CHAPTER X
CONCLUSION &
SUGGESTIONS
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It is now possible for us to draw out certain broad generalisations regarding the credit policy of the Reserve Bank of India and the effectiveness of the various tools used by it to achieve its objectives. So far as the credit policy is concerned we can divide it into four broad periods:

(i) Period from 1935 up to 1939
(ii) Period from 1939 up to 1950
(iii) Period from 1951 up to 1955, and
(iv) Period from 1956 onwards

The first period was the time when Reserve Bank as the Controller of the currency and credit was in its infancy, and no set conventions had been formed. Indian rupee at a peculiar position in the foreign exchange markets because of
its linking with sterling and absence of independent position rendered a task of any bold attempt at stabilising the value of rupee in the external market very difficult. Internally, there was a lost of limitation both with regard to policy and powers of the Bank. It was a period of depression and the prices were constantly on decline not only in India but throughout the world. As we have already seen some steps towards checking the rot in the economy were undertaken by the Reserve Bank but they hardly produced much successful results.

The second period which may be termed as war period was characterised by rising prices. The second world war continued from 1939 upto 1945 with its after-effects extending upto 1947 and even later. In 1947 independence came to the country but it brought numerous problems of its own mainly resulting upon the division of the country and migration of population on a scale un-precedented in Indian history or the history of the any other country of the world. The Government of India naturally took some time in formulating the objectives of monetary policy in the context of changed circumstances.

During the war period the monetary policy was geared at restraining consumers credit and making every effort at mobilising the resources for the war. The bank, however, was faced with stupendous task of controlling the expansion of currency which was increasing at a stupendous pace under the cover of sterling balances from His Majesty's Government.
During this period the number of currency notes rose several-folds. In an emergency period like this the role of monetary authority becomes of a secondary importance and fiscal authorities dominate the show. Even then within its own limitations the Reserve Bank of India played its part well in supplementing its efforts to meet the major objectives of economic policy.

The third period or the First Plan period is of major significance in this respect as it was during this period that monetary policy has taken a definite shape. This was a period of falling prices, the fall being mainly experienced in the field of agricultural products. Besides this, the Government of India had embarked upon a massive investment programme to boost the economy of the country.

Monetary policy under these circumstances was one of credit support or what may be termed as a cheap money policy. The objective of this policy was on one hand to place increasingly larger resources at the disposal of trade and industry while on the other to facilitate the raising of loans by the Government in the open market at reasonable rates. The Cheap money policy of the bank brought good results and there was a great expansion in the ban-credit during this period. The total ban-credit to non-Government borrowers went up from Rs.547 crores in 1950-51 to Rs.761.3 crores in 1955-56. While banks' investment in Government Securities rose to Rs.360 crores. Cheap money policy was helpful in raising investment in the country by creating a suitable climate for investment.
The credit policy of the Reserve Bank was also aimed at removing the seasonal stringency on money market and making the monetary system more elastic to adjust itself to busy and slack seasons which characterised the economy of the country. Another objective of the credit policy was to place increasingly larger sums at the disposal of agricultural sector in order to reduce the vast disparity among interest rates between the organised money market and agricultural sector. The agricultural credit department has done a lot in this respect and Reserve Bank's advances to various co-operative banks have shown a significant increase during the period. The Reserve Bank's advances to State Co-operative Banks which were negligible in 1950-51 rose to Rs.11.22 crores in 1955-56. It is not possible to say that Reserve Bank's policy in this respect has been successful because rates of interest continue to be high in the rural areas even now. In view of the vast magnitude of the problem the bank cannot be blamed for the lack of success in this respect, but nevertheless it has been able to do a lot in this respect.

The fourth period was characterised with rising prices and Reserve Bank of India was faced with some very complicated problems in respect of monetary policy. On one hand increasingly larger sums of money had to be made available to agricultural industry and the Government while on the other credit had to be restrained in specific sectors to restrain the prices that were shooting up under the pressure
of increased money supply. A selective credit control policy was therefore the only alternative left out with the Reserve Bank of India and this has dominated the monetary tools exercised by the bank during this period.

The selective credit controls which were first introduced in respect of foodgrains were gradually extended to shares, sugar, oilseeds, jute, etc. They have been modified from time to time according to the economic situations that prevailed in the country and specially with regard to the commodity subject to credit restraint. Suitable exemptions were allowed to co-operative institutions and new branches. Selective credit control is an administrative nature and its success would very much depend upon the rapidity with which the Reserve Bank is able to grasp the situation and the measure of response that it receives from the banks.

As regards the use of tools of credit management year 1960-61 may be regarded as an important landmark. The Reserve Bank had seen how selective credit controls in themselves had failed to achieve the objectives unless backed by general credit controls. Consequently, some drastic general credit control measures were taken out in the year 1960-61. These include raising of the reserve ratio upto 25 per cent on new deposits and extending it to 50 per cent later on, and also the introduction of the tier-system of interest rates in September, 1960. According to this new system while the Bank Rate was maintained at 4 per cent penal rates were
charged for borrowing above the quota. There have been a number of adjustments since then, the three-tier system being converted into four-tier system. The four-tier was abolished under the pressure of emergency and was followed by a rise in the Bank Rate from 4 to 4½ per cent. It is thus evident that since 1960 added emphasis has been placed upon general credit control measures and the bank Rate policy has assumed increased importance.

With the Chinese massive invasion on our borders an entirely new situation has been created in the economic field. In this respect also the Reserve Bank of India was quick enough to take proper steps for meeting any sudden rise in prices created through emergency. The declaration of emergency was followed by drastic credit control measures by the Reserve Bank of India which include raising of the Bank Rate and restriction of credit against a number of commodities viz., shares etc. The measures of general credit controls have also been strengthened.

We can, therefore, conclude that so far policy is concerned Reserve Bank has been alive to the situation and adjusted its policy to the new challenges as and when they have appeared before the economy. Since 1956 it is one institution that has fought valiantly single-handed against the rising prices and flood-gates of money opened through the fiscal policy of the Government of India.
Inspite of the appropriate policy it is difficult to say that the objectives of the monetary policy were fully achieved. In this respect the bank has met some grave failures. During the First Plan period it was successful to some extent in checking the downward movement of the prices but after 1956 it has failed to arrest the rising trend. This is because of the various limitations of both policy and powers that make the monetary tools less effective. Some of these difficulties are enlisted below.

First of all there is a wide gap between the fiscal and monetary policies in India. While the Reserve Bank of India is entrusted with the task of restraining credit and keeping the prices under check the Government of India in its fiscal policy have been following the opposite view. There has been large investment mostly through deficit financing which has led to a large increase in the money supply. The pattern of investment has been defective in the sense that greater emphasis was laid on capital intensive and basic industries which failed to create income in the real terms. This, together with failure of the consumer goods sector to expand itself with rising demand has created an inflationary gap which continued to widen as more and more time passed. It has not been possible for the Reserve Bank of India to meet this ever widening gap through monetary measures.

The monetary policy in the context of economic development has certain inherent contradictions that militate
against the successful use of the tools of monetary policy. The tools of general credit control become essentially less effective because they cannot work via curtailment of investment growing unemployment and shattering of market confidence. While using these measures the Reserve Bank has to take precaution that it does not put too hard a pressure upon the economy and hold back the process of development itself.

Because of these various considerations the Reserve Bank has been restrained from using too drastic steps. Various exemptions had to be allowed to new branches, co-operative banks and other institutions in order that their development may not be restricted. Really speaking a policy could not be one of credit restraint but of credit readjustment which is a more difficult task for any monetary authority to accomplish specially when there is a lack of co-operation from fiscal authority.

Structure of the money market is no less responsible for weakness and ineffectiveness of monetary measures. At present according to the confessions of the ex-governor of the Reserve Bank, Mr H.V.R. Lengar nearly 50 per cent of the trade is financed by unorganised sector where the measures of the Central Bank do not produce much influence. In fact, a very large portion of the economy, nearly 37 per cent is still under barter system where money plays no part as a medium of exchange. Under these circumstances efficacy of monetary measures is automatically reduced.

The scheduled banks and the trade in country are not subject to control by the Central Bank. The scheduled
bank borrowings from the Reserve Bank form only a small portion of the total bank credit and this makes them generally immune to general credit control measures. This along with existence of large investments in Government Securities makes the situation still more complicated. In times of emergency the banks have been found to make good any restraint on their resources by selling of Government Securities for cash. This kind of tendency was witnessed in 1960 when stricter credit control measures were introduced.

The existence of large scale government securities with banks and other financial institutions is an other limitation upon the powers of the Central Bank to regulate credit. A rise in the Bank Rate which leads to a rise in the general market rate of interest results in a fall in the price of all long-term securities, particularly the government securities. Any substantial fall in the prices of these securities means a large reduction in the assets of financial institutions many of which are under statutory obligation to maintain a part of their assets in form of government securities.

Besides, endangering the financial position of these institutions it makes further raising of loans very difficult. The result is that the Reserve Bank of India cannot take any drastic steps towards raising the rate of interest and must come forward in support of government securities when their value is going down in the market. Professor Chandler who was invited by Bombay University while lecturing on monetary problem...
asserted that interest rate in India should be raised sufficiently to maintain the new equilibrium and save the wastage of capital that the present cheap money policy encourages. This view has been further expressed by other foreign economists. But in view of the peculiar situation prevailing in India any substantial increase in the Bank Rate is not possible.

The unorganised nature of money market is another actor that hampers the effectiveness of monetary measures specially the Bank Rate. In India we have a number of localised money markets, each one working independently of the other. Among these markets there is no free flow of money with the result that a variety of rates of interest ranging from 6 per cent upto 150 per cent prevails in the country. This compartmentalisation of money market into separate self contained blocks does not furnish the operation of monetary factors to produce its proper economic effects.

The constitutional position of the Reserve Bank of India and its powers over even sch. banks was limited. The Banking Companies Act 1949 increased the powers of the Central Bank which again have been extended from time to time by suitable amendments. The last change is taking place after the failure of Palai Bank. The Reserve Bank at present is equipped with necessary powers to regulate and control the working of the scheduled banks in India and safety and use of funds can be watched with complete accuracy.
The Statistics Department of the Reserve Bank of India has been amply strengthened and the bank is now in possession of elaborate information regarding the money and capital markets as well as the lending operations of each individual bank and it is in a position to take timely action in matters of financial trouble faced by any bank individual or by all banks collectively.

The powers of the Bank over the capital market have also been strengthened during recent times. In fact, this capital market itself provided a large scope for evading the regulations of the Reserve Bank of India. Reserve Bank is now an influential member and on the board of management of various institutions that have been set up after independence. In fact, it works as a coordinating authority between these institutions on account of its common membership of nearly all of them and because of the peculiar financial powers enjoyed by it. So far the Reserve Bank has not exerted its influence upon the capital market as is evident from the happenings of Mundra case and other criticisms levelled against the I.F.C. and other Corporations.

The nature of business with lack of specialisation and preponderance of cash economy is still another factor that restricts the effectiveness of monetary measures. In India, there are small shop keepers who do not keep proper records and one man deals in a number of branches. This lack of specialisation has resulted in the failure of selective credit
controls to bring down the prices. Whenever credit restrictions are imposed on one article the businessman tend to compensate through greater credit on other articles of trade. It is because of this reason that since 1960 Reserve Bank has decided to supplement selective credit control measures with general credit control measures.

In matters of stability of foreign exchange value of rupee the situation has been far from satisfactory. It is one of the duties of the Central Bank to maintain the value of home currency in terms of gold and foreign currency. In fact much of the inflow of foreign capital and even economic aid is dependent upon the way in which the monetary works are conducted by any country. The Reserve Bank of India in this respect also is placed under serious limitations and has played a second fiddle to the Government of India. The external value of rupee depends to a large extent upon the internal price level and the balance of payment position in general and sectorwise. The Reserve Bank in this respect has confined its action to exchange control alone and the regulations for it have been made more and more stringent year after year as the foreign exchange position worsened in the country. During the present emergency the regulations have been made extremely hard.

Control over foreign exchange can hardly provide a long-term remedy to the economic malice that is so deep rooted in our country. The Reserve Bank of India has refrained
from exercising such weapons of monetary policy as devaluation of currency and monetisation of certain notes. Of course, such a policy can hardly be regarded as advisable in face of India. Some economists have recently been talking about regarding devaluation of rupee to step up our exports. They, however, fail to realise the enormous increase in the burden of foreign debt which is already too much. This increase in debt burden and the current payments by way of interest and other charges would be so burdensome that it will easily outweigh the small margin of increase that may take place as the result of devaluation.

It is thus clear that within its limitations the Reserve Bank has been following a correct policy with regard to credit. It has been fully vigilant and the control measures have come rather quickly whenever the situation has demanded them. The failure of monetary policy particularly in the field of stabilising the price level and maintaining the value of rupee abroad has been mainly due to the economic conditions under which Reserve Bank of India has to work. The success of these measures should therefore be judged in relation to these circumstances rather than in absolute terms. We can definitely say that but for the wise policy followed by the Reserve Bank of India the impact of expansionary fiscal policy upon the price level would have been more dangerous. We should, therefore, think how much the prices would have gone up as a result of increased money supply had these restrictive
measures not been in operation rather than how far the Reserve Bank was able to reduce them.

The following suggestions may be found useful for a sound functioning of monetary measures in India:

1. Every attempt should be made to reorganise the money market and galvanize it into one single organised free market within which the flow of money is maintained. Unhindered. It is necessary for this purpose that indigenous bankers and cooperative banks should work in close cooperation with the scheduled banks and be under the overall control of the Reserve Bank.

2. Credit facilities on the organised scale should be given through the expansion of credit institutions in the rural areas. The expansion of co-operative credit and the branch expansion scheme of the State Bank of India have done some useful work in this respect but this has touched only a fringe of the problem although Reserve Bank of India has granted special facilities to scheduled banks for branch expansion, they have been reluctant in expanding their business in this direction mainly because of the problem of security and of the fact that a more lucrative business awaits them in the cities. For sometime the work of providing credit to rural areas will have to be entrusted to co-operative organisations. Of course, there is a need for suitable modi-
fications in their working so as to operate them on more commercial lines and enlist the support of local money lenders and other agencies engaged in agricultural finance. Reserve Bank of India can play a useful role in this respect.

Reserve Bank of India should be given a complete control over monetary matters both with regard to formulation of policy and its implementation. There should be an increasing degree of cooperation and co-ordination between the Reserve Bank of India and the Government of India. Mr. H.V.R. Lengar, the Ex-Governor of the Reserve Bank of India at the time of his retirement specially mentioned this point in one of his speeches. Of course, we cannot expect the fiscal authorities to be completely subservient to monetary authorities as the two operate in fundamentally different fashion. There may be occasions when the two may stand to differ. What is meant, therefore, is a fact that there should be greater co-ordination on many aspects and it is only under these circumstances that monetary measures are expected to achieve their objectives.

We have seen how a diagonally opposite policy followed by the fiscal authority has led to failure of monetary measures. In their zeal for doubling the national income in the least possible time the planners
in India have thrown to winds all precautions regarding the safety and stability of economy. The monetary authorities were thus left to tackle the uptill task that was so imprudently created by the Government. A better co-ordination would, therefore, produce a more tranquilising effect upon many such policies and programmes and the task of the Reserve Bank would be rendered easier.

(4) Some attempt should be made at reorganisation of consumers credit and make it more disciplined. At present consumers credit is completely out of control on account of the pre-dominance of cash economy and it is not only the trade credit but also excess of purchasing power with the consumers that has rendered the task of monetary management more difficult. The development of banking habits and organised marketing is likely to be helpful in this respect.

(5) As regards the trade credit the Reserve Bank must take greater interest in developing it by expansion of the bill market. Although the cash credit which predominates the credit system is equally amenable to control. The increase in use of bills and greater re-dis-counting from the Central Bank would provide added powers in the hands of the Reserve Bank to control the credit. The Bill Market scheme of Reserve Bank of India has not met with much success on account
of the economic conditions and orthdoxy of banking system but a more determined step in this direction is likely to bring better results.

(6) In the present set-up administrative measures of credit control are bound to play an important role in the regulation of credit for some time to come. Selective credit controls, exchange restrictions and margin requirements would continue to be useful weapons for regulating credit in the specific fields. But their limitations must be realised and they must be supplemented by suitable general credit control measures also.

(7) In all underdeveloped countries monetary measures have continued to have limited utility in regulating the economic activities. India is no exception to it. But as economic development takes deeper roots in the country and the growth process injected by way of planning gradually expands the monetary tools of Reserve Bank of India are likely to pay increasingly useful role in regulating guiding and advancing the direction of growth and bringing the growth and stability of economy. It is for this great task in future that the Reserve Bank of India hasto prepare itself.