CHAPTER XI

CONCLUDING OBSERVATIONS

Some important observations emerging from the earlier discussions are presented in this chapter.

In contrast to the classical economists, money is now no longer considered to be the passive factor in the basic functioning of the economic system. In recent years, monetary theory is considered to be the part of the more general theory of asset holding especially the financial ones.

Financial development and economic development are inter-dependent, and, therefore, a sophisticated financial system is essential for economic development. In a developing economy an underdeveloped financial system acts as a constraint to economic growth, by delinking the saving - investment process.

Financial Intermediaries

The saving-investment process gets disintegrated in the sense that the savers are very large in number and diffused and the users are comparatively few. Effective mobilisation of savings for economic development requires institutional intermediation between ultimate lenders and ultimate borrowers.

Financial intermediaries are in a better position to mobilise savings and to allocate them for the most efficient productive investment. They, thus make possible the use of savings in an optimum manner.

The development of financial institutions, therefore, is sine qua non for the integration of the process of saving-investment and therefore, for economic development. The massive financing of large scale industries and the effective use of modern technology is not possible without simulteneous growth of financial institutions.

Development Banking in India

The demand for medium and long term industrial finance has grown much beyond the capacity of traditional sources of finance. The setting up of special financial institutions is also increasingly felt by the developing countries. As an integral part of planned economic development a battery of development banks has come into being in India. With a variegated institutional financial structure the industries are able to satisfy their financial needs in diverse forms.

The rise in the quantum of assistance sanctioned and disbursed by the development banks show ever increasing services rendered by these institutions to the industrial growth of the country. They have shown keen interest in the development of priority sector industries, especially chemical and fertiliser industries.

Inter-State Disparity

Inspite of the efforts made by development banks for the industrial development of the country there has remained vast inter-State disparities. No wonder the development banks have come under heavy criticism for their failure on this score.

It may be however, noted that the development banks are not wholly responsible for this state of affairs. It is largely due to the fact that there is real dearth of sound proposals from the less developed regions.

Institutional Coordination

In view of the establishment of a multitude of institutions in India for industrial finance, one is some times inclined to think that there is overlapping of functions in the operations of these institutions. Since its establishment IDBI as an apex body, had tried to coordinate the activities of these institutions. The entire structure of the financial institutions in the country appears to be in need of systematic coordination and demarcation of activities.

Lopsided Capital Structure

The predominance of the financial institutions in the capital market in India has created distortion in the form of financial practice of questionable prudence. The financial institutions provide most of the funds in the form of term loans and, therefore, there is predominance of loans in the financial structure of corporate enterprises over the equity capital. These has made the capital structure lopsided and appears to be highly imprudent.

The rapid industrial expansion does not take place solely on the basis of internal finance. Industrial expansion, therefore, should rely on raising more funds from the capital market. The industrial units should be made less reliance on the public financial institutions for their financing. Industrial concerns should be encouraged to make their financing requirements from a wide range of investors through marketable securities that can also assist the development of the capital market.

Source of Funds of the Specialised Institutions

As far as the sources of funds of the specialised financial institutions are concerned , most of their resources come from the Government or Government financial institutions and very little effort has been made by them in augmenting their resources. They should give more attention to this aspect, by accepting public deposits or selling bonds, so that they can increase their rate of growth.

Commercial Banking

After the nationalisation of 14 major banks in July 1969 and 6 other banks in April 1980, the public sector banks are covering more than 90 per cent of the total banking business in the country.

Public sector banks have considerably diversified their lending policies, simultaneously, the Reserve Bank on its part has been advocating to provide precise measures and guidelines in this regard. As a result while the credit needs of the organised sector which the banks hitherto almost soley met, the institutional credit facilities at reasonable rates of interest are extended to large number of borrowers of small means. The banks have taken rapid strides to improve the geographical and functional coverage, and to cater to the needs of hitherto neglected sectors of the economy.

While it is heartening to note about the growing share of the priority sectors in the total credit disbursements by the banks, it is disheartening to note that at the same time large outstandings have accumulated against these sectors. Thus, unless proper care is taken while loaning funds to the borrowers covered under the priority sectors, this would impose heavy strain on the resources of the banking system. Moreover, with respect to the deployment of credit, while the priority sectors would be provided with the financial resources, the needs of the large industry sector should also be taken care of.

Banks have not been much successful in mobilising deposits. No doubt their deposits have increased in absolute terms in the post-nationalisation period, they have not made much headway in mobilizing deposits from the rural areas. As on the last Friday of June 1980, rural deposits accounted for only 11.9 per cent of the total outstanding deposits.* Banks have to make concerted efforts in taping the rural deposits.

Banking and Development

The functions of the modern banking has been shifted from the passive traditional commercial lending to the active role of contributing to the acceleration of the process of economic development.

In a developing country like India, where scarcity of financial resources is admittedly one of the constraints for accelerating the pace of economic growth, an efficient and responsive banking system is of utmost importance. It may be noted that bank credit can never be an engine of growth. Bank credit constitutes only an enabling factor. Credit is a thread, one can not pull things by means of thread. At the most the thread can pull the lighter things.

Regional Rural Banks (RRBs)

Regional rural banks are recent addition to the institutional financial structure of India. The RRBs are unique credit

* RBI, Report on Currenty and Finance, 1980-81, Part, I., p.154.

institutions. Their uniqueness lies in the specialisation of the task of rural development. RRBs would be to supplement and not to supplant the other credit institutions in the field. RRBs should be identified as the rural banks for the rural poor. Considering the utility of RRBs for this purpose the Committee to Review the Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) has recommended that the RRBs should continue to confine their operations to the weaker sections. However, in the interest of agricultural development normal credit facilities should not be denied to any class of farmers. In this connection the Review Committee (popularly known as Dantwala Committee) suggested that atleast 60 per cent of the loans advanced by the RRBs should be earmarked for the benefit of small farmers, rural artisans and other rural poor. In respect of 40 per cent loans, there should be a suitable ceiling on each individual loan.

Local Participation in RRBs

In order to promote greater participation by the local people in the management of RRBs it is suggested* that a local person of high standing in the field of social service, taking an active interest in the local development of the areas or a scholar working in the field of economic development of the rural areas and belonging to the command area of the concerned RRB be chosen as the chairman of the RRB.

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* Wadhva, C.D., Rural Banks for Rural Development, Macmillan, 1980, p. 176.

As the RRBs are to become an integral part of the rural credit structure they should be kept free from the pressure of the political people.

Within the short peiiod of their existence the RRBs have made appreciable progress in respect of opening of branches in the rural areas, but their performance in respect of deposit mobilisation is not appreciable. RRBs can do much in mobilising savings of the rural households.

Asset Preferences of the Household Sector

From the study it is observed that the household sector contributes about three-fourth of the overall domestic savings in the country, and this sector will dominate the domestic saving structure of the country. To increase the rate of domestic saving, it is, therefore, imperative that all efforts should be made to augment especially the financial savings of the household sector.

In the portfolio structure of the households it is evident that amongst the financial assets, deposits account for the major share. Sophisticated instruments such as corporate securities and even units of UTI have not much weight in the financial portfolio of the household sector. This asset preference pattern has to change by the introduction of the new financial instruments. Contractual savings have also good prospects.

Mobilisation of Rural Surpluses

As rural development programmes involve increasing development outlays in rural areas, and the consequential expansion of rural incomes, monetary income flows towards the rural sector are increasing. Mobilisation of rural surpluses requires effective financial intermediation. The asset preference structure of the rural households has to be switched over in favour of financial assets. For, so long as the rural households continue to put a significant portion of their savings in physical assets, financial intermediation in rural sector can not improve. Amongst the financial assets, sophisticated financial assets such as corporate securities are not likely to be well received by the rural households, especially due to low educational standards and understanding of the rural savers.

In the case of sophisticated financial intermediation though the commercial banks are fast penetrating the rural scene, their operations still are peripheral, with a very large part of it being accounted for by the cooperative institutions. Institutional layering of these organisation should be replaced by vertical integration of the primary institutions, which are more looked upon as distributories of credit rather than depositories of savings.

Yield Structure

The interest rate structure has been evolved as an adjunct to the fiscal and monetary policies of the Government and the Reserve Bank of India.

From the study of the structure of the interest rates in India it is suggested that there is an imperative need to rationalise interest rate structure. Such rationalisation would involve escalation of interest rates on saving and term deposits of banks and sharp rise in rates of interest on Central and State Government loans.

In India largely all rates are administered rates and the element of competition between them is very little. The different savings instruments are not much comparable from the point of view of yields with each other e.g. units of UTI are not comparable with the policies of the LIC or the deposits with the banks. The company deposits are not comparable with bank deposits. The Government securities are also not comparable with corporate securities. The combination of riaks, return and marketability/liquidity differs in these savings instruments and, therefore, an element of competition between the different savings instruments should be allowed for effective saving mobilisation. Administered rates are inadequate means for the purpose. For effective financialisation of surplus resources or savings what is required is not the monotonous financial technilogy but a sophisticated financial technology.

Rural Rates

In the case of rural interest rate structure there may be applied a bilateral strategy of levering up deposit rates and removing subsidy element in the loan rates. Raising interest rates should constitute an important item in the policy package for the financialization of savings at the rural as also national level.

Moreover, the interest rate policy should be used as a weapon for not merely promoting financial discipline but also for stepping up the rate of capital formation so that it can eventually help the planners to achieve the objectives of growth.

Growth of NFIs and Monetary Policy

Monetary policy can be effectively implemented if banks were the only source of finance available to borrowers. But with the growth of NFIs the financial structure of the country registered a change. Finance can now also be available from the NFIs. Thus, under changing circumstances the conventional monetary policy requires thorough renovation and reorientation.

From the empirical analysis it is found that with the rise in domestic savings by Rs. 100 the deposits with NFIs rise by Rs. 9.75 and NFCs* and NNFCs* taken separately rise by Rs. 4.09 and Rs. 5.65 respectively.

In absolute terms the deposits with NFIs compare very poorly with the bank deposits but the rate of growth in the former can not be ignored. However, it is true that if the present rate of growth of deposits with NFIs is maintained or is allowed to be maintained, the NFIs are likely to emerge as competitors of importance to banks in the future in the field of deposit mobilisation.

* Abbreviations are as used in the Chapter X of the present study.

The deposit acceptance activities of the NFIs though not much serious at present, but in the depositors interest the necessary precautions have to be taken by the Government/ the Reserve Bank of India to regulate the activities of the NFIs, however, such regulatory measures should not result in intercepting the new financial technology.