



CREDIT POLICY : TECHNIQUES AND CULTURE

Commerce

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KEYWORDS

Coming to the Institute kindles a feeling of festive occasion and it is a benefit and a honour to be here with you. There have been significant achievements, in preparing, in diversified fields, with new initiatives and a more extensive scope in the zone of research and consultancy. As a matter of fact, there is a greater amount of sponsored research now. Of course, one of my previous colleagues Ms. Indrani Banerjee, who as well as others worked with me on a cash laundering Report in the Reserve Bank, is with the Institute now. I am blissful that the Institute is starting to use Rbi's human resources gainfully. The trade of information resources amongst our institutions is certain to furnish increasing returns to both. It is exceptional to note that distinguished banking colleagues are exploiting the services of the Institute and surely they will press on to do so in a more terrific measure in the years ahead.

There is a reference in Dr. Saha's appear for the possibility of making our presence felt in the neighbouring countries and this seems extremely suitable because we have a Saarc Finance Group which is liable to meet in April 2004. Also, as Dr. Saha knows, Ms. Anne Krueger, the first Deputy Managing Director of the Imf who was also the Chief Economist of the World Bank 10-15 years back, is visiting this Institute shortly. She will convey an address on January 21, which might also furnish this Institute a chance for investigating further avenues of studying through coordinated effort and connection with others.

MONETARY DEEPENING

Around the major indicators that we might need to take a gander at from a more extended term perspective of financial sector advancement, are some of the financial ratios that signify the nature and degree of financial developing. The information shows that banking and insurance as a rate of Gdp has developed from just in the ballpark of 1.6 for every penny in 1969 to 6.5 for every penny. Inside the services sector, its share has become from in the vicinity of 4.2 for every penny to 11.8 for every penny showing that the financial sector has quickly picked up noticeable quality in the generally speaking economic action. The stream of funds accounts for the Indian economy which are accessible till 1995-96, show that the account degree, i.e., the proportion of sum financial issues to national salary, has become four times between 1969-70 and 1995-96 from 10.4 for every penny to 41.1 for every penny showing considerable financial developing. It is interesting that the intermediation degree has developed at a much lesser pace i.e., 57.8 for every penny to 70.2 for every penny throughout the same period. This means that despite the fact that the Indian financial system is all in all bank-situated, the financial extending has been supported, both by financial intermediaries as well as financial markets. We need to constantly take note of some of th characteristics of the financial developing and the way of improvement of the financial markets. Specifically compelling to our nation is the share of business banks in country household obligation which rose from scarcely 0.3 for every penny in 1961 to 29 for every penny in 1991. The question that arises is the thing that has been going on from that point. There is some quantitative evidence and positively a strong discernment that business banking movement for the country households may not be increasing at the same pace as soon after 1991. It is great to note that throughout the change period, the part of capital markets enhanced however is it exceptional to discover that the presence of banks in the country households is not increasing commensurately? This leads to the main problems of credit conveyance mechanisms, which we hailed in the monetary policy this time. What are the constraints which are influencing the stream of credit? What is the part of credit stream in a deregulated financial

environment in a developing nation? 'Rising nation' by definition, has structural or institutional bottlenecks. In such a situation, how to look after a parity between deregulation that brings about medium to long haul proficiency gains and the credit stream that is desperately needed to various sectors? It is discriminating at this point, to address these issues at this stage of our economic advancement and state of financial sector.

FINANCIAL, CREDIT AND REGULATORY PLANS

Basically, there is a distinguishment about the separation as well as the connection between monetary and credit policy. In India, we now call our policy statement as Monetary and Credit Policy Statement. Upto 1992, our statement was called Credit Policy Statement and the Cell (in Rbi) was called Credit Planning Cell. Starting 1998, it is renamed as Monetary Policy Department. This signified the shift in the policy from an arranged and administered interest rate system to a business situated financial system however while making the shift, we have been sensible enough not to discard the vitality of credit and focus just on leading monetary policy. The main problem is to characterize the way of the connection between monetary and credit policies, how it is changing and how we need to administer it. Past experience shows that credit allotment and administered valuing unquestionably ensure a reasonable level of credit stream in the desired course at the desired cost, yet at a cost in addition to inefficiencies as well as distortions. In such a situation, the cost has to be borne in diverse ways - incorporating appropriation through Cash Reserve Ratio (Crr), which around then of launch of reforms had touched the statutory greatest of 15 for every penny (rejecting the incremental Crr on incremental Ndtl) and Statutory Liquidity Ratio (Slr) at 38.5 for every penny, almost touching the statutory most extreme of 40 for every penny. Since the change, the focus of the policy environment has been to evacuate most of these constraints yet the question is if the purpose of credit conveyance at a reasonable cost of credit has been served and if the new system is honestly superior in all respects?

Later experience shows that policies of liberalisation, deregulation and empowering environment of agreeable liquidity at a reasonable cost don't immediately translate themselves into credit stream. There are glitches or hurdles in a well meaning monetary policy to be translated into desired credit system, and these, I accept, are the linkages to be investigated.

There is an alternate aspect to the issue of credit valuing and credit conveyance hailed in the Mid-term Review of Monetary and Credit Policy statement this time. The administrative policies identifying with banks have a direction on credit stream. Case in point, tightening of the administrative policies specifically cycles, especially the downside cycle, will sometimes worsen the situation. The administrative administration has a propensity to be star cyclical and, in this manner, it has implications for both, monetary and financial stability, especially when the administrative administration itself is transforming. In a word, there is a basic need to unmistakably discern the links between monetary policy, credit policy, and administrative administration in a dynamic situation, including the generally speaking structural transformation of the true sector, the financial sector and the opening of the economy. As you are conscious, Rbi is also controller of banks, non banking financial companies, Primary Dealers, government security markets and currency markets. In this manner, in policy making, Rbi now looks at what may be known as the 3 by 3 matrix and see how we can catch these linkages. The 3 by 3 matrix consists of three policy objectives and three policy-instruments.

Gave us a chance to start with the objectives. What are the policy-objectives that the Reserve Bank of India has? The national bank, until a decade back, was focusing on development and value stability and the exchange off between development and value stability. A later expansion reflecting the developments in the financial markets has been the third target, viz., financial stability. The monetary policy looks at this third goal also and there are sure exchange offs included between the three objectives, especially in the short run. There are also complementarities between the three all the more so over the more extended run. While there are three objectives with their own particular interrelationships, we also have three instruments - monetary policy, credit policy and administrative policies. The three instruments are also used reciprocally to serve distinctive objectives. For instance, interest rate changes serve as monetary policy signal, while around then changing the cost of credit as also ensuring stability in asset prices.

The use of instruments results in short-term exchange offs, needing some other correlative measures. In quite integrated economies with no institutional bottlenecks, monetary and administrative policy co-appointment is essential, yet for us, because of transitional problems and transactional costs, we need to have a credit distribution policy and, in this manner, one should take a gander at the changing dynamics of these relationships in what may be known as the 3 x 3 matrix.

CREDIT TECHNIQUES

There are three pillars on which our credit system was based in the past - one was settling of prices of credit or interest rate and on occasions even quantum connected with purpose; second, insisting on guarantee; and third, prescribing the finish use. One column identifying with interest rate prescription and settling quantum has been significantly decreased. There are issues in security-based or collateralised giving and how would we handle that?

What will happen to the services sector, which accounts for slightly more than 50 for every penny of Gdp assuming that we continue insisting on security? Similarly, if innovation is more critical than the material segment what is the part of guarantee? The third is the finish use specification. Given the fungibility of resources, numerous sources of stream of resources, as well as provision of funds, are finish use restrictions pertinent and operationally feasible? I might solicit views of the bankers so that we can make headway with changes.

There is an alternate issue identifying with the connection or absence of the connection between formal and casual sectors which is still persisting. Typically, in a honestly nature, if markets are reasonably integrated, the difference in credit terms, especially interest rates, between the formal and casual sectors should not be expansive. In any case, almost everyone in our nation concedes that significant uniqueness in giving terms between the two sectors still Persists. The interest rate in casual markets, especially in country areas, is 3 for every penny for every month or Annualised rate of over 38 for every penny whereas in Formal sectors, it is 10 or 12 for every penny for every Annum. The persistence of dissimilarity means that, with all the deregulation, the formal credit mechanisms are not ready to puncture the casual system. The incentives radiating out of the disparity in terms of credit is such that the borrower will take recourse to the all the more costly casual fund in inclination to the formal loan specialist if the borrower has shortage of funds. Right now, since it is highly unlikely for the formal sector to have the capacity to indulge all the credit requirements, especially for consumption purpose, perhaps we should ponder what suits our own society such as family-based credit in provincial areas as opposed to consumption credit, generation credit, and so on. At last, we should attempt to achieve a level of union between formal and casual sectors perhaps by pushing the supply of credit from the formal sector in a supply heading approach to lessen the cost or interest. How would we go about it? We might acknowledge suggestions from the bankers and others assembled here.

Micro-back is in a manner realizing the meeting. In micromoney, whereas there are no collaterals and, interest rates are high, the level of Npas is low. Is there a lesson for our banks? A possible demonstration is in terms of what is called "obvious cost" and "absolute true cost". "Obvious cost" is what is shown on the credit archive, whereas the "sum genuine cost" includes cost caused on formalities incorporating documentation and so on. The amount of photocopies that are needed, trips to the Sub Registrar's office, the paper work, the aspect of timeliness - if every one

of those are added to the evident cost, then it becomes the "sum true cost". There is a perspective that the dissimilarity between the formal and casual is just because of the differences in the "evident cost" showed in casual sector and sum true cost in the formal sector. These are some critical areas of studies in credit systems, that should perhaps be attempted.

An alternate aspect with which we have been coming work now is that credit business has to be a stand-alone credit business and I suppose we have had the purist approach, viz., that bank credit should not be debased with different business. The telecom insurgency was started with Std kiosks, which as a general rule rendered several different services. There is have to consider joining credit with physical supplies of inputs/outputs. Perhaps, in considering credit conveyance in country areas, we need to take a gander at the conveyance mechanisms, by studying creation, distribution and consumption processes, Especially their linkages