Study on Selective Credit Control in India

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Abstract – Credit control is an important tool used by the Reserve Bank of India, a major monetary policy instrument used to control the economy's demand and supply of cash (liquidity). Control over the credit that commercial banks offer is controlled by the Central Bank. The RBI is using such a strategy to bring "Economic Development with Stability" This means that banks can not only monitor inflationary economic patterns, but also boost economic growth, eventually leading to a rise in the stability of real national income. Given its functions, such as issuing notes and retaining cash reserves, credit not regulated by the RBI will lead to social and economic instability in the country. To foster financial stability and economic growth, the banking system is regulated. While growing public sector ownership of banks and a combination of joint-stock firms, branches, cooperatives and corporations has been observed in the post-independence period, it does not guarantee the optimal banking structure that financial reforms have sought since 1991. An significant area in the study of macroeconomics is the banking system and money management. Since the monetary policies of the Government and the RBI will influence our defence budget in several ways, we should be fully aware of this important area of the macroeconomic system as defence planners.

Keywords: Banking Structure, Credit Allocation, Economic Growth

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INTRODUCTION

It seems almost universal in economic literature that monetary policy is a strong tool for improving a country's macro-economic status. Monetary policy has been regarded as a significant economic policy organ. Therefore, monetary policy priorities broadly align with the objectives of the overall economic policy. Development, social justice and price stability have been the three main objectives of economic policy in India. While it is generally accepted that the goal of price stability is one that monetary policy can most effectively follow, monetary policy has in practise, often made a substantial contribution to achieving other objectives. The effective design and execution of monetary policy, however, depends on the prevailing economic situation and on systemic factors such as the proportion of the money supply currency, the size of the government debt, the size of the non-monetary sector in the economy, etc. Because monetary policy, through its tools, affects the ultimate goals, the issue of defining targets assumes importance.

CREDITAND MONETARY POLICY IN INDIA

Monetary policy is by general consensus, a central bank's defining feature. The Reserve Bank of India pursued a range of developmental initiatives in independent India, unusually for a central bank, although monetary policy remained its central concern. Monetary policy is applied, generally referred to as the monetary policy system, consisting of monetary policy goals, monetary policy objectives and objectives, and monetary policy instruments aimed at controlling the supply of money and the cost and availability of credit in the economy. Therefore the Reserve Bank of India was more likely than more conventional central banks to take a broader view of its monetary policy, including the institutional responsibility for deepening the financial sector of the economy within its framework. We will address these aspects in the Indian sense in this section.

In the hands of the Reserve Bank of India, selective credit control is a mechanism for limiting bank finance to sensitive commodities. In general, these sensitive commodities include:

(i) Grains of food, i.e., cereals and pulses.

(ii) textiles made of cotton, including cotton yarn, man-made fibres and yarn, and textiles made of man-made fibres, partly cotton yarn and partly man-made fibres.

(iii) Selected major indigenously grown oil seeds, viz. Groundnut, rapeseed/mustard, cottonseed, linseed, castor seed, vegetable oils, vanaspati and all imported vegetable oils and oils.

(iv) Sugar, Khandsari and Gur.

(v) Kapas and raw cotton.

As must be noted, all of these goods are of mass use and the Government makes every effort to ensure that these commodities are properly supplied in the free market. Therefore the strategy is to deter development as much as possible against these goods and the aim is accomplished by 'Selective Credit Control,' which has two distinct aspects as follows:

(i) The minimum lending margin is fixed against the security of the specified commodities.

(ii) The ceiling is set at the credit level.

These measures limit the banks' overall borrowing against these commodities. The Reserve Bank of India has also made use of the minimum lending rate for goods protected by Limited Credit Control. This stipulation has since been eliminated with the liberalisation of interest rates declared by the Reserve Bank and banks are free to decide the interest rate w.e.f. 18 October 1994.

Selective Credit Control (SCC):

This approach has been used by the RBI to control the credit flow of particular branches of economic activity, thus checking the misuse of borrowing facilities.

Commercial banks have been forbidden to extend credit by traders for speculative hoarding of certain commodities. The main thrust of selective controls is this.

As part of the 'managed growth' programme of the RBI, the SCC was first implemented in early 1956. Usually, the SCC includes the following commodities: food grains, big oil plants, and Vegetable oils, cotton and kapas, sugar, gur and khandsari, cotton textiles, including cotton thread, manmade fibres and yarn, and fabrics (including stock-in-process) made from manmade fibres.

Role of Credit

With declining markets, higher availability of cheaper sources of funds, such as external commercial borrowings (ECBs), and similarly declining capital markets, corporate borrowers are paying more attention to domestic banks in order to obtain their funds. In two types, working capital and term loans, banks provide credit. Historically, more funds for working capital than for term loans have been advanced by banks. For the banking sector as a whole, loans accounted for roughly 45% of total advances, compared with 50% of total advances at the end of 2009. Also the regulator, i.e. the Reserve Bank of India (RBI), took effective steps, such as reducing the statutory liquidity ratio and the cash reserve ratio required. In its monetary policy stance, it has also revised its credit growth target to 24 percent from 20 percent, so that banks can fulfil the credit requirements. In the third quarterly review of monetary policy, 2008-09, which was announced on January 27, 2009, the banks were told of this upward target.

Significance of Bank Credit

An significant pre-requisite for growth is the availability of adequate and timely finance. Economic activity is influenced by monetary policy not only through the traditional interest rate channel, but also through the availability of bank credit. Banks have historically been the key source of finance for different sectors of the economy in most developing countries, and in some advanced regions such as Europe. In comparison, market-based finance structures predominate in many industrialised economies, such as the US. In addition to financing growth, bank credit fluctuations are a significant medium for the transmission of monetary policy mechanisms, and also for central banks that rely on interest rates to express their policy stance.

Bank Credit: The Indian Experience

An significant goal of monetary policy in India has been the adequate availability of credit to support the demand for investment in the economy. At the same time, monetary policy has had to satisfy itself with rising fiscal deficits. In the light of the administered interest rate mechanism, the higher borrowing requirements of both the Centre and the State Governments were effectively met by a staggered increase of 69 in the statutory pre-emption of bank deposits. Not only were the lendable capital of the banks to be shared between the private sector and the government, society's social problems had to be taken into account as well. This took the form of targeted lending in the form of priority sector lending targets, so an elaborate and arduous credit planning mechanism was in place by the early 1980s. Credit preparation included sectoral limitations for loan deployment, with credit for procurement operations as the first payment on credit demand. Without stoking inflation expectations, the broad objective of the credit policy was to meet legitimate credit needs for productive purposes.

Need for credit control

Among the most important functions of the Reserve Bank of India is the management of credit in the economy. In the economy, the basic and essential needs of credit management are—"priority sector" priority sector,"prioritized" prioritized. In general, these sectors total about 15 in number.

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To regulate the channeling of credit such that credit is not given for undesirable purposes.

- To accomplish the target of inflation and deflation management.
- To improve the economy by facilitating the flow of sufficient bank credit volumes to various sectors.
- To grow the economy.

Bank Credit and National Policy

In the commanding heights of the economy are financial institutions. The national strategy and goals must be fulfilled by them. In India, twenty major banks have been nationalized to better serve the growth needs of the economy in line with national policy and objectives. In the aftermath of nationalization, critical changes in banking policies and practices were urgently needed to serve the larger social objective of establishing democratic socialism in the country. The definition of protection observed by bankers in their attitude towards the previously weaker and ignored parts of society over the last two decades has undergone major changes. Banks have been designed to fund large-scale producers, small industrialists, skilled individuals and transporters, etc. Banks have also been urged to assist in the implementation of the 20-point programme and have been directed to ensure that banks' advances in priority sectors are increasingly attributable to the weaker and less privileged sectors at concessional interest rates. Protection of funds is not pursued solely for the borrower's tangible assets, but also for the borrower's technological competence, management capacity, fairness and integrity. Significant numbers of loans are issued to skilled individuals for the setting up of small businesses or for beginning practise.

Such loans are guaranteed by the Deposit Insurance and Credit Guarantee Corporation; it should be noted that bank credit must serve as an effective instrument to achieve a broader social aim, national policy and objective. The basic principles of sound lending, however are fundamental and are also practised by nationalized banks. Of course, the forms in which the fundamental concepts are practised can be altered to meet the needs of the hour.

RBI's Guidelines on Bank Credit

It offers a basis for the rules/regulations/instructions on statutory and other limits on loans and advances issued to SCBs. These directives should be followed by banks and appropriate precautions should be introduced in order to ensure that the banking activities performed by them function on sound, prudent and profitable lines.

Sectoral Flow of Credit

Indian banks are free to settle on the credit flow for the different segments. Regulators have however, recommended exposure limits for the sectors, taking into account the importance of meeting the credit needs of the different sectors, so that a large chunk of the funds are not cornered by an entity or community. Banks need to establish and implement effective credit risk assessment techniques with the change in approach from micro-management of credit by different legislation, credit allocation goals, and administered interest rates to a risk-based lending framework and market-determined interest rates. During the post-nationalization period, there was a sea change in the geographical and functional lending of the Scheduled Commercial Banks (SCBs). They also devoted significant attention to providing loans to overlooked sectors that are generally referred to as the priority market.

History of Banking System

The English word "Bank" is thought to have originated from the Italian word "Banco" (long bench), since Jewish bankers used to sit on them, usually in populated areas such as markets or preaching halls, when offering currency exchange and loan services. The root of "Bank" can also be traced to the German word "Banch," meaning "a pile," the word used by the Germans to describe a kind of public debt. Regardless of how the word emerged, banks were significant financial institutions that were connected to the world's economies. Banks have traditionally served to provide facilities for deposits, loans, and currency exchange. Over time, these banking services have become increasingly important for the economic development of a country.

Banking started with the first prototype of ancient-world merchant banks that made grain loans to farmers and merchants who carried goods between towns. This started in Assyria and Babylonia around 2000 BC. Later, lenders based in temples made loans in ancient Greece and during the Roman Empire and added two significant innovations; they accepted deposits and changed money. In ancient China and India, archaeology from this time also reveals signs of interest in money lending.

Banking can be traced to mediaeval and early Renaissance Italy, to the wealthy northern cities of Florence, Venice and Genoa, in the modern sense of the term. In the 14th century, the Bardi and Peruzzi families dominated banking in Florence, creating branches in many other parts of Europe. The Medici bank, founded in 1397 by Giovanni Medici, was perhaps the most famous Italian bank. 3 Monte dei Paschi di Siena, headquartered in Siena, Italy, which has been functioning continuously since 14724, is the oldest bank still present.

From northern Italy, the growth of banking spread across the Roman Empire and into northern Europe in the 15th and 16th centuries. This was accompanied by a number of major developments that took place in Amsterdam in the 17th century during the Dutch Republic and in the 18th century in London. Developments in telecommunications and computing caused significant changes to the operations of banks throughout the 20th century and enabled banks to increase dramatically in size and geographic spread. Many bank failures, including some of the world's largest banks, were triggered by the financial crisis of 2007-2008 and prompted much discussion about bank regulation.

The State Bank of India is the largest bank, and the oldest one still in operation. It emerged in June 1806 as the Bank of Calcutta. It was rebranded as the Bank of Bengal in 1809. This was one of the three banks financed by the government of the Presidency, the other two being the Bank of Bombay and the Bank of Madras. The three banks were combined in 1921 to create the Imperial Bank of India, which became the 'State Bank of India' in 1955 upon the independence of India. The presidential banks, like their successors, had served as quasi-central banks for many years until the 'Reserve Bank of India' was established in 1935, under the Reserve Bank of India Act, 19348.

Under the State Bank of India (Subsidiary Banks) Act, 1959, the State Banks of India were granted control of eight state-associated banks in 1960. These are now referred to as its affiliate banks9. In 1969, 14 large private banks were nationalized by the Indian government. 6 more private banks were nationalized in 1980. The majority of lenders in the Indian economy are these nationalized banks. Owing to their large scale and widespread networks, they dominate the banking sector.

Commercial banks in the financial sector play an important role in the modern economy. A bank is an entity that deals with cash and credit. The major component of the supply of money in a modern economy is credit money. The creators of credit are commercial banks. Basically, the strength of every country's economy depends on a sound and solvent banking system. A Commercial Bank is a benefit that is pursued by business companies that trade in money or rather say money. It protects the public's investments and provides loans and advances. "The Banking Companies Act of 1949 defines a banking company as one "accepting deposit money from the public for the purpose of lending or investing, repayable on request or otherwise and drawn by cheque, draughts, and order or otherwise. A variety of functions are carried out by modern commercial banks. They still keep the wheels of trade, commerce and industry spinning. Main or banking functions and secondary or non-banking functions are major functions of a commercial bank.

OBJECTIVES OF CREDIT CONTROL

In India, the broad objectives of the credit management policy have been—

- Ensure ample liquidity levels to achieve high economic growth rates along with full resource utilization, but without creating high inflationary pressure.
- Achieve stability in the country's exchange rate and money market.
- Meeting the financial criteria during an economic recession and even in regular times.

CONCLUSION

Credit has played a critical role in India's promotion of agricultural development. The Green Revolution, which was marked by a greater use of inputs such as fertilisers, seeds and other inputs, increased the credit requirements offered by the financial institutions of the agricultural sector. While outreach and the amount of agricultural credit have increased over the years, the viability and sustainability of these institutions has been affected by a number of weaknesses. In addition, the old-fashioned legal system and obsolete tenancy laws have hindered the credit flow and growth of large and productive agricultural credit institutions. A review of agricultural credit performance in India shows that although the overall institutional credit flow has increased over the years, there are several gaps in the system, such as inadequate credit provision to small and marginal farmers, lack of medium and long-term loans and limited deposit mobilization, and heavy reliance on borrowed funds by major agricultural credit providers These have important consequences for the growth of agriculture as well as the well-being of the farming community. Therefore, efforts are needed to resolve and rectify these issues. Following shifts in consumption and dietary habits from cereals to non-cereal items, a silent transition is taking place in rural areas, calling for agricultural production to be diversified and value-added processes to preserve the employment and income of the rural population.

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