

## Credit Controls in India with Special Reference to Agricultural Commodity Prices

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*This paper attempts to assess the influence of selective credit policies on bank credit and their impact, in turn on prices for selected agricultural commodities rice, wheat, sugar, cotton, jute and groundnut. The study observes that for all commodities, price changes with a lag of one or two months activate Selective Credit Controls (SCCs). Tightening of SCCs has a negative and significant impact on the real outstanding bank credit of rice, wheat, sugar and jute. The ratchet effect of the lagged real bank credit on the current level has been found significant in all commodities. The real outstanding bank credit, a proxy for stock, has a negative influence on commodity prices.*

### 1 Introduction

The Reserve Bank of India (RBI) issues directives<sup>1</sup> to the Scheduled Commercial Banks from time to time to regulate credit against security of agricultural commodities<sup>2</sup> to restrain speculative activity and thereby help to stabilise prices. The controls are applied to commodities whose prices are sensitive to supply - demand imbalances. The three basic instruments of controls, namely, margin against value of security of stocks, credit ceiling and interest rate, are used in combination to regulate credit against stocks of sensitive commodities.<sup>3</sup> The intensity of the use of these instruments varies between intra season and inter year depending upon the output and the price situation.

In this paper an attempt is made to assess the influence of selective credit policies on bank credit against commodity stocks and its impact, in turn, on prices. As the objective of selective credit controls is to regulate trade credit with a view to stabilise prices three inter related aspects are examined.<sup>4</sup> They are firstly, the seasonal nature of operation of Selective Credit Controls (SCCs) against trade credit, secondly, the influence of SCC regulations on the real outstanding bank credit against trade stocks advanced by the Scheduled Commercial Banks<sup>5</sup>, and finally, the impact of real outstanding bank credit, a proxy for stocks held under SCC financing on prices. The seasonal aspects are studied based on monthly information for the period broadly from

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<sup>1</sup> Refers to the policy directives issued by the RBI under Section 21 of the Banking Regulation Act, 1949.

<sup>2</sup> The commodities currently covered under SCC are (i) Foodgrains: (a) Paddy and rice, (b) Wheat, (c) Other foodgrains; (ii) Oilseeds: (a) groundnut, (b) Rapeseed/Mustard seed, (c) Castor seed; (iii) Oils: (a) Groundnut oil, (b) Rapeseed/Mustard oil, (c) Castor oil, (d) Linseed oil, (e) Vanaspati; (iv) Sugar/Gur/Khandasari; and (v) Cotton and Kapas. Raw Jute has been removed from the SCC in April 1971.

<sup>3</sup> Chakravarty Committee Report (1985), p. 269.

<sup>4</sup> Other issues like credit fungibility, fixation of margin, credit ceiling and interest rate, efficacy of various other forms of controls and whether Government interference is desirable or not have not been examined in this study.

<sup>5</sup> A Scheduled Commercial Bank is one that is registered in the Bank Schedule of the RBI upon fulfilling certain conditions pertaining to the amount of paid-up capital and the conduct of business.