Report of the Committee on Differential Interest Rates

Reserve Bank of India
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REPORT OF THE COMMITTEE
ON
DIFFERENTIAL INTEREST RATES

At his meeting with the Chairman/Custodians of the public sector banks on July 22, 1970, the Finance Minister, Shri Y. B. Chavan, made the suggestion that lower interest rates should be charged to carefully selected low-income groups, who deserve financial assistance for productive endeavour but cannot easily negotiate with banks, while higher rates may be charged to the more affluent borrowers. In pursuance of this suggestion, the Reserve Bank of India constituted, in September 1970, the following Committee to examine the question of differential interest rates :

1.	Dr. R. K. Hazari, Deputy Governor, Reserve Bank of India, Bombay.	*Chairman*
2.	Shri K. P. J. Prabhu, Custodian, Canara Bank, Bangalore.	*Member*
3.	Shri T. R. Varadachary, Managing Director, State Bank of India, Bombay.	*Member*
4.	Dr. A. M. Khusro, Professor, Institute of Economic Growth, Delhi.	*Member*
5.	Shri T. R. Shah, Economist, United Bank of India, Calcutta.	*Member*

6. Dr. Ashok Mitra, *Member*
Chief Economic Adviser,
Government of India,
Ministry of Finance,
Department of Economic Affairs,
New Delhi.

7. Shri M. Narasimham, *Member*
Secretary,
Reserve Bank of India,
Bombay.

2. The Committee's terms of reference are :

(1) To review the scope and the extent to which differential interest rates are already being charged by banks to borrowers in each sector.

(2) To determine the criteria for identifying the borrowers who could be granted the benefit of a lower interest rate within each sector.

(3) To indicate the range of the differential that could be allowed in each sector.

(4) To examine if any other concessions could be granted either in lieu of or in addition to lower interest rates.

3. The Committee first met on October 17, 1970 at Bombay. There were six subsequent meetings of the Committee.

4. While interest is only one element in total costs, the burden it constitutes could bear quite heavily on small and weak borrowers. At present the small borrowers get credit from banks at rates somewhat lower, in general, than large borrowers. This by itself does not indicate that there is no regressiveness in the burden of rates. The principal justification for charging lower interest rates to certain categories of borrowers is that the credit system would thereby explicitly recognise the fact that the investment activity of the small man does not, in the short run, always yield a return which would enable him to service loans made at conventional rates of interest and at the same time, meet his minimum consumption requirements. The interest rate mechanism, by itself, however, provides rather limited scope for redistributive policies. The day-to-day operations of bank offices, which require close attention to details, make for practical difficulties

in the pursuit of such wider objectives. Any wide-ranging scheme of selective subsidies introduced through the interest rate mechanism would pose practical policy and operational problems for the commercial organisations that banks are, and have far-ranging implications for bank earnings as well as financial policies and practices. In the present context of rapid extension of the geographic and functional operations of banks, the need to arrest any declining trend in profits and to strengthen reserves is all the greater.

5. In the opinion of a majority of the members of the Committee, the present pattern of differential between sectors, brought about through deliberate policy (described below) has already added a new dimension to the distribution of bank credit. In particular, the establishment of bank branches in hitherto unbanked and under-banked centres has already begun to narrow the difference between the interest rates prevailing in the organised and unorganised sectors. While it could be argued that this difference is sometimes notional, inasmuch as the prohibitive cost of credit in the unorganised market in effect shuts out some potential borrowers, it cannot also be denied that the extension of banking has created the essential pre-conditions for the easier availability of credit to an increasing segment of the population, both rural and urban.

Terms of Reference —No. 1

6. In recent years, an element of differential has been introduced in the interest rates charged to certain selected priority sectors. Thus, since August 1967, the Reserve Bank of India has prescribed a maximum rate on credit extended by banks to exporters.* Under the scheme for financing of primary co-operative societies by commercial banks in selected areas, banks are required to provide such loans at $7\frac{1}{2}$ per cent.† In regard to credit extended to both these sectors, banks are entitled to some concessional refinance from the Reserve Bank of India.

* To begin with, a distinction was made between types of export credit and categories of commodities for the purpose of a maximum interest rate. Packing credit to exporters of engineering and metallurgical products had to be provided at 6 per cent, and to exporters of other commodities at 8 per cent, while on rupee export bills, the maximum rate specified was $1\frac{1}{2}$ per cent above the Bank rate. Subsequently (in March 1968), the distinction was abolished and all types of export credit were required to be provided at not more than 6 per cent. With the changes in the interest rate structure following the increase in the Bank rate (January 1971), this ceiling has been raised to 7 per cent with effect from April 16, 1971; for credits to exporters on deferred payment terms, however, the ceiling rate of 6 per cent continues.

† The interest rate for the ultimate borrower from these primary societies works out to around 9 per cent.

The Industrial Development Bank of India also provides refinance on concessional terms for certain types of export credit. Further, in the case of export finance, a subsidy of 1½ per cent is provided by the Government. Also, there is in export credit, a built-in flow of additional income through exchange commission which compensates to some extent, though not fully, for the loss in earnings caused by the charge of lower interest rates. In the case of yet another priority sector, small-scale industry, there is neither a directive on maximum interest rate chargeable,* nor a subsidy, nor any automatic source of additional income. Nevertheless, banks have generally been charging all borrowers who are within the official definition of small-scale industry, a rate ½ to 1 per cent lower than that charged to other sectors. In addition, a few banks also absorb the commission payable for the blanket guarantee cover provided for all loans to this sector. Some of the special schemes introduced by some banks for assisting the self-employed and new entrepreneurs also have an element of interest differential. Since the cost of servicing or administration of loans to small borrowers is more than that of loans to large industry and trade, the effective additional cost to banks on account of lending to priority sectors is greater than is indicated by the lower level of interest rates for borrowers in these sectors.

7. Apart from this, there is a long-standing traditional form of differential related to the type of loan or security provided. For instance, hypothecation loans generally carry around ½ to 1 per cent higher interest than pledge loans. Some other factors too have brought about a degree of differential and the same rate does not always apply to similar types of loans in all sectors or to all borrowers within a certain sector, mainly due to historical reasons. The length and type of association of borrowers with banks, the age and size of the accounts, any additional advantage that might be derived through a loan such as foreign exchange business, etc., are considerations which lead sometimes to a small reduction in the rates charged to particular customers. This sort of preferential treatment is losing its prominence since interest rates are subject to review at the time of renewal of limits and upward revisions have been effected in most cases.

8. There has, however, been no attempt so far to assist weaker borrowers *within* any sector through reduced interest charges. In

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* Except that in regard to term loans refinanced by the Industrial Development Bank of India, banks cannot charge more than 7 per cent in the case of small industries in backward areas and 8½ per cent for those in other areas. In both these cases, Industrial Development Bank of India refinance is available on concessional terms.

attempting to work out a scheme of intra-sectoral differential rates, the Committee would proceed on the implicit basic assumption that a reduction in interest to some borrowers should not adversely affect the earnings of banks. There should hence be a matching rise in the cost of credit extended to other borrowers, to cover both the fall in income because of the provision of selective cheaper credit and the rise in costs that would follow from the administration of a number of small loan accounts, so that the average net earning rate remains substantially the same, given the policy regarding the level of interest rates.

9. The two statements appended show the distribution of the advances of the State Bank of India and the 14 nationalised banks, according to purpose and rate of interest, as at the end of December 1969. It may be seen from these statements that 36 per cent of total bank lending and 51 per cent of the total number of borrowal accounts were then charged between 9 per cent and 10 per cent. The range of 8 to 9 per cent was the next most significant, accounting for around 33 per cent of total credit and 22 per cent of borrowal accounts. Separate data in respect of small-scale industry are not available, but it is likely that most of the loans to this sector would have been provided within the latter interest range. Bank lending at below 6 per cent and above 10 per cent was negligible and even the loans at 6 per cent were apparently mainly for exports. Changes in monetary policy effected since the date to which these data relate would have had the effect of altering the distribution pattern to some extent. In Janaury 1970, the ceiling restriction (9½ per cent) on interest on bank advances was removed and there was consequently some increase in the lending rates. A minimum lending rate of 10 per cent for advances against certain sensitive commodities was prescribed in January 1970 and in respect of advances against oilseeds and cotton and *kapas*, this minimum rate was further raised to 12 per cent in April 1970. With the rise in the Bank rate in January 1971, banks have been advised that in making consequential adjustments in their lending rates, they should ensure that, on an average, the increase in the rates charged by them is only 1 per cent. The cumulative result of all these developments would be an increase of 1 to 2 per cent in the present average rate of bank lending as compared with the end-1969 position.

Terms of Reference —No. 2

10. In viewing the question of intra-sectoral differentials as a whole, the Committee has decided to confine the scope of preferential interest rates to those sectors in which, by common knowledge, the economically handicapped are preponderant. While it cannot be denied that there

are " weak " borrowers in every sector, it cannot also be argued that all these are equally weak and handicapped and in equal need of concessional finance. It has hence been assumed that for the purpose of preferential interest rates, borrowers from the sectors of agriculture, small-scale industry, small business, transport operators and professionals would be taken into consideration.

11. The question that comes up next is that of identifying the borrowers in each of the selected sectors for the purpose of applying the differential. Various criteria would suggest themselves such as the size of holding in the case of agriculturists, the total resources of the borrower, his " background " and the alternative sources of income or finance that may be available to him, etc. The criterion selected has to be clear, objective and administratively practicable. The " means " or " background " of a person can seldom be accurately or objectively determined. Any extension of credit based on an investigation for this purpose is liable to be balked by one of two difficulties. If the decision-making on loan proposals is to be decentralised and left to the discretionary powers of branch agents, there are bound to be wide divergences between branches leading to complaints about misuse of powers by agents. On the other hand, should the decisions in regard to low interest loans be centralised at the Head Office, the process would involve so much delay as to nullify the benefit of the lower charge.

12. The majority of the Committee feels that a relatively more objective criterion for the identification of the borrowers to be given the advantage of interest differential is necessary for the feasibility of the scheme. This criterion can only be the size of the loan which need not necessarily be uniform for all sectors. The assumption implicit in this—that only the smaller man asks for small loans while the bigger and stronger borrowers would require larger credit facilities—admittedly has its limitations. Nonetheless, this would seem to be the best of the various alternatives available.

13. As a measure of automaticity for the selection of small borrowers, the Committee suggests that the scheme for differential interest rates should be linked with the new Credit Guarantee Scheme for covering small loans to borrowers in the priority and neglected sectors. This Credit Guarantee Scheme is framed to provide a simple but comprehensive system of guarantees or comparable facilities for encouraging bank assistance to small borrowers in the priority and neglected sectors. This is in addition to the Credit Guarantee Scheme for Small-scale Industries, which has been in operation since July 1960. The new

guarantee scheme differs from the old mainly in regard to coverage. Although both the old and the new schemes provide for payment to the credit institution in respect of the guarantee, of 75 per cent of the 'amount in default',* in the case of the new scheme, the 'amount in default' has been so defined as to enable the Guarantee Corporation to meet, as far as possible, only actual losses on account of the eligible loans. The guarantee fee for loans to small-scale industries (old scheme) is one-tenth of 1 per cent and that for other sectors (new scheme) is one-half of 1 per cent. A Credit Guarantee Corporation has been set up and has begun to function from April 1, 1971 as the guarantee organisation in respect of all selected sectors other than small-scale industries, for which the scheme would continue to be operated by the Industrial Finance Department of the Reserve Bank of India on behalf of the Central Government. The eligibility conditions for categories of borrowers and the limits for guarantee cover, under both the Guarantee Scheme for Small-scale industries and the Small Loans Guarantee Scheme are as follows :

I. Credit Guarantee Scheme for Small-scale Industries

Credit facilities to units whose investment in plant and machinery does not exceed Rs. 7.50 lakhs are eligible for guarantee cover. The Scheme provides for payment of 75 per cent of the amount in default or the amount guaranteed, whichever is lower. The maximum amount payable to the credit institution under the guarantee is limited per borrower to Rs. 7.50 lakhs in respect of working capital advances and Rs. 2.50 lakhs in respect of term loans.

II. Small Loans Guarantee Scheme—
(a) Transport Operators

Credit facilities granted to an individual operator or association of not more than six persons owning and operating a transport vehicle, including rickshaw, cart, boat, barge, etc. for carrying passengers or goods, and where

* 1. In the case of the Guarantee Scheme for Small-scale Industries, 'amount in default' means any amount in respect of a guaranteed advance remaining unpaid, the borrower having failed to discharge his obligations to repay the dues when called upon to do so. (In respect of loans repayable in instalments, the 'default' can be deemed to have occurred when an instalment has not been paid on the due date or when any terms and conditions governing the grant of the loan have not been complied with and the loan has been recalled in pursuance of such terms.)

2. In regard to the Guarantee Scheme for small loans, only that amount on account of an eligible credit facility which has been treated by the credit institution as bad or doubtful of recovery and has been provided or accounted for as such in the books of the institution, is treated as 'amount in default'.

the amount of the loan granted to the operator does not exceed Rs. 50,000, are eligible for guarantee cover. The amount payable to the credit institution under the guarantee is restricted to 75 per cent of the amount in default.

(b) Traders in goods other than fertilisers

Credit facilities granted to a trader, not assessed to sales tax, or if assessed, does not have an annual turnover of more than Rs. 1 lakh, are eligible for guarantee cover. The amount payable to the credit institution under the guarantee is restricted to 75 per cent of the amount in default or Rs. 15,000, whichever may be lower.

(c) Traders in fertilisers

Credit facilities granted to a trader not assessed to sales tax, or if assessed, does not have an annual turnover of more than Rs. 2 lakhs, are eligible for cover. The amount payable to the credit institution under the guarantee is restricted to 75 per cent of the amount in default or Rs. 30,000, whichever may be lower.

(d) Professional and Self-employed persons

Credit facilities to professional and self-employed persons granted to a medical practitioner (including dentist), chartered accountant, cost accountant, lawyer or solicitor, engineer, architect, surveyor, construction contractor or management consultant or to a person trained in any other art or craft or a technically qualified person or to a firm, the members of which are individuals severally eligible for credit facilities indicated above, are eligible for guarantee cover provided :—

(*i*) the loan does not exceed Rs. 1 lakh in the case of an individual or firm of construction contractors or an individual or firm owning or establishing a medical nursing home or clinic,

(*ii*) the loan does not exceed Rs. 50,000 in the case of an individual or firm of engineering consultants or architects,

(*iii*) the loan does not exceed Rs. 20,000 in any other case.

The amount payable to the credit institution under the guarantee is restricted to 75 per cent of the amount in default.

(e) Business enterprises

Credit facilities to any individual or firm who owns and manages a business enterprise, mainly for the purpose of providing any service not being a professional service, covered by item (d) above, and where the original cost price of the equipment to be used for the purpose of business does not exceed Rs. 50,000, are eligible for guarantee cover. The amount payable to the credit institution under the guarantee is restricted to 75 per cent of the amount in default.

(f) Farmers and agriculturists

Credit facilities granted to any individual who is owner, tenant or lessee of any land or who has any interest in such land, or engaged in sericulture, animal husbandry, poultry farming, fruit or vegetable or flower gardening or pisciculture including catching of fish, etc., are eligible for guarantee cover, provided the amount of credit facility is not in excess of Rs. 1,000 for financing seasonal agricultural operations, or Rs. 5,000 if the facility is required for developmental purposes, acquisition/installation of pump-sets, machinery, equipment or other capital assets.

However, higher limits not exceeding Rs. 50,000 (to be notified from time to time by the Credit Guarantee Corporation), if required for acquiring a mechanised boat for catching fish or an insulated vehicle for transporting fish, or for acquiring cattle, equipment, etc., for carrying on the business of sericulture, animal husbandry, poultry farming or dairy farming, are also eligible for guarantee cover.

The amount payable to the credit institution under the guarantee is restricted to 75 per cent of the amount in default.

14. It is conceivable that some leakage could occur by a single party obtaining several lines of cheap credit from various bank offices. The linking of preferential interest rates with the Credit Guarantee Schemes with their procedures for proper checks should, however, be expected to prevent such leakage. Under the Small Loans Guarantee Scheme, a borrower who has failed to repay any loan obtained from a credit institution leading to a claim on the Guarantee Corporation will not be eligible for any fresh facilities so long as earlier dues are outstanding. Should any such facility be unwittingly allowed by any institution, it will not have the protection of guarantee. The " Note explaining the salient features of the Scheme " * states, " Credit institutions are expected to ensure in their own interests that they do not assist any party who is in default in meeting his liabilities to any other institution. They will normally be able to obtain information in regard to credit facilities granted by other institutions by asking for it in the application forms at the time that the credit facility is granted and later on at quarterly or other intervals. Independent enquiries should also be made from time to time with a view to verifying the particulars furnished by the borrowers, so that credit institutions may be in a position to protect their own interests." The Note also says, " Credit institutions are expected to satisfy themselves about the integrity of the borrower and the genuineness of his requirements. The project or purpose is expected to be productive or socially useful and to yield a surplus from which the loan can be repaid." Any scheme introducing special benefits on a selective basis only enhances the general need, perhaps more obvious now than ever before, for vigilance and close follow-up.

Terms of Reference —No. 3

15. The next important point to be decided is a range of differential that would be simultaneously beneficial, acceptable and practicable. The majority of the Committee strongly feel that too wide a range of differential would be inadvisable. An unrealistically low minimum would cause a stampede for bank funds, generating pressures which the banks may not be able to withstand. Also, a sudden, sharp lowering of the rate at which funds are available from banks could cause diversion of resources from the organised to the unorganised sector through re-lending. Further, a very low rate at one end of the spectrum would involve the charge of an unusually high rate, at least to some section of borrowers, since the average rate is to continue unaltered, except to the extent dictated by policy changes and other relevant considerations.

* Annexure III, Credit Guarantee Scheme for covering Small Loans to Borrowers in the Priority and Neglected Sectors - Supplement to the Reserve Bank of India Bulletin, February 1971.

16. An immediate practical difficulty in the way of banks charging rates of interest more than 2-3 per cent higher than the current maximum lending rates of banks is the prevailing legislation aimed at regulation of money-lending. In most States, the maximum interest that is permitted by law (and that too in respect of unsecured loans) is around 12 per cent. The Expert (Talwar) Group appointed to study State enactments having a bearing on commercial banks' lending to agriculture has pointed out that although banks are exempt from the purview of most of the State enactments, this exemption is neither uniform nor always clear. The Group, which has examined the question with a wider frame of reference than just the rate of interest, has found that the implementation of all its recommendations would involve many amendments to a large number of State enactments and has hence suggested a single, consolidated piece of legislation.

17. Even if the charge of an interest rate higher than 12-13 per cent were immediately practicable, some possible repercussions would need to be recognised. Logically, this high rate would have to fall on the bigger borrowers—mainly, medium and large industry and trade. The argument that substantially higher rates of interest could be easily borne by these borrowers would be valid only to the extent to which they enjoy a surplus because of scarcity conditions or monopoly/oligopoly situations and where the buyer is already being charged what he can bear. Here higher interest rates would cut into the surplus and would indeed be socially justifiable. However, not all cases are of the above type. In several instances, the scope for transmission of higher costs to consumers is very great. This is especially so in the case of industries where the administered price system permits upward revision on the basis of increases in costs, fixed on a formal or informal basis.

18. Taking these considerations into account and with a view to immediate practicability, the Committee suggests that the lowest interest rate to be charged to any borrower (exclusive of any direct subsidies) should be approximately equal to the ratio that the cost of raising and using funds (i.e., interest charges and operational expenses) bears to total resources (deposits, borrowings and owned funds). With the present structure of interest rates, it is estimated that this rate is, on an average, about 8½ per cent.

19. A further point to be decided is whether the range of differential is to be introduced in slabs—that is, whether different rates should be charged to different groups of borrowers upto some pre-determined limit, which could be a proportion of the total credit extended by a

bank. The Committee is of the view that a single cut-off point (setting apart the preferred borrowers from the others) rather than slabs of credit for different interest rates would be in keeping with the fairly limited differential range it favours. It hence suggests interest rates varying between 8½–10 per cent to the preferred classes of borrowers. To all other borrowers banks may charge such higher rates as they consider appropriate and which are permissible by law and/or indicated by the Reserve Bank; the broad principle of what the traffic can bear and the overall consideration of maximising profitability could be kept in mind in arriving at decisions in individual cases.

20. The precise manner in which a differential interest rate structure could be fitted into the framework of the Guarantee Scheme would have to be worked out as practical experience is gained in the operation of the Credit Guarantee Scheme. As an initial exercise, the following interest rates are recommended for different types of loans in each sector :

(1) *Small Farmers*	
Crop input loans	8½%
Term loans ..	9%
(2) *Small Retail Traders*	
(*a*) For traders on obtaining general hypothecation	9%
(*b*) For traders handling fertiliser distribution	
Key loans	8½%
General hypothecation	9%
(3) *Small Business Concerns*	
Key loans	8½%
General hypothecation ..	9%
(4) *Transport Operators*	
(including operators of rickshaws, taxis, etc.) For acquiring single vehicle (on hypothecation of vehicle):	
For rickshaw, cart, boat, scooter.. ..	8½%
For other vehicles	9½%
(5) *Professionals and Self-employed*	9½%
(6) *Small-scale Industrial Concerns*	

(The differential interest to be applicable only to loans totalling Rs. 2 lakhs or under, both working capital loans and term loans to be considered together for the purpose of the upper limit of loan size.)

Loans for Working Capital	
Key loans	9%
Hypothecation	9½%
Term loans	10%

As a further measure of relief to small borrowers, it is recommended that no distinction be made in the interest rate as between secured (hypothecation) and unsecured advances. Where, however, the borrower is in a position to offer security, the lending bank should avail itself of the same.

21. It is also recommended that the guarantee fees in the case of all borrowers who are granted preferential interest rates, should be borne by the lending bank. The fee is one-tenth of 1 per cent in the case of the existing Guarantee Scheme for Small-scale industries and, one-half of 1 per cent in all other cases. For an individual borrower, the guarantee fee may not amount to much of an additional burden and its transfer to the bank might appear a notional advantage. The small agriculturist, for instance, would still get his loan at 8½ per cent but the earning for the bank on this account would be lower. However, though the amount of total fee in respect of all the loans extended by a bank and provided with guarantee cover could be substantial, this payment also contains an element of savings. The fee paid would constitute an expense for the bank and would hence be deductible for tax purposes. Thus, if the total fee paid by a bank in a year amounts to Rs. 5 lakhs, profits before tax would be reduced by that amount. Had the fee not been paid by the bank, the amount would have been included in gross profits and subject to taxation. At the same time, it has to be conceded that there are some additional charges, incidental to the new Guarantee Scheme, that banks would have to bear. These arise out of requirements such as the separation of all registers, ledgers, etc. pertaining to the guaranteed accounts, perparation of detailed statements of individual accounts every quarter, quarterly verification of eligibility for guarantee cover, etc., all of which would add further to the cost of servicing small loans.

Terms of Reference —No. 4

22. The last of the Committee's Terms of Reference—to examine other concessions that could be granted either in lieu of or in addition to lower interest rates, is of major significance. The normal standards hitherto adopted by banks in regard to types of securities and margins

could prove so restrictive as to offset the advantage of a lowered interest rate. A relaxation of these standards in favour of weaker borrowers is hence essential. The Committee suggests, in addition to experimentation with unsecured loans, the following concessions, more as an indication of the lines along which banks could proceed than as a maximum standard where the loans are secured. These concessions could be applied not merely to the categories of borrowers eligible for concessional interest rates but in other deserving cases as well.

Lower Margins in the case of

(1) Small Farmers	15% to 25% of crop or fixed assets
(2) Small Retail Traders	20% to 25% on the estimated value of stock in trade
(3) Small Business Concerns	10% to 25%
(4) *Transport Operators:*	
For new vehicles	15% of invoice value
For second-hand vehicles not more than 3 years old	25% to 30% of the appraised value
(5) Doctors setting up practice: for purchase of equipment etc. ..	10% of invoice value
(6) *Small-scale Industrial Concerns:*	
(*a*) A Viable New Unit:	
Plant and Machinery	5% to 10%
Raw materials	15% to 20%
Finished products	20% to 25%
(*b*) Established Units:	
Plant and Machinery	10% to 15%
Raw materials	20% to 25%
Finished products	25% to 30%

In actuality, margin requirements may even be entirely dispensed with in deserving cases and loans sanctioned to the extent of the full value of the security offered. This would be of special assistance during the gestation period of projects begun by small entrepreneurs and to small farmers. In such cases, it is important that the borrower should, in course of time, begin to provide a margin and gradually build it up, until he reaches a stage when no concession is needed.

23. Concessions by way of relaxations on security and repayment holidays are also important. In the case of self-employed persons particularly, softer terms could prove even more meaningful than cheaper credit. Depending on merits, unsecured loans could be sanctioned and certain unconventional items also accepted as security. The Committee that reviewed the Special Credit Schemes of Banks has made a valuable suggestion in this regard, that the technical expertise and other non-financial contribution of small entrepreneurs should be given due weightage as security. The repayment schedule of term loans sanctioned to new small industrial units, professionals and self-employed should be worked out realistically, with an initial 'holiday', if necessary.

24. The suggestions made in the preceding paragraphs have immediate relevance to commercial banks. The Committee is aware that it is not the intention to leave out of consideration the possibility of extending similar concessions to the weaker borrowers from co-operatives. The Committee recommends that the question of co-operative institutions adopting the suggestions made in regard to lower interest rates and adaptation of terms and conditions of loans should accordingly be examined.

25. Dr. Ashok Mitra does not agree with the views of the majority of the Committee expressed in this Report and has appended a Note of Dissent.

26. The Committee wish to place on record their deep appreciation of the excellent work done by the Secretary, Miss Meenakshi Tyagarajan, in the preparation of material and in the drafting of the Report.

R. K. HAZARI	*Chairman*
K. P. J. PRABHU	*Member*
T. R. VARADACHARY ..	*Member**
A. M. KHUSRO	*Member**
T. R. SHAH	*Member*
ASHOK MITRA	*Member*
M. NARASIMHAM	*Member*

BOMBAY, *May* 21, 1971.

* Shri T. R. Varadachary and Prof. A. M. Khusro could not attend the last meeting of the Committee and hence could not sign the Report. They are, however, in agreement with the majority views.

STATEMENT-I

Distribution of Advances of Public Sector Banks According to Purpose and Interest Rate as at the end of December 1969.

(Rs. lakhs)

Interest Rate	Total	Total —Less Exports	Fixed capital for industry	WORKING CAPITAL FOR INDUSTRY				TRADE—WHOLESALE			Agri-cultural Produc-tion finance	Others (includ-ing Retail Trade)
				Finance against inven-tories	Export finance	Import finance	Finance for distri-bution (Inland D.A. Bills, D.P. Bills, etc.)	Agri-cultural commo-dities	Agri-cultural Inputs	Others		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1. Below 6%	26,50 *(1.2)*	25,85 *(1.3)*	2,56	1,11	65	1	33	61	—	52	21	20,50
2. 6% and above but upto 8%	510,21 *(23.4)*	406,36 *(19.7)*	15,38	188,54	103,85	3,96	15,66	17,51	27,47	32,79	30,42	74,63
3. Above 8% and upto 9%	721,71 *(33.1)*	712,75 *(34.6)*	50,84	444,43	8,96	5,45	43,47	7,92	1,30	36,37	43,39	79,58
4. Above 9% and upto 10%	776,03 *(35.6)*	770,91 *(37.5)*	52,90	285,29	5,12	5,23	59,53	23,32	2,94	118,48	22,01	201,21
5. Above 10%	13,32 *(0.6)*	13,26 *(0.6)*	1,16	2,98	6	24	2,59	1,01	11	2,53	1	2,63
6. Unspecified	134,40 *(6.1)*	129,38 *(6.3)*	2,55	5,92	5,02	99	31,13	10,88	9	32,61	33	44,88
7. TOTAL ..	**2182,17** *(100.0)*	**2058,51** *(100.0)*	**125,39**	**928,27**	**123,66**	**15,88**	**152,71**	**61,25**	**31,91**	**223,30**	**96,37**	**423,43**

Note: Figures in brackets relate to percentages to total.

STATEMENT–II

Distribution of Number of Accounts of Advances of Public Sector Banks According to Purpose and Interest Rate (as at the end of December 1969).

Interest Rate	Total	Total —Less Exports	Fixed capital for industry	WORKING CAPITAL FOR INDUSTRY				TRADE—WHOLESALE			Agricultural Production finance	Others (including Retail Trade)
				Finance against inventories	Export finance	Import finance	Finance for distribution (Inland D.A. Bills, D.P. Bills, etc.)	Agricultural commodities	Agricultural Inputs	Others		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1. Below 6%	21,684 *(3.2)*	21,659 *(3.2)*	189	172	25	14	233	123	4	265	1,122	19,537
2. 6% and above but upto 8%	108,456 *(16.1)*	104,135 *(15.6)*	327	6,591	4,321	795	938	385	57	4,169	5,776	85,097
3. Above 8% and upto 9%	148,108 *(22.0)*	147,894 *(22.2)*	2,093	12,883	214	261	3,281	1,263	846	4,442	57,183	65,642
4. Above 9% and upto 10%	341,634 *(50.8)*	341,337 *(51.1)*	2,455	12,290	297	525	6,548	5,087	1,051	27,511	44,898	240,972
5. Above 10%	4,272 *(0.6)*	4,252 *(0.6)*	18	184	20	6	224	260	26	922	44	2,568
6. Unspecified	48,640 *(7.3)*	47,910 *(7.3)*	73	1,183	730	267	5,293	2,944	31	14,009	1,124	22,986
7. **TOTAL** ..	**672,794** *(100.0)*	**667,187** *(100.0)*	**5,155**	**33,303**	**5,607**	**1,868**	**16,517**	**10,062**	**2,015**	**51,318**	**110,147**	**436,802**

Note: Figures in brackets relate to percentages to total.

Note of Dissent

BY

DR. ASHOK MITRA

I regret that I am unable to agree with the conclusions reached by my colleagues regarding the structure of differential lending rates of interest that could be introduced by the banking system. Since my point of view is substantively different from that held by them in several respects, I have thought it proper to append this Note of Dissent to the Committee's Report.

2. I find the suggestion put forth in paragraph 5 of the majority report, namely, that 'a new dimension to the distribution of credit' has already been brought about through the introduction of differential rates between sectors, somewhat unconvincing. In so far as lending rate differentials are intended to provide relief to the economically weaker sections of the community, the current practice of offering loans at preferred rates for exports or to the co-operative societies or—to small industries—does not quite meet the requirements. Exporters are not by and large the struggling segments of society; nor can a policy of according marginally favourable treatment to the primary co-operative societies or the so-called small industrialists be considered *per se* as a major blow for egalitarianism in the distribution of credit.The magnitude of the existing differentials apart, the end-use of the funds flowing to the co-operative societies and the economic background of the parties who obtain the loans intended for 'small industries' need to be analysed before a judgment can be reached on the income-distribution effect of the existing differentials in interest rates. Besides, the 'long-standing traditional form of differential, related to the type of loan or security provided', to which there is a reference in paragraph 7 of the majority report, is, if anything, viciously anti-egalitarian. Borrowers having long-standing association with individual banks have no doubt been often allowed a reduction in the rate of interest charged on their loans. These borrowers, however, scarcely belong to the category of the under-privileged; they have received—and continue to receive—preferred treatment from the banks because of their large incomes and asset-holdings. By offering them loans at favoured rates, the banks are not only perpetuating, but aggravating the inequalities in the distribution of incomes and assets. The purpose of the Committee, if I have understood the spirit underlying the terms of reference set for it, is to suggest a scheme which would at least provide a check to the propagation of precisely such historical perversities.

3. Nor can I endorse fully the proposition that the interest rate mechanism by itself provides limited scope for distributive policies. Aggregate bank advances, after all, today outstrip the Union Government's annual fiscal outlay. If certain social objectives are to be pursued, monetary policy should, therefore, be as efficacious an instrument as fiscal policy. There is a reference in the majority report to 'practical policy and operational problems' involved in enforcing a differential rates structure. But these problems have to be faced if we are to serve faithfully the objectives set for us.

4. I have about equal reservations regarding the position taken by the majority on the criteria to be applied for identifying the borrowers who are to be the beneficiaries of relatively lower interest rates in each sector. It is difficult for me to accept the suggestion that the size of the loan should be the principal determinant of eligibility. As have been seen in the case of the development of small industries, large industrial houses themselves have, in many instances, sponsored so-called small-scale units to evade the provisions of the Industrial Development and Regulation Act. If the smallness of the size of the loan asked for would automatically qualify the loan applicant for being offered a favoured rate of interest, the genuinely needy parties would often be crowded out by those who have the organisation, acumen and ingenuity to set themselves up as small industrialists, small farmers, or small traders. It should be possible to evolve more objective criteria for judging the economic condition of the parties seeking loans. In agriculture, landlessness or the smallness of the size of ownership/operational holdings could be one such criterion. Similarly, in the case of industry, trade and transport, the means and motivation of the party should be amenable for investigation at the local level. The problem, as I see it, is not one of lack of objective criteria for identifying the economically under-privileged. It is administrative: whether branch agents could be trusted to apply these criteria without fear or favour. In view of the wide-ranging discretionary powers already enjoyed by the branch agents, it is difficult to see why one should cavil at burdening them with the further responsibility of identifying the economically weaker parties.

5. Equally difficult to appreciate is the anxiety on the part of my colleagues to link up the procedure of the selection of small borrowers with the new Credit Guarantee Scheme. The integration proposed between this scheme and the one envisaged for differential interest rates is, in my view, neither justifiable nor necessary. I do not consider that just one cut-off point among parties—which is the feature of the

Credit Guarantee Scheme—would be equally appropriate for interest differentials. The structure of varying rates of interest, if it has to make an impact, should have a flexibility of its own. There should be a fair number of cut-off points—and of interest rates—in line with the existing heterogeneity of economic groupings in our society.

6. I am thus unable to agree with the majority of the Committee that too wide a range of differential has to be avoided. My views with respect to this crucial question are elaborated in the subsequent sections. In paragraphs 17-20 of their Report, my colleagues have indicated their preference for rates of interest within the range of $8\frac{1}{2}$ to 10 per cent for the weaker borrowers and by implication, a maximum of 12-13 per cent for the others. Let me quote from the majority Report : " To all other borrowers banks may charge such higher rates as they consider appropriate and which are permissible by law and/or indicated by the Reserve Bank." (Paragraph 19.) Paragraph 17 is, however, more explicit on the inadvisability of raising lending rates higher than 12-13 per cent. The legal difficulty to widening interest rates does not appear insuperable. And if the maximum lending rate is to be left to the discretion of the Reserve Bank of India, perhaps there was then no occasion for the labours of this Committee. As Statement I on the distribution of bank advances attached to their Report shows, the interest rates charged by banks for the overwhelming proportion of their advances were already in the range of 8 to 12 per cent. With the upward adjustment in Bank rate in January 1971, I would suspect this proportion to have gone up. What my colleagues are proposing thus in effect amounts to the maintenance of the existing structure of lending rates with minor modifications here and there. Such *dirigisme*, I feel, would be contrary to the objective behind our terms of reference.

7. Finally, I consider it crucial that along with the commercial banks, the co-operative sector too is brought under the proposed scheme of interest differentials. In the Report of the majority, I am afraid, this point has not received adequate emphasis. Roughly two-thirds of the total institutional loans flowing to agriculture still emanate from the co-operative sector; to leave out this sector from the purview of the differential rates structure would, therefore, mean the exclusion of institutional financing of the bulk of the most important economic activity in the country. It would also lead to the absurdity of two parallel rates structures obtaining in agriculture, with attendant practical difficulties. There is hardly any economic justification for according a kid-glove treatment to the co-operative sector. Unless a fresh look is taken at this sector and the mode of its lending operations,

much of the expectations raised in the countryside would, I am afraid, remain unfulfilled.

8. In what follows, I have attempted to present briefly my own ideas regarding a feasible structure of differential interest rates. For convenience of presentation, I have dealt in Section II with the general pattern of differential rates I have in mind; in Section III, I discuss specifically some of the problems involved in applying the scheme to agriculture.

II

9. The pattern of advances on the part of nationalised banks detailed in Statement I attached to the majority Report indicates that, as of December 1969, excluding the export sector, roughly three-quarters of the aggregate advances were being offered at rates of interest ranging from 8 to 10 per cent. The modal rate of interest then obtaining must, therefore, have been around 9 per cent; it would be approximately 10 per cent following the recent rise in the Bank rate. I agree with my colleagues that a reduction in the interest charged to some borrowers must not adversely affect the overall earnings of banks. The boundary condition should be that there would be no downward deviation from the average rate of return to the banks on credit advanced to individual sectors; it follows that, whatever the range of differentials that may be introduced in lending rates, the average return from total advances should yield at least 10 per cent.

10. The emphasis, according to me, should be on ensuring this minimum return on aggregating advances, and not on, as the majority have suggested, equating the lowest rate of lending to the ratio that the cost of raising and using funds bear to total banking resources. If subsidy to a deserving section of the community can be combined with overall profitability, there is no reason to flinch from such a subsidy. The majority's view appears particularly incongruous since, even today, affluent farmers receive both power and irrigation water considerably below costs.

11. The constraint set for us implies that the aggregate advances should be so distributed over the different groups at varying rates of lending that the overall rate of interest still approximates to 10 per cent. Once the principle of differential rates is accepted, the practical problem then reduces itself to an exercise involving choice among alternative weighted averages. This exercise in weighted averages can, however, be carried out either within a narrow range or by widening the range.

For example, by spreading marginally the present bands of lending rates to the extent of half a per cent or one per cent at either end, it could be claimed that the less privileged sections of the community have been discriminated for and the affluent sections discriminated against. This is basically what the majority of the Committee have pleaded for. There is one imponderable even in such a relatively *simpliste* exercise : if the demand for advances is pronouncedly interest-elastic, a lowering of the rate of interest by as little as ½ per cent for loans to certain groups could lead to an abrupt and perceptible enlargement in the demand for advances. If overall return is not to be affected, it would then be necessary to stiffen further the rates of lending for the relatively more prosperous groups, or, in the alternative, to ration the credit for each group. This caveat notwithstanding, the adjustment in the rates structure called for would still be of a relatively simple character here. It does not connote much of a revolution to raise the rate of interest from 10-11 per cent to, let us say, 12-13 per cent for some sections, just as much as no river will be set on fire if, for some other sections, the rate is lowered from 9 per cent to, say, 8½ per cent, as my colleagues have suggested. Adjustments of this kind would be a fiddle here and a scratch there, and would hardly accord with either the social needs or the social expectations.

12. We need to go much further. Bank advances have been used in the past to foster, nurture and enhance the inequalities of incomes and asset-holdings in society. Those in charge of loanable funds not only diverted the overwhelming proportion of such funds to favoured groups : the funds were offered to these groups also at relatively favourable rates, terms and conditions. If I may reiterate, I regard the task of this Committee as one to provide a scheme for the correction of this historical perversity. True, such perversities cannot be eliminated overnight. There is a certain inertia in the system which we cannot get rid of at one fell stroke : to try to do so might do damage to the production process. It is, however, necessary that we do not err at the other extreme, and shun exploring the range of reforms that are possible to be accomplished in the short run even within the constraints of the given situation.

13. The crux of the problem, according to my colleagues, is the availability of credit and not the rate of interest at which it is offered. This way of looking at things neglects one particular aspect of demand : where the rate of interest appears to be forbiddingly high, prospective creditors in the lower income groups—or who are otherwise economically weak—tend to opt out. The barrier which a high interest rate

structure presents is much more than just a psychological one. A struggling engineer or artisan who wants to prove himself in a small enterprise—and who may initially be lacking the organisational resources, including those for marketing—may find it difficult to attain straightway a rate of return necessary to cover the high interest on loans contracted. For such a person, the possibility of obtaining loan at a relatively low rate of interest is a matter of considerable objective significance.

14. Of course, charging low interest for some loans implies that, for some others, higher rates must be applied. Is this at all practicable ? In this connection, it is relevant to take into account the rates of return obtaining at the other end of the spectrum. In certain sectors of the economy, particularly in trade and commerce, the effective rate of return on investments, it is well known, is as high as 100 per cent, or even more. To suggest that raising the rate of interest for funds advanced to these sectors would, through raising the cost of operations, affect production is a fallacy. In the first place, many of the activities yielding high returns are not productive at all, and so there can be no question of harming production through higher lending rates. My colleagues have argued in paragraph 16 of their Report that the prevailing market conditions for products or service might be such that the incidence of the higher interest would be shifted to the consumers. This need not be the case. In most instances, a limit can be discerned to what the traffic can bear at any given moment; manufacturers, traders and speculators are generally aware of this limit and charge the end-users and consumers accordingly, so that a stiffening of the rate of interest might merely lower the rate of profitability, and not lead to a rise in prices. A lending rate pegged to within 12-13 per cent merely enables a large number of traders, speculators and quasi-manufacturers to enjoy a certain unearned rent. This rent is accruing to them because of their established connections with the banking sector, and because of the rigidity in the rates structure. Those who are currently earning abnormal profits are unlikely either to interrupt their activities or to pass on the extra burden to the consumers if the rate of interest for loans advanced to them is increased from 12-13 per cent to, let us say, 20 per cent; despite the high interest, their profitability, after all, would continue to be high.

15. The advantage of thus raising the lending rate of interest to 20 per cent or thereabout for the bigger borrowers in selected sectors is obvious : it makes it possible to reduce substantially the rate of interest for the less affluent groups without at the same time affecting

the overall return from lending operations. Provided we are able to fix the rate of interest for at least one-fifth of the total advances at 20 per cent, perhaps another one-fifth of the total credit may then be earmarked for the economically deserving groups who could be asked to pay only a commitment charge of, for example, 1 per cent and nothing more; despite this 'departure,' a return of 10 per cent on the total advances could still emerge. The following table will bear this out :

Advances	*Rate of Interest*
1st quintile	20 per cent
2nd quintile	14 per cent
3rd quintile	10 per cent
4th quintile	5 per cent
5th quintile	1 per cent
Total	**10 per cent**

16. Needless to add, this rather crude table is purely for purposes of illustration. One can have several alternative combinations of differential rates, each of which would give a return of about 10 per cent on aggregate advances. The rates of interest can also be placed on a continuum than be discrete as in the example cited. In our quest for a viable structure of differential lending rates, there is thus no need to confine our attention to within narrow bands.

17. In paragraph 17 of their Report, the majority of the Committee have referred to the problem of what is immediately practicable. In the present context, what is feasible should be practicable. Differential lending rates—including, in some instances, loans at even zero interest—are now an established feature of international lending : it should not pose a problem in the case of intra-national lending. At the other end too, in the structure of interest rates pertaining to deposits, there is a well modulated system of differentials : current deposits, for example, fetch zero interest. As long as overall profitability is not affected, it would thus be difficult to justify the mental reservations about a flexible and wide-ranging structure of differentials in lending rates.

18. A few special issues to which reference is made from time to time may, however, be examined. The first pertains to the identification of the less affluent groups for whom the lending rate of 1 per cent is to apply. I have already briefly touched on this point in Section I. It is

not as difficult to locate these groups as it is occasionally made out to be. The poor and the needy are with us and despite national goals and objectives, will continue to be with us for some more time: what is required in our context is to separate the genuinely enterprising amongst them from the rest. The size of the loan asked for should not be the only desideratum applied here, but branch managers should be encouraged to investigate the background of the parties, and satisfy themselves regarding their economic circumstances. The fear of misuse of power by local agents is much over-rated. It is the leadership from the top which is crucial here. Once branch managers know that corruption will not pass, while favoured treatment to the genuinely needy parties will be appreciated by the head office, a vast change in climate is bound to come about.

19. In the second place, it can be argued that if the lending rate is lowered to, for example, 1 per cent for the low-income or economically weaker groups, an excessive crowding of demand for bank credit would occur. As put by the majority of the Committee (paragraph 15): " An unrealistically low minimum would cause a stampede for bank funds, generating pressures which the banks may not be able to withstand. " This again is a misconception. One discipline to be enforced in such a situation is to ask each bank to operate its low-interest loans only upto a pre-determined ceiling. A kind of rationing, based on proper technical-cum-financial appraisal, can ensure that funds are not disbursed for frivolous purposes or to dubious parties. Each bank may be advised to set up a credit appraisal unit, which would have the responsibility for applying the objective norms to identify the genuinely needy parties. The appraisal unit should take into consideration, apart from the size of the loan asked for, the purpose for which it is sought, the background of the party applying, and the alternative sources of finance available to it.

20. National credit planning implies a certain integration with socio-economic planning, involving the allocation of aggregate credit among different sectors and groups in terms of national priorities. Rationing should thus constitute the core of credit planning. If this factor is not reflected in policy, the very rationale of bank nationalisation falls through.

21. Another question raised by the majority of the Committee is about the danger of proliferation of corruption if lending rates are significantly lowered for some groups or individuals. A sharp reduction in the rate of interest, it has been suggested, might cause

diversion of resources from the organised to the unorganised sector through extensive re-lending. This is a matter on which it is possible to have more than one point of view. Corruption reflects, more than anything else, the prevailing social *mores*. If the system is corrupt, the administration of advances at subsidised rates too can certainly get corrupted. Even with the strictest vigilance, there is bound to be some misdirection of resources and some distortion in the flow of cheap funds away from sections whom we want to support to others who hardly need any such support. Corruption *apropos* of bank advances is not absent in the current situation; nor will it be absent in case the scheme proposed by the majority is put into operation. The point at issue is whether the magnitude of corruption is likely to increase or decline following the introduction of the new regime of lending rates, and whether, despite leakages, the net effect of the changed rates structure will be towards tilting the balance of advantage in favour of the less fortunate sections of the community. The argument that the poor should not be offered credit at subsidised rates since such credit is likely to get transferred to the rich would, if stretched, lead one to conclude that all subsidy to the poor is unwise, since all such subsidy is in danger of being diverted to the prosperous ones in society.

22. It has also been stated that if rationing is introduced to choke off excess demand for credit at, say, 1 per cent rate of interest, there will be a large unsatisfied demand even among the deserving, so much so that those obtaining loans at 1 per cent would now constitute a privileged group. But those who do not get credit at 1 per cent would not be altogether shut out: they would qualify for obtaining loans at the next higher slab of interest, and so on all along the line. Besides, a so-called privileged group consisting of the socially most deserving would not be something which is either morally repugnant or, for that matter, economically unsound: it would partly redress the wrong rendered through the decades.

23. In paragraphs 6 and 8 of their Report, my colleagues have invited attention to the rise in costs that might occur as a result of the administration of a number of small-loan accounts. It is difficult to offer any judgment *a priori* in this matter. Whether unit cost of administration will rise in a regime of differential interest rates will partly depend upon the ability of the banks to re-deploy their existing resources to meet the challenge of the new institutional arrangements. Partly, the idea of a commitment charge is intended to cover this aspect of cost. And if unit cost does in fact go up, I have no doubt in

my mind that the burden has to be borne by the prosperous borrowers through a further rise in the rates at which they receive the loans.

III

24. It is important that we discuss separately some of the questions related to the introduction of a scheme of differential interest rates in the agricultural sector. There are some oddities here which call for review. The rate of interest charged by the Reserve Bank of India on short-term advances to the State co-operative banks for seasonal operations and marketing of crops is 2 per cent below the prevailing Bank rate; loans for the purchase and distribution of chemical fertilisers is at the Bank rate. Loans from the National Agricultural Credit (Stabilisation) Fund to the State co-operative banks for the conversion of short-term loans into medium-term ones are at $1\frac{1}{2}$ per cent below the Bank rate. So is the case with medium-term advances from the National Agricultural Credit (Long-term Operations) Fund; advances intended for financing small and medium cultivators to enable them to purchase shares in co-operative sugar factories are again at the Bank rate. The nationalised banks too have been enjoined to advance funds to the co-operative societies at $7\frac{1}{2}$ per cent. The co-operative institutions are, therefore, obtaining funds for agriculture which, in the aggregate, would certainly cost them less than 5 per cent. What is however perturbing, as the Annexure makes clear, is that the primary credit societies are charging from the farmers interest in the range of usually 9 to 11 per cent, and, in some instances, even more. The hiatus between what the co-operative sector is paying for money and what it in its turn extracts from the farmers is truly remarkable. It is conceivable that many amongst the small farmers, who would have been keen to obtain funds from the co-operative institutions in case these were made available at cost—that is, at between 4 and 5 per cent—feel inhibited to borrow the funds when confronted with a rate of lending as high as 10 to 12 per cent. The wide gap between the average rate at which the co-operative sector obtains the loanable funds and the average rate at which these are disbursed reflects a problem of structure, namely, that of the multiplicity of tiers with which the system is burdened.

25. We will clearly be remiss in our duty if we do not invite a thorough appraisal of the co-operative credit arrangement with a view, first, to lowering the average cost of credit to agriculture as a whole and, second, to evolving a frame of differential lending rates which would, from now on, discriminate in favour of the landless labourers and the small farmers.

26. As seen above, if the organisational tiers could be eliminated, the cost of loanable funds channelled through public institutions would on the average work out to less than 5 per cent for agriculture. For the present, we may therefore suggest a frame of differential rates of interest for this sector which would cover this basic cost alongside with reasonable overheads. An interest of 6 per cent on overall advances should satisfy this condition. It would also be desirable to introduce a minimum commitment charge from each and all, including the least affluent sections. However, as against the minimum lending rate of 1 per cent suggested for the rest of the sectors, the lowest rate of interest—reflecting the commitment charge—could be ½ per cent in agriculture. The spectrum I have in mind for lending rates in agriculture would start at ½ per cent and could go up for the present to 12 per cent.* The suggested upper limit is what already prevails in a number of States: it is the lower limit which may raise eyebrows. For landless labourers who might want to buy a tenancy, or for small farmers possessing less than two acres of land, there is justification for the lending rate being kept nominal till as long as this can be done without affecting the overall viability of agricultural lending operations. In view of the fact that nearly two-fifths of the total agricultural community consist of the landless and small farmers owning less than two acres of land, at least 40 per cent of the total advances in agriculture could be earmarked for these groups at lending rates not exceeding 3 per cent. Even then, it would not be difficult to ensure a rate of return of the order of 6 per cent from the total advances, as the following example brings out:

Advances	*Rate of interest*
1st quintile	.. ½ per cent
2nd quintile	.. 3 per cent
3rd quintile	.. 5½ per cent
4th quintile	9 per cent
5th quintile	.. 12 per cent
TOTAL ..	.. **6 per cent**

* Obviously, if no reform is possible in the tier system in the co-operative sector and the cost of maintaining the tiers is to be added to the average cost of lending, the maximum lending rate has then to be adjusted further upwards.

27. Once more, there could be any number of combinations of varying interest rates satisfying the condition of overall profitability. In the light of local factors, one could decide on the actual differentials, as also the upper limits, in the different States.

28. As elsewhere, so too in agriculture, a differential rates structure has to be accompanied by a clear-cut policy of credit rationing. This is necessary not only to protect the viability of the scheme, but also to prevent its exploitation by those who constitute the top hierarchy in our rural society. Here I can do no better than quote from an excellent paper on the subject by Dr. C. H. Hanumantha Rao, " In a situation where large farmers wield considerable power at the local level, it would be impossible to ensure an equitable distribution of institutional credit without a clear-cut policy from above regarding the allocation of credit between different land-holding groups, backed by measures to enforce such limits. We need to practise credit rationing if institutional credit is not to become a means for widening the existing disparities in income and wealth and if indeed it is to be made an instrument for reducing such disparities."*

29. I am not ignoring the additional burden which such a regime of differential lending rates may involve in different directions. Work in the branches of the commercial banks and co-operative societies will, up to a point, become more complicated; the criteria for qualifying for credit at subsidised rates have to be carefully formulated and scrupulously applied; much judgment would be called for making on-the-spot decisions; a continuous check will need to be kept on the tempo of recoveries. At the other end, there are bound to be uproars and protests from those for whom the rate of interest would now be pitched at higher levels. These are, however, travails which are associated with structural changes; a change which does not involve difficulties or hurt anybody is a suspect species.

IV

30. Other questions of course remain. The inequalities in the credit structure embrace such aspects as margins and collateral. There is a built-in regressivity in the present arrangement regarding margins, with affluent parties receiving relatively more favourable treatment all along the line. Similarly, the insistence on security in several cases prevents individuals lower down in the economic scale from availing of the diverse facilities of the banking system. If the irrationalities

* " Farm Size and Credit Policy ", *Economic and Political Weekly*, 1970.

in regard to margins and collateral are not taken care of, much of the gains expected from a differential rates structure might come to nought. However, in case a beginning is made in the area of interest rates, the multiplier effect of the endeavour would also possibly induce similar reforms in the practices involving margins and collaterals.

31. In paragraphs 23 and 24 of their Report, my colleagues have argued for a relaxation in favour of the weaker borrowers of the standards hitherto adopted by the banks regarding securities and margins. I generally endorse their suggestions, particularly those recommending that margin requirements be entirely dispensed with in deserving cases and that, depending on merits, unsecured loans be sanctioned and certain unconventional items accepted as security. Purely for the sake of symmetry, however, I would suggest that the traditional policy of the banks for relaxing the requirements in regard to margins and collateral in the case of affluent borrowers should be reviewed: what the traffic can bear, the traffic should be made to bear.

V

32. In concluding this note of dissent, let me add that it is far from my intention to ignore the so-called practical considerations. Such of these as have been mentioned do not, however, affect the interests of the economy as a whole, but those of individual groups or sections. Nor can it be maintained that my proposals cannot be accepted on account of their indivisibility. For example, if a beginning could be made by charging interest at 20 per cent on, let us say, an amount of Rs. 50 crores advanced to trade, that would immediately make it possible to offer another Rs. 50 crores at a nominal rate to small artisans, self-employed individuals, or farmers. For the present, I would plead for a pilot experiment with the scheme, and its subsequent extension only if the initial results are encouraging. To argue for the *status quo*, on the other hand, would be to do less than justice to the Committee's terms of reference.

ASHOK MITRA

May 21, 1971.

ANNEXURE

Primary Credit Societies—Interest Rates on Advances during 1968-69.

(Per cent per annum)

State/Union Territory	Small-sized Agricultural Credit Societies				Large-sized Agricultural Credit Societies				Agricultural Marketing Societies			
	Short-term		Medium-term		Short-term		Medium-term		Short-term		Medium-term	
	Range	Usual	Range	Usual	Range	Usual	Range	Usual	Range	Usual	Range	Usual
1. Andhra Pradesh ..	8¼–12	8¼	8¼–12	8½	8¼–12	8¼	8¼–12	8½	8¼–12	8¼	8¼–12	8½
2. Assam	7½–10	9½	7½–10	9½	7½–10	9½	7½–10	9½	7½–10	9½	7½–10	9½
3. Bihar	8¼–9¼	8¼	8½–9	8½	8¼–9¼	8¼	8½–9	8½	8¼–9¼	8¼	8½–9	8½
4. Gujarat	6¼–10	7½	7½–9¼	8	6¼–10	9	8	7	9½–12	8½	6–9	7½
5. Haryana	9.37	9.37	9.37–9.87	9.37	9.37	9.37	9.37	9.37	9.37	9.37	9.37	9.37
6. Jammu & Kashmir	9	9	9	9	9	9	9	9	—	—	—	—
7. Kerala	6½–12	9	7½–12	9	6½–12	8¾	7½–12	9	7½–12	9	7½–12	9
8. Madhya Pradesh ..	6¼–10¾	9	9½–11¾	10	6¼–10¾	9	9½–11¾	10	8–11	9½	9–11	9½
9. Maharashtra ..	7 4/5-12	9	6¼–10½	9	7 4/5-10½	9	7 4/5-10½	9	8½–12	9	9–10	9
10. Mysore	8–8½	8	8½–9	8½	8½	8½	8½–9	8½	11	11	—	—
11. Orissa	8–10	9½	8–10	9½	8–10	9½	8–10	9½	8–10	9½	8–10	9½
12. Punjab	6–12	9	6–12	9	6–12	9	6–12	9	6–12	9	6–12	9
13. Rajasthan	8–9	8–9	8–9	8–9	8–9	8–9	8–9	8–9	8	8	8	8
14. Tamil Nadu ..	7 4/5–8 2/5	7 4/5	9-9 3/5	9	7 4/5-8 2/5	7 4/5	9-9 3/5	9	8 2/5	8 2/5	—	—
15. Uttar Pradesh ..	9¼	9¼	9¼	9¼	9¼	9¼	9¼	9¼	9¼–12	9¼	9¼–12	9¼
16. West Bengal ..	7½–12½	10	9½–12½	10	10–12½	10	10–12½	10	8-12½	10	9½-12½	12
17. Chandigarh ..	9 3/8-12	9 3/8	—	—	—	—	—	—	9 3/8–12	9 3/8	—	—
18. Delhi	—	—	—	—	—	—	—	—	—	—	—	—
19. Goa, Daman & Diu	7½–8	7½	7½–8	7½	—	—	—	—	7½–8	7½	—	—
20. Himachal Pradesh..	8½–12	8½	8½–12	8½	8½–12	8½	8½–12	8½	8½–12	8½	8½–12	8½
21. Laccadives	8–10	8	8–10	8	—	—	—	—	—	—	—	—
22. Manipur	10	10	—	—	10	10	—	—	10	10	—	—
23. Pondicherry ..	8	8	9	9	8	8	9	9	8	8	—	—
24. Tripura	8½–12	9	8½–12	9	8½–12	9	8½–12	9	—	—	—	—

Source: *Statistical Statements Relating to the Co-operative Movement in India*—1968-69.