CREDIT PLANNING: THEORY AND PRACTICE

- Danda Pani Paudel* -

I. Meaning

Credit planning has both a narrow connotation and a broader one. In the narrow sense, it is concerned only with the allocation of the available credit among different uses. In the broader sense, it covers aspects such as monetary budgeting, deposit mobilisation as well as credit allocation

II. Need and Rationale for Credit Planning

Credit has a crucial role in the economic system. Schumpeter regarded credit a fundamental phenomenon of development and the banking system as one of the key elements in the process of economic development.[1]

Demand for credit and its uses are positively correlated with stages of development. Credit is a booster for economic growth. Hence, credit planning is more essential in developing countries. Even the first five year plan in India expressly states that central banking in a planned economy can hardly be confined to the regulation of the overall supply of credit or to a somewhat negative regulation of the flow of bank credit. It would have to take on a direct and active role firstly, in creating or helping to creat the machinery needed for financing development activities all over the country and secondly in ensuring that the finance available flows in the directions intended. "For the successful fulfilment of the plan, it may be necessary to direct special credit facilities to certain lines of high priority..... The banking system..... will thus have to be fitted increasingly into the scheme of development visualised for the economy as a whole; for, it is only thus that the

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1 "The banker, therefore, is not so much primarily a middle man in the commodity 'purchasing power' as a producer of this commodity. However, since all reserve funds and savings today usually flow to him, and the total demand for free purchasing power, whether existing or to be created, concentrates on him, he has either replaced private capitalists or become their agent; he has himself become the capitalist par excellence. He stands between those who wish to form new combinations and the possessors of productive means. He is essentially phenomenon of development,... He makes possible the carrying out of new combinations, authorises people, in the name of society as it were, to form them. He is the ephor of the exchange economy". Or take the following. " We now come to the third of the elements, with which our analysis works, namely the new combination of means of production and credit. Although all three elements form a whole, the third may be described as the fundamental phenomenon of economic development". J.A. Schumpter, the Theory of Economic Development, 1949, p.74.

process of mobilising savings and of utilising them to the bast advantage becomes socially purposive".[2]

The chief rationale of credit planning in developing countries is the empirical experience which indicates that, so far as the financial system is concerned, the so-called magic of market mechanism guided by the criterion of profit maximisation has not assisted in facilitating the growth of the domestic economy. This seems to be particularly true in the case of the economies which have inherited the banking system from the colonial era. There are at least two important reasons why such a banking system led to inefficient allocation of banking sector's resources. First, when left to the autonomous decisions of banks, the banking system's resources are channelled into projects/sectors that promise the highest yield under certain risk conditions. Traditionally, most commercial banks concentrated on financing foreign trade and domestic commerce. Even when banks tended to diversify, the direction was generally towards urban-based activities such as real estate projects, large industries, service industries, etc. Paradoxically enough, the developing economies where the primary sectors, mainly agriculture, accounted for a sizeable share of national income, credit needs of agriculture and also those of small industries and business including traditional enterprises were totally neglected by the banking system. The latter category of sectors was therefore left to fend for itself and its credit requirements were met, to the extent possible, by non-institutional sources, with all their attendant adverse consequences.

The second related reason which led to the allocational inefficiency is concerned with the so-called 'banking collateral syndrome' The reference here is to the rigidly risk-averting attitude of banks reflected in their insistence on approved securities like real estate as collateral. Other criteria like repayment potential, project appraisal and borrower's character, on the basis of which credit could be extended, were either not considered or considered only marginally. It is this attitude which probably debarred many borrowers in the latter category of sectors from being qualified for loans. The net result of this approach was that the economies incurred substantial social costs in terms of foregone economic opportunities and activities.[3]

So the logic of policy intervention in the sphere of bank credit stems from the fact that left to the so-called market forces, the allocation pattern of commercial bank credit would not be necessarily such as would promote the optimum growth of the economy. Many central banks in Asia, Africa and Latin America have made significant efforts to ensure that the pattern of credit allocation is consistent with the development objectives.[4] As Mr.

2 Quoted in M. Narasimham, Credit Planning in India: Its Rationale and Content. Framework for National Credit Plan, Bombay, NIBM, 1979, p. 617-from the document of the First Five Year Plan of India.

3 N.A. Majumdar, Credit Planning: Rationale and Techniques. Background Paper for the SEACEN Seminar on Credit Planning, Kathmandu, Sept., 1984, pp 2-4.

4 Ibid., pp. 6-7.

Brimmer put it as early as 1974 that "it is probably in this area that the greatest amount of central banking expertise and effort has been extended to promote economic development"[5]

III. Objectives of Credit Planning

In a mixed economy like that of Nepal the basic objective of credit planning is to guide investment and output along the lines postulated in the development plans.[6] This means that monetary policy and techniques have to be properly aligned to achieve the fulfilment of the various investment and output targets of the plan. This in turn involves estimation of the expansion of bank credit in relation to the various aggregative and sectorial targets stipulated in the plan. Such an exercise warrants not only the control of the overall magnitude of credit expansion, but equally importantly, ensuring that expansion is selective so that sectors needing credit in terms of production plans are able to obtain the necessary credit. Viewed from this angle, credit planning is concerned not only with the quantum of credit expansion but also with the allocation of credit in its qualitative or directional aspect.

In a wider sense, credit planning should cover not only working capital but also development capital. In postulating the term; 'capital requirements', not only is the banking system but also, the development banking institutions like term-lending institutions are also involved. More recent efforts have therefore been directed towards evolving an integrated credit plan covering co-operative and development banking institutions as well[7]. From the long term point of view, credit planning also aims at bringing about certain structural changes in the commercial banks' operations.

The objectives of credit planning are obvious in a developing economy. It should be an integral part of the development in a national plan. So firstly, the basic objective of credit planning is to guide investment along the lines postulated in the development plan. Credit planning in this sense is an allocation mechanism or exercise. The credit plan is built in the overall economic plan. The latter embodies the aggregative and sectorial targets in respect of financial requirements and provides also an indication of the sources of finance such as banks and other credit institutions. For example, in France the association of the Bank of France and other financial agencies at the stage of formulating the plan itself also places on them the responsibility that the financial techniques and policies are properly aligned to achieve the fulfilment of the various investment and output targets. The accent on selectivity and the purpose of the loan is closely scrutinized for ensuring its conformity

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5 A.F. Brimmer, Central Banking and Economic Develpment, Development Digest. April 1974.

6 All industries except those which are defense-oriented are open for private sector ownership and investment. Only if the private sector does not respond to meet the investment programme, government or its agencies step in Industrial Policy of HMG/N, 1980, p.3.

7 N. A. Mujumdar, Credit Planning: Techniques and Implementation. Framework for a National Credit Plan, Bombay, NIBM, 1979.

with the plan in all cases involving sizeable amounts. Even in other cases loans are processed on the basis of the guidelines offered by the plans[8].

Secondly, the objective of credit planning should be to achieve development with price stability. In other words, credit plan should be such that monetary expansion does not run amuck and open the floodgates of the inflation. That is to say, the aggregative aspect is as important as the allocative aspect of the credit plan. Thirdly, Credit planning should ensure balance regional development. Credit can be obtained from commercial bank only where there are its branches. So, implicit in credit planning is a policy whereby bank branches are opened all over the country and not only in selective places. Fourthly, in a country like Nepal where agriculture is still the main occupation, credit flow to agriculture must be encouraged. In other words, agriculture should receive a more favourable treatment. The very raison-de-tre of credit planning is that, historically speaking, agriculture has been discriminated against in matters of credit supply. This has had a disastrous effect for the whole economy. In Nepal as in India banks gave step-montherly treatment to small farmers, artisans and weaker sections. The balance should be redressed now and more favourable treatment should be given to small farmers, artisans, self-employed persons and the weaker sections in general. Fifthly, in view of the balance of payments difficulty, export-oriented industries should also receive preferential treatment.

The other objectives of credit planning should be to foster and encourage savings, to minimize loan defaults by proper monitoring of the end use of loans, to help promote financial markets, to maintain a close liaison between central bank and commercial banks, and so on. As D'Mello pointed out in the Indian context, the objectives of credit planning for the entire financial system are: (i) regulation of money supply and credit expansion so as to maintain price stability, (ii) preferential allotment of credit, in quantum and cost, to 'priority sectors' and for purposes like food procurement, fertiliser distribution, export promotion, etc., iii) directing the flow of credit to various public and private sector industries in accordance with the priorities in the national plan for economic development, and (iv) providing enlarged supply of credit to rural areas in general and backward districts in particular. Recently, this last objective has been amplified to mean credit support for implementing district/block plans for integrated development. These objectives have to be spelt out in detailed programmes for implementation by commercial banks within stimulated target dates[9].

Finally, one more point should be noted in the specific Nepalese context. Fulfilling the basic needs of the people is only feasible in a growing economy, for even a drastic redistribution of the present income will not suffice to uplift the majority of the populace above the poverty line. 'And a very radical redistribution is also socially and politically

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8 For an eloquent discussion about the French experience see, M. Narashimham - Credit System in French Planning. Commerce, Bombay, Vora & co. Publisher Pvt. Ltd.,1967, pp. 1-39. Also, see Narasimham, op. cit., 1979.

9 L.D' Mello, Credit Planning - Critical Review of Organised Aspects. Framework for a National Credit Plan, Bombay, NIBM, 1979, p. 233.

undesirable, if feasible Only in a growing economy the private and public sectors financial needs can be accommodated through the planning pattern where some get more than others but none get less than before.'[10] But growth is only the necessary condition It is not sufficient. It should be growth with multiplicity objectives such as faster increase in GDP, rapid progress towards full employment, viability of balance of payments, immediate improvement in consumption standards, acceleration of the domestic savings rate, modernisation of the economy and society, maintenance of individual liberty and freedom of choice, etc.[11] To achieve growth and to achieve the other desirable objectives, developmental planning is the tool. And developmental planning minus credit planning is like a'knight without his horse .

IV. Level of Credit Planning

Credit planning should be a multi-level exercise. Firstly, it should be at the grass-root level. That is to say, it should be at the micro-level of bank branches. Branch level planning should have three distinct purposes: (a) determination of the basis of a study of environmental factors of operational targets and strategies which are consistent with official policies and priorities, (b) organising credit for official developmental programmes, and (c) implementation of brach-wise commitments under the district credit plan.[12] Despite the importance of branch level planning, especially in connection with the financing of agriculture, rural industries and trades, this is the least developed part of credit planning system. The major handicap in this regard is the lack of skill at the branch level for gathering environmental data to formulate operational plan. Secondly, there is no acceptable quantitative relationship between changes in environmental factors and banking variables like deposits and advances in various segments of the local economy.[13] The second level of credit planning is the district level plan. Finally, there is macro level credit planning.

V Techniques of Credit Planning

Formulation of monetary budget constitutes the first stage in macro credit planning exercise. A developing economy requires planned monetary expansion. Given the postulated rate of growth in real national income, the plan for monetary expansion will have to provide for a slightly higher rate of increase, even on the assumption of price stability. This is for two reasons: firstly, increasing monetization, which may be called the 'extensive' factor, calls for larger money supply. There has been a marked expansion of the monetized sector in recent years. Secondly, there is the 'intensive' factor. As the national income increases the cash balance requirements of the community go up. It has

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10 K. G. Wold, Credit and Monetary Policies and Their Role in General Economic Policies, Economic Bulletin, Norges Bank, 1979. p. 108.

11 K. S. Krishnaswamy, Development Strategies and Planning. Discussion Papers for the SEANZA Central Banking Course, Kathmandu, April, 1985, p.1.

12 D'Mello, op.cit, p. 288.

13 Ibid, p. 239.

been suggested in some quarters that the increase in money supply should be 2-3 per cent higher than the expected rate of growth in real income to take care of the 'intensive' and extensive' factors mentioned above. The monetary budget can also be framed on the basis of an assumed value of money multiplier, i.e. the relationship between the reserve money and money supply.[14]

It is obvious that there are many imponderables in the situation which might make the calculations worse than useless in a dynamic setting. Given the assumptions, the quantum of additional credit to be generated by banking system in a period will have to be consistent with the money supply expansion envisaged in the monetary budget. In this sense, commercial bank credit to commercial sector becomes an important policy variable. But there are other problems. The behaviour of the external sector in influencing money supply expansion is too well-known to be ignored. And an estimate of the disequilibrating force that may be generated in the external sector becomes incumbet. But here, for reasons well-known, any estimate will have a significant margin of error which will render any econometric exercise somewhat naive.[15]

Once the monetary budget is framed, it would be possible to estimate the deposit resources of the bank. The estimated growth in total deposits (demand + time) could be cross-checked with the help of past trends and the likely outlook for the economy and the banking sector. This could also be cross-checked with the trends in ratio of bank deposits to national income.

Now, all the deposit resources are not available for lending to the customers. There are statutory pre-emptions which have to be provided for. For example, in Nepal banks have to maintain cash reserves equal to 5 per cent of their total demand and time deposit liability. Similarly, cash in vault and other defined liquid assets holding respectively constitute four and 16 per cent of the total deposit liability. In other words, the aggregate liquidity requirement is 25 percent of the total deposit liability (But at present, cash reserves should be maintained at 12 per cent of deposits, with cash in vault and balance with NRB to be at 4 and 8 per cent respectively. Besides, there should be an additional liquidity requirement of 24 per cent in the form of government bonds issued under the CBPASS, NRB bonds and treasury bills. The aggregate liquidity requirement thus comes to 36 per cent of the total deposit liability.). Thus, only a part of the bank deposits is available for credit creation. Once the quantum of loanable fund is estimated the next step in credit planning is to allocate it as between different sectors and regions.

However, credit planning, in order to be meaningful, depends largely on a correct estimate of the sectoral demand for credit. The first step in making the demand estimate is to generate "data inputs" for such a forecasting exercise. The central bank expects to get the

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14 P.N. Joshi, Credit Planning - Some Methodological Issues, in P. K. Thingalaya (ed.) On Bankers and Economist, Macmillan India Ltd., 1981, p. 67.

15 H. N. Roy, The Political Economy of Credit Planning: Some Observations. Papers Presented to the Conference of Indian Economic Association, Pune, 1980, p. 26.

necessary information from the users of credit and for this purpose the central bank holds frequent discussions with different orgnisations of industrialists and merchants as well as public sector organisations

Thus, an important aspect of credit planning is planning at micro level The commercial banks are expected to prepare their indvidual credit plans taking into account their share in the macro plan as also in the light of the potential of the customer requirements. The credit plans of these individual banks, after discussions with the central bank, could feed the process of national plan formulation. Broad parameters of the macro plan thus evolved could be conveyed to the banks which would help the latter to assess their performance vis-a-vis the national plan. In short, the macro plan and the micro plan should be consistent with each other in formulation.

So in theory the technique of credit planning is simple and strainghtforward. In practice, in most countries where credit planning is practiced, credit planning is flawed in many ways. Individual banks are expected to hold dialogues with their major customers. In practice such dialogues are rare. The Economic and the Statistical Departments of the banks or the Planning Department of the banks prepare the credit budget. The credit budgeting in most banks starts only after the pro formas are received from the central bank and it ends as soon as the formats have been filled in and returned to the central bank. The central bank discusses with individual banks perhaps once in a year. The generation of 'data inputs' is thus only tentative and the credit plans are also more or less guesstimates.

VI Credit Planning in Nepal

In the sixth Plan document of Nepal a reference was made to the setting up of a high level committee for extending credit to priority sectors on the basis of the annual credit plan to be prepared by the committee. The credit plan of the commercial banks was to be integrated with this plan. The Plan document further stated that in the context of the price and the balance of payments position and the need to ensure rapid pace of the economic development, a yearly monetary budget should be prepared so that short term monetary and credit policies could be implemented effectively. This view was reiterated by the Finance Minister in his Budget Speech for the fiscal year 1982/83. The Finance Minister stated that "an urestrained growth of money supply will adversly affect the economy. So, with a view to keep money supply within a desirable limit, the flow of credit channelised to unproductive sector will be controlled. And the foreign assets will be used in the productive sectors. In order to streamline the credit operations and divert the flow of funds towards the productive sector, a credit plan will be formulated in the coming year."[16]

Nepal Rastra Bank, after giving due considerations to this important matter, set up a Credit Planning Cell with a view to strengthening the monetary control and monitoring credit development in the light of national objective or policy. It was realised that efforts

16 Budget Speech for the Fiscal Year 1982/83, Finance Ministry, Kathmandu, 1982.

till date to quantify the relationship between credit and money supply were outside the broad framework of national policy parameters. The Credit Planning Cell was set up in August 1981 to do following functions:

- Preparation of monetary budget taking into account the desirable growth of money supply, the various factors affecting its growth and , in particular, the projection of total credit needs at macro level;

- Monitoring the sectoral flow of credit particularly to the priority areas; and

- Ensuring proper end-use of credit extended by banks and financial institutions for production purposes through toning up of the apparaisal and follow up standard.

The staff for the Credit Planning Cell was drawn primarily from the Research Department. Howerver, the Cell at the initial period was engaged in conceptualising the framework of credit planning in the Nepalese context and, for this purpose, it used consultancy services of an expert study team from the Reserve Bank of India. A study report was also submitted to the NRB by the team. Fortunately, the first SEACEN Seminar on Credit Planning was also held in Kathmandu in 1984 with a view to interchange of experiences regarding the burning topic of the credit planning in the member countries.

Later, the Cell was transferred under the Banking Development and Credit Department. The Cell was born under an evil star and it was never properly equipped or staffed. It is an instance of abortion of good intention.

Even before the establishment in August 1981 of the now moribund Credit Planning Cellthe Priority Sector Coordination Committee was formed. It has the task of allocating credit to priority sectors in Nepal. It is composed of 11 members with the Governor of Nepal Rastra Bank as its Chairman. The members of the committee included the secretaries in the Ministries of Finance, Food and Agriculture, Industry, Commerce and the National Planning Commission as well as representatives from the different banks and financial institutions, the Centre for Economic Development and Administration (CEDA) and the private sector.

The committee determines periodically the priority areas, fixes the annual financial assistance required by the banks and financial institutions and prepares an annual loan plan for the priority sectors. A quarterly review of the implementation aspect of the loan plan is also undertaken by the committee to ensure the efficient and effective utilisation of credit in the priority sectors.[17]

The first step in the matter of credit planning, as we have noted above, is the preparation of monetary budget. The direction and structure of credit is primarily determined by monetary budgeting. Monetary budget in Nepal is prepared by taking into

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17 G.S. Tison, Credit Planning and Allocation in SEACEN Countries. Background Paper for the SEACEN Seminar on Credit Planning, Kathmandu, 1984, p. 6.

account the real rate of growth in gross domestic product, rate of inflation and the expansion in the degree of monetisation in the economy. While preparing the monetary budget, the most important task before Nepal Rastra Bank is to contain monetary expansion within the limit necessary for economic growth and price stability in the economy. Monetary budget also takes into account the savings mobilisation potential of the people and contemplates the credit needs of the productive sectors of the economy including the extension of banking facilities both in rural and urban areas of the kingdom. Monetary budget also takes care of the problems related to flow of resources to private sector. In the process, Nepal Rastra Bank has been suggesting the government to limit its borrowing from the banking system so that more resources could be made available to the agricultural and industrial sector of the economy.[18]

The monetary budget is prepared by the Monetary Division of Research Department. The first exercise in the monetary budget is done sometime in May for the purpose of Economic Survey to be presented by the government in Parliament before the submission of the Budget. The monetary budget is revised in July after the presentation of Budget Proposals since data on government deficit or surplus, and market borrowings programmes, etc. become available and, moreover,a fairly reliable crop estimate is then possible. In the preparation of monetary budget there is collaboration between several Divisions in the Research Department as well as the Banking Operations Department. For example, data on foreign assets are furnished by the Balance of Payments Division of the Research Department and data on claims on government are furnished by the Public Finance Division of the Research Department. The NIDC and ADB/N furnish respectively the Industrial Credit Division and the Agricultural Credit Division a work-plan indicating, inter alia, likely resource gap and the likely dependence on Rastra Bank for the finance facility.

The agriculture sector is the backbone of Nepal's economy and has been accorded top priority since the country followed a planned economic development path in fiscal year 1956/57. To promote the development of the agriculture sector, a three-year crash programme was launched in 1981/82 in accordance with the general framework laid in the sixth five year Plan. For one, the programme has to ensure the supply of credit to agriculture and, therefore, action of all agencies have been coordinated to achieve this end.

Some credit allocation measures are already in place in Nepal. In 1974, Nepal Rastra Bank had made it obligatory for commercial banks to invest at least 5 percent of their total deposit liabilities in agriculture and other priority small sectors. In addition, the principal source of institutional financing for agriculture, the ADB/N, provides short, medium and long term agricultural loans. On the other hand, another specialised financial institution, i.e. NIDC, takes care of the financing requirements of the industrial sector.

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18 Nepal Rastra Bank, " Credit Planning in Nepal." Background Paper for the SEACEN Seminar on Credit Planning, Kathmandu, 1984, pp. 7-8.

Measures to ensure credit flows to priority sectors are supplemented with regulations to see to it that credits are obtained at lower costs and are used for the purposes they are intended. For example, Nepal Rastra Bank in the past prescribed a 10 percent ceiling on the interest rate on working capital loans for cottage and rural industries with fixed capital of two hundred thousand rupees. For working capital credit over two hundred thousand rupees, commercial banks were directed to charge 14 per cent per annum. With a view to checking the misuse of credit extended to the priority sectors, the Nepal Rastra Bank had instructed banks in June 1980 to charge a penal rate of 16 per cent on such misused credit. This measure was designed to discourage the misappropriation of credit meant for the priority sectors which were obtained at lower interest rates.[19]

VII The Efficacy of the Monetary Policy and Credit Planning in Nepal

Monetary policy in developing countries has severe limitations. It is hamstrung by the fiscal policy to which it plays the second fiddle. In practice there usually are big deficits in the annual budget and the central bank is obliged to cater to the fiscal needs of the government. That is why, deficit financing is the order of the day in developing countries. Most of the financial institutions are 'loan windows', the funds being provided mostly by the central bank. Thus, the autonomy of the central bank could become a myth. The goal of monetary stability could drive out of their reach. As Patel remarks in the Indian context that if the government cannot resist deficit financing and if the banks cannot resist borrowings from us (RBI), then, of course, we make money.[20]

Nepal shared a similar experience. Nepal Rastra Bank did not have a free hand in the monetary sphere as the central banks in developed countries enjoy. It was always at pains to reconcile the consequences of the governmental prodigality with the goal of monetary stability. The declared objectives of the monetary policy in Nepal are: higher level of GDP and increase in employment, price stability, egalitarian distribution of institutional finance, balance of payments equilibrium, exchange rate stability and development and expansion of banking and non-banking financial intermediation.[21] But, in practice, the NRB could turn out to be a tool to monetize the budgetary deficit. As the apex institution , it also provides the lion's share of the funds to the financial institutions which are essentially a 'proxy for the capital market'. Naturally, there are inflationary consequences.

It is thus clear that the scope of the monetary policy in Nepal is limited. The constraints are: (a) deficit financing, (b) unfavourable balance in external trade, and (c) refinance obligations. As Brahmananda has said in the Indian context which is also very true of Nepal that not all production credit flows from banks, nor do banks always make

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19 Wison, op. cit., pp. 6-7

20 Patel, op.cit., p.9.

21 P.R. Reejal, Monetary and Credit Policies of Nepal Rastra Bank and Their impact on the Nepalese Economy. Kathmandu, Ratna Pustak Bhandar, 1986, p. 94.

loans only on the basis of collaterals and not all types of producers depend upon credit.[22] So the grip of the central bank over the monetary field cannot be firm Still, a little scope is left to the NRB to manipulate the monetary system through interest rate flexibility, CRR, SLR, credit ceiling and other means of direct intervention Within this limited scope the NRB can and does act to balance the expansionary forces to contractionist forces The contractionary policy is pursued with the help of maintenance of higher interest rate to step up savings rate (since mid-seventies) (interest rate since August 1989 is determined by the commercial banks themselves -ed.) and imposition of credit ceilings since FY 1984/85(imposition of credit ceiling has been discontinued from FY 1990/91 - ed.). Although the volume of time deposit and capital and net other items have shown a markedly increasing trend, money supply has shown a rate of double-digit increment. We can thus observe that the net result of the dualistic approach has been inflationary. A consensus is still lacking regarding the optimum dose of monetary inflation to encourage economic development. But in Nepal signs are that monetary expansion has crossed the critical point with deleterious effect on the growth of the economy.

For achieving economic growth the approach can be both from the supply side and demand side. The supply side approach is time consuming and calls for some fundamental structural changes and adjustments. The demand side approach is quicker in giving results. In the case of Nepal, supply side analysis of the stabilisation problem, having its roots in structural and institutional arrangements, deserves much significance and the demand management approach happens to be a second line of defence.[23] Moreover, it may also help in augmenting aggregate supply. Credit planning, as a component of the demand side approach, has thus a vital role to play in Nepal. Hence, the necessity of the proper monetary management and credit planning. The time lag between expansion of money and its absorption by increased flow of goods and services creates the inflationary gap. So post-savings through inflation is a dangerous recipe for economies where the gestation period of new project is long. In Nepal, therefore, the monetary policy should be alive to the explosive potential of the expansionary monetary forces which can give rise to socio-economic and even political unrest.

It is also an empirically tested fact that the impact of loan on money supply is higher and immediate than the impact of investment in securities. As Campbell has pointed out that a loan expansion involves largely new loans, which have a large immediate propensity to be spent, but that a securities expansion has a lower chance of leading to immediate additonal spending: Additional spending will result after a decrease in yields leads to changes in a broader spectrum of yields and increases in the

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22 P.R. Brahmananda, Monetary Theory in Indian Setting. Prajnan, Vol. 1, No. 1, 1972, Jan-March, Bombay, p. 18.

23 G.N. Sharma, Monetary Control Techniques in Nepal. An unpublished Ph. D. Thesis submitted to the University of Rajasthan, Jaipur, 1984, p. 45.

supply of securites [24] So a necessary ingredient of anti-inflationary monetary policy should be preference to investment in securities than to direct loans. Even where loans are to be given, preference should be given to such loans which immediately add to employment and production. Loans should be widely diffused rather than narrowly concentrated. They should also be regionally balanced.

VII. Conclusion

Resource mobilisation and its diversion into different channels by the financial system in general and the banking system in particular plays a crucial role in a planned economy. In Nepal, credit planning can help achieve many goals. Firstly, the vice-like-grip of big borrowers over the banks can be loosened. Secondly, the genuine credit gaps can be identified and filled up. Thirdly, a project-oriented approach can be adopted in giving loans. Thus, innovative entrepreneurs, especially of the core sectors, will not be starved of credit only because they do not have proper collaterals to offer. Fourthly, the branch managers can help discover local skills and talents, which can be harnessed to build up small scale and tiny industries. In Nepal, 'small is beautiful' and the national policy admits that the small scale enterprises can be viable. They rather give the biggest promise for national economic regeneration. The banks have the duty to locate and promote such feasible enterprises. Fifthly, banks can help promote savings and their activisation. Finally, banks can see to it that the public distribution system in its task of making available essential commodities to the people is not handicapped by resource drought. Credit planning is not the panacea. Still, with its help the credit sector can and should contribute to the resource requirements of the various sectors of the economy according to the plan priorities. It is high time banks rationalise their credit structure. The study period of the article extends to the five year Plan sixth which ended in mid-July 1985. Although many conceptual and practical improvements have been observed in the banking, monetary and fiscal fields since then especially after the implementation of the structural adjustment programme in Nepal since 1987, it is nonetheless believed that the article would be of some theoretical interest to the readers in the subject of credit planning-ed.

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24 T.S. Campbell, Monetary Policy and Bank Portfolio Composition: An Empirical Analysis of their Impact on GNP. Journal of Money, Credit and Banking, Ohio University Press, Vol X, No. 2, May, 1978, p. 240.