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Banking Awareness

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Study Material
For

Banking Awareness Aptitude

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Banking Awareness For IBPS PO / SBI PO / Bank Clerical Exams

INDEX

1. Brief History of Banking in India

The origin of western type commercial Banking in India dates back to the 18th century. The story of banking starts from Bank of Hindustan established in 1770 and it was first bank at Calcutta under European management. In 1786 General Bank of India was set up. Since Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, it became a banking center.

Thereafter, Three Presidency banks were set up under charters from the British East India Company- Bank of Calcutta, Bank of Bombay and the Bank of Madras. These worked as main central banks in India for many years.

- ✓ The Bank of Calcutta established in 1806 became Bank of Bengal.
- ✓ In 1921 these 3 banks merged with each other and Imperial Bank of India was formed. It is today's State Bank of India.
- ✓ The name was changed after India's Independence in 1955. State bank of India is the oldest Bank of India.

Next came Allahabad Bank which was established in 1865 and working even today. The oldest Public Sector Bank in India having branches all over India and serving the customers for the last 146 years is Allahabad Bank. Allahabad bank is also known as one of India's Oldest Joint Stock Bank.

The first Bank of India with Limited Liability to be managed by Indian Board was Oudh Commercial Bank. It was established in 1881 at Faizabad. This bank failed in 1958. The first bank purely managed by Indian was Punjab National Bank, established in Lahore in 1895. The Punjab national Bank has not only survived till date but also is one of the largest banks in India. However, the first Indian commercial bank which was wholly owned and managed by Indians was Central Bank of India which was established in 1911.

Bank of India was the first Indian bank to open a branch outside India in London in 1946 and the first to open a branch in continental Europe at Paris in 1974. Bank of India was founded in September 1906 as a private entity and was nationalized in July 1969. Since the logo of this Bank is a star, its head office in Mumbai is located in Star House, Bandra East, Mumbai.

There was a district in Today's Karnataka state called South Canara under the British empire. Four banks started operation during the period of Swadeshi Movement and so this was known as "Cradle of Indian Banking.

The above information was of the first phase of Indian banking which was a very slow in development.

The Second Phase starts from 1935 when Reserve bank of India was established. Between the period of 1911-1948, there were more than 1000 banks in India, almost all small banks. The Reserve Bank of India was constituted in 1934 as an apex Bank, however without major government ownership. Government of India came up with the Banking Companies Act 1949. This act was later changed to Banking Regulation (Amendment) Act 1949. The Banking Regulation (Amendment) Act of 1965 gave extensive powers to the Reserve Bank of India. The Reserve Bank of India was made the Central Banking Authority. The banking sector reforms started immediately after the independence. These reforms were basically aimed at improving the confidence level of the public as most banks were not trusted by the majority of the people. Instead, the deposits with the Postal department were considered safe.

The first major step was Nationalization of the Imperial Bank of India in 1955 via State Bank of India Act. State Bank of India was made to act as the principal agent of RBI and handle banking transactions of the Union and State Governments. In a major process of nationalization, 7 subsidiaries

of the State Bank of India were nationalized by the Indira Gandhi regime. In 1969, 14 major private commercial banks were nationalized. These 14 banks Nationalized in 1969 are as follows:

1. Central Bank of India
2. Bank of Maharashtra
3. Dena Bank
4. Punjab National Bank
5. Syndicate Bank
6. Canara Bank
7. Indian Bank
8. Indian Overseas Bank
9. Bank of Baroda
10. Union Bank
11. Allahabad Bank
12. Union Bank of India
13. UCO Ban
14. Bank of India.

The above was followed by a second phase of nationalization in 1980, when Government of India acquired the ownership of 6 more banks, thus bringing the total number of Nationalized Banks to 20. The private banks at that time were allowed to function side by side with nationalized banks and the foreign banks were allowed to work under strict regulation.

After the two major phases of nationalization in India, the 80% of the banking sector came under the public sector / government ownership.

The third phase of development of banking in India started in the early 1990s when India started its economic liberalization.

2. Commercial Banking

Banking occupies one of the most important positions in the modern economic world. It is necessary for trade and industry. Hence it is one of the great agencies of commerce. Its presence is very helpful to the economic activity and industrial progress of a country.

A commercial bank is a profit-seeking business firm, dealing in money and credit. It is a financial institution dealing in money in the sense that it accepts deposits of money from the public to keep them in its custody for safety. So also, it deals in credit, i.e., it creates credit by making advances out of the funds received as deposits to needy people. A bank is, therefore like a reservoir into which flow the savings, the idle surplus money of households and from which loans are given on interest to businessmen and others who need them for investment or productive uses.

2.1 Definition

"A bank is an establishment which makes to individuals such advances of money as may be required and safely made, and to which individuals entrust money when not required by them for use."

2.2 Types of Banks

Banks can be classified into
A) Commercial banks and
B) Central bank.

Commercial banks are those which provide banking services for profit.

The central bank has the function of controlling commercial banks and various other economic activities.

There are many types of commercial banks such as deposit banks, industrial banks, savings banks, agricultural banks, exchange banks, and miscellaneous banks.

2.3 Types of Commercial Banks

2.3.1. Deposit Banks:

The most important type of deposit banks is the commercial banks. They have connection with the commercial class of people. These banks accept deposits from the public and lend them to needy parties. Since their deposits are for short period only, these banks extend loans only for a short period. Ordinarily
these banks lend money for a period between 3 to 6 months. They do not like to lend money for long periods or to invest their funds in any way in long term securities.

2.3.2. Industrial Banks:

Industries require a huge capital for a long period to buy machinery and equipment. Industrial banks help such industrialists. They provide long term loans to industries. Besides, they buy shares and debentures of companies, and enable them to have fixed capital. Sometimes, they even underwrite the debentures and shares of big industrial concerns.

The industrial banks play a vital role in accelerating industrial development. In India, after attainment of independence, several industrial banks were started with large paid up capital. They are, The Industrial Finance Corporation (I.F.C.), The State Financial Corporations (S.F.C.), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI) etc.

2.3.3. Savings Banks:
These banks were specially established to encourage thrift among small savers and therefore, they were willing to accept small sums as deposits. They encourage savings of the poor and middle class people. In India we do not have such special institutions, but post offices perform such functions. After nationalization most of the nationalized banks accept the saving deposits.

2.3.4. Agricultural Banks:
Agriculture has its own problems and hence there are separate banks to finance it. These banks are organized on co-operative lines and therefore do not work on the principle of maximum profit for the shareholders. These banks meet the credit requirements of the farmers through term loans, viz., short, medium and long term loans. There are two types of agricultural banks,
(a) Agricultural Co-operative Banks, and
(b) Land Mortgage Banks.

2.3.5. Exchange Banks:
These banks finance mostly for the foreign trade of a country. Their main function is to discount, accept and collect foreign bills of exchange. They buy and sell foreign currency and thus help businessmen in their transactions. They also carry on the ordinary banking business.

2.3.6. Miscellaneous Banks:
There are certain kinds of banks which have arisen in due course to meet the specialized needs of the people.

2.4 Functions of Commercial Banks

Commercial banks have to perform a variety of functions which are common to both developed and developing countries. These are known as 'General Banking' functions of the commercial banks. The modern banks perform a variety of functions. These can be broadly divided into two categories: (a) Primary functions and (b) Secondary functions.

2.4.1. A. Primary Functions
Primary banking functions of the commercial banks include:

1. Acceptance of deposits
2. Advancing loans
3. Creation of credit
4. Clearing of cheques
5. Financing foreign trade
6. Remittance of funds

2.4.2. B. Secondary Functions
Secondary banking functions of the commercial banks include:

1. Agency Services
2. General Utility Services

2.5 Sources of Bank Revenue
A bank is a business organization engaged in the business of borrowing and lending money.

A bank can earn income only if it borrows at a lower rate and lends at a higher rate. The difference between the two rates will represent the costs incurred by the bank and the profit. Bank also provides a number of services to its customers for which it charges commission. This is also an important source of income. The followings are the various sources of a bank's profit:

1. Interest on Loans: The main function of a commercial bank is to borrow money for the purpose of lending at a higher rate of interest. Bank grants various types of loans to the industrialists and traders. The yields from loans constitute the major portion of the income of a bank. The banks grant loans

generally for short periods. But now the banks also advance call loans which can be called at a very short notice. Such loans are granted to share brokers and other banks. These assets are highly liquid because they can be called at any time. Moreover, they are source of income to the bank.

2. Interest on Investments: Banks also invest an important portion of their resources in government and other first class industrial securities. The interest and dividend received from time to time on these investments is a source of income for the banks. Bank also earn some income when the market prices of these securities rise.

3. Discounts: Commercial banks invest a part of their funds in bills of exchange by discounting them. Banks discount both foreign and inland bills of exchange, or in other words, they purchase the bills at discount and receive the full amount at the date of maturity.

4. Commission & Brokerage: Banks perform numerous services to their customers and charge commission, etc., for such services. Banks collect cheques, rents, dividends, etc., accepts bills of exchange, issue drafts and letters of credit and collect pensions and salaries on behalf of their customers. They pay insurance premiums, rents, taxes etc., on behalf of their customers. For all these services banks
charge their commission. They also earn locker rents for providing safety vaults to their customers. Recently the banks have also started underwriting the shares and debentures issued by the joint stock companies for which they receive underwriting commission.

Commercial banks also deal in foreign exchange. They sell demand drafts, issue letters of credit and help remittance of funds in foreign countries. They also act as brokers in foreign exchange. Banks earn income out of these operations.

3. Structure of Banking In India

At the time of independence Indian banking system was not sound. There were hundreds of small banks under unscrupulous managements. Hence, in 1949 two major actions were taken which were very important from the point of view of structural reforms in the banking sector.

First, the Banking Regulation Act was passed. It gave extensive regulatory powers to Reserve Bank of India over the commercial banks. Another development of no less importance was the nationalization of the RBI. These two major developments in the immediate Post-Independence period proved to be the turning points in India's commercial banking.

Indian banking system comprises of both organized and unorganized banks. Unorganized banking includes indigenous bankers and village money-lenders. Organized banking includes Reserve Bank of India, Commercial Banks, (including Foreign Banks), Development Banks, Exim Bank, Co-operative Banks, Regional Rural Banks, National Bank for Agriculture and Rural Development, Land Development Banks etc.

3.1. Indigenous Banks

From very ancient days, India has had banking of some type, known as indigenous banking. Indigenous banking peculiar to India had been organized in the form of family or individual business. In different parts of the country the indigenous bankers have been called by different names, such as Shroffs, Sahukars, Mahajans, Chettis, Seths, Kathiwals etc. They vary in size from petty money lenders to substantial shroffs who carry on large and specialised banking business. They are to be found in all parts of the country- in large towns and cities and villages.

Indigenous bankers are individuals or private firms which receive deposits and give loans and thereby operate as banks. Since their activities are not regulated, they belong to the unorganized segment of the money market. The indigenous bankers have been engaged in the banking business in both ancient and medieval periods. They received set back with the introduction of modern banking after the arrival of the British. Over the past two and a half decade with the growth of commercial and cooperative banking the area of the operations of the indigenous bankers has contracted further. Still there are a few thousand indigenous bankers particularly in the western and southern parts of the country who are engaged in
traditional banking business. The volume of their credit operations is however not known.

Indigenous bankers do not constitute a homogeneous group. Broadly they may be classified under four main sub-groups. Gujarati Shroffs, Multani or Shikarpuri Shroffs, Chettiars and Marwari Kayas. The Gujarati shroffs operate in Mumbai, Kolkata and the industrial and trading cities of Gujarat. The Marwari Shroffs are active in Kolkata, Mumbai, tea-gardens of Assam and other parts of North-East India. The Multani or Shikarpuri Shroffs are to be found mainly in Mumbai and Chennai and the Chettiars are concentrated in the South. Of the four main such groups of the indigenous bankers the Gujarati indigenous bankers are the most important in terms of the volume of business.

Types

There are three types of indigenous bankers:

(a) those whose main business is banking,
(b) those who combine their banking business with trading commission business, and
(c) those who are mainly traders and commission agents but who do a little banking business also.

The majority of the indigenous bankers belong to the second group.

Functions of Indigenous Bankers

The main functions of the indigenous bankers are as follows:

1.Accepting Deposits: Indigenous bankers accept deposits from the public. These deposits are of two types:

(a) the deposits which are repayable on demand, and
(b) the deposits which are repayable after a fixed period.

The indigenous bankers pay higher rate of interest than that paid by the commercial banks.

2.Advancing Loans: The indigenous bankers advance loans to their customers against all types of securities, such as land, houses, crops, gold and silver. They also give credit against personal security. They finance inland trade, including the movement of agricultural commodities like sugar, oil seeds etc. But they do not grant direct loans to farmers. They give loans to farmers through money-lenders. They provide loans to small industries which cannot fulfill the necessary loan conditions of commercial banks. In recent years, they are also providing working capital to the small industrialists.

3.Business in Hundies: The indigenous bankers deal in hundies. They write hundies and buy and sell hundies. They also discount hundies and thereby meet the financial needs of the internal traders. They also transfer funds from one place to another through discounting of hundies.

4. Acceptance of Valuables for Safe Custody: Indigenous bankers accept valuables of their clients for safe custody. Some indigenous bankers provide cheque facility. They provide remittance facilities also.

5. Non-banking Functions: Most of the indigenous banks or bankers also carry on their non-banking business along with the banking activities. They generally have their retail trading business. They also participate in speculative activities. Sometimes, they act as agents to big commercial firms and earn commission.

Defects of Indigenous Bankers

1. Mixing Banking and Non-banking Business: The indigenous bankers, generally combine banking and non-banking business. Many of them undertake speculative activities. Their business is risky as they combine both trading and banking. This is against the principle of sound banking.

2. Unorganized Banking System: The indigenous banking system is highly unorganised and segmented. Different indigenous bankers operate separately and independently. They have no coordination with each other. They have no regular contact with the commercial banks. The transfer of funds is not possible in such a system.

3. Insufficient Capital: The indigenous bankers largely depend upon their own capital. As a result, their financial resources are insufficient to meet the demand of borrowers.

4. Meagre Deposit Business: The main business of the indigenous bankers is to give loans and deal in hundies. Their deposit business is meagre or very small. They have failed to tap and mobilize rural savings effectively.

5. Defective Lending: The indigenous bankers, generally do not follow the sound banking principles while granting loans. They provide loans against insufficient securities or even against personal securities. They also give loans against immovable properties. They also do not distinguish between short-term and long-term loans.

6. Unproductive Loans: The indigenous bankers do not pay attention to the purpose for which the loan is used. They also give money for unproductive and speculative activities or for paying off old debts.

7. Higher Interest Rates: The indigenous bankers charge very higher interest rates for the loans than those charged by the commercial banks. High rates of interest adversely affect the inducement to produce.

8. Exploitation of Customers: The indigenous bankers adopt all types of malpractices and exploit their customers in many ways. For example, they make unauthorized deductions from loans. They overstate the amount of the loan in the document.

9. Discouragement to Bill Market: The indigenous bankers also stand in the way of developing a proper bill market in the country. Bulk of their business is based on cash transactions rather than on hundies.

10. Secrecy of Accounts: They adopt a traditional accounting system in vernacular. The indigenous bankers keep secrecy about their accounts and activities. They neither get their accounts audited nor publish annual balance sheets. This raises suspicion in the minds of the people.

11. No Control of Reserve Bank: The indigenous banking business is unregulated. The Reserve Bank of India has no control over these bankers and cannot regulate their activities. In this way the indigenous banks are a great hurdle in the way of developing an organized money market in the country.

Indigenous Bankers and the Reserve Bank

Since its inception in 1935, the Reserve Bank of India has been making sincere efforts:

(a) to bring the indigenous bankers under its control,
(b) to integrate them with the modern banking system, and
(c) to provide various central banking facilities to them.

But the Reserve Bank failed to achieve success. It is unable to control the activities of the indigenous bankers. They are outside the control and influence of the Reserve Bank. The policy of the Reserve Bank would become effective only when indigenous banks are directly linked to it. Suggestions for Reform Various suggestions have been made to improve the functioning of indigenous banking in the country.

They are:

1. The indigenous bankers should be directly linked with the Reserve Bank.
2. The indigenous banks should separate their non-banking business from banking business.
3. They should re-organize their banking business on modern lines. They should maintain proper accounts and get them audited regularly.
4. The wasteful competition between the indigenous bankers and the commercial banks should be ended.
5. The indigenous bankers should stop various malpractices in their business.
6. The benefits of the Banker's Book Evidence Act should be extended to the indigenous bankers also.
7. The indigenous bankers should develop bill-broking business, like bill brokers in the London money market.
8. They should be members of an association.
9. The Reserve Bank should supervise and inspect the conduct of indigenous bankers.
10. The Banking Commission, 1972, in its report suggested that the best way to control the business of indigenous bankers should be through commercial banks. The commercial banks should be encouraged to co-operate with the indigenous bankers.

They should provide help to the indigenous bankers. They should provide facilities to indigenous banks to discount their hundies more easily. Thus, commercial banks must take greater responsibility in controlling the activities of indigenous bankers. In view of the great role played by the indigenous bankers in the Indian economy, it is better to improve indigenous banking than to abolish it altogether. It is also better to reform them rather than replacing them by commercial banks. Legislation should be passed for regulating the activities of indigenous bankers by the Reserve Bank of India. This will help the Reserve Bank to secure effective control over the Indian money market. In the interest of the development of the country, the indigenous bankers should change their attitude and consider organizational and operational changes. Indigenous banking has a positive and perspective role to play in the money market of India.

3.2. Moneylenders

Moneylenders are those persons whose primary business is money lending.

They lend money from their own funds. Broadly, the moneylenders may be classified into two categories:

(a) the professional moneylenders, and
(b) the non-professional moneylenders.

Professional moneylenders are those persons whose business is only lending of money. The Maharajas, Sahukars and Banias are professional moneylenders. They usually hold licenses for money lending. Non-professional money lenders are those persons who combine money lending with other activities. They do not depend entirely on money lending business. They are mainly engaged in other types of activities. They consist of landlords, agriculturists, traders, pensioners, rich windows etc. They have no license to carry on money lending business. They give loans to known people within their circle.

Features of Moneylenders

The methods and areas of operations vary from moneylender to moneylender. However, there are certain common features of their activities. They are as follows:

(a) Moneylenders mostly lend their own funds.
(b) The borrowers from moneylenders are mainly illiterate and economically weaker sections of the society.
(c) The loans of the moneylenders are highly exploitative in nature.
(d) The credit provided by moneylenders may be secured or unsecured.
(e) The lending operations of moneylenders are prompt, informal and flexible.

Differences Between Money lenders and Indigenous Bankers.

The following are the important differences between the moneylenders and the indigenous bankers:

1.The primary business of the moneylenders is money lending. But the primary business of indigenous bankers is not banking.
2.The moneylenders do not accept deposits from the people. But indigenous bankers accept deposits from the people.
3.The indigenous bankers deal in hundies. But moneylenders do not deal in hundies.
4.The indigenous bankers generally lend for trade or productive purposes. But the moneylenders lend for consumption purposes.
5.Moneylenders operate in a limited area. So the scope of their business is limited. But indigenous bankers have a wider area of operation. So they have a large scale financial operations.
6.The indigenous bankers are largely urban-based, where as money-lenders carry on their business in rural areas.

7.Moneylenders functions in an isolated manner. Generally, they do not have any link with the organized sector of the money market. But indigenous bankers maintain some link with the organised sector because of their hundies business.

Defects of Moneylenders

The working of moneylenders has the following defects:

1.The moneylenders have inadequate resources to meet the needs of the rural people.

2.The loans of moneylenders are exploitative in character. They charge very high interest rates. They adopt all types of malpractices in their business. Some of the malpractices are:

(a) demanding interest in advance,
(b) demanding gifts,
(c) manipulating accounts etc.

3. The loans are mostly provided for consumption and unproductive purposes.
4. The moneylenders give loans against standing crops. In this way, they compel the cultivators to sell their produce at low prices to them.
5. Moneylenders have no uniformity in the matter of rate of interest. Different rates of interest are charged in different parts of the country.

The Government has taken various legislative steps to regulate the activities of moneylenders. There are acts like the Deccan Agriculturist Relief Act and the Moneylenders Act passed by the various states in India.

With the growth of rural banks, co-operative societies and other financial agencies in the rural areas, the importance of moneylenders has considerably declined. In near future, they will at the most, play a marginal role in the matter of rural finance in our country.

3.3. Co-operative Banks

Co-operative banks, another component of the Indian banking organization, originated in India with the enactment of the Co-operative Credit Societies Act of 1904 which provided for the formation of co-operative credit societies. Under the Act of 1904, a number of cooperative credit societies were started. Owing to the increasing demand of cooperative credit, a new Act was passed in 1912, which provided for the establishment of cooperative central banks by a union of primary credit societies.

Co-operative banks is an institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the co-operative banks collect funds through shares. They accept deposits and grant loans. They are generally concerned with the rural credit and provide financial assistance for agricultural and rural activities.

3.3.1. Structure of Co-operative Banks

Co-operative banking in India is federal in its structure. It has three sections. At the top there is the State Cooperative Bank which is the apex bank at the state level. At the intermediate level there are the central unions or the central cooperative banks. There is generally one central cooperative bank for each district. At the base of the pyramid there are the primary credit societies which cover the small towns and villages. Each higher level institution is a federation of those below, with membership and loan operations restricted to the affiliated units.

A. Primary Agricultural Credit Societies

A co-operative credit society, commonly known as the Primary Agricultural Credit Society (PACS) is an association of persons residing in a particular locality. It can be started with ten or more persons. The members generally belong to a village. The membership is open to all the residents of the locality or village. Hence people of different status are brought together into the common organization Each member contributes to the share capital of the society. The value of each share is generally nominal so as to enable even the poorest farmers to become a member. The members have unlimited liability, that is, each member is fully responsible for the entire loss of the society, in the event of failure. This will

mean that all the members should know each other fully well. The management is honorary, the only paid member normally being the secretary - treasure. Loans are given for short periods, normally for one harvest season, for carrying on agricultural operations, and the rate of interest is fixed about 6 per cent. Dividends are not declared and profits are generally used for the welfare and improvement of the village. The village co-operative society was expected to attract deposits from among the well-to-do members and non-members of the village and thus promote thrift and self-help. It should give loans and advances to needy members mainly out of these deposits. However, the village societies failed to attract deposits and therefore, the Government had to bring into existence two other credit institutions, known as the Central and State Co-operative Banks, whose main function is to provide funds to the primaries which, in turn, will lend to the farmers.

Provides in a nutshell an idea of the co-operative banking system in India. Progress of PACS (Primary Farmer's Agricultural Service Credit Societies Societies). The PACS occupy a strategic position in the co-operative credit structure of the rural economy.

Shortfalls of PACS

Though the PACS have made remarkable progress in the area of rural finance, their shortfalls may be enlisted as under:

1. They have failed to adequately fulfill the credit needs of the small farmers and tenants.
2. A large number of them lacked potential viability.
3. The Banking Commission (1972) observes that PACS neither provided credit for all productive activities of the farmers nor fulfilled their credit needs adequately.

The National Bank for Agriculture and Rural Development (NABARD) has recently stressed the need for a time-bound program for improving the contents of services rendered by the PACS. It has been suggested that the PACS should:

(a) provide diversified credit facilities to their members
(b) extend marketing facilities, and
(c) mobilize rural deposits.

B. Central Co-operative Banks

The central co-operative banks are federations of primary credit societies in a specific area, normally a district and are usually located in the district headquarters or some prominent town of the district. These banks have a few private individuals as shareholders who provide both finance and management. The central co-operative banks have three sources of fund via, their own share capital and reserves, deposits from the public and loans from the State Co-operative Banks.

The Central Co-operative Banks (CCB) are of two types: (a) pure, and (b) mixed. A pure CCB confines its membership to co-operative organizations only. It is called the Banking Union. A mixed CCB keeps its membership open to co-operatives as well as individuals. Mixed CCBs are found in the states of Assam, Andhra Pradesh, Tamil Nadu, Karnataka and others.

Functions

The major functions of the CCBs are:

1. They finance the primary credit societies. By furnishing credit to the primary socities, CCBs serve as an important link between these societies at the base level and the money market of the country.
2. They accept deposits from the public.
3. They grant credit to their customers on the security of first class gilt edged securities, gold etc.
4. They provide remittance facilities.
5. They act as balancing centers by shifting the excess funds of a surplus primary society to the deficit ones.
6. They keep watch on their debtor primary societies working and progress of recovery of loans.
7. To take up non-credit activities like the supply of seeds, fertilizers and consumer goods necessary to the farmers.

8. To prepare proposals for better utilization of the financial resources of PACS.

Defects of CCBs

The following are the major defects of the CCBs:

1. They violate the principle of co-operation by working on the lines of commercial banks.
2. They do not appoint experts to examine the creditworthiness of the primary societies. Hence, there has been problems of recovery and over dues.
3. They combine financing and supervisory work together. As a result supervisory work has been a failure in many cases.
4. Some CCBs have been utilizing their reserve funds as working capital. This is not a very sound practice.
5. Mixed CCBs vitiate the very purpose of federation of the primary societies.
6. The CCBs charge very high interest rates to meet their high administration costs of small and uneconomic units.
7. Many CCBs are financially and organizationally weak.

To rehabilitate the weak CCBs, the Government of India formulated a scheme called the Central Sector Plan in 1972. Under the scheme, selected by CCBs were to be provided financial assistance for writing off bad debts. But the operation of the scheme has failed to bring about the desired results for two reasons.

(a) Nobody (including the concerned CCBs) took the Program seriously.
(b) There was no effective functioning of the state and district level committees constituted for monitoring the Program.

C. State Co-operative Banks

The state co-operative banks, also known as apex banks, from the apex of the co-operative credit structure in each state. They obtain their funds mainly from the general public by way of deposits, loans and advance from the Reserve Bank and their own share capital and reserves. Any where between 50-90 per cent of the working capital of the SCBs are contributed by the Reserve Bank. Like the CCBs, SCBs are also pure or mixed.

Functions of State Co-operative Banks

The following are the major functions of SCBs:

1. The SCB acts as a banker to CCBs.
2. They have no power to supervise or control the activities of the affiliated CCBs.
3. A SCB serves as a leader of co-operative movement in a state.
4. In the absence of a district co-operative bank in a state, the SCB may give district financial assistance to the primary credit societies.
5. It co-ordinates the policy of the government with the co-operative principles.
6. It also brings about co-ordination between RBI, money market and co-operative credit societies.
7. It gives a number of subsidies to DCBs for improving co-operative credit societies.
8. It simplifies loan distribution system to enable its member to get loans very easily.
9. It helps the government in framing the schemes for the development of co-operatives in the state.

Defects

SCBs also have the same defects of the CCBs. The following are the major defects of SCBs:

1. They mix up commercial banking activities with co-operative banking.
2. They have insufficient share capital.
3. They utilize their reserve funds as working capital.
4. Some SCBs are not pure federations as they permit individual membership along with affiliation to the CCBs.

3.3.2 Importance or Benefits of Co-operative Banks

The co-operative movement has become a powerful instrument for rapid economic growth. It has resulted in several benefits. The expansion of co-operative banks has resulted in several benefits. They are:

1. They have provided cheap credit to farmers. They discouraged unproductive borrowing.
2. They have reduced the importance of money-lenders. More than 60% of the credit needs of agriculturists are now met by co-operative banks. Thus, co-operative banks have protected the rural population from the clutches of money-lenders.
3. Small and marginal farmers are being assisted to increase their income.
4. They have promoted saving and banking habits among the people, especially the rural people. Instead of hoarding money, the rural people tend to deposit their savings in the co-operative or commercial banks.
5. They have undertaken several welfare activities. They have also taken steps to improve the morals, polity and education.
6. They have played an important part in changing the old customs and traditions of the people which are an obstacle to progress and economic betterment.
7. They have greatly helped in the introduction of better agricultural methods. Co-operative credit is available for purchasing improved seeds, chemical fertilizers and modern implements cheaply and sell their produce at good prices.

3.3.3 Problems or Weaknesses of Co-operative Banks

Various committees and commissions have reviewed the working of the co-operative banking system. They pointed out a number of weaknesses of the system. Major weaknesses or problems are given below:

1. Excessive Over dues: The borrowers from the co-operative banks are not repaying the loans promptly and regularly. There are heavy overdues. Besides overdues at all levels are increasing alarmingly. Lack of will and discipline among the farmers to repay loans is the principal factor responsible for the prevalence of overdues of co-operatives. Large amounts of overdues restrict the recycling of the funds and adversely affect the lending and borrowing capacity of the co-operative societies.

2. Inefficient Societies: The co-operative credit societies are managed by people who have no knowledge of co-operation. They do not have necessary experience and training. As a result most of the societies are inefficient.

3.Regional Disparities: Co-operative benefits are not evenly distributed as between different states. There is the problem of regional disparities in the distribution of co-operative credit. The loans advanced per member varies widely. The farmers of Gujarat, Punjab, Haryana and Tamil Nadu are getting much more than those in Orissa, Bihar and West Bengal. Besides, the production loans and investment credit supplied in most of the tribal and hill areas is comparatively very less.

4. Benefits to Big Land Owners: Most of the benefits from co-operative have been cornered by the big land owners because of their strong socio-economic position .Small farmers are neglected by co-operative societies. Poor farmers are not able to get enough credit.

5. Dependence on Outside Resources: Co-operative societies or banks depend heavily on outside resources. State Governments and NABARD are the main sources of funds to co-operative societies. This heavy dependence on outside resources will be a great problem in future.

6. Political Interference: The co-operative societies are dominated by political parties and politicians. There is favoritism and nepotism in the granting of loans.

7. Inadequate Coverage: Co-operatives have now covered almost all the rural areas of the country. But the membership is only around 45% of the rural families. 55% of rural families are thus

still not covered under the co-operative credit system. Agricultural laborers and rural artisans constituted only 10% of the total membership of the co-operative credit system. The weaker sections of the rural community are still not adequately represented in the membership roll.

8. Lack of Other Facilities: Besides the provision of adequate and timely credit the small and marginal farmers also need other facilities in the form of supply of better seeds, fertilizers, pesticides etc. and marketing services. Very little attention is paid on the provision of such facilities.

9. Dual Control: There is dual control of the co-operatives, on the one side the **NABARD** and on the other by the State Government under the Co-operative Societies Act. Co-operative societies are treated as part and parcel of the Government has discouraged initiative in management.

10. Competition from Private Agencies: Co-operative banks are facing stiff competition from money-lenders and traders. Because of this competition, co-operatives could not make much progress.

11.Credit Linked to Assets: The credit given to a member is based on his assets .Those who do not have assets or those who have small assets do not get enough credit.

3.3.4 Suggestions for the Improvement of the Co-operative Credit Structure

1. The resources of the co-operative banks should be improved. Their dependence on outside resources must be reduced considerably.
2. The primary societies should be made more viable and economically strong units.
3. The liability of the members of the primary co-operatives should be made limited.
4. Loans should be given not on the basis of the assets of the member but on the basis of the estimated value of production. Although this method is introduced, it is not functioning properly, and not all societies have implemented it.
5. Loans given should be enough to meet agricultural and other expenses so that the members need not approach the money-lenders.
6. Agricultural inputs like fertilisers, seeds etc., should be supplied by the co-operatives. Credit and marketing should be integrated. Marketing and processing activities should be undertaken by the co-operatives.
7. The co-operatives should be given freedom to adopt management practices, rules and regulations to suit the local needs and conditions.
8. Co-operative training facilities should be expanded and the co-operatives should be manned by well trained personnel. Management should be professionalized.
9. Co-operative movement should become people's movement. They should be made to realize the benefits of co-operations.
10.They should be made agents of commercial banks wherever possible.
11.Steps must be taken for effective audit and inspection.
12.Political interference in the affairs of the co-operatives must be put to an end.
13. Co-operative should take steps to commercialize agriculture to increase the income level to the members and introduce appropriate technologies in agriculture. Members should be encouraged to take up subsidiary occupations. Co-operative banks should diversify their activities and take up banking related services just like commercial banks. The credit societies or banks should be reorganized into multi-purpose societies.

3.4. Land Development Bank

Already, co-operative credit institutions were started and were working successfully in providing short-period credit to farmers. The Government wanted a special credit institution which would cater to the long-term credit needs of the farmers. Such an institution should be able to assist farmers with long-term loans carrying modest rates of interest and convenient methods of repayment. The Government started the land mortgage banks for this purpose; these banks have now come to be called the land development banks.

The land development banks were setup during the 1920's but their progress has been quite slow. After independence, they have been enjoying a great measure of prosperity, but whatever progress has been achieved is concentrated in only a few states viz., Tamil Nadu, Andhra Pradesh, Karnataka, Maharashtra and Gujarat. There are two types of land development banks in the country. At state level, there are Central Land Development Banks, and under each central bank, there are primary land development banks. In some states, there is one Central Land Development Bank for the state which has branches all over the state.

3.4.1 Sources of Funds

There are three important sources of funds of land development banks:

(a) their own share capital and accumulated reserves
(b) deposits from the general public, and
(c) issue of bonds or debentures.

The first two sources did not assume any significance and land development banks largely depend upon the third source. They are issued by the Central Land Development Banks and they carry a fixed rate of interest. The period of the debentures varies from 20-25 years. The banks issue two types of debentures, namely ordinary and rural debentures. The period of rural debentures varies between 7 and 15 years. The banks are required to create regular sinking funds to provide for repayment of the debentures.

The debentures are generally guaranteed by the State Governments regarding payment of interest and repayment of principal. They are subscribed for by the public, the cooperative banks, commercial banks, the State Bank of India, the LIC and the Reserve Bank of India. These debentures are classified as trustee securities. The Reserve Bank lends on the security of these debentures, if they are guaranteed by the concerned state Government.

3.4.2. The Working of the LDBs

The Land Development Banks provide long-term loans to the agriculturists for permanent improvements on land. They usually charge a percent interest. They grant loans against the security of land or other agricultural property. Loans are usually given on the first mortgage and sometimes even on the second mortgage of land or agricultural property. Generally, they give loans up to 50 per cent of the market value of the mortgaged property.

3.5. Regional Rural Banks

In spite of the rapid expansion program undertaken by the commercial banks in recent years, a large segment of the rural economy was still beyond the reach of the organized commercial banks. To fill this gap it was thought necessary to create a new agency which could combine the advantages of having adequate resources but operating relatively with a lower cost at the village level.

After the declaration of emergency, the then Prime Minister, Smt. Indira Gandhi, announced on July 1, 1975 the 20 point economic program of the Government of India. One of the points of this program was the liquidation of rural indebtedness by stages and provide institutional credit to farmers and artisans in rural areas. The Government of India promulgated on September 26, 1975, the Regional Rural Bank Ordinance, to set up regional rural banks throughout the country; the Ordinance was replaced by the Regional Rural Banks Act, 1976. The main objective of the regional rural banks is to provide credit and other facilities particularly to the small and marginal farmers, agricultural laborers, artisans and small entrepreneurs so as to develop agriculture, trade, commerce, industry and other productive activities in rural areas.

3.5.1. Objectives of Regional Rural Banks

The following are the main objectives of regional rural banks:

1. To provide credit and other facilities particularly to the small and marginal farmers, agricultural laborers, artisans, small entrepreneurs and other weaker sections.
2. To develop agriculture, trade, commerce, industry and other productive activities in the rural areas.

3. To provide easy, cheap and sufficient credit to the rural poor and backward classes and save them from the clutches of money lenders.
4. To encourage entrepreneurship.
5. To increase employment opportunities.
6. To reconcile rural business aims and social responsibilities.

3.5.2. Capital Structure

Regional Rural Banks were established under the provisions of an Ordinance passed on 26 September 1975 and the RRB Act. 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors. These were set up on the recommendations of The Narasimham Working Group during the tenure of Indira Gandhi's government with a view to include rural areas into economic mainstream since that time about 70% of the Indian Population was of Rural Orientation. The development process of RRBs started on 2 October 1975 with the with forming the first RRB, the Prathama Bank. Also on 2 October 1976 five regional rural banks were set up on with a total authorised capital of Rs. 100 crore ($ 10 Million) which later augmented to 500 crore ($ 50 Million). There were five commercial banks, Punjab National Bank, State Bank of India, Syndicate Bank, United Bank of India and United Commercial Bank, which sponsored the regional rural banks. Earlier Reserve Bank of India had laid down ceilings on the rate of interest to be charged by these RRBs..

3.5.3. Features of Regional Rural Banks

The following are the features of the regional rural banks:

1. The regional rural bank, like a commercial bank, is a scheduled bank.
2. The RRB is a sponsored bank. It is sponsored by a scheduled commercial bank.
3. It is deemed to be co-operative society for the purposes of Income Tax Act, 1961.
4. The area of operations of the RRB is limited to a specified region relating to one or more districts in the concerned state.
5. The RRB charges interest rates as adopted by the co-operative societies in the state.
6. The interest paid by the RRB on its term deposits may be 1% or 2% more than that is paid by the commercial banks.
7. The regional rural bank enjoys many concessions and privileges.

3.5.4. Functions of Regional Rural Banks

The functions of Regional Rural Bank are as follows:

1. Granting of loans and advances to small and marginal farmers and agricultural labourers, either individually or in groups.
2. Granting of loans and advances to co-operative societies, agricultural processing societies and co-operative farming societies primarily for agricultural purposes or for agricultural operations and other related purposes.
3.Granting of loans and advances to artisans, small entrepreneurs and persons of small means engaged in trade, commerce and industry or other productive activities within a specified region.
4. Accepting various types of deposits.

The credit policy of regional rural banks is more liberal than co-operative banks. It is not necessary for the borrower to mortgage property or deposit title deeds. It is not necessary to produce “not encumbrance certificate” or get legal opinion.

3.5.5. Progress Achieved by Regional Rural Banks

The Regional Rural Banks have achieved significant progress in all directions. The progress achieved is discussed below:

1.Number of Banks: The first, five regional rural banks were started at Moradabad and Gorakhpur in Uttar Pradesh, Bhiwani in Haryana, Jaipur in Rajasthan and Malda in West Bengal. There are now (June 2001) 196 regional rural banks, covering over 400 districts in the country with 14,550 branches. The largest number of offices are started in Uttar Pradesh.

2. Deposits: The deposits of regional rural banks increased substantially over the years. The total deposits were only Rs. 20 lakhs in 1975. They increased to Rs. 25, 430 crores by June 2001.
3. Advances: Total advances granted by all regional banks amounted to Rs. 10 lakhs in 1975. The total advances granted increased to Rs. 11,020 crores in 2000. Over 90% of the advances of regional rural banks are direct advances to small and marginal farmer, landless laborers and rural artisans.
4. Self-employment Schemes: The regional rural banks are making notable effort to encourage self-employment schemes.
5. Creation of Local Employment Opportunities: Regional rural banks have been taking active steps to create employment for the local people and achieved good success.
6.Participation in Various Program: During the last 22 years regional rural banks have been active participants in program designed to provide credit assistance to weaker sections. For instance, they are providing credit assistance to identified beneficiaries under the New 20-Point Program for scheduled castes and tribes.
7.Assistance to Physically Handicapped Persons: Physically handicapped persons are provided finance for purchase of artificial limbs, hearing aids, wheel chairs etc.
8. Farmers Societies: Regional rural banks have also sponsored and financed about 90 farmers societies.
9.Integrated Rural Development Program (IRDP Scheme): Regional rural banks have been taking active part in the Integrated Rural Development Program.
Regional rural banks, thus, have achieved notable progress in expanding branch network and extending credit support to weaker sections in rural areas. They exist as rural banks of the rural people.

3.5.6. Problems

The following are the major problems faced by the regional rural banks:
1. **Existence of Overdues:** The most serious problem faced by the regional rural banks is the existence of heavy overdues. Overdues are rising continuously. It is estimated that about 30% of the loans sanctioned still remain due from the borrowers. This has caused innumerable financial problems besides limiting the capacity of regional rural banks to lend and operated as viable units.
2. **Losses:** Most of the regional rural banks are not economically viable. They have been continuously incurring losses for years together. The accumulated losses are estimated to be Rs. 1200 crores upto March 2000.
3. **Limited Channels of Investment:** Since the regional rural banks have to lend to small and marginal farmers and other weaker sections of the society, the channels of investment are limited. Therefore, their earning capacity is low.
4. **Difficulties in Deposit Mobilization:** Regional rural banks have been facing a number of practical difficulties in deposit mobilization. Richer sections of the village society show least interest in depositing their money in these banks because they are served by these banks.
5. **Procedural Rigidities:** Regional rural banks follow the procedures of the commercial banks in the matter of deposits and advancing loans. Such procedures are highly complicated and time-consuming from the villagers point of view.
6**. Hasty Branch Expansion:** There is haste and lack of coordination in branch expansion. It has resulted in lopsidedness in branch expansion. It has increased infrastructure costs and reduced profitability.
7. **High Establishment Costs:** The salary structure of regional rural banks has been revised with the result that establishment costs have gone up. The regional rural banks are unable to cover the increased costs, since their customers are specified weaker sections enjoying concessional interest on loans and advances. The surplus available for meeting interest on deposits, administration costs and other expenses is said to be very low.
8. Multi-agency System of Control: Regional rural banks are controlled by many agencies.
The present multi-agency control of regional rural banks involves sponsor banks, NABARD, Reserve Bank, State Governments and the central government. This is not conducive to high operational efficiency and viability. So the present multi-agency system of control should be replaced by single agency control.

9. Slow Progress in Lending Activity: The growth in loan business of regional rural banks is low. For this the following reasons may be given:
(a) There has been limited scope for direct lending by regional rural banks in their fields of operation.
(b) It is always difficult to identify the potential small borrowers.
(c) Most of the small borrowers do not like the bank formalities and prefer to borrow from the money-lenders.
(d) There is lack of co-ordination between officials of district credit planning committees and the regional rural banks.
10. Inefficient Staff: As the salary structure of regional rural banks is not attractive when compared to other banks, efficient persons have a tendency to shift to commercial banks to improve their salary and career. Besides, many employees are not willing to work in villages. There is no true local involvement of the bank staff in the villages they serve.

Despite these problems, the regional rural banks have been trying their level best to achieve their social objectives. They have succeeded in projecting their image of "Small Man's Bank." They are in fact, development banks of the rural poor. They have been trying to fill regional and functional gaps in rural finance in our country.

3.5.7. Suggestions for Reorganizations and Improvement
Several expert groups have made a number of suggestions necessary to reorganise the structure and improve the working of regional rural banks. The important suggestions are given below:

1.These banks should continue to work as rural banks of the rural poor.
2.The state governments should also take keen interest in the growth of Regional Rural Banks.
3.Participation of local people in the equity share capital of the regional rural banks should be allowed and encouraged.
4.The regional rural banks should be linked with primary Agricultural co-operative societies and Farmer's service societies.
5.The regional rural banks should be strongly linked with the sponsoring commercial banks and the Reserve Bank of India.
6.A uniform pattern of interest rate structure should be devised for the rural financial agencies.
7.The regional rural banks must strengthen effective credit administration by way of credit appraisal, monitoring the progress of loans and their efficient recovery.
8.The regional rural banks should increase their consumption loans to the villagers and weaker sections. They should be allowed to increase their loans to richer sections of the society.
9.The regional rural banks should be permitted to provide full range of banking services, such as, remittance and other agency services, which would help a lot in developing banking habits among the villagers.
10.The regional rural banks should diversify their loans.
11.The present multi-agency system of control of regional rural banks should be replaced by single agency control.
12.As far as possible, natives should be appointed to work in them. The employees should be given suitable training.
13.Effective steps should be taken to prevent the misuse of funds by borrowers and willful defaulters.
14.Lending procedures should be made easy in order to avoid undue delays.
15.The image of regional rural banks should be improved. They should not be identified as "Second class" banks or an extension of the urban-oriented commercial banks. They must develop their own identity.

Regional rural banks have an important role to play in our rural economy as they have to act as alternative agencies to provide institutional credit in rural areas. They have not been set up to replace co-operative credit societies but supplement them. What the commercial banks have not done in rural areas, regional rural banks are trying to do it now. A such, regional rural banks should be specially assisted to solve their problems and be made real promoters of growth in rural India.

3.6. NABARD

The National Bank for Agriculture and Rural Development (NABARD) was set-up on 12th July, 1928 under an Act of Parliament. It has been established by merging the Agricultural Credit Department, and Rural Planning and Credit Cell of the Reserve Bank and the entire undertaking of Agricultural Refinance and Development Corporation. Hence, the National Bank has to perform a dual function: (a) The function of the Reserve Bank as an apex institution, and (b) The function of Agricultural Refinance and Development Corporation as a refinance institution.

3.6.1. Objectives

The National Bank for Agricultural and Rural Development (NABARD) is essentially a development bank for promoting agricultural and rural development. The major objectives of NABARD are:

1. To give financial assistance for increasing the agricultural production.
2. To supply the long-term needs of the rural areas.
3. To supply loans by way of refinance.
4. To help small industries, cottage industries and also artisans.
5. To achieve overall rural development.

3.6.2. NABARD's Financial Resources

NABARD set up the Rural Infrastructure Development Fund. Vrajlal Sapovadia noted schemes for the bank for rural development. Under the RIDF scheme Rs. 51,283 crore have been sanctioned for 2,44,651 projects covering irrigation, rural roads and bridges, health and education, soil conservation, water schemes etc. Rural Innovation Fund is a fund designed to support innovative, risk friendly, unconventional experiments in these sectors that would have the potential to promote livelihood opportunities and employment in rural areas. The assistance is extended to Individuals, NGOs, Cooperatives, Self Help Group, and Panchayati Raj Institutions who have the expertise and willingness to implement innovative ideas for improving the quality of life in rural areas. Through member base of 25 crore, 600000 cooperatives are working in India at grass root level in almost every sector of economy. There are linkages between SHG and other type institutes with that of cooperatives.

3.6.3. Management

NABARD is managed by a Board of Directors, consisting of a Chairman, a Managing Director and 13 other Directors. They are appointed by the Central Government in consultation with the Reserve Bank. There will be also an Advisory Council.

3.6.4. Functions of NABARD

NABARD does not provide credit directly to the farmers and other rural people. It provides refinance credit to the state co-operative banks, regional rural banks and other financial institutions as may be approved by the Reserve Bank. It is a single integrated agency for meeting the credit needs of all types of agricultural and rural development activities. It performs the following functions:

1. Apex Institution for Rural Finance: NABARD performs all the functions which were previously performed by the Reserve Bank of India. It directs the policy, planning and operations in the field of credit for agriculture and other economic activities in rural areas. It, thus acts as an apex bank in the country for supporting and promoting agriculture and rural development. It is described as "Rural Reserve Banks."
2. Refinance Institution: It serves as an apex refinancing agency for the institutions providing production and investment credit for promoting various developmental activities in rural areas. These activities are related to agriculture, small scale industries, village and cottage industries, handicrafts, small artisans etc. NABARD has taken over the function of refinancing from the Agricultural Refinance Development Corporation. It provides refinance facilities to state co-operative banks, regional rural banks, commercial banks and other financial institutions approved by the Reserve Bank of India. Commercial banks lead in availing of refinance from NABARD.

3. Credit Functions: NABARD is empowered to give short-term, medium-term and long-term loans in a composite form. It looks after the credit requirements of all types of agricultural and rural development activities.
(a) It provides short-term, medium-term and long-term credits to state co-operative banks, land development banks, regional rural banks and other financial institutions approved by the Reserve Bank of India.
(b) It grants long-term loans, upto 20 years, to state governments to enable them to subscribe to the share capital of co-operative credit societies.
(c) It provides medium-term loans to state co-operative banks and regional rural banks for agricultural and rural development.
(d) It gives long-term loans to any institution approved by the Central Government.
4. Contribution of Share Capital: NABARD contributes to the share capital of any institution concerned with agriculture and rural development.
5. Investment in Securities: NABARD can invest in securities of any institution concerned with agriculture and rural development. For promoting innovative investments, NABARD has started "Venture capital fund."
6. Conversion and Rescheduling Facilities: NABARD provides refinance to eligible institutions for conversion and rescheduling of loans, under conditions of drought, famine or other natural calamities, military operations etc.
7. Financial help to Non-agricultural Sector: Besides providing credit to agricultural and allied activities, the NABARD also renders financial help to the non-agricultural sector with the aim of promoting integrated rural development. It provides financial assistance to small scale industries, cottage and village industries and industrial co-operative societies for meeting their working capital and fixed capital needs.
8. Co-ordination of Activities: NABARD co-ordinates the activities of central and state governments, planning commission and other institutions concerned with the development of small-scale industries, village and cottage industries, rural crafts and industries in the decentralised sector.
9. Regulatory Function: NABARD has the responsibility to inspect regional rural banks, and central and state co-operative banks.
10. Maintenance of Research and Development Fund: NABARD maintains research and development fund:
(a) to promote research in agriculture and rural development,
(b) to formulate program to suit the requirements of different areas, and to cover special activities.
11. Training Program: NABARD has to provide comprehensive training
Program to its own staff as well as to the staff of state co-operative banks, regional rural banks etc. The training is to be meant for upgrading the technical skill and competence of the staff.
12. Evaluation of Projects: NABARD undertakes monitoring and evaluation of projects refinanced by it. It is responsible for the development, policy, planning operational matters, co-ordination, monitoring, training, consultancy etc., relating to rural credit.

3.6.5. Achievements of NABARD

NABARD is playing a vital role in the reduction of regional imbalances and providing assistance to small farmers, marginal farmers and weaker sections. It has been performing its various functions smoothly. Its performance in extending various types of financial assistance is as follows:
1. Short-term Assistance: NABARD sanctioned short-term credit limits worth Rs. 51223 crores during 1997-98 to state co-operative banks for financing seasonal agricultural operations. The credit facility is available at a concessional rate of 3% below the bank rate.
2. Medium-term Assistance: NABARD has continued to follow the policy earlier laid down by the Reserve Bank in regard to sanctioning medium-term credit limits for approved agricultural purposes. A major portion of medium-term credit of NABARD went to state co-operative banks and central co-operative banks to convert short-term loans granted to farmers into medium-term loans.
3. Long-term Assistance: NABARD grants long-term credit to State Governments for contribution to the share capital of co-operative institutions
4. Schematic Lending: During 1997-98 NABARD sanctioned 6,810 schemes involving its own commitments of Rs. 3930 crores. Largest number of schemes sanctioned were related to minor

irrigation followed by those related to farm mechanisation. Land development, farm mechanization, plantations and horticulture, poultry, sheep-breeding, piggery, dairy, fisheries etc., are other important schemes which are financed by NABARD.

5. Assistance to Less Developed States: NABARD like ARDC has continued the policy of promoting agricultural investment in the less developed and unbanked states. Uttar Pradesh, Bihar, Madhya Pradesh, Rajasthan and Orissa have been receiving the largest share of financial benefits from NABARD.

6. Assistance to Non-farm Sector: NABARD has also provided financial help to non-farm activities with a view to promote integrated rural development. Finance has been provided for production and marketing activities of co-operative sugar mills, handloom weaver's societies, industrial co-operatives, rural artisans etc.

7. Rehabilitation Program: NABARD has been playing an energetic role in strengthening and reorganizing the co-operative structure in the country. It has initiated a rehabilitation Program for financially and administratively weak central and state co-operative banks. It has also been providing help in the rehabilitation work of state land development banks and primary land development banks. State

Governments have been asked to take effective steps to ensure functional co-ordination between short-term and long-term credit by co-operatives. It has also created a "cell" to monitor the implementation of this directive.

8. Assistance to Research and Development Projects: Every year NABARD has been providing financial help to a number of banks from its Research and Development Fund for setting up or strengthening their "Technical Monitoring and Evaluation Cell." It has been sanctioning funds for organizing research, conferences and seminars on subject having relevance to NABARD.

9. Credit Plans Under the New Strategy: Under the "Service Area Approach", the annual credit plans are prepared by the bank branches. The district level offices of the NABARD would help to improve the quality of credit plans prepared by banks branches and also co-ordinate and effectively monitor the credit plans.

10. Integrated Rural Development Program: NABARD has helped the implementation of the "Integrated Rural Development Program." Under the 20-point Economic Program, the NABARD has taken steps to provide adequate financial facilities to the weaker sections of the society.

11. Regional Rural Banks: After the establishment of NABARD, all the refinance facilities earlier available to regional banks have been provided by NABARD.

Thus, NABARD has given a tremendous push to agricultural credit and thus promoted agricultural and rural development. Today, the NABARD has become a king-pin of rural development.

3.7. Commercial Banks

Commercial banks are very popular almost in every country because of the service they provide to individuals, commerce and industry. A commercial bank may be defined as a financial institution which accepts deposits against which cheques can be drawn, lends money to commerce and industry and renders a number of other useful services to the customers and the society. Commercial banks borrow money from those who have surplus funds and lend to those who need funds for commercial and industrial purposes. Thus, they act as dealers in loan able funds of the society. Commercial banks receive deposits in

the form of fixed deposits, savings bank accounts and current accounts and advance money, generally for short periods, in the form of cash credits, overdrafts and loans. They also render a number of service to their customers, such as collection of cheques, safe custody of valuables, remittance facilities and payment of insurance premium, electricity bills, etc.

The commercial banks perform the following major functions:

(a) Receiving deposits from the public and the business firms.
(b) Lending money to various sections of the economy for productive activities.
(c) Issue of demand drafts, traveller's cheques, bank cards, etc., for the smooth remittance of funds.

(d) Provision of locker facility to the customers.
(e) Safe custody of documents, ornaments and other valuables of customers.
(f) Payment of telephone, electricity and water bills on behalf of the customers.
(g) Collection of cheques of the customers.
(h) Issue of letters of credit.
(i) Acting as trustees, executors of wills, etc.

4. Nationalization of Banks

The Government of India nationalized 14 major banks in the country in July 1969 and another 6 banks in 1980. The nationalization of banks was described as "historic", "momentous," "bold" and "timely" by certain sections of the people. The State Bank of India and its seven subsidiaries had already been nationalized. The regional rural banks from their very inception are in the public sector. Thus about 90% of the country's commercial banking system is now in the public sector.

4.1. Achievements of Nationalized Banks

A banking revolution occurred in the country during the post-nationalization era. There has been a great change in the thinking and outlook of commercial banks after nationalization. There has been a fundamental change in the lending policies of the nationalized banks. Indian banking has become development-oriented. It has changed from class banking to mass-banking or social banking. This system has improved and progressed appreciably.

Various achievements of banks in the post-nationalization period are explained below.

1. Development-oriented Banking: Historically, Indian banks were mainly concerned with the growth of commerce and some of the traditional industries such as, cotton textile and jute. The banks were concentrated in the big commercial centers. They mostly granted short-term commercial loans. They were unwilling to venture into new fields of financing. But after nationalization of banks, the concept of banking has widened from acceptance of deposits and mere lending to development oriented banking. Banks are increasingly catering to the needs of industrial and agricultural sectors. From short- term lending, banks have been gradually shifting to medium and even long-term lending. From well-established large industries and business houses, banks are positively shifting to assisting small and weak industrial units, small farmers, artisans and other neglected groups of people in the country. They have adopted the Lead Bank Scheme. Under this scheme, all the districts of the country are allotted to some bank or the other. The lead bank of district is actively engaged in:

(a) Opening bank branches in all important localities.
(b) Providing maximum credit facilities for development in the district, and
(c) Mobilizing the savings of the people in the district.

2. Branch Expansion: Rapid economic development pre-supposes rapid expansion of commercial banks. Initially, the banks were conservative and opened branches mainly in cities and big towns. Branch expansion gained momentum after nationalization of top commercial banks and the introduction of "Lead Bank Scheme." The Lead Bank Scheme has played an important role in the bank expansion Program. The number of branches of all scheduled commercial banks increased from 8,260 in 1969 to 64,240 in 1998. Thus within 38 years after bank nationalization, there was over 800 per cent increase in the number of branches. There had been a significant increase in bank branches in the rural, under banked and unbanked areas. The number of branches in rural areas increased from 1860 in 1969 to 32,880 in 1998. With the progress of branch expansion Program, the national average of population per bank office has declined from 63,800 to 15,000. M. Gopalkrishnan says "the single striking feature of the post-nationalization banking scene is the rapidity with which the branch network has multiplied itself. The rate of branch expansion has been unparalleled any where else in the world." Thus, the overall growth of bank branches in the last 30 years has been remarkable in its geographical coverage and removal of regional imbalances in the country.

3. Expansion of Bank Deposits: Since nationalization of banks, there has been a substantial growth in the deposits of commercial banks. Thus bank deposits had increased by 150 times. Development of banking habit among people through publicity, extensive branch banking and prompt service to the customers led to increase in bank deposits. To attract deposits, Indian banks have introduced many attractive saving schemes. To attract deposits from widely scattered areas, mobile bank's branches have been introduced by a number of banks.

A number of banks have started evening branches, Sunday branches for the benefit of their customers. Apart from the quantitative increases in deposits, there has been an impressive qualitative shift. The number of small account holders with the banks has been increasing day-by-day. Aggregate deposits are composed to time deposits and demand deposits. Earlier there was predominance of demand deposits. Now there is predominance of time deposits. The ratio of time deposits to total deposits has been increasing.

4. Credit Expansion: The expansion of bank credit has also been more spectacular in the post-bank nationalization period. At present, banks are also meeting the credit requirements of industry, trade and agriculture on a much larger scale than before. Credit is the pillar of development. Bank credit has its crucial importance in the context of development and growth with social justice.

5. Investment in Government Securities: The nationalized banks are expected to provide finance for economic plans of the country through the purchase of government securities. There has been a significant increase in the investment of the banks in government and other approved securities in recent years.

6. Advances to Priority Sectors: An important change after the nationalization of banks is the expansion of advances to the priority sectors. One of the main objectives of nationalization of banks to extend credit facilities to the borrowers in the so far neglected sectors of the economy. To achieve this, the banks formulated various schemes to provide credit to the small borrowers in the priority sectors, like agriculture, small-scale industry, road and water transport, retail trade and small business. The bank lending to priority sector was, however, not uniform in all states.

It was quite low in many backward states like U.P., Bihar and Rajasthan. Under the new banking policy stress is laid on the weaker and under-privileged groups in the priority sector "weaker sections" refer to all persons who became suppressed, depressed and oppressed because of socio-political, socio-economic or socio-religious reasons. The concept of profitability has been substituted by "social purposes" with regard to lending to weaker sections of the society. Quantitatively, banks have done well in priority lending. But overdues and bad debts have been a serious problem faced by banks in respect of advances made to the weaker sections of the society. There is always the problem of ensuring the effective end use of the loans given to the priority sectors.

7. Social Banking -Poverty Alleviation Program: Commercial banks, especially the nationalized banks have been participating in the poverty alleviation Program launched by the government.

(a) Differential Interest Scheme: With a view to provide bank credit to the weaker sections of the society at a concessional rate the government introduced the "Differential interest rates scheme" from April 1972. Under this scheme, the public sector banks have been providing loans at 4% rate of interest to the weaker sections of the society.

(b) Integrated Rural Development Program (IRDP): This is a pioneering and ambitious Program to rectify imbalances in rural economy and also for all- round progress and prosperity of the rural masses. Under this Program banks has assisted nearly 1.8 million beneficiaries during 1997-98 and disbursed a total amount of Rs. 1990 crores as loan. Out of the beneficiaries, over 1 million belonged to scheduled castes and scheduled tribes and 0.7 million were women. Other important scheme introduced by the government of India and implemented through the banking system includes

(a) self-employment scheme for educated youth,
(b) self-employment Program for urban poor, and
(c) credit to minority communities.

8. Growing Importance of Small Customers: The importance of small customers to banks has been growing. Most of the deposits in recent years have come from people with small income. Similarly, commercial banks lending to small customers has assumed greater importance. Thus banking system in India has turned from class-banking to mass-banking.

9. Innovative Banking: In recent years, commercial banks in India have been adopting the strategy of "innovative banking in their business operations." Innovative banking implies the application of new techniques, new methods and novel schemes in the areas of deposit mobilization, deployment or credit and bank management. Mechanization and computerization processes are being introduced in the day-to-day working of the banks.

10. Diversification in Banking: The changes which have been taking place in India since 1969 have necessitated banking companies to give up their conservative and traditional system of banking and take to new and progressive functions. The government had been encouraging commercial banks to diversify their functions. As a result, commercial banks have set up merchant banking divisions and are underwriting new issues, especially preference shares and debentures. There are now eight commercial banks which have set up mutual funds also. Commercial banks have started lending directly or indirectly for housing. Venture capital fund is also started by one public sector bank. State Bank of India and Canara Bank have set-up subsidiaries exclusively for undertaking "factoring services." In future all commercial banks can be expected to diversify their functions and adopt new technologies.

11. Globalization: The liberalization of the economy, inflow of considerable foreign investments, frequency in exports etc., have introduced an element of globalization in the Indian banking system.

5. RESERVE BANK OF INDIA

Several attempts were made from time to time to set up a Central Bank in India prior to 1934. But unfortunately these attempts failed to bear any fruit. In 1921, the Government of India established the Imperial Bank of India to serve as the Central Bank of the country. But the Imperial Bank did not achieve any appreciable success in its functioning as the Central Bank of the country. In 1925, the Hilton Young Commission was asked by the Government to express its views on the subject. The commission made out a forceful case for the establishment of a brand new Central Bank in the country. According to the Commission, it was not desirable to keep the control of currency and credit in the hands of two separate agencies. The Government of India controlled currency while the Imperial Bank regulated credit prior to the establishment of the Reserve Bank of India in April 1st, 1935. The Hilton Young Commission did not consider this double control on currency and credit as a desirable feature of the Indian monetary system. It
was on this account that the Commission recommended the transfer of the control of currency and credit to a new Central Bank to be set up in the country. It was on this account that the Commission recommended the establishment of the Reserve Bank of India as the Central Bank of the country. The Government of India while accepting the recommendations of the Commission brought forward a Bill before the Central Legislature. But the Bill could not be passed on account of differences amongst the members of the legislature. The Government of India, therefore, postponed the idea of a new Central Bank for sometime. In 1929, the Central Banking Enquiry Committee again made a forceful plea for the establishment of the Reserve Bank. Consequently, the Reserve Bank of India Act was passed in 1934, and the Reserve Bank started functioning from 1st April, 1935.

The Reserve Bank of India is the king pin of the Indian money market. It issues notes, buys and sells government securities, regulates the volume, direction and cost of credit, manages foreign exchange and acts as banker to the government and banking institutions.

The Reserve Bank is playing an active role in the development activities by helping the establishment and working of specialized institutions, providing term finance to agriculture, industry, housing and foreign trade. In spite of many criticisms, it has successfully controlled commercial banks in India and has helped in evolving a strong banking system. A study of the Reserve Bank of India will be useful, not only for the examination, but also for understanding the working of the supreme monetary and banking authority in the country.

5.1 Capital

Originally, the Reserve Bank was constituted as a shareholders bank, based on the model of leading foreign central banks of those days. The bank's fully paid-up share capital was Rs. 5 crores divided into shares of Rs. 100 each. Of this, Rs. 4,97,80,000 were subscribed by the private shareholders and Rs. 2,20,000 were subscribed by the Central Government for disposal of 2,200 shares at part to the Directors of the Bank (including members of the Local Boards) seeking the minimum share qualification. The share capital of the bank has remained unchanged until today. The Reserve Bank also had a Reserve Fund of Rs. 150 crores in 1982. It was nationalised in January 1949 and since then it is functioning as the State-owned bank and acting as the premier institution in India's banking structure.

Every commercial bank has to keep certain minimum cash reserves with RBI. Consequent upon amendment to sub-Section 42(1), the Reserve Bank, having regard to the needs of securing the monetary stability in the country, RBI can prescribe Cash Reserve Ratio (CRR) for scheduled banks without any floor rate or ceiling rate, [Before the enactment of this amendment, in terms of Section 42(1) of the RBI Act, the Reserve Bank could prescribe CRR for scheduled banks between 5% and 20% of total of their demand and time liabilities]. RBI uses this tool to increase or decrease the reserve requirement depending on whether it wants to effect a decrease or an increase in the money supply. An increase in Cash Reserve Ratio (CRR) will make it mandatory on the part of the banks to hold a large proportion of their deposits in the form of deposits with the RBI. This will reduce the size

of their deposits and they will lend less. This will in turn decrease the money supply. The current rate is 4.00%.. -25 basis points cut in Cash Reserve Ratio(CRR) on 17 September 2012, It will release Rs 17,000 crore into the system/Market. The RBI lowered the CRR by 25 basis points to 4.25% on 30 October 2012, a move it said would inject about 175 billion rupees into the banking system in order to pre-empt potentially tightening liquidity. The latest CRR is 4%

5.2 Organization

As per the Reserve Bank of India Act, the organisational structure of the Reserve Bank comprises:

(A) Central Board

(B) Local Boards

5.2.1. (A) Central Board

The Central Board of Directors is the leading governing body of the bank. It is entrusted with the responsibility of general superintendence and direction of the affairs and business of the Reserve Bank.

The Central Board of Directors consists of 20 members as follows:

1. One Governor and four Deputy Governors: They are appointed by the Government of India for a period of five years. Their salaries, allowances and other perquisites are determined by the Central Board of Directors in consultation with the Government of India.

2. Four Directors Nominated from the Local Boards: There are four local Boards of Directors in addition to the Central Board of Directors. They are located at Mumbai, Kolkata, Chennai and New Delhi. The Government of India nominates one member each from these local Boards. The tenure of these directors is also for a period of five years.

3. Ten other Directors: The ten other directors of the Central Board of Directors are also nominated by the Government of India. Their tenure is four years.

4. One Government Official: The Government of India also appoints one Government Official to attend the meetings of the Central Board of Directors. This official can continue for any number of years with the consent of the Government, but he does not enjoy the right to vote in the meetings of the Central Board. The Central Board of Directors exercises all the powers of the bank. The Central Board should meet at least six times in each year and at least once in three months. Usually, the Central Board keeps a meeting in March every year at New Delhi so as to discuss the budget with the Finance Minister after its presentation in parliament. Similarly, it keeps a meeting in August at Mumbai in order to pass the Bank's annual report and accounts.

For all practical purposes, however, the committee set-up by the Central Board looks after the bank's current affairs. The committee consists of the Governor, the Deputy Governors and such other Directors as may be present. The committee meets once a week. Two sub-committees have also been appointed to assist the committee of the Central Board. Of these, one is called the Building Sub-Committee which deals with matters relating to building projects. The other is called the Staff Sub-Committee which is concerned with staff and other matters.

The Governor is the highest official of the Reserve Bank. There are four Deputy Governors to help and advise him. Each Deputy Governor is allotted a particular job to do, and he is fully held responsible for the proper execution of the job.

5.2.2. (B) Local Boards

The Reserve Bank of India is divided into four regions : the Western, the Eastern, the Northern and the Southern regions. For each of these regions, there is a Local Board, with headquarters in Mumbai, Kolkata, New Delhi and Chennai.

Each Local Board consists of five members appointed by the Central Government for four years. They represent territorial and economic interests and the interests of co-operative and indigenous banks in their respective areas. In each Local Board, a chairman is elected from amongst their members. Managers in-charge of the Reserve Bank's offices in Mumbai, Kolkata, Chennai and New Delhi are ex-officio Secretaries of the respective Local Boards at these places.

The Local Boards carry out the functions of advising the Central Board of Directors on such matters of local importance as may be generally or specifically referred to them or performing such duties which may be assigned to them. Generally, a Local Board deals with the management of regional commercial transactions.

5.3 Offices of the Bank

The headquarters of the Reserve Bank is located at Mumbai. But for the efficient performance of its functions, the Bank has opened local offices at New Delhi, Kolkata, Chennai, Bangalore, Kanpur, Ahmedabad, Hyderabad, Patna and Nagpur. The Bank can open its office at any other place with the prior consent of the Central Government. The State Bank of India acts as the agent of the Reserve Bank at those places where the latter does not maintain its own offices. The regional offices of the exchange control department of the Reserve Bank are located at New Delhi, Kanpur, Kolkata and Chennai.

The Reserve Bank has three training establishments viz.,
(a) Bankers Training College, Mumbai,
(b) College of Agricultural Banking, Pune and
(c) Reserve Bank Staff College, Chennai.

5.4 Departments of the Reserve Bank

To carry out its functions/operations smoothly and efficiently, the Reserve Bank of India has the following departments:

1. Issue Department.
2. Banking Department.
3. Department of Banking Development.
4. Department of Banking Operations.
5. Agricultural Credit Department.
6. Exchange Control Department.
7. Industrial Finance Department.
8. Non-Banking Companies Department.
9. Legal Department.
10. Department of Research and Statistics.
11. Department of Government and Bank Accounts.
12. Department of Currency Management.
13. Department of Expenditure of Budgetary Control.
14. Rural Planning and Credit Department.
15. Credit Planning Cell.
16. Department of Economic Analysis and Policy.
17. Inspection Department.
18. Department of Administration and Personnel.
19. Premises Department.
20. Management Services Department.
21. Reserve Bank of India Service Board.
22. Central Records and Documentation Centre.
23. Secretary's Department.
24. Training Establishments.

There are also Zonal Training Centres situated in Mumbai, Kolkata, Chennai and New Delhi for conducting induction, functional and short-term preparatory courses for the clerical staff.

5.5. Functions of the Reserve Bank

According to the preamble of the Reserve Bank of India Act, the main functions of the bank is "to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage." The various functions performed by the RBI can be conveniently classified in three parts as follows:

5.5.1. A. Traditional Central Banking Functions

The Reserve Bank of India discharges all those functions which are performed by a central bank. Among these the more important functions are as follows:

1. Monopoly of Note Issue: Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denomination. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government. The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes. The assets and liabilities of the Issue Department are kept separate from those of the Banking Department, originally, the assets of the Issue Department were to consist of not less than two fifths of gold coin, gold bullion or sterling securities provided the amount of gold was not less than Rs. 40 crores in value. The remaining three-fifths of the assets might be held in rupee coins, Government of India rupee securities, eligible bills of exchange and promissory notes payable in India. Due to the exigencies of the second World War and the post-war period, these provisions were considerably modified since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of Rs. 200 crores, of which at least Rs. 115 crores should be in gold. The system as it exists today is known as the Minimum Reserve System.

2. Banker to the Government: The Reserve Bank of India serves as a banker to the Central Government and the State Governments. It is its obligatory function as a central bank. It provides a full range of banking services to these Governments, such as:

(a) Maintaining and operating of deposit accounts of the Central and State Government.
(b) Receipts and collection of payments to the Central and State Government.
(c) Making payments on behalf of the Central and State Government.
(d) Transfer of funds and remittance facilities of the Central and State Governments.
(e) Managing the public debt and issue of new loans and Treasury Bills of the Central Government.
(f) Providing ways and means advances to the Central and State governments to bridge the interval between expenditure and flow of receipts of revenue. Such advances are to be repaid by the government within three months from the date of borrowed.
(g) Advising the Central/State governments on financial matters, such as the quantum, timing and terms of issue of new loans. For ensuring the success of government loan operations, the RBI plays an active role in the gilt-edged market.
(h) The bank also tenders advice to the government on policies concerning banking and financial issues, planning as resource mobilization. The Government of India consults the Reserve Bank on certain aspects of formulation of the country's Five Year Plans, such as financing pattern, mobilisation of resources, institutional arrangements regarding banking and credit matters. The government also seeks the bank's advice on policies regarding international finance, foreign trade and foreign exchange of the country.

The Reserve Bank has constituted a sound research and statistical organisation to carry out its advisory functions effectively. The Reserve Bank represents the Government of India as member of the International Monetary Fund and World Bank.

3. Banker's Bank: The Reserve Bank has the right of controlling the activities of the banks in the country. All the commercial banks, co-operative banks and foreign banks in the country have to open accounts with the bank and are required to keep a certain portion of their deposits as reserves with the Reserve Bank. Cash reserves are not to be less than 3% of the demand and time liabilities of the bank. The Reserve Bank has the power to increase this ratio upto 15%. Through this, Reserve Bank is able to regulate and control the credit created by the commercial banks. In addition to this, the scheduled banks are also required to submit to the Reserve Bank a number of returns every Friday.

4. Lender of the Last Resort: The scheduled banks can borrow from the Reserve Bank on the basis of eligible securities. They can also get the bills of exchange rediscounted. The Reserve Bank acts as the clearing house of all the banks. It adjusts the debits and credits of various banks by merely passing the book entries. The Bank also provides free remittance facilities to the banks. Thus, it acts as the banker's bank. The Reserve Bank also acts as the lender of the last resort and an emergency bank. It grants short-term loans to scheduled commercial banks against eligible securities in time of need. Similarly, it rediscounts the eligible bills of exchange brought by the commercial banks.

5. National Clearing House: The Reserve Bank acts as the national clearing house and helps the member banks to settle their mutual indebtedness without physically transferring cash from place to place. The Reserve Bank is managing many clearing houses in the country with the help of which cheques worth crores of rupees are cleared every year. The ultimate balances are settled by the banks throught cheques on the Reserve Bank.

6. Credit Control: The Reserve Bank of India is the controller of credit, i.e., it has the power to influence the volume of credit created by bank in India. It can do so through changing the bank rate or through open market operation. According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities. Since 1956, selective controls of credit are increasingly being used by the Reserve Bank.

The Reserve Bank of India is armed with many more powers to control the Indian money market. Every bank has to get a license from the Reserve Bank of India to do banking business within India. The license can be cancelled by the Reserve Bank if certain stipulated conditions are not fulfilled. Every bank will have to get the permission of the Reserve Bank before it can open a new branch. Each scheduled bank must send a weekly return to the Reserve Bank showing, in detail, its assets and liabilities. This power of the bank to call for information is also intended to give it effective control of the credit system. The Reserve Bank has also the power to inspect the accounts of any commercial bank.

As supreme banking authority in the country, the Reserve Bank of India, therefore, has the following powers:
(a) It holds the cash reserves of all the scheduled bank.
(b) It controls the credit operation of banks through quantitative and qualitative controls.
(c) It controls the banking system through the system of licensing, inspection and calling for information.
(d) It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.

7. Custodian of Foreign Exchange Reserves: The Reserve Bank has the responsibility of maintaining the external value of the rupee. There is centralisation of the entire foreign exchange reserves of the country with the Reserve Bank to avoid fluctuations in the exchange rate.

The RBI has the authority to enter into foreign exchange transactions both on its own account and on behalf of government. The bank is also empowered to buy and sell foreign exchange from and to scheduled banks in amounts of not less than the equivalent of Rs. 1 lakh.

As the custodian of the nation's foreign exchange reserves, the RBI also administers exchange controls of the country, and enforces the provision of the Foreign Exchange Regulation Act, 1973.

8. Collection of Data and Publications: The Reserve Bank of India collects statistical data and economic information through its research departments. It compiles data on the working of commercial and co-operative banks, on balance of payments, company and government finances, security markets, price tends, and credit measures. The bank is the principal source of certain financial statistics and banking data. It publishes a monthly bulletin, with weekly statistical supplements and annual reports which present a good deal of periodical reviews and comments pertaining to general economic, financial, and banking developments, including the bank's monetary policies and measures, adopted for the qualitative and quantitative monetary management.

The followings are the regular publications of the Bank:
(a) Reserve Bank of India Bulletin (monthly) and its weekly statistical supplements.
(b) Report of the Central Board of Directors (Annual).
(c) Report on Trend and progress of Banking in India (Annual).
(d) Report on Currency and Finance (Annual).
(e) Review of the Co-operative Movement in India (Published once in two years).
(f) Banking Statistics (Basic Statistical Returns).
(g) Statistical Tables Relating to Banks in India.
(h) Statistical Statements Relating to the Co-operative Movement in India.
(i) Adboc Export Committee's Reports and Monographs.
(j) Results of surveys conducted by the bank, such as the survey of India, Foreign Liabilities and Assets, All-India Debt and Investment Survey 1971-72, etc.
(k) History of the Reserve Bank of India (1935-51).
(l) Functions and Working of the Reserve Bank of India.
(m) Banking and Monetary Statistics of India and its Supplements.
(n) Reserve Bank of India Occasional Paper (Bi-annual).

5.5.2 B. Promotional Functions
The scope of the functions performed by the Reserve Bank has further widened after the introduction of economic planning in the country. The bank now performs a variety of promotional and developmental functions. The bank's responsibilities include, apart from monetary functions, the institutionalization of savings through the promotion of banking habit and the expansion of banking system territorially and functionally. The RBI has to provide facilities for agricultural and industrial finance.

(a) Reserve Bank of India and Agricultural Credit: The bank's responsibility in this field has been occasioned by the predominantly agricultural basis of the Indian economy and the urgent need to expand and coordinate the credit facilities available to the rural sector. The RBI has set up a separate agricultural department to maintain an expert staff to study all questions of agricultural credit and coordinate the operation of the bank with other agencies providing agricultural finance. The RBI does not provide finance directly to the agriculturists, but through agencies like cooperative banks, land development banks, commercial bank etc. After the establishment of the National Bank for Agriculture and Rural Development (NABARD) on July 12, 1982, all the functions of the RBI relating to rural credit have been transferred to this new agency.

(b) Reserve Bank of India and Industrial Finance: The Reserve Bank of India has taken initiative in setting up statutory corporations at the all-India and regional levels to function as specialised institutions for term lending. The first of these institutions was the Industrial Finance Corporation of India set up in 1948. Followed by the State Finance Corporations in each of the state from 1953 onwards. The RBI has also helped in the establishment of other financial institutions such as the Industrial Development Bank of India, the Industrial Reconstruction Bank of India, Small Industries Development Bank of India, Unit Trust of India, etc. For the promotion of foreign trade the Reserve

Bank has established the Export and Import Bank of India. Similarly, for the development of the housing industry the RBI has established the National Housing Bank.

Furthermore, the Deposit Insurance and Credit Guarantee Corporation (DICGC), a wholly owned subsidiary of the Reserve Bank, operates credit guarantee schemes with the objective of providing cover against defaults in repayment of loans made to small borrowers, including small-scale industrial borrowers, in order that credit flow to them is enlarged.

C. Supervisory Functions

Over the years, extensive powers have been conferred on the Reserve Bank of India for supervision and control of banking institutions. The Banking Regulation Act 1949, provides wide powers to the Reserve Bank to regulate and control the activities of Banks to safeguard the interests of depositors. Amendment Act passed in 1963, and effective from February 1, 1964, provided further powers to the Reserve Bank, particularly to restrain control exercised by particular groups of persons over the affairs of bank and to restrict loans and advances as well as guarantees given by the bank to or on behalf of any one company, firm, association of persons, and gave greater control to the Reserve Bank over the appointment and removal of bank's executive personnel.

The various aspects of the supervisory/regulatory functions exercised by the Reserve Bank may be briefly mentioned as under:

1. Licensing of Banks: There is a statutory provision that a company starting banking business in India has first to obtain a licence from the Reserve Bank. If the Reserve Bank is dissatisfied on account of the defective features of the proposed company, it can refuse to grant the licence. The bank is also empowered to cancel the license of a bank when it will cease to carry on banking business in India.

2. Approval of Capital, Reserves and Liquid Assets of Bank: The Reserve Bank examines whether the minimum requirements of capital, reserve and liquid assets are fulfilled by the banks and approves them.

3. Branch Licensing Policy: The Reserve Bank exercises its control over expansion of branches by the banks through its branch licensing policy. n September 1978, the RBI formulated a comprehensive branch licensing policy with a view to accelerate the pace of expansion of bank offices in the rural areas. This was meant to correct regional imbalance of the banking coverage in the country.

4. Inspection of Banks: The Reserve Bank is empowered to conduct inspection of banks. The inspection may relate to various aspects such as the bank's organisational structure, branch expansion, mobilisation of deposits, investments, credit portfolio management, credit appraisal profit planning, manpower planning, as well as assessment of the performance of banks in developmental areas such as deployment of credit to the priority sectors, etc. The bank may conduct investigation whenever there are complain about major irregularities or frauds by certain banks. The inspections are basically meant to improve the working of the banks and safeguard the interests of depositors and thereby develop a sound banking system in the country.

5. Control Over Management: The Reserve Bank also looks into the management side of the banks. The appointments, re-appointment or termination of appointment of the chairman and chief executive officer of a private sector bank is to be approved by the Reserve Bank. The bank's approval is also required for the remuneration, perquisites and post retirement benefits given by a bank to its chairman and chief executive officer.

The Boards of the public sector banks are to be constituted by the Central Government in consultation with the Reserve Bank.

6. Control Over Methods: The Reserve Bank exercises strict control over the methods of operation of the banks to ensure that no improver investment and injudicious advances made by them.

7. Audit: Banks are required to get their balance sheets and profits and loss accounts duly audited by the auditors approved by the Reserve Bank. In the case of the SBI, the auditors are appointed by the Reserve Bank.

8. Credit Information Service: The Reserve Bank is empowered to collect information about credit facilities granted by individual bank and supply the relevant information in a consolidated manner to the bank and other financial institutions seeking such information.

9. Control Over Amalgamation and Liquidation: The banks have to obtain the sanction of the Reserve Bank for any voluntary amalgamation. The Reserve Bank in consultation with the central government can also suggest compulsory reconstruction or amalgamation of a bank. It also supervises banks in liquidation. The liquidation have to submit to the Reserve Bank returns showing their positions. The Reserve Bank keeps a watch on the progress of liquidation proceedings and the expenses of liquidation.

10. Deposit Insurance: To protect the interest of depositors, banks are required to insure their deposits with the Deposit Insurance Corporation. The Reserve Bank of India has promoted such a corporation in 1962, which has been renamed in 1978 as the Deposit Insurance and Credit Guarantee Corporation.

11. Training and Banking Education: The RBI has played an active role in making institutional arrangement for providing training and banking education to the bank personnel, with a view to improve their efficiency.

In brief, the Reserve Bank of India is performing both traditional central banking functions and developmental functions for the steady growth of the Indian economy.

5.6 CREDIT CONTROL

Commercial banks grant loans and advances to merchants and manufacturers. They create credit or bank deposits in the process of granting loans. In modern times, bank deposits re regarded as money. They are as good as cash. They can be used for the purchase of goods or in payment of debts. But excessive creation of credit by commercial bank leads to inflation. Inflation has serious social and economic consequence. For instance, people with fixed incomes, workers and salaried persons suffer greatly on account of rising prices. So, a Central Bank must control the credit created by commercial banks in order to maintain the value of money at a stable level. Similarly, excessive contraction of credit leads to deflation. Deflation leads to unemployment and suffering among workers. Under such circumstances the central bank should encourage credit creation. Hence it is essential that the creation of credit is kept within reasonable limits by the central bank. The central bank has to control and regulate the availability of credit, the cost of cost and the use of credit flow in the economy. Credit control is an important function of the central bank. The central bank is in a position to control credit in its capacity as the bank of issue and the custodian of the cash reserves of the commercial bank.

5.7 Weapons of Credit Control

Various weapons or methods or instruments are available to the Reserve Bank of India to control credit creation or contraction by commercial banks. These methods are divided into two categories:

(A) Quantitative or general methods or instruments.
(B) Qualitative or selective methods or instruments.

5.7.1 A. Quantitative or General Methods

These are traditional methods of credit control. These methods have only a quantitative effect on the supply of credit. They are used for either increasing or reducing the volume of credit. They cannot control credit for its quality. The important quantitative methods or instruments of credit control are as follows:

1. Bank Rate: The bank rate is the rate of interest at which the Reserve Bank of India makes advances to the commercial banks against approved securities or rediscounts the eligible bills of exchange and other commercial papers. The Reserve Bank of India Act, 1934 defines the bank rate as "the standard rate at which it (the Bank) is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under the Act." The change in the bank rate leads to changes in the market rates of interest i.e., short-term as well as long-term interest rates. If bank rate is raised rates of interest in the money market including the lending rates of commercial banks also rise. So the cost of credit rises. The demand for bank loans generally falls and so the demand for goods will also fall. Thus inflation can be checked or controlled by raising bank rate. Similarly, deflation (i.e., state of falling prices) can be checked by lowering the bank rate. So the bank rate acts as a "pace-setter" in the money market. The Reserve Bank of India has changed the bank rate from time to time to meet the changing conditions of the economy. The bank rate was raised for the first time, from 3 per cent to 3½ per cent, in November 1951, with a view to checking an undue expansion of bank credit. The bank rate was further raised to 4 per cent on May 16, 1959. In February 1965, the bank rate was further raised to 6 per cent. In March 1968, however, the bank rate was reduced to 5 per cent with a view to stimulating recovery from the industrial recession of 1967. In January 1971, the bank rate was, however raised to 6 percent as an anti-inflationary device. Subsequently, the bank rates was raised to 10 per cent in July 1981 and to 12 per cent in October 1991. The bank rate was, however, reduced to 10 per cent in June 1997. The increases in the bank rate were adopted to reduce bank credit and control inflationary pressures. The Reserve Bank of India has made only a modest use of this instrument.

2. Open Market Operations: Open market operations consist of buying and selling of government securities by the Reserve Bank. Open market operations have a direct effect on the availability and cost of credit. When the central bank purchases securities from the banks, it increases their cash reserve position and hence, their credit creation capacity. On the other hand, when the central bank sells securities to the banks, it reduces their cash reserves and the credit creation capacity. The Reserve Bank of India did not rely much on open market operations to control credit. It was not used for influencing the availability of credit. Due to under-developed security market, the open market operations of the Reserve Bank are restricted to Government securities. These operations have also been used as a tool of public debt management. They assist the Indian government to raise borrowings. During 1951-52 the sale of securities was more. But in 1961 the purchases were more. This proves that it is not used to credit restraint only.

In India, the open market operations of the Reserve Bank has not been so effective because of the following reasons:

(a) Open market operations are restricted to government securities.
(b) Gift-edged market is narrow.
(c) Most of the open market operations are in the nature of "switch operations" (i.e., purchasing one loan against the other).

3. Cash-Reserve Requirement (CRR): The central bank of a country can change the cash-reserve requirement of the commercial banks in order to affect their credit creation capacity. An increase in the cash-reserve ratio reduces the excess reserves of the banks and a decrease in the cash-reserve ratio increases their excess reserves. The variability in cash-reserve ratios directly affects the availability and cost of credit. Originally, the Reserve Bank of India Act, 1934 required the commercial banks to keep with the Reserve Bank a minimum cash reserve of 5% of their demand liabilities and 2% of time liabilities. The amendment of the Act in 1962 removes the distinction

between demand and time deposits and authorises the Reserve Bank to change cash reserve ratio between 3 and 15%. The method of variable cash-reserve ratio is the most direct, immediate and the most effective method to credit control. The Reserve Bank of India used the technique of variable cash reserve ratio for the first time in June, 1973. It raised the cash reserve ratio from 3 to 5% in June 1973. The cash-reserve ratio was further raised to 7% in September 1973. Since then, the Reserve Bank has raised or reduced the cash reserve ratio many times.

Recently, the cash reserve ratio was raised to 11% effective from July 30, 1988 and to 15% with effect from July 1989. The present cash-reserve ratio is 4%. This method is mainly intended to control and stabilize the prices of commodities, stocks and shares and prevent speculation and hoarding. The Reserve Bank used the CRR as a drastic measure to curb credit expansion.

4. Statutory Liquidity Ratio (SLR): Under the Banking Regulation Act, 1949, banks are required to maintain liquid assets in the form of cash, gold and unencumbered approved securities equal to not less than 25% of their total demand and time deposits. This minimum statutory liquidity ratio is in addition to the statutory cash-reserve ratio. Maintenance of adequate liquid assets is a basic principle of sound banking. The Reserve Bank has been empowered to change the minimum liquidity ratio. Accordingly, the liquidity ratio was raised from 25% to 30% in November 1972, to 32% in 1973, to 35% in October 1981, to 38% in January 1988, and to 38.5% in September 1990. There are two reasons for raising the statutory liquidity requirements or ratio by the Reserve Bank of India.

They are:
(a) It reduces commercial bank's capacity to create credit and thus helps to check inflationary pressures.
(b) It makes larger resources available to the government.

5.7.2 B. Qualitative Selective Methods

Selective credit controls are qualitative credit control measures undertaken by the central ank to divert the flow of credit from speculative and unproductive activities to productive and more urgent activities. Selective credit controls are better than the quantitative credit controls in many respects. They encourage credit to essential industries and at the same time discourage credit to non-essential industries. Similarly, they encourage productive activities and at the same time discourage speculative activities. In a developing economy like India, qualitative credit controls are mainly intended for the following purposes:

(a) To prevent anti-social use of credit like speculative hoarding of stock.
(b) To divert credit from unproductive activities to productive activities.
(c) To divert credit from non-essential to essential industries.
(d) To encourage credit for certain sectors like priority sector.

5.8 METHODS OF SELECTIVE CREDIT CONTROLS ADOPTED BY RESERVE BANK

The Banking Regulation Act, 1949, granted wide powers to the Reserve Bank of India to adopt selective methods of credit control. The Act empowered the Reserve Bank to issue directions to the banks regarding their advances. These directives may relate to the following:

(a) The purpose for which advances may or may not be made.
(b) The margins to be maintained on secured loans.
(c) The maximum amount of advances to any firm or company, and
(d) The rate of interest to be charged.

The Reserve Bank of India has undertaken the following selective credit controls to check speculative and inflationary pressures and extend credit to productive activities.

1. Variation of Margin Requirements: The "margin" is the difference between the "loan value" and the "market value" of securities offered by borrowers against secured loans. By fixing the margin requirements on secured loans, the central bank does not permit the commercial banks to lend to their customers the full value of the securities offered by them, but only a part of their market value. For example, if the central bank prescribes the margin requirements at 40%, that means that the commercial banks can lend only 60% of the market value of the securities of the customers. If the margin is raised to 50%; the banks can lend only 50% of the market value of the securities to the customers. Thus, by changing the margin requirements, the amount of loan made by the banks can be changed in accordance with the policy of the central government. If the central bank raises the margin requirements, the amount of bank advances against securities will be automatically reduced. As a result the bank credit will be diverted from the field of speculative activities to the other fields of productive investments. If, on the contrary, the central bank lowers down the margin requirements, the amount of bank advances to the customers against securities can be automatically increased. Thus by altering margin requirements from time to time, the central bank keeps on changing the volume of bank loans to the borrowers. This method is an effective way of checking the flow of credit to less productive and less desirable uses in the economy

The Reserve Bank of India has been increasingly using this method in recent years to control bank advances against essential commodities like food-grains, oil-seeds, sugar etc. The main object is to prevent speculative dealings in such commodities. In 1957, the margin against loans on food-grains was increased to 40% and again to 60% in 1970. In March, 1977, the minimum margin was fixed at 85% on advances against stocks of groundnut oil, castor oil etc. This was done to check undue rise in the price of oil-seeds and vanaspathi. The margin requirements were also increased in the case of pulses, sugar, vanaspathi and oil-seeds in subsequent years. During 1984-85 the maximum margins on bank advances against stocks of food-grains was 45% in the case of mills and 60% in the case of others. Reserve Bank has been using this method flexibly according to the needs of the situation. The margin requirements was increased when the prices are going up and decreased when the credit flow has to be increased.

2. Credit Authorization Scheme (CAS): Credit Authorization Scheme is a type of selective credit control introduced by the Reserve Bank in November, 1965. Under the scheme, the commercial banks had to obtain Reserve Bank's authorization before sanctioning any fresh credit of Rs. 1 crore or more to any single party. The limit was later gradually raised to Rs. 6 crores in 1986, in respect of borrowers in private as well as public sector. Under this scheme, the Reserve Bank requires the commercial banks to collect, examine and supply detailed information regarding the borrowing concerns. The main purpose of this scheme is to keep a close watch on the flow of credit to the borrowers. This scheme requires that the banks should lend to the large borrowing concerns on the basis of credit appraisal and actual requirements of the borrowers. But this scheme was abolished in 1982. Though the scheme has been abolished, the Reserve Bank, however, insists that the banks have to get its approval once the loans have been sanctioned by them to big borrowers. The Reserve Bank would monitor and scrutinize all sanctions of bank loans exceeding Rs. 5 crores to any single party for working capital requirements, and Rs. 2 crores in the case of term loans. This post-sanction scheme has been called "Credit Monitoring Arrangement (CMA)."

3. Control of Bank Advances: This is also used as selective control method. The Reserve Bank has fixed from time to time maximum limits for some kinds of loans and advances. In May 1956, the Reserve Bank issued a directive asking all the commercial banks in the country to restrict their advances against paddy and rice. This directive was issued to check speculative hoarding of paddy and rice. In September 1956, these restrictions were applied to cover food-grains, pulses and cotton textiles. In 1970, the maximum limit for loans against shares and debentures was fixed to Rs. 5 lakhs. This was done to prevent speculation in shares with the help of bank loans.

4. Differential Interest Rates: In 1966, the Reserve Bank announced the policy of "Selective Liberalisation of Credit." According to this policy, the Reserve Bank encouraged credit to defence industries, export industries and food-grains for procurement by government agencies. The

Reserve Bank agreed to provide refinance at the bank rate in respect of advances to the above industries. At the same time it made credit dearer for other purposes.

5. Credit Squeeze Policy: Since 1973, the Reserve Bank has adopted a "Credit squeeze policy" or dear money policy as an anti-inflationary measure. This policy aims at curbing overall loan able resources of banks and also enhancing the cost or credit of borrowers from banks.

6. Moral Suasion: This method involves advice, request and persuasion with the commercial banks to co-operate with the central bank in implementing its credit policies. The Reserve Bank has also been using moral suasion as a selective credit control measure from 1956. It has been sending periodic letters to the commercial banks to use restraint over their credit policies in general and in respect of certain commodities and unsecured loans in particular. In June 1957, the banks were advised to reduce advances against agricultural commodities. Regular meetings and discussions are also held by the Reserve Bank with commercial banks to impress upon them the need for their co-operation in the effective implementation of the monetary policy.

Selective credit controls are flexible. They can be tightened, relaxed, withdrawn and re-imposed according to price situation in the market. For influencing the purpose and direction of credit. The Reserve Bank has been using various selective credit controls. It should be noted that qualitative methods are not competitive but complementary to quantitative methods of credit control. Both methods should be employed to control credit created by commercial banks.

5.8 MONETARY POLICY OF THE RESERVE BANK OF INDIA

Monetary policy, generally refers to those policy measures of the central bank which are adopted to control and regulate the volume of currency and credit in a country. According to Paul Einzig, an ideal monetary policy may be defined "as an effort to reduce to a minimum the disadvantages and increase the advantages resulting from the existence and operation of a monetary system." Broadly speaking, by monetary policy is meant the policy pursued by the central bank of a country for administering and controlling country's money supply including currency and demand deposits and managing the foreign exchange rates:

Reserve Bank of India and Monetary Controls

The main objective of monetary policy pursued by the Reserve Bank of India is that of 'controlled monetary expansion.' In order to achieve this objective the Reserve Bank has at its disposal various instruments, the important among these are as follows:

1. Quantitative requirements, and
2. Qualitative or selective controls.

In a developing country like India, the most important objective of monetary policy should be that of 'controlled monetary expansion.' Controlled monetary expansion implies two things:

(a) Expansion in the supply of money, and
(b) Restraint on the secondary expansion of credit.

(a) Expansion in the Supply of Money

In a developing country like India, money supply has to be expanded sufficiently to match the growth of real national income. Although it is difficult to say what relation the rate of increase in money supply should bear to the rate of growth in national income, more generally, the rate of increase in money supply should be somewhat higher than the projected rate of growth of real national income for two reasons.

(i) As incomes grow the demand for money as one of the components of savings tends to increase.
(ii) Increase in money supply is also necessitated by gradual reduction of non-monetized sector of the economy.

In India, the rate of increase in money supply has been far in excess of the rate of growth in real national income. It has resulted, to a large extent, in the creation of consistent inflationary pressures in the economy.

(b) Restraint on the Secondary Expansion of Credit: Government budgetary deficits for financing a part of the investment outlays constitute an important source of monetary expansion in India. It is, therefore essential to restrain the secondary expansion of credit. While exercising restraints, care should be taken that the legitimate requirements of agriculture, industry and trade are not adversely affected. The Reserve Bank has also to channelize credit into the vital sectors of the economy, specially the priority sectors.

In order to achieve the twin goals, it is essential to formulate a monetary policy which may regulate the flow of credit to desired sectors. So far as the choice of instruments of the monetary policy is concerned, the Reserve Bank of India has a very limited scope in this respect. The Reserve Bank has at its disposal both quantitative (traditional) and qualitative (selective) methods to control credit. In the past, the Reserve Bank has employed bank rate, open market operations, variable reserves ratio and selective credit controls as the instruments to restrain the secondary expansion of credit.

The progress of the various methods of credit control, contemplated by the Reserve Bank of India suggests that the objective of monetary policy i.e., 'controlled monetary expansion' has been realized to a limited extent. While the supply of money has increased in a greater proportion than the national income, the restraints on the expansion of credit have been rather weak and ineffective. In spite of the various methods employed by the Reserve Bank to contain the inflationary pressures, the general price level has been showing a rising trend. It leads up to this inevitable conclusion that there is something wrong with the monetary policy pursued by the Reserve Bank of India in the recent post. The policy should be that of 'controlled contraction' rather than 'controlled expansion.'

However, if we take into account the nature of the Indian economy and the needs of developmental finance, it would be a folly on our part to adopt a monetary policy of 'controlled contraction'. India is a developing economy, and for the overall development of the various sectors like agriculture, industry, trade, commerce, transport, and foreign trade, availability of huge financial resources is essential. With the concept of developmental planning gaining momentum, the availability of monetary resources in sufficient quantity becomes all the more essential. With limited supply of money the Indian economy will not be able to achieve the objective of self-sustained economic growth.

Therefore, the RBI will have to continue with the policy of controlled expansion. The only change that the RBI has to introduce is that it will have to implement the various restraints on the expansion of credit more vigorously and with great authority.

5.9 Limitations of Monetary Policy

A major failure of the monetary policy in India lies on the price front. The monetary authorities have not been in a position to curb an inflationary rise in price which has often taken violent jumps at intervals. A number of causes account for this failure.

(a) Monetary policy, to be effective, should be able to regulate supply and cost of credit. The Reserve Bank tries to do by controlling the activities of commercial banks and to some extent of co-operative banks. But the proportion of total credit provided by non-banking institutions and other agencies is much higher. The impulses generated by the Reserve Bank have thus a limited impact.

(b) In relation to commercial banks the task of the Reserve Bank is rendered difficult by the limitations inherent in the various instruments of monetary control.

(c) In part the freedom to curtain Reserve Bank accommodation for banks is also constrained by the fact that the device of offering preferential facilities has been used for encouraging banks to lend to such sectors with so many windows opened for refinance as an adjunct to efforts to change the long-term pattern of bank finance, it becomes difficult for the Reserve Bank to close these special windows just when the banks may find it necessary or tempting to use these special facilities.

(d) There is a special consideration that hitherto neglected sectors should be shielded as far as possible from credit curbs. This makes the task of the monetary policy more difficult.

(e) The type of the policy the Reserve Bank has pursued so far requires the presence of a sound statistical and monitoring system. Any defects in this system make it difficult to bring about a speedy and appropriate turn around in credit trends.

5.10 ROLE OF RBI IN ECONOMIC DEVELOPMENT

The Reserve Bank is India's central bank. It occupies a pivotal position in the monetary and banking structure of our country. It is the apex monetary institution in the country. It supervises, regulates, controls and develops the monetary and financial system of the country. It performs all the typical functions of a good central bank. It also performs a number of developmental and promotional functions. It also assists the government in its economic planning. The bank's credit planning is devised and co-ordinated with the Five year plans. It assists the government in the great task of nation building.

Contribution to Economic Development

Since its inception in 1935, the Reserve Bank of India has functioned with great success, not only as the apex financial institution in the country but also as the promoter of economic development. With the introduction of planning in India since 1951, the Reserve Bank formulated a new monetary policy to aid and speed up economic development. The Reserve Bank has undertaken several new functions to promote economic development in the country. The major contributions of the Reserve Bank to economic development are as follows:

1. Promotion of Commercial Banking: A well-developed banking system is a pre-condition for economic development. The Reserve Bank has taken several steps to strengthen the banking system. The Banking Regulation Act, 1949 has given the Reserve Bank vast powers of supervision and control of commercial banks in the country. The Reserve Bank has been using these powers:

(a) To strengthen the commercial banking structure through liquidation and amalgamation of banks, and through improvement in their operational standards
(b) To extend the banking facilities in the semi-urban and rural areas, and
(c) To promote the allocation of credit in favour of priority sectors, such as agriculture, small-scale industries, exports etc.

The Reserve Bank is also making valuable contribution to the development of banking system by extending training facilities, to the supervisory staff of the banks through its 'Banker's training colleges.

2. Promotion of Rural Credit: Defective rural credit system and deficient rural credit facilities are one of the major causes of backwardness of Indian agriculture. In view of this, the Reserve Bank, ever since its establishment, has been assigned the responsibility of reforming rural credit system and making provision of adequate institutional finance for agriculture and other rural activities. The Reserve Bank has taken the following steps to promote rural credit:

(a) It has set up Agricultural Credit Department to expand and co-ordinate credit facilities to the rural areas.
(b) It has been taking all necessary measures to strengthen the co-operative credit system with a view to meet the financial needs of the rural people.
(c) In 1956, the Reserve Bank set-up two funds. Namely, the National Agriculture Credit (long-term operations) Fund, and the National Agricultural Credit (stabilisation) Fund, for providing medium-term and long-term loans to the state co-operative banks.
(d) Regional rural banks have been established to promote agricultural credit.
(e) Some commercial bank have been nationalised mainly to expand bank credit facilities in rural areas.
(f) The National Bank for Agriculture and Rural Development has been established in 1982 as the apex institution for agricultural finance.
(g) The Reserve Bank has helped the establishment of many warehouses in the country.

As a result of the efforts made by the Reserve Bank, the institutional finance for agriculture has been increasing considerably over the years. The agricultural output has increased by leaps and bounds. Probably no other central bank in the world is doing so much to help, develop and finance agricultural credit.

3.Promotion of Co-operative Credit: Promotion of co-operative credit movement is also the special function of the Reserve Bank. On the recommendations of the Rural Credit Survey Committee, the Reserve Bank has taken a number of measures to strengthen the structure of co-operative credit institutions throughout the country. The Reserve Bank provides financial assistance to the agriculturists through the co-operative institutions. The Reserve Bank has, thus, infused a new life into the co-operative credit movement of the country.

4. Promotion of Industrial Finance: Credit or finance is the pillar to industrial development. The Reserve Bank has been playing an active role in the field of industrial finance also. In 1957, it has set up a separate Industrial Finance Department which has rendered useful service in extending financial and organisational assistance to the institutions providing long-term finance. It made commendable efforts for broadening the domestic capital market for providing the medium and long-term finance to the industrial sector. In this regard the Reserve Bank took initiative in the establishment of a number of statutory corporations for the purpose of providing finance, especially medium and long-term finance, to industries; Industrial Development Bank of India, Industrial Finance Corporation of India, State Finance
Corporations, State Industrial Development Corporations and the Industrial Credit and Investment Corporation of India are some of important corporations established in the country with the initiative of the Reserve Bank. The Reserve Bank has contributed to the share capital of these institutions and providing short-term advances also to some of them. The role of these corporations in providing financial
help to industries is commendable. The Reserve Bank has played an active role in the establishment of the Unit Trust of India. The Unit Trust of India mobilises the savings of people belonging to middle and lower income groups and uses these funds for investment in industries. By mobilising the small savings of the people, the Unit Trust has been promoting capital formation which is the most important determinant of economic development. The Reserve Bank also has been encouraging commercial banks to provide credit to the small-scale industries. It has been encouraging credit for small industries through its “Credit Guarantee Scheme.” Small-scale industries have been recognised as a priority sector. The Reserve Bank has also been, acting as a “developmental agency” for planning, promoting and developing industries to fill in the gaps in the industrial structure of the country.

5. Promotion of Export Credit: “Export or Perish” has become a slogan for the developing economies, including India. In recent years, India is keen on expanding exports. Growth of exports needs liberal and adequate export credit. The Reserve Bank has undertaken a number of measures for increasing credit to the export sector.

For promoting export financing by the banks, the Reserve Bank has introduced certain export credit schemes. The Export Bills Credit Scheme, and the Pre-shipment Credit Scheme are the two important schemes introduced by the Reserve Bank. The Reserve Bank has been stipulating concessional interest rates on various types of export credit granted by commercial banks. The Reserve Bank has been instrumental in the establishment of Export-Import Bank. The Exim Bank is to provide financial assistance to exporters and importers. The Reserve Bank has authority to grant loans and advances to the Exim Bank, under certain conditions.

6. Regulation of Credit: The Reserve Bank has been extensively using various credit control weapons to regulate the cost of credit, the amount of credit, and the purpose of credit. For regulating the cost and amount of credit the Reserve Bank has been using the quantitative weapons. For influencing the purpose and direction of credit, it has been using various selective credit controls. By regulating credit, the Reserve Bank has been able
(a) To promote economic growth in the country.
(b) To check inflationary trends in the country.
(c) To prevent the financial resources from being used for speculative purposes.
(d) To make financial resources available for productive purposes keeping in view the priorities of the plans, and
(e) To encourage savings in the country.

7. Credit to Weaker Sections: The Reserve Bank has taken certain measures to encourage adequate and cheaper credit to the weaker sections of the society. The "Differential Rate of Interest Scheme" was started in 1972. Under this scheme, concessional credit is provided to economically and socially backward persons engaged in productive activities. The Reserve Bank has been encouraging the commercial banks to give liberal credit to the weaker sections and for self employment schemes.

The Insurance and Credit Guarantee Corporation of India gives guarantee for loans given to weaker sections.

8. Development of Bill Market: The Reserve Bank introduced the "Bill Market Scheme" in 1952, with a view to extend loans to the commercial banks against their demand promissory notes. The scheme, however, was not based on the genuine trade bills. In 1970, the Reserve Bank introduced "New Bill Market Scheme" which covered the genuine trade bills representing sale or despatch of goods. The bill market scheme has helped a lot in developing the bill market in the country. The bill market scheme has increased the liquidity of the money market in India.

9. Exchange Controls: The Reserve Bank has been able to maintain the stability of the exchange value of the "Rupee" even under heavy strains and pressure. It has also managed "exchange controls" successfully.

Inspite of the limitations under which it has to function in a developing country like India, the over all performance of the Reserve Bank is quite satisfactory. It has been able to develop the financial structure of the country consistent with the national socio-economic objectives and priorities. It has discharged its promotional and developmental functions satisfactorily and acted as the leader in economic development of the country.

Conclusion

From the above discussion, it is made clear that the Reserve Bank of India is the kingpin of the Indian money market. It issues notes, buys and sells government securities, regulates the volume, direction and cost of credit, manages foreign exchange and acts as banker to the government and banking institutions. The RBI is playing an active role in the development activities by helping the establishment and working of specialised institutions, providing term finance to agriculture, industry housing and foreign trade.

6. STATE BANK OF INDIA

The Reserve Bank of India had been attempting to help the villagers through the state cooperative banks but the extent of its assistance was very limited. At the same time, the need to help the farmers in all possible ways so as to increase agricultural production has been most pressing since independence. The All India Rural Credit Survey Committee (AIRCSC) recommended the setting up of a State Bank of India, a commercial banking institution, with the special purpose of stimulating banking development in rural areas. The State Bank of India was set up in July 1, 1955, when it took over the assets and liabilities of the former Imperial Bank of India.

6.1 Capital

SBI had 14,816 branches in India, as on 31 March 2013, of which 9,851 (66%) were in Rural and Semi-urban areas. In the financial year 2012-13, its revenue was INR 200,560 Crores (US$ 36.9 billion), out of which domestic operations contributed to 95.35% of revenue. Similarly, domestic operations contributed to 88.37% of total profits for the same financial year.

6.2 Management

The management of the State Bank vests in a Central Board constituted thus: A Chairman and a Vice-chairman appointed by the Central Government in consultation with the Reserve Bank; not more than two Managing Directors appointed by the Central Board with the approval of the Central Government; six Directors elected by the shareholders other than the Reserve Bank; eight Directors nominated by the Central Government in consultation with the Reserve Bank to represent territorial and economic interests, not less than two of whom shall have special knowledge of the working of co-operative institutions and of the rural economy; one Director nominated by the Central Government; and one Director nominated by the Reserve Bank.

6.3 Functions

The State Bank of India performs all the functions of a commercial bank and acts as an agent of the Reserve Bank in those places were the latter has no branch offices. Further it is required to play a special role in rural credit, namely, promoting banking habits in the rural areas, mobilizing rural savings and catering to their needs. It is expected to look after the banking development in the country. It provides financial assistance to the small scale industries and the co-operative institutions.

We can discuss the functions of the State Bank under the following three sub-heads:

6.3.1. A. Central Banking Functions

Though the State Bank is not the Central Bank of the country, yet it acts as the agent of the Reserve Bank in all those places where the latter does not have its own branches. As agent to the Reserve Bank, the State Bank performs some very important functions:

1. It acts as the Bankers Bank: It receives deposits from the commercial banks and also gives loans to them on demand. The State Bank rediscounts the bills of the commercial banks. It also acts as the clearing-house for the other commercial banks. In addition to this the State Bank also provides cheap remittance facilities to the commercial banks.

2. It acts as the Government's Banker: It collects money from the public on behalf of the government and also makes payments in accordance with its instructions. The bank also manages the public debt of the Central and the State Governments.

6.3.2. B. Ordinary Banking Functions

The ordinary banking functions of the State Bank are as follows:

1. Receiving Deposits from the Public: Like other commercial banks, the State Bank also receives different types of deposits from the public. The total deposits of the State Bank stood at Rs. 36,188 crores on 29th June, 1990. Of this amount, Rs. 7,105 crores were demand deposits and Rs. 29,083 crores were time deposits.

2. Investment in Securities: Like other commercial banks, the State Bank invests its surplus funds in the Securities of Government of India, the State Governments, Railway Securities, Securities of Corporations and Treasury Bills. The total amount invested by the State Bank in these securities stood at Rs. 9,942 crores on 29th June, 1990.

3. Loans and Advances to Businessmen: The State Bank grants loans and advances to businessmen against the security of government papers, exchange bills, approved promissory notes and title deeds. The total advances of the State Bank to businessmen stood at Rs. 24,047 crores on 29th June, 1990.

4. Foreign Banking: In recent years, the State Bank of India has extended its foreign banking business. It has opened its branches in important world banking centres, such as Nassau, Singapore, Hong Kong, London, New York, Frankfurt etc. The Bank's foreign business is expanding every year. It has been able to give a new direction to its foreign business. The State Bank, in collaboration with leading foreign banks, has also been extending loans to foreign governments.

5. Miscellaneous Work: The miscellaneous functions of the State Bank are as follows:

(a) The State Bank can receive securities, jewels etc. for safe custody.
(b) Sale and purchase of gold, silver, bullion and coins.
(c) Safe custody of the valuables of its customers.
(d) Issuing of credit certificates to the customers.
(e) Issuing drafts on its own as well as the branches of the subsidiary banks.
(f) Telegraphic remittance of funds from one place to another place.
(g) Acting as the agent of the co-operative banks under certain circumstances.
(h) Working as the liquidator of banking companies and doing other miscellaneous jobs assigned to it by the Reserve Bank.
(i) The State Bank grants special credit facilities to small scale industries and co-operative societies.

6.3.3 C. Prohibited Business of the State Bank

The State Bank of India Act has enumerated certain business which cannot be done by the State Bank.
(a) The State Bank cannot grant loans against stocks and shares for a period exceeding six months. But, according to an amendment of the Act, made in 1957, the State Bank can grant loans to industries against their assets for a period of 7 years.
(b) The State Bank can purchase no immovable property except for its own offices.
(c) The State Bank cannot re-discount those bills which do not carry at least two good signatures.
(d) The State Bank could neither discount bills nor extend credit to individuals or firms above the sanctioned limit.
(e) The State Bank can neither re-discount nor offer loans against the security of those exchange bills whose period of maturity exceeds six months.

6.4 Role of the State Bank in Economic Development

Growth of banking facilities is indispensable for speedy economic development. By helping in the encouragement of small savings, mobilization of savings and development of credit into the priority sectors, the State Bank of India is playing a significant role in India's economic development. The role of the SBI can be studied under the following heads:

1. The SBI and Small-scale Industries: State Bank Group has been the most important single source of institutional finance to small-scale industries in the country. The SBI has set up several pilot centres, to experiment with financing schemes. Through its Installment Credit Scheme the SBI provides finances for the purchase of equipments and machinery by small and medium size business engaged in approved manufacturing industries. In 1967, the State Bank introduced the "Entrepreneur Scheme", under which credit to the small sector was based on the ability and competence of the entrepreneurs as well as the technical feasibility and economic viability of the project.

2.The SBI and Agricultural Credit: The SBI provides direct advances to farmers for all agricultural operations and indirect loans to Primary Co-operative Credit Societies, Farmers Service Societies, etc. The SBI Group provides agricultural advances for a variety of purposes which include loans to co-operative banks, advances to Land Development Banks, Village Adoption Scheme, Integrated Rural Development, Financial Assistance to marketing and processing societies, development of warehousing facilities, etc.

3. The SBI and Small Road and Water Transport: The development of transport facilities, especially in the rural areas, is very vital for the maximum utilization of the localized resources. The SBI provides advances to the small road and water transport operators at concessional rates.

4. The SBI and Industrial Estates: The State Bank of India has been playing a significant role in the establishment of industrial estates in the country. The total advances for setting up of industrial estates have increased to over Rs. 2 crores in June 1989.

5. The SBI and Export Promotion: The State Bank of India also helps in the export promotion by providing finances to exporters, maintaining close relationship between exporters and importers, collecting and disseminating information about market etc. About 30 per cent of the total export finance of scheduled banks comes from the SBI Group.

6. The SBI and Regional Development: The SBI is also helping in reducing the regional disparities by establishing a major portion of its new branches in the rural and unbanked areas. The Lead Bank Schemes has been very successful in the integrated development of the rural areas.

In brief, the State Bank of India is playing the role of leading public sector commercial bank for the speedy economic development of the Indian economy.

6.5 Conclusion

Thus, the SBI is truly shaping itself as a national institution of major financial importance. It has helped in making more effective Government control over the country's money market.

It has extended appreciably banking facilities to rural and other areas lacking badly in such facilities. The Bank massive resources are made available to the high priority sectors of the economy according to the objectives of planned development. To achieve so much in such a short time is highly creditable indeed.