Reserve Bank of India

Origin:

The Reserve Bank of India (RBI) was established in 1935 under the Reserve Bank of India Act, 1934. Its Head Quarters is located at Mumbai

The RBI was set up to

- regulate the issue of bank notes
- secure monetary stability in the country
- operate currency and credit system to its advantage

Functions role of RBI in agricultural development and finance:

The role of RBI in agricultural credit was found in the establishment of Agricultural Credit Department (ACD).

The primary functions of ACD are

- To Coordinate the functions of RBI with other banks and state cooperative Banks in respect of agricultural credit
- To maintain expert staff to study all the questions of agricultural credit and be available for consultation by central government, state governments, schedules commercial banks and state cooperative Banks.
- To provide legislations to check private money lending and checking other malpractices.

All India Rural Credit Survey Committee (AIRCSC) under the chairmanship of Sri. Gorwala in 1954 suggested several recommendations with regard to the activities of RBI in the sphere of rural credit. Based on this two funds were established after amending RBI act, 1934.

1. **National Agricultural credit (Long-term operations) fund-1955:** Started with initial capital of Rs.10 crores and annual contribution of Rs.5 crores and later this was increased to Rs. 15 crores. This fund was meant to provide long–term loans to various state governments so as to enable them to contribute to the share capital of different

types of cooperative societies including Land Mortgage Banks (LMB's). Loans and advances out of this fund are made to state governments for period not exceeding 20 years.

2. **National Agricultural credit (Stabilization fund)-1956:** Started with RBI's initial contribution of Rs. 1 crore and subsequent annual contribution of Rs. 1crore. This fund is utilized for the purpose of granting medium-term loans to State Co-operative Banks (SCB's), especially during the times of famines / drought and other natural calamities when they are unable to repay their loans to RBI.

The state and central cooperative banks and PACS in turn provide a similar facility to the farmer borrowers regarding short-term production loans taken for crops affected by the natural calamities. This helps the farmers in getting additional finance at the same time reducing their burden of repaying the loans immediately.

The role/functions of RBI in the sphere of rural credit can be dealt seen under three aspects:

1. Provision of finance
2. Promotional activities
3. Regulatory functions

Provision of Finance:

- Reserve Bank of India provides necessary finances needed by the farmers through the commercial bank, cooperative banks and RRB's on refinance basis.
- It advances long-term loans to state governments for their contribution to the share capital of the cooperative credit institutions like State Cooperative Banks (SCB's) and District Cooperative Central Banks (DCCB's).
- It advances medium-term loans to State Cooperative Banks.
- It extends refinance facility to the RRB's only to an extent of 50 per cent of outstanding advances.

Promotional activities:

Reserve Bank of India constitutes study teams to look in to the organisation and operation of the cooperative credit institutions all over the country. It also conducts number of surveys and studies pertaining to rural credit aspects in the country.

The RBI felt that the cooperatives are the major force in the field of agricultural credit and based on that following policies/measures were framed for the strengthening of cooperatives

- Reorganisation of the state and central cooperative banks on the principle of one apex bank for each state and one central bank for each district.
- Rehabilitation of those central cooperative banks, which are financially weak due to mounting over dues, insufficiency of internal finances, untrained staff, poor management etc.
- Strengthening of PACS's to ensure their financial and operational viability.
- Arranging suitable training programmes for the personnel of cooperative institutions.

Regulatory functions:

- Reserve bank of India is concerned with efficiency of channels through which credit is distributed.
- Banking Regulation Act, 1966 makes the RBI to exercise effective supervision over cooperative banks and commercial banks.
- As per the Credit Authorised Scheme (CAS) of 1976, the cooperative banks should get prior authorisation/ acceptance from RBI for providing finances beyond a certain limit.
- The cash liquidity ratio (CLR) and cash reserve ratio (CRR) are fixed by RBI for cooperatives, farmers service societies (FSS), regional rural banks (RRB's) and agricultural development banks (ADB's) at lower level than those fixed for commercial banks. For these cooperative banks the bank rate 3 per cent less than that of commercial banks.

They are permitted by RBI to pay 0.5 per cent higher rate of interest on deposits.

Credit Control/ Credit Squeeze:

The term credit control or credit squeeze indicates the regulation by monetary authority i.e. RBI, on the volume and direction of credit advanced by the banking system, particularly the commercial banks.

At times of inflation, credit control operations aim at contraction of credit while during deflation they aim at expansion of credit. There are two methods of credit control

1. **Quantitative (or) General Credit control**: Aims to regulate the amount of bank advances i.e. to make banks to lend more or less.
2. **Qualitative (or) Selective credit control**: Aims to divert the bank advances in to certain channels or to discourage them from lending for certain purposes. These controls, in recent times assumed special significance, especially in under developed economies.

Credit Rationing: It is nothing but rationing of loans by non-price means at times excess demand for credit. Ex: under variable capital-asset ratio the RBI fixes a ratio of capital to the total assets of the commercial banks.

Some of the important terms pertaining to RBI:

- **Bank Rate:** This is the rate at which central bank (RBI) lends money to other banks or financial institutions. If the bank rate goes up, long-term interest rates also tend to move up, and vice-versa. Thus, it can said that in case bank rate is hiked, in all likelihood banks will hikes their own lending rates to ensure that they continue to make profit.
- **Repo rate and Reverse Repo rate:**
  Repo (Repurchase) rate is the rate at which the RBI lends short-term money to the banks against securities. When the repo rate increases borrowing from RBI becomes more expensive. Therefore, we can say that in case, RBI wants to make it more expensive for the banks to

borrow money, it increases the repo rate; similarly, if it wants to make it cheaper for banks to borrow money, it reduces the repo rate. Reverse Repo rate is the rate at which banks park their short-term excess liquidity with the RBI. The banks use this tool when they feel that they are stuck with excess funds and are not able to invest anywhere for reasonable returns. An increase in the reverse repo rate means that the RBI is ready to borrow money from the banks at a higher rate of interest. As a result, banks would prefer to keep more and more surplus funds with RBI.

- **Fiscal Responsibility and Business Management:**
  The FRBM act is a fiscal sector legislation enacted by the government of India in 2003, aiming to ensure fiscal discipline for the centre by setting targets including reduction of fiscal deficits and elimination of revenue deficit. It is a legal step to ensure fiscal discipline and fiscal consolidation in India.
- **Moral Suasion:**
  Moral suasion and credit monitoring arrangement are other methods of credit control. The policy of moral suasion will succeed only if the Central Bank is strong enough to influence the commercial banks. In India, from 1949 onwards, the Reserve Bank has been successful in using the method of moral suasion to bring the commercial banks to fall in line with its policies regarding credit. Publicity is another method, whereby the Reserve Bank marks direct appeal to the public and publishes data which will have sobering effect on other banks and the commercial circles.
- **Statutory Liquidity Ratio (SLR):** This term is used by bankers and indicates the minimum percentage of deposits that the bank has to maintain in form of gold, cash or other approved securities. Thus, we can say that it is ratio of cash and some other approved securities to liabilities (deposits) It regulates the credit growth in India.
- **Cash Reserve Ratio (CRR):** Cash Reserve Ratio is a specified minimum fraction of the total of customers deposits, which commercial banks have to hold as reserves either in cash or as

deposits with the central banks. CRR is a crucial monetary policy tool and is used for controlling money supply in an economy.

- **Open Market Operations:**

  Open market operations refer to the sale and purchase of securities by the Central bank to the commercial banks. A sale of securities by the Central Bank, i.e., the purchase of securities by the commercial banks, results in a fall in the total cash reserves of the latter).

  A fall in the total cash reserves is leads to a cut in the credit creation power of the commercial banks. With reduced cash reserves at their command the commercial banks can only create lower volume of credit. Thus, a sale of securities by the Central Bank serves as an anti-inflationary measure of control.

National Bank for Agricultural and Rural Development (NABARD):

Genesis / Origin:

Agriculture Refinance and Development Corporation (ARDC) had not made an expected dent / impact in the field of direct financing and delivery of rural credit against the massive credit demand for rural development. As a result many committees and commissions were constituted like,

* Banking commission in 1972

*National Commission on Agriculture (NCA) in 1976

* Committee to Review Arrangements for Institutional Credit in Agricultural and Rural Development (CRAFICARD) in 1979. This CRAFICARD, under the chairmanship of Sri. B. Sivaraman, a farmer member of planning commission recommended the setting up of a national level institution called NABARD for providing all types of production and investment credit for agriculture and rural development. As a result of CRAFICARD'S recommendations NABARD come in to existence on July 12^{th}, 1982.

The then existing national level institutions such as Agricultural Refinance and Development corporation (ARDC), Agricultural credit Dept (ACD) and Rural Planning and Credit Cell (RPCC) of RBI were merged with NABARD with a Share capital of Rs.500 crore equally contributed by Government of India and RBI. NABARD operates through its Head Office at Mumbai and 17 regional offices-one each in major states, 10 sub-offices in smaller states / U.T'S and 213 district offices.

Board of Management:

Central Government in consultation with RBI appoints all the directors in the "Board of Management "along with the chairman and the Managing Director (MD). The M.D. is the chief executive officer (C.E.O) of NABARD and he is primarily responsible for the various operations of the bank. Apart from M.D & Chairman, the Board of Management consists of 13 other directors and these directors will act as "Advisory council" of NABARD. Of the 13 directors of Advisory council

- 2 are experts in Rural Economics & Rural Development.
- 3 are representatives of co- operatives
- 3 are representatives of commercial banks
- 3 are the officials of Government of India
- 2 officials belong to State Governments

Sources of funds:

Authorized share capital of NABARD is Rs. 500 crore equally contributed by Government of India and RBI. Issued and paid up capital of Rs. 100 crore. Other sources are:

- Borrowings from Government of India (GOI) and any institution approved by GOI
- Borrowings from RBI
- Deposits from state Govts & local authorities
- Gifts & grants received.

Objectives:

As an apex refinancing institutions, NABARD survey & estimate all types of credit needed for the farm sector and rural development

- Responsibility of promoting and integrating rural development activities through refinance.
- With the approval of Govt. of India, NABARD also provide direct credit to any institution or organization or an individual.
- Maintaining close links with RBI for guidance and assistance in financial matters.
- To act as an effective catalytic agent for rural development i.e in formulating appropriate rural development plans and policies.

Functions/activities of NABARD:

The functions / activities of NABARD are of 3 broad categories

a) Credit activities
b) Development activities
c) Regulatory activities

a) Credit activities:

- NABARD prepares for each district a potential liked credit plan annually and this forms the basis for district credit plan.
- It participates in finalization of annual action plan at block, district and state level.
- It monitors the implementation of credit plans.
- It frames the terms and conditions to be followed by credit institutions in financing rural farm and non- farm sectors.
- It provides refinance facilities. Refinance is of two types

1. Short-term refinance is extended for Agricultural production operations and marketing of crops by farmers & farmers cooperatives, marketing and distribution of inputs like fertilizers, seeds, pesticides etc. and production and marketing activities of village and cottage industries.

The eligible institutions for S.T refinance are state Cooperative Banks (SCB's), Regional Rural Banks, Commercial Banks and other banks approved by RBI. The time period is 12 months.

2. Medium term & long term refinance is extended for investments in agriculture and allied activities such as minor irrigation, farm mechanization, dairy, horticulture, for investment activities of rural artisans, small scale industries(SSI) etc. The period is up to a maximum of 15 years. The eligible institutions are Land Development Banks(LDB's).

The extent of refinance under various schemes is

- Pilot rainfed farming projects (100%)
- Wasteland development scheme of individuals (100%)
- Non-farm sector schemes (out side the purview of IRDP) 100%
- Agro-Processing units (75%)
- Bio-gas Scheme (75%)
- All other schemes including IRDP(70%)
- Farm mechanization (50%)
- Rural Electrification Corporation (50%)
- Apart from refinance, NABARD also provides direct finance to state governments, state sponsored corporations.

NABARD will monitor its assisted project in order to ensure their proper implementation. It also undertakes consultancy work for projects even though they are not refinanced by NABARD.

b) Development activities:

For the productive use of credit the following developmental activities are under taken by NABARD.

- Institutional Development: Providing financial assistance for establishment and development of institutional financial agencies.
- Research and Development Fund: Providing funds for research and development efforts of institutional financial agencies.

- Agricultural & Rural Enterprises Incubation Fund (AREIF): For providing assistance while inception of new enterprises.
- Rural Promotion Corpus Fund (RPCF): It is meant to provide financial assistance for training cum production centres, rural entrepreneurship development programmes, and technical monitoring & evaluation centres.
- Credit and Financial Services Fund (CFSF): It aims at providing the assistance for innovations in rural banking and credit system, supports institutions for research activities, surveys, meets etc.
- Linking SHG'S to Credit institutions: During the year 1992, NABARD started the pilot project of linking SHG'S to credit institutions. Under this it provides 100 percent refinance to banks for loans extended to SHG'S.

c) Regulatory activities

As an apex development bank, NABARD shares with RBI, some of the regulatory & supervisory functions in respect of cooperative banks and regional rural banks (RRB'S). They are

- Under Banking regulation act 1949, NABARD undertakes the inspection of RRB'S & Cooperative banks (other than PAC'S)
- Any RRB (or) cooperative bank seeking permission of RBI, for opening branches needs recommendation of NABARD.
- The state & district central cooperative banks also need an authorization from NABARD for extending assistance to units outside the cooperative sector & non -credit cooperatives for certain purposes beyond the cut-off limit.