arising from the need to provide finance to the priority sector and to maintain output (if not to increase them) in all sectors". Shabatosh Patna, "Money and economic activity -
problems and issues" in 'Recent Development in Monetary and Policy', p. 9, RBI Publication 1976.


3. The RBI has also found that compliance by the banks to the directive can be easier if the directive is issued before the expansion has undertaken rather than after the expansion had occurred. Currency and Finance, 1960-61, p. 49.

RBI observes that "The selective credit controls worked with a larger measure of success during the year than in the earlier years, since they were operated in conjunction with the general quantitative controls".