

BANKING IN INDIA - DEVELOPMENT AND STRUCTURE

by

Swarn Singh Upal

B.A., University of British Columbia.

A thesis submitted in partial fulfilment of the
requirements for the degree of

MASTER OF ARTS

in the Department of
Economics and Political Science

We accept this thesis as conforming to the
standard required from candidates for the
degree of

MASTER OF ARTS

Members of the Department of
Economics and Political Science

The University of British Columbia

October, 1963.

In presenting this thesis in partial fulfilment of the requirements for an advanced degree at the University of British Columbia, I agree that the Library shall make it freely available for reference and study. I further agree that permission for extensive copying of this thesis for scholarly purposes may be granted by the Head of my Department or by his representatives. It is understood that copying or publication of this thesis for financial gain shall not be allowed without my written permission.

Department of

Economics

The University of British Columbia,
Vancouver 8, Canada.

Date

October 3, 1963

BANKING IN INDIA - DEVELOPMENT AND STRUCTURE

By

SWARN SINGH UPAL

(ABSTRACT)

In spite of the fact that Indian civilization was at the height of its glory when Western civilization had not yet seen the light of day, and India was once far more advanced industrially than any one of the present industrialized nations, the Country until very recently had long been the forgotten Nation of the East because her affairs were controlled for some two hundred years by a foreign colonial power. It was only as recently as 1947 that India finally got her independence and the national Government was able to take steps to improve the economic condition of its people. This was to be accomplished through a broad developmental program, consisting of a succession of Five Year plans. In this herculean undertaking the Country's banking system has played and continues to play a leading role. It provides the Country's currency, finances its current output and mobilizes in one form or another the savings so desperately needed for the industrial expansion program now underway in India. In view of its importance in the expanding Indian economy the author undertook, as a thesis, the task of setting forth both historically and analytically the structure and development of the Indian banking system.

The System itself consists of two large non-competing, though

not completely dis-associated, parts usually referred to as the "organized" and "unorganized" sectors of the Indian money market. The link between the two sectors is so weak and tenuous that changes in one are seldom reflected in the other. The unorganized sector consists of a large number of Indigenous bankers and money lenders who, since time immemorial, have catered to the banking and credit needs of the Indian economy. With the institution of the European banks in India the activities of these bankers were mainly restricted to financing the internal trade of the Country and to providing for the credit needs of agriculturists, artisans, small tradesmen, etc., and save for local trade associations, national trade organizations and such correspondents as outside collections and remittances make necessary, these bankers operate independently without any direction or control by the Reserve Bank. So far all attempts of the Reserve Bank to bring them within its province and thus regulate their banking business have borne no fruit.

It has long been held, with some element of truth, that the members of the unorganized sector of Indian money market tend to charge exorbitant rates of interest on their loans, and have long stood in the way of the economic progress of the Country. Moreover it is contended that they have further complicated and compounded the problems of their usually impoverished borrowers. However, this extremely one-sided view seems to overlook their real contribution to Indian banking needs and the important role they play in financing the internal trade of the Country. They provide credit facilities to those who can provide no tangible security and thus finance many undertakings which could not otherwise be carried out.

The so called organized sector of the Indian money market consists of: i) a substantial number of privately owned Joint Stock banks incorporated under Indian laws and manned primarily by Indian nationals; ii) a number of branches of foreign banks popularly known as Exchange Banks which are managed almost entirely by foreigners; iii) a State sponsored System of Cooperative and Land Mortgage banks designed ultimately to support the Indigenous bankers and money lenders; iv) a rather unique postal savings system which provides savings facilities to the lower income group of the Indian population and channel these savings into productive enterprises through the purchase of Government securities; v) the now publicly owned State Bank of India which even as a foreign owned and operated institution, serving an immense private banking clientele, functioned for many years as a semi-central bank of India, and still retains many of its central banking functions; and finally, vi) the recently established and now nationalized Reserve Bank of India around which have been arranged a number of public and semi-public financial institutions which in one way or another are designed to help fulfil the twin goals of the National Government - i.e., a modern self-sustaining industrial economy based on a socialistic pattern.

In addition to the Reserve Bank itself the latter group includes among others the aforementioned State Bank of India, the Industrial Finance Corporation, the National Industrial Development Corporation and the Life Insurance Corporation of India. The latter has been given a monopoly of all life insurance business within India and thus collects and makes available to the Government a large part of the

voluntary savings of the Indian people.

The author's task in this thesis is a large yet unpretentious one. By tracing the growth and development of each of the above classes of institutions he has sought to bring before a Western audience not only the nature of the banking structure and banking practices in India but the related problems still to be solved if the Country is to achieve the ultimate goal of a higher standard of living in a self sustaining and dynamic economy. Each of the several classes of banks has been analysed with a view to establish its past contribution to the development of India and the role it is designed to play for the future growth of Indian economy.

Most of the Country's financial planning and planning instrumentalities originate in the joint action of the Government and the Reserve Bank with the latter in the role of a consultant advisor and finally that of a servant to carry out the planned programme. In an overall sense the expanding role of the Reserve Bank provides the most revealing part of this thesis. This institution has developed into a strong, all embracing central bank employing the most modern credit control and direction measures. The bank has used these measures not only to check any undue increase in bank credit but to channel it into various planned productive enterprises. Moreover it functions as a regulatory authority over all public and private, scheduled and non-scheduled banking institutions. In this capacity the Bank has strengthened the Indian banking structure by encouraging and insisting on the consolidation of small banks and has improved their operations by a system of regular inspections. Its achievements since its nationalization both in the

field of monetary management and the development of a sound and efficient banking system provide a new chapter in the history of Central banks.

Joseph A. Grant

TABLE OF CONTENTS

Chapter	Page
Preface	i
Table of Contents	vi
List of Tables	xii
I ORIGINS AND ANTECEDENTS OF EXISTING BANKING INSTITUTIONS	1
Part 1. Indigenous Bankers and Money Lenders	1
2. Indian Joint Stock Banks	10
Development to 1860	10
Early Growth	11
Development Between 1860-1935	13
Indian Banks and the Upsurge of Nationalism	15
3. The Presidency Banks	20
Capitalization	20
Functions	21
Progress to 1935	23
4. Exchange Banks	26
Functions	27
5. Cooperative Banks	30
Establishment	31
The Cooperative Societies Act	31
Progress to 1935	34
6. Postal Savings Banks	38
II. THE RESERVE BANK OF INDIA	40
Part 1. Antecedents, Proposals and Institutions	41
Imperial Bank Experiment	42
Findings of the Hilton-Young Commission	43

	The Round Table Conference and the Emergence of the Reserve Bank of India	46
Part 2.	Provision of the Enabling Act	47
	Capitalization and Ownership	48
	Administration and Control	49
	Prerogatives and Functions	51
	Note Issue	51
	Exchange Control	53
	Fiscal Agent for Government	54
	Reserve Bank as a Banker's Bank	55
	Membership Qualifications	55
	Clearing and Collecting Facilities	56
	Legal Reserve Depository	57
	Lender of Last Resort	58
3.	The Role of the Reserve Bank, 1935-49	59
	As a Monetary Authority	61
	As a Banker's Bank	64
	As a Banker by Government	65
	Reserve Bank Credit and Prices	69
III.	DEVELOPMENT IN THE PRIVATE BANKING SECTOR, 1935-49	74
Part 1.	Indigenous Bankers and Money Lenders	75
	Proposed Inclusion in Reserve System	75
	Money Lenders and Rates of Interest	78
	Character Loans - Professional Money Lenders	79
	Character of Loans - Non-Professional Money Lenders	79
	Rates of Interest	80
	Government Regulations	81
2.	Indian Joint Stock Banks	82
	Amendments to 1913 Companies Act	84
	Other Legislation Prior to 1949	87
	Growth and Operations 1935-49	88
	Comparative Importance - Scheduled and Non-Scheduled Banks	90

	<u>page</u>
Part 3. Imperial Bank of India	96
Relations with Government and Reserve Bank of India	96
Nature and Size of Operations 1935-49	100
4. The Exchange Banks	102
Nature of Criticism	102
Growth 1935-49	104
5. The Cooperative Banks	106
Restrictions and Regulations	106
The Land Mortgage Banks	108
Membership and Operations Cooperative Credit Societies	
Cooperative Credit Societies	110
The Central Cooperative Banks	111
The State Cooperative Banks	115
Number and Operation of Land Mortgage Banks	117
Combined Operations, Primary and Central Banks	117
Relative Importance of Primary and Central Land Mortgage Banks	119
6. The Postal Saving System	121
IV. NATIONALIZATION AND EXTENSION OF CENTRAL AUTHORITY	124
Part 1. Nationalization of the Reserve Bank	126
Changes in Administrative Structure	131
Jurisdictional Changes	132
Extension of Regulatory Authority	133
The Licensing of Banks	134
Directives to Loans and Interest Rates	135
Merger and Amalgamation	135
Appointment of Officials	136
Inspection, Supervision and Suspension	137

	<u>page</u>
Additions to Instruments of Monetary Policy	138
Selective Credit Control and Credit Rationing	138
Interest Rates on Deposits	139
Reserve Ratio Manipulation	140
Moral Suasion	141
2. Nationalization of the Imperial Bank	141
Ownership of the State Bank of India	144
Administration and Management	145
3. Industrial Banks and the Life Insurance Corporation of India	145
The Industrial Finance Corporation	146
Capitalization and Ownership	146
Administration and Control	148
Source of Working Capital	148
The State Financial Corporations	149
Capitalization and Ownership	150
Administration and Control	151
Source of Working Capital	152
The National Industrial Development Corporation	152
Capitalization and ownership	153
Administration and Control	153
The Industrial Credit and Investment Corporation	154
Capitalization and Ownership	155
Administration and Control	156
The Refinance Corporation	157
Capitalization and Ownership	157
Administration and Control	158
The National Small Industries Corporation	159
Capitalization and Ownership	160
Administration and Control	161
The Life Insurance Corporation of India	161
Capitalisation and Ownership	162

	<u>page</u>
CHAPTER V. OPERATIONS OF THE RESERVE BANKS, THE STATE BANK AND OTHER FINANCIAL INSTITUTIONS 1949 ONWARD	164
Part 1. Operations of the Reserve Bank, 1949 onward	165
The Exercise of Monetary Authority	165
Counter Measures for the Korean War Inflation	166
Bank Rate	167
The Bill Market Scheme	169
Extension of Bill Market Scheme	170
The Containment of Budgetary Inflation	172
Bank Rate and Open Market Operations	173
Selective Credit Control in Agricultural Products	174
On Paddy and Rice	174
Ground Nuts	178
Raw Jute and Jute goods	179
Selective Control on Stocks and Shares	180
Credit Rationing	182
Reserve Ratio Variation	184
Moral Suasion	187
Accomplishments of the Monetary Control	188
Reserve Bank Operations	191
Part 2. The State Bank of India - Operations and Growth	195
Extension of Duties and Facilities	196
The State Bank and Financing of Small Industries	197
The State Bank and Agricultural Finance	199
Magnitude of Operations 1949-61	200
Part 3. Operations of Industrial Banks and Life Insurance Corporation of India.	203
The Industrial Finance Corporations	203
The State Financial Corporations	208
The Industrial Credit and Investment Corporation	211
The National Industrial Development Corporation	214
The Refinance Corporation	217
The National Small Industries Corporation	219
The Life Insurance Corporation - Operations	222

	<u>page</u>
CHAPTER VI. PROGRESS IN PRIVATE SECTOR 1949 ONWARD	227
Part 1. The Indigenous Bankers	228
Indigenous Bankers and the Reserve System	229
Formulae for Consideration	230
Part 2. Joint Stock Banks	233
Provisions of the Banking Companies Act, 1949	233
Impact of the Banking Companies Act on Indian	
Joint Stock Banks	237
On the Conduct of these Banks	237
On Joint Stock Bank's Operations 1949 Onward	241
Scheduled and Non-Scheduled Banks	244
Concentration of Banking Business	246
Part 3. The Exchange Banks	251
Effects of the 1949 Banking Companies Act	251
Trend in Operations	253
Comparative Growth	255
Part 4. The Cooperative Banks	257
Measures Relating to Cooperative Banks	258
Inspection and Training of Personnel	261
Operations of Cooperative Banks	262
Primary Credit Societies	262
The Central Cooperative Banks	263
The State Cooperative Banks	266
Operations of the Land Mortgage Banks	268
Primary Land Mortgage Banks	269
Central Land Mortgage Banks	269
Measures Relating to Land Mortgage Banks	272
Part 5. Postal Savings Banks	273
CHAPTER VII. SUMMARY AND CONCLUDING OBSERVATIONS	276

List of Tables

	Page
Number, Principal Assets and Liabilities of Indian Joint Stock Banking Enterprises Between 1870 and 1935	18
Principal Assets and Liabilities of the Presidency Banks - 1870-20, and the Imperial Bank, 1920-35 Inc.	25
Number, Deposits, Cash in Hand and Earning Assets of Exchange Banks, 1870-1935	29
Number, Membership and Working Capital of Cooperative Credit Institutions in India, 1907-1935	37
Number, Deposits and Balances Outstanding of Postal Saving System Between 1885-1935	40
Short-term Operations of the Reserve Bank 1936-1949 Inc.	63
Operations of the Issue Department of the Reserve Bank, 1935-1949 Inc.	67
Operations of the Banking Department of the Reserve Bank 1935-49 Inc.	68
Combined Operation of the Reserve Bank of India 1936-49 Inc.	70
Government Debt, Reserve Banks' Credit and Purchasing Power of the Rupee 1936-1949 Inc.	72
Number, Principal Assets and Liabilities of Indian Joint Stock Banks (Excluding Imperial Bank) 1935-1949 Inc.	91
Number, Principal Assets and Liabilities of Non-scheduled Banks 1935-49 Inc.	92
Number, Principal Assets and Liabilities of Scheduled Banks (excluding Imperial Bank) 1935-49 Inc.	93
Comparative Number, Deposits and Earning Assets of Indian Scheduled and Non-scheduled Banks 1936, 1940, 1945 and 1949	95
Branches, Principal Assets and Liabilities, Imperial Bank of India, 1935-49 Inc.	105
Number, Deposits and Earning Assets of Exchange Banks in India, 1935-49 Inc.	105
Number and Business of Primary Cooperative Credit Societies, 1935-1949 Inc.	112
Number and Business of Central Cooperative Banks, 1935-49 Inc.	114

	Page
Number and Business of State Cooperative Banks, 1935-49 Inc.	116
Number and Business of Central and Primary Land-Mortgage Banks (Separately), 1945-1949 Inc.	118
Number, Deposits and Balances Outstanding Postal Savings System	122
Comparative Percentage Increase in Employment by Industries, Periods 1934-1939 and 1939-1945	126
Regional Distribution of Ownership of Reserve Bank Shares, 1935-1948 Inc.	128
Regional Distribution of Share-Holders, 1935-1948 Inc.	128
Comparable Rates of Growth of Public Debt, Reserve Banks Credit and National Income, 1949-1961 Inc.	190
Principal Assets and Liabilities of the Reserve Bank (Issue and Banking Departments) of India, 1949-1961 Inc.	192
Principal Assets and Liabilities, Reserve Bank (Issue Department) of India, 1949-1961 Inc.	193
Principal Assets and Liabilities, Reserve Bank (Banking Department) of India, 1949-61 Inc.	194
Branches, Principal Assets and Liabilities, State Bank of India 1949-61 Inc.	202
Operations of the Industrial Finance Corporations 1950-61	205
Business of State Financial Corporations, 1955-61 Inc.	210
Loans, Guarantees and Underwriting Operations of Industrial Credit and Investment Corporation, 1956-61	212
New Business of the Life Insurance Corporation and its Predecessor Insurance Companies 1954-61	223
Distribution of Investment Portfolio of the Life Insurance Corporation 1957-60	226
Number, Capital and Deposits of Banks, Liquidated or Otherwise Closed, 1953-61	239
Number, Principal Assets and Liabilities of Private Indian Joint Stock Banks	243
Comparative Number, Deposits and Earning Assets of Indian Scheduled and Non-scheduled Banks, 1950-1955 and 1960	245

Number, Principal Assets and Liabilities of Non-scheduled banks 1949-61	247
Number, Principal assets and Liabilities of Privately owned Indian Scheduled Banks 1949-61	248
Relative Importance of Ten largest Indian Banks at the end of 1961	250
Number, Principal Assets and Liabilities of Exchange Banks, 1949-61	254
Relative Importance of Exchange Banks and other Primary lenders in Indian Banking Structure, 1950-1999 and 1960	256
Number, Loans and Working Capital of Primary Credit to Societies 1949-1960	264
Number and Business of Central Cooperative Banks 1949-61	267
Number and Business of State Cooperative Banks 1949-61	267
Number, Loans and Working Capital of Primary Land-Mortgage Banks	270
Number, Loans and Working Capital of Central Land-Mortgage Banks	271
Number and Deposits of Postal Savings offices 1949-61	274

PREFACE

India, like many other developing countries, is in the process of attempting to accomplish through a succession of five year plans the enormously complicated task of modernizing her economy through the establishment of new industrial enterprises and the improvement of the Country's agricultural operations with a view to raising in so far as possible the living standard of the people which is one of the lowest in the world today. In this mountainous task great reliance has been placed on financial institutions, some of the more important of which have emerged as a part of the planned development itself. Others are not of such recent origin yet still make very important contributions to the Indian banking structure and to the Indian economy in general. The author of this thesis has undertaken as his task to present to a Western audience the origins and development of the several main categories of banking institutions in India, and in the process of doing so to analyse the problems that banks have encountered both in the past and more recently in connection with the projection of the Country's modernization program...

For purposes of exposition the development of Indian banking system is divided into three main periods: 1) developments from the earliest times down to 1935 when Reserve Bank of India was established as a private institution; 2) developments between 1935 and 1949 when the Reserve Bank was nationalized - a period which includes not only the problems incident to India's participation in World War II, but those as well that arose in connection with the partition of India and the Country's ultimate assumption of Sovereign authority over its own

destiny; 3) developments after 1949 the more important of which took place under the vigilance of the nationalized Reserve Bank now working hand in hand with the Government to expedite the planned economic development of the Country on a socialistic pattern.

India now has five principal categories of banking institutions namely: Indigenous banks and money lenders; Indian Joint Stock banks organized and operated under Indian banking laws and regulations; foreign owned and operated Exchange banks; Cooperative banking institutions sponsored by the respective States; a postal savings system, and finally a group of public and quasi-public banks arranged around the nexus provided by the Reserve Bank of India. In addition to the Reserve Bank itself considerable importance is attached to the State Bank of India which as the Imperial Bank of India has served to all intents and purposes as the Country's semi-central bank until 1935; and continues to serve in that capacity at places where the Reserve Bank has no competing branches. The State Bank and its subsidiaries play an important role in spreading banking facilities to the remote corners of the Country and in providing short and medium term loans to agriculturists and to small industrial enterprises. Significant roles are also played by the Industrial Finance Corporation, the State Financial Corporations, the National Industrial Development Corporation, etc., which are designed to handle the financial needs of industrial enterprises; and by the Life Insurance Corporation which has a monopoly of all the life insurance business of the Country and thus can make available to the Government, for investment, most of the voluntary savings of the Indian people.

The material on each class of these banking institutions is so arranged that the reader may trace its development through each of the periods adopted for the overall plan of the thesis. Yet one may also concentrate on the comparative developments affecting each class in any one period. Thus it follows that the origin of all constituents of Indian banking system save the recently established public and quasi-public banking institutions will be found in Chapter One which brings their development down to 1935. Chapter Two is devoted to the establishment and performance of the Reserve Bank of India between 1935 and 1949. Chapter Three is given over to the changes in laws affecting the private banks including the then Imperial Bank of India and to the performance of the various categories of banks between 1935 and 1949. Chapter Four is given over to the nationalization of the Reserve Bank of India, the Imperial bank, the life insurance business in India and to the establishment of several public, semi-public and private financial institutions designed to expedite the financing incident to the carrying out of the successive five year plans. Chapter Five traces the performance of each of these categories of financial institutions between 1949 and 1961. In Chapter Six we have presented the important legislative measures affecting the operation of banking institutions still in the private sector. Here the growth and expansion of these banks and their relative importance in the Indian banking system have been emphasized. In Chapter Seven the author has attempted to bring together such pertinent conclusions and observations as may properly be made from the analyses which have already been made in connection with the

progress of each categories of banks particularly in respect of the Reserve Bank itself to which, save for the Indigenous bankers and money lenders, all other banking enterprises have been made more or less subordinate..

The study of the Indian banking system is fraught with more than the usual difficulties encountered in undertaking a work of this character. There is a considerable scarcity of original source material. The author had to depend on inter-library loans which in itself was an arduous task and involved considerable delay. More often than not it provided him with material that did not prove to pertain to the subject. The documentation of the little material that is available in the Asian Studies Library has not yet been completed. Finally such information as is available is extremely fragmentary and often difficult to translate into Western usage. The statistical data usually need more explanation before one can comprehend, compare and interpret them intelligently. The data are sometimes changed from year to year without sufficient explanation. Moreover data even from the same source are sometimes conflicting.

This study was undertaken at the suggestion of Professor Joseph A. Crumb and has been carried through under his constant guidance and often unrelenting criticism. While I am wholly responsible for the demerits of the work, these would have been far greater but for his vigilance. In fact this work would have been impossible without his generous help. I am deeply indebted to other persons who have helped me in many ways to complete this work. I would like to thank the staff of the Social Sciences Division and the Humanities Division of

the University library who kindly arranged a large number of books on inter-library loans for me and fully cooperated in obtaining other needed material. I would also like to thank Professor William L. Holland, Head of the Asian Studies Department, who so kindly arranged to lend me many useful books from his personal library and also made the Asian Studies library available to me. The Bank of Canada proved most cooperative in providing a copy of the Reserve Bank of India Act, 1934, and the Reserve Bank of India's Reports on Currency and Finance without which a part of the information included in the thesis would have been far less complete.

CHAPTER I

ORIGINS AND ANTECEDENTS OF EXISTING BANKING INSTITUTIONS

Though a transformation of considerable consequence has recently been made in the structure, ownership and control of banking in India, the underlying pattern of these institutions and their practices, many of which are of very early origin, remains basically unchanged. It consists of native or indigenous bankers and money lenders; branches of foreign banks known as exchange banks, local banking institutions originally sponsored by foreign interests and resident aliens; now classified as Indian joint stock banks; the presidency banks; the cooperative banks and the postal savings system.

Part 1

Indigenous Bankers and Money Lenders

The indigenous bankers and money lenders, who have traditionally catered to the needs of peasants, artisans and small trading and manufacturing enterprises in India, make up the oldest if not the most significant part of the country's banking structure. Although there is no clear demarcation between indigenous bankers and money lenders, the former, as a rule combine their banking business with mercantile and trading enterprises, and do not necessarily distinguish the one type of undertaking from the other. They accept time deposits withdrawable by person and characteristically finance trade and small industries. As they often advance secured loans and their clients are punctual in

repaying their loans the indigenous bankers generally charge a lower rate of interest than the money lenders. The latter do not accept deposits and mostly finance consumption and indebtedness. The professional money lenders known as Mahajans, Sahukars and itinerant money lenders such as PATHANS, NAGAS, GOSSAINS, QUISTWALAS, etc., are generally known to be available to anyone who desires to negotiate a loan. The non-professional money lenders, who are mostly well-to-do agriculturists, pensioners, widows, priests, shopkeepers, labour foremen are not generally known to be money lenders, but lend as a rule to their friends and acquaintances. The non-professional and itinerant money lenders are often more greedy and charge higher rate of interest than the professional money lenders. They generally make unsecured loans to improvident and impoverished borrowers.

If we were to look into ancient Indian history, we would find that the business of financing and money lending were followed originally by Vaisyas and later on by Baniyans, Shroffs, Multanis, Chettiers, etc., castes usually identified with commerce and trade. Even during the Vedic Age, which approximately covers the period from 2000 B.C. to 1400 B.C., the granting of loans and credits in one form or another was carried on by Indian merchants, traders and money lenders Debt (Rna) is repeatedly mentioned in the Rig Veda - the sacred book of the Hinduism - apparently having been a normal condition among the Vedic Indians.¹ However, little is known about either the method of recording the loans, the period of payment or the rate of interest.

1. L.C. Jain, Indigenous Banking in India, Macmillan & Co.Ltd., London, 1929, p.3.

After the sixth century B.C. Buddhist writings reveal to some extent the nature of the prevailing lending practices and the heavy burden of interest borne by the debtor. According to Professor Jain, who obtained his information from the Buddhist life stories (Jatkas), the legal rate of interest was usually set at 15 per cent per annum,² but this does not appear to have been an upper limit. In Kautilyas Arthashastra, an important compilation of rules governing among other things the lending of money, fixing of rent, rate of interest, etc., which were current from about 400 to 200 B.C., it was held "that 15 per cent should be the maximum legal rate of interest on secured loans. On unsecured loans the nominal maximum was 60 per cent, but the actual rate could go as high as 240 per cent if the risk element was also very high".³

Between 200 B.C. to 200 A.D. trade and industry flourished in India and Indian merchant bankers, in addition to accepting deposits and making loans, engaged in financing internal trade. According to Professor M. Taylor both the art and science of banking was comparatively well developed at this time.⁴ He reaches this conclusion after familiarising himself with the writings of Manu - an eminent contemporary law-giver and advisor to the crown. The laws of Manu,

2. E.C. Jain, op. cit., p. 5

3. S. G. Panandikar, Banking in India, Orient Longmans Ltd., Calcutta, 1948, p.1.

4. M. Taylor, Student's Manual of the History of India, as cited by G.B. Jather and S. G. Beri, Indian Economics, Vol. II. Humphrey Milford, Oxford University Press, Madras, 1937, p. 440.

he states, "disclose how thoroughly the art of banking was known 2000 years ago. Then bankers understood and followed the fluctuation of money value. They kept account books and ledgers by simple and double entry. They charged interest and compound they granted bills of exchange and, in short, they followed the practices of modern times which are little changed from ancient rules".⁵

The Muslim invasions of India during the 10th century A.D. brought a period of uncertainty and insecurity. As the invaders were mainly interested in Indian riches, they looted and plundered everywhere they went. Baniyans, Shroffs, Multanis and other banking communities were hardest hit. In addition to personal losses, the invasions virtually brought to an end their deposit or safe keeping business because the people no longer trusted the bankers with their savings. The general public began to hoard its money savings by burying precious metal and coin, either in the ground, or in the wall or in some other inconspicuous place in their homes - habits which have persisted to some extent among Indians down to the present time.

Even though that of a conqueror Muslim rule established law and order throughout the country and thus gave an impetus to trade and commerce. Eventually the country again prospered. Local bankers took advantage of the opportunity and again added the financing of trade to their business activities. The money lenders presumably continued with little interruption their age-old usurious practices.

5.

G.B. Jather and S.G. Beri, op. cit., p. 440

It was during this period that the bill of exchange (Hundi)⁶, as we know it today, came into common use.

Referring to the discount rates charged on bills of exchange J.B. Taternier, a French traveller, reported that "at Lahore on Surat the exchange goes up to 6.1/4 per cent; at Agra from 4.1/4 to 5 per cent; at Ahmadabad, from 1 to 1.1/2 per cent; at Sironj, to 3 per cent; at Burhan Pur, from 2.1/2 to 3 per cent; at Dacca, to 10 per cent; at Patna, from 7 to 8 per cent and at Benaras up to 6 per cent".⁷ Apparently these rates varied according to the extent of competition in the respective exchange market; also according to the degree risk involved in the movement of both. Coins and goods between different trading centres. Trading and financing of trade has since become an important source of income to the indigenous bankers.

6.

A Hundi may be defined as a written order (usually unconditional) made by one person or another for the payment, on demand or after a certain specified time (mentioned in the Hundi) of a certain sum of money to a person mentioned in that order. In the former case it is called a Darshani Hundi (demand bill of exchange) and in the latter case, Muddati Hundi (usance or time bill of exchange).

These hundis can further be sub-divided into the following categories:

- i. Dhanijog Hundi - payable to a Dhani or a person. (commonly used)
- ii. Shahjog Hundi - payable to a Shah or a respectable person.
- iii. Firmanjog Hundi - payable to order.
- iv. Dekhanhai Hundi - payable to the presenter or bearer.
- v. Jokhami Hundi - this hundi is drawn against the goods dispatched and contains certain conditions according to which if the goods are lost or destroyed in transit, the drawer or holder of the hundi has to suffer the loss. It is in the nature of a policy insurance.

7.

Travels in India as quoted by L.C. Jain. op.cit. p. 14.

Money changing was also an important source of income for the indigenous bankers during the period of Muslim rule. The Muslim rulers set up numerous mints in India and each succeeding ruler issued his own coins. Later issues were generally of different weight and design than were those minted earlier. At that time only bankers were qualified to handle the exchange and assaying business and reconstitution of the coinage provided them with an added source of income. Moreover many bankers were appointed as the officers of the mint by the state. In this capacity they bought the metal, minted coins and shared the profits with the Muslim rulers. During the reign of the Mughal Emperor, Akbar the Great, there were four gold mints and the number of silver and copper coin mints were estimated at fourteen.⁸ The market price of a coin, at that time, was determined not only by its face value but by the year and the reign during which it was coined, also the wear and tear suffered during its use. Discontinued coins were frequently valued at considerably less than their bullion value. The money changers melted down these coins and got them recoinced at a profit.

Referring to the chicanery of these money changers, J.B. Tavernier stated, "All the Jews who occupy themselves with money and exchange in the Empire of the Grand Seigneur pass for being very sharp; but in India they would scarcely be apprentices to these Indian Money changers".⁹ However, the money changing business came to an end in 1835 when the currency of British India was unified by the East India Company.

8. N.K. Sinha, The Economic History of Bengal, vol.I.
Sri Lalchandroy Gossain and Co. Calcutta, 1956. p.118.

9. Travels in India as quoted by L. C. Jain, op.cit. p. 11.

In addition to their lending and money changing activities, native Indian bankers rendered important services to the state, such as lending money to the state, collecting revenue, etc. Some of these bankers held prominent positions in the Royal Courts. In fact there was no Court without a state banker - a position generally held by a well-established and well known merchant banker. This gave the local bankers a privileged position. They performed most of the functions of a modern state bank.

Of all the native bankers in India, the House of Jagat Seth was the most prominent. One may compare the position of this banking house with that of the Bank of England in its earlier stages of development. It reached the height of its glory under Fateh Chand, a merchant banker of Bengal, who apparently managed all the state loans as well as his own substantial business. When referring to this banking house, Professor Muranjan tells us that in 1722 the Emperor Mohamad Shah conferred on Fateh Chand the title of Jagat Seth or world banker as a hereditary distinction; also, the Khillat (insignia of the magnificent robes of honour), an elephant and a pearl ear-ring.¹⁰ Thereafter no Emperor of Delhi ever sent the Khillat to the Nizam of Bengal without also sending one to the Jagat Seth.

When the European traders came to India during the first half of the 17th Century they found indigenous bankers to be well equipped to handle domestic banking needs but incapable of handling the credit required to finance either the newly imported products or the exports

10.

S.K. Muranjan, Modern Banking In India, Kamla Publishing House, Bombay, 1952. p. 9.

necessary to pay for them. There were no mercantile establishments through which external trade could be channeled because Indian bankers and merchants had little knowledge of external trade practices. Moreover there was a language barrier and probably some hostility towards foreign profit seekers.

In order to overcome these difficulties the European traders employed, first, Indian bankers in their services but ultimately set up their own merchant houses. The East India Company employed Indian bankers at its trading centers in Surat, Agra and Calcutta. An indigenous banker by the name of Burgee Parack was the banker and financier of the company at Surat. In 1685 he was voted the treasurer and interpreter (Baniya) at Surat, a gold medal and a chain of the value of ₹ 150.¹¹ Professor Sina states that "the 18th Century Bengali baniya was interpreter, head book-keeper, head secretary, head broker, the supplier of cash and cash keeper"¹². About a century later when the revenue collection of Bengal was handed over to the East India Company, Indian bankers served as collectors for the Company.

By the end of the 18th century the Muslim rule at Delhi had become weak, corrupt and ineffective and the British influence in Bengal was being established. There were continuous wars between the different states of India and between the Indian States and the East India Company. Under these unsettled conditions trade practically disappeared and along with it the business of native Indian bankers.

11. S.K. Muranjan, op. cit., p. 9.

12. N.K. Sinha, op. cit., Vol.I. p.118.

Many of them lost their personal fortunes because even the owners of princely states could not repay their loans, Many other borrowers failed to honour their obligations. The ranks of the Indian bankers were further thinned by the emerging competition of the former employees of the Company who meantime entered the banking and trading business in the more important commercial centers. These company servants were given special privileges such as exemption from excise taxes; they also enjoyed cordial relations with Company officers. Sometimes they even doubled as Company officials to get better prices from Indian dealers. Through these devices and others they were able in many instances to take over the business of Indian merchants.

The loss of business and personal fortunes built up earlier under the Company's patronage by the indigenous bankers was never fully recovered. With the establishment of Company's rule in Bengal, and the consequent increase in its trade, it became expedient to replace the native bankers either with Agency Houses or Company enterprises under its sponsorship. Company treasury officers were set up at Calcutta, Bombay and Madras. European trading firms were allowed to establish Agency houses in Bombay, Calcutta and probably in Madras.¹³ Thereafter indigenous bankers tended to revert to their status as merchant bankers in the interior parts of India - a role they have continued to play down to the present time. No data are available on the size and extent of their operations but they, nevertheless, constitute a significant part of Indian banking enterprises. The All India Rural Credit Survey Report of a later

13.

M.V. Subba Rao. An Outline of Banking System in India.
Vora & Co. Publishers Ltd, Bombay, 1948, p. 18.

date (1954) estimates that the Indigenous bankers and the money lenders provide as much as 70 per cent of all rural credits granted in India.¹⁴ They are also very important in the small urban cities

Part 2.

Indian Joint Stock Banks

Corporate Banking ventures in India grew out of the trading activities of both European and native Indians. As indicated above the East India Company allowed European trading firms to establish Agency Houses in the Country's important trading centres - Bombay and Calcutta - and to combine banking facilities with their trading activities. These Agency Houses were manned for the most part by former Company servants who were often able to gain special concessions from the Company and occasionally doubled as Company agents, i.e., Government Agents. Because of their knowledge of local customs, indigenous bankers and money lenders were employed by the Agency Houses and not infrequently became principals in these banking and trading ventures.

Development to 1860

The first of these Banking-trading enterprises, known as the Bank of Hindostan, was established by Messrs. Alexander and Company in 1770 at Calcutta. By the end of 1803, twenty nine such banking-trading ventures were in operation in India.¹⁵

14.

Reserve Bank of India, All-India Rural Credit Survey, p. 9.

Report of the Committee of direction. Vol.II. Bombay, 1954. p. 167.

15.

N.K. Sinha, Economic History of Bengal, Vol.I. Sri Lal Chand Roy Gossain and Co., Calcutta, 1956, p. 90.

Early Growth

Some of the banking enterprises, which grew out of the Agency Houses, issued their own currency notes. Those of the Hindostan Bank, though not accepted by the Company Government, had a local circulation which occasionally rose to as much as Rs 5,000,000.¹⁶ The extent to which the notes acquired circulation depended on their acceptability at the Governments' local treasuries and by the local mercantile and trading establishments in the urban centers. However, regardless of the extent of their acceptability, these notes had little or no circulation in the countryside where people customarily used metallic money.

There was keen competition among these banking-trading houses to secure the status and privileges of Government bankers. Each banking enterprise tried to make its notes legal tender at Government treasuries because with this prerogative it could lend more than its proprietary assets and thus expand its operations. The East India Company recognized the advantages of the banknotes in the internal payment mechanism and eventually accepted those of the General Bank of India. But this Bank went into liquidation during the late 1780's and the Government then turned to the Bank of Calcutta¹⁷ with which, presumably, it continued to deal until 1806 when steps were taken to establish a state partnered bank completely divorced from trading activities.

16.

N.K. Roy, Indian Banking and Money Market, M.C. Sarkar and Sons Ltd, Calcutta, 1952, p. 8.

17.

L.C. Jain, Indigenous Banking In India, Macmillan and Company, Ltd. London, 1929, p. 141.

Since these banking enterprises were carrying trading activities along with banking, and their main motive was trade promotion rather than the stability of their banking enterprises, a number of these so called banks over-extended themselves and failed during what has since been called the 1829-32 banking crisis. In a criticism of the banking practices of this period Professor Jain said, "thanks to the combination of banking with speculative trading ventures, and a policy of placing profits before safety, the inevitable happened during the 1829-33, when commercial disaster overtook the trading firms and brought several of them along with their banking undertakings to ruin".¹⁸ Although the Company gave some assistance to these banks, it was not sufficient to save them from bankruptcy. The commercial disaster of the period 1829-33 appears to show that, if bank failures are to be averted, banking business should not be mixed with commercial undertakings.

During the period from 1833 to 1860 there were few additions and little expansion of joint stock banking and trading ventures. Large scale failure during the 1829-32 crisis had shaken the public confidence in the agency house banking institutions and the East India Company subsequently took steps to establish and support banking institutions - the Presidency Banks - which devoted themselves exclusively to the banking business.¹⁹ During the 1840's and early 1850's several joint stock trading banks were established but most of them either failed or were subsequently amalgamated with other institutions.

18.

L.C. Jain, op. cit., p. 141.

19.

See part 3 page 18. infra.

The slow progress of the Indian banking during this period may also be attributed to attendant economic and political conditions. The Afghan War of the late thirties, the Sikh Wars during the fourties, the ever present anti-British feeling, and, finally, the Indian Revolution of 1857 kept the country in a continuous political turmoil and its economy, unsettled and disorganized. It was only after 1858, when the government of India was transferred to the British Parliament and order was restored, that new attempts were made to establish banking and trading enterprises.

Developments between 1860 - 1935

The year 1860 is an important one in the history of Indian banking enterprises. In that year, under the Act VII, 1860, the privilege of limited liability was introduced in India and extended to the joint stock trading banks.²⁰ Because of this privilege many institutions were established in the years immediately following but the nature of their undertakings were such that only a few survived. In most cases failure to survive was due to investment in the Indian cotton boom which resulted from the American Civil War.

The outbreak of this war had cut off the main source of the supply of cotton for England's Lancashire mills and the British cotton goods industry had turned to India, hitherto only a supplemental source of cotton fibre. As an immediate consequence cotton prices in India rose to about 10 times their normal level.²¹

20.

S.G. Panandikar, Banking In India, Orient Longmans, Bombay, 1948.
p. 11.

21.

A Financial Chapter in History of Bombay, Cited by L.C. Jain,
op. cit., pp. 143-44.

This sudden and unexpected rise led to an extensive increase in the production of cotton in India. The increase was mostly financed by the newly established joint stock banking-trading ventures. The usual procedure, according to Professor Jain, was as follows.²² A land reclamation company would be formed and the capital required for preparing the land for cultivation would be supplied by a financial consortium made up of a group of owners of newly established trading banks. Many of these reclamation projects were not well conceived, others were mismanaged and probably burdened with heavier financial charges than they could carry. Moreover, the end of Civil War in the United States of America brought even the successful ventures into competition with original suppliers in the United States. This resulted in the large scale failure during the years 1965 and 1966, involving the trading banks as well as the cotton enterprises themselves.

During the years which followed the cotton boom the progress of Indian banking enterprises was undoubtedly retarded by the currency confusion that existed in India between 1870 and 1893. By 1870 most of the world's leading countries had abandoned bimetallic standards in favour of gold. Unfortunately for silver standard countries like India, almost immediately thereafter huge deposits of silver were discovered in the America's, substantially increasing the flow of silver to the World markets and depressing its price considerably below its mint parity with gold. This had the effect of seriously depressing the sterling equivalent of Indian rupees and thus raising considerably import prices in India. For the time being at least,

22.

L.C. Jain, op. cit., p. 147

it also lowered the sterling recoveries of Indian -exporters committed to Rupee contracts. Under the Coinage Act of 1893, the free coinage of silver and of gold was abandoned and the rate on sterling was fixed at 1 = Rs.15.²³ Had it not been for the exchange instability and the abortive cotton boom which preceded it, it seems reasonable to assume that the growth of joint stock banking and trading enterprises would have been substantial during the latter part of the 19th century.²⁴ As a result of these unhealthy developments there were only nine such trading banks with a capital and reserves of Rs. 500,000 or over at the end of the 19th century.

Indian Banks and the upsurge of Nationalism

During the first decade of the 20th century the Nationalist (Swadeshi) Movement in India made considerable progress. Among other accomplishments this movement gave a stimulus to the growth of joint stock bank and trading companies which at this time had become almost completely identified with native Indian ventures. Between 1906 and 1913 the number of banks with capital and Reserves of Rs.500,000 or over increased from 9 to 18. On the latter date their total paid-up capital and reserves were Rs.40 millions, and their total deposits amounted to Rs.220 millions.²⁵ Such important institutions as the Bank of India, the Central Bank of India, the Bank of Baroda, the Indian Bank of Madras and the Bank of Mysore were established during this period. The number of smaller banks that were established was much greater.

23. B.E. Dadachanji, Monetary System of India., D.B. Taraporewala Sons & Co. Ltd. Bombay, 1948, p. 223.

24. G.B. Jather and S.J. Beri. Indian Economics. Vol. II, Oxford University Press, Madras, 1937, p. 450.

25. S.G. Panandiker, op. cit., pp. 11-12.

These banks were the instruments by which Indian nationalists hoped eventually to compete on even terms with the foreign institutions. However, the owner-managers of the newly established banking enterprises often lacked the experience and foresight which would have saved them from a good many subsequent disasters. They invested their funds in high yielding, non-liquid securities and often kept low cash reserves and paid high interest rates to attract deposits before and during World War I. Many of the banks lent money on what eventually proved to be unsound business undertakings. They also financed their own often speculative trading and mercantile enterprises with the result that most of the small banks and a few large ones failed to survive the war period. Professor Jain places the number of failures which occurred between 1913 and 1918 at 87 with a combined paid-up capital of Rs. 17,500,000. This latter sum represented more than half of the total paid-up capital of all joint stock banks that were operating at the beginning of this period.²⁶

The post World War I recovery and the establishment of the Imperial Bank of India in 1921 initiated another period of expansion of Indian joint banking institutions. Many new banking trading ventures sprang up in Uttar Pradesh, Punjab and Western India, during the following ten years; but, like some of their predecessors, were either poorly conceived or mismanaged. Consequently many of them failed during the Great Depression. According to Professors Jather and Beri the failures had many different causes. They list

26.

J.P. Jain, Indian Banking Analysed, Rajhan Publications, Delhi, 1949, pp. 19-20.

i) the absence of a strong central bank; ii) inadequate banking legislation; iii) lack of experience among the Indian bankers; iv) high rates of interest to attract deposits; v) indulgence in speculative activities; (vi) dishonesty, fraud and mismanagement; vii) cyclical fluctuations in Indian agriculture and business activity; and finally viii) the negligence of the Indian Government itself.¹¹

In spite of failures and other shortcomings there was a substantial increase in the number and deposits of the Joint Stock banking enterprises between 1920 and 1935. The number of reporting Indian Joint Stock Banks increased from 2 to 38 and their deposits from Rs. 1,400,000 to Rs. 844,500,000. A summary of their development is presented in table I on page 18.

18
Table 1

Number, Principal Assets and Liabilities of Indian Joint
Stock Banking enterprises Between 1870-1935

<u>Year</u>	<u>No. of Reporting Banks¹</u>	<u>Capital Funds</u>	<u>Deposits</u>	<u>Cash in hand and at Banks²</u>	<u>Loans and Investments</u>
1870	2	1.2	1.4	0.5	0.9
1875	3	1.7	2.8	0.7	2.1
1880	3	2.1	6.3	1.7	4.6
1885	4	2.4	9.4	2.1	7.3
1890	5	5.1	27.1	5.6	21.5
1895	8	9.4	56.5	9.7	46.8
1900	9	12.8	80.8	11.9	69.9
1905	9	16.2	119.9	17.4	102.5
1910	16	37.6	256.6	28.0	228.6
1912	18	42.6	272.6	40.0	232.6
1914	17	39.3	171.1	35.3	135.8
1915	20	43.8	178.7	39.9	138.8
1916	28	46.1	247.1	60.3	186.8
1918	19	60.2	405.9	84.9	311.0
1920	25	109.2	711.5	163.1	548.4
1925	28	106.0	544.9	101.0	443.9
1930	31	119.0	632.6	76.8	555.8
1935	38	132.0	844.5	191.2	653.3

Source: Adapted from Reserve Bank of India, Monetary and Banking Statistics of India, Bombay, 1954, p. 14.

1 Banks with Capital funds of Rs 500,000 or over.

2 Including gold bullion.

Note: Loans and Investment column is derived by subtracting cash, etc. from total deposits.

The data in this table reveal that until 1900 the progress of these banking enterprises was relatively slow. By the end of the 19th century there were only 9 reporting banks with deposits of Rs. 80,800,000 and earning assets amounting to Rs. 69,900,000. However, after 1905, when the Nationalists movement started, these banks made considerable headway. Between 1905 and 1912 their number increased from 9 to 18 and their deposits, from Rs. 119,900,000 to Rs. 272,600,000 - about 100 and 240 per cent, respectively. During the same period their earning assets increased from Rs. 102,500,000 to Rs. 232,600,000. Between 1912 and 1918 the number of these banks remained relatively unchanged; i.e., new banks did not exceed the number of bank failures. However, there was a sharp decline in their deposits from Rs. 273,000,000 to Rs. 171,000,000 between 1912 and 1914. After the latter year their deposits substantially increased and reached Rs. 406,000,000 by the end of 1918. During the same time their earning assets increased by about 240 per cent. This increase in their deposits and earning assets, without an increase in their number, may be attributed to the expansion of Indian trade and industry during World War I. Between 1918 and 1920 there was a sharp increase in their number, deposits, capital funds and earning assets - about 33%, 80%, 90%, and 77%, respectively.

After the year 1920 their number continued to rise and reached 38 by the end of 1935. However their deposits decreased between 1920 and 1925 from Rs. 712,000,000 to Rs. 544,000,000 but rose to Rs. 844,500,000 by the end of 1935. Between 1920 and 1925 their earning assets dipped from Rs. 548,400,000 to Rs. 444,000,000, and then increased to Rs. 653,300,000 by the end of 1935.

Part 3.

The Presidency Banks

Until the end of the 18th century the banking business of the East India Company was handled by agency-house banks and Indigenous bankers. The Company itself appears to have been reluctant to engage in banking enterprises. However, the services of the Indian bankers and the agency-house banks were often inadequate and, at times, unreliable. Moreover the failure of the Bengal Bank and the General Bank of India - institutions that had handled the Company's banking business, in the early 1790's-and the uncertain future of more recently established banks led the Company to sponsor and to invest in banking institutions designed to handle its banking business and, at the same time, to support the agency-house banks still in existence.

The first of these ventures was established in 1806. Later on in January 1809, it was incorporated by the Company as the Presidency Bank of Bengal. (The word Presidency is the Indian equivalent of a province or state). Two other provincial banking institutions, the Presidency Bank of Bombay and the Presidency Bank of Madras were established in 1840 and 1843, respectively.

Capitalisation

The Presidency Bank of Bengal started its operations with a fully paid-up capital of Rs. 5,000,000 equally divided into 500 shares. Of this capital Rs. 1,000,000 was supplied by the Company and the balance, mostly by Europeans. The share capital of the

Presidency Bank of Bombay was Rs.5,000,000; that of the Presidency Bank of Madras was Rs. 3,000,000. As in the Presidency Bank of Bengal, the Company held substantial investments in both of the latter institutions. The Company had the right to appoint three of the directors of each of these banks. In order to ensure trained personnel their secretaries and treasurers were drawn from the Indian Civil Service.²⁷

Functions

The Presidency Banks accepted deposits and made loans and advances to merchants and traders. They also negotiated domestic bills of exchange and invested in securities of the Company and other government bodies. They were allowed to buy and sell gold and silver, and were authorised to act as the Company's fiscal agent in the Presidency capitals. They were also allowed to manage the fiscal affairs of some of the municipalities.

These banks did not compete with other banking enterprises in the field of international finance. They were forbidden to trade in coins or precious metal or to undertake the financing of external trade. They were not allowed to raise money outside of India or to open branches in any other country.

In addition to their fiscal operations, the Presidency Banks undertook other duties usually associated with a central bank. As implied above, they acted as fiscal agents for the government of India - the East India Company. They also held government balances in the Presidency towns. As a banker's banks, they frequently held

the cash balances of other banking institutions and assisted them in times of stress. During the 1829-33 commercial disaster, when many banking enterprises failed, the presidency Bank of Bengal advanced Rs. 300,000 to the Hindostan Bank.²⁸

Under its charter the Presidency Bank of Bengal was empowered to issue currency notes provided that its total note liability did not exceed its capital of Rs. 500,000; provided also, that its cash on hand did not fall short of one-third of its demand liabilities.²⁹ As the Bank gained experience and demonstrated its stability, these latter restrictions were gradually relaxed. The Presidency Banks of Bombay and Madras, which were established somewhat later, were also granted privileges similar to those of the Presidency Bank of Bengal.

On March 1, 1862, when the management of all paper currency was taken over by the Imperial Government of India, the note issuing privileges of the Presidency Banks were withdrawn. Thereafter, the lending activities of these banks were governed by the extent of their capital funds and the deposits of their customers. As a partial compensation for the restriction on their fiscal activities, the interest payment required on government balances was set aside.

In 1876 the government of India sold its interest in these banks and withdrew from their management. However to ensure that these banks would not compete with the exchange banks, which meantime had

28.

Vera Antsey, The Economic Development of India, Longmans, Green and Company, London, 1936, p. 405.

29.

Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 3.

established themselves in India,³⁰ and indulge in speculative activities the government of India passed the Presidency Bank Act of 1876. Under this measure it was stipulated that these banks³¹

1. could not draw, discount, buy or sell bills of exchange unless they were payable in India or Ceylon;
2. that they could not borrow money or receive deposits payable outside India or maintain a foreign balance or agency for this and similar purposes.

In order to assure the safety of these banks' deposits, this Act also provided that the Presidency Banks

3. could not lend for a period longer than 6 months, and could not advance funds, on the security of immoveable property, or promisory notes bearing less than two names; or on personal security.

With these statutory safeguards in force, the government of India entrusted some of its banking business to these banks. This government patronage enhanced their position in their respective communities and helped to attract to them a large amount of business from purely private enterprises.

Progress to 1935

In spite of the several restrictions imposed upon them, the Presidency Banks enjoyed no inconsiderable growth and prosperity. The increase in their banking operations was equally as great as that of the Indian joint stock banking enterprises as well as that of the Exchange Banks.³² Neither the joint stock banks nor the Exchange

30. infra., see part 4. p.26

31. J.M. Keynes, Indian Currency and Finance, Macmillan and Company Ltd, London, 1913. pp. 201-02.

32. See Part 4, p. 26

banks were restricted in their operations. In fact the limitations imposed on the Presidency banks proved to be a blessing in disguise. They were shielded from the speculative activities which sounded the death-knell of many less restricted banking institutions. As Professor Keynes rightly pointed out "the restrictions under which they work have in the past contributed beyond doubt, to their stability".³³ In 1920 these banks were amalgamated under the name of the Imperial Bank of India. In addition to ordinary banking activities the latter institution served as the country's only central bank until the establishment of the Reserve Bank of India in 1935. The progress made by the Presidency Banks before their amalgamation in 1920, and by their successor the Imperial Bank, between 1922 and 1934 is shown in table 2 on page 25.

The data in this table disclose that, while Government deposits of the Presidency Banks increased by about 60 per cent between 1870 and 1920, their private deposits increased by almost 1200 per cent during the same period. Even the banking difficulties of World War I, during which almost one-half of the Indian Joint Stock Banks failed, had little ill-effect on the operation of the Presidency Banks. In fact their private deposits almost doubled, increasing from Rs. 358,000,000 millions in 1912 to Rs. 509,000,000 in 1918. This shows that the Presidency Banks continued to hold the confidence of their customers and thus came through the 1913-18 banking crisis unscathed.

This table also reveals a decline in the Presidency Banks' Cash/deposit ratio, indicating the extent to which these Banks were

33.

J.M. Keynes, op. cit., p. 203.

25
Table 2

Principal Assets and Liabilities of the Presidency Banks --
1870-1920, and the Imperial Bank, 1920-1935
(Rs.000,000)

Year	Capital	Reserves	Gov't. Deposits	Private Deposits	Cash and Due from Banks	Investment	Loans
1870	33.6	2.6	54.3	64.0	99.7	13.0	5.6
1875	37.6	4.2	49.8	50.7	69.5	24.9	6.1
1880	35.0	5.5	29.1	84.9	74.1	25.5	14.4
1885	35.0	7.7	23.1	76.9	59.7	18.2	22.1
1890	35.0	9.8	35.9	147.6	129.7	33.4	20.4
1895	35.0	14.0	33.3	131.2	77.0	27.8	59.7
1900	36.0	20.0	28.1	128.8	50.4	30.3	76.2
1905	36.0	26.3	31.2	222.6	82.3	41.0	130.5
1910	36.0	33.1	42.4	323.0	113.5	61.0	190.9
1912	37.5	36.4	42.7	358.0	117.8	64.3	218.6
1914	37.5	38.9	56.2	400.4	208.4	96.2	152.0
1915	37.5	37.3	48.9	386.1	146.5	125.8	162.7
1916	37.5	36.1	52.1	447.1	172.5	124.5	202.0
1918	37.5	34.5	86.4	509.8	170.8	127.4	298.0
1920	37.5	37.8	90.3	772.6	260.3	142.4	460.2
1922	56.2	40.6	156.3	617.8	259.4	109.4	490.6
1924	56.3	45.1	184.3	738.6	200.2	138.4	697.5
1925	56.3	47.2	168.4	727.1	255.2	155.5	591.5
1926	56.3	48.8	169.6	748.7	541.8	185.4	471.6
1928	56.3	51.5	66.5	713.1	146.4	225.2	530.1
1930	56.3	53.5	144.9	717.7	185.4	292.9	478.5
1932	56.3	50.9	96.7	633.1	178.6	266.4	381.1
1934	56.3	52.5	72.2	748.1	199.4	460.2	250.8
1935	56.3	53.9	--	749.9	177.6	421.3	258.8

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 10-11, and 30-31.

Note: The Loans and Advances column is derived by subtracting total investment plus Cash balances from the total deposits.

able to put the Country's liquid assets to good use. Whereas this ratio was as high as 80% during the 1870's, it had dropped to as low as 30% by 1920. The balance had gone into investment portfolio, and into loans and advances. The former increased from Rs. 13,000,000 in 1870 to Rs. 41,000,000 in 1910 and had reached Rs. 142,000,000 millions by 1920. The latter increased from Rs. 5,600,000 in 1870 to Rs. 76,000,000 in 1900 and had risen to Rs. 460,000,000 by 1920 - a substantial sum indeed.

The progress made by the successor Imperial Bank though substantial was not so spectacular. In spite of its role as a semi-central bank, its government deposits actually decreased and the gains made in private deposits - from Rs. 617,000,000 in 1922 to Rs. 717,000,000 in 1930 - was not phenomenal. During the Great Depression of the 1930's both public and private deposits declined substantially. In 1935 private deposits were still below the peak recorded in 1926.

Part 4

The Exchange Banks

Although a student of banking would generally define an exchange bank as a banking institution that specializes in financing foreign trade or deals in foreign exchange, this is not so in India. To the native Indian an exchange bank signifies a bank that has its head office outside India and is owned and operated by foreigners. The exact date of the establishment of the first of these banks is not known. However, it is generally agreed that they started operations during the early 1850's shortly before the Government of India was transferred to the

British Parliament.³⁴ Since the Presidency Banks were not allowed to deal in foreign exchange or to finance external trade, and the native bankers had little experience in this field, the prospects for the success of foreign banks were undoubtedly bright. Branches of leading British banks came first, soon to be followed by branches of the important banks of other European countries. By 1917 there were 10 exchange banks operating branches in most of the important trading centres.³⁵

The Exchange Banks may be divided into two categories - those which did a large portion of their business in India, and those which had small business transactions in India. The Chartered Bank of India, Australia and China; the National Bank of India; the Mercantile Bank of India; the Eastern Bank, and Messrs Cox and Company did most of their foreign business in India itself. The Hong Kong and Shanghai Banking Corporation, the International Banking Corporation, the Yokohama Bank, the Comptoir National d'Escompte de Paris and the Russo-Asiatic Bank had branches all over Asia and in the Western hemisphere as well.³⁶

Functions:

In spite of their foreign origin, exchange banks played a vital role in the development of Indian trade and commerce and occupied an important place in the Indian banking structure. They soon extended their operations to include every important type of banking business available to Commercial banks in India. By 1935 when the Reserve Bank

34.

G.F. Shirras, The Indian Banking and Finance, Macmillan & Co, Ltd., London, 1920, p. 344.

35.

Vera Autsey, The Economic Development of India, Longmans, Green and Company, London, 1936. p. 408.

36. G.F. Shirras, op. cit. p. 384.

was formed they had not only acquired a monopoly of the Country's foreign exchange and external traded financing business; they were also important competitors of the Presidency and the Joint stock banks in the purely domestic banking sphere.

They financed much of the inland movement and distribution of important merchandise. They also financed much of the outward movement of Indian export products. For this purpose they either maintained sub branches in most of the important trading and commercial centres or obtained controlling interests in existing joint stock banks through the purchase of share capital. In 1917, the Exchange Banks had 46 branch offices in India. The Presidency banks had 69 and the joint stock banks had 199. The deposits of the Exchange banks amounted to Rs. 36,000,000 as against the Rs. 50,000,000 of the Presidency Banks and Rs. 21,000,000 of the Indian Joint Stock Banks.³⁷ Their progress is presented in table 3 on page 29.

Progress 1870-1935

The data in table 3 reveal a gradual increase in the number, deposits and earning assets of (foreign) Exchange Banks from 1870 to 1915. During this 45 years interval, their number increased from only 3 to 11 but their deposits, from Rs. 5,200,000 to Rs. 335,500,000 and their estimated earning assets, from Rs. 5,000,000 to Rs. 260,000,000. During the next five years there was relatively rapid increase from 11 to 15 in their number, a doubling of their deposits and earning assets. Between 1920 and 1930, while the number in operation increased from 15 to 18, their deposits had declined from Rs. 748,000,000 to Rs. 681,100,000. During this time their earning assets had increased

37.

G.F. Shirras, op. cit., p. 384.

29
Table 3

Number, Deposits, Cash on Hand and Earning Assets of Exchange
Banks in India, 1870 to 1935

(Rs.000,000)

<u>Year</u>	<u>No. of Foreign Banks Represented</u>	<u>Deposits</u>	<u>Cash in Hand & at banks (including) (bullion)</u>	<u>Estimated Earning Assets</u>
1870	3	5.2	6.1	--
1875	3	10.7	5.7	5.0
1880	4	34.0	18.0	16.0
1885	4	47.6	13.1	34.5
1890	5	75.4	35.0	40.4
1895	7	103.1	27.6	75.5
1900	8	105.0	24.0	81.0
1905	10	170.4	37.8	132.6
1910	11	247.9	43.9	204.0
1915	11	335.5	76.0	259.5
1920	15	748.1	251.8	496.3
1925	18	705.5	94.2	611.3
1930	18	681.1	77.1	604.0
1935	17	761.8	125.5	636.3

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 14.

Note: Earning Assets are estimated as the difference between deposits and Cash balances.

from Rs. 496,300,000 to Rs. 604,000,000. By 1935, their number had declined to 17 but their deposits had risen to Rs. 761,800,000, somewhat in excess of the previous 1920 peak, and earning assets, to Rs. 636,000,000.

that of the
Like the Presidency Banks, the cash-deposit ratio of these banks decreased substantially during the period under review, indicating a more effective use of their loanable funds. In 1900 this ratio was 1 to 4. By 1935 it had declined to about 1 to 6. Meanwhile their earning assets had grown from an estimated amount of Rs. 81,000,000 to Rs. 636,300,000.

The National Planning Committee of India attributed the very considerable success of foreign owned and operated exchange banks to the competence and experience of their management, also to the fact that down to 1935 they encountered little domestic competition.³⁸ The Presidency Banks were not allowed to engage in the financing of external trade and the Joint Stock Banks, could not match the Exchange Banks in either resources or experience.

Part 5.

Cooperative Banks

In an attempt to solve the problems of rural indebtedness and usurious exactions by the money lenders, the Imperial Government of India enacted from time to time legislation designed to assist the agricultural communities. The first of such measures, the Land Improvement Loans Act, 1883 and the Agriculturists Loans Act, 1884,

38.

K.T. Shaw, Currency and Banking, (National Planning Committee Series) Vora and Co., Bombay, 1948. p. 115.

gave the farmer's the right to negotiate secured loans at the Governments Land Revenue Offices at reasonably low rates of interest. Unfortunately these measures did not bear much fruit. Most of the people for whom these privileges were intended still could not obtain credit because they had little or no security to offer.

Establishment

Towards the end of Nineteenth Century Sir F. Nicholson conducted an extensive enquiry into the problem of rural indebtedness in the state of Madras. As a result of the enquiry he recommended the institution of Cooperative Credit Societies, believing that they would meet the credit needs of the rural people as well as inculcate habits of thrift and self help among them. "The best way to do this" he said, "was to find Raiffeisen"³⁹ meaning to establish cooperative banks patterned after the Raiffeisen banks then operating in Germany. This solution was also advocated by Professor Duperhex, a teacher in one of the Anglo-Indian colleges, in his People's Bank in Northern India.⁴⁰

The Cooperative Societies Act

In keeping with the Nicholson and Duperhex recommendations and realising the need for such banks in India, the Imperial Government passed the Cooperative Societies Act in 1904. The object of this Act was "to encourage self help and cooperation among agriculturists, artisans and persons of limited means".⁴¹

39.

Vera Anstey, The Economic Development of India, Longmans, Green and Company, London, 1936. p. 190.

40.

ibid. p. 192.

41.

P.A. Wadia and K.T. Merchant. Our Economic Problems, Vora and Company Publishers (PVT) Ltd., Bombay, 1957. p. 295.

It provided for the establishment of a Cooperative Department in each province under which Cooperative Credit Societies would be authorised and registered. It set forth the arrangements under which the Societies were to be formed and the business procedures to be followed. Each society was to consist of persons living in the same village or locality so that the members should know each others' positions and character. The working capital of these Societies was to be obtained from membership subscriptions, from interest bearing time deposits and from government grants. Loans could be made only to members and were to be given for productive purposes only. They were to be secured by either real or personal property.

The Cooperative Credit Societies were classified as "rural" or "urban" according to their location and the nature of the liability of their members. The rural societies conformed to the utopian ideals of the Raiffeisen Societies and their members had unlimited liability. The urban societies followed Schulze-Delitzsch model and generally had limited liability.

Because of the poverty of their members and a resultant shortage of working capital, early cooperative credit societies did not make much headway. In order to enlarge the scope of their usefulness the Government of India passed the Cooperative Societies Act of 1912 which, among other things, provided for the establishment of Central or local district cooperative banks; also for the establishment of State cooperative banks. The Central cooperative banks were designed to coordinate the activities of the primary societies, and State cooperative banks were designed to supervise and to promote the expansion of

the whole system; also to provide a channel for State grants to Control and Primary banks. The Primary credit societies characteristically became members of the Central Cooperative banks and the latter in turn became members of the State Cooperative banks. Both the State and Central cooperative banks also had some individual members.

The working capital of the Central cooperative banks is built up from deposits of Primary credit societies; also from individuals both members and non-members, membership fees and from advances from the State cooperative banks. The working capital of State cooperative banks is built up from deposits of Central cooperative banks and individuals - both members or non members; from membership fees and advances from State Governments. On occasion commercial banks find it convenient to maintain deposit accounts in the State cooperative banks.

The management of the Cooperative banks is quite simple and direct. The operations of the Primary credit societies are in the hands of the members themselves and are generally recorded by a paid secretary who may or may not be a member of the society. The operations of the Central and the State cooperative banks are delegated to a paid secretary - manager designated by the Registrar of the Cooperative Departments of the respective States. Until 1917 the Cooperative banks were under the supervision of the Central Government of India. During that year their supervision was transferred to their respective State Governments with the result that there has since been no particular uniformity in their conduct.

Interest rates charged by each tier in the structure vary from state to state as does the character of the loans granted. Even so, interest rates generally are much lower than those charged by competing money lenders and indigenous bankers. Cooperative Credit Societies have charged as a rule between 6% and 25% for their loans in contrast to the 15% to as much as 240% charged by the money lenders. One of the more beneficial results of the establishment of the Cooperative banks was the subsequent reduction in the rates charged by the local money lenders.⁴²

Progress to 1935

Although by 1935 Cooperative Credit Societies and Cooperative banks had ~~already~~ been established only in the states of Madras, Bombay, and Uttar Pradesh, their operations had become, never-the-less, quite significant for the Country as a whole. Studies made by the staff of the Reserve Bank of India indicate that about 800 Primary Credit Societies with a membership of about 90,800 were in operation in 1907. Their capital and reserves amounted to Rs. 600,000 and their borrowed funds and deposits to Rs. 1,800,000. By 1935, the time of the establishment of the Reserve Bank of India, the number of Primary Credit Societies had grown to 104,974 and their membership to 4,592,448. On this latter date their capital and reserve amounted to Rs. 292,000,000; their borrowed funds and deposits, to Rs. 676,800,000. Data, showing their progress between 1907 and 1935 are given in section A of table 4 on page 37.

42.

Vera Anstey, op. cit., pp. 195-96.

Data for the Central Cooperative banks are available from 1916 onward and reveal that the number of these institutions continuously increased from 239 on that date to 615 in 1935. However, a parallel continuous growth was not recorded in the number of their individual members, and Primary Credit Societies. The number of individual members rose from 33,000 in 1916 to a peak of 112,000 in 1925, and subsequently declined to 85,000 in 1935. The number of member societies increased from 11,800 in 1916 to 101,500 in 1930, then declined to 89,100 in 1935. In spite of the decline in their membership, the working capital of the Central Cooperative banks continued to increase and reached Rs. 61,000,000 in 1935. No doubt, because of the increased availability of membership funds the amount of borrowed funds and deposits decreased meanwhile from a peak of Rs. 261,900,000 in 1930 to Rs. 233,000,000 in 1935. The average working capital per Central Cooperative bank, made up of memberships, deposits and borrowed funds, increased from approximately Rs. 136,000 to Rs. 478,000 during the same time. The five year Data showing their growth between 1916 and 1935 are given in Section B of Table 4 on page 37.

Between 1916 and 1935 the number of State Cooperative banks increased from five to eleven; the number of their individual members from 2,000 to 3,000; and the number of Primary Credit Societies and Central banks, from 1600 to 19,400. Their working capital rose from Rs. 7,700,000 in 1916 to Rs. 116,400,000 in 1935, revealing an average per state cooperative bank of Rs. 1,540,000 in 1916 and Rs. 10,580,000 in 1935. In 1916, their borrowed funds and deposits held amounted to Rs. 6,400,000. By 1935, the amount had risen to

Rs. 100,900,000. The Primary Data, showing their progress between 1916 and 1935 are given in Section C of Table 4, on page 37.

In-as-much as the data available until 1935 do not reveal the total amount of loans outstanding to members as of any particular date, this information could not be included in the table. One could assume, however, that about 90 percent of the working capital of these banks was at all times employed. These institutions always appear to have had a greater demand for loans from members than their available working capital would provide.

It should perhaps be noted that one of the continuing problems of the Cooperative banks was a shortage of funds which could safely be lent on agricultural land improvements. All Indian states had made some provision for loans for such purposes under the Agriculturists Loans Act, 1884, and the Land Improvements Loan Act, 1883.⁴³ Although early data on the extent of such loans are not available, their volume in 1954 was approximately the same as that reported by the Cooperative banks.⁴⁴ In 1929 the States of Madras and Bombay undertook to encourage such loans by the establishment of Land Mortgage Banks under the supervision of their respective Cooperative Departments. However data on the operations of these institutions are not available until 1938, which takes us beyond the boundaries of this chapter.

43.

S.G. Panandikar, op. cit., p. 139.

44.

Reserve Bank of India, All India Rural Credit Survey,
Vol. II. General Report, Bombay, 1954, p. 169.

Table 4

Number, Membership and Working Capital of Cooperative Credit
Institutions in India, 1907-1935.

Year Ending in June	Primary Credit Societies					Central Coop. Banks (a)					State Coop. Banks (a)					
	No. Membs.		Working Cap.(b)			No. of Banks	Members		Working Cap. (b)			Members		Working Cap.(b)		
	No.	Mem- bers	Captl. and Reservs	Depsts. & bor. money	Indiv.		Soc.	Captl. and Resrvs.	Depsts. & bor. money	Indiv.	Soc.	Captl. and Resrvs.	Depsts. & bor. money			
1907	0.8	90.8	0.6	1.8												
1910	3.5	230.7	2.6	9.8												
1915	17.1	831.7	20.1	68.7	239	33	11.8	5.7	26.6	5	2	1.6	1.3	6.4		
1920	39.4	1641.9	52.0	162.1	393	93	29.1	12.2	52.1	7	2	2.8	3.0	21.2	37	
1925	69.9	2814.2	110.8	371.1	546	112	65.4	26.9	135.1	9	2	10.8	6.0	44.4		
1930	102.6	4388.1	212.3	682.9	588	90	101.5	47.1	261.9	10	2	18.6	10.1	76.1		
1935	105.0	4592.4	292.0	676.8	615	85	89.1	61.0	233.0	11	3	19.4	15.5	100.9		

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954.
Pp. 410, 422, and 384.

- (a) Figures for Central Coop Banks and State Coop Banks start from the year 1916.
(b) Working capital of these banks consists of capital and Reserve funds and deposits and money borrowed from other banks.

Part 6

Postal Savings Banks

A discussion of the ramifications of Indian banking enterprises would not be complete without taking into account the development of the Country's postal saving system, which was instituted to encourage saving habits among the lower income group of Indian population. Some time after the establishment of Imperial rule in India, the Indian Government instituted small district savings banks in various administrative districts of British India. The Presidency Banks had also established savings offices in their respective Presidency towns. No authentic information is available on either the size of these institutions or their number. It is known that these earlier savings offices were eventually absorbed into the Country's postal savings system which was established in 1882.⁴⁵ The latter differs in some respects from the typical postal system of the Western World in that funds may be accumulated either by direct deposits at the post office or by the purchase of savings certificates from rural mail couriers. In the early years of its operation the minimum deposit was 4 annas (a Anna = 1/16 of a Rupee) or approximately 5 cents. This has since been raised to one Rupee or approximately 21 cents.

The original legislation governing the operation of these postal banks limited the amount that any individual may deposit in a single year to Rs. 750; the total of the accumulated deposits to Rs. 5000 for an adult and to Rs. 1000 for a child.⁴⁶

⁴⁵. Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 366.

⁴⁶. S.G. Panandiker, Banking in India, 6th ed. Orient Longmans Ltd., Calcutta, 1934, p. 148.

This limit has been raised from time to time. The most recent increase was in 1956 when the National Government of India, in order to mobilise the savings of lower and middle class people for the Second Five Year Plan, raised the maximum to 15,000 for an individual; and, to Rs. 30,000 for a joint account. Interest at the rate of 2½% was allowed on deposits up to Rs. 10,000 and above that, 2%.⁴⁷

Except for temporary setbacks, the Post Office Savings System has expanded its business continuously. The very considerable amount that has been accumulated by people, generally ^{thought} to be too impoverished to be capable of any thrift whatever, is truly remarkable. Between 1885 and 1900 balances in Postal savings banks grew from Rs. 13,400,000 to Rs. 96,500,000 - an increase of about 700%. By March, 1935 balances had grown to Rs. 583,000,000 and later information reveals that during 1960 the figure was in excess of Rs. 2,600,000,000. The five yearly data showing the development of Postal Savings banks is shown in table 5 on page 40.

47.

K.K. Dewett, J.C. Singh, Indian Economics, Premier Publishing Co., Delhi, 1959, p. 522.

Table 5
Number, Deposits and Balances Outstanding of Postal
Saving System Between 1885-1935

(Rs.000,000)

<u>Year Ended March</u>	<u>Number of Banks</u>	<u>Deposits</u>	<u>Int.</u>	<u>Balances Outstanding</u>
1885	5499	16.6	0.4	13.4
1890	6350	32.8	2.1	58.7
1900	6479	47.0	2.8	96.5
1905	7855	66.7	3.8	134.1
1910	8767	73.7	4.5	158.7
1915	10,161	116.1	5.4	148.9
1920	10,670	203.8	5.6	213.5
1925	10,727	205.5	7.1	256.4
1930	12,768	295.9	10.3	371.3
1935	12,679	430.6	13.5	583.0

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954. p. 369.

Note: Deposits include Transfer transactions from one Post Office to another from 1900 onward.

CHAPTER II

THE RESERVE BANK OF INDIA

The fairly late establishment of the Reserve Bank of India was not due to a relatively late awakening of the Country to the advantages of a central banking institution. The need for a central fiscal agency was felt as early as the beginning of the 19th century when the rule of the East India Company spread over the vast and divergent areas of the Country. In 1809 it was suggested that the Presidency Bank of Bengal should take on these functions. But for various reasons, economic as well as political, the suggestion was not acted upon. Later, in 1836 the idea of establishing a central bank primarily for fiscal operations was again brought up among Company officials. According to Professor Shirras, a proposal was put forward during that year for a "great banking establishment for British India" to facilitate the receipt of revenue and its subsequent diffusion through the various channels of public expenditure, to furnish the remittance to Great Britain of the sums required there for the Home Charges,¹ and to enable the East India Company to act up to the intentions of the British Parliament by keeping the government of India entirely aloof from that interference with the Commerce of India which the present system of remittance involves.² But the Afghan War of the late 1830's and the Sikh Wars during the 1840's diverted the Company's attention from proposals for banking reform to the establishment of its political authority over the Country.

1. Home charges were the payments that India made to the United Kingdom for maintenance of law and order, Pensions to British officers and the expatriation of British capital investment in India.

2. G.F. Shirras, Indian Banking and Finance, Macmillan, London, 1920, pp. 350-51.

After the transfer of Government in India from the East India Company to the British Parliament in 1858, a succession of noteworthy proposals for the establishment of a central bank in India were made. In these proposals the structural needs of a banking system, as well as those of government treasuries were emphasized. There were also some developments in the central banking facilities provided by private banks before a full fledged central bank was authorised and established.

Part 1

Antecedent Proposals and Institutions

James Wilson, the founder of the "Economist", and the first finance member of the Imperial government of India, was also the first advocate of the establishment of a full fledged central bank in India. In 1858, he proposed the institution of a national bank capable of gradually embracing all banking operations in India, and of extending its branches to the interior trading cities as opportunity might offer.³ A similar proposal, including the constitution of the proposed central bank along lines similar to those of the Bank of France, was put forward in 1870 but neither proposal bore fruit. Between 1870 and 1899 the uncertainty over silver prices and consequent changes in the exchange value of the Rupee was a more pressing question than that of a central bank, and no attempt was made to establish such an institution during this period.

The question of a central bank came up before the Fowler Committee which was set up in 1899 to enquire into the feasibility of introducing

3.

G.F. Shirras, "A Central Bank for India", Economic Journal, Vol.38, 1928, p. 573.

a gold standard in India. Sir Everard Hambro of that Committee emphasized, as indeed did the witness Mr. Alfred de Rothschild, the advantages of having a strong central bank to assist in the exercise of current policy and in the development of banking institutions in India.⁴ Professor Panandikar claims that a witness before the Fowler Committee, presumably Alfred de Rothschild, advocated the establishment of a central bank but the Government of India, under Lord Curzon, did not favour the proposal.⁵

In 1913, when the Royal Commission on Indian Finance and Currency, usually known as Chamberlain Commission, was appointed, the proposal for instituting a central bank in India again came under discussion; this time with greater vigour. The Report of the Commission contained a submission by J.M. Keynes in which a comprehensive plan for a central bank was set out. His proposed institution resembled the Bank of France in that it combined central and commercial banking functions in the same institution. Owing no doubt to the outbreak of World War I, this plan as well as other recommendations of the Commission were put aside indefinitely, contributing little if anything to the central banking institution which ultimately emerged.

The Imperial Bank Experiment

The large scale bank failures during the World War I and the uncertain exchange value of Indian Rupee thereafter clearly showed the defects and dangers of India's individualistic banking structure where

4.

G.F. Shirras, op. cit., p. 574

5.

S.G. Panandikar, Banking in India, Bombay, 1959, Orient Longmans, p. 7.

each bank conducted its business in its own way without the help of a central institution. Moreover the clearing and collecting activities carried on by the Presidency Banks during the World War I and their support of other banking institutions brought to light some of the very real advantages of a fully empowered central institution. This undoubtedly led to the formation of the Imperial Bank of India which in effect brought the three Presidency Banks under one control, and thus enlarged the scope of their central banking activities. The Imperial Bank, however, did not constitute a central bank in the modern sense. The country's coinage and currency was still issued by the Controller of Currency Department, and neither that department nor the Imperial Bank exercised any conscious control over the country's monetary and banking structure. There was no developed discount market through which Indian banks could obtain short term credit and no official lender of last resort in times of emergency. The absence of adequate rediscount facilities unnecessarily tied up the liquid funds of Indian banks--funds which they had to maintain in order to meet uncertain cash demands of their depositors. There was no machinery either for regulating the interest rates or for providing a measure of uniformity in them. There was no central authority to collect data on banking operations or to publish information on the conditions in the Indian money market.

Findings of the Hilton-Young Commission

In October 1920, not long after formation of the Imperial Bank of India as a semi-central bank, the International Financial Conference was held at Brussels to study financial crises and the means of

mitigating their consequences. Among its other findings was the need for the institution of a central bank in countries where no such bank existed.⁶ This implied advocacy of a central bank for India was taken up by Indian nationalists including many Indian bankers. As a consequence, in 1926 the Government of India appointed the Hilton-Young Commission to investigate and report on the working of the Indian exchange and currency system and to recommend any changes or modifications in the interest of the Indian people. This Commission laid down a blueprint for a central bank in India, a bank which in organization and structure would not be unlike the Bank of England as it was then constituted; i.e, private ownership and separation of issue and banking departments. But the linking of this proposal with a higher exchange rate on sterling aroused suspicion among Indian nationals who not only realised the increased burden of the new rate on India's sterling debit but feared that the central bank might also be used as an instrument to enforce it. Moreover the Commission had recommended that the Reserve Bank be a privately owned institution. This ran counter to the desires of Indian nationalists who favoured a public owned institution and insisted that the central bank should be subject only to the control of the representative political assembly rather than to a body of private shareholders. The latter they held was likely to be captured by vested interests within and without the Country and not operated in the public interest.⁷

6.

League of Nations, The Monetary and Economic Conference,
Information Section Secretariate of League of
Nations, Geneva, 1933. p. 36.

7.

K.N. Raj, The Monetary Policy and Reserve Bank of India, National
Information and Publishing Co., Bombay, 1948,
p. 64.

In spite of the opposition of the Indian nationalists, the Imperial Government of India accepted the recommendations of the Hilton-Young Commission. Accordingly, in January 1927 it introduced the Gold Standard and Reserve Bank of India Bill in the Indian legislative Assembly. The then finance member of the Government of India commended this Bill as the greatest measure of financial liberalism ever offered to the Indian people.⁸ The Government of India left no stone unturned to point out the advantages of the Bill and to influence Indian opinion in its favour, yet when the Bill was referred to the Select Committ of the Assembly, the latter recommended the following far reaching changes which would have had the effect of creating a truly national institution.⁹

1. Either the Governor or Deputy Governor should be an Indian national.
2. The majority of the members on the Board of Directors should be of Indian nationality.
3. The Capital of the bank should be owned and subscribed by the state.
4. Members of state or federal legislatures should not be barred from membership on the Board of Directors.

These recommendations were quite contrary to both Government and commission policy as expressed in the Bill - a policy which favoured private shareholders, presumably operating the bank for private gain - the arrangements then prevailing in the United Kingdom. The Commission, itself overwhelmingly British, was not prepared to assume that a truly national bank would place the integrity of money above the fiscal needs

8.

K.N. Raj, op. cit., p. 64

9.

S.K. Muranjan, Modern Banking in India, Kamala Publishing House, Bombay, 1952, p. 246.

of government. The economic interest of the members of the Commission dictated at least monetary neutrality; for, representing a creditor country, they were concerned with the financial policies of India, then greatly in debt to Britain. If the Reserve Bank were free from political pressure, it would follow the traditional British financial policy and would hesitate to experiment with the new ideas on monetary reform then being discussed in academic circles. As a result of this conflict of ideas and interests the Government of India withdrew the Bill in February 1928 and thus shelved the idea of a central bank for India for a few more years.

The Round Table Conference and Emergence of the Reserve Bank of India

In 1931, when the Round Table Conferences between the representatives of the Indian people and the British government were held to decide the future political status of India, the question of establishing a central bank was raised once more; this time with good prospects for favourable action. To begin with, India could look forward with assurance to less British interference in her purely domestic affairs, including the establishment of a central bank, as long as the latter appeared to fall within the pattern of similar institutions that were being established in other commonwealth countries. Moreover there appears to have been a desire to give the people of India a greater measure of responsibility in the management of their public debt; yet, as shown later on, the desire of Indian nationalists for a state-owned and operated central bank still went unheeded.

At the time the Round Table Conference was called, the world appeared to be rapidly sinking into the great Depression of the 1930's. Britain had just gone off the gold standard and the United States appeared to be contemplating a similar action. Then too there was uncertainty over the future of some of the established central banks and misgivings on the prudence of establishment of a new institution when the outlook was still so uncertain. Even so, the complementary nature of the economies of the British Empire countries, and a need for Imperial cooperation appeared to call for the early establishment of central banks in all Commonwealth countries. It was finally decided that while the new institution should be established its actual opening should be postponed until after the depression had at least indicated its course and the country had achieved a favourable balance of trade and a balanced budget.

These conditions were realized in 1933. In the Autumn of that year the Government of India introduced the Reserve Bank of India Bill in the Central Legislative Assembly and piloted it successfully through both Houses. The Bill received the assent of the Governor General in March 1934 and became the Reserve Bank of India Act of that date. The Reserve Bank, emerging from this Act, started its operations on April 1st, 1935.

Subsequent amendments to the Reserve Bank Act have not significantly altered the basic structure and administration of the Reserve Bank itself.

Part 2

Provisions of the Enabling Act

The Reserve Bank of India has its head office in Bombay and its main branches in Calcutta, Delhi, Madras, Karachi, Lahore, until 1948

in Rangoon, and a branch in London.¹¹ It is authorised, subject to government approval, to establish branches or agencies in any other place in India. After 1942, the Reserve Bank ceased to be the central bank of Burma. Like the original Bank of England, the Reserve Bank's Issue and Banking Departments are operated as separate entities. Although the Bank is authorised to deal with the public in emergency cases, the Act generally restricts the Banks' operations to banking institutions only.

Capitalization and Ownership

Under the enabling Act, the Bank began its operations as a private shareholders' institution with a paid-up capital of Rs. 50,000,000. This capital was divided into 500,000 shares of Rs. 100 each. However, in excess of 900,000 shares were subscribed. In order to ensure a wide and representative distribution of these shares throughout British India,¹² the Government divided the country into five regional allotment centers; Bombay, Delhi, Calcutta, Madras and Rangoon. The number of shares allotted to these centers were 140,000; 115,000; 145,000; 70,000 and 30,000 respectively. The Government itself purchases 2200 shares to be held for such directors as might be short of the minimum qualifications of 50 shares.¹³ The share capital of the Reserve Bank could not be increased without the prior approval of the Governor-General in Council and the Central Legislature of India. The extent and manner of such an increase was to be decided by the Bank's shareholders in a general meeting.

11.

Government of India. Reserve Bank of India Act, 1934 (as modified up to November 1, 1956.) Section 6, New Delhi, 1957. p.3.

12.

At the time of the inception of the Reserve Bank, Burma was also a part of India.

13.

In addition to this purchase of share capital, the Government of India transferred to the Bank Rs. 50,000,000 worth of government securities which were to serve as additional backing for the treasury note currency taken over by the Bank.

To keep the Bank in Indian hands, the Act stipulated that a shareholder of the Bank must be either an Indian or a person domiciled in India. A concession was made to a British subject ordinarily resident in India, but temporarily domiciled in any part of the British Empire, provided there was no local government discrimination against Indians or against Indian companies either registered under the Indian Companies Act or incorporated under the law of any part of the British Empire.¹⁴ In order to forestall the concentration of Bank shares in a few hands, the Act put the maximum individual holdings originally at fifty shares. Somewhat later this maximum was raised to 200 shares. While the ownership of five shares entitled the holder to vote, no share-holder could cast more than ten votes irrespective of the number of shares held. These provisions remained substantially unchanged until the Reserve Bank was nationalized in 1948.

Administration and Control

The administration of the Reserve Bank, subject to any directions from the Governor-General-in-Council, was entrusted to a main body made up of a Central Board of Directors and five subordinate Local Regional Boards. The former consisted of sixteen members including the Governor and two deputy governors. In order to keep a close watch over the operations of the Bank, the Governor-General-in-Council was empowered to nominate the Governor of the Bank and his two deputies, after considering the recommendation of the Central Board. The Governor General was also authorized to nominate five of the thirteen other directors, four of whom represent important elements of Indian economy, i.e.,

14.

S.G. Panandikar, Banking in India, 6 Ed. Orient Longmans, Bombay, 1948, p. 341.

agriculturists, industrialists, etc., and the Government representative on the Board. The remaining eight directors were elected by the share holders; two each from the regions of Bombay, Calcutta and Delhi, and one each from the regions of Madras and Rangoon. The balance of power still rested with the elected members of the Central Board because the Deputy Governors and the Governments representative on the Board are not authorized to vote. However the Governor-General-in-Council had the privilege of disapproving any action of the Central Board deemed not to be in the public interest.

The Central Board of Directors was associated by Local Regional Boards representing each of the five regions. The Local Boards consisted of eight directors five of whom were elected by the share-holders of the region. The remaining three were nominated by the Central Board and represented the territorial and economic interest of their respective areas.

The Governor and the two Deputy Governors held office for five years and were eligible for re-appointment. The elected members of the Central Board as well as those of the Local Boards held office for five years and were eligible for re-election. However, the term of office of the appointed directors, both on the Central Board and the Local Boards, depended on the pleasure of the nominating authority.

No change was made in this set up until the Bank was nationalized in 1948.

Prerogatives and Functions

Like central banks in other countries, the Reserve Bank of India was established to stabilize the value of money and to coordinate the operations of the Country's underlying banking structure. In terms of the preamble to the enabling Act, its main objectives were "to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in British India and generally to operate the currency and credit system of the Country to its advantage".¹⁵ In order to achieve these ends the Bank was given responsibility for the issue and regulation of the Country's paper currency and the maintenance of its external value. It was also designated as the Governments' banker and fiscal agent, and equipped to function as a banker's bank. In the exercise of these functions and prerogatives the Reserve Bank became the Country's official monetary authority. In some respects it became a regulatory authority as well.

Note Issue

The first official operation of the Reserve Bank was the take-over of the responsibility for note issue from the Controller of Currency Department. Incidentally, the amount of note-issue then outstanding was Rs. 1,861,000,000.¹⁶ Under the enabling Act the sole

15.

Government of India, Reserve Bank of India Act, 1934. (as modified up to November 1, 1956); Preamble, New Delhi, 1957.

16.

Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 648.

right of currency note issue was conferred on the Reserve Bank but the Treasury Department continued to issue one rupee notes, secured by deposits of coins, for the convenience of public.

Originally the Bank issued notes in the denomination of Rs. 2, 5, 10, 100, 1000 and 10,000. The latter two denomination were withdrawn in 1946. The notes of the Reserve Bank are legal tender throughout British India. At the time of the Reserve Bank's nationalization the outstanding note issue was Rs. 11,250,000,000.¹⁷

Under Section 33(1) of the original Act, it was laid down that the assets of the Issue Department shall consist of gold coin, gold bullion, sterling securities, rupee coin, rupee securities, and such bills of exchange and promisory notes payable in India as are eligible for purchase by the Bank.¹⁸ Of the total assets 40 per cent to a minimum of Rs. 400,000 without special permission must consist of gold, gold coin, and sterling securities. (Gold was valued at the rate of 8.47512 grains of pure gold per rupee). It was further provided that the value of Government securities should not be more than 25 per cent of the total assets of Rs. 500,000,000 which ever was greater.¹⁹ In times of emergency and shortage of money in circulation, government security holdings could with the consent of the government go up to Rs. 600,000,000 and sterling securities could fall below 40 per cent of the total assets. In the latter event the Bank was

17. Reserve Bank of India, op. cit., p. 648.

18. Government of India, op. cit., Section 33.

19. P.C. Jain, Currency Banking and Finance in India, Chaitanya Publishing House, Allahabad, 1960, p. 193.

required to pay a penalty on the amount of the deficiency, starting at one per cent above the Bank's lending rate and rising by one per cent with each 2.1/2 per cent increase in the deficiency.

In contrast to the rigid fiduciary reserve system under which the Bank of England operated during most of its history, the ability of the Reserve Bank to take advantage of increases in gold and sterling securities to increase its note issue adds considerable flexibility to its currency operations and, indirectly, to the operations of primary lenders in the Country's money market. A given increase in the Issue Department's gold and sterling security holdings could result in 2.1/2 times that much currency being added to the country's money supply. As the Reserve Bank could also issue bank notes against the security of 'eligible' bills of exchange, any increase in the volume of the latter could be used to support an increased demand for bank credit on the part of primary lending banks as long as 60 per cent of the total assets of the Issue Department were not exceeded.

Exchange Control

Under the provisions of the Reserve Bank Act, 1934, the Bank was charged with the responsibility of maintaining the external value of the Rupee at 18d. with upper and lower limits of $18\frac{3}{16}$ d. and $17\frac{49}{64}$ d. respectively. In order to minimise the speculative holding of foreign funds on the part of well-to-do Indian residents, the Reserve Bank was empowered to limit the purchase and sale of sterling funds to authorized banks which included all Exchange Banks and a few large Indian Joint Stock Banks. These Banks were entitled to buy and sell foreign exchange at the Reserve Bank in amounts not less than Rs. 200,000, the equivalent

of £13,333.²⁰ This control was extended during World War II, and all foreign exchange transactions were handled through the Exchange Control Department of the Bank that was set up under the Defence of India Regulations. Since the exchange control was maintained after the War in order to conserve foreign exchange funds, prevent flight of capital and to check speculative dealings in foreign funds, this Department continues to operate even today. The exchange regulations introduced during the War were continued until 1948.

When India became a member of the International Monetary Fund in 1945, the Reserve Bank was authorised to deal in currencies of all member countries of the Fund. However the Reserve Bank's exchange transactions were mostly confined to sterling as Indian trade was carried on primarily with countries in the sterling area. Even the rest of the trade was financed through the London Money Market.

Fiscal Agent for Governments

As the central Bank of India, the Reserve Bank took over the central Government's banking business from the Imperial Bank and was designated later on, as banker for State governments. Unlike the Imperial Bank, the Reserve Bank receives some special benefits from handling the governments banking business. It does not have to pay interest on government balances and receives some compensation for floating its securities. Although there is no lower limit to the deposits which the Central government may keep with the Bank, the Provincial or State governments have to maintain such minimum balances

20.

Government of India, op. cit., Sec. 40.

as are agreed upon between them and the Bank. If the amount of a Provincial Government's balance falls below this minimum, the deficiency must be made good either by selling treasury bills to the Bank or by negotiating a loan at rates which do not exceed the Bank rate.²¹

The Reserve Bank was also given responsibility for managing the public debt of the Central and Provincial governments. For this purpose the Bank set up a Public Debt Office through which the floatations of government bonds, interest payments, conversions, consolidations, renewals, and redemptions may be handled. For these services the Bank is entitled to receive a commission of 0.02 per cent of the amount of loans involved.

Reserve Bank as a Banker's Bank

In order to ensure that the Reserve Bank would be a banker's bank as well as a monetary authority - and thus systematize the country's banking structure - the Reserve Bank Act, itself, designated in its second schedule or appendix the private banks which were to become participating member institution.

Membership Qualifications

The scheduled banks, as members of the Reserve System are known in India, had to be primarily engaged in the banking business and to maintain capital and reserves of not less than Rs. 500,000 - then equivalent to about \$150,000. These requirements eliminated from membership all relatively small joint stock banking ventures,

21.

S.G. Panandikar, op. cit., 9 ed., p. 389.

and, of course, all indigenous bankers and money lenders. The schedule, as originally drawn, listed the Imperial Bank, twenty-nine joint stock banks and twenty exchange banks - a total of fifty, with aggregate capital and reserves estimated at Rs. 230,000,000 and aggregate deposits of slightly less than Rs. 2,500,000,000. The fifty banks included in the schedule constituted about 38 per cent of the 132 corporate banking institutions then reporting in India. They held an estimated 87 per cent of the capital and reserves of reporting banks and 95 per cent of their deposits.²² By the end of 1948, when the Reserve Bank was nationalised, the number of scheduled banks had increased to 94. At this latter date the scheduled banks constituted only 15 per cent of all reporting corporate banking institutions but these banks held 92 per cent of the total deposits of all reporting commercial banks. Of the total deposits of Rs. 11,182,200,000, the share of scheduled banks was about Rs. 10,354,000,000.

Clearing and Collection Facilities

The Reserve Bank and its branches were made reserve depositories and clearing agents for Indian banks, and were equipped to transfer money (cash currency) from one part of the Country to another. In the exercise of its clearing functions, the Bank was empowered to take over the clearing houses which earlier had been established by the Government of India. The Imperial Bank of India was designated the Reserve Banks agent at places where the latter had no branches.

22.

Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 8 - 9; 14 - 15.

The branches of the Reserve Bank not only provide reserve depositories and clearing facilities for local banks under the Reserve Banks jurisdiction, but remittance facilities as well. A local branch can transfer, without cost, Rs. 10,000 or any multiple thereof between any of the branch offices of the Reserve Bank and the main office at Bombay. A local bank can make weekly remittances of Rs. 5,000, or any multiple thereof, without cost to its principal account with the Reserve Bank providing the latter has a local office or agency. For non-multiple remittances in excess of Rs. 10,000 the Reserve Bank receives a commission of $\frac{1}{64}$ of one per cent. For weekly remittances below Rs. 5,000 the commission is $\frac{1}{32}$ of one per cent.²³

Legal Reserve Depository

In common with other more recently established central institutions, the Reserve Bank was made the sole depository of the legal reserves of the scheduled banks. Under Section 42 of the 1934 Act all scheduled banks are required to maintain or deposit at the Reserve Bank at least 5 per cent of their demand deposits and 2 per cent of their time deposits.²⁴ If a bank failed to maintain the required legal reserves, it is prohibited from accepting additional deposits and is subjected to a penalty charge. The latter is computed at 3 per cent above the Bank rate on the deficient amount for periods up to one week, and at 5 per cent above the Bank rate for periods in excess of one week.²⁵ The Reserve Bank

23. S.G. Panandikar, op. cit., p. 353.

24. Government of India, op. cit., Section 42.

25. Government of India, op. cit., Sec. 42 (3).

determines whether or not the reserve requirements have been maintained by the scheduled banks from the weekly statements which the latter are required to submit. Under section 42 (2) of the Reserve Act, failure to submit a weekly statement is subject to a penalty of Rs. 100 per day of default. In addition to information on reserves these weekly statements provide the Reserve Bank with the basic data published in its weekly, monthly and annual reports.

Lender of Last Resort

In its role as a 'lender of last resort' the Reserve Bank under Section 17(2) of the enabling Act, is empowered to purchase, sell or discount bills of exchange and promisory-notes, which arise out of bona fide trade transactions and are drawn on and payable in India. These credit instruments must bear two or more good signatures, one of which shall be that of a scheduled bank, and mature within 90 days. On bills covering the marketing of agricultural products the time limit may be extended to nine months (later on increased to 15 months) and the bank signature may be that of a cooperative bank.²⁶ Although the scheduled banks seldom took advantage of these rediscounting facilities before the nationalization of the Reserve Bank, such facilities are, nevertheless, an essential part of a properly conceived central banking mechanism. In addition to rediscounting the schedule banks may, under Section 17 (4) of the Reserve Act, borrow directly from the Bank on the security of gold, silver, and other marketable securities for periods not exceeding 90 days.²⁷

26. Government of India, op. cit., Sec. 17(2)

27. Ibid. Sec. 17(4)

Part 3

The Role of the Reserve Bank, 1935 - 1948

In-as-much as the central banking operations of the Imperial Bank of India had not been entirely restricted in the original Reserve Bank Act, and the participation in the Reserve System had been restricted to large and therefore usually self reliant scheduled banks, the role of the Reserve Bank during the first thirteen years of its existence, was not predestined to be a particularly impressive one. The Bank executed the more or less routine tasks involved in the management of the Country's money supply and in the handling of such clearing and cash transfers as the location of its principal offices and branches made possible. While it held considerably more of the deposits of the scheduled bank than prescribed under the Reserve Bank Act, the latter institutions made only occasional use of the Reserve Banks' rediscounting and lending facilities. Between 1936 and 1948 the Bank purchased or rediscounted bills of exchange amounting only to Rs. 200,000.²⁸ Even its other loans and advances never exceeded Rs. 1,500,000 between 1936 and 1946. It was only in 1947 and 1948 that the amounts had increased to Rs. 8,200,000 and Rs. 12,100,000, respectively.²⁹ The scheduled banks had already established mutually advantageous correspondent relationships with the well established Imperial Bank. These banks could not have been expected to transfer their business to the new and inexperienced Reserve Bank and go through

28.

Reserve Bank of India. Banking and Monetary Statistics of India, Bombay, 1954, p. 561.

29.

Infra. Table No. 6, p. 63.

all the formalities that were involved in securing a loan from the Bank. Meanwhile no extraordinary conditions had arisen that would make an exercise of the Reserve Bank's emergency powers and duties necessary. As a consequence the policy makers of the Bank concerned themselves for the most part with measures designed to unify and regulate the operations of the indigenous bankers and thus to expand the scope of the Reserve Banks' jurisdiction to both the organized and unorganized sectors of the banking system of India.³⁰

With the outbreak of World War II, and India's very considerable direct as well as indirect participation on behalf of the United Kingdom, the role of the Reserve Bank became singularly important. The Indian Government had undertaken to train and equip a native army not only to free the British garrisons for duty elsewhere but to take active part in defence of the freedom and the liberation of other countries - activities which incidentally India herself had been denied. This involved considerable expense to the Indian Treasury. As the areas of conflict expanded India undertook to provide troops, equipment, and other supplies for the Asian and African theatre. Although most of these latter undertakings were underwritten by the United Kingdom Government, they still had to be financed in India. The total cost of supplying these war requirements amounted to a staggering sum of Rs. 17,000,000,000.³¹ Much of this was represented on the one hand by an increase in Indian public debt and in notes outstanding at the Reserve Bank of India; on the other by the increased holdings of blocked

30. See: Reserve Banks' proposals regarding extension of membership to Indigenous bankers in Chapter 5, P...

31. Reserve Bank of India. Report on Currency and Finance, 1944-45. Bombay 1945, pp. 38-39.

sterling assets.

As a Monetary Authority

The operations of the Reserve Bank as a monetary authority were more or less confined to i) fixing and maintaining a Bank Rate at which it was prepared to make loans or to provide discount facilities to its member banks, ii) incidental attempts to unify short term rates and lending practices in the country's short term money markets, and iii) supplying at reasonable rates the massive amounts of credit through which, in the main, the Government's war contributions were financed.

The Bank Rate was first set at $3\frac{1}{2}$ per cent. This was the level at which the Bank was prepared to supply day to day loans against Government securities and on ~~the~~ eligible commercial paper. However the $3\frac{1}{2}$ per cent rate offered no margin to potential dealers in the short term money markets and was soon reduced to 3 per cent. Before the War some advances were made to the scheduled banks but the totals were negligible - not exceeding Rs. 200,000 in any one year. Even during the War the amount of Reserve Bank loans and advances to scheduled banks remained relatively insignificant. However, after the war there was ^a substantial increase in such advances; the amount rose to Rs. 12,100,000 in 1948. Purchases of commercial paper, if made at all, were at no time significant.

Meanwhile the Reserve Bank engaged in open market operations to support the price of short term government securities at something approaching the 3 per cent rate. Its direct advances to the Treasury had taken on significant proportions even before World War II and rose

to as much as Rs. 26,200,000 during 1948. Roughly equivalent amounts of Treasury Bills were acquired in open market operations in order to maintain a 3 per cent market for the latter type of issue. Some idea of the size of the Reserve Bank's purchases of short term Government securities as well as its short term loans and advances during the period under review is given in Table No. 6 on page 63.

Some of the advances made to the scheduled banks and a part of the Bank's commitments in Treasury Bills arose out of a successful attempt to minimise the spread in short term money rates between the Bombay and Calcutta money markets. Before the intercession of the Reserve Bank the spread on secured loans and call money to support trading on the stock markets, on the average, had been about 1/2 of 1 per cent, with banks in Bombay money market charging the higher rate. When the Reserve Bank entered these markets as a buyer of Treasury Bills; also, of other gilt edged securities; short term money became more plentiful. Interest rates were driven down and also equalized in the two money markets. The results of these operations are reflected in the following summary of interest rate levels recorded in the two markets.

<u>YEAR</u>	1935	1938	1941	1944	1947	1948
Average Rate:						
Bombay Money Market	$1\frac{11}{16}$	1/2	1/4	1/4	1/2	1/2
Calcutta " "	7/8	5/8	1/2	1/2	1/2	1/2

Table 6

Short Term Operations of The Reserve Bank, 1936-1949 Inc.

(Rs.000,000)

<u>Year ending in March</u>	<u>Advances to Gov't.</u>	<u>Holding of Treasury Bills</u>	<u>Investment in Rupee Securities³</u>	<u>Advances to Banks</u>	<u>Internal Bills Purchased and Rediscounted²</u>
1936	8.7	--	54.8	0.1	--
1937	15.4	--	60.5	0.1	0.1
1938	7.9	0.5	71.2	0.2	0.1
1939	17.2	15.3	63.6	0.2	--
1940	10.5	28.7	72.5	1.0	--
1941	20.1	9.7	77.8	0.7	--
1942	40.9	2.7	89.6	0.4	--
1943	14.9	6.8	71.2	0.4	--
1944	4.9	9.1	76.1	1.5	--
1945	4.3	14.6	131.3	1.1	--
1946	2.2	33.5	246.5	1.2	--
1947	0.5	23.3	317.0	8.2	--
1948	15.7	26.2	815.3	12.1	--
1949	17.1	39.3	756.3	33.4	2.9

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 561.

- 1 The Reserve Bank of India ceased to be the banker to the Governments' of Burma and Pakistan on April 1, 1947 and July 1, 1948 respectively.
- 2 No external bills were discounted during this period.
- 3 Investment of the Banking Department consists mainly of Rupee securities of the Government of India and of the State Governments.

As a Banker's Bank

As a banker's bank the Reserve Bank was put to a severe test when it was still at an early stage of development. In order to weed out inefficient and weak banking institutions and thus to sponsor the development of a sound banking system it had encouraged the amalgamation of banks. In 1937, it had advanced substantial sums (amount not disclosed) to the Travancore National Bank and the Quilan Bank to make their amalgamation scheme possible. However, a banking scare in South India during 1938 caused large withdrawals of deposits which the newly amalgamated bank could not meet. For undisclosed reasons the amalgamated banks could not support additional advances at the Reserve Bank and was forced to close its doors in June 1938. As it did not allow the Reserve Bank to inspect its accounts and determine the value of its assets, the latter did not feel obliged to come to its rescue.³² The Reserve Bank was able to give substantial help to other banks which were adversely affected by the Travancore - Quilan failure. Professor Sayers stated that "as soon as the news of the crisis was received, credit limits were granted to many banks in South India and these limits were later doubled".³³

During this crisis the inspection of the accounts of many banks by the Reserve Bank revealed that their eligible liquid assets were quite limited and thus insufficient to support substantial withdrawals during a banking scare. These banks needed considerable advances to meet a "run". This was revealed in a circular which was intended to

32.

R.S. Sayers, Banking in British Commonwealth, Oxford University Press, London, 1952, p. 233.

33.

Loc. Cit.

be instructive but, unfortunately, the bankers interpreted it as a refusal of the Reserve Bank to grant emergency assistance in the future. This considerably undermined confidence in the Reserve Bank - a confidence which was badly needed by the young and still not fully accepted institution.

As a Banker to Government.

In theory it is possible to distinguish between the fiscal and the banking operations of a central bank but in practice the former has usually dictated the latter and monetary policy has become the hand maiden of fiscal necessity. The operations of the Reserve Bank during both World War II and the Communal riots of 1947 were no exception to this general observation. The Government's revenues from ordinary sources and from voluntary savings spent on Government bonds fell far short of requirements during both emergencies and the balance had to be made up from forced savings provided, as in other countries, through the credit granting facilities of the Central Bank. At the beginning of World War II, the central Government's funded and unfunded rupee debt stood at a little over Rs. 7 billions, its sterling debt at about Rs. 4.7 billions. The combined total was thus about Rs. 11.7 billions.³⁴ Even though the sterling debt had been reduced to about Rs. 0.64 billions during the war, the Rupee debt of the Government of India had increased to Rs. 19.1 billions. In the meantime the Reserve Bank of India had granted Government credits on blocked sterling assets equivalent to the staggering sum of Rs. 15.5 billions.³⁵ In all, funded

³⁴. Reserve Bank of India, op. cit., p. 560.

³⁵. Ibid., p. 881. Do., 1954, . . .

expenditures and current advances had increased from Rs. 11.7 billions at the beginning of World War II to Rs. 35.2 billions at the end of the War or by Rs. 23.5 billions.

Of this latter sum approximately Rs. 9.7 billions - almost all in foreign currency assets - was funded by an increase in the note issue of the Reserve Bank. The latter rose from Rs. 2.1 billions in 1939 to Rs. 11.8 billions in 1946. By the end of 1948, the last year of the period under review, the Reserve Bank's note issue had increased to Rs. 12.75 billions. The extent to which direct and indirect Government advances contributed to the outstanding note issue of the Reserve Bank during its first thirteen years of operations is detailed in Table 7, page 67.

It will be noted from table 7 that while the Issue Departments' holdings of gold-coins and bullion remained fairly constant, the note circulation increased from about Rs. 3,106,000,000 in 1939 to Rs. 9,796,000,000 in 1945 and further increased to Rs. 12,749,000,000 by the end of March, 1948. This substantial increase in note issue reduced the banks metal cover from about 53 per cent in 1938 to 6 per cent in 1948. Meanwhile the foreign currency cover increased from Rs. 621,000,000 in 1936 to Rs. 8,637,000,000 in 1945. It had reached Rs. 11,353,000,000 by the end of March 1948.

Not all the evidence of the Reserve Banks fiscal operations is contained in the statement of the Issue Department. As noted earlier the Reserve Bank made substantial short term advances to the Government and also acquired substantial holdings of Treasury bills. These operations along with those undertaken in the ordinary course of its dealings with the scheduled banks are revealed in the annual statements of the Banking Department which are summarized in Table 8, page 68. The summary of the

Table 7

Operations of The Issue Department of The Reserve Bank, 1935-1949, Inc.

(Rs.000,000)

Year Ending in March	Note Liabilities			Note Cover				Bullion and Coin as % of note issue
	in general Circln.	Held in Banking Dept.	Total	Gold coins and bullion ¹	Rupee Coins ²	Foreign Currency Assets ³	Gov't of India Rupee Securities	
1936	1640.6	275.8	1916.4	442.2	555.1	620.9	296.2	52.2
1937	1758.1	258.1	2016.2	442.2	640.1	695.7	236.2	53.7
1938	1861.5	256.1	2117.6	444.2	602.4	799.2	271.9	49.9
1939	1823.6	282.8	2106.4	444.2	671.1	669.5	321.6	52.9
1940	2092.2	187.9	2280.1	444.1	675.2	786.4	374.4	49.9
1941	2414.1	172.7	2586.7	444.1	358.7	1299.2	484.7	31.1
1942	3076.8	122.2	3199.0	444.1	352.8	1650.0	752.0	24.9
1943	5134.4	118.0	5252.4	444.1	223.3	3191.1	1393.9	12.7
1944	7771.7	105.0	7876.7	444.1	142.8	6435.2	854.5	7.4
1945	9686.9	109.3	9796.1	444.1	135.1	8637.4	579.5	5.9
1946	11,626.4	164.1	11,790.5	444.1	155.2	10612.7	578.4	5.1
1947	12,229.6	326.1	12,555.7	444.1	194.3	11338.9	578.4	5.1
1948	12,278.2	471.2	12,749.5	444.1	323.6	11353.3	628.4	6.0
1949	12,374.2	220.2	12,594.4	424.9	438.6	9074.7	2656.2	6.9

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 560.

1 Gold valued at 8.47512 grams per rupee.

2 Including government of India Rupee notes issued from July 24, 1940.

3 Only sterling securities up to December 31, 1948.

Table 8
Operations of The Banking Department of the Reserve Bank, 1936-1949 Inc.
(Rs.000,000)

Year ending in March	Liabilities						Assets							
	Deposits			Bills pay- able	Other Lia- bilities	Total ¹	Cash		Balance held abroad ²	Loan & advncs. to gov't	Other Loans & Advances ³	Trea- sury Bills	Gov't Rupee Secur.	Other Asset
	Gov't.	Banks	Others				Notes	Rupee and other coins						
1936	112.6	272.6	0.9	0.7	8.4	495.2	275.8	1.3	149.9	8.7	0.1	--	54.8	5.1
1937	98.3	265.6	4.0	0.8	10.6	479.3	258.1	1.0	136.2	15.4	0.2	--	60.5	8.1
1938	113.7	249.6	7.0	0.9	7.7	478.9	256.1	0.8	134.8	7.9	0.2	0.5	71.2	7.2
1939	132.1	161.9	7.5	1.0	11.8	431.2	282.8	1.0	42.1	17.2	0.2	15.3	63.6	9.0
1940	115.0	178.0	10.4	1.0	14.5	442.5	187.9	0.9	123.4	10.5	1.0	28.7	72.5	17.5
1941	152.9	368.4	19.2	3.2	22.4	687.1	172.7	1.2	393.2	20.1	0.7	9.7	77.8	11.7
1942	151.8	377.3	38.9	7.8	35.5	735.5	122.2	1.3	460.8	40.1	0.4	2.7	89.6	17.6 ⁰
1943	203.9	573.6	32.9	28.0	51.1	996.6	118.0	1.3	751.1	14.9	0.4	6.8	71.2	33.0
1944	418.5	646.9	66.5	25.4	82.8	1346.3	105.0	2.7	1117.2	4.9	1.5	9.1	76.1	30.8
1945	1786.9	905.7	132.5	34.8	105.8	3073.8	109.3	2.6	2772.8	4.3	1.1	14.6	131.3	37.8
1946	4063.8	902.2	165.6	32.6	130.6	5407.1	164.1	3.1	4882.3	2.2	1.2	33.5	246.5	74.2
1947	4907.7	850.4	142.4	42.3	130.9	6187.6	326.1	2.4	5288.3	0.5	8.2	23.3	317.0	221.8
1948	3691.7	1024.7	3421.1	29.2	116.4	5449.6	471.2	122	4069.5	15.7	12.1	26.2	815.3	485.5
1949	2387.9	805.3	565.2	39.5	112.8	4190.5	220.2	1.1	3077.8	17.1	36.3	39.9	756.5	41.4

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954. p. 561.

1 Includes Rs. 100,000,000 of paid up capital and reserves

2 Includes Cash and short term securities.

3 There are no external bills purchased or discounted during this time.

Reserve Bank's operations presented in the previous Table reveals that its holdings of Government Rupee securities continuously increased during the period under review. Between March 1936 and March 1949 the amount of such holdings rose from about Rs. 55,000,000 to the substantial sum of Rs. 756,500,000. Its investment in treasury bills increased from a nominal sum of Rs. 500,000 in 1938 to about Rs. 40,000,000 at the end of March 1949. It also reveals the substantial growth in the Bank's holdings of foreign assets (sterling securities) which reached a peak of Rs. 5.3 billions at the end of March 1947 and then decreased to about Rs. 3.1 billions at the end of March 1949. The Issue Department as shown earlier held foreign securities; on the latter date, amounting to approximately Rs. 9.1 billions, thus making a combined total of about Rs. 12.2 billions of these securities.

Meanwhile the deposits of scheduled banks with the Reserve Bank increased from Rs. 272,600,000 in 1936 to a peak of Rs. 1,024,700,000 in March 1948 then decreased to Rs. 805,000,000 in the following year. Government deposits increased from Rs. 112,600,000 in 1936 to approximately Rs. 2388,000,000 in 1949.

The combined summary of the Bank's operation for the period under review is presented in Table No.9, on page 70.

Reserve Bank Credit and Prices

It goes without saying that no central bank could have financed such a major portion of a country's credit needs as that revealed in the foregoing tables without generating a rapid rise in prices which it was powerless to control. And in this case the magnitude of the Reserve

Table 9

Combined Operations of the Reserve Bank of India, 1936-1949 Inc.
(Rs.000,000)

Year ending in March	Liabilities				Assets					
	Notes in Circu- lation	Deposits	Other Lia- bilities	Total ¹	Gold Coin and Bullion ²	Foreign Currency Assets	Rupee and Subsidiary Coins	Gov't Securities	Advncs. and Re- discnts.	Other Assets
1936	1640.6	3861	9.1	2135.8	444.2	770.8	5561.1	350.9	8.7	5.1
1937	1758.1	367.9	11.4	2237.4	444.2	831.8	641.1	296.7	15.5	8.1
1938	1861.5	370.2	8.7	2340.4	444.2	934.0	603.2	343.1	8.7	7.2
1939	1823.6	3185.5	12.8	2254.8	444.2	711.6	672.1	385.2	32.7	9.0
1940	2029.2	327.1	15.4	2534.7	444.1	909.8	676.1	447.0	40.2	17.5
1941	2414.1	561.5	25.5	3101.2	444.1	1692.3	360.0	562.4	30.5	11.7
1942	3076.8	592.2	43.3	3812.3	444.1	2110.8	354.1	841.6	44.0	17.6
1943 ³	5134.4	817.5	79.1	6131.0	444.1	3942.2	224.5	1465.1	22.1	33.0
1944	7771.7	1138.1	108.2	9118.0	444.1	7552.5	144.5	930.6	15.4	30.8
1945	9686.9	2833.2	140.6	12,760.6	444.1	11,410.2	137.7	710.8	20.0	37.8
1946	11,626.4	5143.8	163.2	17,034.4	444.1	15,495.0	158.3	824.9	36.8	74.2
1947	12,229.6	5904.4	183.2	18,417.1	444.1	16,627.2	196.6	895.4	31.9	221.8
1948	12,278.2	5204.0	145.5	17,727.8	444.1	15,422.8	324.8	1443.7	44.0	48.5

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954. p. 560.

1 Includes Rs 100 millions of paid up Capital and Reserves.

2 Valued at an rate of 8.47512 grains of fine gold per rupee.

3 Reserve Bank ceased to be the Currency authority and the bankers for the Government of Burma with effect from June 6, 1942 and April 1, 1947 respectively.

Bank's undertakings on behalf of the Government is not revealed in its entirety by purchases of Indian Government securities. To the latter must be added the Reserve Banks' holdings of foreign currency assets which secure Reserve Banks advances on foreign indebtedness to the Indian Government. In Table No. 10, ^{page 72} the total of these investments and advances is compared to the Country's total funded debt and contingent liabilities in foreign currency assets. Price and purchasing power index are presented, also.

The extent to which this massive support of the Government's credit needs contributed to the rise in the Bank's outstanding note issue and ^{decline in the} in turn to the/purchasing power of the Rupee needs little additional comment. There was more than a three-fold increase in prices and a related decline in the value of the Rupee. By no stretch of the imagination could the increase in the Bank's note issue have been absorbed in the cash needs of the Indian economy without inflation and its forced savings counterpart. One may not seriously contend that the implied forced savings could have been avoided by higher taxes and attractive interest rates on Government securities without seriously restricting the War efforts themselves. The patriotic fervour of a nation seldom reaches such a height that people will surrender all of their War gains voluntarily.

During the first two years of World War I the price rise was not considered significant. In his budget speech of March 1943, the then Finance Minister held that "... there is not the remotest risk of inflation of the nature and on the scale which occurred in some of the countries which suffered utter defeat in the last War".³⁶ But Indian economists

Table 10

Government Debt, Reserve Banks Credit and Purchasing Power of the Rupee,
1936-1949 Inc. (Rs.000,000)

Year Ending in March	Public Debt in India			Reserve Bank Credit			Indexes	
	Debt of Indian Gov't.	Indian Debts of For. Gov'ts.	Total Debt to Indian People	Holding of Indian and For. Debts	% of Total Debt	Outstand- ing Note Issue	General Price Index 1939=100	Index of Value of Rupee
1936	11,910	771	12,681	1916	15.1	1130.0	N.A.	N. A.
1937	11,794	832	13,626	2016	14.9	1144	N. A.	N. A.
1938	11,747	934	12,681	2118	16.8	1286	N. A.	N. A.
1939	11,791	712	12,502	2106	16.8	1129	100.0	100.0
1940	11710	910	12,619	2280	18.1	1696	125.6	79.8
1941	12,061	1692	13,753	2587	18.8	2285	114.8	87.5
1942	11,517	2111	13,628	3199	23.4	2996	137.0	73.0
1943	12,978	3942	16,920	5252	31.0	5429	171.0	58.5
1944	14,146	7553	21,699	7877	36.3	8497	236.5	42.3
1945	16,390	11,410	27,800	9796	35.2	12,140	244.2	40.9
1946	19785	15,495	35,280	11,790	33.4	16,356	244.9	40.8
1947	21,852	16,627	38,479	12,556	32.6	17,556	275.4	36.3
1948	21,456	15,423	36,879	12,749	34.5	16,898	308.2	32.5
1949	23,853	12,153	36,005	12,594	34.9	15,632	376.2	26.5

Source: 1 Adapted from Reserve Bank of India, Report on Currency and Finance, 1951-52, Bombay 1952. p. 147.
 2 Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 560, 561, and 881.

in a manifesto issued on April 12, 1943 pointed out the dangers of creeping inflation generated by the peculiar system of War finance adopted by the Central Government. They were particularly concerned with the implication of the process by which the United Kingdom Government and other Allied Governments purchased material from India and paid for their purchases in inconvertible sterling securities and blocked sterling balances. As noted, the Reserve Bank issued currency and credit against these securities and it was not able to liquidate them from the proceeds of current imports. In order to check further inflation the economists suggested price controls and rationing; also increased dependence on long-term borrowing and increased taxation.

All of these devices were put into effect and, no doubt, did arrest the pace of the inflation between 1944 and 1946. During this period the general price index increased from 237 to 245. But, as shown, continued acquisition of long-term securities by the Bank to support their prices and the continued acceptance of foreign currency assets brought parallel increase in the money supply. Hence, in spite of price controls, prices continued to rise. In addition to the controls the Government attempted to siphon off some of the excess supply of money by selling approximately Rs. 800,000,000 worth of gold.³⁷ It appears that the sale of gold souped with other deflationary measures did arrest the price rise between 1944 and 1946 but only temporarily. In 1947 when the controls were relaxed the general price index moved rapidly from 275 to 376, the figure recorded for March 1949. On the latter date the Rupee was worth in real goods about one-fourth of its pre-World II value.

CHAPTER III

DEVELOPMENTS IN THE PRIVATE BANKING SECTOR, 1935-1949 INC.

The establishment of the Reserve Bank of India and its banking operations before 1949 appear, on the surface at least, to have had little if any impact on the day-to-day operations of the several classes of primary banking enterprises which function in the Indian economy. The Indigenous bankers and money lenders continued to provide the bulk of the credit required by the agriculturists, small tradesmen, and other artisans, with little effective competition from the cooperative banks which were particularly designed to meet the credit needs of such people. The Imperial Bank improved upon its already significant role as a primary lender and a quasi-central bank; the Joint Stock Banks continued to finance domestic commerce and trade. Meanwhile the Exchange banks as before, financed most of the country's external trade. These banks also competed with the Indigenous bankers and the Indian Joint Stock banks in financing the internal trade of the country.

Yet

/it would be quite misleading to leave the impression that these several classes of primary lenders were neither affected by the existence of the Reserve Bank nor by what, for lack of more accurate term, we may call the Reserve Bank's non-banking undertakings. The latter took on the form of attempts to increase the scope of its jurisdiction to Indigenous bankers and non-scheduled Joint Stock banks, participation in attempts to eliminate the usurious rates charged by money lenders, and prime mover in strengthening the laws under which the ordinary banks operated. In fact during this period the foundations were laid for

the future extension and expansion of the Reserve Bank's regulatory authority over all incorporated banking institutions.

The nature and implications of these non-banking undertakings on the operation and accomplishments of each class of banking enterprises are now our immediate concern.

Part I

Indigenous Bankers and Money Lenders

Two significant undertakings mark the progress of indigenous bankers and money lenders between 1935 and 1949. However neither undertaking was promoted by these self reliant, tradition-bound native bankers who provide such a significant part of India's banking needs and make up the so-called "unorganized" sector of the Indian money market. One was an attempt of the Reserve Bank to extend its jurisdiction to include such indigenous banking enterprises as could meet the conditions laid down by the Bank and thus qualify for membership in the Country's Reserve Bank system. The other was a more or less concerted move on the part of governmental agencies to control the interest rates charged on loans to the usually hard pressed agriculturists and small tradesmen to whose financial needs the money lenders catered.

Proposed Inclusion in Reserve System

Probably because the indigenous bankers and money lenders do not operate under formal banking legislation and are not subject to public supervision or control, it has become customary to designate them as

the 'unorganized' sector of the Indian money market. But, to a Westerner at least, such a designation could be quite misleading. In fact it would be nearer the truth to designate them as the "native banking system" and thus eliminate the erroneous suggestion that they are either disorganized or are lacking in unifying relationships. The indigenous bankers serve each other as correspondents in the handling of internal bills of exchange (Hundis). They help each other financially or otherwise in times of emergency to keep up the 'name' of their ancestral profession. They also act as banker's banks for the professional money lenders who generally cater to the credit needs of peasants and other rural dwellers. As noted earlier these patriarchal lending institutions have, on occasion, served as state bankers and exercised the important note-issue privilege.¹

Because of their number and basic importance in the Indian economy (exact data are unavailable) the Central Banking Enquiry Committee recommended that, on the establishment of the Reserve Bank, such indigenous bankers as were engaged exclusively in the banking business, or would divest themselves of all non-banking business, be brought into direct association with the Reserve Bank in the same manner as the Joint Stock banks. This presumably implied the maintenance of reserve accounts at the central bank, use of the latter's clearing and cash transfer facilities and the important privilege of rediscounting eligible commercial paper. It probably also implied the listing of qualified indigenous bankers, many of whom are rich and influential, as "scheduled" banks.

1.

Government of India, Report of the Central Banking Enquiry Committee, Bombay, 1931, p. 107.

banks.

In spite of these attractions, however, none of the indigenous bankers sought association with the Reserve Bank and the Reserve Bank itself took steps to remedy the situation early in 1937. It issued a circular to all scheduled banks and indigenous bankers seeking a consensus on the question of linking the indigenous bankers directly to the Reserve System and the extent of the changes which the indigenous bankers should be required to make to secure this linkage. On the basis of replies, it would appear of the scheduled banks only, the Reserve Bank drew up a plan under which the indigenous bankers would be granted the same facilities and privileges as the scheduled banks providing the indigenous bankers undertook to:²

- i. segregate their banking business from their trading and non-banking business;
- ii. maintain proper records and make them available for inspection by the Reserve Bank;
- iii. submit regular statements of their banking business to the Reserve Bank; and to
- iv. have a minimum working capital of Rs. 200,000 which would be increased to Rs. 500,000 within a reasonable period of time.

As might have been expected none of the indigenous bankers was willing to comply with these conditions. In many cases their banking business was not as important as their mercantile business. Sometimes their loans were made in kind and thus posed the difficulty of recording them in monetary units. There was also considerable reluctance on the part of indigenous bankers to disclose the nature of their business to the Reserve Bank authorities. Yet one may infer that a significant thought not explicit reason was the fact that the Reserve Bank could

2.

S.R.K. Rao, The Indian Money Market, Allahabad, Chaitanya Publishing House, 1959, pp. 87-88.

provide no facility or privilege which was not already available within the indigenous system itself or through correspondents relationships with the Imperial Bank and other larger joint stock institutions.

The question of affiliation with the Reserve Bank was brought up again in 1941, interestingly enough, by the Bombay Shroffs who desired to make their internal bills available for rediscount and were impressed by the possibility of developing a deposit business to supplement their working capital. This group was willing to meet the original conditions set out by the Reserve Bank save the giving up of all their ancestral non-banking undertakings and the disclosure of the extent of their business. The Reserve Bank was prepared to allow the Shroffs a number of years in which to make other provisions for non-banking undertakings but not to concede the ruling principle that a participating or member bank should be engaged exclusively in the banking business. Hence nothing came of this second attempt to incorporate the indigenous bankers in the country's Reserve Bank system. Even so, the move does reveal the realization on the part of the Shroffs that some advantages could be gained by affiliating with the Reserve Bank. As indicated in Chapter V, another unsuccessful attempt was made in 1951.

Money Lenders and the Rate of Interest

The practices of money lenders, as would be expected in any unorganized profession, are not uniform throughout the Country but vary from State to State, and even from one place to another in the same State. They vary according to local customs and traditions, to the needs and circumstances of the borrowers and to the nature of security, if any, offered.

Character of Loans - Professional Money Lenders

The professional money lenders make many small loans to borrowers whom they can trust without even the formality of a promisory note. But when the loans involve a substantial amounts of money and renewals, or are made to strangers, promisory notes with witnessed signatures are taken from the borrowers. When security is required it may consist of conditional bills of sale on ornaments, land, houses, and other valuable property. Cases are not uncommon where the loan is secured by cattle, crops or other movable property. Loans are made to farmers on the security of crops with the understanding, expressed or implied, that the borrower will sell the crop through the money lender or his agent - in some cases, no doubt, the indigenous banker or agent from whom the money lender obtains his funds. Loans are generally for short periods but, since their proceeds are used primarily for personal needs or to meet consumer obligations rather than for productive purposes, they carry usurious interest rates. The debtor may become more or less permanently enslaved to the money lender. The activities of the money lender, who may also be a borrower, may also be restricted.

Character of Loans - Non-Professional Money Lenders

The non-professional money lenders, as described in Chapter One, generally lend in kind; i.e., seeds, consumer goods, etc., usually on the security of land and chattles. In many cases no security whatever may be required and the loan may be made on mutual trust. No formal records are kept of the transactions and sometimes the illiterate and ignorant borrowers are cheated to their last penny by greedy non-professional money lenders. Since the loans made by the non-professionals

are usually to a more impoverished group of borrowers than those made by the professionals, interest rates are often higher. Yet the non-professional lenders are able to secure the payment of a larger proportion of their loans than are the professional money lenders as the former generally lend to their friends and usually hold a strategic economic and social position in the community.

Rates of Interest

As would be expected there was and continues to be a great diversity in rates of interest charged by money lenders. Individual rates vary from one State to another, from one money lender to another, and according to the degree of risk involved. According to the Provincial Banking Enquiry Committee set up in most of the provinces of India during the early 1930's, interest rates charged by money lenders ranged anywhere from 12 per cent to 37½ per cent depending on the security offered, the amount of loans and on the amount of credit available to the borrower from other sources.³ On unsecured loans made by the money lenders interest rates were much higher. Those charged by itinerant money lenders are the highest and range from 75 per cent to 360 per cent.⁴ Professor Jain, referring no doubt to the local money lenders, states in effect that interest charges may vary from ½ Anna to two Annas per Rupee per month or from 37½ per cent to 150 per cent per annum.⁵ He further states that the rate of interest charged by the Pathans (one of the several ^{classes of} itinerant money lenders) comes to over 300 per cent per annum.⁶

3. S.G. Panandikar, Banking in India, Bombay, Orient Longmans, 1959, p.50

4. Loc. cit., p. 111, 112

5. 1 Anna = 1/16 of a Rupee

6. J.C. Jain, Indigenous Banking in India, Macmillan, London, 1928, The personal experience of the writer confirms the observations of Professor Jain.

Government Regulation

Moderately high interest rates can be accounted for and justified by the element of risk involved in the loans made by the money lenders, but rates in excess of say 3 per cent per month could arise only from the illiteracy and ignorance of the borrowers plus the indifference of the Government. In order to protect the simple country folks from the malpractices of the money lenders, the Government of India passed a Usurious Loans Act as early as 1918. This measure empowered the courts to examine all loan transactions in cases where the court was convinced that the rate was excessive and exceptionally high. However like many other pious undertakings, no agency was set up to weed out the malpractices, and the onus of proving guilt appears to have been left to a plaintiff, often too ignorant to know his rights and always too impoverished to plead them.

At a somewhat later date various States took steps to eliminate the usurious practices of money lenders. In 1930, the Punjab Government passed a regulation of accounts Act requiring all licensed money lenders to keep in a prescribed form a separate account for each debtor. The form revealed the date and the principal of the loan, the rate of interest, the amount and the date of repayment, and the amount repaid. The money lenders were also required to provide their borrowers with semi-annual statements in which principal and interest were shown separately. If the money lender failed to comply with the law, the Courts were empowered to dis-allow either part or all of the accrued interest.⁷ In 1934, the same State passed a relief of

7.

indebtedness Act fixing the maximum allowed rates of interest at 7½ per cent on secured loans and at 12½ per cent on unsecured loans.

The extent to which measures of this character were enacted either before or during the period under review and the limits placed on interest rates is summarised on the following page.

Although these Acts probably have unified the practices of professional money lenders and to some extent checked the abuses practised on impoverished borrowers, they did not result in the complete elimination of these practices. Some unscrupulous non-professional lenders continue to exploit their needy and captive borrowers, if not by one device then another. Moreover, while the professional money lenders did keep within the laws, they did so by restricting or even denying loans to these more impoverished and hence unreliable borrowers. Many of them discontinued their lending operations and devoted their talents to other allied occupations. Since most of the customers of money lenders are agriculturists, the problem of credit availability has since taken the place of extortionate rates of interest.

Part 2

Indian Joint Stock Banks

The 1935-48 period was one of singular importance for the banking enterprises incorporated in India. The conduct and operations of both the scheduled and non-scheduled banks were affected by a tightening of the Companies Act of 1913 under which they were incorporated and by the extension of the authority of the Reserve Bank, In spite

MEASURES TO REGULATE MONEY LENDING IN INDIA

<u>State</u>	<u>Title of Act</u>	<u>Maximum interest rate allowed:</u>	
		<u>On secured loans</u> %	<u>On unsecured loans</u> %
Assam	The Assam Money Lenders Act, 1934	9 3/8	12 1/2
Bihar	The Bihar Money Lenders (Regulation of transactions) Act, 1939	9	12
Bombay	The Bombay Money Lenders Act, 1946.	9	12
Madhya Pradesh	The Usurious Loans Act of 1918 as Amended in 1934.	12	18
Madras	The Madras Pawnbrokers Act, 1943.	6 1/4 - 9 3/8	---
	The Madras Debtors Protection Act, 1934.	9	15
Orissa	The Orissa Money Lenders Act, 1934.	9	12
Punjab	The Usurious Loans Act, 1918 (as amended by the Punjab Relief of Indebtedness Act, 1934) also Regulations of Accounts Act, 1930.	2% above bank rate	12 1/2
Uttar Pradesh	The Usurious Loans Act, 1918, as amended in 1934.	12	24
West Bengal	The Bengal Money Lenders Act, 1940.	8	10
Hydrabad	The Hyderabad Money Lenders Act,	6	9
Mysore	The Mysore Money Lenders Act, 1939.	9	12
Coorg.	The Coorg Money Lenders Act, 1939.	7 1/2	12

8.

S.R.K. Rao, The Indian Money Market, Chaitanya Publishing House, Allahabad, 1959, pp. 94-96.

of this attempt to circumscribe their operations, especially those of the non-scheduled banks to banking business only - or perhaps

because of this - a substantial growth in both their number and volume of business was recorded. Like the Reserve Bank itself, these predominantly Indian banking enterprises participated heavily in the financing of activities growing out of World War II. Through them liquid funds, originally provided for the war effort were mobilized, then channeled into peace-time pursuits.

Amendments to the 1913 Companies Act

It will be recalled that Indian Joint Stock banks; i.e., banking institutions incorporated under the Indian Companies Act of 1913, began as a rule as banking-trading ventures. In this latter respect they were not unlike the enterprises of the competing indigenous bankers. It will also be recalled that the growth of these banks down to 1935, while substantial, was nevertheless marked by numerous failures and intermittent public criticism of both their management and the lack of a proper banking law, prescribing the boundaries of their operations. In 1931 the Indian Central Banking Enquiry Committee, which was set up to investigate and report on the operations of Indian banking enterprises, and to make suggestions for their future development, recommended that a special bank act be passed, defining the business of banking and laying down the restraints and conventions under which this business was to be conducted. Such statutory definition of banking in India, as against little or no banking legislation in England, was considered necessary because of conditions peculiar to India. It is true of course that sound banking practices depend on good bankers rather

than on banking laws, but not all bankers are good bankers. A majority of the unscrupulous bankers would be influenced in the right direction and might be kept on a sound banking track by means of judicious banking legislation. Foreign experts, whose opinion was sought by the Government, advised that the same end could be achieved with less complication by amendments to the Companies Act of 1913. Their advise was eventually followed. In 1936/^{some presumably}far-reaching additions were made to the 1913 measure. The more important ones may be grouped as follows:⁹

1. No banking company can be registered under the Companies Act, 1937, unless it limits itself to the business of banking. The latter is specifically defined as: a. the accepting of deposits withdrawable by cheque, draft or order; b. the granting of loans; c. dealing in bills of exchange, promisory notes, Government and stock exchange securities etc.; d. the handling of collections, remittances, trust funds, etc.
2. A bank may not be managed by an agent other than another bank unless given special permission by the Government. It may not hold shares in non-banking enterprises.
3. No bank may be chartered after 1937, a. with less than Rs.50,000 in paid up capital and no such bank may b. make charges against its unpaid capital. c. All non-scheduled banks shall apply at least 20 per cent of their profit to reserves until the latter are equal to paid-up capital.
4. All non-scheduled banks are required a. to maintain cash reserves of at least 5 per cent of their demand deposits and 1½ per cent of their time deposits; 6. to file monthly statements of their liabilities and cash reserve position (as declared each Friday) with the Registrar of Companies.
5. Both scheduled and non-scheduled banks were required to display in their offices an audited statement of their condition certified by independent auditors not indebted to the bank.

These amendments suggest that many of the banks were in fact primarily under-capitalized trading companies; that some were operated by people without banking experience; that in many cases their depositors could obtain no reliable information on their solvency. In one way or another however the bankers managed to circumvent most of these new restrictions and the legislation appears to have accomplished little more than to reveal the ingenuity of the bankers and the courts in working towards this end. The courts generally upheld the contention that conformity to the new definition of a banking enterprise was not mandatory on existing banks. Most of the other restrictions were held not to apply on the technicality that a mixed banking trading venture did not conform to the new definition of a bank. It would appear, as if by design of the law makers themselves, that no provision was made for an enforcement agency; and this more than anything else left the provisions of the 1936 amendment Act without sanctions.

After the failure of Travancore National and Quilan Bank in 1938, the Reserve Bank took cognizance of the extent of questionable banking practices. It appealed to the Government for stricter legislation to be enforced, presumably by itself, and submitted a draft banking bill to the Government in November 1939.¹⁰ But the latter's preoccupation with the emergent problems introduced by World War II limited its immediate reaction to measures designed to enforce compliance with the more important provisions of the 1936 amendments. A 1942 amendment to the

10.

A.B. Dass and M.N. Chatterji, Indian Economy; its Growth and Problems, Calcutta, Bookland, 1953, p. 424.

Indian Companies Act provided in effect that any enterprise which after November 1943 continued to use the term 'bank' or 'banking' in its title would be deemed to be a bank and would be subject to the provisions of the 1936 amendment of the Indian Companies Act regardless of the extent of its non-banking activities. Another amendment in 1944 provided that, after July, 1946, the banks were prohibited from paying their managers in whole or in part on a commission basis. Banks incorporated after Jan. 15, 1937 were required to pay up at least one-half of their subscribed capital and voting rights were limited to paid-up shares. This latter restriction grew out of the practice of issuing non-voting preference shares and deferred payment voting shares in addition to ordinary shares; i.e., divorcing management from responsible ownership.

Other Legislation prior to 1949

Of considerable significance to the conduct of banking enterprises in India was an interim measure entitled the Banking Companies (Inspection) Ordinance Act, brought down by the Government on January 1, 1946 at the insistence of the Reserve Bank.¹¹ This Act gave the Reserve Bank with the permission of the Government authority to inspect the books and accounts of any banking company with a view to determine whether or not it should continue in the banking business. The granting of such an authority would in itself have a salutary effect on any questionable banking undertaking. It not only marks the beginning of the exercise of regulatory authority in India but for the first time on record makes the exercise of that authority the responsibility of a central bank. In the same year the Government enacted a law under which new branches of a bank

11.

Reserve Bank of India, Report on Currency and Finance, 1946-47,
Bombay, 1947, p. 112

could be established only on procurement of a licence from the Reserve Bank.¹² Under the Banking Companies Control (Ordinance) Bill of September 18, 1948, the Reserve Bank was given sweeping authority to determine the lending policy of a bank, the purposes for which loans could be made, the margins to be maintained, and even the rate of interest to be charged.¹³ A year later a comprehensive banking measure incorporating all these earlier amendments or ordinances was enacted. This latter measure known as the Banking Companies Act of 1949 went into effect in 1950 and belongs, chronologically at least, to the material covered in Chapter V.

Growth and Operations, 1935-1949 Inc.

In spite of a significant failure rate and alienations resulting from the separation of Burma (in 1937) and of Pakistan (in 1946), Indian Joint Stock banks achieved a phenomenal growth during this short but eventful period under review. The number of reporting grew from 100 in 1935 to a peak of 678 in 1939. Thereafter many small trading enterprises appear either to have stopped reporting or to have complied with the amendment to the Indian Companies Act by eliminating their banking operations; for, by 1941, the number of reporting banks had decreased to 455. During World War II, many new banking enterprises were incorporated, raising the number reporting in 1945 to a new peak of 721. However, the measures enacted during the war to force compliance with the 1936 amendment of the Indian Companies Act and the eventual alienation of banks now in Pakistan reduced the number to 598 by 1949.

12.

Reserve Bank of India, Report 1946-47, op. cit., pp. 112-113.

13.

Because of some technical difficulties the Bill did not become an Act in that year. Its provisions were incorporated in the Banking Companies Act of 1949.

While admittedly significant in other ways, the progress in numbers is a misleading indicator of the volume of banking business - the liabilities and earning assets - of the reporting banks. Except for the decrease in their capital funds from Rs. 153,600,000 in 1936 to Rs. 146,700,000 in 1938, there was a continuous increase in their aggregate capital and reserve funds. The earlier decrease may be attributed to the failure of the Quilan Bank and the alienation of many banks with the separation of Burma from India. The capital funds of the Banks increased from Rs. 146,700,000 in 1938 to Rs. 171,400,000 in 1939. In spite of the decrease in the number of reporting banks from 678 in 1939 to 475 in 1942, capital funds increased from Rs. 171,400,000 to Rs. 229,200,000 during the same period. Between 1942 and 1945 reported capital funds increased by almost 100 per cent, reaching Rs. 509,000,000 on the latter date. This substantial increase in such a short period may be attributed to excessive earnings arising from an increase in trade and industrial activity. After 1945 the rate of increase in capital funds was considerably decreased but, even so, the amount reached Rs. 645,000,000 at the end of 1949.

There was also a phenomenal growth in their deposit liabilities and earning assets of the Joint Stock banks during the period under review. Total deposits increased from Rs. 897,300,000 in 1935 to a peak of Rs. 7,222,400,000 in 1946, then decreased to Rs. 5,808,100,000 in 1949. Meanwhile loans and discounts grew from Rs. 565,200,000 in 1936 to a peak of Rs. 3,647,600,000 in 1946 then declined to Rs. 3,038,600,000 in 1949. Because of active participation in the

Country's war effort, the Banks holdings of Government bonds and other securities increased from Rs. 383,000,000 in 1936 to a peak of Rs. 3,110,100,000 in 1945. These holdings remained relatively unchanged during 1946 and 1947, despite the uncertainties prevailing during that period but declined to Rs. 2,639,600,000 in 1949.

The annual data revealing the progress of Indian Joint Stock banks is presented in tables 11, 12 and 13 on pages 91, 92 and 93 respectively.

Comparative Importance Scheduled and Non-Scheduled Banks

Attention has already been directed to the fact that only the very large banking enterprises which carry on no non-banking activities were placed on the schedule of banks associated with the Reserve Bank of India. A breakdown of the data relating to scheduled and non-scheduled banks given in tables 12 and 13 reveals the progress made by each sub-division.

As is shown in table 12 there was a substantial increase both in the number and operations of the non-scheduled banks between 1936 and 1945. But this growth may not be attributed to new banking institutions alone, because a considerable number of small banks began to report their business only after 1938 when the provisions of the 1937 Indian Companies (Amendment) Act went into effect. Even after taking this factor into consideration, however, the data reveal that between 1941 and 1945 the number of reporting non-scheduled banks increased from 413 to 646 and their deposits from Rs. 246,900,000 to Rs. 1,107,500,000 - an indeed remarkable increase. Meanwhile earning assets grew from Rs. 249,400,000 to Rs. 893,100,000. After 1945 there was a substantial decrease both in

Table 11

Number, Principal Assets and Liabilities of Indian Joint Stock Banks
(Excluding Imperial Bank), 1935-1949 Inc.
(Rs.000,000)

<u>Year</u>	<u>Number Reporting</u>	<u>Capital and Reserves</u>	<u>Total Deposits</u>	<u>Cash on hand & at banks³</u>	<u>Loans and Discounts</u>	<u>Gov't Bonds</u>	<u>Total Earning Assets</u>
1935	100	146.7	897.3	199.4	N.A.	N.A.	N.A.
1936	112	153.6	1028.4	162.5	565.2	383.0	948.2
1937 ¹	148	150.2	1086.6	181.2	626.5	396.4	1022.9
1938	161	140.7	1066.2	152.6	598.5	436.5	1035.0
1939	678	171.4	1154.4	189.2	719.8	416.8	1136.6
1940	630	182.6	1304.8	294.8	672.5	479.0	1151.5
1941	455	196.2	1536.8	293.8	810.3	649.6	1459.9
1942	475	229.2	2140.6	535.8	823.3	1109.5	1932.8
1943	546	309.7	3726.0	897.1	1367.1	1782.5	3149.6
1944	558	414.5	5126.7	1166.8	1976.4	2501.6	4478.0
1945	721	508.8	6535.5	1404.5	2788.7	3110.1	5808.8
1946 ²	619	551.9	7222.4	1438.8	3647.6	2943.6	6591.3
1947	624	586.6	7031.9	1387.5	3437.9	3111.5	6549.4
1948	618	635.4	6705.6	1286.0	3301.0	3037.2	6338.2
1949	598	645.0	5808.1	1033.5	3038.6	2639.6	5678.2

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 14-16.

1 Excluding Burma banks from 1937 onward.

2 Data relates to banks in Indian Union from 1946 onward.

3 Including gold bullion up to 1938.

Table 12

Number, Principal Assets and Liabilities of Non-scheduled Banks,
1935-1949 Inc. (Rs.000,000)

<u>Year</u>	<u>Number Report- ing</u>	<u>Capital Reserves</u>	<u>Total Deposits</u>	<u>Cash on hand at banks³</u>	<u>Loans and Discounts</u>	<u>Gov't Bonds</u>	<u>Total Earning Assets</u>
1936	82	40.2	126.3	18.0	105.5	20.0	125.5
1937 ¹	117	33.1	144.8	22.0	115.8	29.6	145.4
1938	129	37.4	148.4	18.1	121.6	34.1	155.7
1939	641	54.6	217.4	28.2	195.7	52.2	247.9
1940	591	58.4	243.7	44.8	184.8	55.1	239.9
1941	413	62.8	246.9	52.0	184.4	65.0	249.4
1942	431	66.7	247.2	98.1	216.5	91.8	308.3
1943	489	72.5	481.0	154.6	277.8	112.3	390.1
1944	499	93.9	756.0	262.8	347.6	180.8	578.4
1945 ²	646	121.1	1107.5	342.2	573.2	319.9	893.1
1946	542	118.2	1110.3	274.4	587.1	241.8	828.9
1947	544	120.9	833.2	172.7	553.8	263.1	816.9
1948	540	127.6	756.5	132.7	526.0	240.8	766.8
1949	521	133.9	715.5	118.4	528.0	221.0	749.0

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 14-17.

1 Excluding Burma banks from 1937.

2 Data relates to banks in Indian Union from 1946 onwards.

3 Including gold bullion up to 1938.

Table 13

Number, Principal Assets and Liabilities of Indian Scheduled Banks
(Excluding Imperial Bank), 1935-1949 Inc.
(Rs.000,000)

<u>Year</u>	<u>Number Report- ing</u>	<u>Capital and Reserves</u>	<u>Total Deposits</u>	<u>Cash on hand and at banks³</u>	<u>Discounts</u>	<u>Gov't Bonds</u>	<u>Total Earning Assets</u>
1936	30	113.4	902.1	144.5	459.7	363.0	822.7
1937 ¹	31	117.1	941.8	159.2	510.7	356.8	867.5
1938	32	109.3	917.8	134.5	476.9	402.4	879.3
1939	37	116.8	937.0	161.0	524.1	364.6	888.7
1940	39	124.2	1060.5	250.0	487.7	423.9	911.6
1941	42	133.4	1289.9	241.8	625.9	584.6	1210.5
1942	44	162.5	1893.4	437.7	606.8	1017.7	1624.5
1943	57	237.2	3245.0	742.5	1089.3	1670.2	2579.5
1944	59	320.6	4365.7	904.0	1578.8	2320.8	3899.6
1945	75	387.7	5428.0	1062.3	2215.5	2790.2	5005.7
1946 ²	77	433.7	6112.1	1164.4	3060.7	2701.9	5762.6
1947	80	465.7	6198.7	1214.8	2884.1	2848.4	5732.5
1948	78	507.8	5949.1	1153.3	2775.0	2796.4	5571.4
1949	77	511.1	5092.6	925.1	2510.6	2418.6	4929.2

Source : Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 15.

1 Excluding Burma banks from 1937 onward.

2 Data relates to banks in Indian Union from 1946 onward.

3 Including gold Bullion up to 1938.

the number of banks reporting and their deposits. This may be attributed both to the partition of India and to the restrictive authority conferred on the Reserve Bank. By 1949, the number reporting had decreased to 521; their deposits, to Rs. 715,500,000. On this latter date earning assets amounted to Rs. 749,000,000.

The progress made by the scheduled banks, though not as phenomenal as that of the non-scheduled banks is, nevertheless, significant. During the period under review the number reporting increased from 30 to 77; their deposits from Rs. 902,100,000 to Rs. 5,092,600,000. Meanwhile their earning assets increased from Rs. 822,700,000 to Rs. 4,929,200,000. After 1947 a slight decrease is recorded in their deposits and earning assets. This may be attributed to the dislocation of Indian trade and commerce during, and subsequent to, partition.

The tabular analysis on page 95 gives perhaps a better answer to the significant question of the relative importance of the mixed banking-trading ventures represented by the non-scheduled banks and the more orthodox banking enterprises represented by the scheduled banks.

The Table displays a marked contrast in the number and the size of operations of the scheduled banks, on the one hand, and the non-scheduled banking-trading ventures, on the other. Although the number of scheduled banks is substantially less than that of the non-scheduled banks, the former hold between 80 per cent and 90 per cent of the total banking business of the Indian Joint Stock banks. By the end of the period under review the scheduled banks constituted only about 13% of the total number in operation, but they held 88% of the deposits, 83% of the total of loans and bills discounted, and 92% of the total investment

95
Table 14

Comparative Number, Deposits, and Earning Assets of Indian Scheduled
and Non-scheduled Banks, Years 1936, 1940, 1945 and 1949.
(Rs.000,000)

	1936	1940	1945	1949
1. Number of Indian Joint Stock Banks:	<u>112</u>	<u>630</u>	<u>721</u>	<u>598</u>
Scheduled Banks:	30	39	75	77
Non-scheduled banks:	82	591	646	521
Percent Scheduled	27%	6%	10%	13%
2. Total deposits:	<u>1028.4</u>	<u>1304.2</u>	<u>6535.5</u>	<u>5808.1</u>
Scheduled banks:	902.1	1060.5	5428.0	5092.6
Non-scheduled banks:	126.3	243.7	1107.5	715.5
Share of scheduled banks:	88%	81%	83%	88%
3. Total loans and Discounts:	<u>565.2</u>	<u>672.5</u>	<u>2788.7</u>	<u>3038.6</u>
Scheduled banks:	459.7	487.7	2215.5	2510.6
Non-scheduled bands:	105.5	184.8	573.2	528.0
Share of scheduled banks:	81%	72%	79%	83%
4. Total Investments:	<u>383.0</u>	<u>479.0</u>	<u>3110.0</u>	<u>2639.6</u>
Scheduled Banks:	363.0	423.9	2790.2	2418.6
Non-scheduled banks:	20.0	55.1	319.9	221.0
Share of scheduled banks:	94%	88%	89%	92%
5. Comparative Size in Deposits:				
Average all banks:	1028.4	1304.2	6535.5	5808.1
Average Scheduled Banks:	30.1	27.2	72.4	66.1
Average Non-scheduled Banks:	1.5	0.4	1.7	1.3

portfolio. As can be seen from the Table, in spite of the considerable increase in the number of non-scheduled banks, the scheduled banks continued to control the bulk of the business carried on by the Indian Joint Stock banks.

Part 3

Imperial Bank of India

As noted in Chapter One, the Imperial Bank, representing a merger of the Presidency Banks in 1921, had become an important semi- central banking institution decades before the establishment of the Reserve Bank of India. Like the Bank of France, The Commonwealth Bank of Australia and the Ottoman Bank of Turkey, it carried on its Central banking functions along with its ordinary commercial banking undertakings. Before the establishment of the Reserve Bank Indian nationals favoured the conversion of the Imperial Bank into a central Bank of India. But the Imperial Government opposed the move on the grounds that the Country should not be deprived of the primary banking services of such a vast commercial banking institution. In 1935, when the Reserve Bank started its operation, the Imperial Bank had a wide net of branches spread throughout India and held almost 25 per cent of the deposits of all reporting commercial banks.

Relations with Government and Reserve Bank of India

With the establishment of the Reserve Bank of India in 1935, the Imperial Bank experienced some changes in the character of its operations, but little or no reduction in their volume. It relinquished its role as a banker and fiscal agent for the Government to the Reserve Bank but

by way of compensation the Government removed most of the restrictions on its primary banking operations. It was granted the right to lend money on the security of real property and to make advances for more than six months. Though an unquestionable practice, it could, in common with the Indian banks, lend on the security of its own shares. The Imperial Bank was finally allowed to deal in foreign exchange - a significant concession indeed. But most important of all, no restrictions were placed on its role as a central correspondent to other banking institutions. Indeed, one may assume that the Government and the Reserve Bank were disposed, on economic grounds at least, to take full advantage of the experience and structural facilities already available at this pioneer foreign institution. Because of its past experience, country-wide branches and ample resources the Reserve Bank Act itself provided that the Imperial Bank could be appointed as an agent of the Reserve Bank at places where the latter had no office or branch but the former had one.¹⁴ In these places the Imperial Bank continued to manage currency chests and to handle Government receipts and payments. For such services the Bank was to receive during the first ten years a Commission fixed by the Government at the rate of 1/16 of one per cent for the first Rs. 2,500,000 and 1/32 of one per cent for the remainder.¹⁵ After ten years these rates were to be revised after every five years. In addition to the Commission the Reserve Bank undertook to pay Rs. 1,900,000 to the Imperial Bank during the ensuing fifteen years for the retention of the latter's existing branches many of which, it would seem, might

14.

Section 45 (1), Reserve Bank of India Act, 1934

15.

S.G. Panandikar, op. cit., p. 418

have been closed down because of un-economic operations¹⁶ The Imperial Bank could not open a new branch in substitution of an existing one without prior approval of the Reserve Bank.

Although the Imperial Bank lost its privileged position as a Government banker, its nomination as an agent of the Reserve Bank and the consequent handling of Government transactions at many of its branches considerably enhanced its prestige in the financial circle of the Indian economy. It continued to function, though unofficially, as a banker's bank after the establishment of the Reserve Bank. As the Bank Rate, and the Hundi Rate were both equal to three per cent during the period under review, Indian banks who were accustomed to borrow from the Imperial Bank, continued their practice and turned to this Bank when they were short of funds.

This is clearly revealed in Table 14 which shows that the amount of bills purchased and discounted by the Imperial Bank reached the significant total of Rs. 99,300,000 in 1946. The corresponding total for the Reserve Bank was relatively insignificant. While in 1935 the Imperial Bank held about 33 per cent of the deposits of all scheduled banks compared to about 26 per cent in 1946, its vast network of branches (the number increased from 228 to 358) and association with the Reserve Bank, assured its continuance as the most important Bank in the Indian banking structure.

The predominant position of the Imperial Bank as a functioning central banking institution and the consequent restriction of the activities of the Reserve Bank appears not to have been seriously questioned before 1947, at least by the Government and the Reserve Bank.

But some Indian bankers objected to the appointment of the Imperial Bank as an agent of the Reserve Bank on the ground that it was not in the interest of other Indian Joint Stock banks to have all this business and prestige in the hands of one bank - and a foreign one at that. It was pointed out that, if the Imperial Bank was put on the same basis as other Indian banks, it would be able to realize the difficulties against which other banks were operating. It would then use its weight to remove the difficulties and, in seeking to promote its own interest, would also promote those of other Indian banks. They further suggested that the Reserve Bank be free to appoint any Joint Stock bank as its agent and thus distribute the privileges that go with such appointments.¹⁷ However little attention was paid to this suggestion.

ist
As the National Movement grew stronger during the early 1940's, public resentment of the Imperial Bank's foreign origin and foreign personnel became widespread. Its natural opposition to Indian nationalism and to Government ownership combined to raise many voices against the privileged position it occupied in the Indian economy. The Eastern Economist, after noting the rising public opinion against the Bank and accusing it of an anti-national tradition, goes on to ask "Is there no way of bringing this public institution to a due sense of its responsibilities?"¹⁸

As a result of these criticisms and in keeping with its professed collectivist philosophy, the National Government of India, on assuming

17. Central Committee, Minority Report, pp. 279, 283-85, as quoted in S.G. Panandikar, Banking in India, 9ed. p. 297

18. The Eastern Economist, February 28, 1947. New Delhi, p. 397

office in August 1947, announced its intention to nationalize the Imperial Bank along with the Reserve Bank of India. But for reasons that will be dealt with in Chapter V the Government withheld action on the Imperial Bank until 1956. The only immediate consequence was the appointment of a Government representative who was to participate in all meetings of the Bank's Central Board of Directors, and to observe the Bank's operations.

Nature and Size of Operations, 1935-1949

Though impressive, the growth experienced by the Imperial Bank from 1935 to 1949 was not as phenomenal as that of the Indian Joint Stock banks of which in some respects it was a competitor. If deposits are taken as an indicator of growth of these banks, the deposits of Indian Joint Stock banks increased by about 700 per cent during this period and those of the Imperial Bank, by about 352 per cent. Branch offices of the Imperial Bank grew from 228 in 1935 to a peak of 426 in 1946; then, after a sudden drop to 358 in 1947, increased to 377 in 1949. This substantial earlier decrease was no doubt due to partition. The Capital funds of the Bank increased from Rs. 110,200,000 in 1935 to Rs. 119,200,000 in 1949; deposits, from Rs. 768,600,000 to Rs. 2,639,700,000 during the same period. Meanwhile total earning assets increased from Rs. 680,100,000 to Rs. 2,234,300,000 indicating an over three-fold increase. The annual data showing the progress of the Imperial Bank during this period under review are given in Table 14 on page 101.

Among other things this Table reveals the very extensive operations of the Imperial Bank on behalf of the Indian Government during and

Branches, Principal Assets and Liabilities, Imperial Bank of India,
1935-1949, Inc. (Rs.000,000)

<u>Year</u>	<u>No. of Branches</u>	<u>Capital and Reserves</u>	<u>Total Deposits</u>	<u>Cash on hand and at banks</u>	<u>Loans and Advances</u>	<u>Bills prchd. and Discounted</u>	<u>Gov't securi- ties</u>	<u>Other Invest- ment</u>	<u>Total Earning Assets</u>
1935	228	110.2	768.6	177.7	233.7	25.1	418.7	2.6	680.1
1936	269	111.1	787.2	207.9	200.7	29.0	436.4	1.5	667.6
1937	319	111.3	818.4	176.3	239.4	37.3	443.1	12.9	732.7
1938	358	111.4	812.2	149.3	278.7	37.6	428.0	11.4	755.7
1939	381	111.9	844.7	138.6	319.5	40.2	431.9	91.7	801.3
1940	390	112.4	911.4	174.4	380.7	44.5	397.5	9.7	832.4
1941	401	112.6	1018.2	191.9	303.0	44.6	562.9	11.5	922.0
1942	398	112.9	1340.2	293.9	276.3	40.3	813.3	12.4	1142.3
1943	404	113.8	1877.8	338.6	320.5	34.9	1263.6	20.2	1639.2
1944	419	115.1	2242.8	402.5	528.5	50.3	1339.2	32.3	1950.3
1945	426	116.5	2393.1	403.1	613.2	44.7	1413.4	45.2	2090.5
1946	358	117.3	2636.5	414.2	633.4	99.3	1525.3	66.5	2324.5
1947	362	118.3	2733.5	509.2	735.6	58.6	1459.5	64.9	2318.6
1948	307	118.8	2830.3	496.6	825.0	50.5	1479.4	83.9	2438.8
1949	377	119.2	2639.7	513.7	998.0	63.1	1070.8	102.4	2234.3

101

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 30-31.

1 As given by S. G. Panandikar, Banking in India, 9 ed. p. 9.

following World War II. During the War, when the Government was a heavy borrower in the market, the Bank's investment in Government Securities increased from Rs. 397,500,000 in 1940 to Rs. 1,525,300,000 in 1946, thus showing about four-fold increase during the War. The Imperial bank placed, as a rule, more than half of its customers funds at the Government's disposal. Meanwhile the Imperial Bank continued to serve its correspondent banks through the purchase and discount of bills of exchange. The amount of such bills increased from Rs. 25,100,000 in 1935 to a peak of Rs. 99,300,000 in 1946. As a result of Partition, the amount was substantially reduced in 1947 but had reached Rs. 63,100,000 by 1949.

Part 4

The Exchange Banks

Although the Indian branches of the several foreign owned and operated Exchange Banks must always have been a target for the resentment generally directed against foreign agencies, This resentment became increasingly vocal during the period under review. In spite of the public criticism these banks continued to make substantial material progress.

Nature of Criticisms

The Exchange Banks and their operations were criticized on many grounds. Native Indian bankers were of the opinion that Exchange Banks presented an effective barrier against the development of foreign exchange business by the less well equipped Indian Joint Stock banks. Moreover they complained against failure, or perhaps more appropriately

the unwillingness, of the Exchange Bank to appoint native Indians to their official personnel. The banks were also accused of investing Indian earnings abroad and thus hindering the development of the Country. Lack of interest or enthusiasm in the development of a domestic exchange market - a project hardly less appealing to Indian nationalists than the Reserve Bank project itself--was probably the most significant of all the criticisms levelled at the Exchange Banks.

At one time it was formally proposed that all India Exchange Bank be nationalized^{and,} in order to ensure the success of this project, considerable restriction be placed on the Exchange Banks operations. The only tangible immediate result, however, was the setting aside of the restrictions imposed on the exchange operations of the Imperial Bank, itself a foreign institution. This did make possible, though, the eventual breach of the Exchange Banks monopoly of the financing of India's external trade.

The 1936 and the subsequent amendments to the Companies Act, 1913, did not in the main apply to the scheduled banks - which incidentally included all Exchange Banks. The only significant legal enactment that may have restricted their operations between 1935 and 1948 was the Branches Restriction Act of 1946. The latter, as noted under the discussion of the Indian Joint Stock Banks, gave the Reserve Bank the authority to restrict the establishment of new branches; also to pass on changes in existing locations.

Growth 1935 - 1949 Inc.

It is significant to note that the number of Exchange Banks was smaller at the end of this period than at its beginning. Yet this comparison may be misleading because of insufficient data on branches and changes of identity within the group. The number of branches in operation at the beginning of 1946 was 84 and it may well be that this figure represents a substantial increase over the number in operation in 1935. Moreover, the withdrawal of ^{The} Yokohama Specie Bank, the Mitsui Bank and the Bank of Taiwan on the outbreak of World War II, and a number of consolidations during this conflict, suggests that there still may have been several new recruits among the banks reporting in 1949. End of the year data on the number of Exchange Banks, their deposits, cash reserves, loans and bills discounted are presented in Table 15, on page 105.

These data reveal a considerable increase in demand deposits and in bills discounted, although the latter were at all times considerably less than the former. Demand deposits increased from Rs. 395,000,000 in 1935 to a peak of Rs. 516,000,000 in 1946. Thereafter a rather significant decline set in, reducing the amount recorded in 1949 to Rs. 1227,100,000. Meanwhile loans and advances pursued an even more erratic course. From a previous all time high of Rs. 424,300,000 in 1939, the total decreased to Rs. 177,800,000 in 1942, then rose very significantly to a new all time high of Rs. 1,076,100,000 in 1948. In the following year the total was Rs. 1,048,400,000. Whereas loans and discounts constituted about 50 per cent of total deposits in 1935, these earning assets constituted about 66 per cent in 1935. Although data on investment were not available for the period under review, it may be properly assumed the remainder of the deposited funds were re-invested in Government of India bonds and other securities.

Table 16

Number Deposits and Earning Assets of Exchange Banks in India,
1935-1949 Inc. (Rs.000,000)

<u>End of Year</u>	<u>No. of Banks</u>	<u>Captl. Funds</u>	<u>Deposits</u>			<u>Cash on Hand and at Banks</u>	<u>Loans and Bills Discounted</u>
			<u>Demand</u>	<u>Time</u>	<u>Total</u>		
1935	20	Not allocated prior to 1949.	395.0	298.0	639.9	27.1	316.4
1936	20		413.7	284.7	698.4	23.0	345.5
1937 ¹	18		387.3	281.8	669.1	43.8	312.6
1938	18		375.6	263.7	639.3	24.6	312.6
1939	17		432.2	238.7	670.9	37.6	424.2
1940	17		557.5	217.7	775.2	132.6	255.7
1941	15		722.7	228.8	951.5	83.9	295.1
1942	16		977.9	190.6	1168.5	67.4	177.8
1943	16		1181.1	220.8	1401.9	109.0	301.3
1944	15		1403.2	250.5	1653.7	115.9	352.9
1945	15		1515.0	275.0	1790.0	102.0	458.2
1946 ²	15		1516.0	272.3	1788.3	88.6	699.6
1947	15		1359.8	298.6	1658.4	177.7	791.7
1948	15		1184.7	352.5	1547.4	63.8	1076.4
1949	15		1184.7	345.5	1581.6	79.0	1048.4

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 192-227.

1 Excluding Burma banks from 1937 onwards.

2 Data after 1946 relates to Indian Union.

Part 5

The Cooperative Banks

Though significant, the progress made by the Cooperative banks from 1935 to 1949 was not impressive. Many of the primary credit societies did not survive the great depression. Among those which did were many with uncollectible loans and exhausted cash reserves. The period could best be characterized as one of retrenchment and a growing concern for the future of the cooperative movement by both State and Federal Governments and by the Reserve Bank. On the one hand this took the form of restrictions on questionable loans and the institution of a system of regulations; on the other, increased access to loanable funds and relief from the pressure of non-liquid farm improvement loans. The latter was accomplished through the institution and development of Land Mortgage Banks under the jurisdiction of Cooperative Departments of the several States.

Restrictions and Regulations

In the wake of failure of the cooperative credit societies - all too casually attributed to the great depression - were many examples of bad lending practices and too great a dependence on the basic integrity of the borrower. Many who could have paid their loans took advantage of legislation providing for the scaling down of debts. Cases were not uncommon where the borrowers refused to repay simply on the ground of an inability which could have been known at the time the loan was originally granted. Collateral security, though often required, was seldom properly assessed and executed, and the vital question of

the ability of the loan to provide for its own repayment appears not to have been the governing consideration in granting it. In fact the self-realizability test could seldom, if ever, have been used.

In response no doubt to the recommendations made by the Agricultural Commissions and Provincial Banking Enquiry Committees set by 16 States during the depression several State Governments through their supervisory Cooperative Departments brought down regulations governing the type of loans to be granted and the nature of security to be provided. These supervisory departments also initiated the requirement that all Primary Credit Societies arrange for individual audits. The latter were to include not only an investigation of the adequacy of records and the book values of their assets and liabilities; but also called for an assessment of the realizability of their outstanding loans; hence an estimate of the extent of their solvency or insolvency.¹⁹ The Registrars of the respective States were empowered to liquidate the affairs of societies classed as hopeless and to assist, through consolidation and advances, in the reconstruction and rehabilitation of others with some chance of recovery. In a study made in 1939, it was estimated that nine per cent of the Primary Credit Societies were in liquidation and that anywhere from 25 per cent to 40 per cent, depending on the State, were in the hopeless class.²⁰

Meanwhile in 1942, the Reserve Bank itself undertook to make advances on properly negotiated crop loans and to rediscount domestic

19. Panandikar, Banking in India, 9th ed. Bombay 1959, p. 334

20. Ibid., p. 95

time bills of exchange to facilitate crop movement and marketing. The Bank supplied much needed information on the form and requirements of the loans and inland bills which the Reserve Bank was authorised to purchase or rediscount.

The Land Mortgage Banks

Definite steps were taken to relieve the Cooperative banks of the constant pressure to negotiate five or more years loans on the security of real property and improvements. This was a type of loan that they were not really equipped and qualified to make because of the necessity of maintaining considerable liquidity in their funds and the existing excessive demand for current output/^{loans}. The relief came in the form of additional support through the institution of Land Mortgage Banks.

Although the first Land Mortgage Bank was established during 1920 at Jhang in Punjab, a real beginning in this field was not made until 1929 when a Central Land Mortgage Bank was established in Madras.²¹ During the latter year a few primary Land Mortgage Banks were also established in Bombay and Madras, and a few more States had established Central Land Mortgage Banks by 1949.

Like the Cooperative banking system there are Primary Land Mortgage Banks and Central Land Mortgage Banks but not a separate structure of State Land Mortgage Banks. The Central Banks coordinate the lending policies and operation of primary institutions; and, with the cooperation of State Cooperative Departments and the Reserve Bank, float debentures to secure loanable funds. The management of the Land Mortgage Banks is

21.

P.C. Jain, Currency, Banking and Finance in India, Allahabad, Chaitanya Publishing House, 1960, p. 244

entrusted to the elected representatives of their members. Their operations are supervised and audited by the Registrars of the Cooperative Departments of their respective States. Day to day operations are carried on by paid managers.

The working capital of Land Mortgage Banks consists of membership fees, loans and deposits from State Governments and State Cooperative Banks and, most important of all, the proceeds of the sale of debentures. These banks are also authorised to accept time loans from members and non-members but such deposits must be committed for a period of five years or over. As a result of this long withdrawal restrictions the deposit of these banks form an insignificant part of their working capital. Yet it should be realized that commitments for a period shorter than five years could hardly be accepted if long term loans were to be negotiated. In order to ensure a market for the debentures which provide most of their loanable funds, State Governments guarantee both their principal and interest. Until 1951 when the Reserve Actk was liberalized, the Reserve Bank was authorized to take up any short fall in popular subscriptions to the extent of 10% of the total offered for sale.²²

As the name suggests the loans of Land Mortgage Banks are to be made to members against the mortgaged security of their land and improvements. These loans as a rule may not exceed one half of the value of the security so mortgaged. In some States the loan ratio is fixed at one-third the value of land, but most States provide upper limits on the amount of the loans, ranging from Rs. 5,000 to R. 10,000.²³

22. See Chap. VI, part 4

23. Panandikar, op. cit., p, 120

Loans are granted for periods ranging from sixteen to twenty years, depending on the State, and are repayable in equal annual instalments so arranged that they fall due at the end of the harvest season. Loans are made principally on the demonstrable need of the borrower and his capacity to meet the instalments and they carry interest rates varying from six to nine per cent.²⁴

As the Land Mortgaged Banks are of fairly recent origin and few in number, no data are available showing the amounts outstanding until 1938. Between 1929 and 1938 only a few States with well-developed cooperative systems had made much progress in this field. In other States Land Mortgage Banks were either non-existent or still in an infant stage of development. Such data as are available are presented in Table 20, page 118.

Membership and Operations Cooperative Credit Societies, 1935-1949 Inc.

The Primary Societies

In spite of many failures, and some consolidations, the number of Primary Credit Societies grew from approximately 93,000 with a membership of a little over 3,000,000 in 1935 to a peak of about 147,000 with over 5,500,000 members in 1946. As a result of the Partition of the Indian sub-continent into Indian Union and Pakistan, the number dropped to about 117,000 in 1947, but there was no absolute decline in their membership; it remained at approximately the 1946 level. By the end of June 1949, their number had moved up to 135,000 and membership had gone to almost 7,000,000. The membership per society increased from an

average of about 34 before the War to about 51 in 1949.

Although there was a considerable reduction in the number of Cooperative Credit Societies after the Partition of India, substantial gains in capital and reserve were, nevertheless, made by the societies still reporting in 1949. Moreover the war prosperity and better credit standards appear to have reduced the amount of overdue loans without discouraging new advances. The annual growth of Primary Credit Societies between 1935 and 1949 is shown in Table 16 on page 112.

The data reveal that, despite jurisdictional losses during the period under consideration, the capital and reserves of these societies increased from Rs. 134,800,000 in 1935 to Rs. 193,700,000 in 1949; deposits, from Rs. 31,600,000 in 1935 to Rs. 57,300,000 in 1949; and total working capital, from Rs. 342,000,000 to Rs. 454,100,000 during the same period. As a result of significant increases made during and after the War, total loans outstanding (made up of loans due and new loans made) increased from Rs. 333,800,000 to Rs. 509,700,000. In the absence of information to the contrary it may be assumed that an excess of loans over working capital was made possible by rediscounting at the Reserve Bank and other banking institutions.

The Central Cooperative Banks

Because of the separation of Burma from India in 1937 and the creation of Pakistan in 1947^{and} the consequent reduction in the number of Central Cooperative Banks did not have an appreciable effect on the membership of these banks. In spite of the expected reduction in their capital and reserves, substantial gains were recorded in their average

Table 17

Number and Business of Primary Cooperative Credit Societies,
1935-1949 Inc. (Rs.000,000)

Year ending June	Number in 000		Working Capital					Loans to Members		
			Deposits and borrowed money from:					Current Loans	Due and Unpaid	Total
	<u>Soci- eties</u>	<u>Mem- bers</u>	<u>Capital and Reserves</u>	<u>Members and Non- members</u>	<u>Other Co- operative</u>	<u>Gov't.</u>	<u>Total</u>			
1935	93	3008	134.8	31.6	173.9	1.8	342.1	59.5	274.2	333.7
1936	94	3047	139.6	29.1	175.4	1.6	345.7	60.50	272.0	332.5
1937 ¹	96	3152	141.9	28.1	174.7	1.1-	345.8	65.1	269.6	334.7
1938	96	3163	135.0	26.3	157.3	0.9	319.5	62.8	244.7	307.5
1939	105	3560	127.8	26.6	160.9	0.8	316.1	73.9	248.0	321.9
1940	119	4098	123.5	24.3	156.5	0.9	305.2	81.8	239.5	321.3
1941	124	4341	126.6	23.8	154.1	0.8	305.3	82.41	233.1	315.5
1942	126	4573	129.8	24.1	147.4	0.7	302.0	91.1	226.3	317.4
1943	126	4493	132.8	28.5	128.7	1.0	291.0	130.44	215.8	346.2
1944	135	4815	143.6	38.3	115.2	1.3	298.4	146.4	195.4	341.8
1945	136	5013	152.9	42.2	108.7	1.6	305.4	147.3	209.1	356.4
1946	147	5501	164.6	51.9	111.0	2.4	329.9	182.1	223.2	405.3
1947 ²	117	5539	141.1	45.7	114.8	4.0	305.6	196.0	204.4	400.4
1948	126	6216	168.2	43.9	131.1	3.8	347.0	214.3	231.7	446.0
1949	135	6963	193.7	57.3	167.1	36.0	454.1	262.6	247.1	509.7

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954. pp. 448-49.

1 Excluding Burma and excluding Land Mortgage Banks from 1938 onward.

2 Relating to Indian Union after 1947.

working capital - increasing from about Rs. 480,000 in 1935 to about Rs. 990,000 in 1949. Similar growth is indicated in the loans they made to members. The extent of their operations between 1935 and 1949 is given in Table 17. on page 114.

The data disclose that before Partition the number of Central Cooperative Banks remained at about 600 and that immediately thereafter dropped to less than 500; that the number of member societies, however, rose from 89,000 in 1935 to a peak of 121,000 in 1941. After a sharp decline in 1942 the number gradually increased to 118,000 in 1946. By 1949 the number was 93,800. The number of individual members on this latter date was 89,000 - approximately the same as in 1935. The average membership of Primary Credit Societies in the Central Cooperative Banks had thus increased from about 145 in 1935 to about 194 in 1949; and those of the individual members, from 139 to 184 during the same period. Meanwhile loanable funds made up of borrowed money and capital subscriptions rose from Rs. 294,000,000 in 1935 to a peak of about Rs. 451,000,000 in 1946; then dropped back to Rs. 402,000,000 in 1947 as a result of partition. By 1949 the amount had reached a new peak of Rs. 481,000,000. During the period under consideration, the average working capital of the Central societies rose from about Rs. 479,000 to a little less than Rs. 994,000. Until 1942 there was little increase in the loans made by these banks. After that year we notice a considerable increase in their lending operations. Their current loans increased from Rs. 130,000,000 in 1942 to Rs. 927,000,000 in 1949. In spite of this considerable increase in current loans after Partition, the ratio of loans due and unpaid to current loans decreased from 48

Table 18

Number and Business of Central Cooperative Banks,
1935-1949 Inc. (Rs.000,000)

Year ending in June	No. of Banks	Membership (000)		Working Capital			Loans to Members		
		Individ- uals	Primary Soci- eties	Capital and Reserves	Deposits and bor. money	Total	Due and Unpaid	Current Loans	Total
1935	615	85	89.1	61.0	233.0	294.0	204.1	100.0	304.1
1936	615	84	89.7	62.9	231.4	294.3	202.3	98.7	301.0
1937	611	85	91.3	65.1	229.9	295.0	196.9	91.4	288.3
1938 ¹	599	82	91.8	65.2	225.7	290.9	195.9	109.5	305.4
1939	594	81	96.1	66.5	227.7	294.2	199.2	105.1	304.3
1940	600	80	104.1	68.5	223.7	292.2	197.5	108.7	306.2
1941	601	80	121.3	70.5	222.8	293.3	189.8	110.5	200.3
1942	595	80	110.6	73.0	225.4	298.4	187.8	130.1	317.9
1943	589	79	111.5	73.7	254.7	328.4	189.2	210.7	399.9
1944	601	84	115.5	77.2	288.7	365.9	185.6	280.1	465.7
1945	602	84	116.4	80.6	317.6	398.2	190.9	392.2	483.1
1946	601	80	118.1	84.5	366.2	450.7	203.6	430.7	634.3
1947 ²	469	74	86.0	63.7	338.2	401.9	211.3	612.7	824.0
1948	469	79	88.3	67.0	352.0	419.0	217.8	629.1	846.9
1949	484	89	93.8	72.7	408.5	481.5	290.2	926.8	1217.0

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 422-23.

Note: 1 Excluding Burma from 1938 onwards.

2 Relating to Indian Union from 1947 onwards.

per cent in 1946 to 31 per cent in 1949.

The State Cooperative Banks, Operations 1935-1949, Inc.

The number of State Cooperative Banks or top tier Cooperatives, remained more or less unchanged during the period under review. The more significant changes in number were brought about by the alienation of Burma and Pakistan from the Indian sub-continent. The number of individual members gradually increased from about 3000 in 1935 to about 7000 in 1949. However the number of member societies which remained about 19,000 until 1946 sharply decreased to about 8000 in 1947, then moved up to 8900 in 1949. Yearly data showing their progress are given in Table 18. on page 116.

This summary reveals that the capital and reserves of the State Cooperatives continued on the whole to increase, though erratically. The total rose from Rs. 15,500,000 in 1935 to Rs. 30,300,000 in 1946, and after a decline to Rs. 25,400,000 in 1947 again increased to Rs. 29,200,000 in 1949. Average working capital rose from Rs. 10,600,000 in 1935 to Rs. 16,800,000 in 1946 and the amount further increased to Rs. 23,400,000 in 1949. The increase in the amount of loans due and unpaid was arrested in 1940 because the war prosperity enabled many defaulting members to pay their obligations to these banks. But after the war, the amount again increased and reached Rs. 167,600,000 in 1949. However there was a substantial increase in their total loans after the war and the proportion in default was no higher than during the war period itself. Current loans grew from Rs. 168,800,000 in 1946 to Rs. 408,600,000 in 1949. The very considerable increase in loans made

Table 19

Number and Business of State Cooperative Banks,
1935-1949 Inc. (Rs.000,000)

Year Ending In June	Number of Banks	Membership ,000		Working Capital			Loans to Members		
		Individ- uals	Primary & Central Societies	Capital and Reserves	Deposits & Borrowed Money	Total	Due and Unpaid	Current Loans	Total
1935	11	3	19.4	15.5	100.8	116.3	49.8	69.2	119.0
1936	11	4	19.3	18.1	108.2	126.3	54.5	66.6	121.1
1937	11	4	19.2	18.3	107.5	125.8	57.3	80.5	137.8
1938 ¹	10	4	19.2	18.9	104.3	123.2	62.4	70.2	132.6
1939	10	4	19.1	20.6	108.7	129.3	66.4	73.3	139.7
1940	10	4	19.0	22.5	111.7	134.2	70.1	70.6	140.7
1941	10	5	18.8	23.8	115.2	139.0	70.0	69.3	139.3
1942	10	5	18.8	22.6	122.7	145.3	65.8	79.8	145.6
1943	10	5	18.7	23.4	151.5	174.9	56.4	99.6	156.0
1944	10	6	19.2	24.6	162.8	187.4	61.6	179.0	240.6
1945	11	6	19.5	27.1	178.7	205.8	63.7	163.5	227.2
1946	13	8	20.1	30.3	218.7	249.0	65.4	168.8	234.2
1947 ²	11	6	8.1	25.4	194.4	219.8	90.6	246.9	337.5
1948	11	7	8.5	26.0	214.5	240.5	89.6	217.8	307.4
1949	12	7	8.9	29.2	218.9	311.1	167.6	1408.6	576.2

116

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 410-11.

1 Excluding Burma from 1938 onward.

2 Relating to Indian Union from 1947 onward.

during the late 1940's was made possible presumably by taking advantage of the rediscounting facilities available at other banking institutions.

Number and Operations of Land Mortgage Banks

As the Land Mortgage Banks are of very recent origin in India the data with respect to the number and the size of their operations are not available before 1938, and then ^{not} in particularly revealing form. Annual data compiled by the Reserve Bank from 1938 to 1951 combine the operations of both the Primary Land Mortgage banks and the Central Land Mortgage banks and thus give an exaggerated picture of the amount of business originated by the system as a whole. A breakdown of the data is available only after 1945. However the combined totals may be used to indicate the direction of the growth and the importance of these banks in the Country's facilities for agricultural finance, and some estimate of the amount of duplication may be had from a scrutiny of the breakdown of the data after 1945.

Combined Operations - Primary and Central Banks

The combined data for Primary and Central Land Mortgage banks presented in Table 19 on page 118 display a fairly constant expansion and growth in membership if not in number. The membership grew from 63,000 in 1938 to 139,000 in 1945 and reached 180,000 in 1949 - an almost three-fold increase. Such a remarkable growth is not however revealed in the number of banks which increased from 202 in 1938 to only 268 in 1949. Yet, in spite of this small increase, working capital, made up of membership fees, deposits, borrowed money, and the proceeds of debentures, scored an impressive gain, moving from Rs. 41,200,000 in 1938 to Rs. 164,700,000 in 1949.

Table 20

Membership, Number and Business of Central and of Central and
Primary Land Mortgage Banks, 1938-1949 Inc. (Rs. 000,000)

Year ending in June	Number of:		Working Capital				Loans		
	Banks and So- cieties	Indiv. members (000)	Capital and Reserves	Depsts. and bor- owed money	Deben- tures	Total	Current Loans	Due and Unpaid	Total
1938	202	63	3.7	20.8	16.7	41.2	10.6	36.9	47.5
1939	226	80	4.4	28.6	20.4	53.4	15.6	49.4	55.0
1940	243	92	5.1	32.5	25.1	62.7	11.6	57.0	68.6
1941	252	105	5.8	33.8	30.9	70.5	11.4	63.5	74.9
1942	269	116	6.4	35.4	34.4	76.2	11.2	68.2	79.4
1943	271	120	7.2	33.5	37.1	77.8	7.5	65.3	72.8
1944	285	126	7.3	31.7	36.3	75.3	5.8	60.8	66.6
1945	289	139	8.0	69.9	38.0	115.9	7.8	60.8	68.6
1946	289	142	8.7	74.9	40.5	124.1	12.1	65.0	72.1
1947	273	145	9.1	62.5	43.5	135.1	13.7	70.2	84.0
1948	277	158	9.7	86.6	43.5	139.7	16.8	79.1	95.9
1949	268	180	10.5	100.7	53.6	164.7	21.7	92.5	115.2

118

Source: Adapted from Reserve Bank of India, Banking and Monetary Statistics of India,
Bombay, 1954, p. 504.

Loans and advances made by these banks, both current and unpaid, amounted to Rs. 47,500,000 in 1938. By 1949 the comparable total had grown to Rs. 124,800,000. Unfortunately, however, the breakdown of loans reveals that those due and unpaid had increased by considerably more than had new commitments. This may be attributed in part to the long-term nature of loans made by these institutions. The fact that before 1942 the total loans outstanding are in excess of the working capital suggests that the column on loans due and unpaid contain a carry over of loans outstanding from preceeding years. Definite information is not available.

Relative Importance of Primary and Central Land Mortgage Banks

The combined statements of the Central Land Mortgage banks and the Primary Land Mortgage banks presented in the table does not reveal the relative importance of the two categories of Land Mortgage banks. Since separate data are available on their respective operations after 1945, some estimate of their relative importance may now be made. Separate summaries are presented in Table 20. There, as would be expected, it is shown that the number of Central Land Mortgage banks is considerably smaller than that of the Primary Land Mortgage banks. While the number of the former remained at five during this period, the number of the latter decreased from 284 in 1945 to 263 in 1949. In spite of this decrease in number their operations, on the surface at least, appear to have been little affected. The working capital and the outstanding loans of the Central Land Mortgage banks increased from Rs. 43,100,000 and Rs. 32,900,000, respectively in 1945; to Rs. 59,800,000 and to

Table 21

Number and Business of Central and Primary Land Mortgage Banks, 1945-1949 Inc. (Rs.000,000)

Year ending in June	Number of		Working Capital				Loans to Members		
	Banks and Societies	Indiv. Membs. (000)	Capital and Reserves	Deposits and Borrowed money	Debentures	Total working capital	Due and Unpaid	Current Loans	Total
Central Land Mortgage Banks									
1945	5	6	3.8	2.0	37.3	43.1	29.4	3.5	32.9
1946	5	6	4.2	2.5	39.7	46.4	31.3	5.4	36.7
1947	5	6	4.5	4.3	42.9	51.7	34.3	6.3	40.6
1948	5	7	4.8	4.7	42.8	52.1	38.5	7.8	46.3
1949	5	8	5.1	2.0	52.7	59.8	44.9	10.3	55.2
Primary Land Mortgage Banks									
1945	284	133	4.3	30.8	0.8	35.1	31.5	4.4	35.9
1946	284	136	4.6	32.0	0.8	37.4	33.8	6.5	40.3
1947	268	139	4.6	34.8	0.6	40.0	36.0	7.4	43.4
1948	272	151	4.9	38.5	0.6	44.0	40.7	9.1	49.8
1949	263	172	5.4	45.1	0.9	51.4	47.7	11.5	59.2

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 504.

Rs. 55,200,000, respectively in 1949. The corresponding figures for Primary Land Mortgage banks were Rs. 35,100,000 and Rs. 35,900,000 respectively in 1945; Rs. 51,700,000 and Rs. 59,200,000, respectively in 1949.

This table further discloses that, while there were only five Central Land Mortgage banks during this period, they supplied the bulk of the working capital used by themselves and the Primary Land Mortgage banks through the sale of debentures. The data on the Central Banks reveal that the proceeds of debentures accounted for 86 per cent of their working capital in 1945 and 88 per cent in 1949. In the case of these primary institutions, money borrowed presumably from the Central Land Mortgage Bank provides the major portion of the working capital. Under these conditions it would appear fairly safe to conclude that the net total of primary advances by the system as a whole did not exceed the proceeds of the debentures plus capital and reserves of both classes of banks. Table No. 19 disclosed that in 1938 this sum would have been approximately Rs. 20,000,000. In 1949 the corresponding figure would have been approximately Rs. 64,000,000. The 'window dressed' combination of both the primary and secondary advances would encourage one to believe that the total amounted to Rs. 114,400,000.

Part 6

The Postal Savings System

There is little to add to the material already given on India's unique Postal Savings System, save the substantial progress recorded by it during the 1935-1949 period. This is accomplished through

Table No. 21 which, in keeping with the summary of Chapter I, sets forth the annual data on the number of savings offices, their receipts during the year and the total of individual balances outstanding.

TABLE 21

Number, Deposits and Balances outstanding Postal Savings System			
Year ending in March	1935-1949 Inc.	(Rs. 000,000)	
	No. of Savings Offices	Deposits During Year	Balances Outstanding
1935	12,679	430.6	583.0
1936	12,926	510.9	672.5
1937	12,903	493.6	746.8
1938 ¹	12,631	488.9	744.9
1939	12,109	504.3	818.6
1940	11,870	462.5	783.2
1941	11,883	305.9	595.1
1942	11,667	263.9	520.7
1943	11,324	262.5	522.2
1944	11,296	388.6	641.8
1945	11,227	479.1	1150.5
1946	11,202	809.4	1423.5
1947 ²	11,189	1021.0	1372.5
1948	9,939	436.1	1281.1
1949	9,090	529.2	1484.9

Source: Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954. p. 369

1. Excludes Burma from 1938 onwards
2. Excludes Pakistan

Here it can be seen that the jurisdictional alienations, caused by the partition of India in 1947 and the separation of Burma in 1937, reduced the number of offices from a peak of 12,679 in 1935 to 9,090 in 1949. In spite of this considerable decrease in the number of savings offices annual accumulation brought deposit balances on this latter date to approximately 240 per cent of what they had been at the beginning of this period. By 1949 the accumulated savings amounted to almost Rs. 1,500,000,000 which is not an insignificant sum considering the economic condition of India and especially that of the customers of these banks.

CHAPTER IV

NATIONALIZATION AND EXTENSION OF CENTRAL AUTHORITY

World War II brought significant changes in the Indian economy both politically and economically. In the political sphere, India was midway between national and colonial status. The British Government's promise of a full independence after the war provided the Indian nationals an opportunity to fulfill their long cherished desire of moulding their own destiny and of planning their future themselves. In the economic sphere India has made great strides during World War II. Her balance of trade had increased from Rs. 82.7 million in 1938 to a peak of Rs. 379.4 million in 1944¹. Indian industry, in order to meet the war needs of the British Government and her allies, had been considerably diversified. Meanwhile many British establishments had been purchased by the Indian business interests², and this brought a significant increase in the percentage of Indian owned industrial enterprises.

Though national income and product data are not available for the war period, the rapid pace of the industrial expansion which took place may be demonstrated by a comparison of rates of increases in employment in various industries between 1934 and 1939 on the one hand, and between 1939 and 1945³ on the other.

1. Reserve Bank of India, Report on Currency and finance, 1946-47, Bombay p. 47.
2. For further details see H. Venkatasubiah, Indian Economy Since Independence, Asia Publishing House, New York, 1961, p. 80.
3. Ibid, p. 81.

Comparative Percentage increase in Employment by Industries,
Period 1934-1939 and 1939-1945.

<u>Industries</u>	<u>Percent Increase</u> <u>Between 1934-39</u>	<u>Percent Increase</u> <u>Between 1939-45</u>
	%	%
Ordinance factories	67	505
Clothing	62	958
Railway workshop	7	109
Textile	24	24
Food, drink & tobacco	31	25
Paper and printing	33	27
Hides and skin	87	181
Wood stone and glass	82	101
Engineering	25	97
Minerals and metals	39	128
Chemicals and dyes	24	75
Miscellaneous	41	194

This comparison reveals a phenomenal expansion in industries that were closely related to the prosecution of War; i.e., arms and ammunition, clothing for the forces, the repair and construction of railway rolling stock, and the production of minerals and metals. The other industries experienced on the whole a substantial growth but, for obvious reasons, the rates were not so phenomenal.

Once assured of Independence by the Labour Government of Britain, Indian nationalists faced the choice of following either a free enterprise capitalist system or a planned collectivist pattern of economic development.

They had already expressed their choice in their original proposal to establish the Reserve Bank of India as a national institution. Since, after 1947, they were free to choose what they believed would be best suited to Indian conditions, they elected not only to nationalize the Reserve Bank; they also took steps to nationalize its competitor, the Imperial Bank, and to establish a number of governmentally sponsored quasi-public financial institutions to expedite their ambitious plans for the Country's industrialization.

Part 1

Nationalization of the Reserve Bank

The most impressive argument made for the nationalization of the Reserve Bank was the growing concentration of the ownership and control of the Bank's shares in the hands of the vested financial interests. At the time of the establishment of the Bank, the Imperial Government of India had attempted to make it a truly representative share-holders bank by dividing the Country, as mentioned earlier, into five regions and by allocating a fixed number of shares to each. It had also placed a limit on the number of shares that an individual could hold. In spite of these measures, the distribution of the ownership of the shares changed considerably in the years immediately following. This is revealed in some detail in the following table.⁴

4.

J.P. Jain, Indian Banking Analysed, Rajhan Publications, Delhi
1949, p. 157

also

S.K. Basu, A Survey of Contemporary Banking Trends, Book Exchange,
Calcutta, 1957, p. 51

Regional Distribution of Ownership of Reserve Bank Shares,
1935 to 1948 Inc. (In,000)

<u>Regions</u>	<u>April 1935</u>	<u>Dec. 1936</u>	<u>Dec. 1938</u>	<u>June 1940</u>	<u>June 1942</u>	<u>June 1944</u>	<u>June 1946</u>	<u>June 1947</u>	<u>June 1948</u>
Bombay	140	190	206	211	219	231	236	237	239
Calcutta	145	131	123	120	120	119	124	126	128
Delhi	115	97	93	93	86	85	79	79	79
Madras	70	61	60	59	59	55	51	50	49
Rangoon	30	20	18	17	17	10	8	8	5

This summary reveals an eventual concentration of shares in the Bombay region at the cost of the other regions. Whereas the number of shares in the Bombay region increased from 140,000 in 1935 to about 239,000 in 1948, the number in the Calcutta region declined from 145,000 to 128,000. In the Delhi region the decline was from 115,000 to 79,000; in the Madras region, from 70,000 to 49,000; and in the Rangoon region, from 30,000 to 5,000. The regions of Delhi and Rangoon were the heaviest losers.

The data below reveal the reduction that meanwhile had taken place in the number of Individual Shareholders.

Regional Distribution of Share-Holders, 1935-1948, Inc.
(00 omitted)

<u>Region</u>	<u>April 1935</u>	<u>Dec. 1936</u>	<u>Dec. 1938</u>	<u>June 1940</u>	<u>June 1942</u>	<u>June 1944</u>	<u>June 1946</u>	<u>June 1947</u>	<u>June 1948</u>
Bombay	28 0	22 3	20 8	19 8	18 0	18 0	17 4	17 4	17 2
Calcutta	23 9	15 6	13 8	12 8	11 6	11 0	10 6	10 5	10 4
Delhi	23 0	16 7	14 9	13 7	12 2	11 5	10 6	10 3	10 1
Madras	14 0	9 7	8 7	8 2	7 7	7 1	6 6	6 4	6 2
Rangoon	3 1	1 9	1 6	1 4	1 2	0 6	0 6	0 5	0 4
TOTAL ...	92 0	66 2	59 8	55 9	51 1	48 2	45 7	45 0	44 4
Av. No. of shares per share-holder	5.4	7.5	8.4	8.9	9.8	10.4	10.9	11.1	11.3

It is significant to note that the total number of share-holders of the Bank decreased from 92,000 in 1935 to 44,400 in 1948; that meanwhile the average number of shares held by a share-holder increased from 5.4 to 11.3. The data further reveal that the number of share-holders in all regions except Bombay decreased by considerably more than 50 per cent.

Taken together, these tables reveal that the Bombay region had acquired almost half of the Bank's outstanding shares and about 40 per cent of the share-holders. Thus the Reserve Bank was rapidly losing its status as a representative public institution and the original attempt of the Imperial Government to keep the Bank's electorate as wide as possible was being defeated. The Bank was coming increasingly under the domination of vested interests in the Bombay region. Nationalization appeared to be the most decisive way of permanently restoring the Bank to the status of a representative public institution.

The proponents of state-ownership of the Bank also held the view that to entrust the control of the Bank - the proposed hub of the Indian Banking System - to private share-holders; and its management to directors belonging largely to the capitalist class; was not in the best interest of the whole country. Such a public institution should, they believed, represent all interested groups in the Country. It was feared moreover that, since much of the financial structure of India was already in European hands, the policy of the Bank might not coincide with the national interest.

Confidence in the success of the nationalization measures on economic grounds was enhanced by the fact that the earlier take-over and management of the Indian Railways by the Government had proved to be very successful. The profits earned by the nationalized railways had been used both to improve the service and to expand the system. The proponents of nationalization felt that profits earned by the Bank from the free use of public funds and from the issue of the Nation's currency should be used for the benefit of the Country as a whole rather than be left to the disposition of a relatively small group of share-holders.

Unlike the people of the United States of America, the Indian people do not suffer from an innate skepticism of the extension of government authority in the field of business enterprise. The people of India sincerely believed that a publicly owned central bank would win the confidence and cooperation of a great number of private banking institutions which, hitherto, had not seen fit to associate themselves with the privately owned Bank.

In spite of the popular appeal of public ownership of the Reserve Bank, the move was not unchallenged. The Central Board of Directors of the Bank was highly critical, contending that the move was premature and hazardous in the existing state of Indian economic affairs. They feared that it might reduce the flow of incoming foreign capital by creating the impression that this was but the first step towards nationalization of other industries and financial institutions. They also contended that the Bank would become even more the hand maiden of

the Government and so abuse the privilege of note issue as to destroy confidence in the Indian currency.

To all intents and purposes the arguments in favour and against the take-over of the Reserve Bank were concluded by the Minister of Finance, Mr. Liakat Ali Khan, who, in February 1947 made the following announcement:⁵

"I have since given further thought to the matter and am convinced that the advantages of nationalization outweigh any possible disadvantages. I have, therefore, come to the conclusion that the Reserve Bank of India should be nationalized ..."

In order to implement this conclusion, the Government of India passed the Reserve Bank (Transfer to Public-ownership) Act on September 3, 1948. This Act, among several other significant provisions, empowered the Government to purchase all outstanding privately owned shares of the Bank. The effective date of the transfer of ownership was January 1, 1949. The purchase price of the shares was based on the average market price during the preceding 12 months. The latter turned out to be Rs. 1185/8 per share. The par subscription price had been Rs. 100. The share-holders were paid partly in cash and partly in 20 to 25 year 3% Government promisory notes.

Unlike the take-over of the Bank of Canada or that of the Bank of England, the nationalization of the Reserve Bank of India was not merely a political gesture to the pro-collectivist group among the Indian nationalists. It was part of a comprehensive plan to place all banking

5. Reserve Bank of India, Report on Currency and Finance, 1947-48, Bombay, 1948. p. 113

institutions under Government regulation and control with the Reserve Bank as the principal instrument for accomplishment. One of the more significant parts of the Transfer Act is Section 7 which provides that, "The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest". Other sections of this Act in combination with the provisions of the Banking Companies Act of 1949 provide for an extension of the authority of the Bank to practically all formalized banking institutions in India.

Changes in Administrative Structure

As before, the administration of the Bank was entrusted to a Central Board of Directors. But under the Nationalization Act, their number was reduced from sixteen to fourteen. Whereas before nationalization the private share-holders of the Bank controlled the majority of the voting members on the Central Board, the Government take-over made all of them in effect appointees of the Government. Now the directors of the Bank are presumably more concerned with promoting the general interest of the economy than with the profit making potential of the Bank.

The Central Board of Directors now consists of a Governor, two deputy governors, a Government representative and ten other directors. Of these latter ten, four represent the Regional Boards provided in the original Act.⁶ The remaining six directors are representatives of agriculture, industry, trade and commerce, cooperative banks, etc.

6. The original Act provided for five Regional Boards: Bombay, Delhi, Calcutta, Madras and Rangoon. The latter region was eliminated by virtue of the separation of Burma.

Under the Transfer Act, the Governor and the Deputy Governors held office for such terms as may be determined by the Government at the time of their appointment. However it was laid down in the Act that their terms may not exceed five consecutive years. The Government official on the Board holds office during the pleasure of the appointing authority. The Government's representatives on the Board hold office for five years; the representatives of the Regional Boards, for four years; and the representatives of agriculture, industry etc., for three years. The Regional Boards now consist of five members instead of eight as previously. The directors of these Boards are appointed by the Government to represent local economic interests. They hold office for four years. All the members of the Central Board of Directors, except the Government official and the directors of Regional Boards, are eligible for re-appointment.

Jurisdictional Changes

Originally membership in the Indian Reserve Bank system was limited to banks with Rs. 500,000 or more paid-up capital. Only these normally designated scheduled banks were required to deposit their statutory reserves with the Reserve Bank, and to submit weekly reports of their principal assets and liabilities. All non-scheduled banks and indigenous bankers were thus outside the Reserve Bank's province. Presumably to protect the correspondent business of the larger scheduled Banks, discount and remittance facilities were restricted to member banks only. During World War II these facilities were extended to The State Cooperative Banks but not to the other non-scheduled institutions.

However, in the Banking Companies Act of 1949, all non-scheduled banks were, in effect, brought within the scope of the Reserve Bank's authority by the provision that "every banking company not being a scheduled bank shall maintain by way of cash reserves in cash with itself, or in account opened with the Reserve Bank ... a sum equivalent to at least two per cent of its time liabilities and five per cent of its demand liabilities and shall file with the Reserve Bank before the 15th day of every month three copies of a statement of the amount so held on Friday of each week of the preceding month with particulars of its time and demand liabilities on each Friday".⁷ Subsequent to this Act the discount and remittance facilities of the Reserve Bank were extended to all banking companies that may see fit to employ them.

Extension of Regulatory Authority

Although the Transfer Act of 1948 itself did not significantly alter the functions of the Reserve Bank with respect to the exercise of its monetary policy, other banking measures enacted by the Government greatly increased its power and extended its authority to include regulatory authority over all banking institutions. Early in 1949, The Government of India finally passed the revised and comprehensive Banking Companies Act which had been in process of development from 1944 onward. This new legislation included the earlier ad hoc measures such as inspection, and branch limitation along with several others which quite definitely placed all private banks under the supervision of the Reserve Bank. These included the licensing of banks, dictation of their lending policies, responsibility for their inspection and the authority to suspend their operations.

7.

Government of India, Banking Companies Act, 1949, Sec. 18, Government of India Press, Delhi, 1949.

The Licensing of Banks

At the time of the institution of the Reserve Bank of India, and for some years following, no restrictions were placed on the establishment of private banking institutions. This situation, combined with the business expansion that occurred during World War II, prompted the organization of many predominantly small enterprises which called themselves banks. Before 1949, the only restraint upon this mushroom growth was the requirement that the bank be registered with the Registrar of Companies. The only restriction on established banks was the 1946 ordinance providing for the licensing of branches. In order to check this wild and unhealthy growth and to encourage the development of sound banking institutions, the 1949 Act required all existing banking companies to secure a licence from the Reserve Bank of India if they were to continue in business. All new banking companies were required to get a licence from the Bank before they could be established.⁸ When granting licences to existing banks the Reserve Bank was to be satisfied, by inspection or otherwise, that the applicant bank was in a position to meet its obligations and conduct its business on sound banking principles. With respect to the new banks and branches the Reserve Bank was to be satisfied that there was a need for a bank in the area where the bank proposed to operate.

If a banking company should not follow a policy consistent with the national interest and in the interest of its depositors, the Reserve Bank with the consent of the Government is authorised to cancel its licence. The aggrieved banking company may appeal to the Central Government but after the suspension not before.⁹

8. Government of India, op. cit., Section 22(1)

9. Ibid., 22(4)

Directives on Loans and Interest Rates

The Banking Companies Act of 1949 contained several other measures which considerably increased the scope of the regulatory powers of the Reserve Bank as well as its instruments of monetary control. Section 21 (1) provides that the Reserve Bank may give directions to banking companies, either generally or to any banking company or a group of banking companies in particular, as to the purpose for which advances may or may not be made, the margins to be maintained in respect of secured advances and the rate of interest to be charged, and each banking company shall be bound to comply with any directions so given.¹⁰

Under Section 36 (1) of the 1949 Companies Act, the Reserve Bank is empowered to caution and to prohibit banks generally, or any banking company in particular, against entering into any particular transactions or class of transactions not in the public interest.¹¹ With the possible exception of the Commonwealth Bank of Australia, no similar direct regulatory authority has been granted to any present day central bank.

Merger and Amalgamation

Under the provisions of the Banking Companies Act, 1949 banks had to seek the permission of the Reserve Bank for their amalgamation, merger and discontinuance of their banking business.¹² But The Reserve Bank was not authorised to impose compulsory merger or amalgamation on banking companies which it considered weak or not properly managed. It could, and did bring pressure on them to undertake such moves when conditions permitted them to do so. After the rather disastrous failure of the Palai Central Bank and the Loxmi bank in early 1960, to which additional

10. Government of India, Banking Companies Act, 1949, Section 21, Delhi, 1949.

11. Ibid., Section 36 (1),

12. Ibid., Sections 44 and 45.

reference is made in Chapter VI, the Banking Companies Act was amended. Under the provisions of Banking Companies (Second Amendment) Act, 1960 the Reserve Bank was authorised, with the prior permission of such the Government, to initiate/mergers and amalgamations as appeared to be in the public interest and that of the banks themselves.¹³ This same amendment provided that in case of a bank failure depositors were to be given priority over all other creditors, secured or otherwise.¹⁴ Subsequently in 1961, in order to speed up the process of amalgamation or merger,^{the} Banking Companies Act was further amended. Under the provisions of Banking Companies (Amendment) Act, 1961 the Reserve Bank was authorized to prepare plans under which weak and mis-managed banks could be absorbed by the State Bank of India or some other well established bank.¹⁵ Such amalgamation plans are binding not only on banks concerned, their depositors and creditors, but on their employees as well.

Appointment of Officials

In addition to the power to direct the lending activities of the private banks, the 1949 Act gave the Reserve Bank the authority to approve the appointment of managers and chief executive officers of private banking institutions. It also gave the Bank the power to prohibit inter-locking directions, the employment of managing agents, and the granting of unsecured loans either to directors or to firms in which directors had interests.¹⁶

13. Government of India, Banking Companies (Second Amendment) Act, 1960, Section 43 A.

14. Ibid., Section 44 B

15. Government of India, Banking Companies (Amendment) Act, 1961, Section 45

16. Government of India, Banking Companies Act, 1949, Section 10.

These powers of appointment, etc. were considerably enlarged by a 1959 amendment to the Banking Companies Act which gave the Reserve Bank the right to "remove from office the chairman, any director, manager or chief executive officer of a banking company found guilty of contravening any law relating to the operation of the bank".¹⁷ Furthermore, banking institutions were required to seek the approval of the Reserve Bank on such matters as the appointment, reappointment or remuneration of ^{any} director, manager, secretary or treasurer who may be employed by them. Banks have also to seek permission from the Reserve Bank for a grant of retirement benefits to any of these persons.¹⁸

Inspection, Supervision and Suspension

Before its nationalization, the Reserve Bank was not authorized to inspect the working and accounts of banking institutions. A scheduled bank had to submit its accounts to the Reserve Bank for review but it did not have to submit to audit and inspection by Reserve Bank officials. The Banking Companies Act of 1949, specifies that "the Reserve Bank at any time may, and on being directed so to do by the Central Government shall, cause an inspection to be made by one or more of its officers of any banking company and its books and accounts, and the Reserve Bank shall supply to the Banking Company a copy of its report on such inspection".¹⁹ If after due inspection, it is disclosed that the bank had not been operated in a proper manner, the Reserve Bank was authorized to prohibit the bank from accepting new deposits and to apply to the proper court for an order to wind up the bank's affairs. However, if the Reserve Bank considered that a banking

17. Government of India, Banking Companies Act, 1949, Section 6 op. cit.,

18. Reserve Bank of India, Trend and Progress of Banking in India during 1959, Bombay, 1960, p. 16

19. Section 35 (1) Banking Companies Act, 1949, Government of India, 1949

company could be salvaged, application could be made to the Central Government for an order of moratorium. During this moratorium the Reserve Bank could prepare a plan either for the bank's reconstruction or for its amalgamation with another banking company and submit it for approval to the Central Government.

Additions to Instruments of Monetary Policy

Under the original Reserve Bank Act the instruments by which the Bank could attempt to exercise a measure of control over the money supply, credit and prices were quite limited. They consisted of:

- i. the authority to engage in open market operations;
To
- ii. /make or to deny advances to the scheduled banks or to
rediscount their eligible paper; and
- iii. the right to fix the interest or 'bank rate' at which such
transactions would be made.

The Bank neither had the authority to manipulate the reserve ratio nor to ration credit. It did not have sufficient stature in the banking community to exercise moral suasion. Most of these shortcomings were met by provisions of the Banking Companies Act of 1949 and subsequent amendment of this Act and to the Reserve Bank itself.

Selective Credit Control and Credit Rationing

As noted in connection with the Reserve Bank's newly acquired regulatory authority the new Bank Act gave the Reserve Bank the authority to dictate the purpose for which advances by primary lenders may or may not be made as well as the rate of interest to be charged. The monetary

policy implications of this authority are spelled out as follows:²⁰

Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the policy has been so determined, all banking companies or the banking companies concerned as the case may be, shall be bound to follow the policy as so determined.

Later on credit rationing was imposed under this authority in an attempt to arrest the inflationary effects of the Government's vast deficit financing during the Second Five Year Plan.²¹ The Reserve Bank has also used this authority to channel credit away from the speculative stock and produce markets, and into the basically productive sectors of the economy.

Interest Rates on Deposits

In addition to its authority to impose selective credit measures, the Banking Companies Act of 1949 confers upon the Reserve Bank the authority to limit the rates of interest paid on short term deposits by the private banks. This is a subtle way of closing an important avenue of relief of cash shortages resulting from the operation of a restrictive bank rate and considerably enhances the power of the central bank. The 1949 measure provided in effect that the Reserve Bank could force the private institution to keep the interest rate paid on customers' deposits at two percentage points below the Reserve Bank's discount rate.

²⁰. Section 21 (1) Banking Companies Act, 1949, Government of India, 1949.

²¹. See Chapter V, page 164.

Reserve Ratio Manipulation

In an attempt to mitigate the inflationary effects of extensive reliance on central bank credit in the financing of the Country's reconstruction program, Reserve Bank officials in 1956 sought out and were granted the authority to manipulate the ratios governing the reserves of member banking institutions.²² This was accomplished by an amendment to the Reserve Bank Act itself which empowered the Bank to set the prevailing ratio on time deposits anywhere between 2 per cent and 8 per cent; the rate on the demand deposits anywhere from 5 per cent to 20 per cent. Of considerably more significance was the additional provision that under emergency conditions the statutory provision may be exceeded by as much as fifty per cent on additional deposits. That is to say, after the establishment of a given ratio between the authorized limits an additional reserve requirement may be imposed on new deposits of the banks provided the average of 20% and 8% are not exceeded.

This is really a decisive power, for it has the effect of burdening the banks with opportunity cost of holding in extremity as much as 100 per cent of new deposits in idle reserve balances. It also reduces substantially the inflationary potential of the central bank credit made available to Government and other spending agencies.

22.

Government of India, Reserve Bank (Amendment) Act, 1956, Section 42.

Moral Suasion

Though tangible areas of application are not specified, Indian writers on the role of the Reserve Bank hold the view that nationalization generally enhanced the persuasive power and prestige of the Reserve Bank. This is undoubtedly true but one may still wonder if this enhancement was not the result of a very considerably enlarged kit of control instruments and the fact that there was no longer any distinction between Government policy and central bank policy. With the possible exception of the Commonwealth Bank of Australia, no central bank in the admittedly more advanced Western Countries has been granted such a wide range of authority over both the public and private interests of the subordinate banks.²³ Thus, for example, an announcement of the possibility of a change in the reserve ratio or a reduction in the rate of interest in short term funds may be even more effective than the posting of the change itself.

Part 2

Nationalization of the Imperial Bank

As mentioned in Chapter III, the Government of India had decided to nationalize the Imperial Bank as early as 1947. Owing, as it was said, to some technical difficulties presented by the Imperial Banks network of branches in Pakistan, Burma and Ceylon; but more probably to the financial consideration involved in the take-over of this largest of all private banking institution at the initial stage of the country's economic development; the Government had to postpone the

23. This conclusion was reached by Professor Crumb of the University of British Columbia after studying the powers and duties of many of the world's leading central banks.

actual take-over until 1955. By this time the accomplished nationalization of the Reserve Bank and the announcement of the pending nationalization of the insurance companies and other enterprises no longer left any valid political excuse for maintaining a passive attitude towards this vital "foreign" institution. There was also the hope that its vast resources, wide net-work of branches, and its skilled personnel could take on the very real task of improving facilities for financing India's greatest industry - agriculture.

This latter view had already been expressed by the Rural Banking Enquiry Committee which the newly nationalized Reserve Bank had set up to study agricultural finance and to make recommendations to speed up the spread of agricultural banking facilities. Among its other recommendations was one that the Imperial Bank should work as an auxiliary to the Reserve Bank and that it should establish 270 branches in unserved and outlying areas within the following five years.²⁴ This it began to do. As a partial compensation for losses on the new branches the Reserve Bank increased the commission paid to the Imperial Bank on collections and payments made for its account.²⁵

Later on the Reserve Bank appointed the All India Rural Credit Survey Committee to study the rural credit problems and to make recommendations to facilitate the free flow of credit to agriculture

24. S.G. Panandikar, Banking in India, 9th ed, Orient Longmans, Bombay, 1959, p. 314

25. The new rates of Commission were 1/16 of one per cent on the first Rs. 1,500,000,000; 1/32 of one per cent on the next Rs. 3,000,000,000; 1/64 of one per cent on business over Rs. 3,000,000,000 but not exceeding Rs. 12,000,000,000 and 1/128 of one per cent on business exceeding Rs. 12,000,000,000.

and allied industries in rural areas. This Committee was critical of the progress made by the Imperial Bank between 1950 and 1954 in its branch expansion program. The slow progress, the Committee contended, was due to the primary profit motive of the Bank. It could not keep its owners content with the lower dividends that would result from a primary interest in the development of the Indian economy. In its integrated scheme to reorganize the rural credit and thus to provide adequate credit facilities to the rural population, the Committee of Direction of the All India Rural Credit Survey recommended that the Imperial Bank, along with other State associated banks, be made a state institution in language that appears to have presumed as much on the Imperial Bank's existing facilities as on new ones to be added. The Committee concluded in approved collectivist style that the proposed State Bank be: "one strong, integrated, state-sponsored, state-partnered commercial banking institution with an effective machinery of branches spread over the whole country, which, by further expansion can be put in a position to take over cash work from non-banking treasuries and sub-treasuries, provide vastly extended remittance facilities for cooperative and other banks, thus stimulating the further establishment of such banks, and, generally, follow a policy of advances - including advances for agricultural purposes - which, while not deviating from the canons of sound business, will be in effective consonance with national policies as expressed through the central government and the Reserve Bank".²⁶

The Committee went on to state that the Government of India and the Reserve Bank together should hold 52 per cent of the share capital of the proposed State Bank; it also made proposals for the management and operations of the nationalized institution. Similar proposals were

26. Reserve Bank of India, Report on Currency and Finance, 1954-55, Bombay, p. 91

remade~~n~~ by the Shroff Committee appointed by the Reserve Bank to enquire into problems of finance in the private sector. ~~se~~Ther. The Government finally announced its decision to nationalize the Imperial Bank on December 20, 1954. In May of the following year the State Bank of India Act was passed by the Indian Parliament, and on July 1, 1955 the State Bank took over the operations of the former Imperial Bank.

Ownership of the State Bank of India

The conversion of the Imperial Bank into the State Bank was accomplished by the directed sale of the shares of the Imperial Bank to the state owned Reserve Bank at a price of Rs. 1,765 5/8 per share. This was more than three times the original par value of Rs. 500.²⁷ The payment itself was made partly in cash and partly in Government National Plan Bonds bearing interest at 3½ per cent.

Under the provisions of the State Bank of India Act, the Reserve Bank was authorized to dispose of 45 per cent of the share capital of the State Bank to the general public with preference given to the former share holders of the Imperial Bank. The Central Board of the State Bank was authorised to increase the outstanding shares of the State Bank providing the holdings of the Reserve Bank did not fall below 55 per cent of the total.

The State Bank of India Act of 1955 also contained provisions under which other banking companies may be and subsequently were amalgamated with the State Bank.

²⁷. Partly paid-up share of Rs. 100 were bought at Rs. 431 3/4. Their price was based on the average market price for the past twelve months.

Administration and Management

The Administration of the State Bank was entrusted to a Central Board of Directors. This Board consists of twenty members. The chairman and vice-chairman are appointed by the Central Government in consultation with the Reserve Bank. Two managing directors are appointed by the Central Board with the approval of the Central Government. Six directors are elected by shareholders other than the Reserve Bank. Eight directors are nominated by the Government in consultation with the Reserve Bank and these directors represent various economic interests of the country, i.e. agriculture, industry, trade and commerce, and the cooperative banks. One is appointed by the Reserve Bank and one by the Central Government.²⁸ The management of the State Bank continued in the hands of the former official and personnel of the Imperial Bank.

Part 3

Industrial Banks and the Insurance Corporation of India

After August 15, 1947, when India became a sovereign state, the Indian Government was finally free to chart the country's future development. This was done along lines dictated by the needs and aspirations of the Indian people. These needs and aspirations could be summed up in the expression, self generated industrialization. The Indian people looked upon industrialization not only as a means of improving per capita incomes, living standards and employment opportunities, but as an eventual escape from dependence on foreign interests

28. Reserve Bank of India, op. cit., p. 42

for the development of the Indian economy. The program of development which ultimately emerged in a series of five year plans, encompassed agricultural improvements, natural resources exploitation, and the development of iron and steel, ship building and aircraft industries - all to be financed as far as possible from domestic sources. Considering the relatively impoverished state of the Indian economy this was, to say the least, a very ambitious undertaking.

In all, the Government in cooperation with the Reserve Bank and various private financial institutions, established six different financial corporations through which the credit needs of the program of industrialization were to be channelled and in part provided. In approximate order of establishment they were: the Industrial Finance Corporation, the State Financial Corporations, the National Industrial Development Corporation, the Industrial Credit and Investment Corporation of India, the National Small Industries Corporation and the Refinance Corporation. It also nationalized the Country's insurance business through the establishment of the Life Insurance Corporation of India.

The Industrial Finance Corporation

The Industrial Finance Corporation was established on July 1, 1948. This agency was authorized to grant long term capital loans to public limited companies and to cooperative ventures engaged in manufacturing, mining, and the generation and distribution of power. Subsequently ship building was brought within the sphere of its lending operations.

Capitalization and Ownership

This agency has a paid up capital of Rs. 50,000,000 which was subscribed by the Government, the Reserve Bank, the Scheduled Banks,

the Insurance companies and the cooperative banks in the following proportions.

<u>Subscribers</u>	<u>Amount subscribed (000,000)</u>	<u>Percent of Total</u>
Insurance companies	13.0	26.0
Scheduled banks	12.0	24.0
Government of India	10.0	20.0
Reserve Bank of India	10.3	20.6
Cooperative banks	4.7	9.4

The Government of India in conjunction with the Reserve Bank of India contributed about 41 per cent of the share capital of the Corporation. With the nationalization of the Imperial Bank and the life insurance companies of India in 1955 and 1956 respectively, the total share of Government and public institutions became something more than 70 per cent.

In order to make the shares of the Corporation a reasonably attractive investment for the private banks and insurance companies, the Government undertook to guarantee its par value and a minimal dividend of 2½ per cent. The maximum dividend allowed was 5 per cent.²⁹ Any net profit above this maximum accrued to the Government. In 1952 the Enabling Act was amended to provide that dividends payable to the Government and the Reserve Bank be placed in a special fund until such payments amounted to Rs. 5,000,000.³⁰

²⁹ S.L.N. Simha, The Capital Market of India, Bombay, Vora & Co., Bombay, 1960, p. 144

³⁰ Reserve Bank of India, Report on Currency and Finance, 1952-53, Bombay, 1953, p. 54

Administration and Control

The administration of the Industrial Finance Corporation is entrusted to a Board of Directors consisting of 13 members. The Government of India on behalf of itself and the Reserve Bank appoints seven members of this Board including the managing director and the chairman. The other directors are appointed by the scheduled banks, the insurance companies and the cooperative banks. In addition to its majority control, the Government has the right to discharge the entire Board if the latter should fail to follow Government policy.

Sources of Working Capital

In order to augment its capital funds the Industrial Finance Corporation was originally authorised to issue bonds and debentures up to five times its paid-up capital. By 1957 this authorization had been raised to ten times the paid-up capital.³¹ Meanwhile bonds and debentures issued by the Corporation had risen from Rs. 58,000,000 in 1951 to Rs. 222,000,000 by the end of 1960.

Under the original Act the Corporation was not authorised to borrow from the Reserve Bank. In order to increase its immediately available lending capacity and thus to enable the Corporation better to serve its customers, the Act was amended in 1952 to permit such borrowing provided proper collateral was presented. The latter included securities of the Corporation itself and other securities acceptable to the Reserve Bank. The total of such loans could not exceed Rs. 30,000,000.³² In 1957 the

31. Reserve Bank of India, Report 1952-53, op. cit., p. 44.

32. Reserve Bank of India, Report on Currency and Finance, 1957-58, Bombay, p. 54.

Corporation was authorised to borrow directly from the Government provided its total borrowings from the Government, the Reserve Bank and its own outstanding bonds and debentures did not exceed ten times its capital and reserves. In 1958 the authority to underwrite security issues for other Government corporations was added to this agency's growing powers and duties. In 1960 the Original Act was amended to allow the Corporation to subscribe directly to the common stock of the various industrial enterprises which borrowed from it and for whom it had underwritten share capital. It was also authorised to convert loans already granted and debentures into the share capital of the borrowing concern in question.³³

Under the amended Act the Government was authorised to guarantee such foreign loans as the Corporation may seek from the International Bank for reconstruction and development or from other international financial institutions for making loans in foreign currency to its customers. Before 1960 the Government was not authorised to guarantee such loans. As we shall see in Part 3 of Chapter V the Industrial Finance Corporation played an important role in the financing of the Government enterprises in India. Its successful beginning led to the establishment of various other financial institutions to meet the growing needs of the Government's expansion program.

The State Financial Corporations

At the time of its organization the operations of the Industrial Finance Corporation were limited to large public and cooperative enterprises and other private industrial ventures within the jurisdiction of ^{the} States also needed financial assistance for their development

33. Reserve Bank of India, Report 1957-58, op. cit., pp. 54-55.

and expansion. In order to make this possible the Government of India passed the State Financial Corporation Act on September 28, 1951. Under the provisions of this measure the State Governments were authorized to set up their own financial corporations. By 1961 there were fifteen such corporations - one in each State.

Capitalization and Ownership

The State Financial Corporation Act empowers each State Government to fix the authorized capital of its corporation according to its own needs subject to minimum and maximum limits of Rs. 5,000,000 and Rs. 50,000,000, respectively. The authorized capital of the existing corporations ranges between Rs. 20,000,000 and Rs. 40,000,000. The paid-up capital of these Corporations is Rs. 10,000,000 except for the States of Bombay, Madras, Andhra Pradesh and Orissa where Rs. 20,000,000, Rs. 13,200,000, Rs. 15,000,000 and Rs. 5,000,000 respectively, have been paid in.

The par value of the share capital of each State Finance Corporation and a minimum dividend of three per cent is guaranteed by the respective state Governments. Minimum and maximum rates are fixed at 3 per cent and 5 per cent, respectively. Within these limits, each State Corporation is free to fix its actual dividend rate to reflect the local pattern of interest rates. The guaranteed rate of dividend is $3\frac{1}{2}$ per cent in all States except Punjab and Madras where it is 3 per cent.³⁴ Like the limitation imposed on the Industrial Finance Corporation, the rate of dividend of the state financial corporations cannot exceed the

³⁴. S.L.N. Simha, op. cit., p. 160

guaranteed minimum until reserve funds are equal to paid up capital, and the State Government has been repaid any debt resulting from obligations incurred on behalf of the corporation.

Unlike the Industrial Finance Corporation whose entire stock is either Governmentally or institutionally held, the general public can subscribe to the share capital of State Financial Corporations up to a maximum limit of twenty-five per cent. The remainder is subscribed by the respective State Governments, the Reserve Bank and other financial institutions. As of March 1959, the subscription of State Governments averaged 47 per cent of the total paid up capital, that of the Reserve Bank was 15 per cent and other financial institutions had subscribed on the average about 33 per cent. The remaining 5 per cent was subscribed by the general public.³⁵ Thus the State Governments along with the Reserve Bank controlled about 62 per cent of the total capital of these Corporations.

Administration and Control

The administrations of the State Financial Corporations are entrusted to boards of directors, consisting of ten members. The respective State Governments in consultation with the Reserve Bank appoint the managing directors and nominate three other directors including the board chairman. The Reserve Bank and the Industrial Finance Corporation nominate one director each. The scheduled banks, Cooperative banks, insurance companies and other financial institutions elect three directors from among themselves. The rest of the shareholders elect one director. Thus the majority of the directors are

³⁵. S.L. Simha, op. cit., p. 160.

appointed by the State Governments and public institutions. The enabling Act stipulates that each board shall follow the policies dictated by its Government in consultation with the Reserve Bank.

Sources of Working Capital

In order to supplement their capital funds these corporations are authorized to issue bonds and debentures up to a maximum limit of five times their paid up capital. Like the share capital of the corporations their bonds and debentures are guaranteed by the respective State Governments.

Some indication of the importance of the State Corporations may be gained from the fact that by March, 1961 these Corporations had approved loans amounting to Rs. 361,700,000. Of this sum Rs. 221,600,000, or about 60 per cent, was actually disbursed. At this latter date the amount of loans and advances outstanding was Rs. 141,900,000.³⁶

The National Industrial Development Corporation

With the operations of the Industrial Finance Corporation limited to large public and cooperative enterprises, and those of the State Financial Corporations limited to state and small local private industrial undertakings, there was still need for a financial institution that could provide long term capital to large private industries and assist in the establishment of new ones. The private sector, it was realized, also had to be encouraged if the Country was to realize its full industrial potential. In recognition of the difficulties of private firms in acquiring equity capital for risky ventures and to

³⁶. Reserve Bank of India, Report on Currency and Finance, 1960-61, Bombay, 1961, p. 64

encourage balanced growth of the industrial sector, the Government established the National Industrial Development Corporation on October 20, 1954.³⁷

This Corporation was intended primarily to promote new industrial enterprises for the planned development of the Country's industrial sector and to finance improvements and extensions in existing ones. Particular attention was to be given to the jute industry, to cotton textiles and to the manufacture of machine tools. Priority was to be given to such firms as could make use of equipment, experience and skill available in India.³⁸

Capitalization and Ownership

The National Industrial Development Corporation had a paid-up capital of Rs. 1,000,000.³⁹ Unlike the Industrial Finance Corporation and the State Financial Corporations, where participation in ownership was fairly broad, the Government of India was the sole subscriber to and shareholder of this Corporation. The Government has increased the working capital of the Corporation through loans and grants. During 1956 these loans and grants amounted to Rs. 14,900,000.

Administration and Control

The administration of the National Development Corporation is entrusted to a Board of fourteen Directors drawn from the private business sector and chaired by the Minister of Commerce and Industry.

³⁷. Reserve Bank of India, Report on Currency and Finance, 1954-55 Bombay, 1955, p. 50

³⁸. Loc. cit.

³⁹. Its authorized capital was Rs. 10,000,000

The representatives of private business are nominated by the Government in consultation with the Industrial Finance Corporation and the Reserve Bank. Such prominent industrialists as Tate, Birla, and Medi are represented on the Board. This was done to ensure sound advice and guidance to the Corporation in undertaking and developing new projects. The summary of the operations of the various quasi-public financial corporations given in Part 3 of Chapter V reveals that this Corporation (N.I.D.C) has already made a very substantial contribution to the country's jute and cotton textile industries.

Industrial Credit and Investment Corporation

Although considerable progress towards industrial development was made during the First Five Year Plan the pace of this development was undoubtedly retarded by the fact that little or no inducement had been given to local private enterprises or to foreign investors. No particular attempt had been made to provide instrumentality through which private equity capital could be channelled into industrial undertakings, and no special attempt had been made to tap either the vast capital resources or the technical proficiencies of the Western World. An institution that could bridge this gap was urgently needed.

In 1954, when the Indian Planning Commission was working on the Second Five Year Plan, discussions were held with the representatives of the World Bank, the Foreign Operation Administration of the United States Government and the Commonwealth Development Finance Company on the feasibility of establishing a nominally private investment corporation, to assist in promoting private enterprise. These discussions bore fruit in the form of a recommendation that an industrial

credit and investment corporation be set up in India under which a Indian and foreign investors would join hands to provide equity capital and other benefits to private industrial enterprises. As a result, an institution bearing that name was established on January 5, 1955.

Duties of this Corporation consisted in the main of financial and technical assistance to private industries. One of its principal tasks was to help in the provision^{of} loans in foreign currencies for importing urgently needed machines and equipment. The Reserve Bank of India gave a ~~more~~ detailed summary its main objectives as follows:

- a. To assist in the creation, expansion and modernization of private industries
- b. To encourage and promote the participation of private capital, domestic and foreign, in the ownership of industrial investment and thus expand the investment market by:
 - i. providing long and medium term loans and equity capital
 - ii. underwriting new issue of stocks and bonds of private industries, or by guaranteeing loans from private institutions to such industries
 - iii. furnishing managerial, technical and administrative services to industries.⁴⁰

Capitalization and Ownership

The Industrial Credit and Investment Corporation had an authorized capital of Rs. 250,000,000 of which Rs. 50,000,000 was paid up. Of the latter sum Rs. 35,000,000 was subscribed by Indian nationalists and other financial institutions; Rs. 10,000,000 were contributed by British Eastern Exchange banks, British insurance companies and the

⁴⁰. Reserve Bank of India, Report on Currency and Finance, 1954-55, Bombay, 1955. p. 50

Commonwealth Development Finance Company. The rest of the Rs. 5,000,000 were subscribed by public corporations in the United States and by individuals.

In addition to its share capital the Corporation received an interest free loan of Rs. 75,000,000 from the Government of India repayable after 15 years in 15 annual instalments. It was also granted a 4.5% loan of \$10,000,000 for 15 years from the World Bank.⁴¹ The latter sum was to be used to advance loans in foreign currencies to private firms to enable them to purchase from abroad machinery, equipment, material and services not available in India.

Because of the considerable increase in demand for loans from the Corporation, both in domestic and foreign currencies, its capital funds were further increased in 1959. By an agreement between the Government of India and the United States Technical Corporation Mission on May 21, of that year, the Corporation was provided a loan of Rs. 100,000,000 out of Public Law 480 funds.⁴² During this year the International Bank for Reconstruction and Development granted the corporation an additional loan of \$10,000,000.⁴³

Administration and Control

The Industrial Credit and Investment Corporation is administered by a Board of Directors consisting of fifteen members, who are elected

⁴¹. Reserve Bank of India, op. cit., p. 51

⁴². The legislation under which the United States Government makes grants in aid to foreign countries.

⁴³. Reserve Bank of India, Report on Currency and Finance, 1958-59, Bombay, 1959, p. 47.

by the shareholders. It is stipulated that the chairman of the Corporation must be an Indian national. The Government of India has the right to appoint one director until the Government loan is fully repaid. The day to day business of the Corporation is carried on by the salaried general manager who is also to be an Indian national. The World Bank acts as the Corporation's adviser.

The Refinance Corporation

Under an agreement between the United States Government and the Government of India, it was stipulated that Rs. 260,000,000, the equivalent of \$55,000,000 arising out of the sale of imported food grains from the United States, be reserved for relending to private enterprise through established banking institutions. In order to take advantage of this arrangement, the Indian Government in June 1958 set up the Refinance Corporation - an institution empowered to make advances to member scheduled banks against loans granted to medium sized industrial undertakings.⁴⁴ Advances not exceeding Rs. 5,000,000 to a single concern, were to be made for periods running from three to five years. Preference was to be given to industries included in the Second Five Year Plan and the succeeding plans.

Capitalisation and Ownership

The Refinance Corporation had a paid-up capital of Rs. 25,000,000 which was subscribed by various financial institutions as follows:⁴⁵

44. A medium sized industry is defined as a concern whose paid-up capital and reserves are not less than Rs. 500,000 and not more than Rs. 25,000,000.

45. Reserve Bank of India, Report 1958-59, op. cit., p. 47

<u>Subscriber</u>	<u>Amount of Subscription</u>	<u>Per Cent of Total</u>
Reserve Bank of India	10,000,000	40
Life Insurance Corporation	5,000,000	20
State Bank of India	4,500,000	18
Fourteen scheduled banks ...	5,500,000	22

In addition to its share capital, counterpart funds arising from the wheat sale were made available to the Corporation in the form of an interest bearing loan of Rs. 260,000,000.

Administration and Control

The management of the Refinance Corporation is entrusted to a Board of Directors consisting of seven members. The Governor of the Reserve Bank is its chairman. The other directors include the Deputy Governor of the Reserve Bank, the Chairman of the State Bank of India and the Chairman of the Life Insurance Corporation of India. The remaining three directors represent the participating scheduled banks. The day-to-day operations of the Corporation are carried on by a salaried general manager.

In the beginning loans to banks were restricted to the fourteen scheduled institutions which subscribed to the corporation's capital.

These loans carried an interest rate of 5 per cent, and the borrowing banks were not to charge more than 1½ per cent above this rate to the borrowing customer. Obviously this maximum did not provide enough profit margin for the member banks and hence no particular inducement to utilize the corporation's facilities. In view of these difficulties

the 6½ per cent primary rate limit was relaxed providing the latter did not exceed rates on other types of loans in the same locality. After these concessions the Corporations's lending facilities were extended to forty three scheduled banks, to all State Financial Corporations and to three Cooperative banks.⁴⁶

National Small Industries Corporation

Although the development of small industries falls within the purview of the State Governments, the Central Government has also stepped in to hasten the process. In order to assist in providing the financial as well as technical needs of such industries the Government of India established the National Small Industries Corporation in February 1955 with a main office in Bombay. In order to supplement the operations of this Corporation subsidiary corporations were established in Calcutta, Delhi, Madras: also in Bombay in 1957.

In addition to financial assistance in acquiring machinery under a hire-purchase arrangement, the National Small Industries Cooperation attempts to secure a reasonable share of Government orders for small industries and to provide such technical assistance as may be necessary to fulfill these orders. It also endeavours to secure coordination between large and small scale undertakings to enable the latter to supply ancillaries and components required by the large ones.⁴⁷ Originally the hire-purchase scheme was limited to Indian-made machinery. It was eventually extended to imported machinery as well.

⁴⁶. Reserve Bank of India, Report 1960-61, op. cit., p. 65.

⁴⁷. Reserve Bank of India, Report 1954-55, op. cit., p. 51

Under the original scheme loan applicants were required to make a down payment of 20 per cent of the value of a general purpose machine and 33½ per cent of that of a special purpose machine. The balance of the cost was repayable in half yearly instalments spread over a period not exceeding eight years. The first instalments of such loans were repayable after six months. In 1959 this scheme was liberalised by reducing the down payments on a special purpose machine to the same level as that of the general purpose machine. The down payment of machines valued at less than Rs. 200 was reduced to 10 per cent as against 20 per cent previously; and the first instalment on all loans under the hire-purchase scheme was made payable after one year.⁴⁸ In 1960 the down payment on such machines was further reduced to 5 per cent, providing the remaining 15 per cent was guaranteed by the Government.⁴⁹

Capitalization and Ownership

When originally established this Corporation had a paid-up capital of Rs. 1,000,000 - all subscribed by the Government of India. Because of the great demand for its loans and other assistance, its capital was increased to Rs. 4,000,000 in 1959.⁵⁰ Each of the four subsidiary Corporations had a paid-up capital of Rs. 250,000. In 1960 the Corporation obtained a long term loan of \$10,000,000 from the United States Development Loan Fund. This loan was to be used for procuring machinery from non-Communist countries. Machines valued at more than \$50,000 were to be obtained in the United States only.

^{48.} Reserve Bank of India, Report on Currency and Finance, 1959-60, Bombay, 1960, p. 54

^{49.} Reserve Bank of India, Report 1960-61, op. cit., p. 68

^{50.} Originally its authorised capital was equal to Rs. 1,000,000. In 1959 it was increased to Rs. 20,000,000

In addition to its capital funds the Government supplements the Corporation's working capital with loans and grants.

Administration and Control

The National Small Industries Corporation is administered by a Board of Directors appointed by the Government of India in consultation with the Reserve Bank and the Industrial Finance Corporation. Each of its subsidiaries is administered by a board of directors made up of the regional heads of the Joint Development Commission, the Small Industries Service Institute, a representative of small industries and the managing director of the Corporation.⁵¹

The nature and extent of this Corporation's activities will be found in Part 3 of Chapter V.

The Life Insurance Corporation of India

In line with its policy of development of the Indian economy on a socialistic pattern, the Government of India announced its decision to nationalize the life insurance business in India in 1955. In early 1956 the Life Insurance Corporation Bill was introduced and successfully piloted through both Houses of the Indian Parliament, it was approved on July 1, 1956. Under the provisions of this measure the Life Insurance Corporation of India was set up on September 1, 1956, and all the life insurance business of existing companies in and outside of India was transferred to it. The Corporation was given an exclusive right to carry on life insurance business in India and to continue the foreign activities of the former private companies. - However it is

⁵¹. Reserve Bank of India, Report on Currency and Finance, 1957-58
Bombay, 1958, p. 48

authorized to transfer its foreign business to such insurance companies as it may deem fit.

At the time of its establishment the Corporation took over the life insurance business of 245 insurance companies that were engaged in business in India. The total assets of these latter institutions on August 31, 1956 amounted to about Rs. 4,110,000,000; the total number of policies in force were a little over 5,000,000 with an assured value of approximately Rs. 12,500,000,000.⁵² This was indeed a major conquest for the Indian Government, bringing within its reach a considerable sum of voluntary savings.

Ownership and Control

The Life Insurance Corporation has a paid-up capital of Rs. 50,000,000 all provided by the Central Government. It is managed by a Board of Directors consisting of not more than fifteen members including the chairman. The Board is charged with the responsibility of managing the affairs of the Corporation along proper actuarial lines subject only to such directives on policy matters as may be given by the Government. The Corporation has an Executive Committee and an Investment Committee. The former, consisting of five members, appointed by the Board, is entrusted with the day to day operations of the Corporation; the latter is responsible for the investment policy.

The nationalization of the life insurance business was strategic as well as a political move which brought into the Government's orbit the only really significant savings instrumentality in the Indian economy. Through this newly acquired agency the Government was able to

52.

India, Ministry of Information and Broadcasting, India, 1958, Delhi, p. 251.

channel much of the real savings of the Indian people into Government enterprises.

The operations of the Life Insurance Corporation along with the other public and semi-public financial institutions are reviewed in Part 3 of Chapter V.

CHAPTER V

OPERATIONS OF THE RESERVE BANK, THE STATE BANK AND OTHER PUBLIC FINANCIAL INSTITUTIONS 1949 ONWARD

The banking legislation enacted by the Indian national Government finally provided the framework for a complete re-orientation of the direction and outlook of the Indian banking system. What formerly had been a privately controlled and directed system without a strong centralized authority, to help and guide it had been subordinated to a central bank redesigned to execute Government policy as well as to meet the day-to-day credit and clearing needs of its bank and Government customers. The Reserve Bank of India had been nationalized. Its instruments of monetary control had been considerably enlarged. Moreover its authority was extended to include, where necessary, regulation and direction of the operations of all the private banking enterprises, large or small, scheduled or non-scheduled. Steps had been taken to convert the Imperial Bank to the State Bank of India, to extend its agricultural finance business independently as well as through Cooperative banks, and to expand even further its already wide-spread physical facilities. Among others, the institution of the Industrial Finance Corporation, the State Financial Corporations, the Industrial Credit and Investment Corporation, etc., had provided agencies for making investment funds available for an ambitious program of industrialization - a program which, it was hoped, would provide the Country with a higher standard of living, and at the same time, a measure of economic independence and self reliance.

The operations of what we may now call the governmentally controlled banks and their contribution to monetary policy, and to the Government's program of development from 1949/^{onward,} may now be reviewed. They shed some light on the extent to which an orthodox conception of the business of both public and private banks must, perforce, be disregarded if a planned economic expansion is to go forward under forced draft.

Part I.

Operations of the Reserve Bank After 1949.

The operations of the Reserve Bank from 1949 to date display the often conflicting roles of a Government banker, a banker's banker, and a guardian of the integrity of a country's money. Most of these conflicts are revealed by the Reserve Bank's continuous attempts to restrict price rises in face of a constantly increasing Government reliance on Reserve Bank credit in projecting its program of industrial development.

The exercise of Monetary Authority

At the beginning of 1949, Reserve Bank credit as measured by the Reserve Bank's notes outstanding stood at Rs. 11,635,200,000 and the general price level on a 1939 base at 385.4. Until this time the monetary policy of the Reserve Bank, if one could call it such, was designed to maintain the market for Government securities and thus help to minimise the cost of the rapidly rising Government War debts. During the late 1940's the Bank's open market policy, if used at all, consisted of encouragements in the form of small percentage discounts to the

institutional investors to take off the Bank's hands particular types of securities which at once suited their investment needs and relieved the Bank of the burden of carrying them.¹

Counter Measures for the Korean Inflation

Before and during the Korean conflict many foreign countries, particularly the United States of America and the United Kingdom, were stockpiling industrial raw materials in anticipation of a full scale war. This had led to a considerable increase in Indian exports, a rise in prices and a general spurt in Indian trade and industrial activity. There was a concomitant increase in demand for bank credit and the scheduled banks eventually began to liquidate Government securities in order to meet it. This, in the absence of support by the Reserve Bank, led to a fall in prices of these securities and the corresponding increase in interest rates. To prevent any further decrease in the prices of these securities the Reserve Bank entered the Securities market as a buyer on an unprecedented scale. The Bank's net purchases of Government securities during 1950 amounted to Rs. 562,700,000². This action, coupled with a trade surplus of Rs. 700,000,000 between July 1950 and March 1951, contributed to a sharp increase in the country's money supply and in the general level of prices. Between March 1950 and March 1951 the Reserve Bank's note circulation rose from Rs. 11,635,200,000 to Rs. 12,474,100,000 or by about Rs. 849,000,000.

1. J.S.G. Wilson, "The Rise of Central Banking in India", as quoted in R.S. Sayers, Banking in the British Commonwealth, Oxford University Press, London, 1952, p. 240.

2. For further details of the Reserve Bank's dealings in Government securities, see Appendix I at the end of Chapter VII.

This, as is shown in the table on the combined operations of the Reserve Bank, was largely a result of Government bond purchases.

This expansionist monetary policy, coupled with a continuous increase in both domestic and foreign demand for Indian goods, created boom conditions in India. Prices of industrial raw materials, finished and semi-finished goods were on an uptrend. The General Price Index (1939-100) increased from 410 in 1950 to 435 in 1951. A speculative activity had developed in the goods market. In order to curb this, the Reserve Bank exercised its newly acquired selective credit control authority to direct all banking institutions to restrict their advances against raw jute and jute goods. Scheduled banks in Calcutta and surrounding areas particularly were asked to recall their advances against jute stock to parties other than jute mills and jute exporters within a specified period of time.

Bank Rate

In order to counteract the general rise in prices the Bank increased its discount rate (Bank Rate) from 3 per cent to $3\frac{1}{2}$ per cent, on November 15, 1951, and simultaneously announced that it would not, except in emergency cases, continue to buy Government securities from the scheduled banks at the existing price of Rs. 92.7 per Rs.100. In fact, during the following two years the Bank disposed of almost Rs. 1,300,000,000 worth of Government bonds and thereby reduced the outstanding notes in circulation by approximately the same amount. The Imperial Bank followed the Reserve Bank's lead by raising the rate (Advance Rate) at which it was prepared to make short term loans, from $2\frac{3}{4}$ per cent to $3\frac{3}{4}$ per cent and its Hundi Rate from $3\frac{1}{2}$ per cent to

4½ per cent. The Exchange Banks increased their lending rates on acceptances from 1 per cent to 1½ per cent. The Indian Joint Stock banks generally passed the increase in bank rates along to their customers in the form of higher interest rates.³

As an immediate consequence of these activities the Government's 3 per cent 1985 conversion bonds, which had been supported at Rs. 92.7, had declined to Rs. 80 by December 3, 1951 and the yield had risen to approximately 4 per cent.⁴ Thereafter the price was held at about this level, though not without subsequently adding to the Bank's investment account and its outstanding circulation.

The increase in the Bank Rate, coupled with the changes in open market policy, may have put a brake on credit expansion by the commercial banks. The amount outstanding at the scheduled banks decreased from Rs. 5,321,000,000 at the end of March 1951 to a total of Rs. 5,195,000,000 at the end of March 1952, and to Rs. 4,914,000,000 at the end of March 1953.⁵ Yet it must be realized that the inventory stock-piling by foreign interests had been discontinued and thus one of the temporary but significant pressures on prices had been removed. This, coupled with increased agricultural production, had eased the pressure on the price level. The Consumer Price Index (1949-100) decreased from 106 in 1953 to 99 in the following year, and declined further to 96 in 1955.

3. Reserve Bank of India, Report on Currency and Finance, 1957-1958, Bombay, 1958, Statements 30 and 31.

4. G.P. Gupta, The Reserve Bank of India and Monetary Management, New York, Asia Publishing House, 1962, p. 164.

5. Reserve Bank of India, Trend and Progress of Banking in India - 1960, Bombay, 1961, p.60.

The Bill Market Scheme

Although the Reserve Bank was authorized under the original enabling Act and its subsequent amendments to rediscount bona fide commercial bills, little use had been made of the Bank's facilities by the private banks until 1951. This indifference may be attributed to the existence of other less expensive and more convenient methods of obtaining liquid funds, such as disposing of investments and soliciting deposits, as well as by the traditional association of private banks with the Imperial Bank of India. It left the Reserve Bank without the means of making effective use of the discount rate in the exercise of a short term money policy. In order to correct the situation the Reserve Bank officials in consultation with representatives of some of the large scheduled banks evolved what has since been called the Bill Market Scheme, and introduced it on an experimental basis on January 16, 1952. The important features of the Scheme were:⁶

- i. An undertaking on the part of the Reserve Bank under Section 17 (4) (C) of the Reserve Bank Act, 1934, to make loans against bona fide commercial time bills of exchange and promissory noted drawn on and payable in India, and counter-signed by a scheduled bank at $\frac{1}{2}$ of 1 per cent below the posted discount rate.
- ii. An additional undertaking on the part of the Bank to bear $\frac{1}{2}$ of 1 per cent stamp duty imposed on the conversion of demand bills to time bills by the central Government. Subsequently this duty was withdrawn.
- iii. The Scheme was limited to large scheduled banks with deposits of Rs. 100,000,000 or over.
- iv. The minimum value of an individual bill to be discounted under the Scheme was fixed at Rs. 100,000 and the minimum that a bank could rediscount was fixed at Rs. 250,000.

6. Reserve Bank of India, Report on Currency and Finance, 1953-54, Bombay, 1954, p. 46.

With these enticements the reluctance of the private banks to patronize the Reserve Bank were quickly overcome, and the Scheme proved to be successful. Finally, effective from July 14, 1954, it was extended to all scheduled banks irrespective of their size. The minimum limit on advances to a single bank was reduced to Rs.1,000,000 and that on individual bills was reduced to Rs. 50,000.⁷ The Government added to the attractiveness of the Scheme by temporarily removing the stamp duty altogether.

Although, as disclosed above, the Reserve Bank raised its discount rate on advance secured against Government bonds during the latter part of the Korean conflict, it did not change the rate on discounted bills. This presumably further explains the immediate success of the Scheme and the phenomenal increase in the advances made under it even while the Bank was pursuing, on the surface at least, a restrictive monetary policy. By 1952 advances under the Scheme had risen to Rs. 814,500,000 and by 1957 had reached the impressive figure of Rs. 4,148,100,000.

Extension of the Bill Market Scheme

The success of the Bill Market Scheme with respect to the internal bills of exchange led the Bank to extend this scheme for one year to export bills on October 1, 1958. In this field this Scheme was introduced (and still operates) on an experimental basis at Bombay and Calcutta. Under this scheme the banks that were eligible to borrow against the time bills under the original Bill Market Scheme

7.

Reserve Bank of India, Trend and Progress of Banking in India during 1954, Bombay, 1955, p.8.

and those which were authorised dealers in foreign exchange, could also borrow under the extended Scheme against their export bills. In order to make advances available to small exporters under this scheme the minimum amount to be advanced to a bank and the minimum amount of an individual time bill of exchange to be accepted as security were fixed at Rs. 200,000 and Rs. 20,000, respectively as against Rs. 500,000 and Rs. 50,000, ^{respectively} in the case of other advances under the scheme.⁸ Although the interest rate charged on these loans was the same as on other loans against internal time bills, i.e., four per cent, the Reserve Bank was to bear half the stamp duty cost required for the conversion of demand bills into time bills.

This scheme was further liberalised and extended until September 30, 1961, ^{and} in order to increase exports by assisting Indian exporters, The Bank undertook to pay all the cost of the Stamp Duty. Since the original limits were high for a number of Indian exporters, they were further slashed to bring them within the reach of the average Indian exporters. Thus the minimum amount of borrowing by an eligible bank at any one time, and the amount of an individual time promissory note, were reduced to Rs. 100,000 and Rs. 10,000 respectively. Since January 12, 1961, the latter limit has further been reduced to Rs. 5,000.⁹ In addition to the reduction of these limits, the facilities provided under this Scheme, which were originally limited to Bombay and Calcutta, were extended to all places where ^{branches of} the Banking Department of the Reserve

8. Reserve Bank of India, Trend and Progress of Banking in India during 1958, Bombay, 1959, pp. 106-7.

9. Reserve Bank of India, Report on Currency and Finance, 1960-61, Bombay, 1961, p. 47.

Bank was located. These places include, Madras, Bangalore, Kaupur, Nagpur, and New Delhi. Moreover, the stipulation that the parties concerned should either cover the exchange risk, or maintain the specific margin of relative loans accounts, has been withdrawn and left at the discretion of the banks concerned.¹⁰ Since the Bill Market Scheme in this field is quite new, the data required for a proper study of its operations are not yet available in sufficient detail.

The Containment of Budgetary Inflation

The trend of both wholesale and retail prices turned downward to well below the 1949 level after the collapse of the economic boom caused by the Korean War. A new and sustained upward trend began late in 1955. This was no doubt due to the effect of the mounting budgetary deficits by means of which the Indian Government was able to accelerate its plans for industrial growth and development from that time onward. By 1955, the last year of the First Five Year Plan, annual deficits had reached Rs. 1,500,000,000 and were still growing. By the end of March 1956, these deficits had raised the note circulation of the Reserve Bank to about Rs. 14,700,000,000, an increase of almost Rs. 2,000,000,000 over 1954 and approximately Rs. 3,300,000,000 over 1951. Before this large and not immediately substantiated increase could be absorbed in transaction and reserve cash needs, the general level of wholesale prices had been pushed up some fifteen points, from 91.4 in 1955 to 107.1 in 1957. The comparable change in the Consumer Price Index was from 96 to 112.

10.

Reserve Bank of India, Report 1960-61, op. cit., p. 47

Bank Rate Adjustments and Open Market Operations

Although the Reserve Bank could not have hoped to arrest and inflation for which its own Issue Department was supplying the necessary initial fuel, it could, nevertheless, attempt to constrain it. The first control measure which it employed, not too logically, came in the form of an increase in the Bank's rate on advances against inland bills. This special rate under the Bill Market Scheme was first raised from its original base of 3 per cent to $3\frac{1}{4}$ per cent in March of 1956. In the following November it was further raised to $3\frac{1}{2}$ per cent where, for the moment it was even with the Bank's rate on advances secured by Government bonds. In February 1957, however, the Government reimposed the stamp duty at a rate of $\frac{1}{2}$ of 1 per cent. Until the following May, when the Reserve Bank raised its rate on Government securities from $3\frac{1}{2}$ per cent to 4 per cent, and the Government reduced the stamp duty to $\frac{1}{5}$ of 1 per cent, the effective inland bill rate exceeded the Government security rate by $\frac{1}{2}$ of 1 per cent. Thereafter the Bill rate exceeded the Security rate by $\frac{1}{5}$ of 1 per cent, the latter being effective at 4 per cent.

Meanwhile the state Bank of India had increased its Hundi Rate from 5 per cent to $5\frac{1}{2}$ per cent; its rate on short term advances, from 4 per cent to $4\frac{1}{2}$ per cent; and its Call Loan Rate (on loans of Rs. 500,000 or over) from $3\frac{1}{2}$ per cent to 4 per cent.¹¹ Similar actions were taken by the Exchange Banks and the Indian Joint Stock banks, but the extent of the change in their rates varied. All banking institutions,

11.

Reserve Bank of India, Trend and Progress of Banking in India, during 1958, Bombay, 1959, pp. 44-45.

large or small, followed the lead provided by the Reserve Bank and passed the related rate increases along to their borrowers.

No subsequent increase was posted in the Bank rate on advances against Government securities because of the related increase in the carrying cost of the Government's mounting debt and its effect on the prices of securities already outstanding. Because of possible discouragement of new enterprises and real expansion in the private sector of the economy, no subsequent increase was posted in the rate on advances against inland bills and other commercial paper.. Thereafter the Bank had to rely on its other credit control measures. In fact, open market acquisitions of long term Government bonds had to be continued from that time on to sustain a market price of Rs. 80 and a not too attractive yield of 4 per cent.

Selective Credit Controls in Agricultural Products

During the late 1950's the Reserve Bank turned to the use of selective credit control measures, both in the form of raising margin requirements and of fixing a maximum ceiling on bank loans, which it had first employed to restrict bank advances to speculators in raw jute. The Bank resorted to this measure to curb the abuse of bank credit and, at the same time, to suppress its inflationary potential. It could not of course hope to hold back the tide of ^{the} creeping inflation by such short term measures, but it could contain some of the secondary aggravations most of which had appeared in the agricultural sector.

On Paddy Rice and Food Grains

A substantial increase in developmental expenditure involving large deficit financing during 1955 and 1956 appears to have contributed

to an inflationary psychology. This led to hoarding of agricultural commodities, particularly those in short supply, in an anticipation of future price increases. From the reports submitted by banks during 1956 the Reserve Bank authorities noticed a significant increase in bank loans against paddy and rice, beyond a level that could be justified by the increase in their production. Whereas the total bank advances against paddy and rice amounted to Rs. 116,000,000 during the 1955 crop season, these had increased to Rs. 246,000,000, with little or even no increases in total rice¹ production, during the 1956 crop season.¹² To arrest the price increases of paddy and rice, the Reserve Bank directed all banks on May 17, 1956 not to grant new advances in excess of Rs. 50,000 to individual parties against rice and paddy, and to raise the existing margin requirement on such loans by 10 per cent. The banks were further instructed to bring down their advances against these commodities to a level of 125 per cent of the level of such loans in the corresponding period of the preceding year.¹³ Through another directive on July 12, 1957, bank credit against paddy and rice was further restricted to 66.2/3 per cent of the level prevailing in the corresponding week in 1956.¹⁴ These restrictive measures resulted in a phenomenal cut back in bank loans against paddy and rice, and in the respective prices of these commodities.

The Bank in 1957 made a frontal attack to arrest the price increases in other food grains which were in short supply. Unfavourable

12. G.P. Gupta, op. cit., pp. 206-207.

13. Reserve Bank of India, Report on Currency and Finance, 1955-56, Bombay, 1956, p. 32.

14. Ibid, 1956-57, p. 33.

weather conditions had resulted in a considerable reduction in the 1956 harvest of food grains. Their production that year was ten per cent lower than in 1955. Yet, despite the decrease in harvest and the Bank's earlier general directive, the amount of bank credit extended against these crops had continued to increase. This had made possible the speculative hoarding of these commodities and a rise in their price. In June of 1956 the Reserve Bank directed all commercial banks to increase their margin requirements for advances on food grains to 40 per cent, and to limit individual loans against food grains to Rs. 50,000. The banks were directed to restrict the aggregate of such advances made in succeeding years to 80 per cent of the amount outstanding on the following July 12, 1957.

These selective controls appear for the time being to have accomplished their respective tasks. Restrictions on paddy and rice therefore were relaxed in 1958 to 75 per cent of the average amount of such loans outstanding in the corresponding months of 1955, 1956 and 1957. This somewhat more flexible base was applied to advances on other food grains, but the 80 per cent restriction remained as unchanged.

The production of other food grains was disappointing in the following year and it was feared that their price level would increase substantially. Some State Governments introduced a program for procurement of food grains to counteract the expected price increases. To help them in this program the Bank modified its existing selective credit control measures against food grains. On July 10, 1959, the Bank enjoined all scheduled banks to continue to maintain the existing margin requirements of 40 per cent of the value of stock in respect of

their advances against food grains, but revised these limits down to 25 per cent in respect of their advances against paddy and rice to purchasing agents of the Government of Orissa, and against wheat to storage delivery contractors operating on behalf of the Punjab Government.¹⁵

The production of food grains during 1960 increased by about 6 per cent over the preceding year, while supplies were further augmented by imports under the Public Law 480 from the United States. Credit controls against food grains were relaxed accordingly, and their operations oper/was made more flexible by relating it to the amounts of such credits granted during the corresponding months of 1958 or 1959, whichever was higher.

The prospect of a good crop in 1961 had a dampening effect on food grain prices. In February of that year, the Bank accordingly reduced the margin requirements on advances against food grain from 40 per cent to 35 per cent. With respect to their advances against paddy and rice beginning with March, April of 1961, the banks were required to maintain a level of 110 per cent of the average level of the advances prevailing in the corresponding period of 1960.¹⁶ Fortunately for all concerned, continuing good crops and a fairly stable price had made possible the elimination of all controls on wheat as of May 15, 1961. However in the absence of similar production increase, the controls on bank credit against paddy and rice were continued.

15. Reserve Bank of India, Report, 1959-60, op. cit., p. 34.

16. Reserve Bank of India, Report 1960-61, op. cit., p. 44

Ground nuts

During the first two months of 1959 the spot and forward prices of ground nuts had shown sharp increases, Though a part of these increases could be attributed to a significant decrease in the 1958 crop, which fell by about 8 per cent over the level of production in the previous year, a large part appeared to be due to excessive hoarding supported by bank credit.¹⁷ The amount outstanding of such credit had increased from Rs. 13,800,000 in October 1958 to Rs.129,500,000 by the end of April 1959. In order to check the speculative hoarding of ground nuts without at the same time affecting the operations of legitimate producers and dealers, the Reserve Bank on February 8, 1958 directed all scheduled banks to increase existing margin requirements for advances against the security of ground nuts granted before February 9, 1959 to not less than 45 per cent of the value of stock and to maintain this ratio for all such future advances. For each month hereafter the scheduled banks were enjoined to restrict their total current advances against ground nuts to the level maintained in the corresponding months of 1957 and 1958, whichever was the higher. These provisions did not apply to persons holding valid export licenses for ground nuts and to manufacturers of ground nut oil.¹⁸

Though at first difficult to apply, these restrictive measures appear to have been instrumental in reducing the bank credit against the security of ground nuts.¹⁹ But, despite this fact, the prices of

17. Reserve Bank of India, Bulletin, November 1960. pp. 1692-93.

18. Reserve Bank of India, Trend and Progress of Banking in India during 1959, Bombay, 1960. p. 126

19. Ibid, p. 144

ground nuts and other oil seeds continued to rise. The Bank noticed that speculative hoarding of 'oilseeds' had developed, as bank credit against oil seeds was considerably higher in 1959 than in 1958, it was beyond a level justified by any increase in production. In order to discourage this unhealthy development the Reserve Bank directed all scheduled banks on December 11, 1959 to maintain 40 per cent margins against advances on oil seeds. But, as in the case of ground nuts, these restrictions did not apply to genuine exporters of oil seeds or to manufacturers of vegetable oil.²⁰ It appears that these restrictive measures helped to reduce the demand for oil seeds and the pressure on their prices.

Raw Jute and Jute goods

After a peak crop of jute in 1958 the output of that product was relatively small in the following two years. Prices of raw jute and jute goods reached new heights and because of this supplies were hoarded in anticipation of even higher prices in the future. The price of raw jute rose by 72 per cent, and that of jute goods by 54 per cent between November 1959 and November, 1960. From the weekly and monthly statements submitted by the scheduled banks, the Reserve Bank officials concluded that a substantial part of the price increase was supported by an unwarranted increase in bank credit against jute and jute products. Between October 28, and November 11, 1960 the bank credit against jute had increased by Rs.20,000,000 and a similar increase was noticed against jute goods.²¹ In order to discourage the speculative hoarding and to check any further increase

20. Reserve Bank of India, Trend and Progress of Banking in India during 1959, Bombay, 1960, p. 144.

21. Reserve Bank of India, Report 1960-61, op. cit., p. 44

in jute prices the Bank issued a directive, in December 1960, to all scheduled banks to maintain a minimum margin of 40 per cent of the value of stock against advances, both old and new, on stocks of jute and jute goods and restricted the totals of such advances, every two months, starting from January 1961, to 130 per cent of the average amount recorded for the corresponding period of 1960. In order to avoid any adverse effects on the production and export of jute goods, the maximum margin requirements for advances on raw jute to jute mill operators and exporters of jute goods was fixed at 25 per cent.

The selective credit control measures against jute and jute goods were successful in restraining bank credit against these products, as the Reserve Bank later reported. The 40 per cent margin requirements against jute and jute goods were therefore withdrawn in June 1961.²² However, in evaluating the success of the credit control measure one should not lose sight of the fact that the supply of jute had considerably improved during 1961. In fact, as a result of a bumper crop of jute that year, all restrictive measures against this product were withdrawn on August 29, 1961.

Selective Controls on Stock Trading

Although the All India Index of Industrial securities prices increased only by 14 per centage points between March 1959 and March 1960, the more sensitive index of the Bombay Schoffs increased by as much as 27 per cent over the same period. In the opinion of the Bank this was partly due to narrow margin requirements on call loans, and partly due to an absence of restrictions on the amount of credit

22. Reserve Bank of India, Report, 1960-61, op. cit., p. 44

available to professional speculators. But it may have been the result of a growing number of prudent investors who were hedging against the continued decline in the purchasing power of the Rupee. The former view seems to be nearer to the truth, because between February 1959 and February 1960 bank loans on stocks had increased from 8.6 per cent to 15 per cent of total bank advances, thus restricting the amount of credit available for more socially productive undertakings.²³ To check any further increase in prices in the share market, and to eliminate ill effects that might follow such an unhealthy situation, the Bank on March 11, 1960 raised the margin requirements on loans against stocks to 50 per cent of the value of the Shares traded. But most of the potential restrictive effect of this measure was dissipated by the Bank's attempt to restrict its application to large speculative dealers, and by exempting all purchases of shares amounting to Rs. 5,000 or less.

The Reserve Bank, in order to prevent any circumvention of this directive, prescribed that, in the absence of its special consent, the average ratio of clean advances to total advances in any month starting from April 1960 was not to exceed the average ratio in the corresponding month of 1959. In view of these maximum limits on clean advances, their ratio to total bank advances was reduced from 17.3 per cent in September 1960 to 13.3 per cent in September 1961. When the stockmarket resumed its normal course, these restrictions were set aside, effective from October 23, 1961.²⁴

23. Reserve Bank of India, Trend and Progress of Banking in India during 1960, Bombay, 1961, p. 133.

24. Ibid., p. 12

The Reserve Bank concluded in a 1961 review of the efficacy of selective credit controls as an instrument of monetary policy, that by and large its operations during 1960 and 1961 had been effective. The banking institutions were working within the framework of the Reserve Bank's control measures. Throughout the years advances against paddy and rice remained well below the 35 per cent limit allowed under the directive. Bank advances against food grains and ground nuts were, respectively 26 per cent and 23 per cent below the permitted levels of 35 per cent. Although in April 1961 advances against stocks and shares reached the maximum level permitted, after that date the amount remained well within the limits prescribed by the Bank.

Credit Rationing

As the selective credit controls on agricultural advances and stock trading did not stop the tide of inflation arising from the use of Reserve Bank credit by its member banks, the Reserve Bank turned to other as yet untried expedients. Among these was the rationing of Reserve Bank credit to the commercial banks, and the manipulation of the statutory reserve ratios of banking enterprises.

As noted earlier, a considerable increase in prices during 1960 was supported by an extension of bank credit. During the same year the borrowings of the scheduled banks from the Reserve Bank had increased to Rs. 384,000,000 from a considerably less amount of Rs. 185,000,000 in 1959. In order to curb this source of inflation the Reserve Bank issued a circular on September 21, 1960 according to which the Bank rate

was suspended beyond the quota fixed for each scheduled bank. In the circular each scheduled bank was assigned a borrowing quota equal to 50 per cent of its average of statutory reserve requirements during the preceding quarter. Any bank that borrowed above this limit was charged a penalty rate. According to the directive "any borrowing over this limit up to 200 per cent of the quota would bear a penal rate of 1 per cent over the Bank Rate; i.e., 5 per cent, and borrowing above 200 per cent of the quota, a penal rate of 2 per cent above the Bank Rate."²⁵

Generally an increase in the borrowing rate of the scheduled banks should lead to an increase in their lending rate to primary borrowers. But it need not be true for banks that have excess reserves and that do not need to borrow from the Reserve Bank. Moreover, as the Bank Rate was not increased, such scheduled banks would have found it expedient not to increase their lending rates. Borrowing banks that may be financing the productive credit needs of their borrowers would have been the victims of this restrictive measure. To avoid this the Reserve Bank issued another directive on October 1, 1960, requiring all scheduled banks to charge a minimum lending rate of one per cent above the Bank Rate on all advances except the inter-bank loans and the loans to their employees. The banking institutions were further directed, under Section 21 of the Banking Companies Act of 1949, to raise their average lending rate at least by $\frac{1}{2}$ of one per cent (the base being June 30, 1960) and not to pay interest rates higher than 2 per cent on deposits repayable within 21 days.²⁶

25. Reserve Bank of India, Report, 1960-61, op. cit., p. 42

26. Loc. cit.,

The Reserve Bank modified this three tier rate formula, where necessary to meet the genuine credit needs of expanding industry and trade in order to provide adequate bank credit to jute and sugar mills. It sanctioned large limits on the bills discounted by these mills. The Bank also used this measure to encourage commercial bank loans to small and cooperative industries. To this end it sanctioned additional quotas equivalent to the increase in their loans to such enterprises in the first half of 1961 over the corresponding period of 1960.²⁷

It appears that the increased lending rate of the Reserve Bank above a certain limit restrained the scheduled Banks, borrowing from the Bank. The total amount of their borrowing decreased from Rs. 384,000,000 in 1960 to Rs. 282,000,000 in 1961. The precise effect cannot be observed, however, as other restraining forces were also at work.

Reserve Ratio Variation

The Reserve Bank also took action to restrict further, and more decisively, the ability of commercial banks to expand credit and increase the money supply more rapidly than the output of goods. It exercised its newly acquired authority to raise the statutory reserve ratio of the scheduled banks, requiring them to maintain with it an additional average daily balance equivalent to 25 per cent of the increase in their time and demand deposits accruing after this date.²⁸ These reserve requirements were in addition to the existing statutory reserves of

27.

Reserve Bank of India, Trend and Progress of Banking in India during 1961, Bombay, 1962, p. 11

28.

Ibid., Trend and Progress - 1960, pp. 120-25

5 per cent of their demand deposits and 2 per cent of their time deposits. By way of partial compensation for this sterilization of deposits, the Reserve Bank undertook to pay interest on reserve deposits at a rate determined by the average rate paid by the depository banks provided the rate did not exceed the Bank Rate.²⁹

As might have been expected this increase in the reserve ratio had little if any effect, probably because Indian banks had long been in the habit of actually maintaining considerably more reserves than the addition made necessary. Consequently on May 5, 1960 the Reserve Bank increased the scheduled banks reserve requirements rather drastically. Under the new directive, the scheduled banks were required to maintain;

i) 25 per cent of the amount by which their total deposits on May 6, 1960 exceeded the comparable total on March 11, 1960; ii) 50 per cent of the amount by which their total deposits exceeded the corresponding total on May 6, 1960.³⁰

These measures did of course reduce the credit expansion ability of the scheduled banks, and in the final analysis checked the pace of inflationary forces by making it necessary for primary borrowers to finance a rising real output with the same or even a declining amount of credit. This considerably reduced the credit expansion capacity of the scheduled banks, and placed excessive burdens on them in the form of large reserves. To compensate for losses in their earning capacity the Reserve Bank undertook to pay interest on the

29. Reserve Bank of India, Trend and Progress - 1960, op. cit., p. 124

30. Ibid, p. 126

additional reserves, this time at $\frac{1}{2}$ of 1 per cent above their average rate of interest subject to a maximum of $4\frac{1}{2}$ per cent.³¹

In spite of this decrease in the liquid reserves of the scheduled banks, resulting from the increase in their reserve requirements, bank credit continued to expand. This was made possible by the banks increased borrowing and from the sale of Government securities at the Reserve Bank. In this latter expedient, the open market operation was initiated by the member banks and, as long as the Reserve Bank persisted in maintaining the price of Government bonds and a ceiling on interest rates, nothing could be done about it except to resort to measures which limited the Reserve Bank credit to member banks. This latter took the form of the already discussed credit rationing.

As would be expected under the prevalent conditions in the Indian money market, the substantial increase in reserve ratios do not seem to have achieved the desired objectives. They merely burdened the Reserve Bank with calculating and doling out the interest rates on additional reserves, and discouraged deposit mobilization by scheduled banks. In view of the considerable increase in demand for bank credit during 1960 and 1961, and the unnecessary constraint placed on real growth in the economy, the Reserve Bank removed additional reserve requirements on all deposits subsequent to November 11, 1960. The 50 per cent reserve requirements on additional deposits was reduced to 25 per cent in the following month. Finally, in January 1961, the rest of the reserve restrictions were set aside as the money market showed signs of relief and prices were relatively stable.

31.

Moral Suasion

To Westerners, moral suasion as an instrument of credit control refers to requests for the exercise of restraint that are not covered by the instruments of monetary policy which the central bank has already been authorised to use. This method of friendly persuasion and advice to influence the lending policy of commercial banks has long been used both by the old and newly established central banks. But its effects have been more pronounced in the former case rather than in the latter.

Although the Governor of the Reserve Bank had requested the cooperation of commercial banks on a number of occasions before 1949, it had rarely been complied with. After that year, however, when the Reserve Bank was equipped with sweeping regulatory powers over all banking institutions, the Governor's requests carried more weight and were usually acted upon. During 1957, when prices of agricultural commodities were increasing continuously, the Bank authorities used moral suasion in addition to selective credit control in order to limit the expansion in Bank credit. During a conference with the representatives of banks in August 1957, the Governor of the Bank advised them to bring down their advances to a level of Rs. 8,000,000,000 by the middle of October 1957 and thus help to contain the inflationary forces at work. As the Bank later reported, the Commercial banks fully cooperated and the total bank credit decreased from Rs. 9,380,000,000 in July 1957 to Rs. 8,470,000,000 in September 1957.³²

32. Reserve Bank of India, Report 1957-58, op. cit., p. 31

The latest use of this measure was in May 1960. During that year, the general price level was considerably higher than in the corresponding period of 1959 although the production of both agricultural and industrial goods was higher. From the weekly statements submitted by commercial banks, the Bank authorities noticed that a considerable increase in prices was supported by ^{the} expansion of bank credit. In order to remove this source of inflation, the Governor of the Bank enjoined all commercial banks to reduce their total advances by about Rs. 11,000,000,000, or about 10 per cent, during the slack season (May to November). There seems to have been little response from the banks, as bank credit decreased by only Rs. 203,000,000 during that time.³³

On the whole the Bank authorities have been able to influence the lending policy of commercial banks through this method of credit control. This may partly be attributed to the substantial powers vested in the Reserve Bank. Banking institutions are well aware of the fact that if the friendly nod fails, the regulatory rod is bound to follow.

The Accomplishments of Monetary Control

The Reserve Bank in general has employed in one form or another the entire arsenal of its credit control instruments. Although each appeared to be justified in the particular circumstances prevailing at the time, none of them constituted a frontal attack on the basic prompting force in the country's creeping inflation, i.e., continued

33.

Reserve Bank of India, Trend and Progress of Banking in India during 1960, Bombay, 1961, pp. 137-38.

budgetary imbalances and heavy reliance on Reserve Bank credit in financing the country's planned program of industrialization and economic development. But to have attempted such a frontal attack in the special case of India, particularly during the prosecution of the Second Five Year Plan, would have been tantamount to defeating the program itself. Voluntary savings and foreign assistance were not sufficient, and forced savings with its price increase counterpart was the only answer if a perceptable rate of ^{real} growth was to be maintained. Some of the more important indicators of the nature and extent of the price control problem are brought together in Table No. 26 on page 190.

This somewhat random display reveals, first, the very rapid increase in India's outstanding funded debt after 1954, and the extent to which the Reserve Bank was called upon to support it at a 4 per cent rate by taking excess offerings off the market. After 1954 this one-sided open market operation eventually brought an almost four-fold increase in the Reserve Bank's holdings of Government bonds. In less compelling circumstances the increase in the Bank's share of the total outstanding debt would undoubtedly have been considered alarming. The Reserve Bank's holding of Government debt amounted to Rs. 5,159,000,000 in 1949, which constituted a little over 21 per cent of the total outstanding debt. By 1961 its holdings of Rs. 19,106,000,000 constituted a little over 35 per cent of the total outstanding debt. Meanwhile the increase in the Reserve Bank's credit was put to good use even if it was inflationary. The national income at current prices increased from approximately Rs. 90,000,000,000 in 1949 to an estimated sum of Rs. 142,000,000,000 in 1960 roughly a 57 per cent gain during this period.

Table 26

Comparable Rates of Growth of Public Debt, Reserve Bank Credit and
National Income, 1949-1961, Inc. (Rs. 000,000)

Year	Total Public Debt	Reserve Bank Credit		National Income		Public debt Index
		Holder's of Gov't. Securities	Notes Out- standing	Current Prices	1949 Prices	
1949	23,781	5,159	11,529	90,100	90,100	100
1950	24,627	5,858	11,804	95,300	94,400	103.7
1951	24,722	5,667	12,176	99,700	95,900	104.1
1952	24,598	4,560	11,427	98,200	94,400	103.6
1953	24,935	4,875	11,570	104,800	98,900	105.0
1954	25,052	5,533	12,192	96,100	97,100	105.5
1955	28,439	7,260	13,565	99,800	104,000	119.7
1956	30,672	10,062	14,945	113,100	105,700	129.1
1957	30,078	14,095	15,525	113,900	101,700	147.7
1958	41,179	15,429	16,132	126,000	106,800	173.4
1959	46,235	16,945	17,508	129,400	105,200	194.7
1960	51,291	18,821	18,821	142,100 ^a	114,600	215.9
1961	54,628	19,106	19,770	N. A.	N. A.	230.0

Comparable Rates of Growth, 1949=100

% at Res. Bank	% inc. in R. B. Notes	National Income		Consumer Price Index
		Current Price	'49 Price	
21.2	100	100	100	100
23.8	102.6	105.2	104.7	101
22.9	106.1	115.6	106.5	104
18.9	99.1	109.0	104.9	104
19.6	100.8	116.4	109.9	106
22.1	106.1	106.4	107.9	99
25.6	118.2	110.9	115.5	96
32.2	129.6	125.5	117.4	107
40.2	134.8	126.6	113.0	112
37.5	140.0	141.7	118.0	118
36.7	152.2	143.6	116.9	123
35.3	163.5	157.8	127.2	125
34.9	172.2	N. A.	N. A.	127

Source: 1 Government of India, India, 1958, 1961 and 1962.

- 2 Reserve Bank of India, i) Report on Currency and Finance, 1952-53, 1957-58 and 1960-61. Statements 54, 65 and 66 respectively.
ii) Report on Currency and Finance, 1956-57 and 1961-62. Statements 19, 20 and 17, 19 respectively.

^a Figures are provisional.

After allowing for the price increase in terms of the relatively conservative Consumers Price Index, the real growth as measured in 1949 rupees was from Rs. 90,100,000,000 to Rs. 114,600,000,000 or about 27 per cent for the period. Most of this increase is ^{been} revealed to have/realized after 1955 when prices began to register the effects of the plan period expansion program. If one may use the real national income estimate as a guide, it would appear that something in the neighbourhood of Rs. 15,000,000,000 in Reserve Bank notes would have been sufficient to meet the uninflated cash needs of the Indian economy in 1960. But the amount made available by the rather one-sided open market operations of the Reserve Bank was close to Rs. 19 billion. The difference of some Rs. 4000,000,000 may, in the absence of a more refined estimate, be said to indicate the magnitude of the forced savings effected by the Government through the Reserve Bank.

Reserve Bank Operations

The annual operations of the Reserve Bank portrayed in Tables 27, 28 and 29 on pages 192, 193 and 194. They do not appear to have been greatly affected by the Government take-over, or by the progress of the First Five Year Plan. It is noteworthy, however, that this period was marked by a rapid depletion of the Bank's foreign currency assets. In the absence of this backlog of savings there would undoubtedly have been a reverse trend in the Bank's holdings of Government securities and in outstanding note issue, with all its inflationary implications. The point is that the use of foreign currency assets provided the Government with revenue that did not have to be created either through the budget or through increasing its borrowings

Table 27

Principal Liabilities and Assets of the Reserve Bank
(Issue and Banking Departments) of India
1949-1961, Inc. (Rs.000,000)

Last Fri. in March	Capital and Reserves	Notes Out- standing	Liabilities				Total Liabs. and Assets	Gold Coin and Bullion ²
			Gov't ¹	Banks	Others	Other Liabs. ¹		
1949-50	100.0	11635.2	1749.1	529.2	636.1	198.1	14847.7	400.2
1950-51	100.0	12474.1	1884.4	592.8	723.1	231.0	16005.4	400.2
1951-52	100.0	11411.1	2052.2	469.9	659.0	259.0	14951.1	400.2
1952-53	100.0	11331.2	1556.3	465.2	628.1	307.0	14387.8	400.2
1953-54	100.0	11859.2	1283.6	424.1	437.6	250.8	14355.2	400.2
1954-55	100.0	12770.9	1197.2	477.2	215.3	298.6	15059.2	400.2
1955-56	100.0	14666.9	1293.7	532.4	166.8	494.6	17254.1	400.2
1956-57	<u>100.0</u> 800.0	15260.9	965.2	577.7	742.8	<u>1610.3</u> 910.3	19256.8	<u>400.2</u> 1176.6
1957-58	800.0	15791.3	1031.8	678.3	1175.2	974.6	20451.2	1176.6
1958-59	800.0	17015.3	805.5	675.7	1190.7	1106.7	21593.8	1176.6
1959-60	800.0	18449.0	1061.2	929.0	1001.0	1363.4	23603.4	1176.6
1960-61	800.0	19847.4	1054.5	708.5	879.6	1413.9	24703.9	1176.6
1961-62	800.0	20703.0	871.9	727.3	1523.6	1518.4	26144.2	1176.6

Source: Adapted from Reserve Bank of India, Reports on Currency and Finance, 1952, 1953, 1955-67, and 1961-62. Statements, 21, 37, and 36 respectively.

1. Includes: i National Agricultural Credit (Long-term operations) fund. Details
ii National Agricultural Credit (Stabilization) fund. Opposite

2. Gold valued at 8.47512 grains per rupee up to October 5, 1956 and at 2.88 grains per rupee thereafter.

3. Including one rupee notes.

Assets						
Rupee coins ³	For. crncy.	Inv. in Gov't. Securities	Loans to Gov't.	Other Loans	Bills Disc'd	Other Assets
512.3	8587.8	5159.4	2.4	112.1	19.7	53.8
545.1	8841.8	5858.3	15.6	167.5	82.1	92.0
692.9	7230.7	5667.3	9.4	613.7	37.2	299.9
823.2	7236.8	4559.8	33.0	269.5	88.0	77.2
939.7	7529.7	4875.0	5.1	411.0	107.4	87.2
1025.0	7300.0	5533.2	4.5	478.7	103.7	213.9
1033.1	7461.3	7260.1	0.0	799.4	122.3	177.7
1227.9	5268.3	10062.0	76.5	1278.7	28.9	136.1
12942.2	2670.0	14095.5	212.3	784.0	76.8	140.8
1301.6	2130.6	15429.6	247.7	1134.4	51.8	120.5
1242.3	1971.2	16945.1	223.4	1565.4	336.0	142.6
1197.1	1362.5	18131.5	390.2	1855.0	391.7	198.2
1169.7	1297.0	19105.7	808.9	1776.9	466.0	342.4

i) Rs.100,000,000 from Feb. 3, 1956
150,000,000 from Jul. 6, 1956
200,000,000 from Jul. 5, 1957
250,000,000 from July 4, 1958
300,000,000 from July 3, 1959
400,000,000 from July 1, 1960
500,000,000 from July 30, 1961

ii) Rs.10,000,000 from July 6, 1956
20,000,000 from July 5, 1957
30,000,000 from July 4, 1958
40,000,000 from July 3, 1959
50,000,000 from July 1, 1960
60,000,000 from June 30, 1961

Table 28

Principal Assets and Liabilities, Reserve Bank (Issue Department)
of India, 1949-61, Inc. (Rs.000,000)

Ave. of Friday figures.	LIABILITIES		Total	Gold coin & bullion	Rupee coins ²	Foreing secrts.	Gov't of India rupee secrts.
	Note Circln.	In banking dept.					
1949-50	11,289.4	240.0	11,529.4	400.2	505.3	6470.4	4153.6
1950-51	11,632.1	171.9	11,804.0	400.2	572.1	6247.0	4584.7
1951-52	11,898.4	277.8	12,176.2	400.2	639.8	6252.7	4883.3
1952-53	11,148.4	278.7	11,427.2	400.2	802.2	5644.0	4580.8
1953-54	11,339.5	230.3	11,569.7	400.2	928.3	5940.2	4301.1
1954-55	11,961.9	229.8	12,191.8	400.2	1022.6	6488.1	4280.9
1955-56	13,393.9	170.8	13,564.7	400.2	1068.7	6565.2	5530.6
1956-57	14,757.7	187.5	14,945.2	400.2	1159.3	5459.8	7552.2
1957-58	15,293.6	231.8	15,525.3	1177.6	1300.6	3296.5	9750.6
1958-59	15,938.8	193.0	16,132.1	1177.6	1339.9	1820.4	11,794.2
1959-60	17,309.0	198.6	17,507.7	1177.6	1315.0	1676.2	13,338.8
1960-61	18,631.3	189.4	18,820.7	1177.6	1268.4	1349.9	15,024.8
1961-62	19,574.2	195.8	19,770.0	1177.6	1216.5	1159.3	16,216.7

Source: Adapted from Reserve Bank of India, Report on Currency and Finance, 1952-53, 1954-55 and 1961-62. Statements no. 29, 35 and 37 respectively.

1 Gold valued at Rs 21.24 per tola or 8.47512 grains per rupee up to October 5, 1956 and at Rs. 62.5 per tola or 2.88 grains per rupee there after.

2 Including one rupee notes.

194a

Table 29

Principal Liabilities and Assets of the Reserve Bank (Banking Department)
of India, 1949-1961, Inc. (Rs.000,000)

Ave. of Friday Figures	Capital and Reserves	Liabilities				Total
		Deposits			Other Liabs. ¹	
		Gov't.	Banks	Others		
1949-50	100.0	1643.1	670.0	643.9	157.6	3214.5
1950-51	100.0	1663.1	622.2	622.9	181.4	3189.7
1951-52	100.0	1972.5	586.8	692.2	186.2	3537.7
1952-53	100.0	1441.9	528.9	619.3	236.9	2927.1
1953-54	100.0	1288.4	465.2	574.5	239.1	2667.2
1954-55	100.0	1097.9	552.0	362.9	236.2	2349.0
1955-56	100.0	799.6	537.7	183.1	355.1	1976.4
1956-57	100.0	716.2	524.6	197.3	912.1	2450.2
1957-58	800.0	658.9	810.0	1113.8	639.6	4076.3
1958-59	800.0	784.2	875.3	1187.3	767.7	4414.4
1959-60	800.0	787.4	796.1	1234.8	881.8	4500.1
1960-61	800.0	830.0	973.0	987.6	1053.3	4643.9
1961-62	800.0	772.6	819.5	1407.3	1241.3	5040.8

Source: Adapted from Reserve Bank of India, Report on Currency and Finance, 1952-53, 1954-55, and 1961-62. Statements 28, 36 and 38 respectively.

1. Includes i) National Agricultural Credit (Long-term operation) Fund. Details
ii) National Agricultural Credit (Stabilization) Fund. Opposite

2 Includes one rupee notes.

194 b

Assets						
Notes & Coins	For'gn. Balance	Gov't. Loans	Other Loans	Bills Disc'd.	Invest- ments	Other Assets
241.2	1809.1	33.5	83.9	43.0	960.4	43.4
173.1	2077.9	23.7	67.7	30.5	767.2	50.6
279.2	1871.4	59.0	194.2	63.1	951.9	119.2
280.3	1335.6	28.5	190.3	66.4	897.7	128.3
232.2	1233.1	17.8	198.4	94.6	815.8	75.1
232.4	875.3	11.4	265.5	61.0	805.2	98.2
172.1	669.6	17.3	369.9	97.8	493.6	156.1
189.1	647.7	48.9	853.4	56.9	518.2	136.0
233.0	404.7	329.0	779.1	48.1	2139.2	143.2
194.1	255.7	282.3	658.3	61.8	2844.9	117.3
199.4	289.7	255.3	889.2	155.4	2589.0	122.2
190.2	207.4	381.9	1327.8	287.1	2095.6	153.8
196.4	181.1	638.7	1376.9	341.0	2077.4	229.3

- i) Rs. 100,000,000 from Feb. 3, 1956
150,000,000 from July 6, 1956
200,000,000 from July 5, 1957
250,000,000 from July 4, 1958
300,000,000 from July 3, 1959
400,000,000 from July 1, 1960
500,000,000 from June 30, 1961

- ii) Rs. 10,000,000 from July 6, 1956
20,000,000 from July 5, 1957
30,000,000 from July 4, 1958
40,000,000 from July 3, 1959
50,000,000 from July 1, 1960
60,000,000 from June 30, 1961

at the Reserve Bank. This, in the main, is why there was little if any decline in the purchasing power of the rupee during the First Five Year Plan period.

Beginning with 1955, however it became strikingly apparent that the demands of the Second Five Year Plan were leading to an overburdened budget. Government bond holdings and their circulation counterpart increased very rapidly. Towards the end of the period, moreover, there was a sharp increase in direct loans to Government and Governmentally sponsored lending agencies. Reserve Bank credit as measured by investment in Government securities, loans to Government, and "other loans" (presumably to governmentally sponsored industrial lending agencies), rose from approximately Rs. 6,000,000,000 at the beginning of 1955 to nearly Rs. 22,000,000,000 by 1962.

It is noteworthy that during the whole period there was no really significant increase in the magnitude of advances made to the commercial banks. While the increase in the amount outstanding was remarkable, it was still under Rs. 500,000,000 at the beginning of 1962.

Part 2

The State Bank of India: Operations and Growth

The nationalization of the Imperial Bank and the changing of its name to the State Bank of India did not bring any immediate change in the nature of its operations. It continued to function as a primary lender and as the Reserve Bank's agent at places where the latter had no branch or office. But subsequent extension in both its branches and operational facilities added considerably to its duties and further

enhanced the pre-eminent position the Bank held, and continues to hold, in the Indian banking system.

Extension of Duties and Facilities

In keeping with the recommendations of the All India Rural Credit Survey Committee and the Committee on Finance for the Private Sector, better known as the Shroff Committee, the duties and facilities of the State Bank were considerably expanded. In addition to its ordinary commercial banking business the main functions of the State Bank were to spread banking facilities in rural India and to provide short-term credit facilities to agriculture, small industries and handicrafts. Through the expansion of its branches, especially in areas where no banking institutions exist, the State Bank would help to mobilize the savings of the rural population and channel these to meet productive credit needs. Under the State Bank of India Act of 1955, the Bank undertook to open 400 new branches within five years of its operation as a national institution. By the end of 1960 it had opened 416 new branches. The importance of these lies in the fact that about 75 per cent of them are established in rural and semi-urban areas, i.e., towns with population of 30,000 or less.³⁴ In order to meet losses on the newly established branches, the State Bank maintains an 'Integration and Development Fund', in which all the dividends payable to the Reserve Bank and all contributions which the Reserve Bank and the Government of India may make to the State Bank, are to be kept. The proceeds of this fund are to be used exclusively for meeting losses on its branches, and for defraying other expenditures approved by the Central Government.

All State associated banks were made subsidiaries of the State Bank, under the provisions of the State Bank of India (Subsidiary Banks) Act of 1959, in order to widen the scope of operations of the State Bank and thus provide better and extensive banking facilities.³⁵ The subsidiary banks and their branches conduct Government business at treasury and sub-treasury offices in their respective areas, and thus provide better remittance facilities to other banks and to the public on behalf of the Reserve Bank and the State Bank of India. These, of course, have further extended the operations of this singularly important Bank. By the end of December 1960 the number of branches of the State Bank, along with subsidiaries, totalled 1281, which accounted for about 31 per cent of the 4150 branches of all the scheduled banks. Their deposits, amounting to Rs. 3,940,000,000, constituted about 25 per cent of the total deposits of all scheduled banks.³⁶

The State Bank and Financing of Small Industries

As the branches of the newly established National Small Industries Corporation were located in a few important trading centers and lacked a wide network of branches in the up-country, their credit facilities were not easily accessible to small industrial units located in small towns in the interior of the Country. The flow of credit to such firms was impeded and a considerable waste of time and money was involved in the process of granting and collecting loans, because there was lack of direct and personal contact between the organized lending agencies

35.

The following State associated banks were made subsidiaries of the State Bank: The State Bank of Hyderabad, Oct, 1959; the State Bank of Bikaner, the State Bank of Indore and the State Bank of Jai Pur, on January 1, 1960; the State Bank of Mysore, the State Bank of Patiala, the State Bank of Surashtra, on March 1, April 1, and May 1, 1960 respectively.

36.

Reserve Bank of India, Trend and Progress - 1960, op. cit., p. 32

and small industrial enterprises. The local credit granting agencies, which the State Bank was spreading up-country, could meet the credit needs of small industries more readily and efficiently, and could exercise better supervision over the use of the credit made available, than could an agency away from the scene. To fulfil this objective the State Bank introduced the 'Pilot Scheme' on an experimental basis in 1956 at nine centers where the Bank had its branches. Under the provisions of this scheme the State Bank granted short-term loans to small industries against the security of their readily marketable raw materials and finished products. The successful operation of the 'Pilot Scheme' encouraged the Bank to extend it to 36 centers in 1957, and finally, on January 1, 1959, to all of its branches.³⁷

The rate of interest charged under the 'Pilot Scheme' was 4½ per cent originally, but the borrowers had to pay a Godown Keepers' fee and an Inspection fee, which came to about 2 per cent per annum. Thus the effective rate of interest under the Scheme was 6½ per cent. The rate of interest was fixed at 6 per cent on an all inclusive basis during 1959, when the Scheme was extended to all branches of the State Bank.

The State Bank had committed Rs. 46,000,000 to 1496 small industrial units under the 'Pilot Scheme' by the end of December 1959. The liberalization of the Scheme, and its extension to all branches of the State Bank, considerably increased the demand for its loans. The amount of loans committed had increased from Rs. 78,000,000 in December 1960 to Rs. 101,300,000 to 2811 small firms by the end of December 1961.

On this latter date, the outstanding loans amounted to Rs. 51,000,000.³⁸ Although the State Bank was authorized in 1958 to make medium term loans to small industries, no such loans were made until the end of 1961.

The State Bank of India has also entered into an agency arrangement with the State Financial Corporations and the National Small Industries Corporation. It makes loans and collects such loans as fall due on behalf of these Corporations at places where it has its branches. It gathers such information from the borrowers as is necessary to make them loans. Thus it avoids duplication of such activities and considerably reduces the cost both to the borrower and to the lender.

The State Bank and Agricultural Finance

The State Bank since its inception has been playing an increasingly active role in providing short-term, and to some extent medium-term, agricultural credit, directly as well as through cooperative banks. It provides short term loans to cooperative banks against the security of debentures of Land Mortgage Banks, Government Securities and guarantees, and warehouse receipts. The cooperative banks in turn provide credit facilities to agriculturists and other artisans. Up to the end of September 1960, the credit limits committed by the State Bank against the above mentioned securities, except the warehouse receipts, amounted to Rs. 151,800,000; the amount of such outstanding loans was Rs. 33,500,000. On this latter date the amount committed against warehouse receipts was Rs. 21,600,000, of which about Rs. 4,000,000 were outstanding.

Cooperative marketing and processing societies have been established in India recently in order to eliminate a chain of intermediaries between agricultural producers and consumers and thus to assure a fair return to agriculturists. These societies have limited funds because of the poverty of their membership, and are unable to meet the increasing demand (during the busy season) for loans from their members. The State Bank is now authorized to provide additional funds against a Government guarantee or the stock of these cooperative societies. The Bank had committed a total of approximately Rs. 20,000,000 to 107 such undertakings by October 1959. By October 1960 the number of borrowing societies had increased to 166, while the total committed had increased to about Rs. 41,000,000.³⁹

In addition to these particular activities the State Bank provides free remittance facilities to cooperative banks. The latter can transfer funds twice a week from their head offices to their up-country branches, and three times a week for transfers in the reverse direction. These transfer provisions enable the cooperative banks to meet the seasonal demand for their loans at a relatively constant lending rate.

Magnitude of Operations 1949-1961

The number of branches and pay offices in India operated by the State Bank increased continuously from 377 in 1949 to 946 in 1961. There was, however, a considerable reduction in its foreign branches, which decreased from 36 in 1949 to 8 in 1956. The operations of the Imperial Bank, predecessor of the State Bank, had shown a downward

39.

Reserve Bank of India, Trend and Progress of Banking in India during 1960, Bombay, 1961, p. 32

trend. Its deposits decreased from Rs. 2,505,000,000 in 1949 to Rs. 2,198,000,000 in 1955. Its investment portfolio decreased from Rs. 1069,000,000 in 1949 to a low level of Rs. 852,000,000 in 1951, and then increased to Rs. 1170,000,000 in 1955. But the amount of its loans and bills discounted increased from Rs. 918,000,000 in 1949 to a peak of Rs. 1,428,000,000 in 1951 and then declined to Rs. 1,058,000,000 in 1955. This variation in investments and in loans and advances was due mainly to the Korean War boom.

A significant increase was recorded in the operations of the State Bank after its conversion in 1955. Its capital funds increased from Rs. 120,000,000 to Rs. 128,000,000, and its deposits from approximately Rs. 2355,000,000 to a peak of Rs. 5821,000,000 between 1956 and 1959. Its investment portfolio increased from Rs. 1069,000,000 to Rs. 3780,000,000 during the same period, but the amount of its loans and bills discounted increased only slightly, from Rs. 1,402,000,000 to Rs. 1,669,000,000. The considerable increase in its deposits and investment portfolio was due partly to the P. L. 480 funds which were kept with this Bank. Subsequently from 1959 onward these funds were gradually transferred to the Reserve Bank, leading to a decrease in both portfolios. After 1959, whereas its capital funds increased from Rs. 128,000,000 to Rs. 138,000,000, its deposits decreased considerably from Rs. 5,821,000,000 to Rs. 5,325,000,000 by the end of 1961. As would be expected, its investment portfolio also decreased from Rs. 3,779,000,000 to Rs. 2,367,000,000 during the same period. However the amount of its loans and bills discounted increased from Rs. 1,668,000,000 in 1959 to Rs. 2,553,000,000 by the end of 1961. Table 30, showing the annual progress of the State Bank follows:

Table 30

Branches, Principal Assets and Liabilities, State Bank of India, 1949-1961, Inc.
(Rs.000,000)

Year	No. of branches <u>in India</u>	Capital and <u>Reserves</u>	Total <u>Deposits</u>	Cash in hand and <u>at banks</u>	Loans and Bills <u>Discounted</u>	Invest- <u>ments</u>	Total earning <u>Assets</u>
1949	377	119.3	2504.6	658.9	918.1	1068.5	1968.6
1950	382	119.6	2313.7	281.8	1019.5	1215.5	2235.0
1951	393	119.8	2309.1	295.7	1427.7	851.6	2279.3
1952	410	119.8	2058.5	254.5	1131.7	971.5	2103.2
1953	424	119.8	2069.7	196.4	1063.1	941.4	2004.5
1954	455	119.8	2311.3	363.7	1023.2	1087.2	2110.2
1955	484	119.8	2198.0	293.8	1058.1	1169.8	2227.9
1956	538	120.1	2354.7	277.8	1401.6	1068.7	2470.3
1957	622	122.6	3666.8	395.2	1734.8	1834.3	3569.1
1958	712	126.3	4786.8	554.7	1720.6	2845.7	4566.2
1959	823	128.3	5821.1	648.3	1668.8	3779.3	5448.1
1960	901	130.8	5773.5	679.5	2322.4	3067.6	5390.0
1961	946	138.3	5324.6	675.4	2553.3	2367.3	4920.4

Source: From the Reserve Bank of India, Statistical Tables Relating to the Bank in India, 1952-1961, pp. 3-7.

1 The deposit figures from 1949 to 1955 are not strictly comparable with those for 1955 onward. After the latter year Provident funds, staff security deposits, etc. are excluded. Similarly after 1955, money at call and at short notice are excluded from loans and discounts.

2 Figures for 1949 in this table do not tally with those given in Table no. 14. Probably their later figures are more reliable.

Part 3

Operations of the Industrial Banks and the Life Insurance Corporation of India.

In terms of magnitude of operations, the Industrial Finance Corporation was by far the most important of the public and quasi-public industrial banks established by the Government, with the cooperation of the Reserve Bank. The former, it will be recalled, was charged with the responsibility of financing public and cooperative industrial undertakings. Only recently its operations were extended to finance the imports of machinery by private industries. The State Financial Corporations, through which medium sized industrial undertakings, both public and private, were to be financed within their respective States, made a significant showing in the aggregate as did the Industrial Credit and Investment Corporation of India. The National Industrial Development Corporation, the Refinance Corporation and the National Small Industries Corporation made significant, though perhaps less impressive, advancements. The establishment of the state owned Life Insurance Corporation of India appears not to have affected, one way or another, the accumulation of policy reserves and insurance, but the operation of this Corporation were considerably extended. Such information as was available until 1961 supports these general observations.

The Industrial Finance Corporation

Although the operations of the Industrial Finance Corporation were restricted to public and cooperative large firms engaged in mining,

manufacturing, generation and distribution of power, and shipbuilding, it opened a new era of industrial finance in India. In the wake of successful operations of this Corporation, which is noticeable after 1954, several other industrial banks were established to meet the credit needs of other industries, both in the public and private sectors. The operations of the Corporation are revealed in Table No.31 on page 205.

As would be expected, in the absence of many new industries in the public sector between 1949 and 1954, there was not sufficient demand for loans from the Corporation even to absorb its capital funds. Consequently the Corporation invested its surplus funds in Government securities, and continued this practice until 1954 when sufficient demand was generated to absorb its available funds. By the end of March 1955 the amount of loans disbursed was Rs. 141,000,000 and the amount outstanding was Rs. 128,000,000.

The demand for financial assistance from the Corporation increased at an unprecedented scale with the inauguration of the Second Five Year Plan, in which considerable industrial expansion both in the public and private sector was envisaged. Whereas between June 1949 and March 1956 the amount of loans committed and disbursed had increased only to Rs. 386,000,000 and Rs. 162,400,000 respectively, they had reached Rs. 484,000,000 and Rs. 241,000,000/ by the end of March 1957.⁴⁰ Outstanding loans by then amounted to Rs. 207,000,000. This absolute

40.

Reserve Bank of India, Report 1956-57, op. cit., p. 45

Table 31

Operations of the Industrial Finance Corporation, 1950-61 Inc.
(Rs,000,000)

Year ending March	LIABILITIES							ASSETS			
	WORKING CAPITAL	Reserves	Deben- tures	Re s and Bank loans	Gov't loans	Other Liabi- lities	Total	Cash on hand and at banks	Inv. in gov't securities	Loans Out- standing	Other Assets
1950-51	50.0	--	53.0	--	--	3.7	106.8	4.7	45.8	52.1	4.1
1951-52	50.0	0.2	58.0	--	--	4.1	112.3	5.5	35.8	65.6	5.4
1952-53	50.0	0.3	58.0	--	--	6.1	114.4	2.6	20.1	86.2	5.6
1953-54	50.0	2.8	78.1	2.9	--	4.6	138.4	5.5	20.1	112.0	5.9
1954-55	50.0	3.1	78.1	--	--	5.2	136.2	2.4	--	127.8	6.0
1955-56	50.0	5.0	78.1	6.1	--	8.0	147.0	0.2	--	140.1	6.7
1956-57	50.0	8.7	78.1	10.7	60.0	10.2	217.5	0.9	--	207.0	9.6
1957-58	50.0	6.1	123.7	--	150.0	10.2	339.9	59.9	--	262.0	18.0
1958-59	50.0	8.4	167.5	9.4	100.0	15.1	350.4	7.2	--	321.0	22.3 ¹
1959-60	50.0	11.7	222.4	8.8	82.5	35.3 ²	410.7	0.4	--	367.3	43.0 ²
1960-61	50.0	17.1	222.4	5.1	152.5	63.7 ²	510.9	30.0	--	407.4	73.4 ²
1961-62	68.4	24.8	222.4	--	177.5	120.3 ²	613.4	29.1	--	454.8	129.5 ²

Source: Reserve Bank of India, Reports on Currency and Finance, 1955-56 and 1961-62. Statements 48 and 42 respectively.

1 Includes Rs 6,600,000 in respect of debentures.

2 Includes Rs. 19.9 million as of March 25, 1960 and Rs 47.7 million as of March 31, 1961, and Rs. 104.0 million as of March 30, 1962 in respect of guarantees and underwriting agreements per contra.

rate of increase in loans was maintained fairly steadily thereafter. However, during 1961 and 1962 there was a sharp increase in the volume of loans committed. They rose from Rs. 722,000,000 in March 1960 to Rs. 1,257,000,000 by March 1962. This sudden increase may be attributed to industrial expansion during the Second Five Year Plan, to and/the continuous emphasis on industrial development in the Third Five Year Plan. Since its inception in 1948 up to the end of March 1962, the Corporation had disbursed loans amounting to Rs. 630,200,000, and of this sum Rs. 454,800,000 were outstanding on that date.⁴¹

As was originally envisaged, a major part of the financial assistance provided by the Corporation had been granted to new industrial enterprises - the ventures that were set up after 1947. Of the total amount of loans sanctioned up to the end of March 1959 (Rs. 643,400,000) about 66 per cent were given to new industries, and the remaining 34 per cent to existing ventures for expansion and modernization.⁴² The majority of loans granted after 1959 were for new industries.

The Corporation did not engage in underwriting operations until 1958, as it was not authorised under the original Act to hold shares of industrial concerns for more than seven years. The Act was amended in 1957 to enable the Corporation to provide equity capital to industrial concerns. During 1958 for the first time, it underwrote, in conjunction with two other financial institutions, two issues of 6½ per cent redeemable and convertible debentures for Rs. 16,000,000. Of this amount the Corporation had to take up only Rs. 2,085,000.⁴³ By the end of

41. Reserve Bank of India, Report, 1961-62, op. cit., p. 69

42. S.L.N. Simha, The Capital Market of India, Bombay, Vora, 1960, p. 151

43. Reserve Bank of India, Report, 1958-59, op. cit., pp. 44-45

March 1962 the Corporation had underwritten sixteen issues of redeemable, convertible debentures and preferred and common shares amounting^{in all}/to Rs. 46,000,000. These issues carried interest rates varying between ^{underwritten} 6½ per cent and 7½ per cent. Of the amount/the Corporation had to take up about Rs. 20,000,000 or about 44 per cent, indicating that the economy's capacity for voluntary investment, even at 6½ per cent, was considerably less than anticipated. This may further reinforce an earlier conclusion that, without the cooperation of the Reserve Bank, the Government could not have made much progress with its program of planned development.

In addition to its underwriting operation, the Corporation undertook to provide financial assistance to various industrial ventures for importing machinery, by guaranteeing their deferred payments. It approved deferred payments to the extent of Rs. 36,800,000 during 1958. The amount increased by Rs. 131,300,000 by 1960, then decreased to Rs. 6,500,000 during 1961. In the latter year its assistance in the form of letter of guarantees amounted to Rs. 55,800,000 as against Rs. 29,500,000 in 1960.⁴⁴

In view of this considerable expansion in its lending operations, the Corporation strengthened its capital funds by issuing additional share capital of Rs. 18,400,000, and increased its Government borrowings to Rs. 177,000,000 during 1961. It also secured foreign loans to finance the imports of machinery by various industrial enterprises. It arranged a loan of \$20,000,000 with the Agency for International Development of the United States (formerly known as Development Loan Fund) and a loan of

⁴⁴. Reserve Bank of India, Report, 1961-62, op. cit., p. 69

D.M. 15,000,000 from the Reconstruction Loan Corporation of West Germany.⁴⁴ Thus the Corporation has strengthened its capital funds to meet the increased demand for assistance during the Third Five Year Plan.

The State Financial Corporations

The State Financial Corporations, as described earlier, were set up to provide long term credit both to public and private medium-sized industries that were left outside the province of the Industrial Finance Corporation. However the operations of these Corporations were limited to their respective states. Although the State Governments were authorized to establish these State Financial Corporations in 1952, not all of them immediately exercised the privilege. By 1953 two State Governments had established such Corporations. The number increased to eight in the following year, to twelve by the end of 1955, and fifteen by the end of 1960, or one in each State.

The loans of the State Financial Corporation are generally made to provide equity capital, and run from ten to twelve years. They provide working capital to firms which have not been able to raise it from a bank. In such cases their loans are not to exceed five years.⁴⁵ The loans are granted on the merit of individual undertakings, after a technical examination of the firms' developmental programs. Their rate of interest varies from State to State, but is generally in the neighbourhood of 6½ per cent.

⁴⁴. Reserve Bank of India, Report, 1961-62, op. cit., p. 69

⁴⁵. S.L.N. Simha, op. cit., p. 167

It is not possible to compare the progress made by these financial Corporations individually as the requisite data are not available but the annual progress made by these banks as a group after 1956, when the industrial development envisaged in the Second Five Year Plan was initiated, is indicated in the data in Table No. 32 on page 210. The amount of loans committed by the eleven Corporations established by that time stood at Rs. 69,000,000, and loans disbursed at Rs. 33,000,000. The amount of loans committed and disbursed increased to about Rs. 271,000,000 and Rs. 172,000,000, respectively, by the end of March 1960 and reached peaks of Rs. 491,000,000 and Rs. 300,000,000, respectively, by March 1962. Meanwhile their outstanding loans had increased from Rs. 27,000,000 in 1956 to Rs. 233,000,000 by the end of March 1962. As will be noticed from the Table there is a considerable increase in the lending activities of these Corporations during 1961. The volume of loans committed and disbursed during that year increased by approximately 36 per cent, indicating a considerable increase in demand for loanable funds. The borrowing limit for these Corporations was relaxed from five times their paid-up capital to ten times that amount, to handle this increase in demand. In addition, these Corporations were allowed to borrow from the Reserve Bank for eighteen months, as against only three months as originally provided.

It would seem from the Table that the State Financial Corporations have had considerable excess funds as their lending operations did not

Table 32

Business of State Financial Corporations, 1955-61, Inc.
Rs,000,000

<u>Year Ended March</u>	<u>Capital and Reserves</u>	<u>Proceeds of Boards & Debentures</u>	<u>Total Liabs. and Assets</u>	<u>Cash in hand and at banks</u>	<u>Inv. in gov't securities</u>	<u>Total Loans</u>			<u>Other Assets¹</u>
						<u>Committed</u>	<u>Disbursed</u>	<u>Out-standing</u>	
1955-56	102.9	N.A.	107.0	36.0	39.4	69.0	33.3	27.2	4.4
1956-57	123.6	3.6	147.5	35.9	40.1	113.9	62.0	65.0	6.5
1957-58	132.1	26.0	180.4	46.0	30.6	161.7	98.9	93.5	10.3
1958-59	134.6	61.2	232.2	79.2	28.0	211.6	132.2	113.4	12.6
1959-60	144.8	71.7	263.8	72.1	32.2	270.7	172.1	139.2	20.5
1960-61	154.3	71.7	298.0	45.6	46.0	362.3	219.6	171.2	35.2
1961-62	160.8	135.4	402.0	74.3	45.5	491.4	300.3	232.8	50.8

Source: 1. Reserve Bank of India, Report on Currency and Finance, 1955-1962. Statements 35-42.

2. Reserve Bank of India, Bulletin, April, 1962, p. 600.

1 Including debentures amounting to Rs 1,400,000

fully utilize their capital funds and proceeds from ^{the} sale of debentures. It should be borne in mind that the Corporations in industrially advanced States such as West Bengal, Gujrat, and Maharashtra had not only utilized their funds, but resorted to borrowing from the Reserve Bank. Corporations in less industrialized States, however, had excess funds, as reflected in the combined operations of all State Financial Corporations. It was to meet the growing needs of the former that their borrowing limits had been relaxed.

The cash balances and investment in Government securities of these Corporations was about 50 per cent of their loans outstanding during the last year under review. This indicates that a large proportion of their funds were committed for loans but not disbursed.

The Industrial Credit and Investment Corporation of India

Unlike the other newly established financial corporations, the Industrial Credit and Investment Corporation was broadly based from the very beginning. Among its sponsors were the World Bank, the United States Government and the United Kingdom Government as well as the Government of India. Its operations included not only the provision of both foreign and domestic loans to private industries, but equity capital and technical assistance as well. The financial assistance came for the most part in the form of underwriting stocks and debentures of industrial enterprises as well as by direct subscription to the securities themselves. Technical assistance took on the form of managerial, technical and administrative advice and help in obtaining skilled personnel.

The financial assistance provided to private enterprises by this corporation included undertakings in the following industries; pulp and paper, chemicals, pharmaceuticals, fuel injection devises, electrical equipment, textiles, sugar, metal ores, lime, cement and glass. The magnitude of tangible assistance from the year of its establishment down to 1960 is displayed in the following summary. There is no information available as to the extent of its technical assistance program.

TABLE NO. 33

Loans and Guarantees, Underwriting and Subscription Operations
of Industrial Credit and Investment Corporation,
1956-1961, Inc. (Rs. 000,000.)

Year	<u>Loans & Guarantees</u>			<u>Underwritings & Subscriptions</u>			
	<u>Foreign Currency</u>	<u>Rupee loans & guarantees</u>	<u>Total</u>	<u>Shares Und.wrtn.</u>	<u>Purch.</u>	<u>Total</u>	<u>GRAND TOTAL</u>
1956	-	29.5	29.5	23.8	6.8	30.6	60.1
1957	22.1	32.3	54.4	53.5	8.6	62.1	116.5
1958	31.6	34.8	66.4	55.0	12.3	67.3	133.7
1959	67.4	35.0	102.4	83.0	18.6	101.6	204.0
1960	126.3	65.5	191.8	96.7	25.6	122.3	314.1
1961	194.2	102.1	296.3	102.2	28.6	130.8	427.1

Source: Reserve Bank of India, Report on Currency and Finance, 1956 to 1961, Bombay, 1957-1962., Section: Capital Market.

These data reveal among other things, the increasing contributions made by foreign capital through this Corporation to the economic development of India. Except for the first two full years of its operation, foreign loans granted by the Corporation constituted about two-thirds of its total loans and guarantees. Whereas its Rupee loans increased from Rs. 32,300,000 in March 1957 to Rs. 102,000,000 in March 1962, the corresponding foreign loans increased from Rs. 22,100,000 to Rs. 194,200,000 during the same period. This considerable increase in foreign loans was made possible by the foreign connections of the Corporation that enabled it to raise money outside India more easily than could other financial institutions.

The rate of interest charged on its foreign loans is slightly higher than on domestic loans; namely, $7 \frac{3}{4}$ per cent as compared to $6 \frac{1}{2}$ per cent. In addition, borrowers have to pay a $\frac{1}{4}$ of 1 per cent commission on the former.⁴⁶

The Table further reveals the considerable increase in total financial assistance approved by the Corporation which, starting from a modest amount of Rs. 60,000,000 in March 1956, increased to Rs. 204,000,000 in March 1959 and ^{to} Rs. 427,000,000 in March 1962. Of the latter amount, however, only Rs. 184,000,000 or about 43 per cent was disbursed by the end of March 1962.⁴⁷

Direct subscriptions to the equity capital of various industrial enterprises shows a considerable growth between 1957 and 1960, but the

46. S.L.M. Simha, The Capital Market of India, Bombay, Vora, 1960, p. 183

47. Reserve Bank of India, Report 1961-62, op. cit., pp. 71-72

growth slackened thereafter. Whereas between 1957 and 1960 the amount of shares purchased had increased from Rs. 8,600,000 to Rs. 25,600,000, this had increased to only Rs. 28,600,000 by the end of March 1962.

The underwritings of the Corporation were on a modest scale, and in the beginning were not too successful. Of the Rs. 9,300,000 shares floated during 1957 the Corporation itself had to take up about Rs. 5,800,000 or 63 per cent. In the following year, however, of underwriting operations amounting to Rs. 21,800,000 it had to take up only Rs. 4,500,000 or about 21 per cent. During 1959 the Corporation was still more successful. Of underwritings amounting to Rs. 19,300,000, it had to take up only Rs. 2,800,000, which was about 15 per cent of the total. By 1960 however, the Indian money market had become so exhausted that the Corporation had to take up as much as Rs. 12,300,000 or about 67 per cent of the Rs. 17,200,000 underwritten.⁴⁸ This may be attributed to the fact that other similar financial institutions had entered the underwriting business. Moreover, it should be realized that this was one of the principle reasons for establishing this Corporation in the first place, i.e., to help finance unproven private ventures entering new fields of enterprise.

The National Industrial Development Corporation

The National Industrial Development Corporation was established principally to help in setting up new industries and in the rehabilitation of old ones in the private sector, where the amount of capital required and the degree of risk involved tend to deter private investment. It was

⁴⁸. Adapted from, Reserve Bank of India, Report on Currency and Finance, 1957 to 1961.Ch.Capital Market.

designed mainly to establish those industries that were deemed necessary to fill the gap in the planned industrial sector, and especially those industrial undertakings which promised to remove the country's dependence upon imports of heavy industrial machinery, raw film, aluminium, synthetic rubber and the primary ingredients for drugs, dyestuffs, and plastics.⁴⁹

This Corporation supplied the only channel through which special low-cost government loans would be made available for the modernization of the jute and cotton textile industries. Later on, during 1958, the Corporation adopted a hire-purchase scheme under which instalment loans were made to facilitate the purchase of new machinery, providing that it was produced in India. Under this plan the borrowing firms deposit 25 per cent of the cost of machines and pay the balance in five equal annual instalments at a 6 per cent rate of interest.⁵⁰ Subsequently this hire-purchase scheme was extended to the machine tool industry itself. The need was so great and immediate for imports of machinery, however, that the Corporation in 1960 extended its lending activities to the financing of machinery made abroad, against guarantees and collateral securities.

Although balance sheet summaries of the operations of the National Industrial Development Corporation are not available one may conclude that they were most significant in helping to realize the objectives of the Second Five Year Plan. Up to the end of March 1959 the Corporation had committed loans under the hire-purchase scheme amounting to Rs. 2,100,000 to the jute and cotton textile industry. By the end of March 1961 the amount of such loans had increased to Rs. 3,000,000 - an increase of about 48 per cent over a two-year period. By this later

49. Reserve Bank of India, Report 1956-57, op. cit., p. 47

50. Reserve Bank of India, Report 1958-59, op. cit., p. 49

date the Corporation had also sanctioned, under the hire-purchase scheme, loans amounting to Rs. 3,500,00 to the machine tool industry.⁵¹ The loans under the hire-purchase scheme originally carried a 4½ per cent rate of interest, but it was raised to 7½ per cent in 1958. These loans are repayable in fifteen equal annual instalments.

In addition to the hire-purchase scheme the National Industrial Development Corporation since its inception had committed loans amounting to Rs. 144,100,000 up to the end of March 1960 for the rehabilitation and modernization of the jute and cotton textile industries. By the end of March 1961 the amount had increased to Rs. 196,000,000. But the amount of loans disbursed increased only from Rs. 50,100,000 to Rs. 65,800,000 during the same period. Whereas the loans committed increased by about 36 per cent, the loans disbursed increased by about 30 per cent.

With respect to the establishment of new industrial enterprises, the progress of the Corporation is hampered by the shortage of exchange reserves of the Government of India. Nevertheless, with the collaboration of the Czechoslovakian Government the Corporation has been instrumental in establishing a heavy foundry forge. With the help of the Russian Government, it has established a heavy machine building plant, a mining machinery plant and an optical glass plant.⁵² With the cooperation of Russian technicians, it has prepared plans for the establishment of drugs and pharmaceutical industries, but these have been delayed by a shortage of foreign funds. The Corporation in 1959 promoted the establishment of a Chemical Development Company to engage in the production of

51. Reserve Bank of India, Report on Currency and Finance, 1960-61., Bombay, 1961, p. 66

52. S.L.N. Simha, The Capital Market of India, Bombay, Vora, 1960, p. 176

sulphur from Pyrites. It has also drawn up plans for the establishment of aluminium and synthetic rubber plants, but the projects themselves have been delayed by a constant shortage of ^{the} foreign exchange required to import the specialized machinery required for such projects.

The Refinance Corporation

The Refinance Corporation, as noted in Chapter IV, was established to encourage the participation of Indian banks in financing the development of medium sized private enterprises in the Indian economy. This and other significant deviations from the socialistic ideals of the ruling Congress party was no doubt a concession to the United States, whose Government permitted the Government of India to use the proceeds of the sale of a grain loan, amounting to Rs. 260,000,000, to make advances to private industries through the existing banking institutions. Such advances were to be made to new enterprises included in the Second and succeeding Five Year Plans. In addition to this fund, a share capital of Rs. 250,000,000 was subscribed by the Reserve Bank, the Life Insurance Corporation, the State Bank, and fourteen scheduled banks.

In as much as the loans made possible by this Corporation were available to the borrower at 6½ per cent (the borrowing banks were not allowed to charge more than 1½ per cent above the 5 per cent lending rate of the Corporation) one would have expected that considerable advantage would have been taken by the more enterprising Indians. Yet during its first year of operation in 1958, only Rs. 24,300,000 had been committed, of which only about Rs. 2,000,000 was disbursed. During the following year, though the amount of loans committed decreased to Rs. 17,300,000, the amount disbursed increased to Rs. 11,600,000. By the end of March

1961 the total amount of loans committed amounted to Rs. 76,900,000; the total amount disbursed, to Rs. 32,200,000. At this later date its outstanding loans amounted to Rs. 30,900,000 or about 96 per cent of the loans disbursed.⁵³ This high proportion was due to the medium-term nature of the loans advanced by the Corporation.

The relatively slow response to the advantages of the medium term 6½ per cent loans made possible by the Corporation to private industries was no doubt due to the fact that the Corporation itself charged the lending banks 5 per cent for its loans, thus leaving an operation margin of 1½ per cent for the primary lenders. No private bank can lend at such a low rate and come even close to meeting its operating expenses. As a result the member banks had little incentive to use the lending facilities of this Corporation.

In order to expand its operations and thus utilize its substantial capital funds, its facilities were extended in 1960 to twenty-eight non-member scheduled banks, all State Financial Corporations and three State Cooperative banks. In addition, the borrowing financial institutions were no longer required to maintain a margin of 1½ per cent between their lending rate to the primary borrower and their lending rate from the Corporation. They were free to exceed the 6½ per cent limit subject to the approval of the Corporation. However the Corporation stipulated that loans carrying terms more unfavourable to the borrower than the general rate charged by other lending institutions would not be eligible for refinancing.⁵⁴ Concomitantly the restrictions on the size of borrowing

53. Reserve Bank of India, Report 1960-61, op. cit., pp. 65-66

54. Reserve Bank of India, Report 1960-61, op. cit., pp. 65-66

firm were also removed. Loans granted to large firms (with paid-up capital of Rs. 25,000,000 or over) for a period of seven to ten years were made eligible for refinancing from the Corporation, provided the loans were in conformity with the purposes of the planned industrial developments. Probably as a result of these relaxations, and the extension of the Corporation's lending facilities, there was a considerable increase in the amounts of loans sanctioned and disbursed. By the end of March 1962 the amounts were Rs. 183,000,000 and Rs. 89,700,000, respectively, an increase of about 138 per cent and 178 per cent, respectively, during the year.

This Corporation is likely to have greater success than other financial Corporations that have been set up recently to meet the increasing demand for industrial credit. It places the responsibility for bearing risk on borrowing commercial banks, and thus reduces its chances of loss to a minimum. The banks that grant loans to industrial concerns have their past experience to draw upon, and have ample facilities for scrutinising the loan applications. Moreover these banks are conservative in their outlook and their judgement is likely to be sound.

National Small Industries Corporation

The National Small Industries Corporation, as pointed out earlier, was established not only to provide medium and long-term instalment loans to small industries requiring machinery, but also to obtain for them a share of Government contracts and to coordinate their operations with those of large-scale industries. The original hire-purchase scheme was liberalised in 1959 when the downpayment on special purpose machines was reduced

from 30 per cent to 20 per cent, the same as that for general purpose machines, and the first instalment was due after one year as against six months under the original scheme. Under the terms of the new hire-purchase scheme, there was a considerable increase in demand for loans from the Corporation. Where-as it received only 2167 applications for 8085 machines valued at Rs. 76,000,000 between December 1955 and December 1959, the number had increased to 3990 applications for 14,992 machines valued at Rs. 159,800,000 by the end of December 1960. The number of machines delivered had increased meanwhile from 3204 valued at Rs. 28,000,000 to 4225 machines valued at Rs. 39,000,000.⁵⁵

Encouraged by the increase in demand for its assistance and the increase in the number of machines delivered, the National Small Industries Corporation further relaxed the terms of its hire-purchase scheme in 1960 and 1961. It reduced the down-payment to 5 per cent on all Governmentally sponsored applications, provided the remaining 15 per cent was guaranteed by the sponsoring authority. In addition, the down payment on all machines valued at Rs. 2000 or less was reduced from 20 per cent to 10 per cent. The latter provision was extended the following year to all machines valued at Rs. 50,000 or less. For machines valued at more than Rs. 50,000 the borrowers were allowed to pay 5 per cent in cash and the remaining 15 per cent in bank guarantees cashable at the time of the delivery of the machines.⁵⁶ These provisions appear to have been favourable to small industrial units, for by the end of December 1961 the Corporation^{had} received

55. Reserve Bank of India, Report 1960-61, op. cit., p. 68

56. Reserve Bank of India, Report 1961-62, op. cit., p. 75

7117 applications for 29,385 machines valued at Rs. 287,500,000 i.e., an increase in demand of 14,393 machines valued at Rs. 127,700,000 during 1961. Of this latter total the Corporation was able to supply only 1486 machines worth Rs. 16,800,000.

The National Small Industries Corporation during 1960 and 1961 arranged foreign currency loans to enable its borrowers to import urgently required machinery from abroad. It secured a long-term loan of \$10,000,000 from the United State Development Loan Fund in 1960 which could be used to buy machines valued at \$50,000 or less from any non-communist countries. Machines valued at more than 850,000 were required to be bought from the United States only.⁵⁷ The Corporation received three loans from Japan, The United Kingdom and West Germany in 1961, amounting to Rs. 3,000,000, Rs. 1,000,000 and Rs. 11,9000,000, respectively, which were used for importing machinery for small industries. With respect to the loans for importing machinery, the applicants were required to pay 20 per cent of the c.i.f. cost and the remainders, covered by bank guarantee, in equal annual instalments. No data are available on the extent of loans granted for this purpose.

The Corporation secured only 1525 Government contracts for small industries valued at Rs. 50,000,000 between 1955 and December 1959. In the following year the Corporation made considerable progress in this respect and had secured 2774 orders valued at Rs. 83,000,000 by the end of December 1960. The number had reached 4585, valued at Rs. 150,000,00 0 by December 1961 - increases of about 57 per cent and 55 per cent, respectively.

In addition to financial assistance, the National Small Industries

57. Reserve Bank of India, Report, 1960-61, op. cit., p. 68

Corporation has set up wholesale depots for products of these industries at Agra, Aligarh, Bombay, Calcutta and various other trading centers to expedite the marketing process. It has also set up raw material depots for supplying standardized and controlled raw materials in short supply to these industries at controlled prices. No data are available as to the extent of products sold and raw materials bought, and perhaps it is too early to make an assessment of the contribution made by these depots to the needs of small firms.

As to the corporation as a whole, it would seem that it represents a somewhat overly ambitious scheme for the development of small industries. It may involve hidden costs out of all proportion to its accomplishments. A student familiar with industrial organization in the North American continent looks askance on such projects. Only a fair assessment of all costs, governmental or otherwise, involved in promoting such ventures as ultimately prove to be successful, will prove or disprove this observation.

The Life Insurance Corporation - Operations

The most significant aspect of the operations of the Life Insurance Corporation of India is the market it provides for the legitimate and non-inflationary purchase of Government bonds and other investment media. It has enabled the Government to tap the real savings of the people and channel them into capital developmental projects which otherwise would have had considerable inflationary after effects. By appealing to the national sentiment of the people, the Corporation has been able to expand considerably its business within its first few years of operation.

The progress made by the Corporation is revealed in Table No. 34 on Page 223.

Table 34

New Business of the Life Insurance Corporation and its
Predecessor Insurance Companies,
1954-1961, Inc. (Rs.000,000)

<u>Year</u>	<u>India</u>			<u>Foreign</u>			<u>Total</u>	
	<u>No. of Policies</u>	<u>Sum Assured</u>	<u>Ave. sum per policy</u>	<u>No. of Policies</u>	<u>Sum Assured</u>	<u>Ave. sum per policy</u>	<u>No. of Policies</u>	<u>Sum Assured</u>
1954	740	2376	3210	32,688	177	5,400	733	2553
1955	796	2405	3021	35,461	203	5,733	832	2608
1956	549	1877	3410	17,956	126	7,011	556	2003
1957	811	2777	3424	5,055	54	10,682	816	2831
1958	955	3391	3551	5,399	56	10,409	960	3447
1959	1143	4197	3671	7912	95	11,969	1151	4292
1960	1250	4878	3903	7736	97	12,539	1258	4975
1961	1462	5988	4097	8056	100	12,446	1470	6088

Source: Government of India. India, 1961 and 1962. pp. 241 and 223 respectively.

The data reveal that the Life Insurance Corporation has considerably expanded its business in India over the insurance business of the private companies that preceeded it. Whereas the largest number of policies issued by these companies during a year was 796,000 with an assured sum of Rs. 2,405,000,000 in 1955, the Corporation has improved upon it in the very first year of its operations in 1957, when the number of policies issued by the Corporation totalled 810,700, with an assured sum amounting to Rs. 2,777,000,000. By the end of 1960 the number of policies issued by the Corporation had increased by about 80 per cent, and the sum assured, by 216 per cent.

The foreign insurance business of the Life Insurance Corporation, however, declined considerably. Whereas the foreign policies issued by the predecessor companies numbered 35,461 with a sum assured amounting to Rs. 203,000,000 in 1955, the last year of their independent operations, their number declined to a low level of 5055 with an assured sum equal to Rs. 54,000,000 in 1957. Thereafter the foreign business of the Corporation gradually expanded to 8056 policies with an assured sum amounting to Rs. 100,300,000 in 1961. While the average sum per Indian policy is now considerably higher in the Life Insurance Corporation than it was in the predecessor companies, it is still understandably below the average of the Corporation.

The considerable increase in policy reserves, resulting from the expansion of business of the Life Insurance Corporation, went into Central and State Governments bonds and securities. From a banking point of view this was an important development. It enabled the Government to

channel the voluntary savings of the people into planned capital development projects which otherwise would have been financed by the usual procedure of deficit financing. This would have led to a considerable increase in the money supply, with the resultant increase in prices and their counterpart forced savings. The detailed distribution of investment funds of the Corporation is presented in the Table No. 35 on page 226.

Here it will be seen that the percentage of policy reserves and voluntary savings invested in Government securities was 69 per cent in 1957. By the end of 1960, of the total investment funds of Rs.5,260,000,000, about Rs. 3,827,000 or 73 per cent was invested in Government securities. The Table further reveals that the rate of growth of the Life Insurance Corporation was considerably greater than that of National Income. Whereas the index of growth of the Corporation increased from 100 in 1957 to 138 in 1960, the index of National Income increased from 100 to 125 during the same period.

-Table No. 35

Distribution of Investment Portfolio of the Life Insurance Corporation, 1957-1960. Rs,000,000.

End of year	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>
Securities of, ^{or} loans to central and state govts. & their agencies	2628	2879	3273	3827
Investment in stocks & debentures	702	737	821	925
Investment in foreign securities	133	79	111	128
Investment in mortgages, & real property	344	343	343	372
Other loans and investments	7	10	8	8
Total	3815	4048	4556	5260
Index of growth	100	105.1	119.4	137.9
Index of national income (Current prices)	100	110.6	113.6	124.7

Source: Government of India, India, 1957-1962.

Data for national income for 1960 are provisional.

CHAPTER VI

PROGRESS IN THE PRIVATE SECTOR

1949 ONWARD

The progress made in the private sector of the Indian banking structure during this concluding period of our review displays a number of noteworthy characteristics. First of all it should be recalled that during this period the singularly important Imperial Bank was nationalized to form the State Bank of India. Therefore, this bank was no longer included in the private banking sector. Perhaps the most important aspect of this period is the commanding authority which, with the exception of Indigenous bankers and money lenders, the Reserve Bank was given over both the scheduled banks and the non-scheduled banks. Ultimately this authority was extended to cooperative banks as well. In fact the Reserve Bank was made the crowning edifice of the Indian banking system. If it may be said that before its nationalization the Reserve Bank had little if any influence on the operations of other banks, then it may also be said that after nationalization it nearly dominated them.

Much of the progress of Indian Joint Stock banks reflects the inflationary effects of continuous deficit financing during the Second Five Year Plan, either directly or indirectly, through Reserve Bank credit. An unimpressive showing by the Exchange Banks reflects the loss of the privileged position they once enjoyed, and perhaps the limitation imposed on them under the Banking Companies Act of 1949. They lost considerable

business to the State Bank of India and other scheduled banks. Yet with all of this, the Indigenous bankers, to whom we now turn, continue to handle a major portion of the country's banking business, especially in the small towns and villages. They remained outside the jurisdiction of the Reserve Bank and were not brought under the definitive provisions of the newly drawn Banking Companies Act of 1949 and its subsequent amendments.

Part 1

The Indigenous Bankers

Unfortunately in the absence of data on the extent of operations of the Indigenous bankers and money lenders, there is little of a tangible nature to be added to the information already given on the nature of their activities and operations. This preponderant segment of the Indian banking structure has yet to be brought within the scope of the jurisdiction and authority of the Reserve Bank, thus providing the great enigma of the centralization experiment. In spite of the limitations on interest rates and lending practices now imposed by the respective States and the competition of the cooperative credit banks these merchant-bankers and their dependent money lenders are said to provide about 80 per cent of the agricultural credit of the Country and to finance over 75 per cent of its total internal trade.¹ So far, neither the Cooperative banks nor the Joint Stock banks have been able to alienate any significant part of the legitimate banking business of these well entrenched family enterprises. Moreover no firm or agency, including the government itself, has proposed a substitute for the largely unsecured

1. Reserve Bank of India, Committee on Finance for the Private Sector, Report, Bombay, 1954, p. 66

loans which the small money lenders, with the support of Indigenous bankers, make to artisans, small shopkeepers and to individuals.

Indigenous Bankers and the Reserve System

Dean Gupta of Bikram University in India attributes the failure of the Reserve Bank to extend its jurisdiction to Indigenous bankers to the Reserve Bank itself. This apparently well qualified observer makes two not easily refuted contentions. Firstly, the Reserve Bank's Central Board and the Government have not seen fit - the author assumes for political reasons - to force these bankers to place themselves within the Reserve Bank's sphere of influence and authority. Secondly, approaches made so far to the Indigenous bankers by the Reserve Bank have been wrong in that these bankers were asked to accommodate their age old informal lending practices to the technical requirements of an impersonal governing authority and to meet statutory requirements which would greatly restrict their banking operations.

Both the Reserve Bank Act and the 1949 Banking Companies Act provide most improbable vehicles for the operations of the Indigenous bankers. The latter measure no longer permits the mixing of mercantile and banking business in one corporate enterprise when, in most Indigenous banks, it is doubtful if either form of business could exist without the support of the other. Again both the above mentioned Acts presume upon practices initiated by the usually quite impersonal British banks, e.g. there must always be either bondable security or enforcable guarantees behind all bank loans. Unsecured credit in its true meaning is relatively unknown. Yet it is quite definitely within this latter area that India

needs and, for good or evil, gets the services of these skilled and crafty judges of the credit worthiness of the bulk of native Indian borrowers. Many of the customers of the Indigenous bankers have little more tangible security than the expectation that they can make good their loans. With respect to the provisions of Indian banking laws, Professor Pananadikar contends that "too much blind imitation of the British is unwholesome and out of place in an under-developed country like India".² He is well aware that in the United States the unsecured loan has played a vital role in the development of the Country.

Formulae for Coordination

As things now stand only such Indigenous bankers as are carrying on no ancillary business enterprises can take advantage of the Reserve Bank's Bill Market Scheme and enjoy the facilities now made available to other banks for cash transfers and remittances. Even then the Hundis (their bills of exchange) must carry two good names in addition to that of the bankers and the native bankers must pay the same commission as would an ordinary individual if he is eligible to use the Reserve Banks remittance and transfer machinery. The incorporated banks get a preferential rate and thus have some inducement to affiliate themselves with the Bank. Another discrimination denies the Indigenous bankers access to the legal protection provided by the Bankers' Evidence Act.³

At their annual conference in July 1951 in Bombay, the representatives of the Indigenous bankers agreed to petition the Reserve Bank authorities

2. S.G. Panandikar, Banking in India, 9th ed, Bombay, Orient Longmans, 1959, p. 48

3. Ibid., p. 78

to provide a link between themselves and the Reserve Bank through the establishment of a Central Shroffs' Association. Such a step, they argued, would help considerably to remove the obstacles that had hindered such a relationship in the past. Since the Indigenous bankers were not willing to comply with the conditions already laid down by the Reserve Bank, nothing came of this resolution.

In its report in 1955, the Committee on Finance for the Private Sector appointed by the Reserve Bank, as would ^{have been} expected, reiterated the policy of the Reserve Bank with respect to its recommendations to bring the Indigenous bankers under the Reserve system. No new avenue was explored to overcome the already known obstacles. Knowing the position of both sides, i.e., the Reserve Bank and the Indigenous bankers, the Committee failed miserably to point out new steps to bring about close relations between them. Dean Gupta sees little hope for the future coordination of the Country's two types of banking systems, if the Government and the Reserve Bank persist in changing the tried and tested practices of the Indigenous bankers, thus losing the unique, yet very considerable, contribution they make to the Indian economy. Professor Panandikar, it appears, would have the national Government take full advantage of the services rendered by these banker-merchants in localities too small to support a branch of the State Bank or some other governmentally sponsored institution. This, it is contended, could be accomplished by making additional loanable funds available to them and by removing existing discriminatory measures against them. Far from coercing the Indigenous bankers into changing their proven banking methods, the discriminatory measures have merely served to

accelerate their abandonment of urgently required banking services in favour of other more lucrative forms of enterprise.⁴ Professor Panandikar would in short recognize them as banks and place before them realistic inducements to become associated with the progressive banking movement without sacrificing their real contribution to Indian banking needs.

If the attempts to establish direct relationships between the Indigenous bankers and the Reserve Banks bore no fruit, steps should have been taken to explore possible channels of indirect relationships between them through either the State Bank of India or the private commercial banks. In the opinion of the Committee on the finances for the Private Sector the Reserve Bank should discount the Hundis presented to it through the commercial banks. If the individual bills of exchange (Hundis) are small in amount, the Reserve Bank, as suggested by the Shroff Committee, should examine the possibility of accepting large bills of exchange (Hundis) supported by small ones.⁵ In this way the commercial banks could first assess the credit worthiness of the original advances, make secondary advances against the paper of proven borrowers, and thus enlarge the scope of the services rendered by these singularly important native bankers. Although there are already some commercial banks that handle internal bills of exchange (Hundis), their activities in this field are very limited in scope as there is no support from the Reserve Bank.

Indigenous bankers should also be encouraged to form their own cooperative banking societies under which they could carry on their banking business jointly while, at the same time, they carry on their

4. S.G. Panandikar, op. cit., pp. 82-83

5. Reserve Bank of India, op. cit., p. 69

trade and commerce independently. This would not only enable them to compete with Joint Stock banks in their banking business but, at the same time, help to separate their banking business from their other undertakings. They could then re-discount their bills of exchange (Hundis) with the State Bank or the Reserve Bank through their cooperative banking societies, and thus establish a desirable link between the organized and unorganized money markets.

Part 2

The Joint Stock Banks

From 1949 onward the progress and operations of the Indian Joint Stock banks were mainly conditioned by the limitation written into the 1949 Banking Companies Act and the regulating authority which that measure conferred on the Reserve Bank of India. One could fairly say that from 1949 onward the future of Joint Stock banking in India became as much a matter of Reserve Bank and Government policy as of the enterprise of the bankers themselves. We are concerned first with the important provisions of the Banking Companies Act of 1949, then with its impact on the activities and operations of the Joint Stock banks.

Provisions of the Banking Companies Act, 1949

The Banking Companies Act of 1949 either incorporates or amends in some way all of the earlier sections of the Companies Act relating to banks, as well as the separate Acts and Ordinances extending the Reserve Bank's authority to the regulation of activities of banks and control of branch extensions. The more significant aspects of this comprehensive measure and their implications for Indian Joint Stock banks may now be summarized.

Banking is defined as "the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise".⁶ This definition precludes the continuation of the occasional practice of combining banking and trading ventures. It, as well as Section 7 of the Act, forbids the use of the word, 'bank', 'banker' or 'banking' by Indigenous merchant bankers.

No company may carry on banking business without a license from the Reserve Bank of India. Before granting the license the Reserve Bank has to be satisfied that the Company is in a position to pay its depositors in full as their claims accrue and that it carries on its business in the interest of its depositors.⁷ The Reserve Bank is empowered to cancel a license if the above conditions are not fulfilled, but the existing banks may be given as long as three years to comply with the conditions laid down. The Reserve Bank has similar authority to limit branch extension and changes in the location of existing ones.⁸ These measures were designed to prevent unnecessary and unhealthy competition among the banks rather than the extension of services. They were also designed to eliminate questionable banking ventures that were established before these limitations were put into the Act.

The minimal capital requirements for Indian Joint Stock banks are fixed according to their location and the number of their branches. Under the provisions of the Act it is laid down (1) that a bank with branches in more than one province shall have a paid up capital of

6. Government of India, Banking Companies Act, 1949, Section 5(1)(C).

7. Government of India, op. cit., Section 22

8. Ibid, Section 23

Rs. 500,000. If it has a place of business in the city of Calcutta or Bombay or both the amount is Rs. 1,000,000. (2) A bank with all its branches in one province but none in the cities of Bombay or Calcutta is required to have a capital sum of Rs. 100,000 for its head office; Rs. 10,000 for a branch in the same district, and Rs. 25,000 for a branch in another district. (3) A bank with all its branches in one province but one or more of which are located in the city of Bombay or Calcutta is required to have a paid up capital of Rs. 500,000 and Rs. 25,000 for each Branch outside these cities. (4) Any bank with more than one place of business that does not fall under the above categories, is to have a capital of Rs. 1,000,000; a bank with only one place of business, Rs. 50,000.⁹

In the 1949 Act it was provided that the voting rights of any one shareholder are strictly proportionate to his contribution to the paid up capital of the company provided such rights do not exceed five per cent of the total voting rights of all the shareholders.¹⁰ Originally this measure was not applicable to banking companies incorporated before 1937. Subsequently, under the provisions of the Banking Companies Amendment Act of 1956, this limitation was extended to all banking companies. The 1949 Banking Companies Act further provided that no bank may hold more than 30 per cent of the stock of another business enterprise and then only on the condition that such a holding does not exceed 30 per cent of the par value of the bank's paid up capital.¹¹

9. Government of India, op. cit., Section 11

10. Ibid, Section 12

11. Ibid, Section 19

The first limitation appears to have been designed to eliminate one man control of a bank even though one shareholder may possess most of its shares. The second one eliminates the possibility of a given bank making unduly large commitments to one borrower or from becoming too dependent on the fortunes of a particular enterprise. Either policy can have unfortunate consequences if the enterprise in question should not prosper. It has already been noted that the Reserve Bank may, through selective credit control or other measures, dictate the lending policies of banks both individually and collectively.

Banks are required to maintain a liquidity ratio of 20 per cent of their time and demand liabilities in cash, gold and unencumbered approved securities.¹² However, for the purpose of this section, liabilities do not include the paid up capital and reserves, and loans from the Reserve Bank. It is noteworthy that approved securities are mostly either direct obligations of the Government or those of governmentally sponsored agencies, thus relieving somewhat a usually already over-burdened market for such securities.

It has already been noted that under the 1949 Banking Companies Act the Reserve Bank has been given sweeping regulatory powers over the conduct of Joint Stock banks. These include the duty to inspect the accounts of any bank and subject to Government approval, ^{to} suspend and wind-up the affairs of any banking company that does not comply with the provisions of the Act. The Reserve Bank is also authorised to pass upon the appointment and remunerations of officers of banking companies.¹³

12. Government of India, op. cit., Section 24

13. Supra, Chapter IV, Part 1.

Impact of the Banking Companies Act on Indian Joint Stock Banking

In a rapidly expanding country like India there is no way of determining the extent to which this unusually definitive and often seemingly punitive banking measure may have conditioned the activities of Indian Joint Stock banks. Like the earlier amendments to the 1913 Companies Act and other interim measures its provisions suggest two different answers. Either many banks still could not be trusted to handle their own affairs with the discretion that would appear to be in their own long-term self interest, or the Government was unduly anxious to assert its newly acquired authority in an area where public protests would hardly be contemplated. Meanwhile no such far reaching limitations were placed on the operations of the far more politically significant Indigenous bankers. The manner in which this regulatory authority was exercised on the Joint Stock banks is our immediate concern.

On the Conduct of the Banks

Note has already been taken of the extent to which the lending operations of scheduled banks were restricted by the exercise of monetary policy by the Reserve Bank. In pursuance of its power as a regulatory authority the Bank instituted a system of regular inspections early in 1950 "with a view" to quote the Reserve Board itself, "to helping them in the establishment of sound banking traditions by drawing their attention to the defects or unsatisfactory working methods at an earlier age". Even with a thoroughly trained and experienced training staff recruited from among the Country's well established banks, this was quite an ambitious undertaking. According to Dean Gupta, the

first round of inspections which had begun in 1950 was completed in 1953. Since that time inspections have been conducted at fairly regular intervals. Subsequently such inspections have also been extended to cooperative banks. In order to avoid a number of potential failures revealed by the inspections, steps were taken either through or by the Reserve Bank to amalgamate a number of small banks into larger institutions and to merge the businesses of others with well established banks. These activities were later extended even to a number of state associated banks which, as noted earlier, were made subsidiaries of the State Bank of India. Some indications of the results of the vigilance of the Reserve Banks' inspection division and of strengthening the laws governing the operations of corporated banks may be gained from Table No. 36 on page 239.

The data in this table reveal that between the inception of the inspection program in 1950 and the end of 1961 as many as 289 banking companies with deposits of Rs. 370,187,000 have left the banking scene either voluntarily or under the direction of the Reserve Bank. By the end of the first round of inspection in 1953 eighteen banks with deposits of Rs. 22,600,000 had^{been} asked to wind up their business. Subsequently the number of compulsory bank liquidations decreased considerably. Many banks were winding up their business voluntarily as they could not make any headway under the seemingly punitive and strictly enforced banking regulations. By the end of 1961, the number of compulsory liquidated banks had reached 64; their deposits, Rs. 174,277,000. On this latter date the number of banks that had voluntarily or otherwise

Table 36

Number, Capital and Deposits of Banks Liquidated or Otherwise Closed,
1953 - 1961. (Rs.000,000)

Year	Voluntary Liquidation			Compulsory Liquidations			Otherwise ceased to Function		
	No. of Banks	Paid up Capital	Deposits	No. of Banks	Paid up Capital	Deposits	No. of Banks	Paid up Capital	Deposits
1953	10	3,558	28	18	9,292	22,600	6	2,237	4,580
1954	14	1,374	96	6	2,846	1,140	17 ¹	2,479	8,784
1955	11	2,655	199	6	2,510	10,102	11 ²	2,330	2,030
1956	16	1,452	499	6	695	1,812	6 ¹	1,068	4,745
1957	16	1,682	1,659	3	917	2,876	11	2,366	13,817
1958	9	927	1,125	5	1,367	10,209	15	7,825	57,169
1959	6	542	22	8	2,746	437	19 ¹	3,622	14,272
1960	4	238	41	5	5,375	117,590	18	3,399	4,116
1961	5	453	1,608	7	2,583	7,511	31	6,872	73,156
Total	91	12,881	5,277	64	26,331	174,277	134	32,198	183,029

Source: Adapted from Reserve Bank of India, Statistical Tables relating to Banks in India, 1953, 1960 and 1961, pp. 35-36, 38-40 and 40-41 respectively.

1 Data for one bank not available.

2 Data for two banks not available.

those of

Note: 1961 data is not strictly comparable with/preceding years.

ceased to function was 225 and their deposits amounted to Rs. 196,910,000. In order to ensure a healthy growth of the Indian banking system the Reserve Bank has weeded out directly or indirectly a substantial number of inefficient ^{Banking}/companies and thus provided fertile ground for the expansion of sufficiently equipped and efficiently managed Indian banks.

Despite the inspection and the corrective machinery available to it the Reserve Bank's record of achievement as a regulatory authority appears to have left something to be desired. In June 1960, the Palai Central Bank was placed in liquidation as a result of a continued deterioration in its affairs that apparently had been known to the Reserve Bank for a number of years. The latter appears to have done nothing decisive about the Palai Central Bank until known and suspected losses had more than considerably dissipated the shareholders equity and involved many middle class depositors in substantial losses.

Dean Gupta forthrightly states that "the Palai failed under the very nose of the Reserve Bank of India and in the midst of voluminous banking legislation". He finally concludes his criticism with these words, "we may say that the Reserve Bank grossly failed in its duty to protect the banking structure from this avoidable jolt".¹⁴ Yet the Reserve Bank had some defenses. According to Professor Crumb, who speaks from personal experience, the conditions that warrant the usually tragic decision to close a bank can seldom be clearly established. Bank examiners like doctors may, perhaps, be understood though not necessarily excused, if the idea of euthanasia, even when applied to a bank, may be repellant to them. There are stock holders and life-long employees, as

14. G.P. Gupta, Reserve Bank of India and Monetary Management, Bombay Asia Publishing House, 1962, pp. 252-53

well as depositors, to be considered as long as some chance for recovery still exists. Then too the relatively few decisions that eventually prove to be wrong must be weighed against the many which prove to be right.

The rather subtle suggestion that the Central Government itself may have had a hand in prolonging the life of the Palai Central Bank is supplied in a not too long delayed amendment to the Banking Companies Act which ^{finally} vested the Reserve Bank with conclusive powers over mismanaged banks. Until February 1961 such conclusive powers could be recommended only by the Central Government. As already mentioned in Chapter IV, Part 1, under the provisions of the Banking Companies Amendment Act of 1961 the Reserve Bank could with or without prior Government approval require mergers, amalgamations and reconstructions pending, if necessary, the more drastic request for a liquidation order from the courts.

On Joint Stock Banks' Operations 1949 onward

Neither the monetary policy pursued by the Reserve Bank, nor the exercise of its regulatory authority, appears to have affected materially, the operations of the Joint Stock banks, unless one were to assume that in the long run it served to improve the character of their business and the confidence of their shareholders and depositors. In any event, in conjunction with the State Bank of India and the general improvement of the health of the Indian economy, the business of these banks as a whole, as depicted by their deposits and earning assets, increased substantially during the period under review. Just before and during the Korean conflict their operations increased sharply, and fell off just as sharply when that conflict ended in a stalemate. Thereafter under the

impulse of the budgetary inflation, through which most of the developmental program of the Second Five Year Plan was financed, their business again began to expand rapidly. This, of course, will not slacken off until the Indian budget is again balanced or until more drastic control measures, such as price ceiling and rationing, are used to cover up its inflationary manifestations.

A combined statement of the annual data of all private Joint Stock banks from 1949 onward is presented in Table No.37, page 243.

The table discloses that the number of banks in operation continuously declined from 1949, when there were 589, to 275 in the beginning of 1962 - a decrease of 50 per cent during the period under review. This was, no doubt, due to the Reserve Bank's policy of encouraging the growth of large banks at the expense of smaller ones and the provisions of the 1949 Banking Companies Act requiring all banks to limit their operations entirely to banking business. Meanwhile the number of domestic branches declined from about 4000 in 1949 to somewhat less than 3000 in 1954. Thereafter the number again rose to slightly more than 4000 in March 1962. In the meantime their capital and reserves had dropped from Rs. 647,000,000 in 1949 to Rs. 602,000,000 in 1956, then gradually rose to Rs. 625,000,000 by 1962. In terms of earning assets the size of the average bank in 1950 was slightly over Rs. 10,000,000. By 1962 average earning assets had risen to almost Rs. 40,000,000. Although an inflationary bias is involved, their real progress was nevertheless phenomenal.

After some build up in 1949 and 1950 Indian Joint Stock banks

Table 37

Number, Principal Assets and Liabilities of Private Indian
Joint Stock Banks, 1949-1960, Inc.
(Rs.000,000)

<u>Year</u>	<u>Banks</u>	<u>Number of: Indian Branches</u>	<u>Foreign Branches</u>	<u>Capital and Reserves</u>	<u>Total Deposits</u>	<u>Cash in Hand & at banks</u>	<u>Loans and Discounts</u>	<u>Invest- ments</u>	<u>Total Earning Assets</u>
1949	589	3982	142	647.0	5808.1	1043.5	3038.6	2639.6	5678.2
1950	583	3856	111	647.3	5960.6	1025.9	3153.2	2687.4	5840.2
1951	544	3651	96	631.7	5871.1	969.7	3493.4	2483.5	5931.9
1952	513	3499	93	623.8	5722.8	935.4	3149.5	2510.1	5659.6
1953	503	3450	94	612.4	5965.8	904.8	3349.4	2593.5	5942.9
1954	480	3442	86	606.8	6529.1	977.1	3578.2	2681.7	6439.9
1955	436	3484	95	603.8	7276.0	990.7	4397.7	3000.5	7308.2
1956	404	3459	92	602.2	7990.7	1006.3	5208.3	3023.8	8232.1
1957	371	3531	93	618.0	9089.3	1169.7	5610.5	2970.0	8580.5
1958	354	3713	91	605.8	10271.0	1188.9	5992.3	3975.7	9968.0
1959	342	3865	92	615.5	11732.4	1330.9	7083.4	4481.8	11565.2
1960	327	3969	91	617.1	11855.1	1371.6	8049.3	3934.4	11983.7
1961	275	4005	91	625.3	13003.2	1342.8	8608.9	4168.0	12776.9

243

Source: Adapted from Reserve Bank of India, Statistical Tables relating to Banks in India, 1951-1962, pp. 3-5, and 14-17.

- 1 Data for 1961, being on a revised basis, are not strictly comparable with those of earlier periods.
- 2 Provident Funds and Staff Security Deposits etc., are excluded from Deposits from 1955 onward.
- 3 Money at call and short notices is excluded from Loans and Discounts from 1955 onward.

experienced a rather protracted decline in their operations until the end of 1955 when the effects of the budgetary inflation began to be felt. Total deposits which had attained a high level of Rs. 5,961,000,000 by the end of 1950 subsequently declined to Rs. 5,723,000,000 in 1953. Thereafter their total deposits increased rapidly to Rs. 13,003,000,000 by the beginning of 1962. A similar pattern of progress is revealed by loans and discounts. Their amount had increased to Rs. 3,493,000,000 in 1951 and ^{had} declined to Rs. 3,150,000,000 in 1952. After that year their amount increased steadily and reached Rs. 8,610,000,000 at the end of 1961. Although the investment portfolio increased considerably during this period, its growth was more erratic. The total declined from Rs. 2,687,000,000 in 1951 to Rs. 2,510,000,000 in 1952. After 1952 the amount rose to a new high level of Rs. 4,482,000,000 in 1959 and then declined slightly to Rs. 4,168,000,000 by the end of 1961.

Scheduled and Non-Scheduled Banks

While professing a policy of bringing all banking companies actively within the scope of its jurisdiction and authority, the Reserve Bank continued to restrict its formally associated or scheduled affiliations to banks with a paid up capital of Rs. 500,000 or over. Even after a marked decrease in the number of smaller banks from 1949 onward the average capital of a Joint Stock bank was still only some Rs. 40,000 in 1961 and about 78 per cent of them were still not included in what we have called the Reserve System.

A comparative summary of the growth and relative importance of the scheduled and non-scheduled Joint Stock banks is given in Table 38 on Page 245.

Table 38

Comparative Number, Deposits and Earning Assets of Indian
Scheduled and Non-Scheduled Banks, 1950-1960, Inc.
(Rs.000,000)

	<u>1950</u>	<u>1955</u>	<u>1960</u>
Number of:			
Indian Joint Stock banks.	583	436	327
Scheduled banks	74	71	76
Non-scheduled banks	509	365	251
Share of Scheduled banks.	13%	16%	23%
Number of Branches	3856	3448	7969
Scheduled banks	2317	2307	7180
Non-scheduled banks	1539	1141	789
Share of scheduled banks	61%	67%	90%
Total Deposits	5960.6	7276.0	11855.1
Scheduled banks	5227.0	6574.7	11360.8
Non-scheduled banks . .	733.6	701.3	484.3
Share of scheduled banks	87.6%	90.4%	95.1%
Total Loans and Bills Discounted	3153.2	4307.7	8049.3
Scheduled banks	2677.5	3913.6	7740.4
Non-scheduled banks	457.7	394.1	308.9
Share of scheduled banks	84.9%	90.8%	96.2%
Total Investments	2687.4	3000.5	3934.4
Scheduled banks	2399.4	2692.2	2768.9
Non-scheduled banks	288.0	308.3	165.5
Share of scheduled banks	89.3%	89.7%	95.8%
Average deposits held by all banks	10.2	16.7	36.2
Scheduled banks	80.5	102.5	156.0
Non-scheduled banks	11.7	19.9	47.2

Adapted from tables 37, 39 and 40.

Separate but more detailed data on both classes of banks are given in Tables 39 and 40 on pages 247 and 248.

The data in Table 39 reveal that, while the number of scheduled banks increased slightly from 74 in 1950 to 76 in 1960, it rose percentage-wise from 13 per cent to 23 per cent during the same period. This was due to a decrease of about 50 per cent in the number of non-scheduled banks and an increase in the number of their branches. By the end of 1960 the scheduled banks controlled about 90 per cent of all the branches of Joint Stock banks. Meanwhile the deposits, loans and investments held by the scheduled banks increased from about 88 per cent, 85 per cent and 89 per cent, respectively, in 1950 to about 95 per cent, 96 per cent and 96, respectively, in 1960. In spite of their relatively small number, the scheduled banks, on the latter date, controlled over 95 per cent of the business of the Indian Joint Stock banks.

Concentration of Banking Business

Even among the scheduled banks a handful of large banks enjoy a lion's share of Indian banking business. An important feature of Indian banking system is the concentration of banking business in the hands of a few large banks. As of 1960 there were seventy-seven scheduled banks including the State Bank of India. But there was great variation in the size of these banks. For example, in 1958 the deposits of the Central Bank of India, a scheduled bank, amounted to Rs. 1,591,000,000 and it had 286 branches; the Prabhat Bank, another scheduled bank, had only two branches and its deposits amounted to Rs. 700,000. To show further the concentration of banking business

Table 39

Number, Principal Assets and Liabilities of Non-Scheduled Banks, 1949-1961 Inc.
(Rs. 000,000)

<u>Year</u>	<u>Number of Reporting Banks</u>	<u>Branches</u>	<u>Capital and Reserves</u>	<u>Total Deposits</u>	<u>Cash in Hand and at banks</u>	<u>Loans & Bills dis- counted</u>	<u>Invest- ments</u>	<u>Total Earning Assets</u>
1949	521	1583	135.9	715.5	118.4	528.0	221.0	749.0
1950	509	1529	141.7	733.6	114.4	475.7	288.0	763.7
1951	469	1463	133.7	697.7	112.3	474.2	265.8	740.0
1952	438	1328	140.0	627.6	101.2	436.6	241.3	677.9
1953	431	1261	137.5	635.4	100.7	425.1	246.3	671.4
1954	409	1198	136.1	668.3	106.0	424.1	267.7	691.8
1955	365	1141	127.8	701.3	102.7	394.1	308.3	702.4
1956	333	1100	120.8	737.5	100.6	425.4	319.5	744.9
1957	298	947	94.7	518.1	79.1	347.1	175.2	522.3
1958	298	862	77.5	475.9	80.4	303.1	158.3	461.4
1959	265	828	73.9	512.2	87.1	321.3	161.2	482.5
1960	251	789	69.4	484.3	75.2	308.9	165.5	474.4
1961	208	629	58.1	398.8	61.9	250.2	141.7	391.7

247

Source: Adapted from Reserve Bank of India, Statistical tables Relating to Banks in India, 1951, 1956, and 1961. pp. 3-11.

- 1 Figures for 1961 are on revised basis; therefore are not strictly comparable for those of earlier years.
- 2 Provident Fund and Staff security deposits, etc. are excluded from 1955 onward.
- 3 Money at call and at short notice has been excluded from loans and advances from 1955 onward.

Table 40

Number, Principal Assets and Liabilities of Privately owned Indian Scheduled Banks
1949-1961 Inc. (Rs.000,000)

Year	Number of:		Capital and Reserves	Total Deposits	Cash in Hand and at Banks	Loans and Bills dis- counted	Invest- ments	Total Earning Assets
	Reporting Banks	Branches						
1949	77	2399	511.1	5092.6	925.1	2510.6	2418.6	4924.2
1950	74	2317	505.6	5227.0	911.5	2677.5	2399.4	5076.9
1951	75	2188	498.0	5173.4	857.4	3019.2	2172.7	5191.9
1952	75	2171	483.8	5095.2	834.2	2712.9	2268.8	4981.7
1953	72	2189	474.9	5330.4	804.1	2924.3	2347.2	5271.5
1954	71	2244	473.7	5860.8	871.1	334.1	2414.0	5748.1
1955	71	2307	476.0	6574.7	888.0	3913.7	2692.2	6605.8
1956	71	2359	481.4	7253.2	905.7	4782.9	2704.3	7487.2
1957	73	2584	523.3	8571.2	1090.6	5263.4	2794.8	8058.2
1958	76	2851	528.3	9795.1	1108.5	5689.2	3816.4	9505.6
1959	77	3037	541.6	11220.2	1243.8	6762.1	4320.6	11082.7
1960	76	3180	547.7	11370.8	1296.4	7740.4	3768.9	11509.3
1961	66	3376	567.2	12604.4	1280.9	8358.7	4026.3	12385.0

Source: Adapted from Reserve Bank of India, Statistical tables relating to Banks in India, 1951, 1956, and 1961.
Pp. 3-11.

- 1 Figures for 1961 are on a revised basis, therefore are not strictly comparable with those for preceding years.
- 2 Provident Fund and Staff security deposits, etc., are excluded from deposits from 1955 onward.
- 3 Money at call and short notice is excluded from loans and advances from 1955 onward.

during 1961 we may consider Table 41 on page 250.

The data in this Table reveal that of the total deposits of all the Indian scheduled and non-scheduled banks, amounting to Rs. 18,328 millions in 1961, as much as Rs. 14,024 million or about 76 per cent was held by the Country's ten largest banks. If we take into account the deposits of foreign scheduled banks (Exchange banks) as well, which amounted to Rs. 2,565 million during this year, the share of the first ten banks still stands about 67 per cent of the total deposits of all the banks in India. Even among these ten banks, the first five banks held the major portion of banking business in India. As we can see from the table the share of the first five banks was about 60 per cent of the total deposits of all the Indian Joint Stock banks. This ratio drops to a little over 51 per cent if we also take into account the deposits of Exchange banks. The data in the above table reveal a similar concentration with respect to the investments, and to loans and discounts. Of the latter totals, the shares of the first ten banks amounted to about 78 per cent and 82 per cent, respectively; that of the first five banks, about 60 per cent and 71 per cent, respectively. If we take into account the banking business of Exchange banks as well, the relative shares of the first ten banks are still overwhelming. Of the loans and the investments of all banks in India, the first ten banks hold as much as 51 per cent and 78 per cent, respectively; the first five, as much as 50 per cent and 68 per cent, respectively.

250
Table 41

Relative Importance of the Ten largest Indian
Banks at the end of 1961
(Rs.000,000)

Name of Bank	Total			No. of Branches
	Deposits	Loans & Bills Disc.	Invest- ments.	
State Bank of India	5324.6	2553.1	4363.3	946
Central Bank of India	2147.3	1606.9	589.0	334
Punjab National Bank	1476.2	932.2	494.9	417
Bank of India	1212.0	985.2	266.4	65
United Commercial Bank	955.9	643.1	359.7	138
Total of 1st Five Banks . .	<u>11,116.0</u>	<u>6720.5</u>	<u>6077.3</u>	<u>1900</u>
Bank of Baroda	953.6	703.7	249.0	141
United Bank of India	582.0	376.1	177.1	98
Allahabad Bank	554.8	314.2	225.1	92
D. N. Banking Company	421.6	300.5	127.6	140
Indian Bank	396.1	257.0	130.7	107
Total of 1st ten Banks	<u>14,024.1</u>	<u>6872.0</u>	<u>6986.8</u>	<u>2478</u>
Total of all Indian sched- uled and Non-scheduled banks	18,237.6	11,162.0	8535.3	4951
Total of all scheduled and Non-scheduled banks	20,892.6	13,458.6	8973.2	5022
First 5 banks' share of Indian scheduled and non-scheduled banking business	60.7%	60.2%	71.2%	38.4%
First 10 banks' share of Indian scheduled and non-scheduled banking business	76.5%	77.7%	81.9%	50%
First 5 banks share of all banking business	53.2%	49.9%	67.7%	37.8%
First 10 banks share of all banking business	67.1%	51.1%	77.9%	49.3%

Source:
Adapted from Reserve Bank of India, Statistical tables relating to Banks in India,
Bombay, 1961, pp. 7-35.

Part 3

The Exchange Banks

The Indian branches of foreign banks did not on the whole make any real progress from 1949 onward. In spite of their predominant position in the financing of the Country's external trade, and some encroachments on the internal trade as well, they lost ground both to the State Bank of India and to the Indian Joint Stock banks. This was due for the most part to expansion of the facilities of the Indian banks, but it also reflects the application of some discriminatory measures designed to constrain the magnitude, scope and profitability of Exchange banks. They were no longer allowed the privileged position they held before the Country's independence.

Effects of the 1949 Banking Companies Act

Among the additions to existing legislation incorporated in the Banking Companies Act of 1949 was the requirement that each foreign bank operating in India have a paid up capital and reserves of at least Rs. 1,500,000. If it has a place of business in Calcutta or Bombay or both the amount is Rs. 2,000,000.¹⁵ They were also required to publish an audited statement of their assets and liabilities. The Act further required that all foreign banking companies maintain not less than 75 per cent of their assets in the provinces of India.¹⁶ In the event of bankruptcy, in order to assure that the Indian creditors of Exchange banks were fully compensated, it is laid down that in the event of their failure

15. Government of India, Banking Companies Act, 1949, Section 11(2).

16. Ibid, Section 25 (1)

or otherwise the deposits of the failing bank with the Reserve Bank shall be treated as assets on which the claims of all its creditors shall be a first charge.¹⁷ As these banks did not reveal their capital funds and the extent of their operations prior to this measure, it was reasonable to require the Exchange banks to publish the extent and scope of their business and to provide for capital funds in India. However the amount of capital funds which these banks were to keep with the Reserve Bank, either in cash, in unencumbered securities or a combination of both, appears to be little short of prohibitive. It was three times that required of the scheduled banks and, to make it even more restrictive the Act by implication did not permit individual banks to count their premises and physical equipment as an equivalent part of their capital investment, as would have been the case of any Indian Joint Stock bank. The whole sum was to be deposited in the Reserve Bank in cash or in unencumbered securities. The latter, being for the most part Government bonds, did not yield nearly as much as either the external or internal bills typically held by these banks.

The 1949 measure, as already emphasized, gave the Reserve Bank the authority to pass upon licenses for new branches. This authority was used to restrict the activities of foreign banks to locations already held. Though no example of its exercise is given, the Reserve Bank also had the power to defeat any circumvention of the branch restriction by virtue of its authority to pass upon amalgamations and purchases. The latter had been one of the principal ways in which the foreign banks had gained direct representation in the interior centers of the Country.

17.

Government of India, op. cit., Section 25 (1)

Trend in Operations 1949 onward

A summary of the operations of the Exchange banks between 1949 and 1961 is presented in Table No. 42 on page 254. The data in this table reveal on the whole a pattern not unlike that of Indian Joint Stock banks but without the very rapid growth enjoyed by the latter group after 1955. Total deposits of the Exchange banks had recovered by 1954 from the declines that followed the Korean conflict but thereafter, in response to the general inflation during the Second Five Year Plan, did not increase spectacularly. From Rs. 1,785,000,000 in 1954 the total moved up to Rs. 2,041,500,000; in 1957, fell off slightly in 1957, then moved up to Rs. 2,565,000,000 in 1961. A somewhat more erratic course was followed by loans and bills discounted by the Exchange Banks. The amount increased considerably from Rs. 1,221,000,000 to Rs. 1,745,000,000 during the Korean conflict but thereafter declined to Rs. 1,311,500,000 in 1953. Subsequently in 1956 the amount increased to Rs. 2,019,000,000. By 1958, however, it had dropped back to Rs. 1,601,000,000 but reached a new peak of Rs. 2,296,700,000 by the end of 1961. Meanwhile total investments did not show any expansion. In fact during the period under review the amount decreased from Rs. 503,000,000 in 1949 to Rs. 438,000,000 in 1961.

In the absence of revealing comparisons of all important banking institutions in India, one might assume from the above table that the Exchange banks had done quite well from 1949 onward, in spite of the limitations imposed upon their operations under the Banking Companies Act of 1949. This may be true but they, nevertheless, lost considerable ground, relatively speaking, to the State Bank of India and to the Joint Stock banks.

Table 42
Number, Principal Assets and Liabilities of Exchange Banks,
1949-1961 Inc. (Rs.000,000)

<u>Year</u>	<u>Number of</u>		<u>Allocated</u>	<u>Total</u>	<u>Cash on</u>	<u>Loans and</u>	<u>Invest-</u>	<u>Total</u>
	<u>Banks</u>	<u>Branches</u>	<u>Capital</u>	<u>Deposits</u>	<u>Hand and</u>	<u>Discounts</u>	<u>ments</u>	<u>Earning</u>
					<u>at Banks</u>			<u>Assets</u>
1949	16	76	240	1658.8	153.9	1221.0	502.8	1723.8
1950	16	66	240	1741.6	191.3	1357.4	496.1	1853.5
1951	16	65	240	1698.4	248.4	1745.2	463.0	2208.2
1952	15	65	225	1765.0	168.3	1503.1	443.8	1946.9
1953	16	68	240	1685.4	145.9	1311.5	470.0	1781.5
1954	16	66	240	1784.9	160.5	1506.9	482.3	1987.2
1955	17	67	255	1944.6	178.0	1679.5	496.7	2176.2
1956	17	67	255	1875.4	178.3	2018.6	421.4	2440.0
1957	17	67	255	2041.4	201.7	1942.9	433.0	2375.9
1958	16	66	240	1957.6	146.2	1600.9	427.9	2028.8
1959	16	66	240	2262.1	180.5	1710.9	452.8	2163.7
1960	16	69	240	2389.5	217.4	2111.7	407.7	2519.4
1961	15	71	225	2565.0	232.2	2296.7	437.9	2734.6

Source: Reserve Bank of India, Statistical Tables relating to Banks in India, 1952, 1958, 1961.
pp. 3 - 7.

Comparative Importance of Primary Lenders in the Indian Banking System

By way of concluding the analysis of what one may call the primary lenders in Indian banking structure in comparison by number, deposits and earning assets have been worked out and presented in Table 43 on page 256.

This summary reveals that the State Bank of India, which^{as}/the Imperial Bank had been stigmatized by its foreign ownership and management until its nationalization in 1955, had more than fully recovered its share of Indian deposits and earning assets by 1960. By 1960 the State Bank operated 18 per cent of all the bank branches in India; and held 29 per cent of the Country's commercial banking deposits, 18 per cent of its loans and bills discounted, and 41 per cent of total bank investments.

The Table also reveals that the more numerous Joint Stock banks made similar progress while reducing very considerably the number of their banking locations. Between 1955 and 1960 the share of Joint Stock banks of the Country's banking deposits decreased from 64 per cent to 59 per cent; their share of the loans and bills discounted increased from 61 per cent to 66 per cent, and their share of the total bank investment decreased from 64 per cent to 53 per cent. During the period under review these banks continued to hold their relative share of the Indian banking business.

Meanwhile it appears that Exchange banks lost considerable business to the State Bank of India and some to the Joint Stock banks. Between 1950 and 1960 their share of the country's banking deposits dropped from 17.4 per cent to 12 per cent; their share of the Country's total bank loans and bills discounted dropped from 24 per cent to 16 per cent; and their investment holdings declined from 10.6 per cent to 5.5 per cent.

Table 43

Relative Importance of Primary Lenders in the Indian Banking
Structure in Years 1950, 1955 and 1960
(Rs.000,000)

		<u>Number of</u>		<u>Deposits</u>	<u>Loans and Discounts</u>	<u>Invest- ments</u>
		<u>Banks</u>	<u>Branches</u>			
<u>Totals:</u>	1950	600	4314	10,015.9	5,530.1	4,399.0
	1955	454	4035	11,418.6	7,045.3	4,667.0
	1960	344	4939	20,017.7	7,409.7	13,083.4
<u>State Bank of India:</u>						
	1950	1	382	2,313.7	1,019.5	1,215.5
	1955	1	484	2,198.0	1,058.1	1,169.8
	1960	1	901	5,773.1	2,322.4	3,067.6
<u>% of Total:</u>						
	1950		8.9	23.1	18.5	27.6
	1955		12.0	19.3	15.0	25.1
	1960		18.2	28.8	17.8	41.4
<u>Indian Joint Stock Banks:</u>						
	1950	583	3856	5,960	3,153.2	2,687.4
	1955	436	3,484	7,276	4,307.7	3,000.5
	1960	327	3,969	11,855.1	8,649.3	3,934.4
<u>% of Total:</u>						
	1950		89.1	59.5	57.0	61.1
	1955		86.0	63.7	61.2	64.3
	1960		80.4	59.2	66.1-	53.1
<u>Exchange Banks:</u>						
	1950	16	76	1,741.6	1,357.4	496.1
	1955	17	67	1,944.6	1,679.5	496.7
	1960	16	69	2,389.5	2,111.7	407.7
<u>% of Total:</u>						
	1950		2.0	17.4	24.5	17.3
	1955		1.6	17.0	23.8	10.6
	1960		1.4	12.0	16.1	5.5

Source: Adapted from tables 42 and 37 for this chapter and from table 30 in chapter 5.

The Table on page 256 reveals a noteworthy contrast in the progress made by the different categories of Indian banks. The State Bank of India considerably improved its share of the Indian banking business. Although the Joint Stock banks apparently did not gain at the expense of other categories, they did maintain their relative share of the Country's banking business. In fact they encroached somewhat upon the loans and bill business of the Exchange banks. The Exchange banks lost ground in all areas of operations.

A quite incidental but significant point is suggested by the contrasting changes in the investment portfolio of the State Bank of India with that of the Exchange banks. Both the absolute and relative amount of investment media held by the State Bank rose rather spectacularly under the pressure of budgetary inflation, but an equally spectacular reverse course is noted in the totals reported by the Exchange banks.

Part 4

The Cooperative Banks

In spite of the Government's attempts to relieve the debt burden of the rural population through the development of Cooperative banks, the progress recorded by these institutions until 1949 had fallen considerably short of the high expectations of their architects. Even after 40 years of experimentation these banks have provided only an insignificant part of the rural credit needs of the Indian economy. As recently as 1951 the money lenders still provided an estimated 70 per cent of all rural credit in India; Cooperative banks, only 3 per cent.¹⁸ Recognizing, however, the potentialities of the cooperative

¹⁸. The Reserve Bank of India, All India Rural Credit Survey, Vol. II, The General Report, 1957, p. 326

movement in the dual socio-economic development of the underprivileged section of the rural population of India, the Government and the Reserve Bank of India persisted in their efforts. From 1944 onward additional steps were taken to improve the working and the lending capacity of Cooperatives and the Land Mortgage Banks. Though some of the measures adopted during this period are fairly general and apply to all classes of cooperative credit institutions, their impact on the rural credit problem may be ^{more} easily understood if the Cooperative banks and Land Mortgage banks are treated separately.

Measures relating to Cooperative Banks

Realizing the fact that the Cooperative banks had not been able to meet the credit needs of rural India, the Informal Conference on Rural Finance was held in 1951 to study and recommend immediate measures to increase the availability of Reserve Bank credit to the Cooperative banks. The Conference suggested various procedural changes with respect to Reserve Bank loans to State Cooperative banks under which the latter were given increased access to the Reserve Bank credit. The earlier stipulation that all loans be repaid by September 30th of each year was set aside, and thereafter each loan was to be treated as a separate transaction to be repaid only after full duration of the time period. The credit limits granted to Cooperative banks were originally based on total borrowings during a year. This was changed to total loans outstanding during the year. Thus the loans repaid can be drawn again during the same period. These measures have enabled the Cooperative banks to make better use of the Reserve Bank's lending facilities.

In addition to the modification of existing lending practices respecting the Cooperative banks, the Informal Conference recommended that the Reserve Bank Act be amended to extend the Bank's lending facilities to non-credit cooperative ventures and to provide medium term as well as short term loans (from eighteen months to five years) as well as short term advances to Cooperative banks. In view of these recommendations and those of earlier committees the Reserve Bank Act was amended in 1953 to bring animal husbandry, mixed farming and crop processing within the scope of the Reserve Bank's lending facilities.¹⁹ The Bank was also granted permission to make medium term loans to State Cooperative banks with a maximum limit of Rs. 50,000,000 to a State Corporative bank.²⁰ These loans were to be granted/a concessional rate of 2 per cent. below the Bank Rate. Subsequently the upper limit on advances was withdrawn and in 1956 the National Agricultural Credit (Long Term Operations) Fund was set up to supplement the credit available at the Reserve Bank.

In 1954 the All India Credit Survey Committee, after an exhaustive study of Rural Credit problems in the Country, recommended a complete over hauling of the existing cooperative set up. Its recommendations may be summed up briefly as follows:²¹

- i. The States should join in partnership with the Cooperatives in order to provide adequate capital funds.
- ii. Provision should be made for the coordination of cooperative credit and non-credit ventures, e.g., the marketing and processing of agricultural produce.
- iii. Steps should be taken to provide adequately trained personnel for the operation of cooperative ventures.

19. Government of India, Reserve Bank (Amendment) Act, 1953, Section 17(2)(b)

20. Ibid, Section 17 (2) (b)

21. Reserve Bank of India, All India Rural Credit Survey, Vol. II, General Report, Bombay, 1954, pp. 382-90.

In order to implement these recommendations the Reserve Bank Act was amended in 1955 to provide among other things for the creation of a National Agricultural Credit (Long-term Operations) Fund and for a National Agricultural Credit (Stabilization) Fund. These Funds were to be set up by the Reserve Bank in the initial amounts of Rs. 100,000,000 and Rs. 10,000,000, respectively.²² In addition to these initial amounts the Reserve Bank was to contribute Rs. 50,000,000 and Rs. 10,000,000 annually to the respective funds for the following five years when the operations of these funds were to be reviewed.

The Long-term operation Fund was to be utilized i) for making long term loans to State Governments to enable them to subscribe, directly or indirectly, to the share capital of Cooperative credit institutions and to purchase debentures of Land Mortgage Banks and ii) for providing long and medium term loans to State Cooperative banks and to Land Mortgage banks. The Stabilization Fund was to be used for making medium term loans to State Cooperative banks to enable them to pay their short term loans if, in the opinion of the Reserve Bank, the Cooperatives were unable to repay such loans in due time owing to some natural calamity such as draught, famine etc.

As provided in the Act, the National Agricultural Credit (Long term operations) Fund was set up in February 1956. By the end of June 1961 Rs. 500,000,000 had been paid into it. Of this sum about Rs. 264,000,000 was advanced to various State Governments to enable them to subscribe to the share capital of cooperative credit institutions. Of the total amount of such loans advanced as much as Rs. 243,700,000

was outstanding by the end of June 1961.²³ The loans were usually made for twelve years, carry no interest rate for the first two years, 2 per cent for the next three years, 2½ per cent for the next four years and 3 per cent for the remaining three years.²⁴ The National Agricultural Credit (Stabilization) Fund was established in 1956. By the end of June 1961 Rs. 60,000,000 had been credited to it. However, no occasion had arisen to employ it.

Inspection and Training of Personnel

While these several steps were being taken to expand the lending operations of both the Cooperative banks and the Land Mortgage Banks, the Reserve Bank and the Central Government initiated plans to improve the working of the corporations by providing training facilities for their personnel. By 1955 training centers for both administrative and junior personnel of cooperative banks had been established at Poona, Indore, Meerut, Madras and Ranchi. In the following year the training had been extended to courses in Land Mortgage Banking and other aspects covering cooperative banking. During 1960 as many as 76 senior officers, 353 officers for cooperative marketing, 82 officers for Land Mortgage banks and 5494 Juniors were provided training in their respective fields at the various training centres. This was an important step toward rationalizing and expanding the cooperative movement, including cooperative banking.

During 1952 the Reserve Bank began a system of voluntary inspection which were designed to be educational as well as informative. By June 1960 a total of 1020 such inspections had been completed. Of

23. Reserve Bank of India, Report on Currency and Finance, 1961-62, Bombay, 1962, p. 52.

24. E.M. Hough, The Cooperative Movement in India, 4th ed, Bombay, Oxford University Press, 1959, p. 403.

these inspections as many as 238 had been completed by that time - 67 in the State Cooperative banks and 6 in the Central Land Mortgage Banks.²⁵

Operations of Cooperative Banks

There is no way of determining by how much the very considerable concessions made to the cooperative movement during the 1950-60 decade may have added to its tangible achievements. We have already been told that, substantial as these achievements may have been, they did not seriously encroach upon the operations of the Indigenous bankers and money lenders. Even so, in terms of their modest beginnings real progress was made and very considerable help was given to the agricultural sector of the Indian economy. Comparative data, for Central and State Cooperative banks, unfortunately, were not available to the author beyond 1959. However those for the Primary Credit Societies were available, though in a fragmentary fashion. They are presented below.

The Primary Credit Societies

During the period under review the number of Primary Credit Societies which underlie the whole cooperative structure, after a short decline from 116,500 in 1949 to 107,900 in 1951, considerably increased to 221,000 by the end of the period under review. The rise in their membership from 4,746,800 in 1951 to 21,000,000,000 by the end of 1961 is much more spectacular. As a result average membership increased from 44 to 95. Working capital, made up of membership subscription, deposits and advances from Central and State Cooperative banks, rose from Rs. 352,200,000 in 1949 to Rs. 2,237,000,000 by the end of 1959 -

²⁵. G.P. Gupta, The Reserve Bank of India and Monetary Management, New York, Asia Publishing House, 1961, p. 322

an over six-fold increase. Although a full comparison of the loans is not available, those advanced during the year increased from Rs. 180,000,000 in 1949 to Rs. 2,400,000,000 by the end of 1961. At the end of 1959 as much as Rs. 1,771,100,000 was outstanding. Annual data revealing the progress of these credit societies between 1949 and 1961 is presented in Table No. 44 on page 264.

Central Cooperative Banks

A substantial but understandably less phenomenal growth was experienced by the second tier Central Cooperative banks which provide a liaison between the Primary Credit Societies and the State Cooperative Banks. Annual data showing their progress between 1949 and 1959 is presented in Table No. 45 on page 265.

The data in this table show that the number of Central Cooperative banks, after an initial increase from 498 in 1949 to 509 in 1951, had considerably declined to 400 by the end of 1959. This decrease was due to the deliberate policy of ^{the} respective State Governments to reduce the number of these banks so as to have, as recommended by the All India Rural Credit Survey Committee, one strong, viable central bank for one district. However, there was a considerable increase in their membership which rose from 190,100 in 1949 to 369,000 in 1959. Meanwhile total working capital, made up of money borrowed from State Cooperative banks and the Reserve Bank, deposits of Primary Credit Societies and other individuals or organizations, and capital funds, continuously increased from Rs. 498,700,000 in 1949 to Rs. 2,474,000,000 in 1959 - a really phenomenal growth even after allowing for the inflationary factor of about 26 per cent. The comparative increase in loans outstanding

Table 44

Number, Loans and Working Capital of Primary Credit Societies,
1950-1961 Inc. (Rs.000,000)

Year Ending June	<u>Number in ,000</u>		<u>Working Capital</u>	<u>Loans Total Advanced</u>	<u>Loans Out- standing</u>	<u>Loans Over- due</u>
	<u>Societies</u>	<u>Members</u>				
1949	116.5	4,817.5	352.2	179.9	N. A.	N. A.
1950	115.5	5,153.9	409.6	228.9	N. A.	N. A.
1951	107.9	4,746.8	452.2	242.1	N. A.	N. A.
1952			--- Not Available ---			
1953	126.9	5,849.3	544.1	296.4	N. A.	N. A.
1954	143.3	6,565.4	629.3	354.8	N. A.	N. A.
1955	159.9	7,790.8	791.0	496.2	598.4	149.6
1956	161.5	9,116.8	983.0	673.3	768.2	168.2
1957	166.5	10,221.2	1,337.5	960.8	1,071.0	227.9
1958	182.9	11,901.0	1,709.4	1,255.0	1,350.0	269.0
1959	203.2	14,423.0	2,237.0	1,690.9	1,777.1	377.0
1960	213.0	17,300.0	N. A.	2,080.0	N. A.	N. A.
1961	221.0	21,000.0	N. A.	2,400.0	N. A.	N. A.

264

Source: Adapted from India, Ministry of Information and Broadcasting, India, 1954-1962,
Chapters on Cooperative Movement.

Table 45

Number and Business of Central Cooperative Banks, 1949-1959 Inc.
(Rs.000,000)

Year Ending June	No. of Banks	Member- ship .,000	Working Capital						Earning Assets			
			Owned Funds			Borrowed Funds			Total working Capital	Loans outstand- ing	Invest- ments	Total
			Paid up Capital	Reserve funds	Total	Depo- sits	Bor'd money	Total				
1949	498	190.1	35.4	45.3	80.7	N. A.	N. A.	418.0	498.7	289.2	N. A.	N. A.
1950	505	207.1	40.4	47.9	88.3	N. A.	N. A.	475.4	563.7	341.4	N. A.	N. A.
1951	509	231.3	46.2	51.9	98.1	382.4	120.7	503.1	601.1	359.1	167.6	526.7
1952	505	249.9	51.9	54.8	106.6	391.0	114.6	505.6	612.3	359.1	176.1	535.2
1953	499	247.9	60.0	58.0	118.1	411.9	131.1	543.0	661.2	384.3	188.4	572.7
1954	485	272.0	69.2	661.4	130.6	463.7	142.7	606.4	736.9	428.9	198.8	627.7
1955	478	299.6	85.0	66.5	151.5	557.1	218.0	775.1	926.7	543.4	232.8	776.2
1956	451	310.6	111.1	73.4	184.5	584.8	333.3	918.1	1102.6	719.0	290.5	1009.5
1957	418	322.8	170.7	79.2	249.9	668.8	551.3	1220.1	1470.0	1010.0	285.4	1295.4
1958	402	341.1	231.4	85.4	316.8	779.8	799.7	1579.4	1896.2	1308.3	359.5	1667.8
1959	400	369.0	314.9	102.0	416.9	954.1	1103.0	2057.1	2474.0	1761.1	411.2	2172.3

Source: Adapted from: 1 Reserve Bank of India, Bulletin, October, 1961. pp. 1604-08.
 2 Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 422-423.
 3 India, Ministry of Information and Broadcasting, India, 1954-1962, Chapters on Cooperative Movement.

was from Rs. 289,200,000 to Rs. 1761,100,000. Data on investments are not available until 1951, but between 1951 and 1959 the amount rose from Rs. 167,600,000 to Rs. 411,200,000. It indicates that a considerable part of the money borrowed from the State Cooperative banks to support agricultural loans was not used for that purpose. It appears to have been employed as a sort of 'window dressing' exercise to support the market for Government securities and other investment media.

State Cooperative Banks

The increase in the working capital of the Primary Credit Societies and Central Cooperatives, as one would expect, is reflected in the growth of State Cooperative banks from which these first and second tier institutions obtain the bulk of their loanable funds. Data showing their progress between 1949 and 1959 is presented in Table No. 46 on page 267. A glance at this table reveals that, like the Central Cooperative banks, the State Cooperatives have experienced a phenomenal growth during this period. By the end of 1959 all States had established a State Cooperative bank - some of them had even more than one; i.e., Punjab, Madras, and Uttar Pradesh. Their number had increased from 14 in 1949 to a peak of 24 in 1955 after which it declined to 22 in 1959. This decline is due to ^{the} reorganization of Indian states in 1956 and the consequent merger or amalgamation of some of the State Cooperative banks. Their membership increased from 18,900 in 1949 to a peak of 36,400 in 1956. After the latter year individual membership in these banks was discouraged. Consequently their membership dropped to 31,000 in 1959. It is interesting to note that, whereas

Table 46

Number and Business of State Cooperative Banks, 1951-1959 Inc.
(Rs.000,000)

Year Ending June	No. of Banks	Member ship 000.	Working Capital						Earning Assets			
			Owned Funds			Borrowed Funds			Total Working Capital	Invest- ment	Out- standing Loans	Total
			Paid up Capital	Reserve Funds	Total	Deposits	Borr'd money	Total				
1949	14	18.9	13.5	26.8	34.3	N. A.	N. A.	270.2	304.5	N. A.	141.2	N. A.
1950	15	20.9	15.8	22.2	38.0	N. A.	N. A.	306.2	344.2	N. A.	179.0	N. A.
1951-52	16	23.3	19.0	23.6	42.6	211.8	112.7	324.6	367.2	113.0	200.1	313.1
1952-53	17	25.6	21.7	27.3	49.0	242.0	95.5	337.5	386.4	133.6	199.6	333.2
1953-54	22	32.9	27.5	28.6	56.1	249.0	103.3	352.3	408.4	130.6	226.9	357.5
1954-55	24	36.3	32.4	33.1	65.4	289.5	121.4	410.8	476.3	143.8	244.1	387.9
1955-56	24	36.4	43.7	32.8	76.5	366.7	190.2	556.9	633.4	183.9	347.7	531.6
1956-57	23	33.4	53.1	34.8	87.9	383.9	323.7	707.6	795.4	199.6	496.2	695.8
1957-58	21	32.2	84.7	34.5	119.3	454.5	517.6	972.1	1091.4	253.0	747.3	1000.3
1958-59	22	32.0	105.6	43.6	149.2	584.4	744.0	1328.4	1477.7	319.5	1012.2	1331.7
1959-60	22	31.0	146.2	50.7	196.9	601.5	948.9	1550.5	1747.4	282.1	1298.6	1580.7

Source: Adapted from: 1 Reserve Bank of India, Bulletin, October 1961, pp. 1604-08.
 2 Reserve Banks of India, Banking and Monetary Statistics of India, Bombay, 1954, pp. 410-411.
 3 India, Ministry of Information and Broadcasting, Publications Division. India, 1954-1962. Chapters on Cooperative Movement.

their capital funds increased from Rs. 34,300,000 in 1949 to Rs. 197,000,000 in 1959, their working capital, made up of capital funds, deposits, and borrowed money increased from Rs. 304,500,000 to the substantial sum of Rs. 1747,400,000 during the same period. The rapid increase in working capital was due to an increase in deposits and borrowed money, particularly the latter. Borrowed funds increased from Rs. 112,700,000 in 1951 to Rs. 949,000,000 in 1959. The increase in borrowed funds was especially noticeable after 1955 when the amount rose from Rs. 517,000,000 to Rs. 949,000,000 - an increase of 54 per cent.

In response to a considerable increase in demand for loans after 1955 the respective State Governments increased the statutory limits imposed on borrowing by the State Cooperatives. At present such limits vary from ten to twenty times their capital funds. During the period under review their outstanding loans gradually increased from Rs. 141,200,000 in 1949 to Rs. 244,000,000 in 1954 and then sharply rose to Rs. 1,298,000,000 in 1959. This may be attributed to an expansion of their lending activity during the Second Five Year Plan. During the same period investments increased from Rs. 113,000,000 in 1951 to Rs. 282,000,000.

Operations of Land Mortgage Banks

Data available to the author on the operations of Land Mortgage banks are fragmentary but can be pieced together for the period, 1949 to 1959 inclusive, for both the Primary Land Mortgage banks and the Central Land Mortgage banks.

Primary Land Mortgage Banks

Data revealing the progress of the Primary Land Mortgage Banks are presented in Table No. 47 on page 270.

In this table it will be seen that during the first six years under review, 1949 to 1954, the progress made by these Banks was rather discouraging. Their number increased from 283 to only 292; their membership from 186,000 to 290,000. Loans made during this period increased from Rs. 10,000,000 to only Rs. 14,500,000. However after 1954 there was a substantial growth was recorded by these Banks. By the end of 1959 their number had increased to 408 and their membership, to 550,400. Total advances made during this period increased from Rs. 14,500,000 to Rs 51,000,000 - an increase of about 360 per cent. However, the latter sum fall far short of the working capital available to these Banks. The latter, made up for the most part of the proceeds of debentures and Reserve Bank advances made available through the Central Land Mortgage banks, rose from Rs. 86,600,000 in 1950 to the substantial amount of Rs. 203,900,000 in 1959.

Central Land Mortgage Banks

With respect to the Central Land Mortgage banks data available are more complete and revealing than for the Primary Land Mortgage banks. Growth of these central institutions between 1949 and 1959 is presented in Table No. 48 on page 271.

The data in this table reveal that, while the number of Central Land Mortgage banks has increased from 5 in 1949 to 16 in 1959, their membership grew from 8000 to 216,500. Although their capital funds

Table 47

Number, Loans and Working Capital of Primary Land
Mortgage Banks, 1949-1959, Inc.
(Rs. 000,000)

<u>Year</u>	<u>Number</u>	<u>Membership</u>	<u>Loans and Advances</u>	<u>Working Capital</u>
1949	283	186,000	9.2	58.6
1950	286	215,100	12.9	66.6
1951	289	213,800	13.0	75.9
1952	N. A.	N. A.	N. A.	N. A.
1953	291	265,200	14.1	95.5
1954	292	290,100	14.5	104.2
1955	302	313,800	17.4	113.5
1956	326	333,600	20.5	127.0
1957	347	375,900	25.2	140.6
1958	363	440,200	32.7	165.0
1959	408	550,400	51.0	203.9

Source: India, Ministry of Information and Broadcasting, India, 1954-1962,
Chapters on Cooperative Movement.

Table 48

Number, Loans and Working Capital of Central Land Mortgage Banks
1949-1959, Inc. (Rs.000,000)

<u>Year Ending June</u>	<u>No. of Banks</u>	<u>Member- ship (000)</u>	<u>Working Capital &</u>				<u>Earning Assets</u>	
			<u>Capital and Reserves</u>	<u>Dep & borr'd money</u>	<u>Deben- tures</u>	<u>Total</u>	<u>New Loans</u>	<u>Loans out- standing</u>
1949-50	5	8.0	5.6	4.9	58.2	68.7	10.1	51.2
1950-51	5	9.0	6.5	3.2	67.5	77.2	13.3	59.8
1951-52	6	34.6	8.1	15.3	78.3	101.7	25.1	80.5
1952-53	N. A.	N. A.	N. A.	N. A.	N. A.	N. A.	N. A.	N. A.
1953-54	9	49.7	10.4	14.4	114.5	139.3	19.2	103.5
1954-55	9	65.4	11.9	19.9	127.1	158.9	24.4	116.2
1955-56	9	90.3	13.2	22.6	149.4	185.2	28.3	130.8
1956-57	12	116.6	17.1	26.7	169.5	213.2	38.0	149.4
1957-58	15	151.4	29.7	20.5	204.8	258.8	46.2	198.2
1958-59	15	185.3	37.2	26.4	244.6	313.5	60.1	226.4
1959-60	16	216.5	45.0	53.4	270.7	373.8	85.2	285.0

Adapted from: 1 S. R. K. Rao, The Indian Money Market, Allahabad, Chaitanya Publishing House, 1959, p. 238.

2 Reserve Bank of India, Banking and Monetary Statistics of India, Bombay, 1954, p. 504.

3 India, Ministry of Information and Broadcasting, India 1955-1962, Chapters on Cooperative Movement.

increased from Rs. 5,600,000 in 1949 to Rs. 45,000,000 in 1959, the increase in the total amount of their working capital, including deposits, borrowed money and debenture was from Rs. 68,700,000 to Rs. 373,800,000. The increase was mainly due to the sale of additional debentures which were guaranteed by the Government. This guarantee coupled with the Reserve Bank's policy of taking up as much as 2/3 of the total offered had considerably increased their marketability. The demand for their new loans appears to have slackened between 1951 and 1954. Thereafter, each succeeding year witnessed a substantial increase over the one preceding. The amount reached Rs. 85,200,000 in 1959. During the period under review outstanding loans increased from the nominal sum of Rs. 51,000,000 in 1949 to the substantial amount of Rs. 285,000,000 in 1959. No data on the investments of these banks were available to the writer but it may be assumed that the difference between total working capital and loans outstanding was invested in Government securities.

Measures relating to Land Mortgage Banks

The principal source of funds available to Land Mortgage banks was the sale of debentures to banks and other investors. In 1950 the Reserve Bank raised its maximum contribution to the short fall in public subscription to these issues from 10 per cent to 20 per cent of the total offered. In 1953 the Bank joined with the Central Government in guaranteeing the short fall to 40 per cent of the total offered. Under the First Five Year Plan the Government earmarked Rs. 10,000,000, or one-fifth of its Rs. 50,000,000 allotment for agricultural improvements, for investment in Land Mortgage banks.

debentures and this coupled with the direct commitment of the Reserve Bank appears to have been more support than was actually needed. Not all of it was called into use before 1955. In 1956 the debentures of the Land Mortgage banks were declared to be on par with Government securities and eligible to secure Reserve Bank credit on the same basis as other Government approved securities. Since then, the State Cooperative banks have used these debentures to secure funds to finance subscriptions to the share capital of cooperative non-credit ventures by agriculturists.

After the Second Five Year Plan got under way the Reserve Bank formulated a Rural Debentures Scheme to mobilize the savings of the rural population for Land Mortgage banks. The Reserve Bank appears to have been committed to underwrite a major portion of such issues. It undertook to take up the short fall in public subscriptions to the extent of two-thirds of each issue. This measure has helped considerably to popularise these debentures among small investors. Unfortunately no data on the extent of issue of these debentures are available.

Part 5

The Postal Savings System

Aside from the legislative measure of 1955 to permit the use of cheques for withdrawing from and depositing money in Postal Savings offices, there is nothing of importance to be related in connection with these institutions. This measure was introduced in only few selected postal savings offices and was gradually extended to others as conditions warranted. The development of postal banks between 1949 and 1961 is presented in Table No. 49 on page 274.

Table 49

Number and Deposits of Postal Saving Offices, 1949-1960 Inc.

<u>End of March</u>	<u>No. of Depositors</u> ,000	<u>No. of Offices</u>	<u>Outstanding Deposits</u> (Rs.000,000)	<u>Ave. balance per office</u>	<u>Ave. balance per Depositor</u>
1949	3426	8897	1484.9	163,400	433.3
1950	3808	9063	1671.9	180,600	439.1
1951	4090	9689	1850.6	187,100	452.5
1952	4446	N. A.	1998.1	N. A.	449.4
1953	4830	11274	2176.8	189,200	450.7
1954	5070	11759	2319.5	193,300	457.5
1955	5384	11647	2564.9	215,600	476.4
1956	5988	12128	2935.0	236,900	490.1
1957	6385	12454	3220.8	253,100	504.4
1958	6920	13362	3396.3	249,100	490.8
1959	7724	14052	3607.7	251,800	467.1
1960	8446	15101	3867.5	251,400	457.9
1961	9213	16807	4314.2	252,400	468.2

Source: Reserve Bank of India, Statistical Tables relating to Banks in India, 1961, 1957 and 1955, pp. 31, 32 and 55 respectively.

Data in this Table reveal that the number of depositor accounts held by the postal savings offices considerably increased from 3,426,000 in 1949 to 9,213,000 in 1961. The increase is particularly noticeable after 1957 after which the number grew from 6,385,000 to 9,213,000 by 1961. Similar growth, though not of the same magnitude, is revealed by the increase in the number of savings offices. Their number almost doubled during the time under review, increasing from 8897 in 1949 to 16807 in 1961.

In the meantime outstanding deposits increased from Rs. 1485,000,000 to Rs. 4,314,000,000; average deposits per office, from Rs. 163,400, to Rs. 252,400; and the average per depositor, from Rs. 433 to Rs. 468. In view of the creeping inflation that began after 1954 the decline in the average balance per depositor from 1957 onward is hardly understandable. It could be attributed to the considerable increase in the number of small depositors, for as savings offices spread in the countryside, it appears likely that people with limited means made increasing use of these facilities.

CHAPTER VII

SUMMARY AND CONCLUDING OBSERVATIONS

Until 1947 when India finally achieved her independence and the National Government began the tremendous task of modernizing and industrializing the Country, the development of banking enterprises broadly, speaking, followed no planned or premeditated course. It was, to the contrary, largely the result of the actions of groups and individuals, both native Indians and foreigners, particularly the latter, prompted by the profit motive; and the pursuit of this motive did not always coincide with the best interests of the Indian people.

From earliest times down almost to the present the bulk of all banking business carried out by native Indians was in the hands of Indigenous bankers and money lenders, practically all of whom, particularly the latter, can be accused of taking the greatest possible advantage of the small and poor agriculturists, artisans and tradesmen as well as of other families and individuals who could not raise a loan otherwise. The Indigenous bankers characteristically served the needs of producers and tradesmen; the money lenders, that of impoverished consumers, sometimes with money obtained in the first instance from the Indigenous bankers. Neither class of lenders solicited deposits publically, operating almost entirely on their private fortunes except for occasional borrowing from friends and relatives.

Indigenous bankers were primarily merchants and traders as well as bankers. Many of them were jewellers. Money lenders, while characteristically operating on their own funds, included many wealthy families among them agriculturists and small tradesmen. Both classes of lenders, particularly the money lenders, traditionally charged what today would be called extortionist rates of interest, and were brutal in their collection practices. Though the rates that could be legally charged by money lenders were considerably reduced during the 1930's they had traditionally received interest rates varying between 37½ per cent and 150 per cent. Rates as high as 360 per cent were not unknown.

In spite of overtures made by the newly established Reserve Bank of India, both before and after its nationalization in 1948, the Indigenous bankers are still operating on their own authority, without any supervision and regulation, and have not been brought into the formalised banking system which now surrounds the Reserve Bank of India. Yet it is estimated that these bankers continue to supply as much as 70 per cent or more of the credit needs of the agricultural sector of the Indian economy. It would appear that the failure to bring this important group into the organized sector of the Country's banking system is a continuing challenge to the Government and the Reserve Bank of India; in its programme of formalising and centralizing the Indian banking structure, if indeed the existing structure may be so called. As things now stand the tremendous credit resources of the Reserve Bank are not fully utilized and made available to the agricultural sector of the Indian economy - the sector on which the ultimate improvement of Indian economy would appear to depend.

So far the attack on Indigenous bankers and money lenders has been carried on through the development and expansion of the Cooperative and Land Mortgage banks sponsored by the respective States in India and supported by the Reserve Bank of India. In order to revitalize and strengthen the Cooperative Credit institutions the Reserve Bank undertook to provide them with loans at concessional rates varying between $1\frac{1}{2}$ per cent and 2 per cent below the Bank Rate. It also undertook to improve their operations by providing training centers for their personnel. The extent of Reserve Banks short-term loans at concessional rates to help State Cooperative banks to finance agricultural operations and the marketing of crops may be realized from the fact that the amount of loans ^{made} during the year increased from Rs. 121,000,000 in 1951-52 to Rs. 1,929,000,000 in 1961-62. The corresponding increase in the amount of loans outstanding at the end of the year was from Rs. 64,500,000 to Rs. 1,228,000,000. In addition the Reserve Bank advanced to State Governments Rs. 264,000,000 out of its National Agricultural Credit (Long-term operations) Fund to enable them to contribute to the capital funds of cooperative credit institutions. The bank also made Rs. 7,200,000 available to the Land Mortgage Banks.

In spite of the considerable progress recorded by the Cooperative Credit institutions during the last twelve years or so, they are no where near the point of supplanting the money lenders and Indigenous bankers. The latter still continue to provide over 70 per cent of the credit needs of the agricultural sector of the economy. However after half a century of stagnation the Cooperative Credit institutions, with the constant aid from both the Government and the Reserve Bank, have secured

a significant position in the Country's banking system and are beginning to cut deeply into the business of Indigenous bankers and money lenders. They have put an end to the monopoly of the money lenders and have helped to bring interest rates down considerably. With the future spread of education, an increase in per capita income, a better understanding of cooperative principles by the people, and the availability of trained personnel, the Cooperative Credit institutions have the potentiality of supplanting the money lenders. In fact the eventual spread of formalised banking facilities throughout the length and breadth of the Country would appear to lie in the successful promotion of Cooperative Credit societies.

The authorities on banking in India are divided on the question whether or not the attack on Indigenous bankers and money lenders through the spread of Cooperative Credit institutions should be continued or whether or not it might be better to bring them within the aegis of the Reserve System by modifying the conditions which hitherto have hindered their entry. The author is of the opinion that as far as the money lenders are concerned every effort should be made to supplant them by the spread of Viable Cooperative Credit societies. With respect to the Indigenous bankers, however, new attempts should be made to bring them within the province of the Reserve Bank either by modifying the conditions of entry laid down by the Reserve Bank or by encouraging the Indigenous bankers to cooperate by ^{ing} set/up their joint banking institution and thus carry on their banking business collectively and their trading business independently without mixing the two together. It is conceivable that,

if their capital funds were increased by access to Reserve Bank credit, their operations will greatly expand and the competition for making loans would drive interest rates down to the level prevailing in the money market.

Formalised banking as a separate undertaking did not appear in India until the establishment of the rule of the East India Company during the early 19th century. The first formal banking institution organized along modern lines was the Presidency Bank of Bengal established in 1806. The latter along with the Presidency Banks of Bombay and Madras ultimately became the Imperial Bank in 1921 and finally the State Bank of India in 1955.

Subsequent additions to this category of banks, designated in this thesis as Indian Joint Stock Banks, include many institutions now manned by the native Indians and a small number of publicly sponsored institutions which, in addition to their ordinary banking business, handled the fiscal affairs of the respective States. These latter institutions have recently been taken over as branches by the now publicly owned State Bank of India. With the establishment of the Reserve Bank of India in 1935 the larger Indian Joint Stock Banks i.e., those with a paid up capital of Rs. 500,000 or more became what has since been known as Scheduled banks, or designated charter members of what we have called the Reserve System of India. The far more numerous banks with less than Rs. 500,000 in paid up capital were not eligible for full membership but, under the provisions of the Banking Companies Act of 1949, were granted practically all of the facilities that were available to Scheduled banks.

In contrast to the original Companies Act of 1913, the Banking Companies Act of 1949 incorporates very decisive restrictions on the authority of banks with regard to the character of loans which they may make, appointment and salaries of their executive officials and the reserves they shall carry. It places them under the regulatory authority of the Reserve Bank - the first time in history, so far as can be determined, that a central bank has ever been given such sweeping authority over its affiliated banking institutions.

The Exchange Banks which handle the major part of the financing of the Country's external trade still make up a large though declining segment of the Indian banking enterprises. While the efficiency and integrity of their management has never been questioned, they have, understandably, continued to be treated as foreigners by^a nationally conscious Indian people and as an economic symbol of the Country's long forced dependence on non-Indian banking enterprises. Prior to the Banking Companies Act of 1949 these banks were not subject to any Indian regulatory authority and enjoyed a somewhat privileged position in the Indian money market. However under the provisions of the 1949 Act these banks were made subject to the same type of discriminatory restrictions as branches of Indian Joint Stock Banks would face in foreign countries. Eventually, it would seem, they will be brought under public ownership, along with competing domestic banks engaged in financing the foreign trade of India, by the establishment of an Import-Export Bank in the public sector. This appears to be the expressed and generally approved policy of the Indian Government. The latter has already taken over the business of the Life Insurance companies and

the singularly important former Imperial Bank now known as the State Bank of India.

The State Bank of India, it will be recalled, was originally a foreign bank for it was sponsored by the East India Company and incorporated under laws promulgated by that Company. Until its nationalization in 1955 it was by far the largest bank in India. As a symbol of colonialism but at the same time a very important bank, it constituted an agency which at once Indian nationals could neither tolerate nor do without. It not only carried on an extensive primary banking business but acted as a clearing and collecting agency for the Indian Joint Stock Banks; also as a lender of last resort to support them during periods of heavy withdrawals. Its take-over in 1955 by the already nationalized Reserve Bank of India conclusively destroyed the Imperial Banks' foreign image. It now works hand in hand with the Reserve Bank in extending central banking facilities both to the outlying centers and to provide credit to the agricultural sector of the economy.

Though much other relevant historical material had to be presented in advance, the author's main concern in this thesis was to explore and to present to a western audience the expanding role of the now enormously important Reserve Bank of India. This institution, one might say, was only tolerated by the scheduled banks during the first few years of its operation, yet it still made possible India's substantial contribution to World War II by absorbing in Reserve Bank credit war costs of a magnitude which could not conceivably have otherwise been passed on to the Indian public. This however was not accomplished without a sharp rise in the

general price level - a result which continuous deficit financing through a central bank inevitable brings forth.

It was after the Country became a sovereign state and nationalized the Reserve Bank, however, that the Bank finally was made the hub into which were spoked, so to say, all other incorporated and governmentally sponsored banking enterprises and charged either directly or indirectly with providing the financial machinery for the Government's very ambitious program of modernization and expansion of the Indian economy. It will bear repetition that the wider the provisions of the Banking Companies Act of 1949 and its subsequent amendments the Reserve Bank was also charged with the supervision and regulation of these now subordinated institutions. The Reserve Bank used this newly acquired authority extensively to weed out the inefficient banks and thus ensure the development of a sound banking system.

Since independence the main objective of the national Government has been to promote a rapid but balanced economic growth through successive five year plans and the Reserve Bank has been called upon to meet the financial needs of the Government to carry out its expansion programme and at the same time attempt to maintain a stable price level. The First Five Year Plan was launched on a modest scale in 1951 to organize and strengthen the economy, initiate institutional changes and thus lay down foundations for the future development of the economy. First The total outlay in the public sector during the/Plan period amounted to Rs. 19,600,000,000. Of this amount foreign aid accounted for Rs. 1,880,000,000 and deficit financing, Rs. 4,200,000,000. In spite of the fact that deficit financing accounted for about 22 per cent of

the total outlay in the public sector, it had little inflationary effect. In fact the cost of living Index (1949 = 100) decreased from 101 in 1950-51 to 96 in 1955-56. This may be attributed to the fact that in addition to the use of foreign aid the Government drew heavily upon its blocked sterling balances, which decreased from Rs. 8,842,000,000 in 1950-51 to Rs. 7,461,000,000 in 1955-56, to finance its continuously increasing imports. This had the effect of increasing the supply of goods in the Country without comparably increasing the supply of money and thus offsetting other inflationary undertakings. Favourable weather and moderate monsoons (trade winds) had bestowed on the Country abundant harvests and the national income (at constant prices) increased by 18 per cent as against the 12 per cent projected during the plan period. The total increase in money supply during the plan period, which amounted to Rs. 2,640,000, was easily absorbed by the increase in currency needs of the business community and the public at large.

Thus during this five year period the Reserve Bank was not called upon to execute a decisive monetary policy. It was chiefly concerned with the establishment of the various financial institutions that were designed to mobilize the Country's resources and to channel them into various enterprises included in the plan. In the regulatory sphere it proceeded with its policy of strengthening the Indian banking system through inspections, closures and consolidations.

Encouraged by the success of the First Five Year Plan, and perhaps to further speed-up the economic development of the Country, the Government in 1956 launched a larger and more ambitious Second Five Year Plan in which industrial expansion in India was emphasized. During the

first half of the Plan period a considerable increase in imports of machinery and other capital goods virtually exhausted the Country's foreign currency assets which decreased from Rs. 7,461,000,000 in March 1956 to Rs. 2,670,000,000 in March 1958. Failure of crops because of unfavourable weather had reduced the Country's supply of food and the Government had to resort to increased imports of food grains, and to a scaling down of total out-lays on the plan in the Public Sector from Rs. 48,000,000,000 to Rs. 46,000,000,000. Moreover the Government had to resort to deficit financing on an unprecedented scale if the projected development program was to be completed; for voluntary savings, insurance premiums and the available amount of foreign aid were not sufficient to cover the planned expenditure.

The deficit financing through the Reserve Bank during the Second Five Year Plan amounted to Rs. 11,500,000,000, and meanwhile the supply of money (lawful money + bank money) increased from Rs. 23,100,000,000 to Rs. 29,100,000,000. As a consequence the Reserve Bank was faced with an impossible task. On the one hand the Bank had to issue enormous amounts of money in currency notes to meet the financial needs of the Government; on the other, it was apparently expected to maintain a stable price level. While the Issue Department of the Bank was issuing currency notes to finance the Government undertakings, its Banking Department used all of the measures of control at its disposal to curb its inflationary potential. Selective credit control measures were used to check the speculative increase in the prices of various commodities by denying bank credit to speculators. In order to siphon off the excess reserves of the banking institutions, statutory reserve requirements were increased to as much as 50 per cent of new deposits. In order to

further limit the extension of bank credit, the Reserve Bank imposed credit rationing on the Scheduled banks. Through these and other restrictive measures the Bank was able to constrain the inflationary forces generated by the deficit financing though not to eliminate them. While doing so it provided the banking world with its first example of the combined use of various types of selective and general inflationary controls; and what otherwise would undoubtedly have produced a self-generating spiral of prices was held within tolerable limits without resort to an all out system of price controls and rationing. It is quite unrealistic to assume that under the given conditions any combination of banking restraints, however well executed, could have nullified the entire inflationary potential of the enormous budgetary deficits without seriously restricting and limiting the achievements of the Second Five Year Plan itself.

Appendix

Operations of Reserve Bank in Central Government Securities, 1949-1960 Inc. (Rs.000,000)

<u>Financial Year Ending In March</u>	<u>Total Purchases</u>	<u>Total Sales</u>	<u>Net Purchases (-) Sale (+)</u>
1949-50	892.2	706.8	- 185.4
1950-51	1550.6	987.9	- 562.7
1951-52	660.0	547.8	- 118.2
1952-53	126.6	138.6	+ 12.0
1953-54	177.7	399.1	+ 221.4
1954-55	299.4	579.4	+ 280.0
1955-56	219.7	379.2	+ 159.5
1956-57	474.7	283.0	- 191.7
1957-58	240.1	892.3	+ 652.2
1958-59	651.0	1540.5	+ 889.5
1959-60	233.1	836.4	+ 603.3
1960-61	N. A.	N. A.	+ 1250.0

Source: Reserve Bank of India, 'Bulletin', June 1960, p. 803.

BIBLIOGRAPHY

1. PUBLIC DOCUMENTS

- India, Planning Commission, First Five Year Plan, New Delhi, 1951.
India, Planning Commission, Second Five Year Plan, New Delhi, 1956.
India, Planning Commission, Third Five Year Plan, New Delhi, 1961.
India, Planning Commission, Programs of Industrial Development, 1956-61, New Delhi, 1961.
Government of India, Reserve Bank of India Act, 1934 (as modified up to 1956), New Delhi, 1957.
Government of India, Banking Companies Act, 1949, New Delhi, 1949.
India, Ministry of Information and Broadcasting, India, 1954 to 1962, New Delhi.

2. REPORTS

- Government of India, Report of the Royal Commission on Indian Currency and Finance, vols. I, IV and V, Delhi, 1926.
Reserve Bank of India, Report of the Committee on Direction of Rural Credit in India, Bombay, 1954.
Reserve Bank of India, Rural Banking Enquiry Committee Report, Bombay, 1953.
Reserve Bank of India, Report of the Committee on Finance for Private Sector, Bombay, 1954.
Reserve Bank of India, Report on the Seminar on Financing of Small Scale Industries, in India, Bombay, 1959.
United Nations, ECAFE, Mobilisation of Domestic Capital, Report and Documents of the Second Working Party of Experts, Bangkok, ECAFE, 1953, (Publication No. not given).
League of Nations, The Monetary and Economic Conference, Information Section Secretariat of League of Nations, Geneva, 1933.

3. BOOKS

1. Agrawal, A.N. Industrial Problems in India. Delhi, Ranjit Printers, 1952.
2. Almaula, N.I. Operations of the Reserve Bank of India, 1935-54. New York, Asia Publishing House, 1960.
3. Bajpai, R.G. A Few Aspects of Indian Economy, Kapurtaala, Dhani Ram Muni Lal, 1952.
4. Banerjea, Pramathanath. A Study of Indian Economics. University of Calcutta Press, 1957.
5. Baster, A.S.J. The Imperial Banks. London, P.S. King and Sons, 1929.
6. Basu, S.K. A Survey of Contemporary Banking Trends. Calcutta, Book Exchange, 1957.
7. Basu, S.K. Industrial Finance in India. Calcutta, Book Exchange, 1953.
8. Bauer, P.T. Indian Economic Policy and Development. New York, Frederick A. Praeger, 1961.

9. Buchanan, D.H. The Development of Capitalist Enterprise in India. New York, Macmillan, 1934.
10. Burgess, W.R. The Reserve Banks and the Money Market. New York, Harper, 1936.
11. Chablani, H.L. Indian Currency and Exchange. Madras, Oxford University Press, 1925.
12. Chacko, K.C. The Monetary and Fiscal Policy of India. Bombay, Vora and Co., 1957.
13. Cirvante, V.R. The Indian Capital Market. London, Oxford University Press, 1956.
14. Dadachanji, B.E. Monetary System of India. Bombay, Tarapore Wala and Sons, 1948.
15. Das, A.B. and Chatterji, A.B. The Indian Economy, Its Growth and Problems. Calcutta, Bookland, 1957.
16. Das, N. Banking and Industrial Finance in India. Calcutta, Modern Publishing Syndicate, 1936.
17. Davies, S.J. Central Banking in South and East Asia. Hong Kong, University Press, 1960.
18. Day, A.C.L. Outline of Monetary Economics. Oxford University Press, 1957.
19. Deshmukh, C.D. Central Banking in India - A Retrospect. Poona, Gokhale Institute of Politics and Economics, 1948.
20. Deshmukh, C.D. Economic Development in India, 1946-56. Bombay, Asia Publishing House, 1958.
21. Dewett, K.K. and Singh, G.C. Indian Economics. Delhi, Premier Publishing Co., 1959.
22. Doraiswami, S.V. Indian Finance, Currency and Banking. Madras, S.V. Doraiswami and Co., 1915.
23. Ghosh, B.B. Indian Economics and Pakistan Economics. Calcutta, A. Mukerjee and Co., 1949.
24. Ghosh, B.C. A Study of the Indian Money Market: with Special Reference to the Calcutta Money Market. Calcutta, Oxford University Press, 1943.
25. Goswami, M.N. Central Banking and Monetary Control of India. University of Calcutta, 1948.
26. Gregory, Theodor. The Present Position of Central Banks. University of London, 1955.
27. Gupta, H.C. Problems and Processes of Economic Planning in Underdeveloped Economies. Bombay, Kitab Mahal, 1958.
28. Gupta, J.P. The Reserve Bank of India and Monetary Management. New York, Asia Publishing House, 1962.
29. Hawtrey, R.J. The Art of Central Banking. New York, Longmans Green and Co., 1932.
30. Iengar, H.V.R. Monetary Policy and Economic Growth. Bombay, Vora and Co., 1962.
31. Jain, J.P. Indian Banking Analysed. Delhi, Rajhan Publications, 1949.

32. Jain, L.C. Indigenous Banking in India. London, Macmillan, 1929.
33. Jain, P.C. Problems in Indian Economics. Allahabad, Chaitanya Publishing House, 1956.
34. Jain, P.C. Currency, Banking and Finance in India. Allahabad, Chaitanya Publishing House, 1960.
35. Jather, J.B. and Beri, S.J. Indian Economics, Vol. II. Madras, Oxford University Press, 1937.
36. Keynes, J.M. Indian Currency and Finance. London, Macmillan, 1913.
37. Kockde, M.H. Central Banking, 3rd Ed. London, Staples Press, 1961.
38. Mitra, R.M. Post War Banking in India and a Case for Legislation. Calcutta, A. Mukerjee, 1949.
39. Mukerjee, Radhakamel. Economic Problems of Modern India, Vol. I. London, Macmillan, 1939.
40. Mukerjee, Radhakamel. The Foundation of Indian Economics. London, Longman, Green and Co., 1916.
41. Muranjan, S.K. Modern Banking in India. Bombay, Kamala Publishing House, 1952.
42. Nurske, R. Problems of Capital Formation in Underdeveloped Countries. Oxford, Basil and Blackwell, 1953.
43. Panandikar, S.J. Banking in India, 9th Ed. Bombay, Orient. Longmans, 1959.
44. Plumptre, A.F.W. Central Banking in the British Dominions. The University of Toronto Press, 1940.
45. Raj, K.N. The Monetary Policy of the Reserve Bank of India. Bombay, National Information and Publishing Company, 1948.
46. Rao, S.R.K. The Indian Money Market. Allahabad, Chaitanya Publishing House, 1959.
47. Raturi, A.S. Commercial Banks and their Relation to Money Market. University of Allahabad, 1947.
48. Rau, Ram Chandra. Banks and the Money Market. Calcutta, Lal Chand and Sons, 1933.
49. Reserve Bank of India. Banking and Monetary Statistics of India. Bombay, 1954.
50. Reserve Bank of India. Functions and Working of Reserve Bank of India. Bombay, 1948.
51. Robertson, D.H. Banking Policy and Price Level. London, P.S. King and Sons, 1926.
52. Robertson, D.H. Essays in Monetary Theory. Toronto, Staples Press, 1946.
53. Roy, N.K. Indian Banking and Money Market. Calcutta, M.C. Sarkar and Sons, 1952.
54. Sarma, S.K. Papers on Currency and the Reserve Bank of India. Trichnopoly, S. Krishnaswami, 1934.
55. Sayers, R.S. Modern Banking. Oxford University Press, 1958.

56. Sayers, R.S. (Ed.) Banking in British Commonwealth.
Oxford University Press, 1952.
57. Sen, S.N. Central Banking in Underdeveloped Money Market.
Calcutta, Bookland Ltd., 1952.
58. Shah, K.T. Currency and Banking. (National Planning
Committee Series). Bombay, Vora and
Co., 1948.
59. Shaw, W.A. Theory and Practice of Central Banking.
New York, Pitman and Sons, Ltd., 1930.
60. Shirras, J.F. Indian Banking and Finance. London,
Macmillan, 1920.
61. Simha, S.L.N. The Capital Market of India. Bombay,
Vora and Co., 1960.
62. Sihha, H. Early European Banking in India with Some
Reflections on Present Conditions.
Calcutta, Macmillan, 1927.
63. Sinha, S.K. The Economic History of Bengal, Vol. I.
Calcutta, Sri Lal Chand Roy Gossain and
Co., 1956.
64. Tannan, M.L. and Shah, K.T. Indian Currency and Banking
Problems. Bombay, Ramchandra Govind and
Sons, 1917.
65. Triparthy, R.N. Fiscal Policy and Economic Development
in India. Calcutta, World Press, 1958.
66. Vakil, C.N. and Muranjan, S.K. Currency and Prices in
India. Bombay, D.B. Taraporevala Sons
and Co., 1927.
67. Venkata Subhia, H. Indian Economy Since Independance.
New York, Asia Publishing House, 1961.
68. Vera, Anstey. The Economic Development of India.
London, Longman, Green and Co., 1936.
69. Wadia, P.A. and Merchant, K.T. Our Economic Problems.
Bombay, Vora and Company, 1957.
70. Willis, H.P. The Theory and Practice of Control Banking.
New York, Harper, 1936.

4. ARTICLES AND PERIODICALS

71. Aschheim, Joseph. "Commercial Banks and Financial
Intermediaries - Fallacies and Policy
Implication", Journal of Political
Economy, Vol. 67, 1959, pp. 59-71.
72. Minsky, Hyman P. "Central Banking and Money Market
Changes", Quarterly Journal of Economics,
Vol. 71, 1957, pp. 171-187.
73. Shirras, J.F. "The Reserve Bank of India", Economic
Journal, Vol. 44, 1934, pp. 258-274.
74. Shirras, J.F. "A Central Bank for India", Economic
Journal, Vol. 38, 1928, pp. 573-588.

5. INTERNATIONAL MONETARY FUND STAFF PAPERS

1. Patel, I.J. "Selective Credit Controls in Underdeveloped Countries", Staff Papers, Vol. IV, 1954-55, pp. 73-83.
2. Richard, Goode.; Thorn, S.Richard. "Variable Reserve Requirements Against Commercial Banks' Deposits", Staff Papers, Vol. VII, 1959-60, pp. 9-43.
3. Thorn, S.Richard. "Non-Bank Financial Intermediaries, Credit Expansion and Monetary Policy", Staff Papers, Vol. VI, 1957-58, pp. 369-81.

6. RESERVE BANK OF INDIA

(a) Annual Publications

Reserve Bank of India, Report on Currency and Finance 1946-47,
Bombay, 1947.
Report on Currency and Finance 1947-48,
Bombay, 1948.
Report on Currency and Finance 1948-49,
Bombay, 1949.
Report on Currency and Finance 1949-50,
Bombay, 1950.
Report on Currency and Finance 1951-52,
Bombay, 1952.
Report on Currency and Finance 1952-53,
Bombay, 1953.
Report on Currency and Finance 1953-54,
Bombay, 1954.
Report on Currency and Finance 1954-55,
Bombay, 1955.
Report on Currency and Finance 1955-56,
Bombay, 1956.
Report on Currency and Finance 1956-57,
Bombay, 1957.
Report on Currency and Finance 1957-58,
Bombay 1958.
Report on Currency and finance 1958-59,
Bombay, 1959.
Report on Currency and Finance 1959-60,
Bombay, 1960.
Report on Currency and Finance 1960-61,
Bombay, 1961.
Report on Currency and Finance 1961-62,
Bombay, 1962.
Report on Currency and Finance, 1962-63,
Bombay, 1963.
Trend and Progress of Banking in India During 1954,
Bombay, 1955.
Trend and Progress of Banking in India During 1958,
Bombay, 1959.

Trend and Progress of Banking in India
During 1959,
Bombay, 1960.
Trend and Progress of Banking in India
During 1960,
Bombay, 1961.
Trend and Progress of Banking in India
During 1961,
Bombay, 1962.
Statistical Tables Relating to Banks
in India for 1951,
Bombay, 1952.
Statistical Tables Relating to Banks
in India for 1956,
Bombay, 1957.
Statistical Tables Relating to Banks
in India for 1958,
Bombay, 1959.
Statistical Tables Relating to Banks
in India for 1960,
Bombay, 1961.
Statistical Tables Relating to Banks
in India for 1961,
Bombay, 1962.

Reserve Bank of India,

Report of the Central Board of Directors for the
Year ending June, 1958, Bombay, 1958.
Report of the Central Board of Directors for the
Year ending June, 1959, Bombay, 1959.
Report of the Central Board of Directors for the
Year ending June, 1960, Bombay, 1960.
Report of the Central Board of Directors for the
Year ending June, 1961, Bombay, 1961.
Report of the Central Board of Directors for the
Year ending June, 1962, Bombay, 1962.

C) Monthly Publications.

Bulletin, 1960-1962 (incomplete set).