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Conclusion: The Decade of the 1980s

The decade of the 1980s saw significant policy shifts in response to the changing economic circumstances. Reforms were initiated in various segments of the economic system during the decade, though such efforts lacked an overarching framework. Therefore, the outcomes were mixed and several macroeconomic distortions enveloped the economy by the end of the decade.

MONETARY-FISCAL INTERFACE

The Chakravarty Committee report provided a framework for the reforms in the monetary system. The committee made a number of recommendations relating to the objectives of monetary policy, regulation over money and credit, interest rate policy and co-ordination in fiscal and monetary policy; and most of these recommendations were accepted. The report of the committee emphasised co-ordination between the Government and the Reserve Bank to facilitate formulation and implementation of the policies. This was expected to be achieved giving due regard to the desirable levels of government borrowings, the Reserve Bank's support for the same and the resultant increase in reserve money. It was expressed that such co-ordination was essential as well as feasible. The committee clarified that the Government and the Reserve Bank were required to show due concern for achieving the objective of price stability, and this must motivate government action for raising output levels and the Reserve Bank action for modulating expansion in reserve money and money supply.

Against the backdrop of the continually deteriorating state of Central Government finances during the 1980s due to political compulsions of an

expansionary fiscal policy, managing the finances of the Government took precedence over prudence in monetary management. However, to the extent possible, the Reserve Bank neutralised the expansionary impulses of government deficits and the attendant monetisation using available tools of credit control. Though fiscal dominance was the order of the day, the necessity for integrating monetary and fiscal policies was reinforced on several occasions. Such sentiments were voiced at various forums by the Governor of the Reserve Bank. It was emphasised that fiscal deficit had a direct bearing on money supply and thus a high degree of co-ordination was necessary between fiscal policy and monetary policy so that the growth in money supply was kept within limits.

The Reserve Bank continually impressed upon the Government to contain the level of market borrowings in order to limit the net Reserve Bank credit to the Government and to raise the coupon rates on securities. The Reserve Bank's ability to formulate an effective monetary policy depended upon its success in co-ordinating with the finance ministry and ensuring non-inflationary means of financing fiscal deficits. By their very nature, often these functions came into conflict and the Bank at all times tried to persuade the successive governments not to cross the limits of fiscal prudence in the overall interest of maintaining price stability.

The inflationary impact of growing budgetary deficits had to be tackled by mopping up large increases in reserve money. Given the inflexibility in the interest rate structure, the much-needed absorption of excess liquidity in the system was undertaken by the Reserve Bank by increasing cash reserve ratio (CRR). Statutory liquidity ratio (SLR) had also to be progressively raised to meet the large financing requirements of the Government. This inevitably culminated in CRR reaching its statutory maximum limit, which had to be raised further by amending the Reserve Bank of India (RBI) Act in consultation with the Central Government. SLR was progressively raised to a high of 38.5 per cent by September 1990.

The automatic monetisation of budgetary deficits by issuing *ad hoc* Treasury Bills strained the conduct of credit policy in a number of ways. The practice assumed serious proportions during the 1980s and had several adverse implications. In this context, deeply concerned with increasing monetisation of the deficits, the Reserve Bank came up with a proposal to amend the RBI Act in 1988, whereby the Bank was not to be subject to any direction from the Central Government regarding its (*i.e.*, the Reserve Bank's) holdings of government securities, notwithstanding any powers which the Central Government possessed to direct the Reserve Bank under

section 7 of the RBI Act, and that any such directive be issued with the consent of the Cabinet along with a statement placed before Parliament within the stipulated time. The communication from the central bank also contained certain other suggestions, the important being a progressive reduction in the overall budget deficit spread over the ensuing three years, the longer-term resource requirements of the Government to be met through flotation of dated securities and not Treasury Bills, and a limit to be fixed on the outstanding level of ways and means advances (WMA). It was also envisaged that the Reserve Bank should not be required to provide any support to the market borrowing programme of the Central Government from 1990–91, which meant that the Government should move towards a system of market-related rates on government securities as part of the progressive efforts towards placing the Treasury Bills outside the Reserve Bank; the rate of interest on 182-day Treasury Bills be allowed to move up from the existing level; and as and when the budget deficit reached a point close to zero, 182-day Treasury Bill auctions be replaced by 91-day Treasury Bill auctions. In 1988, it was an idea and an attempt that did not culminate into a concrete proposal or a policy. Well after six years, beginning 1994, however, a definite procedure in this regard took effect.

From the Reserve Bank's point of view, perhaps the most profound change that took place was monetary policy assuming the position of an important variable in the toolbox of economic policy. Fiscal dominance did not end, but the two-decade-long tendency to formulate fiscal policy independent of monetary policy and then asking the latter to adjust to the former gradually diminished.

MONETARY MANAGEMENT

During the period 1981–1989, two major objectives of monetary and credit policy of the Reserve Bank continued to be maintaining price stability and ensuring adequate flow of credit to the productive sectors of the economy. These were, to a great extent, interrelated. However, the objective of price stability or inflation control was the dominant one on the rationale that real growth would be unsustainable if the rate of inflation exceeded acceptable levels. Therefore, the overall stance of credit policy remained cautious. Nevertheless, the focus of credit policy was at times modulated to respond to endogenous developments in the economy, *e.g.*, high inflation induced by oil price hikes (1981–82), sluggish economic conditions (1982–83) and a slump in agricultural output consequent upon the severe drought (1987–88).

The high rate of inflation and the difficult balance of payments (BoP) position faced in the early 1980s were tided over with assistance under the extended fund facility (EFF) from the International Monetary Fund (IMF), supported by tight monetary policy and prudent fiscal measures. After May 1984, when a part of the IMF loan was terminated by India, the monetary and credit policy issues became more complex on account of uncontrolled increase in public expenditure financed by higher public debt, causing a widening of India's fiscal deficit.

The onerous task of limiting the prevalence of excess liquidity present in the economy was carried out mainly through the instrument of CRR, which had a direct impact on monetary expansion. It, however, tended to take a unidirectional upward movement (except on two occasions in 1982–83). Its auxiliary version, *i.e.*, incremental CRR, served a useful purpose to the Reserve Bank in adjusting liquidity in the economy by rendering flexibility to the operations. The fact that the Reserve Bank was required to pay interest on such impounded balances at rates approximating those of term deposits blunted the effectiveness of the instrument. This was compounded by the fact that CRR had already reached the statutory ceiling of 15.0 per cent, and the decision on Reserve Bank's request to the Government in July 1988 to take legislative measures to increase the ceiling to 20.0 per cent for more effective liquidity management was delayed, becoming effective only in January 1991. Thus, with its most potent credit control instrument left effectively non-operational, the Reserve Bank found it challenging to control the excessive liquidity in the economy.

Due to the compulsions of the policies carried over from the earlier years, the refinance windows of the Reserve Bank turned out to be another source of reserve money creation. The first was the export credit refinance, which was formula-based. The other was the general refinance window, which provided short-term funds to banks to tide over temporary liquidity shortages. The Reserve Bank had to fine-tune these to integrate them with the overall stance of credit policy. Nevertheless, the central bank subtly used them to its advantage for quick reassessment of the volume of liquidity in the economy as well as to caution banks that happened to breach any of its prescriptions.

In the context of the Reserve Bank's regulation over bank credit to the public, there were two major statutory pre-emptions over the banks' lendable resources. CRR, at the time of the establishment of the Reserve Bank, was intended to serve as a prudential measure for ensuring solvency of banks, but over the years was transformed into a powerful monetary

control tool. Under the SLR prescription, banks had to statutorily invest a portion of their deposits in government and other approved securities; these securities earned interest at below market rates. During 1981–82, both these pre-emptions totalled well over 40.0 per cent and climbed to 49.0 per cent by 1988–89. Of the remaining lendable resources of banks, the first allocation was food procurement credit and credit to the priority sector (which, at the maximum, was 40.0% of total outstanding credit) at subsidised rates of interest. Credit to the export sector was another preferred sector advance. The differential rate of interest (DRI) scheme claimed 1.0 per cent of outstanding advances at a rate of 4.0 per cent interest. Due to the combination of the statutory pre-emptions of deposit resources of the banking system on one hand and the policy of directed credit based on societal considerations on the other, the impact of the credit policy measures of the Reserve Bank was borne by the commercial sector. The Reserve Bank also made efforts to introduce some degree of rationalisation and simplification in the administered interest rate structure, which had an in-built element of cross-subsidisation.

In addition to its regulatory role, the Reserve Bank actively promoted the evolution of a more efficient functioning of the financial system in the late 1980s by bringing about structural changes and introducing new instruments while strengthening the existing ones. These initiatives facilitated the efforts to widen and deepen the financial system.

THE EXTERNAL SECTOR

On the external sector front, ironically, India began the 1980s with a severe BoP crisis and ended it with another. In the 1980s, the Indian external sector scenario largely mirrored the global situation. In varying degrees, almost all non-oil developing countries (NODCs) ran into BoP problems, with India being no exception.

The 1980s began with the current account deficit (CAD) rising sharply to 1.6 per cent of the gross domestic product (GDP) in 1980–81. Though the deficit in the BoP was partly because of transitory influences such as a rise in the international price of oil and the drought, the deterioration in terms of trade contributed to worsening of the CAD. Therefore, India entered into an EFF arrangement with the IMF for financial assistance to tide over the immediate BoP difficulties. The performance criteria set by the IMF were consistently observed, thanks to constant review and close monitoring by the Reserve Bank. This gradually led to an improvement in

the BoP position in 1983–84 and the Government chose to terminate the IMF loan in May 1984, about six months before the original schedule.

During the period 1984–85 through 1989–90, growth accelerated due to a combination of external and internal developments, but the BoP came under pressure once again, especially after 1987. An important reason for this was high government expenditure resulting in a steep increase in the fiscal deficit from 5.9 per cent of GDP in 1983–84 to 7.3 per cent in 1988–89. An issue causing concern was that despite strong exports growth and softening of international commodity prices, the strain on the BoP did not ease. The fiscal excesses of the Government in the latter half of the 1980s evidently spilled over into widening of the CAD, thereby leading to a gradual build-up of a crisis situation by 1989–90.

With the abandonment of the Bretton Woods system in 1971, major currencies floated relatively free in the world currency market. Most developing countries, including India, were not in a position to allow their currencies to float independently. They chose to either peg to a single currency or to a group of currencies. The choice depended on factors such as the degree of trade concentration and the extent of openness. The choice of currencies and the weights to be assigned to them in the currency basket were matters on which each country had to decide independently. In India, the exchange value of the rupee was determined in relation to a basket of currencies with the pound sterling as the intervention currency. The Reserve Bank thus announced the day's buying and selling rate of the rupee in terms of pound sterling. The market was free to operate within the prescribed bands of the Reserve Bank rate, supplemented by exchange margins allowed within the range prescribed by Foreign Exchange Dealers' Association of India (FEDAI). The authorised banks were also free to deal among themselves in any currency. The Reserve Bank regulations on forward market operations were extensive and well documented with the objective of making the market a useful tool for covering the exchange risk of importers and exporters.

Throughout the 1980s, the exchange rate policy was implicitly aimed at a gradual depreciation of the rupee, in real terms, in order to maintain the price competitiveness of the exports sector. The rupee value underwent several adjustments over the period from 1985, resulting in a real depreciation of about 27.0 per cent cumulatively by 1989–90. As a result, despite the official stance that the rupee was pegged to a currency basket, the IMF, in its classification of exchange rate arrangement of member countries, included India among the group of 'other managed floating currencies.'

By 1988–89, the signs of an oncoming external payments crisis were clear. During the second half of the 1980s, non-concessional borrowing increased. Between 1984–85 and 1989–90, the total debt to gross national product (GNP) ratio increased from 17.7 per cent to 24.5 per cent and the debt-service ratio increased from 13.6 to 30.9 per cent during the same period. The difficulty of financing the widening CAD through external short-term commercial borrowings remained at the heart of the problem. The foreign exchange reserves shrank dramatically by December 1990. India thus ended the decade with a full-blown BoP crisis lurking around the corner.

BANKING

In the early 1980s, the banking system in India broadly reflected the priorities of the Government and functioned in line with the directions provided by the Government of India (GoI). The resource constraints of the Government, the poor economic condition of a vast segment of population engaged in agriculture residing in remote rural areas, and the socio-political compulsions in a plural democratic system were the compelling factors influencing the performance and functioning of the banking system. The Reserve Bank being the regulator of the financial system, however, continually emphasised the need to maintain the soundness and operational efficiency of the banking system.

The banking system during the 1980s was viewed as an institution that should touch the lives of millions, be necessarily inspired by larger societal goals and subserve national priorities and objectives. Towards this end, several measures were initiated. These included, *inter alia*, extending banking facilities to unbanked areas, covering in particular the rural and semi-urban areas; mobilising financial savings; reorienting the flow of bank credit from a relatively few industry and trade accounts to a vast number of borrowers from agriculture, small scale industries (SSIs), small businesses and weaker sections of society; promoting a new class of entrepreneurs, so as to widen the industrial and economic base of the society; and facilitating enhanced professionalism on the part of both bank management and the staff.

The rapid expansion in branch banking, entry into mass banking, vast escalation in banking transactions and lengthening the lines of command and control, however, brought in their wake considerable strains on the banking system. The importance of running banks on professional terms and making banks a viable and reliable financial infrastructure to support the economy on an enduring basis was realised in the middle of the 1980s

and all efforts were made to consolidate banking. Ensuring viability and profitability of the banking system became a subject of serious and conscious discussion at all forums. The Reserve Bank began the process of consolidation by bringing in changes in banking policy and introducing appropriate measures in the areas of organisation and structure, training, housekeeping, customer service, credit management, recovery of bank dues, productivity and profitability, and technology and communication.

The concern voiced by the Reserve Bank at various forums on the need to improve the profitability of banks and make them viable resulted in a change of mindset at all levels, including the Central Government, and contributed to some well-considered reforms in banking in the later part of the 1980s. This gradually led to a major overhaul of policies, particularly after the BoP crisis of 1991. The necessity to reform the banking system was spelt out by the Governor, Dr Manmohan Singh, in his address at the founders' day of the Bank of Maharashtra in Pune on September 16, 1984, where he identified new challenges and responsibilities that the Indian banking system was called upon to meet during the Seventh Five Year Plan. He hoped that this exercise would set in motion a process of thinking and debate about structural reforms, organisational improvements and procedural progression that were urgently needed to enable the banking system to perform successfully in the ensuing phase of India's development.

FINANCIAL INSTITUTIONS

Financial institutions (FIs) played a vital role in meeting the long-term credit requirements of the industrial sector in India. In order to ensure that these institutions were subjected to prudential practices and to apply standard procedures, the Reserve Bank laid down guidelines, keeping in view the nature of operations of the FIs. The management information system (MIS) was devised to capture information on working of the FIs for facilitating monetary control and to examine the quality of assets from the regulatory standpoint.

A number of FIs received assistance from the Reserve Bank either under the long-term operations (LTO) fund or through short-term credit. Towards the late 1980s, a need was felt to devise adequate safeguards for effective monitoring and control of the FIs. With this in view, an in house group on FIs headed by Shri S.S. Tarapore was constituted. Some of the major recommendations of the group related to monitoring the financial health of these institutions and introducing an annual financial review to ensure effective supervision. The group also suggested that a

financial institutions cell (FIC) be set up in the Reserve Bank. Most of the recommendations of the in house group were implemented by the Reserve Bank. As a result, the operations of Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India Ltd (ICICI), Export-Import (Exim) Bank of India, National Housing Bank (NHB), Industrial Reconstruction Bank of India (IRBI), Discount and Finance House of India Ltd (DFHI) and Stock Holding Corporation of India Ltd (SHCIL) were brought under effective monitoring and the control of the Reserve Bank.

NON-BANKING FINANCIAL COMPANIES

The 1980s witnessed the mushrooming of non-banking financial companies (NBFCs) posing a challenge to regulators. The NBFCs carried out multifarious activities, some of which were apparently not permissible under the law, resulting in regulatory arbitrage. Many unregistered companies also operated in various states and union territories (UTs). It was a difficult task, both for the Reserve Bank and the concerned state governments/UTs to exercise proper regulation and adequate control over the practices of such institutions and penalising them for not adhering to the norms. However, stringent action by the regulators and other enforcement agencies within available powers brought back stability to the system. This also brought transparency into the functioning of these companies, which was further strengthened by the prudential norms introduced by the Reserve Bank during the subsequent decade.

The activities of NBFCs such as those engaged in the business of hire-purchase, housing finance, investments, loans, mutual benefit financial and residuary financial companies continued to be regulated by the Reserve Bank. The Reserve Bank was empowered to prohibit NBFCs from accepting deposits from public in case irregularities were observed in their operations and to prosecute defaulters for violating directives under the applicable Act.

During the early 1980s, there was substantial growth of chit fund companies and money circulation schemes throughout the country. Barring a few, the states had not enacted any legislation to control and monitor these activities. To plug this loophole and to bring about a uniform legislation applicable throughout the country, the Chit Funds Act, 1982 was enacted by Parliament. The Reserve Bank followed up with all state governments and UTs for adoption of the Act. The Bank was empowered to inspect the books and accounts of the chit fund companies.

Hire-purchase companies were also regulated by the Reserve Bank under the provisions of the directions of 1977 as the NBFCs. These companies were allowed to raise deposits from public within permissible limits, linked to their net owned funds (NOFs) and were also required to comply with directions relating to the submission of returns, balance sheet and issue of advertisements soliciting deposits. The Reserve Bank was empowered to prohibit acceptance of deposits by such companies in case of non-compliance with the provisions of directions. From time to time, the Reserve Bank with the assistance of the state governments, conducted raids on the office premises of unincorporated bodies. Prosecution proceedings were also initiated against such unincorporated bodies if the related provisions of chapter III C of the RBI Act, 1934 were violated.

SAFETY AND PRUDENTIAL ISSUES

As a result of the efforts of the Reserve Bank and the Government, banks were able to maintain their professional competence and operational efficiency. All the banks drew up a comprehensive plan to improve their overall operations and efficiency, which, *inter alia*, included measures to strengthen the internal administration for ensuring better supervision and control; improving customer services; strengthening credit appraisal and the quality of loan assets; ensuring progress in the recovery of bank dues; reducing costs; and introducing new work technologies. Effective implementation of these tenets, in turn, resulted in better customer service and improved the financial viability of banks. The importance of running banking along professional lines was realised both by the authorities and banks, which rendered it easy to introduce subsequent reforms.

Notwithstanding the perceptible progress achieved under the action plans, industrial sickness and defaults in repayment of bank dues continued to adversely affect the quality of bank assets. While banks were making efforts to step up recycling of funds, it was important to improve the general recovery climate. The existence of a sizeable number of loss-making branches was also a drag on the profitability of banks. It was, therefore, necessary to impart financial viability to such branches through expansion of business within a reasonable time frame. The ongoing tasks of human resource development (HRD) and personnel management needed focus with a view to enhance motivation levels, discipline, efficiency and output as also improve work culture at various levels in the industry. Greater efforts were required in the field of technology upgrading, to improve customer service.

In view of the above concerns, under the directives from the Reserve Bank, banks drew up new action plans with an added emphasis on the qualitative aspects of banking. These plans emphasised various aspects of bank performance including rationalisation of systems and procedures, introduction of efficient MIS, strengthening of the organisational structure, financial viability, proper implementation of the service area approach (SAA), effective credit management, use of the health code of borrowal accounts as a management tool to enhance the quality of bank assets, faster response to signs of industrial sickness and appropriate mechanisation of operations.

In the area of branch expansion, while the process of consolidation continued, it was necessary to allow opening of additional branches in order to achieve appropriate coverage under the SAA — a new strategy of rural lending was introduced in 1988. Apart from strengthening the capital base of nationalised banks, a number of steps were taken to strengthen prudential supervision, such as, issuing guidelines on exposure risk management and recognising non-performing loans (NPLs). To achieve greater transparency, aspects relating to modification of accounting policies and practices of banks also received attention.

The commercial banks diversified into services, such as merchant banking, leasing, mutual funds, venture capital and housing finance, and some banks set up specialised subsidiaries to undertake such activities. The provision of these services was a natural affiliate of the diverse and growing needs of the economy following the economic liberalisation measures initiated in the country and reflected the adaptability of commercial banks to the changing needs of the financial system.

It was well recognised that regulation had to be compatible with socioeconomic objectives. Deregulation and liberalisation appropriate to Indian conditions required reinforcing capital and prudential norms in banks and other FIs to counter enhanced risks arising from such changes. Strengthening the legal framework, standardising accounting practices, improving disclosure of the state of bank operations and consolidating supervisory functions, preferably under a single agency in the context of progressive integration of financial markets, were some of the issues under active consideration in the late 1980s.

Several measures were taken to impart flexibility to the financial system and to encourage competition. The measures, *inter alia,* included modifications in the CAS, which was first liberalised and then abolished and replaced by *ex post* monitoring; interest rate prescriptions with regard

to money market instruments were abolished; and a floor of 16.0 per cent was fixed without a ceiling rate for most non-priority sector borrowers, enabling banks to charge interest in the light of borrowers' track record. At the same time, parties were allowed to transfer their accounts from one bank to another, provided they cleared their liabilities to the existing banks; banks were permitted to issue certificates of deposit (CDs) for large amounts, with the interest rate determined by negotiations between the bank and the depositor; commercial paper (CP) was introduced to enable highly-rated companies to raise money at rates lower than what they paid on their bank borrowings; and banks were allowed to diversify their activities in several new business areas, either directly or through specialised subsidiaries. The money and capital markets were activated by the introduction of several new instruments.

While continuing with onsite inspections and follow-ups as a major tool for evaluating the performance of banks, a number of steps were taken to strengthen prudential supervision. Keeping in view the developments abroad, proposals were considered regarding the introduction of suitable capital adequacy norms in relation to risk assets, including off-balance sheet business. Guidelines were issued regarding exposure risk management in the domestic sector by laying down norms for individual/group exposure, covering both funded and non-funded limits in relation to owned funds. Such norms were already in vogue in respect of the overseas operations of banks. Suitable guidelines were issued regarding recognition of NPLs based on health coding, and banks were advised not to take into account interest income arising from loans so classified. The transparency of the accounting policies and practices adopted by banks in this regard also engaged the attention of the Reserve Bank at this juncture.

The Reserve Bank was actively involved in establishing BANKNET, a data communications network for the banking industry. To assess the requirements of banks as well as to co-ordinate the activities of user banks for speedy implementation of BANKNET phase I, a user group was constituted. Similarly, 36 banks in India and the Reserve Bank were accepted as members of the Society for Worldwide Interbank Financial Telecommunications (SWIFT), a co-operative society based in Belgium. Action was taken to install the SWIFT regional processor in Bombay (now Mumbai) to act as an international gateway. Message formats conforming to SWIFT specifications were standardised jointly by the Reserve Bank and the Indian Banks' Association (IBA).

The pressure on bank profitability was, to a large extent, attributable to irregular accounts of sick or mismanaged industrial units and the unsatisfactory recovery of bank dues from agricultural and other priority sector advances. As regards the first category, in order to make the legal processes for enforcing banks' claims more expeditious and effective, special tribunals were established during the 1990s. With regard to the pending dues in agricultural and other priority sector advances, banks were required to step up efforts towards recycling of funds. Besides, it was important to ensure that the general environment for recovery of dues by commercial and co-operative banks was not vitiated. Towards this end, the Reserve Bank and National Bank for Agriculture and Rural Development (NABARD) undertook measures to make refinancing of state co-operative banks contingent on adhering to the prescribed interest rate and other credit disciplines.

RURAL CREDIT

In the early 1980s, the concern about the inadequate flow of credit to agriculture and other priority sector activities continued, despite several initiatives both from the Government and the Reserve Bank. A landmark was the establishment of an apex development finance institution (DFI), NABARD, in 1982, converting the erstwhile Agricultural Refinance and Development Corporation (ARDC) and merging of Agricultural Credit Department (ACD) of the Reserve Bank to exclusively focus on agriculture and rural development. NABARD was entrusted with a pivotal role in the sphere of policy planning and providing refinance facilities to rural FIs to augment their resource base. The overall regulatory function was, however, retained by the Reserve Bank in view of its overarching statutory responsibilities over the rural credit system. A separate Rural Planning and Credit Department (RPCD) was also set up in the Reserve Bank to encourage and, at the same time to exercise regulation and supervision over the rural credit and priority sector activities of banks and other institutions. The Reserve Bank set up several committees and working groups from time to time to closely monitor the flow of credit to rural areas and improve the performance of the institutions involved in rural credit.

The Government formulated a series of schemes and implemented a variety of programmes subsidising rural credit and financing rural development. The Reserve Bank, as a partner in the process, issued a series of instructions to banks and relaxed credit norms to support such government programmes, including lending targets and sub-targets.

The emphasis on achieving quantitative targets with respect to rural credit, however, had certain adverse consequences. Supervisory focus tended to be biased towards target achievement rather than ensuring meeting prudential requirements and maintaining viability. Adequate attention was not paid to qualitative aspects of lending. Poor loan recoveries and defaults in rural lending became a serious concern in the 1980s. This was partly due to natural causes such as unstable agricultural production in non-irrigated areas, and partly on account of other factors such as wilful defaults, especially among relatively better-off farmers; direct interventions by elected representatives leading often to full or partial across-the-board loan write-offs on a massive scale; creating strong disincentives for loan recovery; and weak legal processes and support for recoveries. The support from some state governments was also not encouraging to improve the recovery climate. The result was a disturbing growth in overdues, which not only hampered recycling of scarce resources of banks but also affected the profitability and viability of FIs.

Despite such shortcomings, good progress was made in achieving the overall objectives of broadening and deepening the rural credit system over the Plan decades. The dependence of rural households for cash debt on non-institutional agencies declined drastically during the period from 1971 to 1991. The share of formal lending more than doubled between 1971 and 1991, reflecting the persistent measures taken by the Government and the Reserve Bank. The strategies adopted in the 1980s in respect of rural credit resulted in substantial gains, and these primarily related to broadening of rural infrastructure for credit delivery and improvements in credit outreach.