CHAPTER TWELVE

Monetary policy of the Reserve Bank of India via-a-vis agriculture

(i) Place of Selective Credit Control in monetary policy

"General or quantitative methods of credit control enable the Reserve Bank to control or regulate the total volume of bank credit either by changing the credit base or by varying the cost at which the credit is to be supplied for economic activity of the country. They affect all the sectors of economy indiscriminately. If banks are compelled to reduce credit volume or to increase its costs, all sectors of economy which need credit are affected irrespective of their importance in the economy. This defect is sought to be removed through selective or qualitative credit control methods. Hence in recent years, qualitative or selective credit control methods have been followed in various countries including India with or without quantitative credit controls. The aim of the selective credit control is to encourage the flow of credit to such forms of activity as are considered essential or specially desirable and to discourage its flow to those which are considered relatively less desirable or less essential. The criteria of essentiality or desirability vary from time to time. Selective credit control methods are generally used with quantitative control methods to enhance their effectiveness." 1

The need to use selective credit control measures in the economy are felt for various reasons. In a developing economy the directions of purpose have to be firmly determined and this can be effected through the measure of selective credit control.

"In the context of planning and development, selective credit control is necessitated to canalise bank credit to socially desirable and economically useful purposes befitting the broad objectives of the plan." 2

This objective can be fruitfully achieved when the Central Bank is vested with such powers. A beginning in this direction was made by the Royal Commission on Monetary and

1. Indian Monetary Policy—A Study in recent developments - By Dr. K.K. Sharma — 1968 p. 112
2. The Reserve Bank of India and Monetary Management by Dr. G.P. Gupta 1959 p. 175
Banking systems in Australia during the forties when it recommended that in regulating credit the Commonwealth Bank should pay some regard to distribution by the bank of the volume of credit among different industries (purposes). While it did not contemplate any interference in particular advances, it wanted the bank to advise the general directions of the advances.

In India, the beginning of the controls have been traced back to 1943. The period April to July 1943 which represented the climax of the inflationary phase also witnessed the first attempts at putting into effect a systematic body of direct, economic control. It began with a warning from the Finance Minister to the speculators in general and to cotton trade in particular. In close succession followed the measures to control the production and distribution of cloth, to prevent hoarding and profiteering in general and to discourage speculation.

(ii) **Powers to impose Selective Credit Control**

The Reserve Bank of India Act 1934 did not equip the Bank with the powers of selective credit control in India. The statutory provision was, therefore, made in 1948 when the Banking Companies (Control) Ordinance authorised the Bank to issue directions to banks in regard to their lending policies in general and any transaction in particular. Later on section 21 of the Banking Companies Act 1949 provided this power to regulate credit on permanent basis. The Bank could thereafter give directions regarding purposes, margins, securities, rates of interest etc.

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1. The Monetary Policies of the Reserve Bank of India by Dr. K.N. Raj 1948 p. 155
Not similar but identical powers have been conferred on the Reserve Bank under section 36 and 20(3) of Banking Companies Act. The subsequent section 35A also empowered the Bank in 1949 to issue directives to banking companies in the matters of policy or administration keeping in view the national interest.

In 1950, the Bank issued a directive to all banking companies asking them to restrict advances against the stocks of raw jute. The bank made use of selective credit control through directives under the powers conferred by Banking Companies Act when it found that credit extended against certain commodities specially foodgrains and cotton textiles appeared unduly large.

(iii) Guidance to scheduled commercial banks through directives

Finding an unusual increase in the advances against paddy and rice by banks, the Bank issued a directive on 17.5.1955 curbing any credit limit in excess of ₹ 50,000. It also increased the margins by 10%. The banks were further asked to bring down their advances to 125% of the corresponding advances in the previous year. The directive had salutary effect. The advances against paddy and rice which were ₹ 26 crores on 27 April 1955 came to ₹ 24.76 crores on 11 May 1956, ₹ 22.33 crores on 25 May 1956, ₹ 18.59 crores on 16 June 1956, ₹ 14.99 crores on 29 June 1956 and ₹ 4.00 crores on 26 October 1956. Consequently the restrictions were removed on 14 November 1956. With the removal of the restrictions, the advances showed an upward spurt which necessitated the reimposition of the curbs on 9 February 1957

1. Circular No. 2060/C/200A/51 dated 30.4.1950
with some modifications.

The Bank extended the selective credit control towards foodgrains with the identical approach. On 13 September 1956, the Bank asked the scheduled banks not to sanction any fresh limits in excess of Rs 50,000. The margins were raised by 10% and the level of advances was restricted to the level of the corresponding week in the preceding year. Again the advances showed a declining trend. In March 1957, the level of outstanding was brought down to Rs 7 crores as against Rs 8 crores in March 1956. In June 1957, the restrictions were reimposed increasing the margins to 40% with the level of outstanding in case of paddy and rice at 66⅔% and other foodgrains at 75% of the corresponding level in the preceding year. The decline in the advances and consequent reduction in the prices of the articles helped the Bank in achieving its objectives but the Bank was itself modest in admitting:

"It is of course difficult to assess precisely the effect of these selective credit controls on prices since the level of prices is determined by several complex factors such as overall supply and demand, local shortages or surpluses, availability of transport etc. However, the directives have probably restrained the upward trend in prices." 1

The policy of the selective credit control continued in 1957-58 with slight modifications. But the Bank exempted certain categories of advances against foodgrains etc.

(a) Advances against foodgrains by new office or branch of banks opened after 1.1.1957 were exempted from the provisions of aggregate level of credit provided the ratio of such advances of the new branches did not extend the comparable ratio of their other offices subject to a maximum of 10%. This helped in encouraging the bank's branch expansion programme.

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1. Report on Currency and Finance 1956-57 p. 34
(b) The advances granted against the warehouse receipt were also exempted from the purview of the directive from 16.1.1958 so as to encourage more advances against warehouse receipt.

In June 1957, the selective credit control was extended to sugar also but the same was withdrawn from 11.12.1957. In July 1958, the Bank further tightened the control over advances against sugar; the margins were raised to 45%. It also brought in its purview the advances to factories and the sugar stocks which have been lifted from the factory premises but on which the excise duty has not been paid.

In February 1959, the Bank covered groundnut besides foodgrains, paddy and rice and sugar. Later on this was extended to other oilseeds except cotton seed. These controls were, however, liberalised in April 1959 due to introduction of a limited programme of food procurement by some of the State Governments. In such states, the new accounts were allowed to be sanctioned credit limits but such accounts were to be of the authorised agents and the limits so sanctioned were not to exceed 3 times of the actual level of such credits in the corresponding month of 1958.

In April and May 1961, all controls were withdrawn on advances against sugar and wheat due to comfortable position of crops and also due to availability of foodgrain under PL 480. A significant change in the policy of the Bank in the area of selective credit control was observed. In January and March 1963, the Bank issued directives withdrawing the exemption on advances against the warehousing receipts because it was observed that the advances against foodgrain and paddy to a great extent accounted
for were against the warehousing receipts. The co-operative 
marketing and processing societies were also exempted. In May 
1963, the Bank fixed the overall limits besides the limits for 
advances against foodgrain etc., exclusive of warehousing receipt. 
These limits within the overall limits were allowed to be utilised 
by the Bank for advances against warehouse receipts. The ware-
houses opened by Central and State warehousing corporation after 
1.1.1961 were exempted from these ceilings.

In 1970-71, the Bank agreed to allow a loan of Rs 2500 for 
each of the cultivator against foodgrain which represented the 
extension of crop loan facility for a period of two months from 
the date of harvesting of the crop so as to help an orderly mar-
keting of the crops. In April 1971, this facility was extended 
to primary agricultural credit societies also. Under these 
directives, margins on the official warehousing receipts were 
reduced from 50% to 40% in case of foodgrains. The following 
striking features came to light during this period.

1. Selective liberalisation of advances against sensitive 
commodities in favour of underbanked centres.

2. Advances upto Rs 25000 per borrower against such ware-
housing receipts were exempted from ceiling control 
concerning all controlled commodities.

3. On May 1972, the Bank exempted all processing soci-
ties covered by Rural Industries Projects completely 
from the provision of selective credit control relating 
to foodgrain, oilseed, oil, vanaspati, cotton and kapas, 
sugar, gur, khandari in view of the difficulties expe-
rienced by them in procuring finance from banks.

Presently, the scope of selective credit control covered 
foodgrains, oilseeds, vegetable oil, cotton and kapas, sugar, gur, 
and khandari etc. The exemption of the processing societies 
under the rural industries projects have been restricted to 
Rs 20000 per unit. From 17.11.73, the minimum rate of interest
was raised to 13% except on exempted categories. In case of the under-banked States, the new branches were allowed to sanction the additional limits against foodgrains up to ₹ 1 lakh as against ₹ 50,000 earlier per branch opened on or after 1.1.1970 at a centre with population below one lakh. In other States, it continued to be ₹ 50,000. The exemption granted to processing societies at centres having population below one lakh were extended to rice mills also.

Thus, it is obvious that the selective credit control is imposed by the Bank keeping in view its impact on prices in relation to demand and the role played by the bank credit in boosting its prices by enabling hoarding. It also indicated that the Bank had been responsive to the needs of the economy on the one hand and was flexible in its approach on the other.

(iv) Extension of the Bank’s powers to Co-operative Banks

The co-operative banks which were nurtured by the Bank right from their inception have remained out of the purview of the selective credit control till 1966 presumably due to:

1. Small advances made by co-operative banks which could have been utilised for hoarding of stocks and consequential increase in their prices.
2. Absence of any statutory powers to the Bank in extending such measures to co-operatives.
3. The uneven development of marketing and processing societies in the country.

In March 1966, certain provisions of the Banking Regulation Act 1949 were extended to co-operative banks. Subsequently the Banking Regulation (Co-operative Societies) Rules 1966 were made applicable to the co-operatives from 3.12.1966.

The Bank invoked the powers relating to the selective
credit control for the first time in April 1967 and covered co-operative banks. It issued directives to the scheduled State co-operative banks under section 21 of the Banking Regulation Act 1949 restricting their advances against cotton and kapas following similar restrictions imposed on the advances of the scheduled commercial banks. The unscheduled State co-operative banks and central co-operative banks were, however, covered on 2.5.1967. Their advances were restricted to a level of percentage of such advances during or at the end of specified periods.

The co-operative cotton mills were later on exempted and other co-operative banks in Gujarat were allowed extension of time for bringing down their advances to desired level.

In pursuance of these directives and also with a view to bring about a proper correlation between the demand for credit and orderly marketing of cotton and kapas, the Bank agreed to sanction separate credit limits to banks for financing the marketing of cotton and kapas at the concessional rate of 2% below the Bank Rate. The margins originally stipulated at 25% and 40% for pledge and hypothecation were relaxed to 10% and 30% in December 1967 in case of credit limits sanctioned to co-operative cotton mills against cotton and kapas which were fully guaranteed by the State Government for payment of principal and interest. The total limits were not to exceed 20% of total liabilities in India in case of State co-operative banks in union territories and central co-operative banks and 10% in State co-operative banks other than those in union territories. In April 1968, the

2. Review of the co-operative movement in India 1966-68 p. 17
aggregate level of credit was raised to 20% in case of State co-operative banks (other than in Union territory) and 40% in case of central co-operative banks and State co-operative banks in union territories upto 30.6.1968. In 1968, the Bank's policy was generally to relax the control due to fall in prices and proper arrival of goods. The margins and ceilings stipulated in case of cotton and kapas were lowered. In 1970-71, the margins stipulated were 30 and 20% for hypothecation and pledge limits respectively against cotton and kapas to cotton mills but these margins could be reduced to 10% of the limits if they were fully guaranteed by the State Government. The margins for the other borrowers were 25% and 40% for pledge and hypothecation respectively. The percentage of the aggregate level of outstanding remained unchanged. However, the advances to co-operative cotton mills were excluded for this purpose. In 1972-73, the Bank extended the above discipline to primary co-operative banks in case the advances were Rs 5 lakhs or more during 1971-72.

The Bank made operative the selective credit control for the first time against advances for gur in 1967. This was done looking to the phenomenal increase in its prices. A ceiling of 70% of last year's outstanding level and 50% margins were imposed. The restriction on the level of credit was rescinded in September 1970 but the margin of 25% and 40% were required to be maintained for pledge and hypothecation limits against gur.

Yet, in 1973-74, the Bank covered under its directive advances against groundnut, mustard seed, rape seed, castor seed, linseed, oil and vanaspati by 45 primary co-operative banks on selective basis in Karnataka, Maharashtra and Gujarat.
Thus we find that Bank applied selective credit control in co-operative fold in respect of such sensitive items where the co-operative institutions had a major role to play. The cotton mills and sugar mills under the co-operative fold have a sizable role in the overall production. In other words, the States which had sizable loans against these commodities were only affected by the control.

(v) Reactions of the banks to these schemes

Despite the fact that there were only a few States which were sizably affected by the selective credit control but it was observed that in general the banks were not enthusiastic about these control measures. The present co-operative structure provides that the State and central co-operative banks would be the main instruments for provision of credit to the primary credit societies for production loans. The disposal of the agricultural produce was to be done by marketing societies for which again the financial assistance was to be provided by the State and central co-operative banks. If these very banks have to take action against its own supported institutions in view of the directives, the very basis of their relationship would be lost.

Besides, there are other factors also for consideration. The marketing societies having an impersonal character have to comply with certain financial disciplines. Their borrowings have to be restricted from certain agencies. In case they are asked to reduce their borrowings by the co-operative banks they would not have the requisite resources except the forced sales of stocks which they had been collecting for sale on attractive prices. In
case of articles like cotton and kapas, the position is slightly different. The bulk purchasers in such cases are only cotton mills etc. which themselves are controlled and guided by the authorities like Textile Commissioners who decide the extent of stocks to be maintained by them and control their inventories. Therefore, in a given situation even if the marketing society is willing to dispose its stocks so as to reduce the outstanding, there may not be any purchasers or demands from the cotton mills. In such a situation, it is more probable that the limits may not get reduced and the same may finally turn into overdues.

Secondly the selective credit control also stipulates the increase in rates of interest. The increase in the rates of interest may blow the death-knell for the co-operative institutions in the form of mounting losses.

Thirdly, the co-operative institutions have a vital problem in providing the margins stipulated by banks. Such margins have to be provided by them with the assistance of the Government and National Co-operative Development Corporation. If the co-operative banks are asked to increase the margins, it would affect the turnover, viability and finally the working of societies. Thus, the co-operative banks and its constituent borrowers do not find it a palatable mixture and have to accept it as 'fait accompli'.

(vii) Extent of success achieved

The salutary effects on the advances of the scheduled commercial banks may be seen from table No.56 appended
<table>
<thead>
<tr>
<th>Security</th>
<th>13.3.70 As %</th>
<th>12.3.71 As %</th>
<th>29.6.72 As %</th>
<th>Last Friday of total Bank credit</th>
<th>Last March Friday credit</th>
<th>As % of total Bank credit</th>
<th>As % of March credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foodgrains (excluding food procurements)</td>
<td>54.96</td>
<td>1.4</td>
<td>52.01</td>
<td>1.1</td>
<td>98.00</td>
<td>1.8</td>
<td>32.64</td>
</tr>
<tr>
<td>Sugar (including Khandari)</td>
<td>158.77</td>
<td>4.1</td>
<td>196.52</td>
<td>4.2</td>
<td>N.A.</td>
<td>113.76</td>
<td>1.9</td>
</tr>
<tr>
<td>Groundnut</td>
<td>16.47</td>
<td>0.4</td>
<td>10.34</td>
<td>0.2</td>
<td>8.76</td>
<td>0.2</td>
<td>15.73**</td>
</tr>
<tr>
<td>Linseed</td>
<td>0.33</td>
<td>-</td>
<td>0.33</td>
<td>-</td>
<td>0.63</td>
<td>-</td>
<td>0.37</td>
</tr>
<tr>
<td>Caster Seed</td>
<td>0.13</td>
<td>-</td>
<td>0.16</td>
<td>-</td>
<td>0.26</td>
<td>-</td>
<td>0.91</td>
</tr>
<tr>
<td>Rape Seed/Mustard seed</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1.26</td>
</tr>
<tr>
<td>Groundnut oil</td>
<td>7.62</td>
<td>0.2</td>
<td>9.02</td>
<td>0.2</td>
<td>5.83</td>
<td>0.1</td>
<td>6.11</td>
</tr>
<tr>
<td>Rape Seed/Mustard Seed oil</td>
<td>1.63</td>
<td>-</td>
<td>2.23</td>
<td>0.1</td>
<td>N.A.</td>
<td>N.A.</td>
<td>1.21</td>
</tr>
<tr>
<td>Caster Seed oil</td>
<td>0.35</td>
<td>-</td>
<td>0.56</td>
<td>-</td>
<td>0.27</td>
<td>-</td>
<td>4.32</td>
</tr>
<tr>
<td>Linseed oil</td>
<td>0.26</td>
<td>-</td>
<td>0.35</td>
<td>-</td>
<td>0.29</td>
<td>-</td>
<td>0.44</td>
</tr>
<tr>
<td>Vanaspati</td>
<td>4.21</td>
<td>0.1</td>
<td>6.25</td>
<td>0.1</td>
<td>5.89</td>
<td>0.1</td>
<td>3.41</td>
</tr>
<tr>
<td>Cotton and Kanas</td>
<td>145.28</td>
<td>3.7</td>
<td>147.05</td>
<td>3.1</td>
<td>163.10</td>
<td>3.0</td>
<td>182.95</td>
</tr>
<tr>
<td>Raw Jute</td>
<td>36.05</td>
<td>0.9</td>
<td>33.37</td>
<td>0.7</td>
<td>21.82</td>
<td>0.4</td>
<td>16.09</td>
</tr>
<tr>
<td>Total</td>
<td>426.06</td>
<td>10.9</td>
<td>458.19</td>
<td>9.8</td>
<td>N.A.</td>
<td>N.A.</td>
<td>379.20</td>
</tr>
<tr>
<td>Total Bank Credit</td>
<td>3914.45</td>
<td>100.0</td>
<td>4672.14</td>
<td>100.0</td>
<td>5479.85</td>
<td>100.0</td>
<td>6115.04</td>
</tr>
</tbody>
</table>

@ Provisional  
* Including Cotton Corporation of India  
@@ Including advances to Jute Corporation of India  
** Including advances to public sector agencies  
### Not covered by Selective Credit Control

TABLE No 56

MOVEMENT IN ADVANCES AGAINST CERTAIN CROPS UNDER SELECTIVE CREDIT CONTROL IN RELATION TO TOTAL CREDIT

<table>
<thead>
<tr>
<th>Date</th>
<th>Total Bank Credit</th>
<th>Sugar</th>
<th>Food grains</th>
<th>Raw jute</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.3.70</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12.3.71</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>29.6.72</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.73</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.74</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
It may be observed from the details given above that the advances against foodgrains have consistently gone down in absolute term as well as in terms of percentage to the total credit. As on 13.3.70, the advances were ₹ 54.36 crores forming 1.4% of the total credit which came down to 1.1% in 1970-71, 0.5% in 1972-73 and 1973-74. The advances have shown slight increase in 1973-74 as compared with 1972-73. In case of sugar also, the percentage of advances to total credit has gone down consistently; however, in 1970-71 the advances in absolute terms showed substantial increase from ₹ 153.77 crores to ₹ 196.52 crores.

In case of cotton and kapas, although, there is no substantial change in the percentage of advances to total credit but in absolute terms the advances have gone up from ₹ 145.28 crores in 1969-70 to ₹ 250.38 crores in 1973-74.

The percentage of total advances affecting commodities covered by selective credit control to total bank credit showed a declining trend from 1969-70 to 1972-73 but in 1973-74 it showed a slight increase from 6.2 to 6.9.

(vii) Suggestions

In view of what has been stated above, it has to be conceded that co-operative institutions were constituted for a specific purpose and have certain limitations in their working. They can neither be equated with the commercial banks on the one hand nor with big business houses on the other hand. Viewed from this angle, the imposition of selective credit control with the rigidity of a commercial bank is neither desirable nor possible. We have, therefore, to find an alternative. The role of the co-operative banks and that of the marketing society is that of a
recognised substitute for a middleman. The end-use of the credit is made by the processing units like cotton mills and oil mills etc. Therefore, if any restrictions are required to be imposed, they should be imposed on these institutions rather than on the middle level institutions. Insistence of the proper compliance of the control in the co-operative sector would be synonymous to punishing an ailing father for the sins of an earning robust son. It would be more fruitful if the middle level institutions in the co-operative fold are exempted from the purview of the discipline of the control and the end-level institutions are asked to comply with the requirements. This can be done through the statutory authorities like Textile Commissioners who had otherwise control over these institutions.

Secondly the commercial banks get the benefit of relaxations allowed by the Bank in respect of the newly opened branches in under-banked areas, warehouse receipt of such warehouses which have been opened after some particular dates, the processing industries working under Rural Industries Projects. But such benefits do not accrue to co-operative banks as they do not deal with individuals, firms and companies. Therefore, the Bank may have to devise a system to ensure that the growth of co-operative institutions are not adversely affected. This, however, does mean that the efficacy of the selective credit control has been undermined. The observation made by the Reserve Bank itself in this regard has to be kept in view to judge the success of the control.
"The efficacy of the control measures should not be assessed mainly in terms of their positive influence on prices, since the latter primarily depend on the availability of supply of the relevant commodities relative to the demand. The success of these controls is to be judged in a limited sphere, namely, their impact on the pressure of demand originating from the bank credit; in this sense the measure should be deemed successful; but for their operation it is likely that the price situation might have been somewhat worse." 1