MONETARY POLICY AND ECONOMIC DEVELOPMENT
THE INDIAN EXPERIENCE*

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Monetary policy in the broadest sense of the term is concerned with the supply and cost of money; it is no more than one aspect of overall economic policy and represents a particular form of the State's intervention in the functioning of the economy. Obviously, therefore, monetary policy is not—and indeed cannot be—an independent entity by itself. This approach represents a marked change in the importance of monetary policy in the regulation of economic activity. In the heyday of the Gold Standard, monetary policy was indeed economic policy. Once the objective was firmly set of maintaining the exchange parity of the national currency vis-a-vis gold, the necessity to regulate the domestic level of economic activity through the control of the level of money was a natural corollary and central banking then was no more than the technical apparatus to assist in the operation of an automatic standard. With the collapse of the Gold Standard, the automaticity in monetary management gave way to a discretionary regulation of the level of money and credit. The Bagehot dictum that "money will not manage itself" was, so to say given a new interpretation in that it was expected that a conscious control needed to be exercised over the money volume in keeping with the desired level of economic activity. The stability of the internal and external value of the monetary unit or, putting it in other way, price and exchange stability which until then formed the cornerstone of monetary management were now recognised to be not so much ends in themselves but as means to bring about stability in economic activity. In other words, violent fluctuations in overall economic activity was considered too high a price for the doubtful benefit of a rigid exchange parity and superficial stability in price level. Thus, the functioning of automatic standard came to be replaced by purposeful monetary management.

While this might suggest, at first, sight, that monetary or central banking policy would now play an even more important role, the assumption by the Government of wider responsibility for the regulation of economic activity and

* This is the text of one the two lectures delivered by the author in the Department of Economics of Sardar Patel University in the year 1966-67,
related to this, its own increasing participation in the economic process has brought to the fore the importance of fiscal policy in regulating the level of employment and economic activity in a more direct fashion. The conduct of monetary and fiscal policy is generally regarded as being the respective responsibility of central bank and the Government. This is true, of course, in the technical sense but clearly both of them along with trade and exchange policy form the essential ingredients of economic policy. Their relation must therefore be viewed as being complementary rather than conflicting and the choice of which form of economic policy and which instruments to be used would have to be based on the necessities of any given situation and the appropriateness or otherwise of a particular instrument or a set of policies in that context.

Does this imply then that the traditional objectives of monetary policy, namely, price and exchange stability, should not command the same importance now as they once did? Obviously not. In fact, price and exchange stability need not be regarded as being incompatible with other objectives of economic policy. In the advanced countries, the objectives of economic policy must include the maintenance of high and stable levels of employment alongside reasonable price and exchange stability, while in underdeveloped countries it must be the furtherance of economic growth along with price and exchange stability. Though the Radcliffe Committee in the U. K. spoke of "the serious possibilities of conflict" between different objectives of monetary policy, to speak of an inconsistency or conflict between any set of objectives of monetary policy is perhaps not putting the issue in correct perspective. Rather it is a question of which of the competing objectives should take precedence over the other at any point of time. Even here we cannot be definitive as, while the furtherance of growth should be a long-term objective, it is quite conceivable that in the short run price and exchange stability might command immediate priority. It is essentially a problem of balancing the various objectives in the long-term and short-run. We cannot obviously have sustained growth without some degree of stability. On the other hand, stability by itself without growth would be no more than a euphemism for stagnation*. The choice of the right mix of objectives

* "The best price level from the point of view of the development objective differs from country to country; it lies somewhere between the extreme of stability without development and inflation without development". J. H. Adler: 'The Fiscal and Monetary Implementation of Development Programmes'; American Economic Review; Vol. I (May 1952)
and their inter-temporal priorities have in the last analysis to be political decisions involving further decisions on the degree and timing of the State's intervention in the economic process. Once these basic decisions are taken, the role of monetary policy and indeed that of fiscal policy must be regarded as being in the nature of instruments of such intervention. Where structural changes in the economy are being attempted fiscal policy commends itself while its impersonality, flexibility and its ability to act quickly are factors to be taken into account in deciding on the employment of monetary policy.

In discussing the role of monetary policy in the development context, one should emphasise that it is not money but real resources that determine the rate of growth. It is only the increase in real resources, the success with which they are mobilised and the efficiency with which they are invested that help to increase the rate of economic growth. "If growth of real output could be purchased by money alone, the central bank could easily solve the problem and solve it in a hurry".* The role of monetary policy, from this point of view, may be secondary but certainly not unimportant for an appropriate monetary policy is necessary to help harness resources and put them to effective use even as an inappropriate monetary policy would retard the process of growth. The development strategy in fact requires bringing into employment of the full resources potential of the economy even as it seeks an increase in the flow of investible resources. The functional responsibility of monetary policy in the phase of development consists in the creation of conditions to bring about the required volume of monetary expansion and in particular the right degree and composition of credit expansion; this, in turn, involves a judgement both of the required magnitude and timing of such expansion and the means to be chosen to bring it about and also judgement on the excess or otherwise of money in relation to the availability of real goods and services at any point of time. In a longer term setting the efficient mobilisation of resources and their effective investment suggests the need for the institutionalisation of savings and investment—which may be regarded as the financial hallmark of development—and the extension of the monetary and credit structure both geographically wide and functionally varied to

service the growing needs of a developing economy. This may be regarded as institutional aspect of growth oriented monetary policy. It is to these two aspects of monetary policy that we may now turn.

The primary functional responsibility of monetary policy in the growth context has been stated to be the bringing about of the right degree of monetary expansion. The rationale behind the substitution of an automatic standard by monetary management would have been lost if the central bank or the monetary authority were not in a position to expand money supply with the secular increase in the demand for it. The approach to this question is essentially an exercise in discretion rather than in the application of mechanistic formulae. Obviously a markedly disparate rate of increase in the overall quantum of money on the one hand and the availability of real goods and services on the other spell danger to price stability. One does not need to believe in an unrefined version of the quantity theory to say this. In a typical underdeveloped economy with structural rigidities, the aggregate supply function tends to be discontinuous. This is especially so in relation to output in the agricultural sector, dependent as it is on the fickleness of weather. On the other hand in such economies with a low rate of saving co–existing with wide opportunities for investment there is a constant pressure towards monetary expansion and it is in these circumstances that decisions regarding the rates of monetary expansion are invested with significance as they have to be related to the absorptive capacity of the economy in the shape of the availability of goods and services.

In a developing economy, the rate of monetary expansion often needs to be larger than is suggested by the rate of real income expansion. With a rise in a community's income its cash balance requirement tends to increase. A rise in income permits a wider range of financial assets and monetary balances consequently grow. This has been the observed experience in several of the now developed countries during their phase of growth and is not something that should occasion surprise*. Again in some less developed countries and India is an example there is a large sector where transactions are mediated without the use of money. The extension of the money economy

to this sector also calls for an increase in the level of money supply ahead of aggregate real income growth. It is thus not a coincidence that in more developed economies the ratio of money supply to national income is higher than in the less developed economies; in our own country we have witnessed such a secular increase in this ratio or to put it in its obverse form there appears to have taken place a reduction in the income velocity of money. Indian experience for instance has indicated (taking aggregate monetary resources in relation to money national income that income velocity over the last 10 years has declined at an annual rate of roughly 4 per cent. The concept of income velocity itself more meaningful over time and needs to be given consideration in framing what might be turned the monetary budget for an economy over a period of years. Thus, for instance, at the time when the Third Plan was formulated the expected rate of income growth was 30 per cent as against which the rate of monetary expansion was set at 35 per cent consistent with the objectives of growth and price stability. While such calculations may be in order for a multi-annual period, the approach to monetary expansion in the development context should ideally combine both the secular view of growing monetary needs of the economy with the problem of management of the money volume in a short term setting. In fact, in the short run, changes in the transaction velocity tend to offset policy induced changes in the money volume, and we can well have a co-existence of a secular decline in income velocity with short period increases in transactions velocity. But to infer from this, as some have done, that any attempt to regulate money volume is doomed to ineffectiveness does not appear warranted in Indian money conditions whatever the applicability of this argument in more advanced economies*. The limits to a near complete compensatory movement in transactions velocity (even if the concept were measurable which it is not in relation to currency) to offset changes in the quantum of money are set in Indian conditions by the inadequacy of the monetary organisation and the fact that the spectrum of financial assets is itself not very wide and hence movement towards the money side of the spectrum from assets progressively further away from it, becomes correspondingly difficult. What this suggests is that concern with the money volume and exerting leverage on the supply of monetary resources are in our conditions not without relevance.

* See in this connection the Report of the (Radcliffe) Committee on the Working of the Monetary System, London HMSO (1959) (para 391)
The need for a central bank (or the appropriate monetary authority) to ensure the adequate degree of monetary expansion is only another way of saying that it should contribute directly to the expansion of its own monetary assets; the extent to which such expansion in assets is needed is in turn suggested by the value of the money multiplier which expresses the relationship between the volume of reserve money (currency plus bank reserves) and total money supply or aggregate monetary resources i.e. currency plus aggregate deposits of the banking system, a ratio which itself may be expected to rise over time with the spread of the banking habit. In an underdeveloped country, where currency constitutes the bulk of money supply, the expansion of the central bank’s assets means in effect the investible portion of the currency backing. The expansion of monetary assets is the technical device to bring about an expansion in money and the distribution of the monetary assets is therefore significant.

Economic development in India like in many under-developed economies has to surmount not only the inflation barrier but the balance of payments barrier. The expansion in monetary assets of the central bank is thus likely to be in its domestic assets—in other words credit to the public and private sectors. Apart from this, changes in foreign assets are the resultant of net credit operations of either the public or private sectors. As far as the impact on foreign assets goes, there is no net creation or depletion of assets but rather a transfer from one type of asset to another in the monetary balance sheet. An increase in credit to the public or private sectors increases money but if part of it were drained out in the form of a decline in external assets, the latter is not an independent factor but only mitigates the impact on money supply the full extent of the deficit. The distribution of the expansion and domestic monetary assets as between the Government and the private sector can be decided on in accordance with the requirements of the development programme. The expansion of credit to the public sector takes the form of investments in Government securities and loans and advances to Governments while loans to and investments in the commercial, co-operative and industrial banking system imply the central bank’s financing of the private sector. In this sense, deficit financing may be considered in its positive aspect of providing the wherewithal for monetary expansion rather than as a residuary source of finance for government or the private sector after all other non-inflationary sources of finance have been exhausted.

In the context of an overall development plan, therefore, with its projections of output and investment, it should be possible to frame an inter-consistent monetary budget over a multi-annual Plan period on the basis of an estimation of an economy's monetary needs. The expansion that is so estimated is in fact the sum of expansion in the various sub-periods and while a given expansion may appear warranted over the period, it does not ensure that in each of the sub-periods there would be approximate balance between aggregate monetary demand (as measured by money supply or aggregate monetary resources) and availability of real goods and services—owing to factors emanating from a discontinuous supply function. There is the possibility also for the central bank's assets expanding by a larger amount than envisaged (owing to unforeseen increases in expenditures) though the supply situation does not indicate it or of the money multiplier itself increasing over the period at a pace faster than assumed. The safe limits to deficit financing are really set by the safe limits to monetary expansion. The larger increase of money in the short run in relation to supply availabilities through excessive credit expansion to Government or the private sector is thus an ever present danger and occasions the need for constant vigilance over the money volume. There thus need be no inconsistency, as we shall see presently, between the long term requirements of monetary expansion and short term need to curtail money supply.

It is against this background that we might survey the recent monetary experience in India. In the First Plan period, the rate of monetary expansion (in terms of aggregate monetary resources) was less than that of real income growth; prices moved downward, a trend reinforced by the corrective tendency to the post-Korean price increase. In the Second Plan this situation was reversed and the rate of real income growth trailed behind that of monetary expansion with its attendant effect on prices; in the Third Plan, this trend has been further reinforced and the disparity between monetary and income growth rates has further widened due both to slow agricultural output growth on the one hand and large increases in aggregate expenditures on the other. Thus, in the Third Plan period, against a monetary expansion of 63 per cent, real income growth has been no more than 14 per cent and in 1965-66 alone while monetary expansion increased by 11 per cent, real output declined by 4 per cent. Even after allowing for the increasing monetary requirements of the economy, this
represents a significant gap between money and output and cannot but be viewed with concern. A legitimate question that arises here is what has monetary policy done to narrow this imbalance. The growth of money is a reflection both of fiscal deficits and private credit and if monetary demand is to be curtailed it is to a contraction at the source of expansion that we must look for an answer. The supply side of the equation in the short run is subject to the incidence of factors often beyond the scope of corrective policy; the vicissitudes of farm output is a case in point and given the lag between the supply of food articles and a secular increase in demand for it, an excess of money impinges on the foodgrains sector. The shortfall in agricultural output coincident with increase in monetary demand has led in India and several Latin American Countries to "the particular combination of a demand generated inflation of food prices with a cost generated inflation of industrial prices"—a situation described by Professor Kaldor as being peculiar to underdeveloped countries. In such a situation, the task before monetary policy in its short run setting has presented itself as the need to contain aggregate monetary demand by cutting back the expansion in money to bring it into closer alignment with the expansion in real goods.

Any attempt to cut back monetary expansion in the short run therefore must take the value of the multiplier as given and this therefore calls for action on monetary assets of the central bank; we may therefore examine the past experience and current possibilities here. The monetary assets, as was mentioned some time ago, take the form either of credit to the public or private sectors. It is these assets that are the counterparts of reserve money viz. the central bank's liabilities in the form of currency or bank reserves. Credit to the public sector is in fact an aspect of fiscal policy though its impact on monetary expansion has been sizeable. The stickiness of administrative expenditure is now a commonplace; investment expenditure also is such that often there are practical difficulties in cutting it back to conform to a change in the overall supply situation; the limits indeed are severely set to any attempt at adjusting annual investment expenditures to the vagaries of the monsoon; thus the trend of government expenditures (especially in the context of an increasing public investment programme) tends to be upward, and to this have been added the imperatives of defence

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<tbody>
<tr>
<td>Growth in Monetary</td>
<td>+14</td>
<td>+41</td>
<td>+9</td>
<td>+9</td>
<td>+12</td>
<td>+10</td>
<td>+11</td>
<td>+63</td>
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<td>Resources (Currency</td>
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<td>plus aggregate deposits)</td>
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<tr>
<td>Growth in National</td>
<td>+18</td>
<td>+22</td>
<td>+3</td>
<td>+2</td>
<td>+5</td>
<td>+8</td>
<td>-4</td>
<td>+14</td>
<td></td>
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<tr>
<td>Income at constant</td>
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<tr>
<td>Change in prices</td>
<td>-17</td>
<td>+35</td>
<td>+0.2</td>
<td>+2</td>
<td>+6</td>
<td>+13</td>
<td>+8</td>
<td>+32</td>
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expenditure. The situation is one where expenditures keep on increasing and in years where output suffers, the imbalance is aggravated. Even if the public sectors expenditures were met out of non-inflationary sources, of funds, there would still be on expansionary influence (through the multiplier effect) of the weight of even a balanced budget during a period of growth of expenditures. The position is more serious when there is recourse to borrowing. Without minimising the importance of fiscal operations in causing monetary variations, we may, following Bhatia, regard the central bank’s claims on the government sector as an ‘autonomous’ factor from the point of view of monetary policy in contra-distinction to claims on the private sector (i.e. the commercial, cooperative and industrial banks) which may be considered a policy induced variable. This also suggests a major structural limitation to the operation of monetary policy in that a large area of activity responsible for monetary expansion is outside its direct purview and it is to fiscal policy that we should look for a correction of the imbalance on this score.

In the First Plan, credit to the public and private sectors were of roughly equal importance in causing monetary expansion; the Second Plan, on the other hand, witnessed a sharp increase in the relative share of credit to the public sector as a factor causing the increase in aggregate monetary resources; in the Third Plan, credit to the private sector has again emerged as a factor of near equal importance relative to the public sector’s operations as a factor causing the monetary expansion. Thus, between March 1961 and 1966 the increase in credit to the public sector has accounted for 56 per cent of monetary resources growth while that to the private sector for 49 per cent with the decline in foreign assets exerting a slight contractionary effect. Over the three plans as a whole, it is clear that the main impetus to monetary expansion has emanated from the side of budget deficits. Increasingly however the impact of private sector credit operations is becoming important. A reference may be made at this stage to the point sometimes made that the private sector’s credit totals are inclusive of the credit operations of public sector industrial and commercial enterprises. In the analysis of monetary variations it is useful to distinguish money creating and money holding sectors. The impact on the monetary volume of the

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<th>TABLE 2</th>
<th>MONETARY EXPANSION 1951–66</th>
<th>(Rs. Crores)</th>
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<tbody>
<tr>
<td>1. Currency with the public</td>
<td>1405</td>
<td>166</td>
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<tr>
<td>2. Demand liabilities*</td>
<td>616</td>
<td>30</td>
</tr>
<tr>
<td>3. Time liabilities sub</td>
<td>331</td>
<td>136</td>
</tr>
<tr>
<td>4. Total demand &amp; time liabilities sub</td>
<td>947</td>
<td>166</td>
</tr>
<tr>
<td>5. Total monetary resources (1 + 4)</td>
<td>2352</td>
<td>332</td>
</tr>
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</table>

**Principal factors affecting expansion**

1. Net bank credit to Government sub |
   808 | 298 | 1195 | 257 | 269 | 281 | 235 | 467 | 1320 | 3809 |
   (13) | (45) | (7) | (7) | (6) | (5) | (9) | (22) |

2. Bank credit to private sector sub |
   588 | 240 | 674 | 139 | 217 | 245 | 237 | 288 | 1158 | 2654 |

3. Net foreign exchange assets sub |
   (-4) | (-25) | (-2) | (-1) | (1) | (-0.4) | (-0.4) | (-2) |

* Includes ‘other deposits’ with the Reserve Bank.

@ Worked out by using the net demand/time deposits of scheduled banks including non-deposit other liabilities also for March 1961.

1. Adjusted for PL 480 and PL 665 accounts with banks.

Note:-(1) Figures within brackets under columns 2, 3 and 9 are percentages to total monetary resources as at the end March 1951, March 1956 and March 1961 respectively. For columns 4 to 8 the percentages relate to previous March end figures of monetary resources in respect of each year.

(2) Net bank credit to Government companies of Reserve Bank’s net credit to Government sector and banks’ credit to Government sector.

(3) Bank credit to private sector comprises of financial assets of banks and Reserve Bank’s credit to private sector.
public sector enterprises credit operations take place only through and at the initiative of the banking system and are not indeed different than if ther were under private control. There is therefore little analytical validity in such exclusion; nor are the amounts ( even if such segregation were attempted ) of any significance to alter the basic point that private credit operations are becoming an important source of monetary expansion.

It is this fact, viz., that more recently private credit operations are a potent force for monetary expansion that constitutes the rationale for an active monetary policy aimed at dampening the pressures for monetary expansion from the side of private credit. In this sense, monetary policy even in the narrow sense of credit policy ( operating on the policy induced variable ) has an independent justification in itself. This is not to minimise the continuing contribution of the fiscal deficit to monetary expansion but rather to emphasise that action on private credit has more to it than merely offsetting the impact of fiscal policy as has sometimes been suggested. In fact, it has been pointed out that in a planned economy, resources are to be allocated in agreed proportion and any attempt to offset an excess of expenditure in one sector by curtailing it in another is only likely to aggravate the imbalance - that the need to curtail expenditure in any sector stands on its own viz. on the excess of expenditures in that sector in relation to the need for it. If credit policy is to be meaningful, it should not become the engine for redistribution of resources at variance with the Plan targets in favour of any sector but should seek to confine its operation to any excess or otherwise in credit to the particular sector viz. the private sector that is directly within its ken.

It is in this sense that one needs to look at the operation of credit policy in India in recent years. Credit policy has sought to curtail private expenditures either because they were in the aggregate adding to the pressures of demand or sectorally were leading to supply distortions by encouraging inventory accumulation in respect of sensitive commodities - food articles in our context. Deficit financing is no less expansionary in its monetary impact when it occurs in the private sector. It may, of course, be contended that credit creation to the private sector has its recompense in a quicker

1. R. J. Bhatia; ibid
addition to output as the credit is extended for short term purposes and hence that any restrictive credit policy carries with it the danger of affecting productive activity itself and thus of throwing the baby out with the bath water. The discussion, incidentally, is in relation to industrial production as the role of commercial banks in the finance of agricultural production (other than for plantations) is in any case not much to speak of; as regards cooperative banks which are engaged in financing agricultural production, they have not been subject to the same degree of restriction. In our conditions, the main impediments to a rapid and sustained expansion in industrial output is the inadequate supply of raw materials (both domestic and imported) and of services such as power and transport. The vicissitudes of domestic agricultural production affect output over a wide range of Indian industry, whose importance in the total of industrial production continues to be large; the difficult foreign exchange does not permit compensatory imports in years of domestic raw material supply shortfall. As regards those industries without an agricultural base—these are expanding but are not yet in the aggregate of major significance—the limits to productive increase arise from the inadequate import of raw material, spares and components. The shortages are in real goods and it is this rather than an inadequacy of finance for working capital that is holding their production back. In fact, it may be contended that freer credit supply would only result in a competitive bidding up of prices in a scramble for scarce raw material supplies and the fact that some of the major industrial raw materials such as cotton, oilseeds, etc. also lend themselves to speculative activity adds point to this misgiving.

One of the difficulties however in either sustaining this criticism of credit policy or indeed of refuting it is that it is impossible to state in quantitative terms what constitutes the legitimate needs of industry for working capital and to arrive at a gap (if any) between such needs and availability of finance. A crude indicator is however provided by comparing the growth in industrial production, the increase in wholesale or industrial raw material price and in bank advances to industry. This reveals that in each of the three Plan periods, industrial advances have risen by a percentage well above the combined increase in rates of industrial production and industrial raw material or-wholesale prices. In the Third Plan period for instance, industrial output has risen by 42 per cent, wholesale prices by 32 per cent (industrial
TABLE 3

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<th>1951-56</th>
<th>1956-61</th>
<th>1961-66</th>
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<tbody>
<tr>
<td>Increase in industrial production*</td>
<td>+25</td>
<td>+41</td>
<td>+42</td>
</tr>
<tr>
<td>Increase in wholesale prices</td>
<td>-17</td>
<td>+35</td>
<td>+32</td>
</tr>
<tr>
<td>Increase in industrial raw materials prices</td>
<td>-29</td>
<td>+45</td>
<td>+30</td>
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<tr>
<td>Increase in manufactured goods prices</td>
<td>-13</td>
<td>+26</td>
<td>+20</td>
</tr>
<tr>
<td>Increase in industrial advances</td>
<td>+42</td>
<td>+147</td>
<td>+120</td>
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*Based on figures relating to the calendar year.

raw material price by 30 per cent) but industrial advances have risen by 120 per cent. Corporate financial data also suggest that the proportion of bank finance going to meet inventory needs (given the limitation of relating one item on the sources side to one item on the uses side of funds) has been increasing. In this connection, it would be useful to distinguish between the restrictive impact on a single firm of not being able to command adequate credit to be able to obtain a larger share of the supplies of raw material and the case of the economy as a whole when freer credit would not by itself lead to larger raw material supply for the industry. In fact one can go further and point to a limitation of monetary policy in its impersonal aspect here; the absence of any selectivity may well mean denial of credit to worthy individual constituents; general controls have therefore to be tempered with a selective emphasis.

That credit policy has been attuned to supply availabilitys is borne out by the experience of the current year; as a result of the likelihood of larger availability of imports following larger non-project assistance and to take into account the possibility of larger domestic supplies of the major industrial raw materials, the Reserve Bank eased credit policy in October 1966 to facilitate a larger seasonal expansion by allowing commercial banks to have larger recourse to it in the busy season.

The appropriateness of credit policy whose avowed object is to regulate the level of commercial and cooperative bank credit has been questioned in India also on the ground that bank money itself does not constitute a dominant portion in money supply and non-bank sources of finance are important. There can be no gainsaying the importance of currency in circu-
lation or the fact that this imports an element of rigidity to attempts at monetary regulation: monetary policy however deals with the factors operating to bring about monetary variations rather than with the precise form in which the monetary expansion takes place which is a matter of institutional form. Even so, the rate of deposit expansion in recent years has been faster than that of currency increase. In the Third Plan period, for instance, aggregate deposits grew by 85 per cent as against the 45 per cent rise in currency and today (February 1967) aggregate deposits account for 53 per cent of aggregate monetary resources. Another way of expressing the idea (and the related one of an extension of the banking habit) is to say that the value of the money multiplier has been rising; from 1.586 in March 1951 it rose to 1.639 in March 1956, to 1.806 in March 1961 and further to 1.866 in March 1966. As regards non-bank source of finance, there is little doubt that the size of the sector is considerable but this market is characterised by limited elasticity to a cash drain in this sector's operations and consequently this sector depends on the organised sector as the residual source of funds; this is perhaps the more important example of the many points of contact between the two sectors which result in a transmission to the unorganised sector of impulses generated in the organised sector.

Before discussing the tools of policy to regulate the availability, cost and use of credit, a brief reference may be made to an important structural factor governing the operation of credit policy in India viz, the marked seasonality that characterises credit needs - a feature typical to the monetary organisation of an agriculture based economy like ours. Credit expansion in the 'busy season' even in recent years has ranged up to 25 per cent (or more occasionally) over the pre-seasonal base despite the fact that the economy is getting more diversified and industries not based on agricultural raw material are growing in importance. The implications of seasonality for the banking system is a pronounced increase in the pressures on its liquidity in the busy season and a liquidity ease in the slack season, with the corollary that in the former period the banking system may not be in a position to finance to the full genuine production and trade needs while in the 'slack season' which is also the lean season for agricultural supplies there is likely to be more credit made than is needed. The implication of seasonality for credit policy is that in the busy season
there is a need for a regulated easing of liquidity pressures and in the slack season a mopping up excess liquidity in the system. The instruments of credit regulations have therefore to be tailored to this structural characteristic and its implications for the content of policy.

Among the traditional weapons in the central bank's armoury, the Bank rate weapon has commanded pride of place but the limitations to the use of this instrument in India stem from an inadequate money market; the Bank rate in the sense of a Lombard Street type of rediscount rate is not relevant here; it constitutes however the basic rate governing central bank refinance to the banking system and has significance in this sense and as a signal for market rates in general and the psychological impact this implies.

Open market operations are also limited in their significance in India in the absence of a broad and active securities market apart from the fact that the prescription in India of a minimum statutory liquidity ratio sets an effective floor to the disinvestment of security holding by banks. The limitation to active open market operations arise in India not, as in countries with developed markets, from a conflict of objectives between debt management and monetary policies in the sense of ensuring to the central bank freedom to regulate the interest rate structure (including the long-term bond yield) in the face of the budgetary implications of a policy of high rates but rather from the structural need to build up a bond market and the more immediate requirement of assisting the government in its borrowing operations.² The limited impact on money supply of multiple credit creation by banks suggests that to bring about a certain change in the level of money the proportionate change on bank reserves would have to be larger whereas the narrowness of the security market precludes the recourse to large scale operations as even small interventions lead to disproportionate price effects which would run counter to the objective of building up an orderly market and widening the investor appeal of government securities.

Consequently, in several countries with undeveloped money and capital markets, central banks have found that direct regulation of reserves through

1. D. R. Khatkhate:ibid
the instrument of variable reserve ratios (or its variant of liquidity ratios) to be potentially a more potent weapon. Though admittedly it is somewhat less flexible than the more traditional instruments of control, it is more certain in its impact. In our conditions, however, this tool of control does not help in the busy season as the level at which the requirement has been kept viz., at 3 per cent is at the lower end of the range of variation and the variability therefore is only in the upward direction. Thus the instrument can be brought into use to mop up liquidity in the slack season but cannot be used in the busy season until the required reserve rate itself has been raised earlier to a level above 3 per cent.

In Indian conditions, therefore, control of credit expansion in the busy season has come to rely on operating on access rights of banks to the Reserve Bank. Borrowings from the Reserve Bank, in terms of averages throughout the year, form only a small proportion of total commercial bank credit but in the busy season such access has reached nearly two-fifths of seasonal credit expansion, and has constituted a significant element in the ability of commercial banks to expand credit. The terms on which such credit is available and its cost therefore condition the attitude of banks in the credit operations. While eligibility criteria determine the range of assets against which commercial bank can obtain refinance or rediscount from the Reserve Bank, the regulation of access rights takes the form of prescribing rediscount ceilings or by varying the cost of Reserve Bank accommodation against eligible assets. Between September 1960 and September 1964 the Reserve Bank operated a quota-cum-slab interest rate system which had features of both a rediscount ceiling system and a higher interest application system. The system worked on the availability doctrine of bank credit regulation but experience with it proved that both as a quantitative check on credit and as an instrument of cost escalation, it was limited in scope. For two years ending with October 1966 the Bank operated a sliding scale system of rates on the basis of bank's net liquidity ratios i. e. the ratio to total liabilities of their liquid assets less borrowing from the Reserve Bank, the State Bank and Industrial Development Bank, with the rate of central bank credit going up progressively with an impairment of liquidity.¹ This system worked in a sense directly on the advances portfolio

¹. For a detailed discussion on the Quota and N. L. R. System see, V. G. Pendharkar and M. Narasimham: Recent Evolution of Monetary Policy in India (R. B. I. Bulletin, April 1966)
of the banks by making it costly for a bank to exceed a certain advances ratio.\footnote{See in this connection the Radcliffe Committee Report (para 527) where a suggestion is made for a system a direct restriction of the proportion of advances to deposits.} It also constituted an application to our conditions of the 'Roosa' effect. In the altered circumstances of the current busy season, the system has undergone a further change and while commercial banks can obtain credit at Back rate as long as their net liquidity ratio is at or above a minimum level, the system progressive rise in cost of central bank credit has been modified as a measure of credit liberalisation.

While this refers to the operation of credit control through directly influencing the availability of central bank refinance, an equally notable aspect of the conduct of monetary policy in India in recent years has been the bringing into play in larger measure of the rate of interest both as a measure of regulating the volume of investment and augmenting the supply of savings. In conventional monetary theory it has been an accepted dictum that the rate of interest affects the level of aggregate demand through its impact on investment expenditure whether it be for purposes of inventory accumulation of fixed capital formation. These propositions have come in for question on the grounds of these seemingly low interest price elasticity of investment. The empirical evidence regarding this is in any case inadequate. Whatever the limitations of the interest rate instrument as a regulator of overall investment expenditures, it is generally admitted that in respect of inventory investment, interest rates have some influence and as our experience has indicated that unplanned and speculative inventory increases have led to investment distortions in the economy, the use of the mechanism of interest rates has commended itself.

The increase in the structure of interest rates has in the words of the Governor of the Reserve Bank "also helped to bring within the scope of monetary discipline the operations of the public sector—a development the significance of which does not appear to have attracted the attention it perhaps merited."\footnote{Shri P. C. Bhattacharyya: 'Monetary Policy and Economic Development' (B. F. Madan Memorial Lecture 1966, Reprinted in \textit{R. B. I. Bulletin}, February, 1966).} The fact that much public sector investment is determined in terms of Plan priorities on the basis of social cost-benefit criteria, and therefore are likely to have low interest elasticity may appear to argue against raising the cost of such projects and put the public sector in Prof. Cairncross’s...
phrase in 'a fit of schizophrenia' through its decision to limit investment expenditures through higher interest and wondering whether and how to react to such high rates when a simpler solution might have been to limit investment through administrative action.\(^1\) Obviously for many areas of public investment expenditure, this point is not without substance, but over an increasing range of public investment, it would seem that the cost of capital is a relevant consideration in determining its efficiency and in assessing profitability. If capital is short in an economy, there must be a conscious decision to know the extent of subsidy involved in a deliberate policy of insulating the public sector’s expenditure from the high cost of capital. An increase in the rate structure is an attempt to bring the cost of capital into closer alignment with its scarcity value in the economy and to induce a more efficient allocation of its use be it in the public or private sectors.

Equally, recent policy seeks to use the interest rates as a factor to induce a more effective mobilisation of real resources through organised channels; the intervention of the Reserve Bank in the deposit rate structure was designed to assist deposit mobilisation particularly in the form of term deposits. There is reason to believe that with a widening of the differential between short-term and longer term deposit rates, there has been a lengthening of the maturity pattern of bank deposits in the last 2 years in consonance with policy objectives.

The regulation of investment discussed so far is in terms of its aggregate level. Indeed the traditional emphasis of monetary policy was on its general impersonal application; this was part of the wider socio-economic milieu which disfavoured direct controls and preferred action through indirect monetary regulation. There is however the recognition even in several Western countries that under certain circumstances, a direct regulation of the direction of credit as distinct from its volume is in order. In several of them, selective controls were imposed as part of wartime resource mobilisation and were continued in some of them for a period after the War. This can be done either to limit credit in particular sector or on the other hand to insulate certain sectors from the rigours of credit control. We in India have operated selective controls over credit in respect of sensitive commodities, sensitive both in view of their importance in mass consumption and in view of their susceptibility to speculative stock-piling. The

techniques of selective controls have comprised prescription of ceilings and margins, and further differentiation between credit to trade and industry or regionally. Our experience with these controls has been somewhat uneven; the absence of effective supervision of the end-use of credit and the possibility of circumvention through inter-sectoral credits constitute inherent limitations of such controls. Indian experience has indicated that such controls work better in combination with overall controls.\footnote{B. K. Madan: The role of Monetary Policy in a Developing Economy, \textit{R. B. I. Bulletin}, April, 1961.} Where selective controls are in operation without the use of overall credit controls, the possibility of such circumvention is the greater for credit, like water, will find its own level. Selective controls cannot take the place of general controls if a reduction in overall volume of credit is desired as they are not likely to have enough bite if they are operated only by themselves. The obverse of this is that in a regime of general controls, special sectors are likely to be more vulnerable, like small industries etc. not on account of their lower priority in a larger economic context but that they are at the margin of a bank’s clientele. Selective insulation of certain sectors is then called for. In a more positive sense, selective regulation of credit has considerable potentialities in integrating the credit structure and policy with the needs of development; this consists of more than a modification of credit policy as such; it covers the whole field of institutional change and it is to this aspect of monetary policy that we may now turn.

\[ \text{[ नायकीय नीति नायका पुरवाक अने तेनी किंवत सधे सर्वी घराने छ. ते दृष्टींचे नेल्यांना ते अर्थकारणती हामींतीमानां सरकार द्वारा घेया येता हस्तक्षेपांना अमेक स्वरूप नू छे. त्यांना असंगीत्यांच्या नायकीय नीतिने पूर्ण तरुण ठेसांनी अंतरराष्ट्रीय व्यवर्त लागू आवश्यक अनि ने]}

\[ \text{विकासना संचालितांनी नायकीय नीतिने अन्यथा घेन्याच्या वाग तिचे विश्वास रोजा ते दृष्टींचे नेल्यांना सर्वी अधिक अमेक विकासनी द्वारे नेल्यांना सर्वी अधिक अमेक विविध गोष्टींचे वाग अद्यावधी होय छे. नायकीय नीती आणि अभावतांना गोष्टी वाग जगाये छे तेंती तेनु अवरे महत्त्व प्राप्त तरी ती किंवा. अभावतांना अबरे ती.}

\[ \text{अथवा ती विकासनी अधिक दरम्यान येते अभावतांना नायकीय विविध घेया छे. त्यांमध्ये आणि अभावतांना जेव्हा मुद्याची} \]
शक्ति नहीं, नागाशिक समाज गतिविधियों विविधता करीते विकासा समय 
हरियाना नागाशिक वित्तरक्त अवस्थाएँ हाय के।

अर्थातः वातावरण के प्रभाव पावन नागाशिक वित्तरक्त अवस्थायों द्वारा 
लेटकर्ता श्रीमती चूत बहरहीं है करार है आपको वहाँ साथ सहानुभूती विकार 
मोटी वटरख पाश पतारा यही अनु आवारानी मांगें सहायता ही ता नोईकों।

आप चार्ना भारतीय श्रीमती नागाशिक वित्तरक्त अवस्थायों द्वारा 
अभियंता अवस्थाया 24 अप्रैल-1 जून मांग आपकी वारानी मांग अवस्थाया ता नोईको।

अभी वर्ष वर्ष वर्ष छै ते मांग नागाशिक नैतिक व्यवाय कर्तन नदी। वर्ष भी 
हेनारी नागाशिक नता प्रदेशकरणी आरक्षामात्रा श्रेष्ठ आपी नागाशिक वित्तरक्त अवस्थाया हर स्वय 
वर्षाती होमेय।

तारातरा गार्डना आपनी विशालकारी नीतिकक्ष नागाशिक वित्तरक्त भारे 
अवश्यक भाषा राखये। आपनी विशालकारी भाषा समहार के उपयोग हरियाना 
वेदना संगठन करते थे वे। जा जा ऐसे विद्युत भाषा अवश्य छै है आ आपकी अवश्य विद्युत विवरण अनु 
आपकी अपादान वारानी आपकी आपकी श्रेष्ठ आपी नागाशिक वित्तरक्त अवस्थाया हर स्वय।

नागाशिक नीतिका विद्यारंभी अंडर हेनेश भारती आपने आपकी श्रेष्ठ आपकी विरोध 
पूर्व विद्युत विश्वास है। अभियंता अपना विश्वास अवस्थाया पाया।

पूरा अग्रणी नीतिका असरदारकता पाया अवश्य है। अब देश भारतीय धनों- 
गृहाभ्यास करिता विश्वास अभिनव धरावारुँ नदी।

आपका अभिनव अविश्वास नागाशिक समाजमात्रा मुनाफामात्रा अभियंता गार्डना 
अवस्थाया अपेक्षा मानसमात्रा नागाशिक विकार हर अवस्थाया भारतीय 
अवस्थाया है। भारतीय अपेक्षा मानसमात्रा नागाशिक विकार हर अवस्थाया 
है। अवस्थाया आपकी भाषा सम्बन्ध अवश्य उपरांत वेदना श्रीमती नागाशिक वित्तरक्त अवस्थाया आपी है।
ભારતમાં આ ઉપરાંત વ્યક્તના કરતો ઉપયોગ પણું થવા લાગયે છે. ભારત એ સૂધીની અભિલાચકત ડીપાર્થ આ અભિલાચ તેની ક્રમચાલના પ્રતિયોગિત થતી લોકોએં. આ ઉપરાંત માટે કેવળ ઉપયોગ કરતો પણું સૂધીની હુલાવથાને વ્યાપાર રહે તે માટે વીઝાઠી દોરાવી આવે છે.

ગુજરાતમાં શાંતિનયાનાં ઉપયોગ અમૂક આસ કરી જનતાના વ્યાપક ઉપયોગનો આવતી શું તથા સંઘર્ષ કરવા માટે આવખાક રાખ પણ ખૂબ તેની નીચે માટે શાંતનયાની માનંદની અનાવા સૌરાષ્ટ્રમાં આવે છે. સારાંશ શાંતનયને સુખધિત કરવામાં ગુજરાતમાં શાંતનયના અગત્યતની ભાગ લખવે છે. [}