CHAPTER VII

INSTRUMENTS OF MONETARY MANAGEMENT (SELECTIVE).

CHAPTER VII

INSTRUMENTS OF MONETARY MANAGEMENT

(SELECTIVE)

I Introductory

- Qualitative and Quantitative aspects of selective controls
- Rationale of selective controls in under-developed countries

II Selective Credit controls in India :

- The back ground
- Some general considerations
- The 'Sayers criterion'
- Forms of selective controls
- General tenor of operations of the control
  - (A) Controls on advances against food-grains
  - (B) Controls on advances against sugar
  - (C) Controls on advances against ground-nuts; other oilseeds and Vanaspati
  - (D) Controls on advances against raw/jute and jute goods; cotton and kapas
  - (E) Controls i) on advances against shares and stocks and ii) on clean advances
- General evaluation of the operation of selective controls
- A few observations on selective controls in India :
  - (1) Ratio of bank credit to total consumer expenditure
  - (2) Discretionary elements in selective controls
  - (3) Warehousing and banking expansion constraints
  - (4) Perverse announcement effects of selective controls
  - (5) Selective controls as being substitutes for or complementary to 'general' controls.

CHAPTER VII.

INSTRUMENTS OF MONETARY MANAGEMENT (SELECTIVE).

I. Introductory:-

During the Depression years and later in the post-war period, the Federal Reserve System resorted to methods of controlling credit by restricting their impact on particular sector(s) of the economy. In the post-war period characterised by general inflationary conditions, use of such 'selective' methods of control, either as independent measures or as supplements to the 'general' instruments, has been much in vogue with the result that a wide variety of them was found or is still to be found in operation in a number of developed and under-developed countries. These measures were more or less used for the purpose of controlling consumer finance; stock market speculation; real estate credit; financing of foreign trade and Capital Issues in the developed countries. Selective controls take their form according to the purpose and function they are designed to serve. Since they are flexible and handy, they could be put to use for restraining inflationary pressure or encouraging 'productive' use of credit. In the more prosperous years of the 'sixties, developed countries have found it advantageous to place more reliance on 'moral suasion' and voluntary agreements so that while the effect is assured, interference with the normal market forces is kept to the minimum.[1]

Quantitative and Qualitative aspects of Selective Controls:

Selective controls may have both quantitative and qualitative effects. Again, it is likely that use of selective controls may keep total volume of bank credit unaffected or bring variation in it; in either case there will be reallocation of funds than would have obtained in the absence of the controls. The Bank of Japan insists on making a distinction between 'Selective' and 'Qualitative' controls on the ground that controls on consumer credit, real estate credit, etc. are 'Selective' as they produce a quantitative effect within a specific sector and their interference with the market mechanism is less pronounced. On the other hand, priority allocation of funds to key basic industries signified 'Qualitative' - controls and involved 'bad interference with the market mechanism'.[2] Tamagna suggests that when a financial institution is asked to limit credit, selective controls have a pronounced quantitative effect and if the share of a particular sector (economic activity) is acted upon the effect is qualitative although he agrees, and Patrick[3] in

---

1. F. Tamagna notes in this connection: "In line with this tendency, the more subtle types of control, such as 'moral suasion' have gained broader acceptance, supported in general by the threat of legal action from the Central Bank and Government"."Monetary Management" a C.M.C.Study publication - p. 158.

2. H.T. Patrick - "Monetary Policy and Central Banking in Contemporary Japan", University of Bombay (1962), p.158-59.

3. Ibid.

his discussion about the distinction made in Japan also brings out, that the distinction is difficult to make in practice as both may overlap depending upon the form in which the control measure is operated. Distinction made on grounds of 'more' or 'less' interference with the market mechanism is neither sound nor helpful for policy purposes. All are forms of direct regulation. The Reserve Bank of India does not make any such distinction and uses the term 'Selective' as against General controls consistently.

Rationale of selective controls in the underdeveloped countries :-

Selective credit controls lie between remotely effective general credit controls and immediately effective physical controls and partake of the characteristics of both. They are suitable in all cases where pressure points develop independently or in the background of general inflationary or deflationary conditions. It has been almost a foregone conclusion that selective controls produce better results when operating with other 'general' instruments, whatever the type of economy. Such a conclusion perhaps derives its strength from the assumption (not always stated explicitly) that general controls do not keep open any 'safety valves' so that selective controls could achieve their purpose. We return to this point later but it would be worthwhile to note how selective controls have had great attraction for the underdeveloped countries.

Programmes of planned economic development, it has been assumed, involve imbalances at various levels. An underdeveloped economy characterised by low elasticities of supply is prone to inflationary pressures and there may be general rise in prices accompanied by heavy distortions in relative prices of some commodities. In this setting, selective controls could play a useful part in checking distortions in particular sectors and to the extent distortions in these particular sectors have greater bearing on the course of the general price level or stability or the growth process itself selective controls would go a long way in moderating fluctuations in the general price level even when they operate - independently. Underdeveloped countries which have special balance of payments problems may find them suitable to regulate imports and encourage exports. They may be applied in directing flow of credit in some desired (in the sense of their being 'productive') - sectors and help the cause of stability or the process of development in general. Thus selective controls being capable of producing both 'allocative' and 'regulatory' effects are thought to be an important policy measure and particularly so when it is argued that general instruments have a limited role to play, in view of the narrow and unorganised financial system of the underdeveloped countries. More so, particularly in view of the limitations of interest rate policy on account of Government's stake in financing a large programme of investment and of the open market policy in view of the smaller holdings of securities with the Central Bank. We saw however in chapter six that narrowness of the market is not that big constraint as is commonly supposed. The case for selective controls therefore needs to be rationalised on firmer grounds than these stances.

II. Selective credit controls in India:-

The background:-

The Reserve Bank of India was empowered under the Banking Regulation Act, 1949 to give directions to commercial banks in India as to the purposes for which advances were to be made, the margins to be maintained and the rates to be charged but it did not make use of these powers until 1956.

Some general considerations:-

The reason why selective controls came to be used only after 1956 is not far to seek and should be stated at the outset as this would give an idea about the tenor of operation of these controls during the period 1956-57 to 1965-66. 1955-56 being the last year of the First Five Year Plan, there was step-up of investment outlay to the extent of Rs. 496 crores as against Rs.388 and Rs. 249 crores in previous two years. Reserve Bank's net credit to Government during 1955-56 was Rs. 164 crores as against Rs. 82 and Rs. 23 crores in the previous two years. Money supply during the year rose by

13.45% as against 6.94% increase and a decline of 1.35% in the previous two years respectively. - Credit expansion during the busy season of 1955-56 was Rs. 164 crores against Rs. 98 crores and 105 crores in the busy seasons of the previous two years. Borrowings from the Reserve Bank and disinvestment in government securities by the scheduled banks during the busy season of 1955-56 were the highest at Rs. 50 crores and 37 crores respectively as compared to all earlier busy seasons. In the background of these general monetary trends the Second Five Year Plan with its ambitious programme of heavy industrialisation and comparative neglect of agricultural development with contemplated Deficit Financing and 'uncovered gap' of Rs. 1,200 and Rs. 800 crores each respectively, was launched from 1st April, 1956. There was general feeling that inflationary pressure and particularly food-grains prices may show disconcerting trends and the evidence was also at hand. Price index (1939 = 100) of Rice which was 415 on March 26, 1955 rose to 518 on March 31, 1956 showing a rise of 24.8 per cent over a year. For Wheat, Bajra and Jowar, respective percentage variations were 22.3; 6.1 and 100.9 per cent. Table 7 (1) throws light on the - movement in prices of these commodities.

TABLE 7(1)

Price Index of selected food articles on selective dates : (1939 = 100)

(Percentage variations are over previous date).

Date	Rice	Percentage variations	Wheat	Percentage variations	Jowar.	Percentage variations.	Bajra.	Percentage variations.
28.3.53	496	-	565	-	209	-	281	-
27.3.54	486	- 2.0	547	- 3.2	223	+ 6.7	237	-15.6
26.3.55	415	-14.6	435	-20.0	102	- 54.3	223	- 5.9
31.3.56	518	+24.8	532	+22.3	225	+100.9	237	+ 6.1
30.3.57	615	+18.8	613	+34.0	271	+ 20.4	351	+48.1

Source: "Currency and Finance Report" 1956-57.

It was feared in informed circles that a large part of the rise in foodgrains prices was made possible by increased bank finance for speculative inventory holdings. On April 4, 1956 the Reserve Bank elicited information from banks in this regard and it confirmed the fear as bank advances against paddy and rice had increased from Rs. 11.6 crores in March, 1955 to Rs. 24.6 crores in March, 1956 showing a rise of 111.5 per cent. In May, 1956 bank advances against paddy and rice stood further at Rs. 38 crores. Similarly, advances against wheat, gram other grains and pulses - together were at a level of Rs. 20.62 crores on June 29, 1956, the highest in the past five years.

Table 7(2) below shows that whereas the price rise was more marked in respect of food articles (and some particular categories of it as seen in Table 7(1)) the variations in respect of other components of the general price index were not so disconcerting.

TABLE 7(2)

Price Indices of commodities (by groups) on selected dates (1939 = 100)

Group	28.3.1953	27.3.1954	26.3.1955	31.3.1956	Percentage of variations: 4 over 1	Percentage of variations: 4 over 3
	1	2	3	4	5	6
I Food articles.	362.6	378.0	293.0	358.8	- 1.0	+ 22.5
II Industrial Raw Materials.	455.7	461.4	400.1	477.9	+ 4.9	+ 19.5
III Semi-Manufactures.	350.5	357.2	332.0	375.5	+ 7.1	+ 13.3
IV Manufactures.	369.4	375.8	376.1	373.7	+ 1.1	- 00.5
V Miscellaneous	585.5	690.0	545.6	494.1	- 15.6	- 9.5
All commodities.	385.0	396.8	349.7	390.4	+ 1.4	+ 11.5

Source: Currency and Finance Report 1956-57.

In regard to Manufactures there was a slight fall in its price index while price index of food articles showed percentage increase (22.5) which was almost twice the percentage increase (11.5) for all groups of commodities during the period 1955-56. Guided by its general policy goal of 'controlled expansion' the Reserve Bank felt both enthused and justified in initiating a policy of selective controls and bring under their pale those commodities which appeared vulnerable. Thus 'Food' articles caught the attention of the authorities first. 'Industrial raw materials' group stood as another candidate for such regulation (showing percentage increase of 19.5 per cent during 1955-56) and this trend having continued further, the commodities under this group embraced the selective regulation method soon afterwards. During the period 1956-57 to 1965-66 the Reserve Bank went on initiating, tightening, relaxing or removing controls on bank advances suspectible to or having been adjuged to have succumbed to speculative influences. Selective controls during the period (and in general thereafter) have thus partaken character of regulatory rather than promotional measures, and as the Bank has put it "In India (selective) controls have been used to prevent speculative hoarding of commodities like foodgrains and essential raw materials to check an undue rise in their prices."[1]

The 'Sayers Criterion' :-

Use of selective controls to check speculative accumulation of inventories is a more justifi~~y~~able case for

---

1. "Reserve Bank of India : Functions and working" - Reserve Bank of India, Bombay (1970) P. 58.

regulation than use of such controls to check speculative trading on the stock market or real estate or consumer finance control as Johnson has so well argued out.[1] With controls on speculative inventory holdings however the greatest difficulty is about making a clear distinction between increased holding due to speculative purposes and due to increased production. To the extent, it harms the latter it affects production. Possibly both the speculators and the regular inventory holders may try to evade regulation due to imprecise definition of the commodity or connivance of the bank managers (such a tendency will be more pronounced for the speculators).[2] Alternatively, there may be activisation of idle funds leading to rise in rates of interest and there may be capital losses. The regular inventory holders may be deferred from following such a course and would prefer to cut back orders with the producers which may affect production. To the extent the speculators give up their plans, consequent upon the 'imposition of controls', the policy remains highly - effective. This however leads us to the consideration

1. H. G. Johnson "Essays in Monetary Economics" (1967) Pp. 232-35.

2. Possibility of alternative sources of finance is another and more important constraint.

about the role of speculation. When selective controls are justified it is being assumed that speculation is destabili-zing. Milton Friedman and others have however argued that speculative buying and selling is not destablizing and they would as such not see any need for selective controls nor any need to make a distinction between speculative and normal inventory holdings. Central banks the world over, have however found it more prudent to ignore these theoretical niceties and continue their resort to selective controls when necessary.

It may be pertinent to note here the observations made by R.S. Sayers in this regard. In his opinion in a country like U.K. where bank advance is usually the 'best and often the only way of getting finance on reasonable terms for business and individuals, selective controls could be used for their quick effects. "More generally, we can say that when an unusually difficult situation calls for sharp effects direct control of bank advances can be justified; its disadvantages are of the kind that point to early relaxation rather than complete avoidance".[2]

Bank finance is the best and 'often the only way of

---

1. M.Friedman "Essays in Positive Economics" Chicago 1953 Pp.157-203, Also W.J. Baumol 'Speculation, Profitability and Stability', Review of Economics and Statistics(1957). To Friedman selective controls are an anathema also in view of his general position in monetary theory and policy.

2. R.S. Sayers " Modern Banking", Oxford (1960) P. 224.

getting finance on reasonable terms' under India conditions also and the two ingrediants of controls - <u>sharp effects</u>; <u>early relaxation</u> - may serve as what we may call the "Sayers criterion" in analysing and evaluating selective controls in India.

<u>Forms of selective controls</u>:

Selections 21, 35 and 36 of the Banking Regulation Act gives wide powers to the Reserve Bank to give directions to banking companies in regard to, (i) the purposes for which advances may or may not be made; (ii) margins to be maintain-ed in respect of secured advances; (iii) maximum amount of advances that may be made; (iv) rates of interest to be charged on advances and (v) other regulatory powers with regard to proper management of a banking company. The forms that such controls would take are: (1) prescription of - minimum margins for lending against specific securities (ii) putting ceilings on the amounts of credit for certain purpos-es and (iii) discriminatory rates of interest charged on certain types of advances. Since selective controls have been resorted to in regard to traders' credit they have been generally confined to the first two types.

Bank finance in respect of the following categories has been brought under control from time to time.

I. <u>Food articles</u> :-

i) Cereals such as paddy and rice, wheat and others as well as pulses.

ii) Other articles like sugar, gur, tea.

II. Industrial raw materials:-

i) Cotton and Kapas.
ii) Raw Jute.
iii) Groundnuts.
iv) Other oilseeds.

III. Semi-Manufactures:-

i) Cotton Yarn.
ii) Vanaspati and groundnut oil.

IV. Manufactures :-

i) Cotton textiles.
ii) Jute textiles.

V. Miscellaneous :-

i) Shares of joint stock companies.
ii) Unsecured advances.

General tenor of operations of the controls :-

Since these controls have been frequently varied with tightening, relaxation or total removal it would be desirable to pinpoint some trends at the outset so as to keep the evaluation of these controls in manageable limits and make it fruitful. During the 10 years period 1956-57 to 1965-66, the Reserve Bank had issued directives 54 times[1] (on a rough reckoning) and directive each time may have covered one or more commodities. Since selective controls are in the nature of expedients with a large element of variability in them, evaluation of each directive in terms of its appropriateness and effectiveness becomes highly cumbersome and much

---

1. Ignoring some other minor instructions these 54 directives consisted of 29 issued during the slack season and 25 issued during the busy season.

less rewarding. Detailed explanation about the justifiability of each directive in an ex-ante manner by the Reserve Bank is not available though an ex-post evaluation in terms of restriction of bank advances has been emphasised by the Bank in its various reports.

Over the ten-year period, out of the regulations of advances against the five categories listed above those against Shares and Stocks; 'Clean advances' and Jute were rather short-lived and totally removed by the end of the period; while regulations against Foodgrains; Sugar; Cotton; Groundnuts; Other oilseeds and Vanaspati remained in force at the end of the period.[1] Dropping out of some categories from regulation may in a way speak about the effectiveness of the controls but it is difficult to arrive at such a clearcut judgement for the pecularity of circumstances necessitating imposition and relaxation of each directive has been much varied.

---

1. During the period, number of times these directives were given (roughly estimated) for different categories were as under:-

Paddy & Rice	22	Clean advances	4
Wheat	12	Vanaspati	2
Sugar	5	Stocks	3
Groundnuts	4	Cotton & Kapas	2
Other Oilseeds	4	Cotton Textiles & Yarn	2
Jute (Raw Jute & Jute textiles)	4		

We may also note at the outset that the Reserve Bank had to reckon with some additional factors in framing its regulation policy. These arose out of the need to conform policy to (i) the general programme of expansion of warehousing facilities in the country (ii) branch expansion programmes of commercial banks (iii) zonal price variations of foodgrains emanating from the existence of 'surplus' and 'deficit' States[1] and (iv) the food procurement programmes of State Governments. Whether these factors constituted constraints on the effective working of policy or merely demanded flexibility of operation (which is the hall-mark of selective control policy) is a point to which we shall return at a later stage.

We shall study operation of the controls under the five groups of commodities as noted above.

(A) Controls on advances against foodgrains:-

Paddy and Rice and Wheat have been the main commodities subjected to control besides sporadic intervention in respect of other cereals and pulses. The method of control has been to vary margin requirements and put ceilings on bank advances against these

1. For the purpose of regulation of food prices zones comprising of more than one State were formed.

commodities.[1]

I. 1956-57 :- On May 16, 1956 a sort of comprehensive directive was given to banks asking them, to refrain from exclusive lending against commodities in general and directing them, in regard to paddy and rice, to (i) raise existing margins by 10 per cent (ii) to limit fresh advances at Rs.50,000/- to individual parties and (iii) bring down the level of advances in the aggregate (against paddy and rice) to 125 per cent (or less) of that in the corresponding period in the previous year.

On 13th September, 1956, the control was extended to cover advances against wheat, other coarse grains, gram and pulses with directives to (i) raise margins in respect of these commodities by 10 per cent (ii) to limit fresh advances at Rs. 50,000/- for each party, against any or all of these food items and (iii) to endeavour to reduce by end of October, 1956 their advances to a level not substantially higher than that in the corresponding period of the last year.

During the year under consideration, advances against wheat, grams etc. declined almost continuously and -

---

1. Since selective controls were in large part directed towards foodgrains they need some elaborate treatment. Again as the controls are 'expedients', they have to be accounted for with each new directive. To keep track of the matter we have shown them under three slices of time I - 1956-57; II - 1957-58 to 1960-61 and III - 1961-62 to 1965-66.

Further since the discussion could not be carried on without making explicit reference to the change made in form of regulation, the changes made each time have been shown under separate short paragraphs, to tamper the element of irksome reading that such detailing might involve.

amounted to Rs. 7 crores on March 29, 1957 as against Rs. 8 crores in March, 1956. Production of wheat during the year had, it may be noted, declined from the previous year level of 8.77 million tons to 8.34 million tons.

In regard to rice and paddy, the directive issued in May, 1956 had immediate effect in that "advances declined considerably from Rs. 26 crores on April 27, 1956 to Rs. 4 crores on October 20, 1956."

> On November 14, 1956, however with a view not to hampering movement of the new crop, restrictions on paddy and rice were completely withdrawn.

On the Sayers criterion of 'early relaxation', the Reserve Bank was justified in withdrawing restrictions but the repercussions of this relaxation measure were disconcerting. With the onset of the busy season in November 1956 advances against paddy and rice which were Rs. 9.61 crores on December, 1956 reached the level of Rs. 21 crores on February 8, 1957 and "it was feared that, on that rate of expansion, the level of advances would exceed the previous year's high level."[1]

> On February 9, 1957, therefore, restrictions on paddy and rice were reimposed asking banks to (i) raise margins by 10 per cent so as not to be less than 35 per cent of the value of the security and (ii) to reduce aggregate credit to 75 per cent of the level in the corresponding week of the preceding year.

---

1. Currency and Finance Report (1956-57) P. 33.

The effect of this reimposition was to hold in check undue expansion in advances and these stood at Rs. 21 crores at the end of May, 1957, as against Rs. 22 crores in May, 1956. Table 7 (3) shows advances against paddy and rice between June, 1955 to May, 1957.

TABLE 7(3)

Advances of scheduled banks against paddy and rice

(In crores of Rupees)

Year	January	February	March	April	May	June
1955	-	-	-	-	-	16.2
1956	14.2	19.4	24.7	26.3	22.3	15.5
1957	16.1	23.1	22.7	22.1	21.4	-
	July	August	September	October	Nov.	Dec.
1955	7.7	5.7	4.2	3.8	4.6	8.1
1956	11.6	7.4	5.3	4.3	6.3	9.6
1957	-	-	-	-	-	-

Source: Trend and Progress of Banking in India (1960).

We observed earlier that on the criterion of 'early relaxation' the Reserve Bank was justified in withdrawing restriction in November, 1956. The above table however shows that advances during the slack season of 1956-57 during all months from July to October in 1956 (slack - 1956) were higher than advances during corresponding months in 1955 and as such the Bank was mistaken in -

withdrawing restrictions. It would not be proper to lay such a charge on the Bank however, for, having initiated the policy for the first time the Bank took the right step in withdrawing restrictions in November, 1956 when advances had reached a low level of Rs. 4 crores. Larger advances during 1956 slack months - pointed to the need for stricter controls rather than long continuance of them. Experience in the subsequent years pointed to such a need.[1]

II. <u>1957-58 to 1960-61</u> (Controls against foodgrains):-

<u>1957-58 :-</u> During the slack season of 1957, advances against foodgrains other than rice and wheat began to show uneasy trends. Advances against latter two categories in January 1957 stood at Rs. 18.14 crores while those against other varieties were at Rs. 8.12 crores. In May, 1957, the corresponding figures were

---

1. Selective controls on cotton textiles and yarn were imposed in September, 1956 and withdrawn in February, 1957. The controls consisted of higher margin requirements with exemptions for cotton textile mills and exporters. Reserve Bank's account of it is: "In view of sharp increase in advances against cotton textiles to Rs. 63.8 crores in August 1956, another directive was issued to banks on September 13, 1956 similar to that for wheat, grams etc. As advances to the trade against cotton textiles showed a declining tendency, the directive was withdrawn on February 1, 1957". ('C. & F. Report' 1956-57 P. 34). We exclude consideration of this measure. Price index of 'Textiles' which was 105.7 in 1956-57 ruled steady and was 107.8 in 1959-60 (1952-53 = 100).

Rs. 25.89 and 18.80 crores. It was feared that uncontrolled 'other varieties' may have helped evasion of controls against rice and wheat and hence in June, 1957,[1] controls were extended to other foodgrains also. However corresponding figures of advances during August and November, 1957 were :

(August)	Rice and wheat :	Rs. 10.16 crores -
	others:	Rs. 12.42 crores.
(November)	Rice and wheat :	Rs. 7.08 crores -
	others:	Rs. 9.44 crores.

so that slack season reduction in advances being of a small order controls for all categories were further intensified in December, 1957.

A change in the technique of regulation has to be noted here. While the methods of margins and ceilings in respect of lending to individual parties were continued, regulation was made more direct and specific by laying down levels of advances in each week of a month as a given proportion of advances in corresponding week or month of earlier year or average of earlier years.[2]

> In June 1957 margins in respect of 'other foodgrains' were raised so as to be 40 per cent of the value of security and aggregate credit was to be reduced to two thirds of the level in the corresponding week of 1956.

---

1. Controls on sugar were initiated in June, 1957. We deal with this separately hereafter.
2. Later on the level of advance was regulated on the basis of a two-month period.

In December, 1957 alongwith continuance of margins and ceilings for individuals, ceilings on aggregate advances were fixed at 75 per cent (in respect of rice) and 80 per cent (in respect of 'others') of the average level of advances in corresponding month of the previous three years 1955,'56 and '57.

To put down concentration of advances in 'surplus' states, the Bank tightened the limit to 60 per cent of advances in the corresponding month of 1957 in Madhya Pradesh and Andhra Pradesh.

New bank offices opened after 1.1.1957 were exempted from the provision of aggregate levels of credit, in certain cases.

The Reserve Bank in the succeeding years shaped its policy by relating it to specified proportion of advances in specific months or weeks in the past and thus brought forth the concept of 'permitted' levels of advances. When it became necessary to give exemptions for advances made (i) against warehouse receipts issued by Central and State Warehousing Corporations (ii) against Demand Documentary bills covering movement of foodgrains (iii) to co-operative marketing and processing societies (iv) to State Governments for their procurement programmes etc. the 'permitted' levels netted of these exemptions were called 'adjusted levels'.

The general basis for policy formulation in 1958-59 and 1959-60 remained that of making reference to levels of advances and price indices, other general considerations apart.

1958-59 & 1959-60 :-

Directives issued in September and December, 1958, April and July 1959 and January 1960 kept margins fixed at 40 per cent which were kept at a lower level of 25 per cent for paddy and rice in Orissa and wheat in Punjab.

The ceiling on 'individual' loans at Rs.50,000 was abolished (July, 1959). The new method of fixing ceilings on aggregate advances appeared better for administrative purposes and could be varied for particular commodities and for particular states depending upon trends in production -etc.

Evaluating the operation of selective controls during the three years period (1957-60) we observe that they were largely successful as reflected in the volume of bank advances being maintained at or near the levels 'permitted' by the Bank from time to time. A snag in the situation however arose out of the behaviour of banks to circumvent the controls by increasing the volume of unsecured advances.

1960-61 :-

Under its 'Package' credit restriction programme of March 11, 1960,[1] the Reserve Bank directed banks to maintain their clean or unsecured advances at a level not higher than the level in the corresponding month of 1959.

Accompanying the plugging of the above loophole however were directives which allowed some liberalisation in advances in particular States (e.g. Kerala) lowering of margins for all foodgrains from 40% to 35% (February 8, 1961) and adjustments for advances against wheat and rice in Punjab, Madhya Pradesh and Andhra Pradesh. The overall trend was to liberalise the controls in view of larger output of rice and wheat.

---

1. As noted earlier this was the beginning of 'restrictive' policy the variable reserve ratio method being used for the first time.

Through various directives, the Reserve Bank from December, 1957 onward intimated to banks the levels of advances they would be 'permitted' to make against foodgrains on a monthly basis. In reporting about the 'implementation and impact'[1] of these measures the Bank utilised the concept of 'adjusted' levels which were exclusive of the advances exempted (noted above) from the purview of the regulations. The two levels were then compared for each month and excess or shortfall of the 'permitted' over the 'adjusted' level emphasised, as an indication of the success or failure of the policy. Now actual level of advances made less exempted categories = adjusted level. If the adjusted level equals the permitted one it would mean that advances against the exempted categories are zero. If the adjusted level is greater than permitted level than actual advances would have been, by definition, greater than 'permitted' advances. If the adjusted level is (more) short of the permitted level it would be taken to mean (larger) success of policy. But logically speaking, adjusted level being heavily short of the permitted level would denote redundancy of controls. It would rather mean that a largerpart of the advances are made for the 'exempted' type and this would imply that bank advances were innocuous and helped the activities that were sought to be encouraged. It may

1. "Trend and Progress of Banking in India" (1960) P. 21.

alternatively mean that there is a strong tendency to circumvent regulation by showing 'controlled' category of advances under the 'exempted' category. The later contingency did arise in respect of advances against warehouse receipts as we shall see later on. A regulatory measure consisting of 'exempted' and 'controlled' components simultaneously for a ubiquitously demanded commodity like bank finance would necessarily face such a dilemma.

TABLE 7(4)

Advances against paddy and rice during 1958 and 1960.

(Amount in Lakhs of Rupees)

Month	1958			1960		
	Actual Level	Adjusted Level	Permitted Level.	Actual Level.	Adjusted Level.	Permitted Level.
January	8,76	6,46	8,18	11,33	6,66	8,43
February	11,11	8,83	11,90	14,25	9,71	13,06
March	12,19	9,78	13,30	14,86	10,82	14,17
April	13,96	9,51	13,22	14,36	11,12	14,44
May	13,31	9,31	12,22	14,37	10,60	13,28
June	9,44	8,14	9,44	13,11	9,60	10,40
July	7,13	6,01	6,66	10,40	7,35	7,51
August	4,48	3,71	4,29	8,32	6,03	4,90
September	3,38	2,54	2,87	5,97	4,11	3,56
October	3,46	2,15	2,45	5,73	3,27	3,18
November	4,40	2,65	3,18	5,76	3,24	4,04
December	5,40	3,13	4,97	7,30	4,41	5,56
Annual average	8,08	6,08	7,72	10,48	6,47	7,24
Excess of annual average of actual over adjusted level.	+200			+401		

We have shown above monthwise levels of actual adjusted and permitted levels of advances against paddy and rice (actual advances in respect of which represented about 1/2 of total advances against foodgrains) for the two selected years 1958 and 1960, Whereas the adjusted level was below the permitted level for all months in 1958, it was above it for only three months (August, September and October) in 1960, which speaks for the success of the control measures. The annual averages for both the years show excess of the permitted over the adjusted level.

The difference between the actual and adjusted levels shows however that the excess of the annual average of - former over the latter (representing 'exempted' advances) was Rs.200 Lakhs or about 25 per cent of total actual advances during 1958, the excess having widened to Rs.401 Lakhs or about 40 per cent of total actual advances during 1960. Taking in view the fact that actual advances (annual - average) during the year 1957 were Rs.13,28 lakhs, well above those in 1958 and 1960, selective controls against paddy and rice may be said to have achieved the purpose of checking flow of advances in the controlled categories without harming activities like development of warehousing facilities. The story for wheat and other grains almost shows similar conclusions during the period 1957-58 to 1960-61. The dilemma inherent in pursuing a dual objective policy as the one mentioned above however soon asserted itself in the subsequent years.

1961-62 to 1965-66 (Controls against foodgrains):-

During the period coinciding with the Third Five Year Plan, the broad pattern of regulation continued and was effected by a variety of factors like intensification of the food procurement policy of the Government, steep rise in general price level (especially after 1963-64) and conflicts with China and Pakistan. The linking of Bank - Rate policy to the net liquidity ratio and the intensifica -tion of food procurement programmes shaped, in general, the pattern of policy.

1961-62 :-

During this year the price situation in regard to wheat being satisfactory all restrictions were withdrawn while these on paddy and rice were - liberalised. There was an alround loosening of selective controls against foodgrains.

The busy season of 1962-63 however caused concern. As the Reserve Bank reported "a large part of the rise in advances against paddy and rice and other foodgrains (exclud -ing wheat) during the greater part of the year was accounted for by advances against warehouse receipts (and) it was, therefore, considered necessary to introduce some measure of check up in regard to advances against these receipts, if selective credit control was not to be rendered ineffective.[1]

---

1. "Currency and Finance Report" (1962-63) P.43-44.

1962-63:-

By the directive issued in January 1963, and March, 1963, the Reserve Bank subjected advances against warehouse receipts to a margin of 25 per cent (for other categories the margin being 35 per cent). Ceiling limits (permitted level) fixed for each two-month period commencing from January-February, 1963 were made inclusive of advances against warehouse receipts.

The above decision was no doubt in keeping with the nature of selective controls (being expedients they are immediately applied when pressure points develop); to the extent however it tampered with the more fundamental - objective of development of warehousing facilities the measure had to be revised in May, 1963.

In may, 1963, the banks were alloted overall cellings with specific limits for advances other than those against warehouse receipts, keeping a specified balance for advances against warehouse receipts. Unutilized portion of non-warehouse receipt ceiling could be used for 'warehouse receipt advances', with the further provision that such advances against warehouses established after April 1, 1962, were exempted from the overall ceilings.

The Reserve Bank could tackle the situation better through exhortation about closer scrutiny of advances made against warehouse receipts rather than the Stop-Go method followed by it. Regulatory measures affecting structural aspects of the economy have to be considered more seriously as the experience of the Reserve Bank suggests.

1963-64:-

Foodgrain prices started rising at inordinately high rates during various months of 1963-64. Contraction in bank credit against seasonal advances to the extent of Rs.166 crores in the slack of 1963 comprised of reduction in advances against paddy and rice to the extent of Rs.11 crores but the price situation in general was causing concern. Index number (1952-53 = 100) of wholesale prices which was 127.9 at March end, 1963 rose to 136.3 at - September end. The busy season of 1963-64 thus opened in the background of steep rise in the general price level and higher prices of rice despite reports about larger output of rice.

> On 8.2.1964 the bank fixed ceiling on bank advances against paddy and rice at a level below 10 per cent of the level in the corresponding months of 1962. On 21.3.1964 ceilings on advances against other foodgrains were also imposed.

<u>1964-65 :-</u>

The year 1963-64 ended with reports about a large fall in production of wheat from the previous year level of 10.8 million tons to 9.8 million tons and hence at the end of the busy season of 1963-64 controls on wheat which were removed in May, 1961, were reimposed.

> On 21.4.1964 margins on advances against wheat were reimposed at 35 per cent (25 per cent for advances against warehouse receipts).

Prices of foodgrains continued showing an upward trend with the onset of the slak of 1964 (price index of cereals being 152.7 in September, 1964) and moderated to some extent due to bumper crop[1] but nevertheless the price index remained at the high level of 140.3 in March, 1965 (a rise of 13.5 per cent over March, 1964) - Vide Table 7(5).

TABLE 7 (5).

Price Index of cereals: (1952-53 = 100)

	Last Friday of Month	Index
Slack 1964	April, 1964	123.6
	June, 1964	134.1
	August 1964	145.9
	September 1964	152.7
Busy 1964-1965	November 1964	140.8
	January 1965	143.8
	March 1965	140.3

Source: "Currency and Finance Report" 1964-65 P. S-22.

Hence despite bumper crop, controls were tightened up. In August, 1964 margins on advances against all foodgrains were raised from 35 per cent to 50 per cent (the 'warehouse receipts' exemption was also tightened raising margin from 25 per cent to 40 per cent). Ceilings on advances against all other foodgrains were fixed at 90% of levels in corresponding months of 1962 so as to bring them on par with paddy and rice.

Price index of foodgrains had risen by 22.5 per cent during 1963-64 and went up again by 14.4 per cent during 1964-65 despite bumper crop situation of the latter year. Busy season (1964-65) credit expansion had reached an all

1. Total foodgrains production increased from 80.2 million tons in 1963-64 to 89.0 million tons in 1964-65 the excess of 8.8 million tons being the largest for any year since 1950-51.

time high level of Rs. 407 crores. The Bank had just to have the controls continued in these circumstances.

1965-66 :-

The broad framework of regulations continued to operate as the slack season contraction of credit against paddy and rice in 1965 was lower (Rs. -5.22 crores) than in the previous year 1964 (Rs. -16.2 crores).

> In May, 1965 ceilings on advances against paddy and rice were fixed on the 1964 levels and in August, 1965 they were extended to wheat and other foodgrains. Ceilings were fixed at higher levels for paddy and rice in Andhra Pradesh and for some other foodgrains in Maharashtra.
>
> In November, 1965, restrictions on advances against wheat were removed in case of six border districts of Punjab.

While we should defer general conclusions on selective controls till we consider controls on other categories of advances, one point of observation is called for at this stage.

It is true that advances against paddy and rice and foodgrains in general constitute a small proportion of total commodity advances and much less smaller proportion of advances in the aggregate as revealed by Table 7(6).

TABLE 7 (6).

Advances against foodgrains as proportion of total commodity advances.

(Amount in Crores of Rupees)

Year (Outstanding end-December)	Total commodity advances. 1	Advances against foodgrains 2	Percentage of (2) to (1). 3
1952	248.56	10.57	4.2
1954	269.75	19.33	7.1
1956	393.01	18.80	4.8
1958	419.65	10.59	2.5
1960	643.99	15.53	2.4
1962	1042.7	26.8	2.5
1964	1225.9	18.1	1.5
1966	1725.0	44.6	2.6

Source:- "Supplement to Banking and Monetary Statistics in India (Part I)" Pp. 69-73 for years upto 1958 and "Trend and Progress of Banking in India", 1960, 1962, 1964, 1966 for the rest of the period.

Thus there is justification in the argument that "excepting for rice in some States, bank credit is unimportant for trade in foodgrains and non-effectiveness of selective credit controls in this regard is emphasised by the need to elaborate the provisions of control of credit in relation to rice continuously and even to discriminate in their operation between deficit States".[1]

It would however be a harsh judgement to undermine the rationale of selective controls on grounds of the relative weightage of "foodgrains credit" in total bank credit. It could be reasonably supposed that in the absence of controls, bank credit would have proved an additional supporting factor in the accelerating price index of foodgrains - a key component with half the weightage, of the total price index. We shall have more to say on this at a later stage.

---

1. D. R. Gadgil : "Effectiveness of credit regulation by the Reserve Bank of India - Arth-vijnana March, 1963 P. 6.

(B) Controls on advances against Sugar:-

The year 1957-58 witnessed a spurt in the price index (1952-53 = 100) of sugar, the index having registered an increase of 24.2 per cent over the previous year ended March, 1957 (the index having moved from 95 to 118). Earlier in June, 1957 the Reserve Bank had instituted controls of sugar.

> June, 1957:- Margins raised by 10 per cent subject to a maximum of 35 per cent; advances to be at a level not higher than 10 per cent in the corresponding week of previous year.
>
> December, 1957 :- Ceilings on advances were withdrawn. However "in view of continued rise in prices of sugar in the first half of 1958 and the fairly high level of bank advances against sugar industry it was apprehended that some portion of these advances was being used to finance speculative stockpiling of sugar."[1]
>
> Advances against sugar rose from Rs. 26.4 crores in December, 1957 to Rs. 50.2 and Rs. 63.4 and Rs. 53.6 crores in February, April and June, 1958 respectively.
>
> In July, 1958, therefore, margins were raised from 35 per cent to 45 per cent.

Price index of sugar showed a percentage increase of 2.5 during 1958-59 as against 24.2 during 1957-58. Bank advances were Rs. 56.9 crores in April, 1959 (as against Rs. 63.4 crores in April, 1958) and this stability having continued in 1959-60,

> On 21st April, 1961, margin restrictions were withdrawn.

---

1. "Currency and Finance Report" (1958-59) P. 31.

In the year ended March, 1963, however the price index had shown an annual increase of 10.5 per cent.

> On 27th April, 1963 margins were therefore reimposed and fixed at 45 per cent (same as in July, 1958).

Over these years the Bank took into account genuine inventory needs of sugar mills and gave concessionary treatment both to the manufacturers as well as to Consumer Co-operative Stores. Bank advances generally remained within expected limits.

Due partly to the fact that price and production trends in the years after March, 1963 showed erratic variations, and partly to assist government in its task of administering price and distribution controls over sugar, the Bank felt justified in continuing controls in terms of margin requirements, till March end, 1966.[1]

(C) Controls on advances against Groundnuts; Other Oil Seeds and Vanaspati :-

I. 1956 to 1962:-

Earlier in September, 1956, the Reserve Bank had exhorted banks to be cautious in their lending against Mustard seeds and oils. But the 'contra-seasonal and speculative spurt in groundnut prices' in the slack of 1958 made it necessary for the Bank to impose controls on advances against groundnuts:

---

1. Margin requirements later removed on 4.5.1970.

Price Index (Weekly) of Oilseeds - 1952-53 = 100.

Week	Index
April end, 1958	118.7
June end, 1958	125.9
August end, 1958	132.6
October end, 1958	135.1
December end, 1958	120.5
February end, 1959	129.2

On 9.2.1959, margin of 45 per cent and a ceiling on advances to be maintained at levels of corresponding months of 1957 and 1958 (whichever was higher) were imposed on groundnuts. On 11.12.1959 margin of 40 per cent was imposed on other oilseeds and the permissible level of advances against groundnuts was reduced to 90 per cent of the levels in corresponding months of 57-58-59.

Since the price index of oilseeds continued to rise, restrictions were continued with some minor modifications for credit limits introduced in February, 1961.

Price index of Oil Seeds (1952-53 = 100)

Year ended March.	Index	Percentage variations over previous year.
1959	128	+ 13.2
1960	141	+ 50.9
1961	160	+ 13.5

The Year 1961-62 saw relaxation of controls. Ceiling on limits for groundnuts were fixed at 105 per cent of March, 1961 to February, 1962 level for the period from March, 1962 to February, 1963 for each month period.

Behaviour of bank credit against groundnuts during the period 1959-62, as seen from Table 7(7), shows that the adjusted levels of advances (annual averages) - against groundnuts[1] for all these years remained below these permitted and the proportion of the former to later fell from 91.6 per cent to 81.3 per cent in 1961 and rose to 84.1 per cent in 1962.

TABLE 7(7).

Advances against Groundnuts.

(Amount in Lakhs of Rupees)

Year	Adjusted Level 1	Permitted Level 2	Excess (+) or Short-fall(-)of (1) over (2). 3	Percentage of (1) to (2). 4
1959	5,88	6,42	- 54	91.6
1960	7,49	7,87	- 38	95.5
1961	7,35	9,04	- 69	81.3
1962	7,51	8,93	-1,42	84.1

Notes: (1) Figures are annual average of both the levels.

(2) The 1959 average is for the period March to December (ten months).

(3) Adjusted level excludes exempted categories of advances such as those made against (i) Demand Documentary Bills covering movement of groundnuts (ii) Warehouse receipts issued by State and Central Warehousing Corporations.

Source:- "Trend and Progress of Banking in India", 1960 and 1962.

---

1. Of the total weightage of 60 (index total=1000) assigned to oilseeds, groundnuts have a share of 27 --- (1952-53 = 100 base).

Price index of groundnuts fell by 6.3 and 10.1 per cent during the two years ended March, 1962 and March, 1963 respectively. The ceiling limits which lapsed in February, 1963, were therefore, not fixed again. Only margin requirements on groundnuts at 45 per cent and on other oilseeds at 40 per cent continued.

1963-66 :-

Both the 'composite oilseeds' index and the groundnut price index fell during the year ended March, 1963 but Price index of all oilseeds and that for groundnuts again showed a rising tendency during the year ended March, 1964. Bank advances against groundnuts (for which figures are available) also showed a rising tendency. During the three years 1964-66 the trends were as noted in Table 7(8).

TABLE 7 (8).

Trends in price index and bank advances: groundnuts and all oilseeds.

(Advances in Crores of Rupees)
Price Index 1952-53 = 100

Year	Price Index (March end) all Oilseeds	Price Index (March end) Groundnuts.	Percentage variations over Previous Year		Bank advances against Groundnuts (Dec. end).
			All Oilseeds	Groundnuts.	
1963	143	134	- 4.0	-10.1	13.6
1964	163	153	+14.0	+14.2	13.5
1965	195	186	+19.6	+21.6	14.5
1966	258	248	+32.3	+33.3	20.7

Sources:- "Currency & Finance Report" 1964-65 and 1965-66 and "Trend and Progress of Banking in India" 1962; 1964; 1966.

The Bank felt justified in reimposing controls from March, 1964.

> On 11.3.1964 margin requirements for groundnuts were raised from 45 to 50 per cent and ceilings on advances that lapsed in Feb., 1963 were reimposed.
>
> On 7.7.1964 margin requirements for other oilseeds were also raised from 40 to 45 per cent and advances against Vanaspati were brought under control.
>
> In July, 1965, ceilings on advances against groundnuts were tightened and in August, 1965, ceilings on other oilseeds were fixed at 90 per cent of the level of advances in the corresponding month of the base period August, 1964 to July, 1965.

The same strictures that we made against the adequacy of controls on foodgrains in view of the very small proportion of bank advances made for these securities would apply to groundnut and other oilseeds also.

(D) Controls on advances against raw Jute and Jute goods; Cotton and Kapas:-

Jute:- As the Reserve Bank reported 'trends in prices of shares, raw jute and jute goods necessitated extension of controls to these items'.[1] Over the year ended November, 1960, prices of raw jute and jute goods increased by 72 and 54 per cent respectively; over the same period advances against each had risen by 31 and 77 per cent respectively.

---

1. "Trend & Progress of Banking in India" 1960 P.19.

Price Index of Jute (1952-53 = 100).

Year (ended - March).	Index	Percentage variation over previous year shown.
1956	122	-
1960	141	+ 15.5
1961	271	+ 92.2
1962	148	- 45.4
1963	152	+ 2.7
1964	151	- 0.7
1965	172	+ 13.9
1966	275	+ 59.9

Source: "Currency and Finance Reports".

12.12.1960:- Margin requirements for raw jute - 25 per cent for mills and 40 per cent for other stockists were imposed - Margin for Jute goods was fixed at 40 per cent.

Ceiling on advances not exceeding 130 of previous year in each two-month period of 1960 was imposed. In April, 1961, concessions were given to shippers for export of jute goods in regard to margin requirements which would be 25 per cent instead of 40 per cent for others.

With a decline in the price index from March, 1961, onward, margin requirements in June, 1961 and ceilings on advances in August, 1961 were withdrawn.

Advances against Raw Jute and Jute textiles: Outstanding December end:

(Amount in Crores of Rupees)

Year (ended December)	Raw Jute	Jute Textiles
1960	19.57	22.7
1961	17.27	- n.a.
1962	26.97	28.8
1963	33.17	29.9
1964	31.37	42.2
1965	25.40	43.0
1966	37.00	56.7

Source:- "Trends and Progress of Banking in India for the years 1960-62-64-66.

The control thus operated for about a year's time. After 1965-66 however both the price index and level of advances as seen from data in the two tables above warranted control measures and the Reserve Bank introduced in October, 1968 after a lapse of about 7 years selective credit controls on advances against raw jute and jute goods.[1]

Cotton and Kapas :- A large part of the scheduled commercial bank advances against seasonal agricultural commodities went to the cotton trade. But the behaviour of the price level being the major consideration or say

1. "Currency and Finance Report 1968-69" P. 109.

the Indicator, warranting institution of selective controls with the Bank, it did not find any reason for imposing such controls on advances against raw cotton and kapas till August, 1965.

Price Index of raw cotton
(1952 - 53=100)

Year (Ended March)	Index	Percentage Variations
1956	111	-
1963	117	+ 5.4 (Over 1956)
1964	120	+ 2.6 (Over previous year).
1965	132	+10.0 (")
1966	128	- 2.3 (")

In August, 1965 margin requirements were imposed for parties other than textile mills.

In September and October, 1965 advances against imported cotton and new cotton crop were exempted.

The control measure produced an immediate effect. Advances against raw cotton and kapas which were Rs.95.5 crores (outstanding as on December end) in 1964 remained within limits at Rs. 104.9 and 79.3 crores respectively in 1965 and 1966 (outstanding December end). In the years after 1965-66, selective controls against cotton and kapas however appear to have been intensified.

(E) Controls (i) on advances against Shares and Stocks and (ii) on 'Clean advances' :-

The Federal Reserve system having initiated in Depression years and having continued till this day, the method of restricting advances, through margin regulation, against stocks and shares has been widely used by Central Banks the world over. The Reserve Bank had made exhortations in 1957 (April) and 1958 (July - August) to the banks to be cautious and 'avoid advances against block shares and to parties known to be speculatively minded'.

While initiating its first comprehensive programme of credit squeeze in March, 1960, the Reserve Bank took advantage of instituting controls on advances against stocks and shares as well as regulating lending in the form of 'clean loans'.

The All-India index of Variable Dividend Industrial Security prices (1952-53 = 100) which was 126.6 in 1957-58 (March-end) rose to 146.8 in 1958-59 (March-end) and to 161.7 in 1959-60 (March-end) registering an increase of 27 per cent over the two-year period. To ensure that this booming condition on the stock exchanges may not contaminate the banking sector and intensify the boom, the Reserve Bank fixed minimum margin requirements for advances against shares and also put a ceiling on clean advances.

Advances against Stocks & Shares.

1. March 11, 1960:- Margin of 50 per cent in respect of advances against equity shares with total exemption for advances of the value of Rs. 5,000/- 'so as not to affect small investors' was imposed. (Direct financing of Badla[1] transactions by scheduled banks was totally banned).

2. With moderation in the rise of security price index (1960-61 : 189.4), in January 1962 margin was reduced from 50 to 25 per cent.

3. With the slump in October, 1962 (following Chinese aggression) in Stock prices and the price index having suffered a decline to 160.3 from previous year level of 162.7, on 30.10.1963 margin requirements were withdrawn. The ban on Badla transactions was retained.

Advances against Clean Loans.

1. March 11, 1960:- Ceiling in the form that the ratio of 'Clean' to 'Total' advances should not exceed those prevailing in corresponding month of 1959 was imposed.

2. On 23.10.1961 the ceiling on 'clean advances' was removed.

3. On 29.6.1965 banks were asked to keep their clean loans at a level not higher than that prevailing on 25.6.1965 but on 9.9.1965 these restrictions were removed so as to enable banks to cater to enhanced defence requirements consequent upon Indo-Pak conflict.

Controls on Shares:-

The March 1960 directive produced an immediate effect in that at the end of December, 1960 advances outstanding against stocks had declined by Rs. 1.2 crores over their March 1960 levels as seen from Table 7(9). In the next two years advances against Shares varied by Rs. + 10.0 and + 6.3 crores respectively. The Reserve Bank might

---

1. Badla transactions refer to purchases of shares in the current settlement (Badla) with a view to effecting sales in the next settlement.

have tightened controls in view of these variations but the slump on stock exchanges after October, 1962 obviated such a need. The Reserve Bank having removed controls in October, 1963 advances against shares till December, 1966 remained almost stagnant at their - December 1962 level.

TABLE 7 (9).

Advances by scheduled banks against Shares and 'Clean advances'.

(Amount in Crores of Rupees)

Year (Outstanding).	Shares	Variation over previous amount.	'Clean advances'	Variation over previous amount.
Dec. 1959	91.2	-	139.9	-
Mar. 1960	99.6	+ 8.4	190.0	+ 50.1
Dec. 1960	98.4	- 1.2	167.1	- 22.9
Dec. 1961	108.4	+ 10.0	172.1	- 5.0
Dec. 1962	114.7	+ 6.3	199.1	+ 27.0
Dec. 1963	116.5	+ 1.8	259.6	+ 60.5
Dec. 1964	117.2	+ 0.7	296.7	+ 37.1
Dec. 1965	116.9	- 0.3	284.7	- 12.0
Dec. 1966	116.2	- 0.7	373.0	+ 88.3

Source: "Trend and progress of Banking in India" - 1960, 1962, 1964, 1966.

Controls on 'Clean Advances' :-

Against an increase of Rs. 50.1 crores in March, 1960, over December, 1959 level, clean advances showed a decline of Rs.22.9 crores in December, 1960. Controls on clean advances having been removed in October, 1961, the year 1961 experienced a decline of Rs. 5 crores over 1960 levels, but from 1962 onward clean advances showed an increasing trend of Rs. + 27.0; + 60.5; and + 37.1 crores during the years 1962; 1963; 1964. The short-lived control in June, 1965 had some effect so that over the year 1965 clean advances declined by - Rs. 12 crores but with the year ended 1966 they again increased by a record amount of Rs. 88.3 crores.

Advances against stocks and shares are most amenable to selective controls.[1] In India, the controls were scrapped in view of the price trends on the stock exchange and the removal was fully justified. In this connection, we may recall the argument noted earlier that bank finance for foodgrains constitutes a small proportion of total advances. Below we cite figures of advances against paddy and rice, wheat, other foodgrains, 'Vanaspati' and sugar as a 'composite group' and advances against shares and debentures of joint stock companies as another group for two selected dates.

(Amount in Crores of Rupees)

Year (Outstanding)	Composite Food Group	Shares.
December, 1960	74.4	98.4
December, 1965	99.1	116.9

Source: "Trend and Progress of Banking in India" : 1960 and 1966.

As may be seen the quantum of bank finance going to the latter group has remained larger.

1. In the U.S.A. selective controls against shares have been retained since 1935 while controls on consumer credit have been intermittent and short-lived.

Controls against the composite 'Food' Group are justified in view of its strategic position and its impact on the cost of living (and even material well-being in subsistence economies). It is not the volume of bank advances made that render a particular category subject to regulation but the strategic position of it in the overall economic situation and the trends in particular prices.[1]

Similarly in regard to 'clean advances' the Reserve Bank was guided by the exigency of the situation and having received representation from the stock exchanges soon in April, 1960 it conceded to their demand for considering "specific cases of hardship caused by the March 11, 1960, directive". The Bank had subsequently "allowed the banks to make advances on a 'clean' basis for an additional amount of Rs. 12 crores" (this amount was not to be taken into account for calculation of the permitted ratio of 'clean' to 'total' advances).[2]

---

1. The suggestion to control advances against cotton (if selective controls at all are to be employed) as implied in the argument that "the largest share of trading advances secured against agricultural commodities is taken up by cotton" did not stand to reason in 1963 but became relevant after 1965 not because of the 'share' of advances going to cotton but because of price and production trends of that commodity.

   For such a suggestion refer D.R.Gadgil, Ibid P.6,

2. "Currency and Finance Report" 1960-61 P.45,

'Clean advances' are a vulnerable category in that whereas they provide an elbow room to prudent but energetic bankers to cater to financial requirements of "potentially productive" borrowers, they might delude them into mistaking unproductive for productive borrowing or induce them to circumvent other control measures by resorting to advances of such nature. The latter possibility had prompted the Reserve Bank in instituting controls on clean advances in March, 1960.[1]

The March 1960 directive 'to keep the ratio at the March 1959 level' was carried out by the banks despite the exemption of Rs. 12 crores from calculation of the ratio given in April 1960. The ratio of Clean loans to total credit (both secured and unsecured) was 13.9 per cent in March, 1961 as against 16.8 per cent in March, 1960.[2]

---

1. "With the operation of selective controls in respect of a number of commodities, there was possibility of some circumvention of the directives through larger expansion of clean advances". "Trend and Progress of Banking in India" (1960) P.20.

2. "Currency and Finance Report" 1960-61 P. 45.

TABLE 7 (10).

Ratio of 'Clean' to 'total' advances.

(Amount in Crores of Rupees)

Year (Outstanding)	'Total' 1	'Clean' 2	Ratio of (1) to (2) 3
December 1960	1003.8	167.1	16.0 %
December 1961	1113.6	172.1	15.4 %
December 1962	1221.3	199.1	16.2 %
December 1963	1318.0	259.6	19.6 %
December 1964	1517.2	296.7	19.5 %
December 1965	1817.1	284.7	15.6 %
December 1966	2054.4	373.0	18.1 %

Source: "Trend and Progress of Banking in India" for the years 1960, 1962, 1964, 1966.

Table 7(10) above showing the ratio of 'clean' to 'total secured' advances indicates a rise in the ratio during 1963 and 1964 which should have prompted the Reserve Bank to reimpose controls on 25.6.1965, the measure being both liberal and short-lived.[1]

1. There could not be any criteria about a particular ratio being 'safe' and 'non-speculative', although a large and sporadic or persistently rising ratio must cause concern. For a large sporadic rise moral suasion may be the best method.

The reasoning underlying demand for making bank credit available to 'small' persons in a large measure in the context of nationalisation of banks would have to concede a rise in the ratio.

<u>General evaluation of the operation of selective - controls :-</u>

Selective credit controls in India may be condemned as being virtually ineffective and possessing only a status-value (to spare the use of a much harsher term nuisance-value) when viewed in terms of their impact on the prices of commodities subjected to regulation or even on the General Price level. The story of variations in the price indices of all those commodities subjected to control over a large part of 1956-66 lends support to such a view as revealed by Table 7 (11).

The thinking of the Reserve Bank in this regard is one inspired by a sense of duty and safeguard as seen in the two following statements made with an interval of twelve years.

> "The success of these (selective) controls is to be judged in a limited sphere, namely, their impact on the pressure of demand originating from bank credit; in this sense (i.e. in the sense of advances having shown a decline) the measures should be deemed successful, but for their operation it is likely that the price might have been somewhat worse" (Currency and Finance Report 1958-59 P. 32) (brackets added).

-- X --

> "What selective credit controls are likely to accomplish is to moderate the price rise rather than arrest the basic trend" (Reserve Bank of India - Functions and Working", Reserve Bank of India, Bombay (1970) P.58).

The Bank may even exonerate itself from the test of 'restriction of advances' in view of the needs of a growing

TABLE 7 (11)

Annual variations in price indices of various commodities during 1956-66

Year (ended March)	COMMODITY : 1952-53 = 100								All-India* Consumer Price Index (Working Class) 1950-51 = 100.	Wholesale Price Index (General) (1952-53 = 100).
	Rice	Percentage variation over previous year.	Wheat	Percentage variation over previous year.	Sugar	Percentage variation over previous year.	Ground nuts	Percentage variation over previous year.		
1955-56	86	-	85	-	95	-	102	-	94	92.5
1956-57	97	+ 12.8	95	+ 11.8	95	-	112	+ 9.8	105	105.3
1957-58	100	+ 3.1	84	- 11.6	118	+ 24.2	103	- 8.0	110	108.4
1958-59	92	- 8.0	114	+ 35.7	121	+ 2.5	121	+ 17.5	116	112.9
1959-60	106	+ 15.2	94	- 17.5	127	+ 4.9	141	+ 16.5	120	117.1
1960-61	101	- 4.7	91	- 3.2	127	-	159	+ 12.8	122	124.9
1961-62	103	+ 2.0	94	+ 3.3	124	- 2.4	149	- 6.3	125	125.1
1962-63	110	+ 6.8	87	- 7.4	137	+ 10.5	134	- 10.1	128	127.9
1963-64	122	+ 10.9	120	+ 37.9	145	+ 5.8	153	+ 14.2	134	135.3
1964-65	128	+ 4.9	141	+ 17.5	151	+ 4.1	186	+ 21.6	154	152.7
1965-66	158	+ 23.4	136	- 3.5	163	+ 7.9	248	+ 33.3	166	165.1
Percentage variation over 1955-56 index		+ 83.7		+ 60.0		+ 71.6		+143.1	+ 76.6	+ 78.5

Source: 1. Currency and Finance Reports various years.

2.* Basic Statistics relating to the Indian economy - Planning Commission, December, 1968 P. 22.

economy and take satisfaction that the level of advances would have been much higher and speculation-feeding than what obtained, but for the operation of the controls. Fortunately the level of bank advances remained under check as desired by the Bank for most of the commodities over most of the period.

A few observations on Selective Controls in India :-

Selective controls in India having been largely designed for checking excessive inventory holding, ideal policy would be that which secures optimal level of bank finance that would meet with genuine requirements of stock holding as determined by trends in production, income, demand and other ascertainable relevant factors. The method of judging success of the policy in terms of "its impact on the pressure of demand originating from bank credit" provides an ex-post rationalisation of policy and does not entitle us to say that the policy was optimally determined. To the extent, it harms production, the policy is to be judged as sub-optimal in character. Moreover the policy may force borrowers (both speculators and others) to seek alternative sources of finance and this constitutes the crux of the matter. Selective credit controls tend to favour established borrowers at the cost of more enterprising new borrowers and turn out discriminatory in character for the same - category of advances (between different categories of advances they are by nature discriminatory). More importantly when selective controls diverts speculative demand to other sources of finance, which are costlier by assumption and the speculators succeed in achieving their plans, the resultant price level will be higher than what would have obtained if they had recourse to bank finance. Non-bank sources of finance[1] which are even quantitatively of far greater importance are thus a drag on the effectiveness of selective controls in India.

In the background of this general limitation, we should note some characteristics and weaknesses of selective controls in India.

1. Ratio of bank credit to total consumer - expenditure :

Categories of advances subjected to control in India relate largely to agricultural products, either food articles or raw materials. Consumer credit (real estate credit and stocks apart) which is subjected to control in the developed economies is characteristically and dimensionally different. If the category of advance subjected to regulation bears a larger (smaller) proportion to total bank loans as well as to total expenditure made by the community in regard to these, the importance of regulation is enhanced (diminished).

1. represented by the whole of the unorganised banking sector; black money and even the Co-operative sector.

While the data are not comparable due to widely divergent economic conditions and also on account of the basic difference that consumer credit in U.S.A. is not subject to regulation at present, it may still be instructive to note, by way of illustration, the ratio of bank credit to total consumer expenditure in U.S.A. and India during the year 1960.

Table 7(12) reveals that whereas bank credit (instalment credit excepted) was about 6.1 per cent of total consumer expenditure in the U.S.A. it was about 0.79 per cent of total consumer expenditure in India. Having related bank finance to the volume of expenditure, we get a better idea about the potential effectiveness of selective controls.

It may be argued that consumer credit in U.S.A. is for 'durables' which in a sense partakes of the character of capital goods whereas bank credit for the 'composite food group' in[1] India is to the dealers and for pure consumption articles. There is however another aspect of the matter which needs emphasis. In a subsistence economy, the percentage expenditure on the 'composite food group' is by hypothesis large and whereas the smaller percentage figure of 0.79 per cent of bank finance to total consumer expenditure would militate against use of selective controls, the larger percentage of the composite food group in total consumer expenditure should enhance the need

1. We refer here to that portion of bank credit which was made against the 'Composite food group' consisting of paddy and rice, wheat, other foodgrains, sugar and vegetable oils including 'Vanaspati'.

TABLE 7(12)

Ratio of bank credit to total consumer expenditure in U.S.A. and in India in 1960.

(1) U. S. A.

(Amount in Billions of dollars)

Personal consumer expenditure.	Consumer credit : Total outstanding (Dec.'60).	Share of commercial banks in total consumer credit (Col.2)	Consumer Credit provided by Commercial Banks (2)x(3) ÷ 100	Percentage ratio of (4) to (1).
(1)	(2)	(3)	(4)	(5)
$ 328	$ 56	36%	$ 20	6.1

Source: "Commercial banking industry" : Monograph prepared for the C.M.C. Prentice Hall (1964) P.182 (Table 5(11)) and p.170 (Table 5-2).

(2) INDIA

(Amount in Crores of Rupees)

Personal consumer expenditure (1960 - 61)	Bank credit outstanding (scheduled banks) against 'Composite - Food group' (Average for the year 1960-61).	Percentage ratio of (2) to (1)
(1)	(2)	(3)
11,988	95	0.79

Notes:- (1) Net private consumer expenditure during 1960-61 was Rs. 11,988 crores arrived at in this manner:

Net Domestic Product at Market Prices	Rs. 14,328	crores
Plus Imports - Exports	+ Rs. 411	"
Net Domestic Expenditure	Rs. 14,739	"
Minus Net Domestic Capital formation	Rs. 1,665	"
Minus Government consumption expenditure	Rs. 1,086	"
Net Private Consumer expenditure	Rs. 11,988	"

(2) Net private consumer expenditure has been equated with personal consumer expenditure in case of India.

Source:- "Trend and Progress of Banking in India" 1960 (P.80-81) and 1961 (Pp. 70-71).

for such controls. This however does not mean that the Central Bank could remain oblivious of the low effectiveness of the controls and this takes us to the question whether the forms of controls should change. We come to this issue at a later stage in this chapter.

(2) Discretionary elements in selective controls :-

Selective controls in India have operated alongwith controls over price and distribution in respect of some foodgrains; sugar, jute, cotton etcetera. On the one hand such controls necessitated modifications in the form and provisions of selective credit controls on foodgrains (such as to take account of variations in prices in - 'surplus' and 'deficit' States). On the other hand, it has reduced the area of operation of credit controls as the proportion of trade handled by Government agencies increased relative to that by private parties[1] and the Bank had then to follow the policy of tightening controls on bank credit to private parties and providing refinance at lower terms to Government agencies in regard to foodgrains. Selective controls operating under conditions of a Dual market in foodgrains, sugar etc. had to be designed with discretionary elements of this nature.

(3) Warehousing and banking expansion constraints:-

Development of warehousing facilities and banking expansions were the other two factors conditioning the

1. Refer "Currency and Finance Report" (1966-67) P. 65.

working of selective controls. This added an element of vacillation in policy and the outcome has not been satisfactory as we noted earlier. The Reserve Bank could perhaps frame out a scheme of voluntary agreements with banks in regard to keeping a check on the use of warehousing facilities for speculative stock holding rather than modify its regulations with so much frequency as it did. It followed the right policy in making controls less stringent for newly opened branches of banks. Selective controls when they affect agro-based commodities do act as a deterrant to branch expansion in the rural areas. Here too, the better method would have been some voluntary agreement with banks with periodic revisions.

(4) Perverse announcement effects of selective controls :-

A plausible argument could be made against selective controls on the ground that they are more prone to produce perverse announcement effects than any of the general controls. The fact that the banks do not raise the price of the loan (except when selective controls take the form of differential interest rates) but just cannot provide the same amount of loan because bank loans are expectedly feeding speculation may induce the existing borrowers to feel strengthened in their speculative bidding and resort to non-bank sources of finance in addition to enthusing potential speculators to enter the field. Price indices of commodities subjected to regulation do provide some evidence in favour of the argument about perverse announcement effects which are again likely to be strengthened when controls have a long span of continuance. It is precisely from this point of view that the 'Sayers criterion' of 'quick effects -- ~~of~~ early relaxation' gets into importance. Selective controls in India have unfortunately not met this basic criterion although it may be argued that trends in agricultural production rather than the proven ineffectiveness of selective controls have been one of the causative factors in the continuance of selective controls.

(5) 'Selective' controls as being substitutes for or complementary to 'General' controls.

The point is often made that selective controls used in combination with general credit controls get added effectiveness than when used alone. This seemingly innocuous point needs to be made more explicit for it is likely to be (and has been) used in defence of the ineffective working of such controls. Thus it has been asseted that "in India, as in other countries, the efficiency of the selective controls has always been more pronounced when they operated in the context of a generally restrictive credit policy, as for instance in the summer months of 1957 when the Bank Rate was raised by 1/2 per cent; on the other hand their efficacy is impaired if they operate in a context of liberal borrowing from the Reserve Bank or of high liquidity with banks".[1] For one thing the May, 1957 rise in Bank was just a case of adjustment for removing the anamoly between the limping official Bank Rate and the effective higher rate of lending[2] under the Bill Market Scheme. The measure had, therefore, little cost effect and reserve effect (if any) and virtually no announcement effect. It must also be noted that selective controls <u>when related to ceilings on bank advances</u> would, if complied with scrupulously by banks, be effective whatever the general liquidity position.

It is true that under conditions of high liquidity the incentive to flout selective controls would be greater than if liquidity is less. Selective controls will then appear as supplements to general credit controls under inflationary (high liquidity) conditions and not as independent measures "designed specifically to curb excesses in selected areas without affecting other types of credit."[3] The upshot of the matter is that when selective controls are to be directed towards controlling "volatile sectors of spending" their authenticity or effectiveness need not

---

1. H.V.R. Iengar, "Monetary Policy and Economic Growth" Vora & Co., Bombay (1962) P. 204.

2. As stated earlier in Chapter V.

3. Reserve Bank of India, Functions and Working, Reserve Bank of India (1970) P.58.

always remain conditional upon their being accompanied by general credit controls. Selective controls have both quantitative and qualitative effects and general credit controls are no less discriminatory; in point of fact as Smith observes "the effects of monetary policy vary from one sector of the economy to the other, effects on a particular sector depend(ing) on many things including the financial practices prevail(ing) in the sector ... structure of the financial markets which channel funds to that sector, nature of Government regulation or controls which may constrain the sector's behaviour and so on".[1]

Effectiveness of selective controls is enhanced when they are used in the form of moral suasion with a threat for legal action in case of non-compliance.

In India commercial banks have complied with selective regulations in a large measure. The Reserve Bank reported in 1961; "The compliance of banks with the selective credit controls has been generally satisfactory, and banks have found it easier to comply with a directive specifying the permitted order of credit expansion before rather than after such expansion had occured".[2] The latter part of the statement deserves

---

1. W.L. Smith "Monetary Policy and the Structure of markets" in "Readings in Money, National Income and stabilization Policy" (Eds. Smith and Teigan) Irwin (1965) P. 261.

2. "Currency and Finance Report" (1960-61) P. 45.

consideration. Such a procedure as suggested by banks in India could obtain under some conditions of credit planning as is being presently thought of it. It may be pertinent to note here the method followed by the Bank of Japan in this regard. A heightened form of moral suasion called Madoguchio Shido (Lending Window Operations) was inauguarated by the Bank of Japan in 1954.[1] This Policy enjoined upon the large City Banks to send estimates of bank loans desired to be made in some particular period well ahead of the time. The Bank of Japan would then suggest its own estimates and desire that the banks adhere to carrying out their operations as per estimates made by it. "Almost always the estimated loan programmes of the City banks are individually and totally greater than those prepared by the Bank of Japan" but the "Bank does not expect the ceilings (Bank's estimates) to be completely rigidly held to". At the end of each period (each month) a meeting between the chiefs of the Loan Departments of the City Banks and the Chief of the Business Department of the Bank of Japan is held which "provides an opportunity for chastising before their peers those banks that have exceeded their ceilings, bringing into play the very effective sanction of shame and loss of face".[2]

---

1. Hugh T. PatricK"Monetary Policy and Central Banking in contemporary Japan", University of Bombay, Bombay (1962), Chapter VIII.

2. H. T. Patrick Ibid Pp. 143-45.

The record of the Reserve Bank of India in regard to moral suasion has been more encouraging than operation of other forms of selective controls. In July, 1957, the Governor of the Reserve Bank met representatives of banks and appealed to them to bring down the level of advances, in the aggregate, to Rs. 800 Crores by October end, 1957.[1] The directive was, by and large, carried out. The prerequisite that banking business should be concentrated for the success of moral suasion is largely fulfilled in India. (More so with a nationalised banking set-up).

It is contended that the co-operating banking system which is outside the purview of selective controls reduces their effectiveness. Moral suasion could be effectively extended to both the categories of banks and will be least resisted by the co-operative sector then any overt form of regulation, for as noted in Chapter 4, this sector subsists heavily on support from the Reserve Bank.

The argument obviously is not - and could not be - replacement of the existing forms of control by a single policy action of 'moral suasion'.

In view of both the lower share of bank credit and larger share of consumer expenditure in the 'composite food group' the policy of moral suasion gets added

---

1. The level of bank credit in June, 1957 was Rs. 886 crores.

importance. Its use in regard to advances against industrial raw materials should not also prove disappointing. The Reserve Bank could operate simultaneously on various sources of finance under this policy of exhortation. The Bank has unfortunately not made further use of this measure despite the encouraging experience of 1957.

In a useful rationalisation of selective controls, Arthur Smithies argued that efficiency of a control system depends upon the degree to which mistakes are avoided in its application. To ensure this it is necessary that "the most efficient control system (should make) use of more controls than the minimum number that may prove effective and it includes the use of selective controls".[1] On the basis of this reasoning, we may say that 'moral suasion' could have well been used even while using other forms of selective control.

Tamagna provides a useful definition of moral suasion when he says "this intangible and yet important aspect of monetary policy may be defined as the day-to-day influence that the Central Bank exercises to induce market institutions to conduct their operations in accordance with its general views and policies".[2] In a

---

1. "Uses of Selective Credit Controls" in Neil Jacoby (Ed.) "United States Monetary Policy" New York (1964) Pp. 114-115.

2. F. M. Tamagna in "Monetary Management" op.cit. p.135.

similar vein Paul Samuelson says "Moral suasion by which I mean the whole atmosphere in which banking is carried on ... is constantly being pooh-poohed by many economists as a factor of any quantitative importance for monetary policy ... but in my judgement it is often a significant variable and, as in so many countries abroad, it will become an increasingly important variable in the future (in the U.S.)"[1]

A nationalised banking set-up would need and render more effective the use of moral suasion.

---

1. "Money, Interest Rates and economic activity" in J. Van Fenstermaker (Ed.) "Readings in financial markets and institutions", New York (1969) P. 206.