CHAPTER II

INTERMEDIATION IN INDIAN ECONOMY

GROWTH OF INTERMEDIARY PROCESS IN INDIA

Financial intermediation in India has had its origin in very ancient days. Intermediation was done in the earlier days by private people. However, their activities were restricted mostly to lending only and did not extend to accepting deposits and as such were not strictly in the nature of intermediation. Intermediation in the real sense of the term commenced in India only with the setting up of modern banking business by the British Agency Houses established in Calcutta. The first bank called the Bank of Hindustan was established in 1770. The first two decades of the current Century witnessed a remarkable activity in this regard; during this period, several banks, which were owned by the Govt. of India, on their Nationalisation, were started. The setting up of the Imperial Bank of India in 1921 by an amalgamation of three Presidency Banks at Calcutta, Bombay and Madras is a landmark in the history of intermediation in India. The Government, with a view to having a Bank of its own, which would also be the Central Bank of the Country, set up, in 1935, the Reserve Bank of India. This was a major step taken by the Government of India and the Reserve Bank of India has been able to exercise since then a fairly effective control over the banking institutions which had, by then, come up in large numbers in the Country; it succeeded in enforcing discipline on banks in regard to their operations, through
The first two decades of the post-Independence era witnessed the Banking System in India record sizeable growth in the volume and nature of their operations. It was in 1952 that the Imperial Bank of India was converted by the Govt. of India into a Public Sector Bank viz. State Bank of India. Further, several amalgamations took place, during this period, resulting in the consolidation of the Banking System in the Country. The process of weeding out sub-standard and non-viable banks was started in 1960 on the basis of the recommendations of the Travancore-Cochin Banking Enquiry Commission. Thus, 208 bank mergers took place between 1960 and the middle of 1969 and these large-scale mergers, which resulted in a steep decline in the number of commercial banks operating in the Country from 566 in 1951 to just 90 in 1968, strengthened considerably the banking structure in the Country. Further, Social Control was introduced in 1968 and this introduced an element of discipline in the operations of banks.

14 major commercial banks in the Country were nationalised with effect from the close of business on July 18, 1969, bringing within the ambit of the Public Sector, more than 90% of the operations of commercial banks in the Country. This Nationalisation is a major landmark in the economic history of the Country.

The co-operative movement is yet another prominent factor in the Indian intermediary process. Since Independence, particularly since the release of the Report...
of the Committee on Co-operative Credit which lauded the success of the co-operatives in the Country, the co-operative movement gained strength and despite difficulty in the field of loan recovery, it has played a significant role in the intermediation process.

The Nationalisation of the Life Insurance Corporation in the Fifties and formation of the General Insurance Corporation in 1973 are yet other important milestones in the growth of intermediation in the Country.

Several other financial institutions such as Industrial Finance Corporation, Industrial Development Bank of India, State Financial Corporation etc. which were set up after Independence have contributed in a large measure to the industrialisation of the Country. Although they do not take part directly in the intermediation process in the Country, yet, they play a vital role in the investment of funds by banks, Government etc. which engage themselves in the task of mobilising the savings of the public.

The unorganised or semi-organised sector of the Country's Economy consists of money lenders, indigenous banks and other non-banking financial intermediaries such as Chit Funds and Finance Companies like the Nidhis. The operations of these institutions are quite important in certain areas and for certain sectors.

Institutions engaged in intermediation
in India
We may classify those institutions which are engaged, some way or the other, in the intermediation process in India into three groups, as under:
a) Those organisations such as commercial and co-operative banks, Regional Rural Banks, Unit Trust of India etc. which are directly engaged in the intermediation process and thereby mobilise and deploy funds in different forms;

b) Those Institutions such as Post Office Savings Banks, LIC, Provident Fund institutions etc. which only mobilise funds to be deployed directly by the Government or to be deployed by these institutions themselves strictly in conformity with the guidelines laid down by the Govt. in this regard.

c) Development Banks such as the IDBI, IFC, State Financial Corporations etc. which are engaged only in deployment of funds contributed to them by others viz. Govt., Reserve Bank of India, commercial banks etc.

ROLES OF INSTITUTIONS WHICH ARE ENGAGED IN FULL-FLEDGED INTERMEDIATION IN INDIAN ECONOMY

The performance of institutions which play a full-fledged intermediary role is set out, in detail, in Chapter X. However, their role is dealt with briefly here with reference to the context.

Commercial Banks

Banks have been playing, particularly since Nationalisation, a vital role in financial intermediation by accelerating the pace of economic development in the Country. Their deposits (mobilisation of savings) spurted between the last Fridays of
1969 and May 1985 by nearly 14 times or Rs. 68,061 crores to Rs. 72,938 crores. The ratio of domestic savings mobilised by commercial banks to total domestic financial household savings in the Country rose from 38.1% in 1970-71 to 45.1% in 1980-81. Similarly, the share of domestic savings in the form of bank deposits to Net National Product at market prices moved up to 4.2% in 1980-81 from 2.1% in 1970-71. This was possible mainly because of a large number of branches opened by commercial banks throughout the length and breadth of the Country. They opened 37070 branches between end June 1969 and end March 1984, taking the total number of branches in the Country to 45,332, of which nearly 73.4% were in rural and semi-urban centres, thus providing opportunities to the rural people, in particular, to save more in terms of money and also extending liberal credit support to the productive pursuits of the rural poor. Further, they lend substantially to the Central & State Governments by investing in their Securities; such investments (of banks) have spurted from only Rs.1055 crores as on the last Friday of July 1969 to Rs.29,229 crores as at the end of May 1985. These investments constitute a vital source of funds for the Government, particularly for improving infrastructural facilities in the Economy. Besides, bank credit is now used as a vital lever for increasing production, generation of employment and minimising imbalances in the Economy. Thus, Nationalisation of banks has heralded a new era in the history of economic growth in the Country. While prior to Nationalisation, profit was the fundamental aim of banks, after Nationalisation, socio-economic uplift of the masses has become their basic and fundamental objective and profit has become only incidental to them. Thus, financial profit as the basic aim of commercial banking has now been replaced by social profit or benefits to the community, particularly the downtrodden. The Government has directed banks
to lend, at concessional rates of interest to the Priority Sectors (which include Agriculture, S S I, Retail Trade, Small Business, Road Transport, Professionals & Self-Employed etc.) an amount which would be equivalent to 40% of the outstanding balance in regard to the Net Credit (i.e. gross credit less bills rediscounted by banks with the Reserve Bank of India, Industrial Development Bank of India and other Financial Institutions). Thus, credit extended by banks to the Priority Sectors has bulged from Rs.441 crores as at the time of Nationalisation to Rs.14,834 crores (or 38% of the Net Bank Credit extended by them) on the last Friday of March 1984, covering over 1.70 lakh borrowal accounts, of which credit extended to agriculture and SSI accounted for a rise of 37 times or Rs.5,971 crores and 20 times or Rs.5,155 crores respectively to Rs.6,133 crores (under 1.20 lakh accounts) and Rs.5,412 crores (covering 15 lakh units) respectively (as of end March 1984). The Government of India fixed a norm that banks should step up their level of direct lendings to agriculture (including 'allied activities!') to such an extent as to constitute 15% of the 'Net Credit' extended by them by March 1985 and 16% by March 1987. Whereas as at the end of December 1982, such lendings of all banks amounted to Rs.3,954 crores which accounted for 12.65% of Net Bank Credit extended by them as on that day. Consequently, not only production has been geared up in these Sectors but employment opportunities also have been expanded. Food production spurted from 94.1 million tonnes in 1968-69 to 155.8 million tonnes during 1983-84. There was a boost in the quantum and value of production in the SSI Sector, the value amounting to Rs.35,000 crores in 1982-83. The SSI Sector now employs about 79 lakh persons. Advances extended by banks to
to all Priority Sectors other than Agriculture & SSI viz. Professional & Self-Employed persons, retail traders, Road Transport Operators, Small Businessmen etc. spurted from a meagre sum of Rs.13 crores as at the end of June 1969 to Rs.3,289 crores as at the end of March 1984. This has generated/ provided gainful self-employment opportunities to several lakhs of unemployed persons in the Country, apart from helping to improve transport facilities in the Country, thereby facilitating easier availability/mobility of goods and commodities etc. Thus, special attention has been/ is paid to all these vital Sectors, after Nationalisation. As at the end of March 1982, Rs.311.50 crores (accounting for over 1% of the Net Bank Credit that was outstanding as on the last Friday of 1981) had been lent by commercial banks under the Differential Rates of Interest Scheme, at a concessional rate of interest of 4% p.a. to the poorest among the poor; of these, advances extended to persons belonging to Scheduled Castes/ Scheduled Tribes amounted to Rs.154 crores which constituted 49.6% of the total credit extended by banks under this Scheme.

On August 15, 1983, the then Prime Minister announced a Scheme for providing 'Self-Employment to Educated Unemployed Youth' in the Country. Banks have participated whole-heartedly in this Scheme and have lent, since the inception of the Scheme and up till March 31, 1984 loans amounting to Rs.397 crores to 2.41 lakh unemployed youth and thereby helped to set themselves up in gainful self-employment.

The launching of the 20 Point Programme has helped accelerate considerably the flow of bank credit at lower rates of interest to the Weaker Sections of Society. Although lending under this Programme was temporarily suspended by banks for a period of two years,
during the Janata Regime, yet after the return of Congress (I) to power, it has been revived and banks continue ever since to lend actively under the Programme. The areas to be covered under the Programme were redefined, in 1981, in terms of the revised 20 Point Programme and banks lend under this Scheme on an increasing scale. Under this Programme, banks had lent, as at the end of 1983, a sum of Rs.3908 crores covered by 85.86 lakh accounts. Thus, the importance of the role played by commercial banks in the economic uplift of the people, generation of self-employment and employment opportunities and in stepping up the level of production in the Country can hardly be exaggerated.

The role of commercial banks in the Country in the reduction of regional economic imbalances and in the monetisation of the Economy also is quite significant. Quick mobility and transfer of funds between places and Regions have become possible because of banks with their vast network of branches. Under the Lead Bank Scheme, almost all districts in the Country have been allotted to various banks wherein they are required to play a 'Lead Role' to help ensure planned and accelerated tempo of economic growth based on Schematic lending by drawing up and implementing Annual Action Plans for extension of liberal and adequate credit assistance by all banks operating in those districts and by opening a large number of branches in those Districts.

Banks, in their endeavour to step up the flow of credit, particularly to the Priority Sectors, have opened a large number of specialised servicing units such as Agriculture Development Branches, Gramodaya Kendras, Rural Development Centres, Multi-Service Agencies, Weaker Sections Development Agencies, Entrepreneur Advisory Cells, Small Scale Cells etc. and have adopted...
a number of Co-operative Primary Societies. Banks have also sponsored 159 Regional Rural Banks in different parts of the Country with a view to providing more extensive and intensive credit support to the rural poor in the Country at lower rates of interest. Though large scale social lending at lower rates of interest has eroded considerably the profitability of banks, yet, they have in no uncertain terms, acted as vital instruments of socio-economic transformation in the Country. A detailed Study about the impact of the performance of banks in various spheres and the resultant erosion of their profitability has been made in Chapter III.

Co-operative Banks:

Co-operative Banks had their origin in India in the setting up of credit societies in the first decade of this Century. The Reserve Bank of India constituted, in 1951, a Rural Credit Survey Committee, which found, after a detailed Study, that the co-operatives had failed in regard to provision of rural credit, though they had a significant role to play in that area. In the words of the Committee, "The operations of the Co-operative banks have so increased in volume in recent years and hence had such an important bearing on currency and credit situations in the Country". Currently, Co-operative Banks have a three-tier system - Primary Agricultural Societies being the units, Central Co-op. Banks forming the intermediary tier and State Cooperative Banks the Apex banks.

Primary Agricultural Credit Societies function at the village level, Central Co-op. Banks at the District level.
and State Co-operative Banks at the State level. Primary Agricultural Credit Societies mobilise deposits from the public; however, deposits collected by them are only minimal compared to the funds lent by them and this is possible for them as they get good funds support from Central Co-operative Banks.

Between June 1961 and June 1983, the deposits and loans outstanding of the Co-operative sector (State Co-operative Banks, Central Co-operative Banks, Primary Co-operative Banks etc.) in the Country increased sizeably from Rs.1,115 crores and Rs.3,578 crores to Rs.10,285 crores and Rs.14,168 crores respectively.

Land Development Banks:

Long term credit needs of agriculturists are met by Land Development Banks. They mobilise funds by way of deposits from the public and grants from State Governments. They extend credit assistance for a variety of purposes, particularly for development of lands, purchase of machinery and other farm equipments, improvement of irrigational facilities etc. Their working capital and advances improved substantially to Rs.3,186 crores and Rs.2,188 crores respectively as of end June 1979 from Rs.1,393 crores and Rs.1,086 crores respectively as of end June 1972.

Regional Rural Banks (RRBs):

The Government of India passed the Regional Rural Banks Act in 1976 and thereby enabled commercial banks to set up RRBs. This was done with a view to ensuring spreading of banking habit among the rural folk and providing adequate credit assistance for the development of the rural economy, particularly the small and marginal farmers,
landless agricultural labourers, share croppers, oral lessees, artisans, craftsmen, small entrepreneurs etc. in rural areas.

Initially five Regional Rural Banks were inaugurated on October 02, 1975. The Regional Rural Banks have since made significant progress in the fields of both mobilisation of deposits and dispensation of credit. As of end June 1984, there were 159 Regional Rural Banks covering 286 districts in the Country with 8213 branches and the total deposits mobilised and advances made by them amounted to Rs.722 crores and Rs.838 crores respectively as on the last Friday of June 1984.

Unit Trust of India (UTI):
The Unit Trust of India was set up in 1964 with a view to helping small investors to participate directly in the industrial development of the Country. It invests the funds collected from them in the form of equity and preference shares of selected companies and also lends to banks. Thus, as of end March 1984, they had investible funds amounting to Rs.1,262 crores, of which they had invested Rs.227 crores in equity and preference shares, Rs.488 crores in debentures and the remaining Rs.545 crores in advance deposits against investment commitments, fixed deposits, bridge finance and money at call and short notice.

ROLE OF INSTITUTIONS (IN INDIA) WHICH ONLY MOBILISE SAVINGS:
There are several institutions such as the LIC, Post Office Savings Banks, Provident Fund Institutions, GIC etc. which are engaged only in mobilisation of funds. These institutions lend only in a selective/limited way.
a. Life Insurance Corporation of India (LIC)

The Life Insurance Corporation of India is one of the most important institutions of this category. As of June 1984, the aggregate outstanding in its fund accounts stood at Rs.9800.38 crores. Its investments in the Securities of the Central and State Governments and their sponsored Organisations and lendings to individuals against pledge/security of property etc. amounted to Rs.9,613.74 crores. These Loans were made up of, inter alia, Rs.1043 crores lent to Electricity Boards of various States, Rs.1077 crores lent to State Governments for Housing and other Schemes and Co-operative Societies and Rs.608 crores lent to Policy holders. But a sizeable portion of the monies collected by the Life Insurance Corporation is invested in the Securities of State Governments and other Trustee Securities. As of end March 1984, it had invested Rs.5,165.17 crores in the Securities of State and Central Governments and in the shares/debentures of other companies.

b. Post Office Savings Banks

Post Office Savings Banks, which constitute the second largest component, next to banks, collect a large quantum of small deposits. The aggregate deposits mobilised by these Banks amounted to Rs.14,048 crores, as at the end of March 1984. The main reasons for their huge collections are (a) availability of Post Office even in the remote rural areas of the Country, (b) tax exemption given by the Government for long term savings in Post Office Savings Banks, (c) higher interest rates offered by these banks etc. Funds so collected are directly used by the Government as sources of funds in its Budget and are utilised for development purposes.
Provident Fund Scheme

The Provident Fund Scheme of the Government provides for compulsory savings for most of the people in the salaried income group. Although, primarily, it is only a social security scheme, yet it enables Government to mobilise sizeable funds from employers and employees alike. Further, savings in the form of Provident Fund are exempted from tax. Contributions received by the Provident Fund Organisation from unexempted establishments as well as Boards of Trustees in respect of exempted establishments are to be invested, after making payments due on account of advances and final withdrawals, according to the following pattern laid down by the Government of India:

- Not less than 20% to be invested in Central Govt. Securities
- Not exceeding 35% to be invested in State Govt. Securities
- 7-Year National Savings Certificates
- 25% in Special Deposit Scheme

The funds collected by the Provident Fund authorities which mainly represent balances in State Provident Funds and in Trusts and Endowments amounted to Rs. 9,185 crores, as of end March 1983.
General Insurance Corporation

General Insurance Corporation has four insurance companies/units in its fold and looks after insurance business other than those that relate to human life. It mobilises small funds from mostly the upper classes of society. The monies so collected by these corporations, unlike in the case of the Life Insurance Corporation of India, are not repayable under normal circumstances unless otherwise claimed by the insured, consequent upon loss incurred by them in the value of their insured items such as vehicles, buildings etc. due to damage caused by fire, accidents etc.

The GIC has made spectacular headway in its business since Nationalisation in 1973. The Government of India has laid down the investment pattern of the (monies collected by) the GIC as follows:

25% to be invested In the form of Central Govt. Securities

10% ** State Government Securities & Securities of various Boards, Debentures of Loans to various Pub. Sec. Companies etc.

20% ** Loans to State Govts. for social Housing Programmes

15% ** Loans to HUDCO

30% ** Investments in Debentures, Equity Shares, Preference Shares etc.
As at the end of 1982, the GIC had invested, in all, Rs.725 crores on the lines set out above.

A few more institutions such as the Deposit Insurance & Credit Guarantee Corporation and the Export Credit & Guarantee Corporation also mobilise funds indirectly from institutions/borrowers for insuring their goods and advances granted to them. They also invest their funds sizably in the form of Govt. Securities.

ROLE OF INSTITUTIONS WHICH ONLY EXTEND CREDIT SUPPORT BUT DO NOT MOBILISE FUNDS (IN INDIA)

Development Banks such as the Industrial Development Bank of India, Industrial Finance Corporation, Industrial Credit and Investment Corporation, Industrial Reconstruction Corporation of India, State Financial Corporations, State Industrial Development Corporations etc. only deploy credit but do not mobilise funds. These institutions derive their funds from the Government, Reserve Bank of India, Banks etc. and by issue of Bonds and Debentures. They lend funds for promotion of industries and other sectors. But as development banks, they do not engage directly in lending to borrowers but route their assistance through financial institutions such as banks and their assistance is in the form of provision of seed capital or underwriting shares etc. Such assistance provided (disbursements made) by Industrial Financial Institutions (both of the Central & State Governments), during 1983-84, amounted to Rs.2,499 crores10.

OTHER INSTITUTIONS/AGENCIES;
There are some other institutions which also mobilise savings. For instance, the Government has permitted public limited companies to accept deposits from the
public and these funds are utilised by them for their own purposes and as such they do not indulge in intermediation. However, there are some non-banking financial intermediaries such as Hire Purchase Companies, Loans and Finance Companies, Investment Trusts and Investment Companies, Chit Funds, Building Societies etc. which mobilise savings from the public and also deploy those funds. These intermediaries play a significant role in the Economy by creating financial instruments to suit the wide and varied preference of savers and borrowers in the Economy. However, these deploying activities are not much regulated by the Government although, of late, legislations have been introduced to regulate them, to some extent.

**EFFECTIVENESS OF THE INTERMEDIARY ROLE PLAYED BY ALL THESE INSTITUTIONS IN INDIA**

Though the main subject matter of the Study is the management of intermediation by banks in India and its impact on the Country's economic growth and development, yet, a broad analysis of the intermediary role played by institutions other than banks also should be done, as they function as complementary and supplementary units to banks in regard to financial intermediation (as otherwise, it would be difficult to assess the significance of the impact of the intermediary role played by/expected of banks in the Country).

**MOBILISATION OF SAVINGS**

The effectiveness or otherwise of the role of intermediation played by the various institutions in any Country is reflected in the ratio of Savings to National Income. Thus, Net domestic savings in India accounted for 15.7% of the Net National Product in 1983-84 and amounted
to Rs.308.77 crores as against only Rs.3,640 crores or 10.6% of MNP in 1970-71. However, this ratio was higher at 17.5% in 1981-82. Thus, savings in the Country have improved substantially both in absolute as well as in percentage terms. It would be worthwhile to study critically this aspect viz. mobilisation of savings by financial intermediaries.

Although, as mentioned earlier, savings in the form of physical assets result in withholding money from consumption, yet such savings would not result in investment and as such savings would not add to either capital formation or production of goods, commodities and services. During the Financial Year 1983-84, the ratio of physical savings to total household savings in the Country accounted for 45.90%. However, such proportion was as high as 87.14% in 1950-51. As mentioned earlier, the role of intermediation lies mainly in the conversion of physical savings in the Economy into financial savings and the Indian intermediary savings agencies have certainly succeeded to a very great extent in this regard. As remarked by the Planning Commission in its revised draft Sixth Five Year Plan 1978-83, it is apparent that the Country has achieved a high rate of savings despite its low per capita income. In fact, our rate of savings as proportion to MNP is comparable to the rates that are recorded in middle income and even some high income/highly industrialised Countries. In the United States of America, Gross fixed capital formation was only 18% of National Income while in the U.K. it was 16%; it was very high in Japan at 29%. Nevertheless, a lot more still remains to be done in our Country in regard to mobilisation of savings as saving potential is yet to be tapped effectively in the rural areas.
Even though the ratio of domestic savings to NNP has improved substantially during the post-Nationalisation period, yet it has shown a declining trend in the recent years. Thus, while the ratio was 19.5% in 1978-79, it declined to 17.5% in 1981-82 and 16.7% in 1983-84 and it is expected to decline further. Hence, concerted efforts are required to be taken to step up this ratio in the Country. While the NNP has increased by more than three and a half times (at current prices) between 1970-71 and 1983-84, savings during this period increased by more than five and a half times. In spite of so much of monetisation in the Economy and a vast expansion in bank branch network in the Country, savings have not grown appreciably. It was again reflected in the incremental ratio of savings to NNP between 1970-71 and 1983-84, which worked out to only 20.58%—just four percentage points more than the ratio of savings to NNP. Perhaps, this might have been due to more equitable distribution of income in the Country which has stepped up consumption. This may also be attributed to what is known as 'Demonetisation Effect' propounded by Prof. Nurkse which is much pronounced in developing countries. In the words of Prof. Nurkse "when people come into contact with superior goods or superior patterns of consumption with new articles or new ways of meeting old wants, they are apt to feel after a while a certain restlessness and dis-satisfaction. Their knowledge is extended, their imagination stimulated, new desires all aroused, the propensity to consume is shifted upwards". Such instances are galore in history. The average urban family in America saved 6% of its annual income in 1917-1919 which fell to almost 0% in 1941.

Further, a high rate of inflation in the Economy which was evidenced clearly between 1979-80 and 1983-84 (the annual rate of inflation was little less than 15% during this period) affected adversely the propensity to save.
In other words, savings moved up more or less at the same rate at which NNP also increased. Hence, the so-called monetisation etc. as spelt out above failed to boost savings. Thus, intermediation has helped the Country to mobilise the incremental NNP more or less in the same ratio and did not lead to any spurt in savings.

However, it should be conceded that intermediation has helped substantially in the conversion of physical savings into financial savings. Thus, financial assets of the household sector as proportion to NNP in the Country rose, during the years from 1970-71 to 1983-84, to 7.4% from 3.9%. Further, mobilisation of such savings by the Banking System as proportion to NNP in the Country rose during this period to 4.1% from 2.1%. Moreover, during this period, the proportion of deposits in banks to the savings of the household sector increased from 38% to 40%. Thus, Nationalisation of banks and the subsequent expansion in terms of, inter-alia, number of branch offices, monetisation of the Economy etc. failed to step up adequately the rate of mobilisation of savings in the Economy.

Although several incentives such as grant of exemption from Income-tax for payments of LIC premiums, purchase of Units, subscription to P.F. etc. are offered for promotion of savings, yet savings, in India, are still restricted to sophisticated savers. Viewed in this context, deposit mobilisation by banks and their conversion of physical savings into financial savings leaves much to
be desired. Perhaps, with the opening of more Regional Rural Banks and with the opening of more number of branches by commercial banks in rural areas of the Country, the Banking System would be in a better position to tap more savings/funds and thereby convert a sizeable quantum of physical savings into financial savings.

Increase in NNP is the main yardstick to measure the growth of the Economy; it is caused by deployment of various factors, particularly finance, which help step up production. But the impact of funds deployed by these Institutions for the development of the Economy cannot be precisely quantified. Nevertheless, these Institutions deploy their funds, normally, in the proper manner and contribute their due share to the growth of the Economy, as they are strictly governed by the policy guidelines issued by the monetary authorities in this regard.

However, a critical appraisal of the role played by the Banking System in regard to intermediation, particularly extension of credit would be quite essential.

The significance of the crucial role played by banks in their capacity as financial intermediaries, especially since Nationalisation, in regard to deployment of funds, particularly extension of credit can hardly be exaggerated. Further,
as mentioned earlier in this Chapter, Banks have stepped up substantially, since Nationalisation, their advances to the Priority Sectors, with a slant on 'Weaker Sections', within the Priority Sectors. These advances have been extended by banks under various tailor-made Schemes such as the 20 Point Programme, particularly the Integrated Rural Development Programme, Differential Rates of Interest Scheme, Prime Minister's Scheme for Self-Employed etc. While aggregate credit extended by the Banking System had improved by thirteen times between June 1969 and March 1984, advances made by them to the Priority Sectors spurted, during this period, by as much as 34 times. Further, bank advances to the borrowers covered by the Priority Sectors carry lower rates of interest than those extended to borrowers covered by the Conventional/Non-Priority Sectors. But banks take to, on a massive/increasing scale, such low return yielding social lending at the cost of their profit. For such social lending becomes high cost lending in view of minor sums being advanced to a very large number of borrowers and fetches, as mentioned earlier, lower rates of interest. Further, the rate of recovery is very poor in these areas which renders effective and quick recycling of funds impossible, which, in turn, affects adversely their profitability. However, banks are happy with the huge social gains that they are able to account for as a result of these huge socio-economic lending operations such as the socio-economic uplift of the rural poor by alleviation of their poverty and pauperism, which are some of the basic aims of the Govt. But the huge advances that are extended by them to the Food Corporation of India for their food procurement
operations, Large & Medium Scale Industries, Wholesale Trade and other Conventional Sectors which, together, account for about 60% of the gross credit portfolio of all Scheduled Commercial Banks, fetch higher income than advances to the Priority Sectors do. Advances extended to large and medium industrial units, in the backward areas of the Country, at concessional rates of interest, help reduce to a great extent regional economic imbalances. Besides, advances to the Food Corporation of India help/have helped the building up of good buffer stocks of food grain in the Country. Identification of sick units and lending to them adequately, at the proper time and at concessional rates, have helped to rehabilitate several of them. Bank credit thus helps accelerate and diversify production and make available finished products at cheaper rates.

The preparation and implementation of District Credit Plans/Annual Action Plans by various banks, under the Lead Bank Scheme, for the development of the various Districts in the Country, have enabled banks to lend in a substantial way to the needy sectors of the rural community in particular, thereby facilitating their planned and steady growth.

The investments of commercial banks in the Securities of Central and State Governments and in those of State Associated Bodies nearly doubled between 1969 and 1981 and this enabled the Government to step up its investments every year for the improvement of the infrastructural facilities in the Country.
Thus, it may be seen that the intermediary role played by the various financial institutions in the Country is quite impressive and commendable though their performance in the field of mobilisation of savings has been somewhat moderate. As regards banks in the Country, it can be stated, in no uncertain terms, that their intermediary role, particularly since Nationalisation, has helped to gear up effectively the process of economic development in the Country. However, this has caused great strain to banks in regard to their profitability. As PEP Committee stated, "these admittedly far reaching reforms unparalleled in the history of the world banking were, however, achieved at a price". As the success of banks lies in not merely opening numerous branches but only in running them on profitable lines, it is necessary for them to evolve suitable measures to ensure that their intermediary role does not affect their viability. A detailed analysis of the impact of the intermediary role played by banks on their profitability/viability is set out in the next Chapter.
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