to achieve growth with stability in an economy. All the instruments of credit control may broadly be divided into following two categories. These are called instruments of monetary policy. Monetary policy is the policy of the central bank to control and regulate money supply and credit in the economy.

(A) Quantitative methods of credit control and

(B) Qualitative or selective methods of credit control.

The Quantitative methods include those instruments which affect the total volume of credit and affect all sections of the economy. It includes the following instruments:

(i) **Bank Rate Policy:** Bank rate is the rate at which central bank provides loan to the commercial banks. The increase in bank rate by the central bank increases the cost of funds to the commercial banks which in turn is passed on to their customers. High rate of interest reduces demand for loan and thus the quantity of credit/money in the economy which squeezes aggregate demand in the economy. Bank rate is increased to control inflation in an economy and it is reduced to fight deflationary situation in the economy.

(ii) **Open Market Operations:** Open market operations refer to the policy of sale and purchase of government securities in the open market by the central bank. The central bank sells and purchases these securities mainly to and from the public and commercial banks. If the central bank wants to control inflation it sells securities in the market so that the excess liquidity may be transferred from public to the central bank. This measure controls the aggregate demand and inflation in the economy. The central bank starts purchasing securities in the market to boost aggregate demand and fight deflation in the economy.

(iii) **Variable Legal Reserve Ratio:** The central bank can influence the credit creating power of commercial banks by varying CRR and SLR. Increase in LRR reduces credit creation capacity of commercial banks and decrease in LRR increases this power of the banks. LRR is increased during inflation and decreased during deflation.

The qualitative or selective credit control does not influence the quantity of credit/money in totality but it is directed towards controlling credit in a particular use of credit. The qualitative methods of credit control are as follows:

(i) **Margin Requirements:** The commercial banks grant loan to borrowers against some collateral securities whose value is more than the the value of loans granted. The difference between the value of collateral securities and the amount of loan is called margin. Increase in margin requirement reduces loan eligibility of the borrower which central uses at the time of inflation. During deflationary situation margin requirement is reduced to promote the growth of volume of credit/money in the economy.

(ii) **Moral Suasion:** Under this method central bank persuades and pressurises the commercial banks to adopt a credit policy which is in line with the overall objectives of the economy.

(iii) **Credit Rationing:** Under this method central bank fixes maximum ceiling of loans to be granted by the commercial banks either on aggregate basis or for a particular use. The rate of interest may vary across sectors or uses.

INTEXT QUESTIONS 28.4

1. Which of the following statements are true and which are false?
   (i) Central Bank is an apex bank in an economy.
   (ii) Central bank has little role in controlling and regulating the operations of commercial banks.
   (iii) Central bank acts as banker to the government.
   (iv) Central bank plays an important role in controlling and regulating money supply in an economy.
   (v) Quantitative methods of credit control influences the overall supply of money in an economy.
   (vi) Increase in bank rate reduces supply of money in an economy.
   (vii) During inflation the central bank increases bank rate and during deflation it reduces the bank rate.
   (viii) During inflation the central bank starts purchasing securities in the market.
   (ix) Selective credit control measures influence supply of money only in some sectors of the economy.
   (x) Credit rationing is an important form of selective credit control.

WHAT YOU HAVE LEARNT

- Barter system is a system of exchange under which goods are exchanged for goods without the use of money.
- Barter system suffered from many difficulties like lack of double coincidence of wants, lack of common measure of value, absence of standard of deferred or future payments and difficulty and wastage in the storage of wealth.
- Money is anything which is generally accepted as a means of exchange.
- Money also acts as measure and store of value and as standard of deferred payments.