CHAPTER 3
MONETARY POLICY OF RESERVE BANK OF INDIA

The purpose of this chapter is to review major actions of the monetary authority taken during the planning period in India i.e. 1951-1971. It will be shown here that RBI has gradually given qualitative colours to quantitative weapons.

In the post independence era, India adopted economic planning with the broad objectives of rapid economic development with stability and social justice. However in a particular period of five year plan some objectives figured more prominently than others depending upon the emerging situation. Thus reducing unemployment, reducing regional or sectoral imbalances etc. have figured in the set of objectives of various plan documents. Realising that economic development might itself not pull the poor people out of poverty line, the removal of poverty is the most pronounced objective in the last few years.

Various policies of the government, such as taxation policy, expenditure policy, public debt policy, export and import policy, industrial licensing policy, price controls and rationing etc. are deployed to achieve the above objectives. Reserve Bank of India (hereafter
called RBI has been following the policy of 'controlled expansion' to achieve the objective of 'development with stability'. Thus RBI has to fall in line with the objectives of Government and take suitable measure. This chapter proposes to outline the monetary policy of RBI in brief, and highlight its qualitative bias.

3.1 Monetary policy during the period '56-'61:

During the period '51-'56, monetary policy was activated for the first time since the establishment of the RBI. On 13th November 1951, Bank rate which had remained at 3% since November '35 was raised to 3-1/2%. Together with this, bill market scheme was introduced. The bank rate was raised as level of advances had reached to Rs.500 crores. During the later part of first plan the credit level was rising and price situation was one of concern. It had already started rising during the last year of first plan. A few qualitative measures taken during the period are narrated in Chapter 4 on "Evolution of qualitative controls in India (1940-1956)."

Since the beginning of the second five year plan, monetary policy had to play a greater role. On the one hand as development efforts increased, monetary policy had to ensure adequate finance for development and on the other hand as the price situation worsened, RBI had to restrain the expansion. Hence the policy of controlled
expansion was followed to achieve the objective of development with stability (1). The policy relied on quantitative as well as qualitative tools. The very concept of 'controlled expansion' implies the emphasis on qualitative aspect. It will be shown in this chapter that quantitative tools are used qualitatively. The detailed discussion of selective credit controls on advances against the security of rice, wheat, groundnut, cotton and gur is carried out in the chapter concerned; hence only a reference will be made here. It may be noted that even when selective credit controls were applied certain forms of activities were insulated from the control frame; thus advances by new branches of a bank or against warehouse receipts or advances for procurement purposes were exempted. It was found during 1956-57 that advances against certain essential commodities such as rice, wheat etc. were unusually high judged on the basis of market arrival and the price situation. Hence during the second plan period selective credit controls against such commodities were applied and modified according to situation and were continued or discontinued also according to need. The main point was to prevent price rise caused by bank finance without hampering trade and necessary activities.

3.1.1 Bank Rate Raised :-

As noted earlier the prices had started rising
during the last year of first plan. Balance of payments also showed deficit. RBI therefore raised its lending rate under the Bill market scheme which was put up from 3 to 3-1/4 %. On March 1, 1956, and was further raised to 3-1/2 % on November 21, 1956. RBI increased its lending rate on advances against government securities from 3-1/2 % to 4 %. Finally bank rate itself was raised from 3-1/2 % to 4 % on 16th May 1957. However with changes in government stamp duty the effective borrowing rate of banks against usance bills came to be 4-1/3 % from that date. Despite the above measures to reduce the cost, credit expansion continued. In June 1957 it was at peak level.

3.1.2 Epocal Session :-

Hence Governor of RBI wrote a letter on 7th June 1957 to banks to bring down the level of advances. Again Governor wrote a letter on 27th June 1957 asking banks to reduce advances without diminishing their assistance to the essential sectors of the economy and in particular without affecting the rising trend of industrial production. This reduction he suggested, could be made against agricultural commodities and generally against all the commodities likely to be in short supply. In the July and August 1957 conferences, Governor urged banks to bring down the advances to Rs. 600 crores by the middle of October 1957. Bank credit came down to Rs. 847 crores.
by the end of September 1957 from Rs. 930 crores in June 1957.

General measures as well as moral suasion were meant to reduce the quantity of credit. The emphasis of policy was on restraining expansion without affecting industrial sector. This was broadly attained, in that the industrial sector claimed a greater proportion of scheduled bank credit in 1957 than in earlier years. Hence the conclusion that the attempts to restrain, in general, inflationary pressures were modified by the needs of industrial sector and thereby qualitative bias imparted to them.

During '59-'60 open market operations were used to absorb liquid resources. Net sales of securities amounting to Rs. 98 crores were made during the year. Network of selective credit controls was widened in '59-'60 to control price rise of essential commodities and stock exchange boom.

3.4.3 Additional Reserve Requirements :-

During '59-'60 up swing in prices continued, despite increase in production. It appeared that the major inflationary factor was rather the high level of aggregate monetary demand, which needed to be curbed. The liquidity of the banking system was also substantial.
and the boom on the stock exchanges contained some unhealthy elements and all this needed some corrective action. RBI therefore considered it necessary for the first time to exercise its powers to vary the statutory reserve requirements of the scheduled banks and required them to maintain additional balances equal to 25% of the increase in total liabilities since March 11, 1960. These additional deposits were to be kept with RBI. This was over and above the deposits hitherto required (viz. 5% of demand liabilities and 2.5% of time liabilities). But in all no scheduled bank would be required to maintain with the RBI an aggregate balance exceeding 20% of its demand and 5% of its time liabilities, which are the statutory maximum rates fixed in terms of section 42(IA) of the RBI Act. These provisions were amended in September 1962. According to amendments banks are required to keep 3% of their total of demand and time deposits as reserves. This proportion can be increased by RBI up to 15%. On 6th May 1960, RBI issued another notification in supersession of the 11th March 1960 directive, requiring each scheduled bank, with effect from 6th May 1960, to maintain with the RBI additional reserve of (1) 25% of the amount by which its total liabilities on 6th May 1960 exceeded the level as of March 11, 1960 and (2) 50% of the increase in total liabilities, since 6th May 1960. The RBI agreed to pay interest on the additional deposits, for each half year, at the average
rate of interest paid for the half year by the scheduled bank concerned on its total deposits. It was then decided to pay $1/2\%$ more interest than paid by banks on total deposits. But such interest should not be more than $4-1/2\%$.

3.1.4 *Corral session again* :-

Corral session was also used to control credit expansion. On June 15, 1959 Governor wrote a letter in which he asked banks to reduce credit level from Rs. 102 crores in the busy season of '58-'59 to Rs. 103 crores in the slack season of 1959. It was on December 11, 1959 that another letter was sent requesting banks to take steps to discourage the practice of rediscounting clean undisc. drawn by parties affected by the RBI's directive. Again on March 6, 1960 RBI urged banks to reduce level of credit in the ensuing slack season.

It was on 21st May 1960 that RBI wrote a letter to non-scheduled banks and asked them to be cautious in granting credit against commodities covered by the RBI's directives to scheduled banks. It was also decided to confine advances under the bill market scheme during June-September 1960 only to such banks as had availed themselves of the facilities in the preceding busy season and to restrict the relative credit limit to each of these banks to the maximum amount of its borrowing between the period October 31, 1959 and May 9, 1960.
3.1.5 Impact of Additional Reserve Requirement

The additional reserve requirements had a marked impact on the liquidity position of scheduled banks but their effect on bankers' credit in the immediate following slack season was negligible. Free reserves (cash + excess reserves) declined. Ratio of free reserves to deposits liabilities declined from 4.9% to 2.9%. Although there was a reduction in the liquidity of the banking system, no significant impact was felt on the level of bank credit which continued to remain high throughout the slack season during July - October, 1960. The contraction in scheduled bank credit was only Rs. 20 crores as compared to Rs. 79 crores and Rs. 91 crores in the preceding two slack seasons. In fact the reduction in seasonal advances in slack season of 1960 was largely offset by an increase in advances against non-seasonal commodities. According to RBI the continued high level of bank advances was facilitated by the relatively low cost of borrowing from the RBI, in the face of rising pressure of demand for credit on the banks. Scheduled banks borrowing from RBI was Rs. 47 crores on September 23, 1960.

3.1.6 Dear Money Policy

It was thought that some stronger measures were necessary to control credit expansion, and limit banks' access to RBI. But the bank rate hike was not favoured.
"However, a straight rise in the bank rate had its disadvantages, particularly its possible impact on security prices"(a). Therefore the following two measures were taken.

(1) Quota cum slab rate system:

RBI announced on September 21, 1960 its decision to introduce with effect from October 1st a system of graded lending rates keeping the bank rate unchanged at 4%. Effective from October 1, each scheduled bank was assigned in respect of borrowing from the RBI a quota for each quarter equal to half of the average amount of the statutory reserves required to be maintained by it under section 42(1) of the RBI Act during each week of the previous quarter. Borrowing upto the quota was to be at Bank rate. Any borrowing over this limit upto 300% of the quota would bear a penal rate of 1% over the bank rate and, borrowing above 200% of the quota a penal rate of 2% above the bank rate. The rates applied to borrowing under both the sub sections 4(a) and 4(c) of section 17 of RBI Act.

(2) Minimum lending rates:

It was considered no longer necessary to fix separate ceilings for individual banks for borrowing under the bill market scheme. Simultaneously, the RBI directed that from October 1, 1960 (i) all scheduled banks should
(a) adhere to a minimum lending rate of 5 3 per annum on all advances, existing or new, clean or secured, but excluding advances to other banks (including cooperative banks) and their own employees and (b) raise their average lending rate at least by 1/2 %, the base period for comparison being the year ended June 30, 1969. This measure was called for to facilitate coordinated action by banks. RBI’s rise in its lending rate might not affect some banks if they did not borrow while others might not feel it immediately. Hence it became necessary to make credit dearer to the ultimate borrower so as to restrain the growing demand of banks.

3.4.7 Impact of紧 Money Policy:---

Following September measures scheduled bank credit declined by Rs. 29 crores between September 30 and November 29, 1969 in contrast to a rise of Rs. 3 crores in the corresponding period of the previous year. It is important to note that while the RBI raised the cost of credit so as to prune down loan urgent demands and generally restrain recourse to itself, it placed no restriction on the volume of credit it would make available to scheduled banks. The impact of tight money policy and rise in interest rate was felt by fall in government security prices. It was noticed that unorganised sector too raised its interest rates. However RBI declared, “It is difficult to be precise about the impact of the September measures
on prices, as ordinarily in this season the price index tends to decline (5). It may be noted that quota cum club rate system was also imported qualitative bias as will be seen in the next section.

3.1.8 Termination of additional reserve requirements

The additional reserve requirements were reviewed in the light of the slow rate of deposit growth and acute stringency in the money market and therefore RBI withdrew this requirement in two stages. From November 11, 1960 further impounding of the increase in liabilities over the level of November 11 was suspended and about half of the reserves already impounded amounting to Rs. 13 crores was also released. Subsequently the additional reserve requirement was completely revoked with effect from January 13, 1961 releasing another Rs. 13 crore of reserves to banks.

During the year '60-'61 selective credit controls on jute were introduced and those on wheat, sugar, rice etc. were modified according to requirements.

3.1.9 Summary of the period '56-'61

This completes the period upto the end of second five year plan. The main points may be summarised below:

(1) Monetary policy of controlled expansion was followed
to achieve the objective of development with stability.

(2) Selective credit controls on advances against rice, wheat, groundnut, sugar, jute etc. were operated flexibly to prevent hoarding of these commodities with the help of bank finance. those (except sugar and jute) are discussed in the relevant chapters.

(3) March 1956 measures to raise lending rates and raising of bank rate in May 1957 could not prevent credit expansion, which was at peak in June 1957.

(4) Moral suasion was used in June, July, and August 1957 to bring down advances without affecting industrial assistance. This is an attempt to import qualitative bias to general restraining measures. This was achieved as industry's share in bank credit rose.

(5) Open market operations were used in '58-'59 to absorb liquid resources.

(6) Additional reserve requirements were introduced since March 11, 1960; to control credit expansion and restrain price rise. Additional reserve requirements were tightened on May 5, 1963. Liquidify
of banks was reduced, but credit level continued to remain high.

(7) Moral suasion was again used in June 1959, December 1959 and March 1960 to control credit expansion.

(8) Facilities under the Bill market scheme were modified so as to restrain free access to RBI.

(9) From September 1960, quota cum slab rate system was introduced to control credit expansion instead of rise in bank rate.

(10) Together with September 1960 measure, a minimum lending rate of 5% was prescribed. Both quota system and minimum lending rate brought down the level of credit.

(11) As there was stagnation in the money market and growth rate of deposit was slow, additional reserve requirements were withdrawn, in two stages, in November 1960 and January 1961.

(12) It may be noted that quota cum slab rate system has a qualitative bias in the sense that only those banks that exceeded the quota were to be penalised; penalty depending upon the excess borrowing over the quota.
Thus during the second five year plan period, monetary policy was more active. Selective credit controls on regular basis with provisions of margin and ceilings were effected. Quantitative tools were deployed. Changes in reserve requirements were used for the first time. Quota cum slab rate system was employed. All the measures aimed at restraining price rise. Beginning is made in the direction of protecting certain sectors from the effect of tight money policy so far as general monetary policy is concerned while desired activities were insulated from the framework of selective credit controls.

3.2 Monetary policy during the period 1961-66

Monetary policy of controlled expansion, with the objective of development with stability adopted during the second plan period is continued in the third plan period also. During the period 1961-66 monetary policy is operated flexibly. Modifications are made in three-tier system adopted earlier and finally the quota cum slab rate system is replaced by net liquidity ratio system, during this period. Even when tighter policy is pursued certain types of activities are insulated from the regulations; thus imparting qualitative bias to quantitative tools.
3.2.1 Qualitative element introduced:–

It seems RBI operated its general credit control measures in a flexible manner with adjustments so as to meet the credit needs of specific sectors (6). Thus the RBI expressed its willingness to sanction larger limits to banks under the bill market scheme on bills by sugar and jute mills so as to enable them to meet the special difficulty of sugar and jute mills (7). Similarly to help small scale and cooperative sectors the basic quota allowed to each bank for borrowings at the base rate was enhanced by an amount equivalent to the increase in the average of their loans to small scale industries and cooperative institutions in the first half of 1961 over the corresponding period of 1960. This shows that the used quota cum slab rate system qualitatively.

During the year '61-'62, in view of the improvement in supply and price situation of commodities concerned, the controls in the case of advances against paddy and rice, groundnuts and shares were relaxed while those in respect of sugar, wheat, raw jute and jute goods on clean advances were withdrawn.

3.2.2 Quota cum slab rate system modified. Lichten policy:–

There was pressure on prices and contraction in bank credit was smaller in the slack season of 1962.
Further, in October 1962 emergency was declared. Level of advances was high against foodgrains, oilseeds etc. To accelerate contraction — to prepare for busy season — RBI modified its three tier system of lending rates in July 1962.

Effective July 2, 1962 a four tier system was introduced, designed to raise the average lending rate of the RBI by 1/2 % or more. The basic quota of each scheduled bank for borrowing at the bank rate was reduced by 1/2 to 25 % of the average statutory reserves of the bank in the preceding quarter; borrowings equal to another 25 % of the average statutory reserves were to be charged a rate of 1 % above the bank rate; those above 50 % to 100 % of the average statutory reserves a rate of 2 % above the bank rate; and those above the statutory reserves a rate of 2.5 % above the bank rate.

3.2.3 Limit on the total borrowing

Since the contraction in slack season was less and because of emergency expenditure was to increase a revised system from October 21, 1962 was announced on the eve of '62-'63 busy season. Under this system, for the first time, a limit equal to a bank's average statutory reserves during the previous quarter was set on the total account which a bank could normally borrow from the RBI.
Borrowing upto 25% of the statutory reserves was to be charged at 4%; another 25% at 5% and the balance at 6%. However, it was indicated that the bank would permit borrowing beyond this limit after making an assessment of the overall position of the borrowing bank and that such special accommodation would be at a higher rate of interest. This policy was subsequently clarified by the Governor of the RBI. It was explained that the revised system of quotas and the lending rates would be operated in a flexible manner. Accordingly, RBI granted appropriate permissible limits of borrowing to applicant banks, after an assessment of their past borrowings from the RBI, their general character of working and pattern of assets and liabilities with special reference to lending for defence production, essential industries and exports as well as demands of particular industries like cotton textiles and tea. Thus a distinct qualitative element can be seen, even in the use of quantitative tool of 'limiting the total of borrowings by the banks' from the RBI.

Borrowings in excess of the basic quote were charged at a higher rate of 6 - 1/2%. Banks were also called upon to readjust their advances portfolio to refuse advances which were likely to be used for purposes of hoarding and speculation and to consider recalling in suitable cases advances against gold and shares and unsecured advances.
Following the introduction by the government of gold control measures in January 1963, banks were advised to value the gold contents of gold bullion and ornaments at a price not exceeding the international price and to call for additional margins in suitable instalments whenever necessary.

3.2.4 Bank Rate Raised :-

The modifications in the slab rates as well as the general leveling up of interest rates in the money and capital markets underlined the need for adjusting the bank rate in line with the prevailing pattern of interest rates. The RBI therefore raised the bank rate by 1/2 % to 4-1/2 % effective from January 2, 1963.

Simultaneously, the three-tier system of lending rates introduced on 31st October 1962, was simplified into two-tier system by merging the first two slabs. Banks were permitted to borrow a sum equal to 50 % of their statutory reserves at the bank rate and the remaining 50 % at 6 %; any borrowing beyond this level was to be charged a higher rate.

3.2.5 Qualitative bias further continued :-

RBI's policy of granting preferential treatment to certain special sectors like small scale industries, cooperatives and exports was continued during the year '62-'63. At the time when the scheme of fixing on
overall limit to a bank's borrowing from the RBI was announced in October 1962, banks were informed that while they could continue to borrow at the bank rate additional amounts based on their lending to small scale industries and cooperatives, their quotas in the next higher slab or slabs would stand reduced to the extent of such additions. This concession which was retained in the revised slab rate system introduced in January 1963 was further liberalized effective March 23, 1963 when the bank decided that the additional quota would be available at the bank rate in respect of such lending, over and above the normal borrowing limit. This is clearly a qualitative bias given to the quantitative tool.

3.2.6 Finance for Export and Coal Industry

As regards export finance, the RBI introduced on March 23, 1963 a scheme under section 17(3) (A) of the RBI Act. With a view to assisting the coal industry in the private sector, the RBI also announced on August 9, 1963 that it would grant, commencing from July 1, 1963 during any quarter to banks at the bank rate over and above the normal limit, additional accommodation equal to the average of their outstanding advances to colliery undertakings covered by the guarantee scheme at the end of each month during the preceding quarter. This shows increasing willingness of RBI to help specific sectors.
and modify monetary policy accordingly.

During the year '62-'63 selective credit controls were modified so as to extend the regulations to advances against warehouse receipts which were exempted hitherto. On January 23 and March 11, 1963, extensions given to warehouses were withdrawn. This was necessary as a large part of advances against paddy and rice etc. was under this exempted category. Hence to make controls meaningful withdrawal of exemption was necessary. Some changes in selective credit controls against groundnut were made to adjust export policy on 25 January 1963. On April 27, 1963, controls levied against sugar as prices were firm and advances were higher.

3.2.7 Liberalisation:

In the 1963 slack season there was unusually large contraction in bank credit and the sluggishness in industrial activity in the first half of 1963. Capital market was also depressed. In view of this development credit policy was geared to stimulate industrial activity and on October 30, 1963, modifications were made in the slab rate system of lending by RBI, the object being to reduce marginally the cost of borrowing and to raise the quantum of finance available on relatively easy terms from banks. The permissible quota for borrowings by scheduled banks (both against bills and government
securities) was raised from 100 % to 130 % of their average statutory reserves, and banks were permitted to borrow 1/2 of their quota at the bank rate i.e. 4-1/2 % and an equal amount at 6 %. Borrowing beyond this limit i.e. in excess of 130 % of bank's statutory reserves, continued to be in the nature of special accommodation subject to discussion between the RBI and the bank. But such accommodation also was to be charged at 6 % and not 6-1/2 % as hitherto. Additional quotas at the bank rate allowed to banks in respect of their (1) advances to small scale industries and cooperatives (2) holding of usance rupee export bills under the export bill credit scheme and (3) advances to co-operatives granted under the guarantee scheme, were continued. The purpose of this direction was to raise quota for bank's borrowing from the RBI as well as to reduce marginally the cost of borrowing in order to assist banks to satisfy all credit demands for productive purposes, in the ensuing busy season, while continuing the concessions to preferred sectors.

3.2.8 Tightening up:

In the '63-'64 busy season, the unusually rapid pace of credit creation by banks, financed to a larger extent than in the past by recourse to RBI credit, called for caution in further credit extension, particularly in the context of the supply situation of agricultural
commodities was less favourable than anticipated. Borrowings from the RBA touched a new peak.

With a view to slowing down further credit expansion by banks, especially when the supply position was not good, RBA announced on March 11, 1964 a series of credit control measures, both general and selective. In the sphere of general controls, the system of quotas and lending rates of the RBA, which had been liberalised on the eve of '63-'64 busy season, was restored to its earlier position, thus reverting to tighter credit policy in force prior to October 30, 1963. The quota for borrowings of funds from RBA was reduced to 100% of statutory reserves. The lending rates of RBA (both for bills and government securities) were fixed at 4-1/2% for amounts up to 50% of the above quota and at 6% for the remaining. Borrowing beyond this limit (i.e. more than 100% of the bank's statutory reserves) would be in the nature of special accommodation and bear a high rate of 6-1/2% (instead of 6% as charged hitherto). Besides, banks were asked to review their clean advances other than those to industrial borrowers and bring down the level of such advances. Banks were also asked to step up their efforts to mobilise deposits by all possible measures including re-examination of the interest rates offered by them on deposits.

Selective credit controls, on sugar was reinforced
on April 27, 1963 after two years as output was lower
and there was spurt of advances to traders. Regulations
against shares which were introduced in January 1963,
as bank advances were rising, was not necessary in
1963 as market remained depressed; hence margin require-
ments were withdrawn in October 1963. Later in '63-'64
busy season selective credit controls on paddy and rice
were tightened and those on wheat and groundnuts were
reimposed as advances were rising in context of tight
supply position and rising prices.

3.2.9 Net liquidity ratio system. Bank rate raised 1-

Against the background of renewed inflationary
pressures and a marked deterioration in the foreign
exchange position, a major revision in the RBI's credit
policy was required. During the year '64-'65, along with
the intensification of selective credit controls, greater
emphasis was laid on the regulation of cost of RBI
accommodation to scheduled banks. Increasing use was also
made of the mechanism of interest rates so as to promote
savings in the economy and to induce a more economic
turnover of funds by the banking system.

Following the inadequate contraction of credit and

* On 6th February 1964 against paddy and rice, 11th March
  1964 against groundnut and on 21st April 1964 controls
  were tightened or reimposed.
the continuance of the upward trend in prices; it appeared by the middle of September 1964 that the ensuing busy season would experience a significant expansion in bank credit. On September 25, 1964 bank rate was raised from 4-1/2 \% to 5 \% and RBI changed the system governing its accommodation to scheduled banks. A differential system of interest rates was adopted in substitution of the quota cum slab rate system. Under the new system, the rate charged on the borrowings of a scheduled bank varied with its net liquidity position defined as a ratio of net liquid assets to aggregate demand and time liabilities. Net liquid assets were defined on September 25, 1964 as the total of a bank’s cash, balances with the RBI, balances in current account with other banks and investment in government securities less its total borrowings from the RBI and the State Bank. This definition was amended on December 4, 1964 thus a total of cash and balances with the RBI, current account balances with other banks and investment in government and other approved securities less the borrowings from the RBI, the State Bank and the IDBI.

Borrowing by a bank with a net liquidity ratio (hereafter called NLR) equal to or more than 20 \% were charged at the bank rate and for every percentage point decline in the NLR below 20 \% the rate on the entire
amount of borrowing rose by 1/2 %.

3.2.10 Additional measures to reinforce the tight policy:

Two additional measures were adopted to reinforce the new policy. One was the placing of a ceiling of 9% which foreign banks and larger Indian banks with aggregate demand and time liabilities of Rs.30 crores and above could charge on their advances/currendy/drafts/ discounts so that these banks did not expand credit by borrowing from the RBI even at progressively higher rates. The other was the regulation of the inflow of banking funds from abroad which added to the borrowing bank's liquid resources offsetting the RBI's restrictive credit policy. A limit of Rs.20 lakhs was placed on the amount a banking company could borrow from abroad without prior approval from the RBI. Beyond this, permission was necessary.

At the same time, with a view to widening the spread between very short term and longer term deposits, the RBI imposed ceilings of 2.5 % and 1.25 % on interest rates payable on deposits for 46 to 90 days and 15 to 49 days respectively. The maximum rate payable on deposits for periods up to 14 days was pegged at the rate payable on current accounts. Banks were also advised to pay a minimum of 4 % interest on deposits of 91 days with
adequate spread for deposits of longer periods, with a view to encouraging further deposit mobilisation.

3.2.11 Bank rate and MLA raised

Even while these measures were having a restrictive influence on the level of credit expansion in the '64-'65 slack season, the price situation continued to be difficult and foreign exchange situation remained critical. Therefore on February 17, 1965 the bank rate was raised by 1% to 6% and the system of progressively rising interest rates on accommodation to scheduled banks was amended to stiffen the cost of RBI accommodation still further. MLA was raised to 30% from 28% and for every fall of 1% or a fraction thereof in the MLA, the rate of interest on the entire amount borrowed by the bank went up by 1/2%.

3.2.12 Interest rates raised

Simultaneously the ceiling of 9% imposed in September 1964 on the rate for advance/overdrafts/discounts of larger Indian and foreign banks was raised to 10%. At the same time to adjust deposit rates suitably to the other changes, maximum interest rates payable on deposits for 15 to 45 days and 46 to 90 days were raised by a quarter of one per cent and 1/2% respectively, and minimum rates were prescribed for
Selective credit controls continued to be administered during the year to dampen the rising tendency of prices of certain individual commodities of common use.

In March 1964 regulation on advances against groundnut were tightened. In July 1964 regulations were applied to other oilseeds as shortages were there. In August 1964 regulations were applied against all foodgrains. The only relaxation effected during the year was in respect of advances against stocks held by vanaspati manufacturers of soyabean oil imported under PL 480 agreement on December 31, 1964.

3.2.13 Advance Deposit on Imports

In the context of continued inflationary pressures and a marked deterioration in the foreign exchange position, RBI adopted a rigorous credit policy during the slack season of 1965. As an additional measure of import regulation, on June 29, 1965 RBI introduced a scheme of advance deposits on imports, requiring importers to deposit with banks 25% of the value of goods shipped to India on or after July 1, 1965; banks were, in turn, instructed to hold the amounts in Government of India
treasury bills, pending return to importers after two months from the date of deposit or the date of remittance for the relative import whichever was later. The requirement did not apply to government imports, PL 480 imports and certain other categories such as imports reprocessed for exports. Thus this regulation was also used in a qualitative manner. RBI also directed scheduled banks to keep their clean advances at a level not higher than prevailing on June 25, 1963. Certain types of advances in respect of export usance bills were exempted from this directive.

Following the changes in import duties in the supplementary central budget in August 1963, the advance import deposit scheme was withdrawn on August 19, 1963.

3.2.14 Withdrawal of regulation on inflow of foreign funds:

Restrictions on clean advances were withdrawn on September 9, 1963, to ensure adequate supply of funds to industries catering to defence requirements. With the suspension of a large part of external assistance following the Pakistani aggression the balance of payments position became critical. To facilitate the inflow of foreign funds, on September 29, 1963, the RBI removed the requirement of prior approval for the inflow of banking funds for amounts over Rs. 20 lakh provided the
funds were not repatriated as long as the bank had outstanding borrowings from either RBI or other bank in India, and the local inter bank call money rate was not lower than the treasury bill rate of the week (the condition about the level of the call rate was withdrawn on November 26, 1965).

### 3.2.15 Tighter monetary policy with qualitative bias

In view of the unfavourable crop prospects and the curtailments of imports of essential raw materials and components for the industries, the RBI continued its policy of credit restraint during the '65-'66 busy season. Though refinance was provided at the bank rate in respect of scheduled bank's advances to finance defence supplies, packing credit for exporters and advances for food procurement and allied activities of governmental agencies, the RBI made accommodation for other purposes dearer by increasing the rate charged by 1 1/2% against 1/2% hitherto, for a decline below 35% of one point, or fraction thereof, in the MLR of borrowing bank. The RBI's scheme of refinance at the bank rate in respect of rupee export bills and the refinance from the RBI (Industrial Development Bank of India) against export credits were continued.

### 3.2.16 Prior Authorization

As an additional measure of credit regulation, the
CBI directed banks to obtain its prior authorization before sanctioning any fresh credit limit of Rs. 1 crore or more or any increase in such limit that would increase the total limit enjoyed by each party from the entire banking system to Rs. 1 crore or more on a secured or unsecured basis. CBI also announced that its credit policy continued to be flexible.

3.2.17 Concessions for food procurement:

In view of the bank credit extended to finance food procurement and allied operations of state governments and government agencies and the progressive increase in such credit, the RBI granted a concession to banks on March 26, 1966, the concession took the form of not including any refinance for the excess of such credit over the previous year’s level in computing the CRR of the borrowing bank.

Selective credit controls on advances against foodgrains, oilseeds, and vegetable oils were tightened during the year '65-'66 to hold the price line. In October 1965 a temporary special scheme under the oil market scheme was announced for holding textile oils. Regulations were also applied against cotton and copra.

3.2.18 Summary of the period '61-'66:

This completes the period between '61-'66 for
which the following points may be recapitulated:

(1) Monetary policy of controlled expansion is continued and operated flexibly.

(2) To help sugar and jute mills, larger credit for them is made available under the bill market scheme.

(3) Quota cum slab rate system operated with concessions for small scale industry and cooperatives and thus used the system qualitatively.

(4) Modications were made in the quota cum slab rate system on July 2, 1962 to raise the average lending rate. Now four tier system was introduced.

(5) As the contraction of credit was less in the slack season of 1962 and because of emergency expenditure was likely to rise, on 31st October 1962, for the first time a limit was set on the total amount which a bank could normally borrow from RBI. But even the limits were operated flexibly and in appropriate cases more borrowing was permitted. This shows the qualitative use of the tool. Four tier system was again converted into three tiers on 31st October 1962.

(6) To bring in line with the prevailing rates, Bank rate
was raised by 1/2 % to 4-1/2 % from January 2, 1963.
Simultaneously the three tier system of lending was
converted into two tier system by merging the first
two slabs.

(7) On March 23, 1963 it was announced that additional
quota would be made available to banks for their
lending to small scale industries, cooperatives and
exporters. This will be beyond the limit and at bank
rate. This is a distinct qualitative use of the
quantitative tool.

(8) On August 9, 1963 coal industry was put on the list
of additional quota entitlement at bank rate
impacting further qualitative bias to quantitative
tool.

(9) In the slack season of 1963, there was sluggishness
in industrial activity and capital market was depressed.
To stimulate economic activity, on October 30, 1963,
the slab rate system was modified to reduce marginally
the cost of borrowing, and to raise the quantum of
finance available from banks on easy terms. Here
also additional quota, at bank rate, in respect of
advances to small scale industries, cooperatives,
exports and coalitions was permitted.

(10) As the supply position was not satisfactory and yet
pace of credit creation was high, RBI therefore adopted some measures on March 11, 1964 (a) The liberal system adopted on 30 October 1963 was changed to the earlier system i.e. operating before 30 October 1963. The earlier tighter system continued, (b) Banks were asked to review their term advances and reduce them (c) Banks were asked to step up deposit mobilisation.

(11) As inflation continued and foreign exchange position was worsening, during '64-'65, RBI raised the bank rate from 4 1/2 % to 5 % on September 29, 1964; and replaced the quota cum slab rate system of lending by Net liquidity ratio system. The objective was to raise the cost of borrowing from RBI.

(12) Together with rise in bank rate and change over to MLI, two other measures taken were (a) a ceiling on interest rate that can be charged by banks was put and (b) Inflow of banking funds were now regulated. Both these were supposed to help the new policy of RBI.

(13) Despite the measures taken by RBI, the prices continued to rise. Therefore on February 17, 1965 the bank rate was raised by 1 % to 6 % and MLI system was tightened.

(14) As foreign exchange situation was deteriorating, en
June 29, 1965 RBI introduced a scheme of advance deposits on imports. This was withdrawn on August 19, 1965 as supplementary budget took necessary measures.

(15) For defence requirements, restriction on loans advances were withdrawn on September 9, 1965.

(16) To facilitate the inflow of foreign funds, on September 29, 1965, RBI removed the requirement of prior approval for the inflow of foreign funds levied earlier.

(17) In '65-'66 busy season, because of unfavourable crop prospects etc. dear money policy was pursued, but refinance for defence supplies, export credit, food procurement credit etc. was provided at concess rate.

(18) Prior authorisation of credit was made compulsory if credit limit is Rs. 1 crore or more.

(19) On March 26, 1966 it was clarified that food procurement credit which in excess over the previous year's level was not to be considered while calculating MSL.

(20) A temporary scheme for helping textile mills was announced on October 1, 1965.

(21) Selective credit controls were used during the period.
more flexibly.

During the period '61-'66, it seems monetary policy is used more flexibly. Selective credit controls are used to prevent price rise with the help of bank finance. Quantitative monetary tools are used to control inflation. But these tools are imported qualitative bias or used qualitatively and certain sectors are insulated from the effects of tight money policy e.g. basic quota was increased to help small scale industries and ELEMENT cooperatives. Qualitative element in the use of qualitative tool can be seen in most of tools. Qualitative element is increased not only on certain sectors experienced difficulty but also on concept and coverage of priority sectors developed.

3.3 Monetary policy during the period '66-'71

Not only the monetary policy of controlled expansion is continued but it is made more flexible and purposeful during this period. In the earlier period restraining inflation and insulating certain desired activities from the effects of tight money policy and controlling undesired activities were the price objectives. Now positive steps are taken to ensure the flow of credit to certain preferred sectors; and just not insulating them from the effects of tight monetary policy. Some innovations are also carried out in the credit policy. Policy is also geared to stimulate economic activity of certain
sectors which experienced recession. MLR and Bank rate are adjusted accordingly, again in the last year, as inflationary forces picked up, tighter policy is pursued.

3.3.1 General situation

In the context of the severe shortfall in output in '65-'66 and the likelihood of further pressure on prices in lean months, the RBI sought cooperation of banks in keeping the credit situation under control. On May 26, 1966 the Governor of the RBI requested all scheduled banks by a letter to invest in treasury bills, the acquisition to their resources by way of deposit increase and the return flow of credit during the current slack season. It seems this was to make banks self-reliant on facility under the bill market scheme was to be suspended. As the slack season is generally the lean season for agricultural supplies and the period when upward pressure on prices is felt, the Governor called on banks to watch closely the credit situation during the slack season and to ensure that the credit extended during the preceding busy season flowed back into the banking system.

Following the devaluation of the rupee on June 5, 1966 the credit prospects in the year ahead were reviewed by the RBI and the banks were advised to (a) strive for a return flow of advances against seasonal commodities,
and (b) invest in government securities, including treasury bills, the increase in their deposits and return credit flow, after allowing for legitimate expansion under non-seasonal advances and credit for priority sectors.

3.3.2 Bill market scheme suspended

The bill market scheme, under which assistance from the RBI is availed of by banks to ease the pressure on their liquidity position during the busy season was suspended at the end of June 1966, but the facilities under the scheme were kept open in respect of refinancing for bank's advances to state governments and their agencies and the Food Corporation of India (hereafter called FCI) for financing food procurement, distribution and storage. This special facility for these activities shows that a distinct qualitative use of the bill market scheme is made. The export bills credit scheme and the rupee export bills scheme continued to operate as usual.

3.3.3 Guarded liberalisation: 'Tranche facility'

In the context of the increased volume of credit demand that was likely to be felt in the busy season of '66-'67 owing to the (then) expected recovery of agricultural production, a larger quantum of imports and the
expected increase in industrial production, credit policy for the busy season of '66-'67 provided for larger access by commercial banks to the RBI at the bank rate. In terms of the new policy, every scheduled commercial bank would, in addition to the funds it could obtain if its NLA was at or above 30%, be able to secure a tranche of refinancing at the bank rate equal to 10% of its NLA at the end of each season. The increase in advances to state governments and their agencies over the level of end October '66 in respect of food procurement and allied activities, continued to be eligible for refinancing at the bank rate, as also the credit in respect of rupee export bills. A penal rate of 10% was prescribed for borrowing from the RBI exceeding the amounts that could be borrowed at the bank rate; if, however, such excess borrowings were either continuous or of a large order, RBI retained the discretion to charge a special penalty rate on the excess of borrowings from the RBI over that the banks were entitled to at the bank rate. The need for overall credit restraint being imperative in the context of continuing inflationary pressures in the economy, credit expansion in the '66-'67 busy season, it was stressed, was meant to meet only the genuine needs of production.

3.3.4 Policy to channelise credit:

In conformity with the above approach, on 30th
September 1966, banks were directed that 60% of their seasonal credit expansion should be directed towards industry and/or against export/import bills. The definition of industry was also enlarged to include not only manufacturing industry but also plantation, mining, transport and generation and distribution of power. Further, banks were advised to pay particular attention to the credit needs of small industries. The banks were also urged to assist agricultural operations directly through extension of short-term credit and indirectly by investing in the debentures of land mortgage banks. So it seems NCL instead of attempting to insulate certain sectors from the effects of tight money policy, now tries to channelise funds to such preferred sectors.

Some adjustments in deposit rates payable by banks were also called for in order to impart some flexibility. The minimum prescribed for interest rates payable on bank deposits for 3 months and 6 months were rescinded. While the minimum rate for one year deposits and for savings deposits were maintained at 6.5% and 4.5% respectively.

3.3.3 Areal session again :-

The sharp expansion in credit in the first half of the busy season of '66-'67 despite the estimated decline of agricultural production and some delay in the pick up of import financing needs, indicated the possibility
of growing monetary imbalance. RBI therefore reminded the larger Indian banks and all foreign banks in the first week of March 1967 of their obligation to utilise at least 80% of the seasonal credit expansion for industry and/or against import/export bills. However, continued expansion of credit at a pace higher than was warranted necessitated a further communication to banks emphasising the need to control the direction as well as the volume of bank credit and drawing their attention in particular to the sizable expansion in clean advances that had taken place and the large resource to the RBI.

3.3.6 Special penal rate specified:

RBI while providing for a tranche facility had pointed out that a penal rate will be charged for excess borrowing. However this penal rate was not specified at that time. This is now done. The banks were advised in March 1967 that penal rates on the excess borrowing would be based on the MLA, and would be such that for a shortfall of every one point or a fraction thereof in banks MLA below 30% on the Friday of the week concerned, the rate would be raised by 1%, over 10%. This was meant to limit the overall magnitude of banks' refinance from the RBI and indirectly the quantum of their credit expansion.

The banks were also advised to:

(a) exercise
control over clean advances as well as on advances against all domestic commodities in short supply. (b) review their credit portfolios in the light of the requirements of the earlier directive regarding credit distribution and take appropriate steps by not sanctioning fresh limits to sectors other than industry and or against import/export bills and, if necessary cancelling unutilised limits to those sectors; and (c) effect the necessary reduction by imposing a percentage cut in sanctioned limits for trade account, the decision regarding the precise percentage reduction being left to the discretion of the banks themselves. As by April 30, 1967 directive informed that its earlier directive in respect of the distribution of credit expansion of the larger Indian banks and foreign banks would cease to operate with effect from that date.

During the year '66-'67 collective credit controls were also operated flexibly. Regulations were rescinded to suit the procurement policy of the governments. Regulations against paddy and rice, cotton etc. were tightened during April 1967. On March 8th and 31st, 1967 NDs were asked banks to control their clean advances which were very high.

3.3.7 qualitative management continued :-

The credit policy for the 1967 kharif season was
designed to counteract inflationary pressures, emanating from larger expansion of credit during the proceeding busy season against overall supply shortages. The emphasis was, therefore, on the need to secure a significant reduction in bank advances against seasonal commodities, to exercise stricter control over advances against commodities in short supply and to enlarge the flow of credit to preferred sectors. In anticipation of the continuance of demand for credit beyond the conventional end of the '66-'67 busy season, likely to arise mainly due to larger requirements of import financing, the facility of additional bank rate of tranche was continued up to June 30, 1967 i.e. till that date the bill market scheme was kept open. At a meeting on 15th June 1967, the Governor re-emphasised the need to secure a sound flow of credit against seasonal securities and to make positive efforts at deposit mobilisation, utilising the proceeds for investment in government securities in view of the continuing pressures on prices and the likely slower pace of deposit accretion in the 1967 clock season compared with the previous clock season. Banks were also advised to enrol their assistance to agriculture, exports and small scale industries.

3.3.9 Monetary measures to come out of recessionary trends

During June/July 1967, indications of recessionary
trends were developing in some of the domestic engineering industries, especially those with export potentialities became evident. RBI therefore, undertook some selective liberalisation through a package of measures announced in August 1967. Refinances from the bank were made available at a preferential rate of 4-1/2% in respect of scheduled commercial banks' packing credit advances to exporters of engineering and metallurgical products and at bank rate in respect of packing credits to exporters of other products, as also in respect of post-shipment export bills in all currencies. Simultaneously, ceilings were prescribed for the rates charged by the banks to the ultimate borrowers at 6% in respect of packing credit advances to exporters of engineering and metallurgical products, at 6 1/2% in respect of other packing credit and post-shipment export bills, irrespective of the banks resort to RBI refinances. This indicates that an added emphasis is given to the qualitative aspect of the policy to stimulate export industries experiencing recessionary trends.

3.3.9 Increase in advances to priority sectors considered as liquid assets: -

To mitigate the impact of advances to priority sectors on the NPA of banks as also the impact of ceiling rates on their earnings, the RBI advised that the increase in banks' advances to the priority sectors over the average
of such advances during July to October '66 for the black season and November '66 to April '67 for the busy season would be treated as part of their liquid assets while computing the M.A. Likewise the IDA liberalised in August and September 1967 the scope of its scheme for refinancing medium term export credit and rediscounting of bills/promotes arising out of sales of indigenous machinery on deferred payment basis.

3.3.10 qualitative liberalisation extended

The credit policy for the '67-'68 busy season was formulated in the context of the expectations of a higher demand for bank credit emanating from the anticipated increase in agricultural output and the expected recovery in industrial production, accompanied by an increase in official procurement operations in foodgrains. However, as the prevailing price situation did not permit a general expansion of credit, the accent of credit liberalisation measures was on selectivity with reference, especially to the priority sectors, such as agriculture exports and small scale industries (10). Measures were also taken to reduce the cost of credit to these sectors.

It was indicated by the RBI on November 2, 1967 that refinance would be provided to the scheduled commercial banks related to their credit to certain preferred sectors and that measure of selective liberalisation announced in
August 1967 would continue to operate. In addition advances to state governments/their agencies/FCI for food procurement operations and advances for financing the distribution of chemical fertilizers and pesticides would be eligible for refinance at bank rate and the entire increase in such refinance over the level of October 27, 1967 would be excluded from the total borrow­
ing from the RAI for the purpose of computing the "L.I.
RAI was also prepared to extend bank rate refinance on a discretionary basis for limited periods in certain special cases.

3.3.11 Penal rates reduced :-

The system governing the application of interest rates on borrowings in excess of bank rate entitlement was also liberalised. If the borrowing in excess of bank rate entitlement was only for a short period i.e. upto a maximum of one week, no higher rate would be charged. For excess borrowings beyond a week a higher rate with a minimum of 8% would apply, the actual rate depending upon the level of FCI below 30%. The penal rate would, however, be chargeable only in respect of excess borrowing over the bank rate entitlement.

3.3.12 Concessional rate of refinance for priority sectors, Area extended :-
With a view to reducing the cost of bank credit to the priority sectors, RBI on January 29, 1960, announced that the total increase in commercial banks' advances over the base period in respect of priority sectors would be eligible for refinancing at a concessional rate of 4-1/2%. Thus, the cost of advances entitled to refinancing at 4-1/2% was expanded. Consequently, the banks agreed to charge not more than 7-1/2% on credit for exports on against 6-1/2% hitherto; the ceiling rate of 6-1/2% in respect of packing credit advances to exporters of engineering and metallurgical products continued to apply.

3.3.13 Bank Rate and Interest Rate structure moved downward:-

As the busy season of 1967-68 advanced the improvement in agricultural output resulted in a decline in prices. The pace of credit expansion was lower than expected. Credit against non-agricultural commodities in particular showed a very small increase. Incremental sections of industry continued to experience recessionary conditions. This suggested that the earlier measures of credit liberalization need to be carried a step further in order to provide a more positive stimulus towards economic recovery.

Accordingly the bank rate was reduced by one full point to 5% effective March 2, 1968. The maximum rate
to be charged by banks on their advances was also reduced from 10% to 9.50%. RBI also prescribed a ceiling of 6% for packing credit and post-shipment credit for exports. Deposite rates were also suitably downward adjusted.

It was further indicated by the Governor on March 12, 1968 that banks should reduce by 1/2% the rate of interest charged on at least 60% of bank's lending as of March 1, 1968. Banks lowered their rates by 1/2%.

Suitable changes in selective credit controls were made during '67-'68, depending upon the needs of the situation in respect of individual commodities and in particular the desirability of encouraging production and promoting exports. Selective credit controls on cotton, groundnut, paddy and rice, gur etc. were either relaxed or tightened according to need. Regulations on advances against gur were levied for the first time in November 1967 as gur prices were rising.

3.3.14 Qualitative liberalisation further widened

During the year '68-'69, the policy of selective liberalisation of credit initiated in 1967 was not only continued but the scope of liberalisation was further widened so as to help recovery of industrial production,
exports, agriculture and small scale industries. It advised the banks to deploy their resources either by larger lending to the priority sectors (agriculture, small scale industries and exports) or by granting credit to areas of activity which were so far neglected by banks.

3.3.15 Liberalisation to boost up some exports

In order to stimulate the flow of financial assistance to the priority sectors, exceptions from certain operational norms and procedures were also granted during the year '69-'70. RBI liberalised its bill purchase scheme relating to packing credit advances in May '69 in order to help exporters of cashewnuts, jute goods and also exporters of cotton textiles to U.K. In June 1969 the benefits of the modifications were extended to exporters of hides and skins and allied products and in July 1969 to exporters of coffee. As a further step the RBI announced waiver of the requirement of prior authorisation in regard to the sanctioning of fresh credit limits of Rs. 1 crore or more in respect of exports.

3.3.16 Even unsecured advances favoured for priority sectors

In June 1968 the banks were advised to make credit available for productive purposes to deserving borrowers
of small means on the basis of the integrity and credit worthiness of the borrower concerned even on an unsecured basis. Banks were also advised in August 1960 to grant unsecured advances to agriculture, which would result into tangible assets. Banks were further asked in October 1960 to help dairy farming, poultry farming and fisheries.

3.3.17 Further measures to help small scale industries

To enlarge the flow of credit to small scale industries the RBI extended in September 1960 the refinancing facilities under section 17(4) (c) of the RBI Act 1934, during the busy season, to commercial banks advances to cooperative banks for purposes of enabling the latter to make advances to small scale industries.

As a further incentive to the credit institutions to render more assistance to small scale industries, the RBI announced in September 1960, that the guarantee commission payable by the credit institutions would be reduced from 1/4 of 1% to 1/10 of 1% per annum with effect from October 1, 1960; provided that the credit institutions agreed to bring under the guarantee scheme all their eligible advances to small scale industries sanctioned or renewed on or after October 1, 1960.

On the eve of the busy season of 68-69, in
October 1968, it was declared to continue the policy of previous busy season on the same considerations viz. credit for exports, engineering and metallurgical industries, agriculture, small scale industries and food procurement continue. However certain changes were made in the method of calculating the incremental accounts in respect of advances to the three priority sectors for purposes of concessional refinance from the RBI. However, prior to October 1968 only the total net increment in advances to all the three priority sectors taken together were eligible for concessional refinance, from October '68, such increments in respect of each of the three sectors taken separately became eligible for refinance at the concessional rate of 4-1/2 %. Banks were also informed that the policy of providing discretionary accommodation at bank rate to individual banks facing liquidity strains owing to operation of special factors would be continued.

3.3.10 Definition of advances to agriculture widened

The definition of advances to agriculture eligible for refinance from the RBI at the bank rate/concessional rate was widened to include not only advances for distribution of inputs such as chemical fertilizers and pesticides but also loans to farmers for crop finance (other than plantation) by way of medium term credit for capital investment purposes such as wells, pump sets, ...
tractors etc. and finance for fisheries, dairies, poultry farms, cold storage etc. As a measure of export promotions, packing credit advances were also excluded from the total credit in calculating the credit deposit ratio; export bills purchased and discounted were already given such an exception.

In October 1968, Governor also indicated that in the context of reviving new investment in industry, the R.S.I. would not be adverse to a higher percentage of medium and long term lending by banks beyond 5% of their total deposits if their overall resources position permitted them to expand their term credit to industry. Banks were in addition asked to pay special attention to the credit needs of the cotton textile industry which had special problems of its own.

3.3.19 Pre-shipment credit scheme

In January 1969, R.S.I. introduced a significant procedural change in order to facilitate the extension of pre-shipment export credit by banks. Under the new scheme called pre-shipment credit scheme, refinance in respect of packing credit for exports were to be given under the amended section 17(3A) of the R.S.I act 1934 and not under section 17(4) (c) as earlier. The change meant that banks could now avail of refinance from the R.S.I. against packing credit by giving declarations of
having extended pre-shipment advances and they were not required to produce eligible usance promissory notes of individual parties.

3.3.20 **Simplification of the system of concessional refinance**:–

In a mid-season review of credit trends and policies, the Governor indicated in his meeting in February 1969 that in the light of prices, production and credit trends in the economy no change was called for in the policy which was announced in October 1966. But RBI announced a simplification of the system of refinance so as to avoid complicated calculations and procedural difficulties. Thus, a uniform rate of 4-1/2 % per annum irrespective of a bank's ELR was to be charged on refinance up to the total of a bank's short term advances to agriculture and those to small scale industries which were guaranteed by the credit guarantee organisation, and not merely in respect of the increment in such advances over the base period. But along with this extension of the facility of concessional refinance to the total outstanding eligible advances to agriculture and small scale industries the earlier arrangement for providing a relief in the ELR calculations in respect of the increases in the advances to these two sectors as well as the increases in refinance for food procure-
ment operations over a base period was discontinued.

After February 1969 only increments in advances for exports over a base period were taken into account for relief in the NLR.

Collective credit controls during '60-'69 were relaxed in appropriate cases in the earlier part of the year; in view of improved supply position and a fall in prices of certain agricultural commodities following the bumper crop of '67-'68. But in the later part the controls had to be tightened against jute and oilseeds.

3.3.24 Exceptions from prior authorisation scheme

During the 1969 slack season some procedural relaxation in credit authorisation scheme and bill credit scheme were made. In May 1969 advances to state governments, FCI and state cooperative banks for financing food procurement operations, advances against government and other trustee securities and advances to state electricity boards and public sector undertakings were exempted from the requirements of prior authorisation. In August 1969, further exceptions were granted from the prior authorisation requirement in respect of the purchase and discount of inland documentary bills and supply bills drawn on quasi government bodies. In
pursuance of the recommendations of the fertilizer credit committee, RBI gave some concessions to such credit.

3.3.22 **General situation**:

In the first three months of the busy season of '69-'70, there was heavy credit expansion and a contrasonnal rise in prices. Therefore, in a letter to banks on February 5, 1970, the Governor drew the attention of the banks to the sharp rise in bank credit as well as in the borrowing of the banks from the RBI during the season and pointed out that the credit expansion was larger than warranted by genuine production and marketing needs. He, therefore, advised the banks to exercise adequate credit restraint and to make a careful analysis of the directions in which the credit expansion had taken place during the season.\(^{11}\)

3.3.23 **Some concessional refinance withdrawn and statutory ratio raised**:

In order to reduce the recourse by banks to refinance credit expansion, the refinance facility at the bank rate in respect of food procurement advances, irrespective of banks MLR was withdrawn, and the availability of refinance at 4-1/2 \% up to the total of short term lending to agriculture was discontinued and only
direct lending to agriculture was made eligible for refinance at bank rate. The banks were also asked to step up their holdings of assets which are included in their statutory liquidity ratio, from 25% to 36% of their aggregate demand and time liabilities within a month. Subsequently, on February 10, 1970, the Governor asked the bankers to exercise utmost caution in extending credit and be vigilant in the matter of end-use of credit. Governor wanted banks to rely on their own resources rather than recourse to RBI. The availability of refinance to banks was further restricted to an amount equivalent to an increase in credit to the priority sectors over the prescribed base period.

3.3.24 **MLR and Interest rates raised**: 

Simultaneously, with the above noted changes, the minimum MLR qualifying for bank rate refinance was also raised from 30% to 31% which was to be stepped up further to 32% by the last Friday of April 1970.

The RBI also took certain additional measures to curb credit expansion and to encourage deposit substitution by banks. On January 2, 1970, the RBI increased the ceiling rate of interest on advances, which was fixed at 9-1/2%, on March 2, 1968. However, in order to maintain the cost of export credit at a reasonable
low level, the RBI continued the ceiling rate at 6 \% for export credit granted by banks (both pre-shipment and post shipment).

Following the removal of ceiling rate of 9-1/2 \% on advances and the upward revision of the rates of interest on certain categories of postal deposits, the RBI raised on March 20, 1970 by 1/4 \% to 1/2 \% rate payable by banks on deposits for periods of two years and above, while retaining the rates of interest on savings deposits and the rates on fixed deposits for periods of less than two years at the previous levels. The new rates came into effect from April 1, 1970.

3.3.25 **Commitment charge levied** :-

With a view to bringing about a more rational allocation of credit and to induce the borrowers to exercise greater care in estimating their credit requirements, the RBI directed on March 20, 1970 to banks asking them to levy a commitment charge of 1 \% per annum effective April 1, 1970, on the unutilized portion of credit limits of Rs. 10 lakhs and above. Suitable exemptions were granted in respect of credit limits for inland, export and import bills, opening credit for exports, letter of credit opened for imports, trust receipts, facilities in connection with the import of
goods, procurement operations as well as credit limits granted to State Trading Corporation for the purpose of storage and distribution of soybean and sunflower oil. Thus this tool is also used qualitatively.

3.3.26 Concessional refinance restored partially

Following the withdrawal of the refinance facility at bank rate in respect of food procurement advances from February 5, 1970, the banks which continued to finance food procurement operations found it difficult to meet the growing financial requirements of other priority sectors as well as some of the industries like the sugar industry which were faced with the problem of carrying a large volume of stocks. The RBI, therefore, agreed in April 1970 to refinance at bank rate plus of the increase in advances granted by banks for food procurement purposes over the average level of such advances in the quarter ended March 1970. This facility was made available till the third Friday of July 1970, after which it was to be reduced to 50% of the outstanding level of such advances.

Selective credit controls were again operated flexibly during '69-'70. Thus selective credit controls on jute were withdrawn in September 1969. Regulations against gur were also withdrawn in January 1970.
tions against sugar were withdrawn on May 4, 1970.
 Regulations against foodgrains were tightened on January 21, 1970. Regulations against oilseeds tightened in May 1969. From January 1970 a minimum rate of interest of 10% was prescribed for advances against various commodities under selective credit controls. This was raised to 12% in April 1970. Regulation against cotton were tightened in May 1969 and January 1970.

3.3.27 Statutory liquidity ratio and MLR raised, to
 restrict price rise and provide finances for
 fourth plan :-

In view of the continuous pressure on prices and such larger credit expansion by banking system in the first half of the year, '70-'71, monetary policy was constantly directed towards curbing the inflationary trends in the economy. In the light of the need envisaged in the fourth plan for reaching a certain proportion of additional deposits to be invested by banks in government and other securities, Governor asked banks, in August 1970 to step up their holdings of deposits that go to make the statutory liquidity ratio from 27% to 32% from the last Friday of August 1970. MLR was also raised to 33% from the same date.

Refinance facilities under the existing bill market scheme for the '69-'70 season which were to lapse
by the close of June 1970 wore, however, continued beyond June 30, 1970 in respect of bank advances to priority sectors as well as for purposes of food procurement and distribution.

### 3.3.20 Modifications in concessional finance

The busy season of '70-'71 had started with an unprecedentedly high level of banks' borrowings from the RBI at Rs. 150 crore. On November 10, 1970, RBI announced its policy and asked banks to stop up deposits mobilisation. To maintain the tempo of economic expansion, higher level of credit was thought to be necessary. Also, the need to continue the provision of credit for priority sectors and backward areas was there. During the busy season of '70-'71, refinance at bank rate/concessional rate was made available in respect of increases over a prescribed base period to the priority sectors, the base period was moved forward to '69-'70 instead of '68-'69 for calculating increases.

RBI had already announced in August 1970 the introduction of the new Bills Rediscounting Scheme with effect from November 1, 1970. The scheme was expected to even out liquidity within the banking system and reduce the bank's recourse to RBI to a minimum. In regard to advances of banks for food procurement/storage and distribution purposes to the Food Corporation of India,
state governments and/or their authorised agents, the RBI announced that refinance would be made at bank base rate plus 50% of the increase in such advances over the actual level of such advances as on October 30, 1970.

In April 1971, this refinance facility was increased to 75% for the period April 9, 1971 till end July 1971. This facility was reduced to 60% for August 1971 and thereafter to 50% of the increase in such advances over the specified base period (October 30, 1970).

1.3.29 Bank rate and MCLR raised:

It was felt that with the progress of busy season of '70-'71, the pressure on prices would intensify further. It was therefore considered necessary to restrain the rate of credit expansion along with the provision of incentives for stimulating savings and assisting deposit mobilisations. With this in view, the bank rate was raised from 5% to 6% with effect from January 9, 1971. MCLR was raised from 30% to 35% from January 29, 1971. Liquidity ratio for the purpose of section 34 of the banking regulation act, together with the cash reserve requirements under section 42 of the RBI Act, however continued to remain unchanged at 11%.

Sanks were advised that while adjusting rates of interest on their advances consequent upon the above
changes, they should ensure that, on an average, increase in their lending rates was only about one percentage point.

3.3.30 **Facilities for priority sectors**:

As for the priority sectors, however, refinance was available (1) at 4-1/2% irrespective of MSL, against the increase in credit over the specified base period in respect of export credit, and credit to primary agricultural cooperative credit societies in the selected districts in terms of the scheme instituted for this purpose (2) at bank rate irrespective of MSL, in regard to the increase in short-term lending to small scale industries and agriculturists over the specified base period and rediscounting of bills under the new Bills Rediscounting Scheme and (3) at the bank rate in respect of bank advances for food procurement operations up to 50% of such advances as on October 30, 1970. To encourage savings and deposit mobilization, interest rates were raised. Consequent upon the tightening of the credit control measures, rate of expansion of credit slowed down and there was reduction in borrowings from the RBI.

The scope of the Bills Rediscounting Scheme was extended on February 4, 1971. It was provided that rediscounting of bills after 30th June 1971 will not impair MSL. The existing bill market scheme was closed
3.3.31 Maximum penal rate :-

In February 1971, RBI fixed a maximum penal rate of 15% for excess borrowing. Nitherto, the rate of interest charged by the RBI increased by one percentage point above the bank rate for a shortfall of every one percentage point or a fraction thereof in the bank's MLC below 34%. The ceiling of 15% would afford relief to the banks when this borrowings from the RBI increased to such a level as to reduce this MLC below 26%.

In February 1971, the basis of refinance facilities against export credits was reviewed in the context of the ceiling of 6% on interest rate on export credits sanctioned by banks and with a view to reducing an element of uncertainty about the quantum of refinance available at 4-1/2% and at bank rate over the year as a whole. According to revised arrangement refinance was to be available irrespective of the MLC upto an amount equal to 10% of the annual average of export credit in 1970 at the concessional rate of 4-1/2% and an additional amount upto 10% of the annual average of export credit at the bank rate.

However, with a view to bringing about a proper alignment of the structure of interest rates charged by
scheduled commercial banks on export credit, the ceiling increased, with effect from April 17, 1971, the ceiling rate of export credit from 6% to 7% per annum for pre-shipment (packing credit) and post-shipment credits other than credit provided for exporters on deferred payment terms. The maximum rate of interest on deferred payment terms was continued at 6% and the subsidy of 1.5% under the export credit (Interest subsidy) scheme continued as before on all export credit provided.

Selective credit controls were operated to suit the requirements. They were moderately liberalised against raw cotton on 23rd October 1970 to help marketing of new crop, but tightened on December 12, 1970 as prices started rising. Again in May 1971 some relaxations were made. Some relaxations in selective credit regulations in case of foodgrains were also made and those on oilseeds tightened as prices had risen.

3.3.32 Summary of the period '66-'71:

This completes the period '66-'71 for which the following points may be noted:

(1) During '66-'66 in the context of heavy pressure on prices, RBI wanted banks to invest more in government treasury bills as probably, facility under the bill market scheme was to be suspended.
except for advances to priority sectors.

(2) During '66-'67 because of recovery in agriculture etc. more demand for credit was expected. Hence a tranche of refinance of OLR was given as additional facility. Increase in advances over October 1966 for food procurement and repea export bills were eligible for refinance at bank rate.

(3) Penal rate of 10 % was provided for excess borrowing from October 1966. Rate could rise further.

(4) To ensure restraint and provide for credit needs of production, on 30th September 1966, RBI directed that 10 % of seasonal advances be given to industry, export etc.

(5) RBI wanted banks to help small scale industries and agriculture during the entire period.

(6) During June/July 1967 some sectors of the economy were experiencing recession. For such sectors refinance at preferential rate of 4-1/2 % was provided, and a ceiling was placed on the rate which banks could charge for such sectors.

(7) During '66-'67 increase in advances to priority
Sectors was to be treated as liquid assets while computing NLR.

(8) To help food procurement etc., total refinance on these was to be excluded from the borrowing from RBI for computing NLR in October 1967.

(9) To reduce cost of priority sectors, it was decided to refinance increases in advances to these sectors at 4-1/2% from January 1968.

(10) To accelerate recovery, bank rate was reduced to 5% on March 2, 1960. Other rates were also reduced.

(11) Policy of selective liberalisation initiated in 1967 was continued and scope widened in 1968-69. Some types of exports were to be encouraged. Banks were urged even to grant unsecured advances to priority sectors in June 1968. Guarantee commission on small scale industries was reduced in September 1968.

(12) During '68-'69 selective liberalisation was further widened. Definition of advances to agriculture was also widened.

(13) During '69-'70 as prices were rising and credit
level was high, RBI tightened its policy. Some of
the concessions were withdrawn, e.g. refinancing at
bank rate for advances given for food procurement.

14) Statutory liquidity ratio was raised to 26 % from
25 %. MLR was raised to 31 % and then to 32 % on
last Friday of April 1970, to control credit
expansion.

15) To curb inflation ceiling rate on advances was
removed except for exports.

16) A commitment charge of 1 % was levied on April 1,
1970 on unutilised portion of credit to induce
borrowers to have more rational estimates of their
credit needs. This was also used qualitatively.

17) In April 1970, RBI agreed to refinance 60 % of
increase in advances for food procurements at bank
rate. This proportion was changed according to
requirement.

18) Statutory liquidity ratio was raised to 28 % from
last Friday of August 1970. MLR was raised to 33 %
to control credit expansion and get core funds for
government.

19) New Bills Rediscounting scheme came in force from
November 1, 1970.
(20) To control credit expansion and increase savings, the bank rate was raised from 5% to 6% on January 5, 1971. MIR was raised to 30% from January 29, 1971.

(21) In February 1971 a maximum penal rate of 15% was fixed.

(22) Ceiling rate on advances for export was raised from 6% to 7% on April 17, 1971.

(23) Selective credit controls were operated flexibly.

It can be seen from the above that monetary policy played a great role during this period, and the quantitative tool of MIR is used qualitatively also. Even when other directives of the nature of general control are imposed, they are also used qualitatively.

3.3.33 Conclusion:

Except for the monetary action of raising the bank rate in 1951, credit policy as such did not play any major role in the first plan period as development efforts were of a meagre order. During the second plan period not only development efforts increased but there were inflationary pressures also. So monetary policy was geared to control inflation. Quantitative as well as qualitative tools were used. Monetary policy of
controlled expansion with the objective of development with stability was followed. Moral suasion, changes in the bank rate, additional reserve requirements, and quota cap aub rates were the main tools besides selective credit controls of the monetary policy of the period 1960-1961.

During the period 1961-1966 monetary policy of controlled expansion is continued. But it can be seen here that attempts are made to protect certain sectors like small scale industries etc. from the adverse impact of tight monetary policy. Quota cap aub rate system is replaced by MLI system. Bank rate is also raised to fight inflation. Advance deposits on imports were required so as to solve foreign exchange crisis. There also exemptions are given for PL 400 imports etc. which indicated a qualitative twist given to the policy. MLI's prior authorisation was now required for advances beyond a certain level. During the period 1966-1971 some innovations are carried out in the field of monetary policy with respect to advances to industries, exports etc. Priority sectors were helped by insulating them against tight monetary actions and encouraging flow of credit to these sectors. Concessional rate of refinance was provided for priority sectors. Distinct qualitative bias is imparted to quantitative tools as indicated frequently in the chapter. Policy was changed to help come out of recessionary trends of economy.
To accelerate recovery bank rates were reduced but in the last year it was raised to control credit expansion. Selective credit controls during the entire period of '51-'71 were used flexibly and changed according to need. Selectivity of any conceivable degree is imparted to selective credit controls. This is shown in subsequent chapters.

Thus monetary policy which played less significant role in '51-'56, came out to control inflation in '56-'61 while a beginning was made in the direction of protecting some sectors and to control inflation as well to protect certain sectors with more emphasis on priority sectors during the period '61-'66. It played a major role in 1966-71 by furthering the interests of priority sectors, pulling out certain sectors from recessions and fighting inflation in general. It is noticeable that for all these quantitative tools are not only used but given qualitative bias. The qualitative element has gradually increased.

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4. Trends and Progress of Banking in India, 1960, p. 16.
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