

REGULATION OF CREDIT BY THE RESERVE BANK OF INDIA AND ITS EFFECTIVENESS

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EFFECTIVENESS of monetary policy is closely related to the degree of integration of the economy and the extent to which commercial banks are the only or main source of credit. Modern commercial banks in India began as financial counterparts of modern business, i.e. English business in the larger Indian ports and cities. At this time there existed within the country a well-developed indigenous financial system. Since the beginning of the 20th century modern commercial banking began to play a progressively important part in Indian business. Even so, the Central Banking Enquiry Committee (1931) noted that: "In India there are two money markets, namely, the Indian money market or the bazar, and the market controlled by banking institutions working on western lines."

The indigenous system had two main divisions: (1) The rural moneylending-trading system and (2) the urban financial system. The latter was originally concerned with even such matters as revenue farming and finance of governments. However, its main residual function in the 19th century was the finance of internal trade. It also played considerable part in finance of industrial growth notably in centres like Ahmedabad. Since 1940 the movement towards transformation of the older types of indigenous banking establishments into commercial banks has been rapid and an urban indigenous financial system which functions independently and has considerable independent sources of finance may be said no longer to exist. Ordinarily large urban modern Indian business may now be taken to be fairly well integrated on its financial side and to be dependent for working funds essentially on commercial banks. An element of non-integration as between the activities of the larger and the smaller businesses may still exist. This is to the extent that smaller businesses cannot yet always have recourse to the banks and have to seek services of other financial intermediaries. Elements like the Multani Shroffs with part independent financial resources continue to operate in the market, though on a relatively diminishing scale. However, these financial intermediaries usually draw, at least a part of their supplies from the banking system.

A new disturbing factor has, at the same time, emerged. This is