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BANKING IN INDIA

BY

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INDIAN EDUCATIONAL SERVICE

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PREFACE

The authoritative and exhaustive banking enquiry of 1929-31 has made enormous material (20,000 pages in print) available for the study of banking in India. But it is too vast, confusing and technical for the ordinary reader. Even the reports of the Central and Provincial Banking Committees, with their dissenting minutes, are not free from these drawbacks. Moreover, important developments in banking have taken place since the completion of the enquiry. The aim of the following pages, therefore, is to give a clear and up-to-date account of banking in India, within a reasonable compass, and in as simple language as possible, for the benefit of the ordinary reader. The writer has endeavoured to make a full use of all the material available regarding the subject.

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CHAPTER I

Progress of Banking in India

1. Indigenous Bankers.

Although evidence regarding the existence of money-lending operations in India is found in the literature of the Vedic times, *i.e.* 2000 to 1400 B. C.,[1] no information is available regarding their pursuit as a profession by a section of the community, or the details of money-lending, remittance of money in cash or by credit instruments, and money-changing till 500 B. C. From this time onwards, India possessed a system of banking, which admirably fulfilled her needs and proved very beneficial to her, although its methods were different from those of modern Western banking. The literature of the Buddhist period, *e. g.* the Jatakas,[2] and recent archeological discoveries relating to this period supply ample evidence of the existence of *sresthis*, or bankers, in all the important trade centres, of their prominent position in the guilds that performed various commercial and industrial functions, and of their widespread influence in the life of the community. Their chief activity was to lend money to traders, to merchant-adventurers who went to foreign countries, to explorers who marched through forests to discover valuable materials, and to kings who were in financial difficulties due to war or other reasons, against the pledge of movable or immovable property or personal surety.

Usury was practised but was held in contempt.[3] From the laws of Manu, it appears that money-lending and allied problems had assumed considerable importance, and that deposit banking in some form had come into existence by the second or third century of the Christian era.[4]

1. See Vedic Index of Names and Subjects by Macdonnell and Keith, Vol. I, p. 109.
2. The Jatakas are taken to refer to the fifth and sixth centuries B. C. See V. Smith's *Early History of India*, p. 11.
3. See *Cambridge History of India*, Vol. I, p. 218.
4. See *Ibid.*, p. 281.

Kautilya's Arthasastra laid down 15 and 60 per cent as the maximum legal rates of interest per annum on secured and unsecured loans respectively, but permitted a maximum of 240 per cent if the risk was specially heavy. The Dharmasastras laid down a variation in the above rates according to the castes of the borrowers, and the eligibility of men belonging to the Vaishya caste alone to take up the money-lending profession.[1]

Hundis or indigenous bills of exchange came into use from the 12th century, and it appears from the writings of a few Muslim historians, European travellers, State records and the Aini-Akbari that both under the early Muslim and Mogul rules in India indigenous bankers played a prominent part in lending money, financing internal and foreign trade with cash or bills, and giving financial assistance to rulers during periods of stress. No exact information is available regarding the rates of interest charged by them, but it appears from the evidence that is available, that they were higher than those prescribed in Kautilya's Arthasastra.[2]

During the Mogul rule the issue of various kinds of metallic money in different parts of the country gave the indigenous bankers great opportunities for developing the very profitable business of money-changing,[3] and the most important among them were appointed mint officers, revenue collectors, bankers and money-changers to Government in various parts of the Empire. Many of them wielded great influence in the country, and those among them who came to be known as Jagat Seths (world bankers) in the 17th and 18th centuries possessed as great a power as the private bankers of any Western country.[4] The indigenous bankers, however, could not develop to any extent the system of obtaining deposits regularly from the public and paying interest on them, and

1 *Cf.* the Bengal Banking Committee Report, pp. 177-9 and Bombay Committee Report, pp. 192-3.

2. See Bengal Committee Report, pp. 180 and 182.

3. See *Aini-Akbari* translated by Blochmann and Jarret, Vol. I, pp. 29-31 and Jain, *Indigenous Banking in India*, pp. 12-13.

4. *Cf.* the U. P. Banking Committee Report, p. 262.

those who made savings either hoarded them, or lent them to friends and neighbours. The reason seems to be that many of them combined trade with banking business; this combination reduced the stability of their banking business, and produced an unfavourable reaction upon banking development in India.

The English traders that came to India in the 17th century could not make much use of the indigenous bankers owing to their ignorance of the latter's language and owing to the latter's inexperience of the finance of the former's trade. Therefore, although the East India Company established connections with the bankers, borrowed funds from them, and for the first few years collected a portion of the land revenue through them, the English agency houses in Calcutta and Bombay began to conduct banking business besides their commercial business. From this time, the business and power of the indigenous bankers began to wane, although the East India Company successfully prevented the establishment in India of banks on Western lines for a considerable time, on the ground that the agency houses and the indigenous bankers were more suited to the banking requirements of the country.

Other causes also operated to bring about the decline of the indigenous bankers. The continuous warfare and chaos that resulted from the break-up of the Mogul Empire seriously checked their activities. Some of them were at times unable to fulfil their promises, had to resort to questionable practices, and found their claims not infrequently evaded by their debtors, some of whom were ruling princes. Further, they lost their profitable money-changing business from 1835, when a uniform currency was established throughout the country. Moreover, the diversion of trade from old to new routes and the change in the basis of India's trade relations with other countries, that were brought about by the development of railways, steamships, post and telegraph, affected their business adversely. Their decline and the gradual expansion of English trade and power in India led the East India Company to abandon its opposition to the establishment of

banks on Western lines in India. Consequently, such banks and Government treasuries came to be established, and they accentuated the decline of the indigenous bankers.[1] With reduced resources and a smaller scale of business, they began to find themselves handicapped in their competition with commercial banks, and they began gradually to lose ground to them, just as in England the private family bankers had to give place to the larger joint-stock banks.

They continued to have a distinct and separate existence from the joint-stock banks, although after a time they found it profitable to increase their resources by borrowing from the Presidency Banks. Consequently, these two important parts of the banking system have remained ignorant of the doings and methods of each other, with loss to both of them. The indigenous bankers have mostly continued their antiquated methods, and have learnt little from the more efficient and advanced methods of the joint-stock banks. The latter have not learnt the economy and simplicity of the former and the traditions of the people, and have not been able to penetrate into rural areas in which the vast bulk of the people live. In spite of the progress of the joint-stock banks, a large amount of banking business is still carried on by the indigenous bankers throughout India. The work of the former has so far been restricted to the ports and the more important towns. Consequently, agriculture and the internal trade in rural areas are still dependent to a large extent upon the services of the indigenous bankers. Many of them also serve as middlemen between the internal traders and the banks, discounting the hundis of the former and re-discounting them with the latter.

2. The Agency Houses, the Presidency Banks and the Imperial Bank of India.

The English agency houses in Calcutta and Bombay that began to serve as bankers to the East India Company, the members of the services, and the European merchants in India, had no capital of their own, and depended upon deposits for their funds. They financed the movement of

1. See Jain, *Indigenous Banking in India*, pp. 20-23.

crops, issued paper money, and paved the way for the establishment of joint-stock banks.[1] The earliest of these was the Hindustan Bank, which was established in 1770 by one of the agency houses in Calcutta, and its business was closely connected with these houses. It issued notes which, although not legal tender, had a substantial circulation. But it was wound up in 1832, when the firm of Alexander and Company, with which it was intimately connected, failed. The Bengal Bank and the General Bank of India were established about 1785. The latter was voluntarily liquidated in 1791 owing to inability to earn profits, and the former failed a little later owing to a severe run upon it caused by the temporary reverses inflicted upon the Company by Tipoo Sultan. These banks were chartered by the East India Company, and were followed by banks established under Acts of the Indian legislature. The latter may be divided into two groups, the first consisting of the three Presidency Banks amalgamated into the Imperial Bank of India in 1920, and the second, of the Indian joint-stock banks.

The Bank of Bengal, the first of the Presidency Banks, was established in 1806 as the Bank of Calcutta, and received its charter as the Bank of Bengal in 1809. The East India Company regarded it necessary to facilitate its own borrowings, which till then had to take the form of the sale of treasury bills, often at a large discount, as well as to facilitate the operations of English traders. In order to be able to share in the direction of the bank's business so as to keep it within safe limits, the Company contributed $\frac{1}{5}$ of the bank's capital of £500,000, and obtained the right to appoint three of its directors. Its secretary was generally a member of the Civil Service. The charter imposed certain restrictions on its working, and one of the restrictions was that its rate of interest must not exceed 12 per cent, for the purpose of bringing down permanently the prevailing rate of interest. In 1823 it was allowed to issue notes, and in 1839 to open branches and to deal in inland exchange, but not in foreign exchange.

1. *Cf.* Central Committee Majority Report, p. 16.

The Banks of Bombay and Madras were established in 1840 and 1843 with a share capital of Rs. 50 and Rs. 30 lakhs respectively, out of which the East India Company provided Rs. 3 lakhs in each case and obtained the right to appoint some of their directors. Their secretaries and treasurers were members of the I. C. S. Both the banks were allowed to issue notes up to a certain amount. The bulk of the shares of all the three banks were subscribed by Europeans. All of them were given the monopoly of Government banking. In 1862 their right of note issue was taken over by Government, and as compensation they were given the use of Government balances in the Presidency towns free of charge.

The Bank of Bombay became involved in the wild speculation of 1862-5 that followed the American Civil War and the rise in the price of cotton, suffered serious losses, and was voluntarily wound up in 1868, but a new bank having the same name was established immediately afterwards with a capital of Rs. 1 crore. Although the depositors were repaid fully, the shareholders of the defunct bank lost nearly the whole of their capital. After this failure, Government withdrew its portion of the capital of the other two banks, and gave up its right to appoint a proportion of the directors and the secretaries and treasurers of all the three banks.

The Government of India appointed a Commission to examine the causes of the failure of the Bank of Bombay, and its report led to the passing of the Presidency Banks Act, which imposed restrictions upon all the three banks to safeguard the interests of Government and the public which deposited funds with them. The chief restrictions were firstly that they were prohibited from dealing in foreign bills and borrowing abroad, as exchange business was regarded risky ; secondly that they were prohibited from lending for more than 6 months ; and finally that they were prohibited from lending on the security of immovable property, as it was not easily saleable. In return most Government banking work was retained in their hands, and the prestige that this gave them enabled them to secure a large amount of other banking business.

These restrictions undoubtedly contributed a great deal to their stability, and in spite of them the banks showed much vitality and power of expansion. But the restrictions were continued even after the banks had built up a very solid position by careful management, and after exchange transactions had ceased to be speculative owing to the establishment of the Gold Exchange Standard. Their unnecessary continuation made the working of the banks out of date, and prevented them from playing as useful a part in the Indian financial system as they might otherwise have done.[1]

The Presidency banks established branches at many important trade centres in India, but they lacked points of contact, the want of which was often deplored. On many occasions it was felt strongly that there should be only one bank of this kind for the whole country. As early as 1836 a large body of English merchants interested in India placed before the Court of Directors of the East India Company a scheme for a "great Banking Establishment for British India," but the latter took no action. From 1860 to 1876 the possibility of the conversion of the Bank of Bengal into a "Bank of India" was under consideration, and the Finance Members of the Government of India during this period favoured the idea. In 1867, the Secretary and Treasurer of the Bank of Bengal placed before the Government of India a project for the amalgamation of the three Presidency Banks. But the Government of India did not favour it on the grounds that the interests of such a big institution might run counter to those of the public: that its influence might overshadow that of the Government itself: that it would be very difficult to manage: and that the merchants of the other two important trade centres, *viz.* Bombay and Madras preferred, and were entitled to, separate Banks to promote their own interests and convenience. The Secretary of State did nothing beyond giving expression to certain maxims of political wisdom regarding the project.

In 1898 some witnesses before the Fowler Currency Committee advocated the establishment of a Central

1. Cf. Keynes, *Indian Currency and Finance*, p. 204.

Bank, but the Government of India under Lord Curzon did not favour the proposal. The Presidency Banks themselves desired to retain their individuality, and were opposed to amalgamation. The Chamberlain Currency Commission of 1913 merely suggested the appointment of a small expert committee in India to examine the question. The banking crisis of 1913–17, however, showed clearly the defects and dangers of India's free banking system, under which the country had no co-ordinated banking policy and each bank conducted its business entirely in its own way, without any control of a central institution. This lesson was reinforced by the experience obtained during the latter part of the War. Co-operation and co-ordination of policy on the part of the Presidency Banks for financing its requirements during the latter part of the War showed the advantages and wisdom of this policy. Finally, the danger arose that if the Presidency Banks were to remain isolated, one of the big five English Banks, or Japanese or American Banks might secure excessive influence and predominance in the financial system of India, by amalgamating with, or absorbing, some of the banks in India.[1] Public opinion in India, therefore, strongly urged the creation of a Central Bank; the Presidency Banks and Government withdrew their opposition to the project; and an Act of 1920 amalgamated the three Presidency Banks into the Imperial Bank of India. At the time of amalgamation they had altogether 59 branches, a total paid-up capital of Rs. 3¾ crores and a total reserve of almost Rs. 3½ crores.

It was intended in 1920 that the Imperial Bank should gradually be developed into a full-fledged Central Bank. In 1926, however, the Hilton Young Currency Commission recommended the creation of a separate bank, to be called the Reserve Bank of India, to perform central banking functions, so as to leave the Imperial Bank entirely free, not only to continue, but also to extend commercial banking activities, the need for which was urgent in the country. The Commission further recommended that the Reserve Bank should be a shareholders'

1. See Ramachandra Rau, *Present Day Banking in India*, p. 32.

institution, and that the members of the Indian legislatures, central and provincial, should be debarred from serving as directors of the Bank, so as to eliminate the danger of political pressure being exercised on the boards of the Bank. A bill incorporating these recommendations was introduced by Government in the Legislative Assembly in 1927, but was withdrawn, because the Assembly desired the Bank to be a State institution and a proportion of its directors to be members of the legislature in the peculiar conditions of the country, but contrary to the principles of sound central banking generally accepted in other countries. In 1933, the British Government made the creation of a Federation and Responsible Central Government in India dependent upon the previous establishment of the Reserve Bank of India, and so in accordance with the recommendations of a Committee that sat in London, another bill providing for the establishment of the Bank was introduced in the Central Legislature towards the close of 1933, and was passed at the beginning of 1934.

The progress of the three Presidency Banks taken together from 1870 to 1920 and of the Imperial Bank from 1921 is shown by the following Table[1]:—

Year.	Paid-up Capital.	Reserve and Rest.	Government or Public Deposits.	Private Deposits.	Cash Balances.
			Crores of Rupees.		
1870	3·36	·25	5·43	6·40	9·97
1880	3·50	·55	2 91	8·19	7·41
1890	3·50	·97	3·59	14·76	12·97
1900	3·60	2 00	2·80	12·88	5·04
1910	3·60	3·31	4·24	32·34	11·35
1920	3·75	3·78	9·03	78 02	26·03
1921	5·62	4·15	6·80	65·78	13 60
1922	5·62	4·33	14·16	57·01	15·07
1923	5·62	4·55	8·57	74·19	15·01
1924	5·62	4·80	7·50	76·71	15·60
1925	5·62	4·93	5·46	77·83	17·47
1926	5·62	5·09	6·45	73 90	20·90
1927	5·62	5·24	7·20	72 07	10·89
1928	5·62	5·39	7 95	71·30	10·58
1929	5 62	5 48	7·60	71·64	14·00
1930	5·62	5·53	7·37	76·60	13·04
1931	5·62	5·14	8·32	63·86	11·03

1. See Statistical Tables relating to Banks in India, 1931, p. 5.

3. Joint-Stock Banks.

The real stimulus for the establishment of joint-stock banks was provided by an Act passed in 1813, which removed all restrictions on Europeans settling in India. Several banks were established on the basis of unlimited liability, mainly by the English agency houses. They conducted ordinary banking business, financed internal trade, and issued not s. One of them also gave loans to industries, and transacted exchange business, and another acted as banker to the East India Company. But most of them came to grief during the crisis of 1829-33, owing to the combination of banking with other business and speculation, mismanagement, and fraudulent use of their funds, although they were managed entirely by Europeans, and although the Company assisted some of them during the crisis. After the crisis, several new banks were started by European houses on the basis of unlimited liability, but half of them failed by 1860 owing to speculation and mismanagement permitted by careless auditing of their accounts, although these also were managed by Europeans. Some of them, however, achieved considerable success, and two had branches in India and London.

In 1860, an Act was passed permitting the starting of joint-stock banks on the basis of unlimited liability, as it was essential to enable large business companies to secure the large amounts of capital that they needed, but soon afterwards the banks were deprived of the right of note issue. Then came the American Civil War which, by cutting off the supply of American cotton to England, caused an unprecedented boom in India's cotton trade with England, and led to an orgy of speculation. A large number of banks and all sorts of other companies were formed to take part in this activity, but all of them failed in a short time, and destroyed public confidence in banks. Further, the currency confusion during 1873–93 caused trade uncertainties, and created an atmosphere unfavourable to the establishment of new banks. Consequently, from 1865 till the end of the century, the progress in the creation of

joint-stock banks was very slow. At the end of the century there were only 9 banks with capital and reserves of over Rs. 5 lakhs, their total paid-up capital and reserves being Rs. 1¼ crores, and their total deposits Rs. 8 crores.

The Allahabad Bank and the Alliance Bank of Simla were established in 1865 and 1875 respectively, both under European management. The latter went into liquidation in 1923, because it had locked up too large a proportion of its funds in subsidiary concerns started by Boulton Brothers of London, which it had absorbed to facilitate its London business. The Oudh Commercial Bank, established in 1881, was the first bank on limited liability to be managed by Indians. It was followed in 1894 by the Punjab National Bank and in 1901 by the People's Bank of India, both of which were started chiefly through the efforts of Lala Harkishen Lal. All of them made good progress, but the last, the most successful of them, failed in 1913; it had locked up too large a proportion of its funds in industrial investments, and when its depositors became frightened, it found its liquid resources inadequate, and the other banks declined to come to its assistance.

The Swadeshi movement that began in 1906 gave much stimulus to banking, and between this year and 1913 the number of banks with capital and reserves of over Rs. 5 lakhs increased from 9 to 18, with a total paid-up capital and reserves of Rs. 4 crores and total deposits of Rs. 22 crores. The number of smaller banks established during this period was much greater. Some of the prosperous Indian banks of the present time, *viz.* the Bank of India, the Indian Bank of Madras, the Central Bank of India, the Bank of Baroda, and the Bank of Mysore were established during this period. Other large Indian banks, that were launched during the period but failed subsequently, were the Indian Specie Bank, the Bengal National Bank, the Credit Bank of India, the Bombay Merchants' Bank, the Standard Bank of Bombay, and the Bank of Upper India.

This boom was followed by a banking crisis during 1913-17. During this period 87 banks failed with a total paid-up capital of over Rs. 1¾ crores, which was slightly more than half of the total paid-up capital of all the joint-stock banks that survived in 1917.[1] The majority of them were small and weak, but at least half-a-dozen of them were large. The failures did much to weaken public confidence in Indian joint-stock banking and to check the growth of banking habits in India, and thus gave a considerable set-back to banking development in India. The causes of the crisis may be briefly considered here.

During the boom of the decade preceding the War a large number of mushroom banks grew up in Western India, the Punjab and the United Provinces, and having developed in good times, and not having existed long enough to remember any previous crises, they conducted their business in violation even of the elementary principles of banking.[2] They had an imposing authorised capital, but the subscribed capital was far smaller, and the paid-up capital was smaller still. The aggregate subscribed and paid-up capitals were only 40 and 14 per cent respectively of the authorised capital. The law did not prevent this malpractice, and the banks took advantage of it to deceive the public, which was ignorant of the differences between the three kinds of capital. The deception of the public was increased by the adoption of high sounding names by some of the banks.

The deficiency of capital made them almost wholly dependent upon deposits for conducting their business. Keen rivalry among them to attract deposits led them to offer much higher rates of interest than they could really afford, if they had conducted legitimate business only. In order to be able to pay the high rates, they employed the funds at their disposal in hazardous enterprises. Large sums were locked up in

1. See Statistical Tables relating to Banks in India for 1917, p. 2.
2. See Keynes, *Indian Currency and Finance*, pp. 223-5, Shirras, *Indian Finance and Banking*, pp. 365-7 and Rau, *Present Day Banking in India*, pp. 213-24.

speculative dealings in silver, pearls and other commodities; long-term businesses were financed without efficient investigations into their soundness, on the chance of earning large profits, and short-term deposits were used for this purpose; too large a proportion of the total available funds was frequently sunk in a single business; and funds were lent in some cases on the security of the lending banks' own shares.

Many of the directors and managers of these banks were incapable men, and had little knowledge either of the principles or of the practice of banking. Many of the former, instead of guiding and supervising the work of the latter, allowed themselves to be led away by the latter. The shareholders, as a rule, were too ignorant or apathetic to exercise their rights and duties and to control either the directors or managers. Many of the latter resorted even to dishonesty, fraud or criminal mismanagement, and could continue it owing to the connivance of auditors, who were their creatures, and whose auditing of the banks' accounts was more or less a farce. Thus, they lent the funds of the banks, of which they were the directors or managers, to themselves or to concerns in which they were directors or partners; they made away with the assets of the banks by showing in the books debts due to the banks that did not exist. To hide this mismanagement and fraud the books were in some cases left in an incomplete state, not being written up to date, or they were falsely made up; window-dressing was freely resorted to in making up the balance-sheets; and in a few cases dividends were paid out of capital and, if that had disappeared, out of deposits. It is, therefore, not surprising to find that very low cash reserves were kept, amounting in the aggregate to no more than 11 per cent of the liabilities; many of the smaller banks kept still smaller cash reserves. These were hopelessly inadequate to serve their purpose in a country like India, where the banking habit is still far from being formed. Even the liquid assets of many of the banks were small, most of their assets being 'slow'.

This description of the causes of the banking crisis and failures did not apply to all the Indian joint-stock

banks. Many of them, especially the larger and older ones, conducted their work on sound lines and, although not as strong as the Presidency or exchange banks, were strong enough to withstand the crisis without untoward consequences. The description applies chiefly to the small banks which had rapidly sprung up after 1904. No conclusion can be drawn from the bank failures regarding the capacity of Indians to manage joint-stock banks, because a large number of such banks have failed in every Western country during the early part of the development of its joint-stock banking. The crisis was aggravated by the complete absence of co-operation between the Indian joint-stock banks themselves, and between them and the Presidency and exchange banks. The Bank of Bengal declined to lend to the banks that were in difficulties in Lahore even against Government securities. This was the result of the complete decentralisation of the Indian banking system, *i. e.* of the absence of a central bank, which in a Western country guides the general banking policy of the country and endeavours to mitigate a crisis by remedial action.[1]

There was a brief respite in bank failures from 1918 to 1921 during which only 21 banks with a total paid-up capital of Rs. 14 lakhs failed. The boom during the latter part of the War and after it gave another impetus to the starting of banks, and a number of banks was established, some specially for financing industries, the chief of which was the Tata Industrial Bank. But from 1922, the number of failures increased once more owing to economic depression, the number during 1922-31 being 154 with a total paid-up capital of Rs. 5 crores 93 lakhs. The most important failures were the Alliance Bank of Simla, mentioned before, and the Tata Industrial Bank in 1923. The latter had to be merged into the Central Bank of India, because it had combined long-term credit to industries with ordinary commercial banking business, and had financed both out of current and annual deposits

1. *Cf.* Pandit Malaviya's note to the Report of the Indian Industrial Commission, pp. 337-8.

instead of financing the former by issuing bonds, and because it was managed by Europeans, most of whom had no previous experience of India.[1] Of the 262 banks that failed in the country during 1913-31, 74 were in the Punjab, 50 in the United Provinces and 41 in Bombay, while Burma and the Central Provinces had only 3 and 1 failures respectively. The reason is that from the Swadeshi movement of 1906 most of the new banks were established in the Punjab and the United Provinces, the wheat producing provinces of India, and in Bombay, one of the chief ports and a centre for speculative activities, chiefly in cotton and silver.[2]

The above tendencies in the development of Indian joint-stock banking from 1913 are reflected in the following table of its total deposits, which are the best indication of the public confidence enjoyed by banks:—

Year	1913	1914	1915	1916	1917	1918	1919	1920	1921	1922	1923
Actual deposits in crores of Rs.	24	18	19	26	32	42	61	73	80	65	48
Deposits converted to pre-War value... ...	24	17	18	20	23	27	36	40	46	40	31
Year	1924	1925	1926	1927	1928	1929	1930	1931			
Actual deposits in crores of Rs.	55	58	63	64	66	66	67	66			
Deposits converted to pre-War value[3] ...	35	36	42	46	47	47	56	56			

The conversion of actual deposits in terms of the pre-war price level is necessary because 1918-21 were years of inflation, and were followed by depression, but the conversion shows no radical change in the trend. The deposits fell sharply after the commencement of the crisis, and did not recover fully till 1917. They increased rapidly during 1918–21, but fell sharply once more in 1922 and 1923, and did not recover to a considerable extent till 1928. The figures thus bring out the weakness

1. *Cf.* Thakur, *Organisation of Indian Banking*, p. 35.

2. *Cf.* Jain, *The Monetary Problems of India*, p. 100.

3. Figures of these have been taken from Jain, *The Monetary Problems of India*, pp. 92 and 96.

of Indian joint-stock banking when economic conditions become unfavourable.

The progress of these banks since 1870 is shown by the following figures[1] :—

Class A. Banks with capital and reserve of Rs. 5 lakhs and over.					Class B. Banks with capital and reserve between Re. 1 and Rs. 5 lakhs.				
Year.	Number of banks.	Capital and reserve.	Deposits.	Cash balances.	Year.	Number of banks	Capital and reserve.	Deposits.	Cash balances.
		Crores of Rupees.							
1870	2	·12	·14	·05					
1880	3	21	·63	17					
1890	5	·51	2·71	56					
1900	9	1 28	8 07	1 19	1913	23	·50	1·51	·25
1910	16	3 76	25 66	2·80	1915	25	·55	·91	·20
1920	25	10 92	71 15	16·31	1920	33	·81	2·33	·42
1925	28	10 60	51 19	10 10	1925	46	1·18	3·41	67
1926	28	10·81	59 68	9·12	1926	47	1 26	3·47	82
1927	29	11 08	60 84	7·70	1927	48	1 22	3 46	·52
1928	28	11 10	62 83	8·19	1928	46	1 20	3·50	·52
1929	33	11 51	62 72	9 05	1929	45	1·15	3 58	45
1930	30	11 85	63 22	7·67	1930	54	1·37	4 31	·52
1931	33	12 03	62 23	7·69	1931	51	1 24	3·81	·47

Although no statistical information is available regarding banks with capital and reserve of less than Rs. 1 lakh, they play, and will continue to play, an important part in Indian banking.

4. Exchange Banks.

In addition to the banks established in India under charters of the East India Company and Acts of the Indian Legislature, a number of foreign banks with head offices abroad have carried on business in India through branches. The most important of these are English banks established under Royal Charters or English Acts. The bulk of India's foreign trade being with or *via* England, it was natural that banks should be established in London to transact exchange business with India. Until 1853, however, the

1. See Statistical Tables relating to Banks in India 1931, p. 6.

East India Company, supported by the agency houses, succeeded in preventing the starting of such banks, with a single exception, for doing business in India, because the Company and the houses were afraid that the banks would profit at their expense from their annual remittances for home expenditure and other exchange transactions. The Company pointed out that Act 47 passed during the reign of George III had given it the power to incorporate such banks, and that the Act limited the Royal prerogative to grant charters to them. The matter was not decided until 1853, and the only English bank to obtain the Royal Charter for operating in India until then was the Oriental Banking Corporation in 1842. The Presidency and Indian joint-stock banks, however, did not usually conduct exchange and remittance business between India and other countries as it was regarded risky, and the business was transacted by the agency houses.

By 1853, legal experts in England decided that Act 47 of George III empowered the Company to incorporate banks merely for transacting general banking business within its territories, and that it did not limit the Royal prerogative to grant charters to banks for carrying on the business of exchange and remittances. Although the Company did not accept this interpretation, it regarded it unsound that the monopoly of the exchange business should be enjoyed by the Oriental Banking Corporation. It, therefore, suggested the incorporation of more banks, and so the Chartered Bank of India, Australia and China and the Chartered Bank of Asia (afterwards the Mercantile Bank of India, London and China) were brought into existence by Royal Charter in 1853. The failure of the agency houses also made the formation of such banks necessary.

The Oriental Bank failed in 1884; the Mercantile Bank had to abandon its Charter in 1893 and was reorganised under the English Companies Act; so that the only English Bank that has continued to do business in India under a Royal Charter is the Chartered Bank of India, Australia and China. The National Bank of India

was formed in 1863 under the name of the Calcutta Banking Corporation with its head office in Calcutta, but the name was altered to its present one in 1864, and its head office was transferred to London in 1866. Later France, Germany, Holland, Portugal, Russia, the U. S. A., and Japan followed England's example, and opened branches of their banks, chiefly at the Indian ports. Three other English banks also opened branches in India. The Indian branches of the Deutsch-Asiatische Bank and the Russo-Asiatic Bank were closed on account of the War and have not been re-opened.

The progress of these banks was fairly rapid, and they form an important and powerful group at present. Their progress since 1870 is shown by the following Table[1] :—

Year.	Number of banks.	Capital and reserve and rest in millions of £s.	Deposits in India in crores of Rs.	Cash balances in India in crores of Rs.
1870	3	2·18	·52	·61
1880	4	3 07	3 40	1·80
1890	5	8 08	7·54	3·50
1900	8	15·77	10·50	2·39
1910	11	34·34	24·79	4·38
1920	15	90·22	74·81	25·17
1925	18	138·39	70·54	9·41
1926	18	148	71·54	10·72
1927	18	180·32	68·86	7·13
1928	18	187·92	71·83	8·05
1929	18	227·99	66·66	9·05
1930	18	193·62	68·11	7·71

5. Banking Inquiry.

Dissatisfaction with the progress of banking in India led to a demand for a comprehensive inquiry into the needs of banking in India from different quarters for a long time. It was first made in 1890 by the first Indian Industrial Conference. Just before the War, the Chamberlain Commission on Indian Currency and Finance recommended the appointment of a committee to examine certain needs

1. See Statistical Tables relating to Banks in India 1931, p. 5.

of banking, and in 1918 the Holland Industrial Commission suggested the appointment of a committee to determine the additional banking facilities that were needed for the financing of industries. In 1919, a resolution recommending the appointment of a committee to examine the whole field of banking in India was passed by the Imperial Legislative Council. The recommendation was supported by the External Capital Committee in 1924 and by the Hilton Young Commission on Indian Currency and Finance in 1926. In 1927, a similar resolution was passed by the Indian Legislative Assembly, and the demand was supported by the Indian Industrial and Commercial Congress, the Indian Economic Conference, the Federation of Indian Chambers of Commerce and Industry, and the Associated Chambers of Commerce of India.

Thereupon, in 1929 the Government of India, after consulting the Central Legislature and the Provincial Governments, organised a comprehensive banking inquiry in three stages. In the first stage, ten Provincial Committees, composed of persons having intimate knowledge of local conditions, dealt with agricultural and co-operative credit, mortgage banks, credit for small industries, the finance of internal trade, encouragement to the habit of investment, and increase of banking deposits, and issued reports. Nineteen of the Indian States appointed similar Committees for their own territories. In the second stage, an All-India Committee co-ordinated the work of the above Committees, and itself examined the aspects of banking which had been excluded from the scrutiny of the Committees, *viz.* credit for India's chief industries, banking regulation, and banking education.

The Central Committee was composed of Sir B. N. Mitra, Chairman, Sir Purshottamdas Thakurdas, Vice-Chairman, and 19 other members, of whom 15 were Indians, two representatives each of the Indian Chambers of Commerce and Industry, the Associated Chambers of Commerce, the co-operative movement, and indigenous bankers, one representative each of the joint-stock banks, exchange banks and the Imperial

Bank of India, six representatives of the general interests of the public needing credit facilities, and two Indian economists. In the third and final stage, after it had finished its investigations, the Central Committee was helped to form conclusions and to make recommendations by a Committee of six foreign banking experts, selected by Government, from England, Scotland, Canada, Germany, Holland and Denmark. The Provincial Committees issued their reports in 1930, and the Central Committee in 1931, a majority report including the foreign experts' report, and a minority report signed by one member only, Mr. Manu Subhedar, who had been appointed on the Committee as an Indian economist. The reports and the volumes of evidence contain an enormous wealth of information and many important suggestions for quickening and improving the progress of banking in India.[1]

1. See Central Committee Majority Report, Chapter I.

CHAPTER II

Rural Finance : Money-Lenders and Indigenous Bankers

1. Rural Indebtedness.

Rural finance is one of the most important economic problems of India, on account of the appalling poverty and the extremely low standard of living of the rural population. According to the Central Banking Committee, the average annual income of an agriculturist in British India is about Rs. 42 or a little over £3.[1] The same authority, on the basis of the figures supplied by the Provincial Banking Committees, has estimated the total rural indebtedness in India to be about Rs. 900 crores.[2] A large part of this chronic debt has been inherited by the present generation from past generations. Social tradition and the custom of each succeeding generation, acknowledging and trying to pay the debts of its forefathers, have been exalted into a legal maxim, *viz.* 'the pious obligation' to pay ancestral debts enforceable in courts of law. Even when no assets have passed and debts are not legally inherited, they are regarded by sons or heirs as debts of honour by the force of tradition. Moreover, there is a general consensus of opinion that this volume of rural indebtedness has been increasing for a century.

The causes of this indebtedness are complex. The more important are the loss of economic equilibrium in the country caused by the decay or destruction of many cottage industries and the scarcity of large-scale industries, a more rapid increase of the population dependent on agriculture than of the cultivated area, the increase of uneconomic holdings owing to their sub-division and fragmentation, low expenditure on agriculture, out-of-date methods of production and consequent low production

1. See Report, p. 39.
2. See Report, p. 55.

from land per head of population and per acre, the dependence of agriculture on the vagaries of the monsoon, and famines, the burden of land revenue, inefficient marketing of produce, the existence of social habits harmful to progress, the extravagance of the cultivators owing to the lack of business sense resulting from illiteracy, increase in their borrowing capacity owing to the application of Western ideas of property rights to their holdings, and last but not least the defective organisation of rural credit with its excessive rates of interest and certain objectionable practices. These pages are concerned with the last cause only, but it should be borne in mind that no organisation of rural credit, however excellent, will prove satisfactory unless simultaneous efforts are made to deal with the other causes of rural poverty and indebtedness and to make agriculture a paying industry. "The supply of cheap credit is only of advantage to the agriculturist if production is, or can be made, profitable and his indebtedness decreased."[1] Economic progress and the development of banking being interdependent, the latter cannot advance in a community steeped in poverty, ignorance and helplessness.

The evils of this indebtedness are the transfer of land from agriculturists to non-agricultural money-lenders, increase of landless labourers, loss of agricultural efficiency, loss caused by the compulsory sale of the harvest to the creditor at a low price as soon as it is gathered, and lack of distinction between loans required for short and long periods. Owing to this lack of distinction, even when a large loan is obtained for capital improvements or for the repayment of old debt, a short period is fixed for its repayment, so that the borrower has to use the bulk of his income for this purpose, has not enough left even for his subsistence, and is, therefore, compelled to spend less on his production from land and to allow the production to fall off.

Rural indebtedness presents two separate problems. The first is to devise measures for liquidating the standing

1. Foreign Experts' Report attached to Central Committee Report, p. 689.

indebtedness, a large part of which has been inherited. This problem will be examined in the next chapter. The other is to devise remedies for arresting the future growth of unproductive debt. This will be considered now so far as the organisation of a satisfactory system of rural credit is concerned.

2. Special Characteristics of Rural Finance.

First of all it is necessary to emphasise that there are certain fundamental differences between agricultural and industrial finance. These give rise to special problems of rural finance that need special treatment and are more difficult to tackle than those of industrial finance.

(1) While other industries have shown a marked tendency towards increasing concentration and scale of production, agriculture has continued to be small-scale, scattered, isolated, individualistic, and relatively unorganised. Moreover, while the future earning capacity of industries can be estimated with reasonable accuracy, this cannot be done with regard to agriculture, to the satisfaction of the ordinary investors. Further, the agriculturists' operations are more complex, longer in their cycle, and subject to special risks from climate and disease, and their capital is sunk in forms of wealth, which only an expert can value, and which cannot readily be accepted as security for loans. Consequently, whereas industrialists obtain their capital by issuing shares and debentures, farmers have to depend largely on their own resources, and although their need of credit is great, they find it difficult to mobilise it owing to their relative inaccessibility to the general savings of the community.

(2) The farmers find it more difficult than industrialists to slow down or cease production with the decline in demand, owing to their greater dependence upon nature and owing to the fact that the farm is their home and, if uncultivated, will produce a crop of weeds. Consequently, their need for finance remains steady, although their production may cease to be profitable, and this may compel them to lower their standard of living and to incur debt.

(3) If there is over-production, industries, owing to their concentration, can obtain sufficient credit from existing institutions to keep from the market a portion of their stocks, and can devise a plan for restricting output so as to check a fall in prices. But agriculture would find it very difficult to do this owing to its isolation, extension over a wide area, and disorganisation, and a special organisation through State help has to be set up for its relief in such a contingency.

(4) It is very difficult to establish a connection between agriculture and the money market, between farmers desiring credit and savers needing investment, through the usual link, *viz.* the commercial banks, because the security that the farmers can offer is not acceptable to the banks. Land, which is the principal security that the former can offer for long-term credit, is regarded as unsuitable by the latter, as it cannot be sold readily, as its price is subject to special influences and can be determined only by special experts, as there may be difficulties in connection with the title to it, and as the right of transferring it may be subject to customary or legal restrictions. Even the more liquid and more readily saleable assets of the farmers, such as crops or live stock, are regarded as unsuitable security by the commercial banks owing to the risk of flood, failure of rains, epidemics among live stock, etc. Moreover, loans to farmers are regarded as frozen credits by these banks, because the repayment of the loans has often to be postponed and spread in small amounts over a number of years owing to unfavourable seasons or a normally small repaying capacity of the borrowers. The banks cannot afford to lock up their funds in this way, because they are obtained in the shape of short-term deposits or call money. This ordinary credit machinery, therefore, which serves the purposes of trade and industries, is not directly available to agriculture.

(5) All these difficulties of rural finance are enhanced in India by the illiteracy, poverty, heavy indebtedness, helplessness and uneconomic holdings of the Indian farmers. The need of devising measures to overcome these difficulties is urgent and great, and the nation and

the State must interest themselves in the matter, because agriculture is not merely an industry or business, but also a public service rendered by the farmers in national interests for the care and use of land which is the basis of national life. If this is true of Western countries how much more so of India![1]

3. Credit needs of agriculturists.

The first step in the consideration of the proper organisation of rural credit is to understand the normal credit needs of agriculturists. These may be divided into short-term, intermediate and long-term.[2] Short-term credit is needed for the purchase of manure and seeds, expenses of transplantation, weeding, hoeing, reaping and threshing, the payment of land revenue or rent, and the maintenance of the farmers, their families and their cattle. For this purpose loans should be available to the farmers at short notice, in moderate but adequate amounts spread over nine months or so, and repayable only after the harvest is sold, and the rate of interest should be reasonable. Intermediate credit is needed for the purchase of cattle and agricultural implements and for carrying out improvements in the ordinary course of agriculture, such as levelling, deep ploughing, irrigation, clearance, drainage, and fencing. For this purpose loans should be available to the farmers in adequate amounts for a period of from one to three years at a reasonable rate of interest.

Long-term credit is needed for obtaining fixed capital, invested permanently or for long periods in the purchase of land and costly equipment, the consolidation and improvement of holdings, and the repayment of prior debt. For this purpose, the loans should be obtainable in amounts sufficient to enable the farmers to conduct their business effectively, and their repayment should be spread, according to the capacity of the borrowers as determined by their margin of profit from their holdings, over such a period as would not starve the borrowers with regard to

1. *Cf.* Central Committee Report, pp. 45-8, and Foreign Experts' Report, pp. 689-90.

2. *Cf.* Bengal Committee Report, p. 84.

their current financial needs, or compel them to borrow elsewhere, or to sell their holdings. Moreover, the farmers need credit, short-term, intermediate, or long-term, for marketing their produce and for rural industries. The Central Committee has mentioned Rs. 300 to 400 crores as a lower limit of the farmers' needs for short-term and intermediate credit in the whole of British India, and has expressed the opinion that there is an almost unlimited scope for the grant of long-term loans.[1]

The agencies that exist at present for supplying rural credit are money-lenders, professional and non-professional, indigenous bankers, co-operative societies and banks, loan offices in Bengal, Nidhis and Chit Funds in Madras, commercial banks including the Imperial Bank and the exchange banks, and Government. We shall now consider their present services, and the improvements that are needed in them.

4. Operations of money-lenders.

Both money-lenders and indigenous bankers lend money. But the first difference between them is that while the latter receive deposits, or deal in hundis, or both, which are essentially banking functions, the former do not usually do so. Some money-lenders may now and then use funds temporarily deposited with them for safe custody by their clients, but this business is too uncertain and too small to justify their claim to the title of bankers. Secondly, while the indigenous bankers finance trade and industry rather than consumption, the money-lenders, especially urban ones, finance consumption more than trade. Thirdly, the former are more careful than the latter regarding the objects for which loans are required. Finally, the former's clients repay more punctually than those of the latter and, therefore, the former usually charge lower rates of interest on the whole.[2] It should be borne in mind, however, that the dividing line between money-lenders and bankers is rather thin in many cases.

1. Report, pp. 70-1.
2. *Cf.* The Punjab Committee Report, p. 130.

The indigenous bankers and money-lenders lack a comprehensive organisation, as their development has varied in different parts of India according to local needs, habits, customs, and traditions. But, broadly speaking, the money-lenders, usually known as *sowcar*, *bania* or *mahajan*, may be classified into professional money-lenders, either rural or urban, including itinerant money-lenders, and non-professional money-lenders such as land-owners, agriculturists, merchants, traders, pleaders, pensioners, jobbers and sardars of labourers, priests and widows, who pursue other activities but lend out their surplus funds.[1]

The professional money-lenders in the villages usually give small loans on a mere entry in their account books, or no entry at all and a verbal promise occasionally backed by an oath, and without a document or even a witness, but receive promissory notes when the loans are large, or when old loans are renewed. They usually give loans for current agricultural requirements on personal security on the understanding that the harvest is to be sold to or through them, or on the mortgage of crops. But when the loans are large or given for a long period, security in the shape of mortgages of land, houses, or ornaments, has to be supplied to them. Unless they have cultivation of their own, they do not usually accept usufructuary mortgages.[2] They often obtain conditional sale deeds on the understanding that the land would be re-transferred on the repayment of the debt.[3] They make no enquiries regarding the objects for which loans are demanded, and the manner in which they would be utilised. The loans are given in cash as well as in kind. Interest is added to the principal at short intervals, so that this form of compound interest rapidly increases the principal to a large amount. The money-lenders in addition conduct agriculture, trade, and retail shops.[4]

1. See Bengal Committee Report, p. 195.
2. See Bengal Committee Report, p. 196.
3. See Bombay Committee Report, p. 209.
4. *Cf.* Madras Committee Report, p. 220.

The relations between them and their borrowers are not so friendly nowadays as they were formerly, owing to the loss of interdependence caused by the disintegration of the village community and the legal protection given to the borrowers. The latter often endeavour to take undue advantage of the protection for evading repayment, and the money-lenders resort to several objectionable practices, mentioned below, in order to protect themselves against the risk of losses, so that the attempts at evasion ultimately harm the interests of the debtors themselves. The operations of the urban money-lenders are similar, but on a larger scale, and they also advance money on hundis.

Itinerant money-lenders, such as Pathans and Kabulis in most parts of the country, Rohillas in the Central Provinces, Qistwalas and Tharakkars in the United Provinces, and Gossains and Nagas in Bihar and Orissa, supply credit to poor labourers, factory workers, menials, peons and low-paid clerks who cannot obtain credit elsewhere. The sums advanced are usually small and are given for short periods. Formerly their methods were very informal, and bonds or written acknowledgements were seldom taken from the borrowers.[1] But nowadays they usually obtain promissory notes, or signatures, or thumb impressions in their khata books, from borrowers as acknowledgement of debts. These men as well as other petty money-lenders give loans to borrowers, receiving weekly or monthly wages, also under the instalment or kist system by which a loan of Rs. 8 is repaid in nine weeks by an instalment of one rupee every week, or a loan of 4,10, 16 or 20 rupees is repaid in 6, 12, 20 or 25 months, by an instalment of one rupee per month.[2] In cases of default, they seldom go to the law-courts, but threaten or use force. Actual force is not used often, as the threat of it proves sufficient in a majority of cases to terrorise the ignorant borrowers, who dare not complain to the police, and who allow themselves to be victimised. The borrowers are also kept in perpetual dread of being

1. See Bengal Committee Report, p. 196.
2. See U. P. Commitee Report, p. 278.

victimised. Most of these money-lenders also sell goods, mainly cloth, on credit at a price which covers a usurious rate of interest.[1]

The non-professional landlord or agriculturist money-lenders are often more greedy and exacting than their professional brethren. They lend seed on the security of future crops, or money on that of land, and eagerly wait for the chance of seizing both. Holding a stronger position in the villages than the professional money-lenders they secure the payment of a larger proportion of their claims. The landlord money-lenders especially are the most dangerous, as they get a double hold over their tenant-borrowers, who have to pay both rent and interest, are apt to fall into arrears of one of the two, and are liable to have their crops seized and to be ejected from the land. In other respects their operations and methods are similar to those of the professional money-lenders. Merchant or trader money-lenders give advances to cultivators on condition that the latter's crops are sold to, or through, them. Owners of cotton gins lend money to cultivators on the condition that they sell their cotton crop to them, or get it ginned in their ginneries. Such money-lenders are less exacting in their terms, as the sale of the crops to or through them gives them substantial profits.[2] Other non-professional money-lenders such as lawyers, pensioners and widows give loans only to acquaintances on the security of land or ornaments.

Loans are obtained from money-lenders for all sorts of purposes. Agriculturists borrow for the expenses of cultivation and the household, or for the payment of rent or land revenue; landlords borrow to pay land revenue or purchase land; tradesmen borrow for the purposes of their business; artisans borrow to purchase raw materials; professional men and employees in receipt of fixed salaries borrow for the expenses of medical treatment, or the education of their children; and all classes of people borrow for social ceremonies such as births, marriages and funerals, for payment of earlier debts, and for litigation.

1. See Bombay and Punjab Committees Reports, pp. 217 and 131.
2. *Cf.* Bombay Committee Report, p. 215.

These money-lenders are generally reasonable as regards the periods for which the loans are given. The short-term loans have to be repaid as soon as the crops are sold, but if the crops fail completely or partially, they are quite willing to extend the periods of the loans or to obtain new agreements for larger sums. They do not rush to court to realise the principal as long as the interest is paid, and prefer to give the borrowers every chance to repay the principal.[1] Many of them do not even press for the payment of the principal before the expiry of the period of limitation, unless the security is found to be inadequate. But they insist on the punctual payment of the interest, because it is their chief source of income. Intermediate loans are given for three years or less, and long-term loans for longer periods. Itinerant money-lenders give loans for short periods only, but they do not compel repayment as long as they regard the loans to be safe.

5. Objectionable practices of money-lenders.

Many money-lenders, however, resort to various objectionable practices in the course of their operations, such as demanding advance interest, demanding presents for opening business, obtaining thumb impressions of the debtors on blank paper with the object of entering any arbitrary figure later, if the debtors do not pay interest regularly, entering in bonds amounts much larger than those actually lent, manipulating the accounts, taking conditional sale deeds as insurance against the possibility of the evasion of payments by the debtors, exacting free service from the debtors who are thus virtually reduced to the position of serfs, dishonesty in the grant and collection of loans in kind, in cattle, and in the grant of loans in instalments. If the money-lenders have any assistants, called munims, these have to be paid commissions to obtain loans, especially if the security offered by the borrowers is not quite satisfactory. Some money-lenders make the borrowers sign promissory notes by which they undertake to repay the loans in any of the several districts

1. *Cf.* Madras Committee Report, p. 228.

mentioned in them, and if they default, the money-lenders sue them and obtain uncontested decrees in distant places, and then execute them at the places where the borrowers live.[1]

It may, however, be mentioned that most of these practices are not confined to India, and that they prevail in all those countries in which money-lenders thrive. Moreover, money-lenders in India do realise that their prosperity depends upon that of their clients, that it is not to their advantage to see them ruined, and on many occasions they do show leniency. Opinion with regard to them is divided. Some condemn them altogether as unscrupulous usurers, land-grabbers and fomentors of factions and law-suits; others commend them as the friends of peasants, the traditional guardians of their property and ever present helpers in time of need. The truth lies between these extremes.[2]

6. Interest charged by money-lenders.

The reports of the Provincial Banking Committees show[3] that in most provinces the rates of interest charged by the money-lenders vary between 12 and 37½ per cent according to the security and the amounts of the loans and the total amount of funds available in the neighbourhood. Loans secured by ornaments, land, or other property carry the lowest rate of interest. Among all the provinces, the rates are the lowest in the Punjab. The rates charged by the urban money-lenders are generally lower than those of the rural money-lenders, while among the latter the rates charged by the professional and non-professional money-lenders tend to be the same in the same area. Loans given without security carry much higher rates, with a maximum of 300 per cent. The Pathan, Kabuli and Rohilla money-lenders charge from 75 to 360 per cent, as they run a great risk of losing their money. These high rates of interest are due to the operation of the following factors.

1. See Bengal Committee Report, pp. 196 and 201.
2. See U. P. Committee Report, p. 281.
3. See Bombay, Bengal, Madras, Punjab and U. P. Committees Reports, pp. 210-11, 198, 221-7, 31 and 280 respectively.

(1) In many parts of the country the money-lenders hold a semi-monopolistic position as they are the only credit agency available to the rural population. Even if other agencies exist, they are not available to all sections of the rural population, and cannot meet adequately the needs even of those sections which they do finance. Many do not like to join a co-operative society owing to the fear of publicity and unlimited liability.

(2) Many villages have no financing agencies, even money-lenders. The needy villagers have, therefore, to go to the nearest village that has a money-lender who, not being personally acquainted with the borrowers, has to charge them a high rate to cover the risk.[1]

(3) Relatively to the demand, the money-lenders' supply of capital is very inadequate. They have to depend largely upon their own resources. The rural money-lenders rarely obtain deposits from the public, and most of the urban money-lenders do so to a small extent only. The rural money-lenders may borrow from the urban ones, and the latter from the indigenous bankers, but such borrowings are seldom large. Both have generally no connection with the money market. The shortage of their capital is being enhanced by the fact that, owing to the lack of a rational system distinguishing the short-term and intermediate credit needs properly from the long-term needs of the borrowers, their capital is getting frozen year by year.

(4) Owing to ignorance and conservatism, borrowers are unable to examine the feasibility of obtaining loans at lower rates from other, especially urban, centres. For the same reason there is no public opinion to condemn the high rates.

(5) The expenses of the money-lenders in connection with giving small loans to a large number of borrowers, managing them, and obtaining repayment of them, are much heavier than similar expenses of joint-stock banks.

(6) The security offered by the borrowers is often inadequate. For long-term credit the only security to offer is land. For short-term and intermediate credit the

1. See Bengal Committee Report, p. 199.

main security is ornaments. But the value of ornaments in most cases is small, and in addition womenfolk do not like to part with them, as they are bound up with certain social and religious uses. The other assets are usually of small value. Industrial labourers, landless agricultural labourers, and cultivators who are already indebted have practically no security to offer. Consequently, the money-lenders have to shoulder far heavier risks than other credit institutions in connection with their respective financial operations, and have to charge higher rates by way of insurance against the greater risks. This is brought out in the reports of some of the Provincial Banking Committees which show that the actual gain of the money-lenders has been much smaller than the rates of interest agreed upon originally.[1]

7. Laws for checking usury.

To check usury on the part of the money-lenders, the Usurious Loans Act was passed in 1918. It empowers the courts of law to re-open and examine all loan transactions, if they are of opinion that the stipulated interest is exhorbitant, or that the transactions are substantially unfair to the borrowers. Before 1918 the courts had to allow interest at the stipulated rates. The investigations of the Provincial Banking Committees show that the Agricultural Commission's opinion that the Act has been little utilised so far is not correct, but that certain defects in the Act need removal.[2] There is a general consensus of opinion, however, that the Act, if utilised more freely and fully, is capable of mitigating considerably the evils of usury that prevail in India. Further, the rule of Damduppat in the Hindu Law of Contract, by which interest in excess of the principal cannot be recovered at any one time, is enforced by the courts in some parts of the Bombay Presidency, in Calcutta, and in Berar. The Bengal Committee has recommended legislation on this principle for the whole

1. See Central Areas Committee Report, p. 105.

2. See Madras, Punjab and Bengal Committees Reports, pp. 173, 118 and 165-6.

country, but the Central Committee does not regard the proposal to be practicable.[1]

The Punjab Regulation of Accounts Act, passed in 1930, compels all those who give loans at interest, excluding loans to merchants and manufacturers, to maintain a separate account for each debtor in the prescribed way, and to furnish him half yearly a statement of account showing the amount of the loan outstanding and all transactions relating to it. Interest must be shown separately from the principal, and if there is no agreement, no portion of the former can be included in the latter. In any proceedings regarding a loan, the courts are authorised to disallow the whole or a part of the accrued interest, if the account has not been regularly maintained by the creditor, or if he has not supplied its half-yearly statement to the debtor. The Central Banking Committee has recommended to the Governments of other provinces the passage of similar legislation, and has suggested that it should also compel the creditors to give receipts for all repayments made by the debtors, and to keep their counterfoils with themselves.

The Bengal Money-lenders' Act, passed in 1933, makes registration compulsory for all money-lenders who are not permanent residents, or have no permanent domicile. It fixes the maximum rates of interest at 12½ and 18¾ per cent per annum for secured and unsecured loans respectively ; abolishes compound interest ; provides that courts shall not decree on account of arrears of interest a sum greater than the principal of a loan ; compels money-lenders to supply, on demand by their debtors, all particulars regarding outstanding loans ; makes habitual usury a penal offence and empowers courts to take tender of money for loans as interest or principal. The city of Calcutta, however, is excluded from the operation of this Act, and the Bengal Government is empowered to exclude municipalities from it with a view to leave industrial finance unaffected by it. The Act is intended to give relief to agriculturists. The United Provinces Agricul-

1. See Bengal Committee Report, p. 171 and Central Committee Report, p. 87.

turists' Relief Act of 1933 empowers courts of law to reduce the rate of interest on loans advanced to agriculturists and to allow repayment of decreed amounts by small instalments, and contains liberal provisions for the redemption of mortgages of land owned by them.

The Deccan Agriculturists' Relief Act, passed in 1879 and amended in 1907 in the Bombay Presidency, enables the courts to go behind the contracts between money-lenders and agriculturists, and to modify them in favour of the latter by reducing an unreasonable rate of interest, granting instalments for the repayment of the amounts due, preventing sale of land unless specifically pledged as security, restoring land to the agriculturists even when there are sale deeds between them and their creditors, and preventing their arrest in execution of court decrees. The Act further requires creditors to pass receipts for all payments made by agriculturists, to give them a statement of account every year, and to register with village registrars all written obligations for payment of money.

In the opinion of all authorities, however, including judges of the Bombay High Court, the Famine Commission of 1901, the Arthur Commission of 1912 and the Bombay Banking Committee, the working of the Act has not been a success. Some of its provisions have remained inoperative and some others have been evaded. It has set a premium on dishonesty by unscrupulous money-lenders and driven away honest ones from rural areas and it has seriously diminished the credit of agriculturists. Wealthy landlords, money-lenders, traders and professional men deriving more income from agriculture than from other business obtain protection from it as agriculturists. The Bombay Committee has, therefore, recommended that the Act should be replaced by a new and simple Act, which should contain a few provisions to safeguard the interests of those only who actually engage personally in agriculture, and whose income is below a certain specified figure. The Act should render possible investigation of past transactions by requiring money-lenders to keep proper accounts, should provide for allowing instalments for the repayment of the amounts decreed, and should

continue the freedom of agriculturists from arrest in execution of decrees.[1]

8. Decline of money-lenders.

The business of money-lenders has declined in recent years, insolvencies among them have increased, and more than one Provincial Banking Committee has mentioned this fact.[2] The following are the causes of this decline.

(1) The money-lenders have to fight against great difficulties in securing the repayment of their loans. Court proceedings for the recovery of debt are very expensive, and there is much delay in obtaining decrees of the courts as well as in executing them.

(2) Some acts passed for protecting the borrowers, such as the Land Alienation Acts, the Usurious Loans Act and the Civil Procedure Code, etc., have increased the difficulties of the money-lenders. There are several cases of persons borrowing money from them with no intention of repaying it, and taking the protection of the Insolvency Act.[3]

(3) The growth of co-operative societies has curtailed their activities.

(4) The general economic depression has produced the same result.

(5) Some money-lenders are tempted by the counter-attraction of trade to leave their villages and to seek their fortunes as traders in the smaller towns.

(6) The relations between them and the borrowers are becoming strained on account of the growth of other credit agencies, the legal protection to the borrowers mentioned above, the decay of the village community with its solidarity of village life, the recent nationalist movement that has made the masses conscious of their rights, their suspicions against the whole money-lending class on account of the objectionable practices of some of its members, and the economic depression which has increased

1. See Bombay Committee Report, pp. 179-82.
2. See the Punjab Committee Report, p. 133.
3. See Jain, *the Monetary Problems of India*, p. 65.

the burden of debts and reduced the debtors' capacity to repay them. This estrangement is seen from the recent increase in crimes against the life and property of the money-lenders. It threatens the basis of India's rural economy, of which the money-lenders have been an indispensable feature. While the borrowers are showing an increasing desire to loosen the grip of the money-lenders, the latter are trying to tighten it by abandoning some of their old informal methods, and adopting new formalities, such as insistence on promissory notes from the borrowers in place of verbal promises, and by insisting on the repayment of loans in cash in place of repayment in kind. These efforts, however, have not arrested their decline.[1]

This decline is regrettable because the money-lenders are still an indispensable part of the country's rural economy.[2] They are accessible at all times of the day and even at night. Their methods of business are simple and elastic. They maintain a close personal touch with the borrowers, and often have hereditary connections with their families. They do not keep their borrowers waiting for their loans until the time for utilising them profitably has passed. They do not conduct embarrassing enquiries into the financial condition of the borrowers. They do not press for the repayment of loans at due date if they know that such repayment is inconvenient. Their local knowledge and experience and presence on the spot make it possible for them to lend to persons having no definite assets, and yet to protect themselves from losses.[3] Such an important section of rural society must not be allowed to disappear. It should be reformed and strengthened.

9. The question of licensing money-lenders and suggestions for reforming them.

The Bengal and Central Provinces Banking Committees have recommended that legislation should be passed compelling all money-lenders to obtain licenses

1. See Jain, *the Monetary Problems of India*, p. 67.
2. See the statement of the Bihar Chamber of Commerce, Bihar Committee Evidence, Vol. II, p. 480.
3. See Bombay and U. P. Committees Reports, pp. 208 and 47.

from Government and making the practice of money-lending without a license a punishable offence, on the grounds that without a licensing system the objectionable practices of unscrupulous money-lenders cannot be eliminated for the benefit of the masses, and that such compulsory licensing or registration has worked well in the cases of the legal and medical professions, and has not led to any legitimate complaints.[1]

The Madras, Bihar and Orissa, Burma and Central Areas Committees and Mr. Subhedar, however, have recommended only voluntary registration of money-lenders on the grounds that (1) most of them will strongly object to any restrictions on their operations; (2) owing to their strong position, the restrictions will either be evaded or, if effective, will worsen the position of the illiterate borrowers who are dependent upon them and cannot afford to lose their goodwill; and (3) it will be difficult to provide for the compulsory licensing of the non-professional money-lenders.[2]

The terms suggested for the license are that (1) the rate of interest charged by the licensees must be within a certain maximum; (2) they must keep their accounts in a prescribed form and must allow them to be examined periodically by Government auditors; (3) they must keep a separate account for each individual borrower, and supply a copy of it to him periodically; (4) they must give receipts to all borrowers for repayments and keep the counterfoils with themselves; and (5) if they charge compound interest, the period of rests must not be less than a year.

In return for these restrictions the licensed money-lenders will be given certain privileges, such as the recovery of loans given by them against agricultural hundis or warehouse receipts by the procedure that is applied to the recovery of public demands, advances of money to them from banks on the security of their agricultural paper,

1. See Bengal and C. P. Committees Reports, pp. 170 and 302.

2. See Central Committee Minority Report, p. 102 and Madras, Bihar, Burma and Central Areas Committees Reports, pp. 228, 207-8, 313 and 168 respectively.

the same remittance facilities to them as those given by the Imperial Bank to other banks and by post offices to co-operative societies, and the facility to them of opening current accounts with post offices withdrawable by cheques. The Bombay, Punjab and Assam Committees and the Central Committee are not in favour of a licensing system, either compulsory or voluntary, for the money-lenders.[1]

The proposal to establish a system of licensing money-lenders has been made for two purposes: to lower the high rates of interest charged by them, and to check the objectionable practices of some of them. The first object can be secured only by the progress of mass education, the development of habits of thrift and saving among the masses, and the promotion of co-operative and joint-stock banks. This will take time, and in the meanwhile all that seems practicable is (1) to make a fuller use of the Usurious Loans Act[2]; (2) to take steps to reduce the hardships experienced by honest money-lenders in recovering their dues, so as to reduce their expenses and to enable them to reduce their charges to honest borrowers; (3) to induce money-lenders to join co-operative societies on the condition that they do not lend privately to the members of the societies[3]; (4) to entrust selected money-lenders with the agency functions of joint-stock banks, such as accepting deposits, and making remittances and payments; (5) to transform them into regular branches of the banks as business develops, or to make them partners of the banks on the German 'Kommandit' system,[4] if the banks desire to avoid the expenses and

1. See Bombay, Punjab, Assam and Central Committees Reports, pp. 185, 142, 182 and 90 respectively.

2. See Bombay, Bengal, Bihar and Coorg Committees Reports, pp. 183, 170, 180 and 121 respectively.

3. See U. P. Committee Report, pp. 189-90 and 288.

4. This is a German form of a joint-stock company in which one or more persons manage the company along with its directors, although they may not hold any shares of the company, and are personally liable to the creditors of the company. These persons are virtually the partners of the shareholders, have a more independent position than the manager or directors of the company, and share in its profits. This system increases the confidence of depositors, and may prove attractive enough to some of the money-lenders and

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heavy liabilities of opening new branches, without losing the advantages of the unlimited liability and local knowledge of the money-lenders; and (6) to make those, who are prepared to abandon business other than banking, members of the Reserve Bank.

To secure the second object, *viz.* the elimination of the dishonest practices of some money-lenders, (1) the Usurious Loans Act, which authorises courts to take into account some of them in dealing with cases coming before them, should be utilised more freely and fully; (2) legislation on the lines of the Punjab Regulation of Accounts Act should be passed in other provinces as mentioned before; (3) additional legislation should be passed on the lines of the English Money-lenders' Act prohibiting money-lenders from levying any charges for expenses relating to the grant of loans, and from increasing interest on account of a default in repayment, and preventing the enforcement of contracts for the repayment of money lent to them, unless there are notes or memoranda in writing of the contracts made and signed by the borrowers before the money is lent; (4) district authorities should watch the operations of Kabuli or Pathan money-lenders, and should prosecute them if they are found resorting to violence or threats of violence against their borrowers, and Government should deport, under the Foreigners' Act or special legislation, those who are found continuing these practices in spite of prosecutions against them[1]; (5) courts should be empowered to dismiss suits brought before them by money-lenders for the recovery of sums due from borrowers living in distant places; and (6) Provincial Governments should conduct propaganda

Continued from page 39)

indigenous bankers in India to induce them to form or join joint-stock banks in which they will retain an independent position justified by their local knowledge and experience and personal ability. See Central Committee Report, p. 629.

1. See Bombay Committee Report, p. 218, Central Committee Report, p. 92 and Bihar Committee Report, p. 181. Mr. Subhedar has recommended that Pathans should be prohibited from conducting money-lending operations unless they are registered with the police and that the registration should be renewed annually so as to make them feel that their operations are being watched by the police. See his report, p. 106.

and education of the masses regarding their rights under these laws and the protection given by the laws against malpractices, and the services of school masters, post masters, pleaders, etc. should be used for this purpose.[1]

10. Operations of indigenous bankers.

As a credit agency that has stood the test of political and economic vicissitudes for centuries, indigenous bankers hold a unique position with regard to the magnitude of their operations and their importance to society. While money-lending is carried on by people belonging to all castes, indigenous banking is mostly confined to certain castes, which are known as the banking castes. It is purely a family business, and hereditary in the families belonging to these castes. The principal caste engaged in banking is the Vaishya, in which the Jains, Marwaris and Chettis must be included. The Vaishyas and Jains are spread all over the country. The Marwaris have their homes in Marwar State in Rajputana and in Central India, but many of them have migrated to Bombay, Calcutta and other trade centres. The operations of the Chettis are mostly in Madras and Burma. The Khatris, who claim to be Kshatriyas, operate in the Punjab. Then there are the Shikarpuri Multanis, who flourish in Sind and Bombay, and the Rehtis or Bohras who work in Gujarat and the north-western part of the United Provinces. The number of Mohammedans operating as money-lenders or indigenous bankers is small, as they are prohibited by their religion from receiving interest. The number of Mohammedan money-lenders, however, is gradually increasing, as they either ignore this religious prohibition, or evade it by taking interest in kind. Two Provincial Committees have mentioned that the Mohammedan attitude towards the taking of interest is changing.[2]

The indigenous bankers, usually known as *kothiwals*, *sarrafs*, *shroffs* or *chettis*, may be divided into urban and rural; those whose entire or principal business is banking proper, those whose principal business is trading but who

1. *Cf.* Burma Committee Report, p. 313.
2. See Bengal and Punjab Committees Reports, pp. 195 and 138.

employ their surplus funds in banking, and those who divide their funds and energies more or less equally between banking and trading[1]; and those whose methods are antiquated, and those who are gradually taking to modern methods.

Some of these bankers have offices and branches in several parts of the country and several trade centres, including Bombay, Calcutta, Madras, Delhi and Rangoon. The branches are managed by their agents, who are known as munims or gumastas. These are given large powers, and are known for their honesty, industry and efficiency, although they are not highly paid.[2] They submit periodical returns and reports of their work to their head offices, obtain instructions from them, and their books and accounts are carefully audited at intervals by the indigenous bankers themselves.

Although the indigenous bankers act independently of each other, some of them still have a few guilds of ancient origin, usually known as the *mahajan*, functioning in the north and south of India. Though the bulk of their activities are social and religious, they settle disputes among their members, and function as insolvency courts. In modern times the bankers have established a few associations, such as the Shroffs' Associations in Bombay, Ahmedabad and Calcutta, the Marwari Chamber of Commerce and the Multani and Shikarpuri Bankers' Association in Bombay, the Marwari Association in Rangoon and the Bankers' Association in Delhi. They have proved useful in bringing the bankers together, binding them to each other in their common interests, and settling their daily disputes, which otherwise would have had to be referred to the law courts. Members of one association have dealings with those of another, and joint meetings of the associations are sometimes held to discuss matters of common interest, but there is no organisation for the interchange of intelligence concerning

1. See Bombay Committee Report, p. 196.
2. See U. P. Committee Report, p. 266.
3. Jain has described two of these, called Gyara Panch and Kovilvasal Mariyal in *Indigenous Banking in India*, pp. 40-41.

the credit position of the constituents and for the enunciation and adoption of uniform policy and methods of work.[1] There is also no co-ordination among the various classes of bankers, although certain sections of them, such as the Marwari and Chettiyar bankers, are united by a strong communal feeling, and are known for their readiness to help other members of their castes in times of difficulty.[2]

These bankers receive no banking education beyond what they learn in the course of their business and from the previous experience of their firms. Their operations are free from formalities and delays. They are available at all times. Their establishments are small and economical. Their accounts are simple and economical, yet accurate and efficient. No audit is needed, and no balance-sheet is to be prepared. No separate accounts, funds or establishments are kept for banking and trading.[3] Knowing the family history of customers and the details regarding their business and financial position, the bankers know easily to whom to lend, and to what extent. Moreover, after giving loans they can watch the doings of their borrowers much more closely than modern organised banks can do. The rarity of failure on their part to make payments whenever demanded, and their readiness to meet any emergency and to maintain the prestige of their firms under any circumstances show that they keep substantial cash balances.[4] Their methods of business, unlike those of the ordinary money-lenders, are marked by a high sense of responsibility and probity, and so they are held in esteem and confidence by traders and the public.[5] They regularly supply their clients with copies of their accounts, as the latter are educated men and therefore able to understand the accounts.[6]

These bankers receive deposits from the public either on current account or for fixed terms, and pay interest on

1. *Cf.* Bombay Committee Report, p. 194.
2. *Cf.* U. P. Committee Report, p. 266.
3. *Cf.* Bengal Committee Report, p. 185.
4. See Bombay Committee Report, pp. 196-7.
5. See Bengal Committee Report, p. 190.
6. See U. P. Committee Report, p. 273.

them at rates varying between 3 and 9 per cent according to the seasons, the amount and duration of the deposits, their relations with the depositors, and their own standing. But while modern banks depend to a large extent upon deposits for their working capital, these bankers do so to a small extent only. Some of them, especially the Multanis and Marwaris, hardly receive deposits from the public,[1] and rely mostly on their own resources and loans from members of their own castes living in Shikarpur and Rajputana respectively. Moreover, the volume of deposits obtained by the indigenous bankers has been declining in some parts of the country in recent years, owing to the increasing competition of co-operative and joint-stock banks and Government which, by the publicity of their operations and their business-like methods, supply a greater sense of security to the depositors.[2] Withdrawals from the deposits are usually in cash, and not by means of cheques. Some bankers issue cheques and pass books in the vernaculars, but these cheques are not accepted, as a rule, by the joint-stock banks and the Imperial Bank, and have only a limited local circulation. These bankers also replenish their resources in the busy season by borrowing from one another. In the cities they obtain accommodation to some extent from the Imperial Bank and the joint-stock banks on demand promissory notes drawn by two approved bankers, or by discounting hundis endorsed by them.

The indigenous bankers generally find it impracticable to establish direct relations with agriculturists, and so finance them through local money-lenders and traders. They have stopped giving loans against agricultural land in those provinces in which Land Alienation Acts are in operation.[3] They have kept themselves in close touch with traders and small industrialists, and have enabled the agricultural and industrial products of the country to be brought to the markets. In financing them they do a

1. See Bombay Committee Report, p. 192.
2. See Bengal Committee Report, p. 156 and the Punjab Committee Report, p. 124.
3. See the Punjab Committee Report, p. 125.

considerable amount of general banking business, such as buying and selling remittance, discounting hundis, receiving deposits, and giving loans against stock-in-trade.[1] In a few industrial centres some bankers keep a portion of their funds on deposit for fixed terms with textile mills. At the end of the fixed periods, they may renew the deposits at a higher or the same rate of interest, or may withdraw them and keep them with other mills which offer higher rates or provide a better sense of security, or may use them in other and more profitable directions. Beyond this, the bankers do not finance large-scale industries. Even this finance is defective because, although the depositors obtain a good rate of interest, *viz.* 7 or 8 per cent, find their funds fairly safe, and periodically are free to transfer them to better investments, this practice means that the long-term needs of the mills have to be met to some extent by the short-term deposits of the bankers.

One of their usual methods is to lend money on written demand promissory notes. In the case of the larger loans, the notes have to be attested by sureties, otherwise a much higher rate of interest is charged. A second method is to obtain receipts signed by the borrowers acknowledging the loans and stating the agreed rate of interest, in place of the promissory notes. A third method is to give advances against bonds written out on stamped legal forms, which state all the conditions of the loans in detail, including higher rates of interest if the loans are not repaid on the due dates, and which are duly executed. A fourth method is to make the borrowers put down their signatures in the bankers' books to which stamps have to be affixed, undertaking to repay the loans, but the conditions of the loans and the rates of interest are not stated, and are left to verbal agreement. This method is analogous to the modern system of book credits.

A fifth method is to lend on the mortgage of land, houses or other property. This method is used in the case of large loans, and a lower rate of interest is charged. The mortgage deeds have to be registered by the

1. See Bombay and Bengal Committees Reports, pp. 199 and 187.

Registrars or Sub-Registrars of the districts in which the properties are located. The mortgages may be either ordinary, in which the possession of the mortgaged properties is retained by the mortgagors, or usufructuary, in which the possession is handed over to the mortgagees who receive the income therefrom as interest. Ordinary mortgages are more common than usufructuary ones. The usufructuary mortgages are either ordinary, in which all the income from the mortgaged properties is enjoyed by the mortgagees, or those known as Zarpeshgi, in which any surplus in the income over the stipulated interest has to be paid to the mortgagors. Usufructuary mortgages may be accompanied by the condition that, if the loans are not repaid by a certain date, the transfer of the properties will become absolute and unredeemable. In the absence of such a condition the borrowers can recover their properties at any time after repaying the loans.

Finally, the indigenous bankers draw and discount hundis, *i. e.* indigenous bills of exchange. They are *darshani* or *muddati*, *i. e.* demand or usance bills, the latter being payable after a certain period mentioned in the hundis and calculated from the dates on which they are drawn. The muddati hundis are usually drawn payable on the 11th, 21st, 31st, 41st and so on, up to the 361st day. No days of grace are allowed if the hundis are of less than 11 days' maturity. For those of 11 to 21 days' use, 3 days of grace are allowed, and for those of longer usance 5 days. The hundis are also *dhanijog* or *sahjog*. In cashing the latter a banker has to make sure that the presenter is the proper person entitled to payment, but he is free from this responsibility in cashing the former. Further, the hundis are *dekhanhar* or *firmanjog*, *i. e.* payable to bearer or order. Finally, the hundis may be purely finance bills, *i.e.* they may be drawn by merchants, who need money, on their agents, firms or others with whom arrangements have been made beforehand, or they may be drawn as a convenient form of remittance of money from one place to another. Or they may be trade bills drawn against produce or goods. But there is nothing in them to show whether they are finance or trade bills,

Hundis can be discounted and rediscounted any number of times, and sent to a number of different places, by means of endorsements on the back before they are cashed on maturity. Every endorser of a hundi is responsible to the holder for its payment. The dishonouring of a hundi is very rare, because it is regarded as equivalent to the bankruptcy of the drawer.[1]

The rate at which the hundis of small traders are discounted by the indigenous bankers is called the bazaar rate. It varies in every locality between 4 and 14 per cent, according to local conditions and the nature of the season. A difference of as much as 4 per cent may exist between the Bombay and Calcutta bazaar rates at the same time, showing that there is no free flow of capital even among the indigenous money markets of these two Presidency towns. The rates of interest charged by the bankers on secured loans vary between 6 and 18 per cent according to the nature of the security and the amount and period of the loans, and on unsecured loans they vary between 18 and 37½ per cent according to the standing of the borrowers. These rates are not subject to seasonal fluctuations, or to serious fluctuations in the cases of individual borrowers.

11. Decline of indigenous bankers.

The majority of indigenous bankers combine banking with trade, and their capital engaged in banking cannot be distinguished from that engaged in trade. The principal exceptions to this are the Nattukottai Chettis of Madras and the Multanis of Bombay. The majority of the others trade or speculate in grain, cotton, jute or other agricultural produce, cloth, or precious metals, or act as general merchants, commission agents, brokers, goldsmiths, or jewellers, or are managers or proprietors of sugar, flour, or oil mills, or cotton, jute, silk, or glass factories. Moreover, some Provincial Banking Committees have pointed out that their banking business has tended to decline in recent

1. For further details regarding the indigenous bankers' methods of business see Jain, *Indigenous Banking in India*, Chapter III, and Bombay, Bengal, Madras and U. P. Committees Reports, pp. 197-8, 188-9, 187-8 and 267-70 respectively.

years, and that they are trying to make up for this loss by developing other activities.[1] The following are the reasons of this decline.

(1) While the competition of co-operative and joint-stock banks, including the Imperial Bank, has been increasing, the majority of the bankers still cling to their antiquated methods.[2] Generally speaking, they find it difficult to compete with the Imperial Bank in remittance, with the co-operative banks in deposits, and with the joint-stock banks in advances, as the Imperial Bank has special facilities for remittance, the co-operative banks, being under the aegis of Government, inspire greater confidence among depositors, and the joint-stock banks have the advantages of large-scale operations and quick business-like despatch.

(2) The heavy stamp duty on hundis has restricted their hundi business.

(3) The legal facilities permitted under the Bankers' Evidence Act are not available to them.

(4) The establishment of branches by exporting firms is depriving them of agency business in the mandis (markets) of the interior.

(5) The expansion of trade in India is increasing their opportunities to engage in it.

(6) They are tempted by the greater facilities for speculation in trade than in banking.

Only a few of them are abandoning their antiquated banking methods, and are taking to modern banking methods, such as issuing passbooks and cheque books, cashing cheques and receiving savings bank deposits. The most notable instance of this development is the Bank of Chettinad Limited in Madras Presidency, which was formed in 1929 by a number of Nattukkottai Chetti bankers and registered under the Indian Companies Act, and which has now about 40 branches in Madras, Burma and Ceylon.[3] There are also seven similar banking firms in the United Provinces.[4]

1. See the Punjab and U. P. Committees Reports, pp. 124, 275.
2. See the statement of the Indian Chamber of Commerce, Calcutta Central Committee Evidence, Vol. II, p. 522.
3. See Madras Committee Report, p. 28.
4. See the United Provinces Committee Report, pp. 66 and 265.

12. Relations of indigenous bankers with commercial banks.

Indigenous bankers, whose names are on the approved lists of joint-stock banks and the Imperial Bank, obtain cash credits from them, against demand promissory notes signed by two of the bankers, or by one banker and one merchant, or discount with them hundis drawn by traders and endorsed by the bankers, up to a certain limit assigned by them to each banker according to his financial standing. In the majority of cases, however, the accommodation which the bankers obtain from the banks is neither free nor regular, and is sought by them occasionally and only during the busy season, when their resources fall short of the accommodation demanded by small traders and cannot be replenished from other bankers.[1] Otherwise, they borrow from each other, as they can usually do so at a lower rate than that charged by the Imperial Bank and the other banks, and without submitting themselves to various inquiries and formalities. Thus, the general impression is that the indigenous bankers do not receive all the support that they should from the Imperial Bank and the joint-stock banks.[2] These banks also refuse to accept cheques drawn on the bankers or crossed in their names. This is due partly to their difficulty of supplying sufficient security, and disinclination to publish a balance-sheet or to divulge their accounts, making it difficult for the banks to determine their financial position, and partly to their not being recognised as possessing the status of bankers. At the same time, it is true that the banks occasionally treat applications for credit from indigenous banking firms having an honourable history behind them with too little sympathy, and insist too rigidly on the observation of mere formalities.

In discounting hundis, the banks prefer trade bills to finance bills because, although the direct security even in the case of trade bills is only personal owing to the absence of documents, such as warehouse receipts, they

1. See the statement of the Manager of the Punjab Provincial Co-operative Bank, the Punjab Committee Evidence, Vol. II, p. 494.

2. See Bombay and U. P. Committees Reports, pp. 201 and 274.

inspire more confidence, being backed by actual goods. Moreover, the banks do not take the hundis direct from the small traders, as reliance upon the latter's personal security would involve undue risks, and insist upon the endorsement of the indigenous bankers on the hundis that they discount, so as to make this business safe.[1] Such endorsement is necessary before the hundis can be re-discounted by the Imperial Bank, because it is prevented by the Act governing it from discounting a bill unless it is endorsed by two independent persons. The bank has found it difficult to obtain a sufficient number of hundis to enable it to borrow the full amount of Rs. 12 crores from Government against their security as provided in the Paper Currency Act of 1923, and has on occasions found it necessary to put pressure on its clients to convert their cash credits into hundis to overcome this difficulty. The reasons for this difficulty are that the prevailing methods of internal trade do not give much scope for the drawing of bills in rural areas, and that the traders, who can draw them, are not trained in drawing and discounting them. The indigenous bankers also obtain remittance facilities from the Imperial Bank on the same terms as the public. They do not get the special terms given by the bank to the joint-stock banks, as they do not keep any balances with it, and do much less business with it than the joint-stock banks.

It is a grievance of the indigenous bankers that the officers of the Imperial Bank, especially the agents of its mofussil branches, take little interest in the bankers' business and needs, and have not cared to cultivate friendly relations with them, partly because they are mostly non-Indians and often ignorant of the vernaculars of the districts and the local needs of the people, and partly because, being moved from branch to branch, they cannot obtain that local knowledge and personal touch that are necessary for an adequate understanding of the needs and financial standing of their customers.[2] Moreover, the

1. See Jain, *Indigenous Banking in India*, p. 176.

2. See Bombay Committee Report, pp. 202-3 and the evidence of the Ahmedabad Shroffs' Association, Bombay Committee Evidence, Vol. III, pp. 413-5.

Bengal Committee has stated that some branches of the Imperial Bank show a lack of consideration even to old, reliable and substantial firms, and sometimes refuse to rediscount hundis bearing their endorsement.[1] It is a serious defect of the Indian banking system that the two most important credit agencies, whose co-operation would be most advantageous for trade and industry, thus remain aloof. There is no correlation of the operations of the bank and of the bazaar consisting of the indigenous bankers, and so the bazaar hundi rate is often different from the bank's rate for discounting hundis. In the absence of co-operation between the indigenous bankers and the central bank and other banks, the development of an open market for discounts and of a co-ordinated credit policy would be impossible.

13. Defects in the organisation of indigenous bankers.

The present organisation of the indigenous bankers thus suffers from the following four principal defects :—

(1) The majority of them are conservative, and jealous of each other, lack adaptability and initiative, and continue antiquated methods of business, often in isolation and secrecy, making impossible the creation of public opinion which alone can enable them to sustain their role. This is due partly to the fact that, being confined to certain families, the class has not been strengthened by the infusion of fresh blood into it, and partly to poor contact with organised banking in the country.

(2) The majority of them have a comparatively small deposit business, or dealing in other people's money, which is a fundamental feature of organised banking. Consequently, the savings of the country, instead of being mobilised as deposits, and made available for exploiting the resources of the country, have remained inert, and the evils of money-lending have increased.

(3) Hundis play a small part in their finance of trade, the bulk of which is financed with cash.

(4) There is no regular contact between them and joint-stock banking in India, so that two money markets exist side

1. See Bengal Committee Report, p. 191.

by side with two sets of rates. Moreover, the indigenous bankers conduct their operations as independent units, and there is no central authority to co-ordinate their activities and to secure team work from them.[1] The banking reserves are widely scattered over the country, and are lacking in mobility as, owing to the want of effective correlation, it is difficult to move them from the centres where they are redundant to other centres where they happen to be inadequate.

14. Suggestions for reforming indigenous bankers.

It is necessary to take steps to remove the above defects in the organisation of the indigenous bankers, to link them with the general banking system of the country, to raise their status, to improve their position and banking methods, and to make them useful members of the banking system, for the following three reasons :—

(1) Out of 2,500 towns, with a population of 5,000 and above, less than 400 have a bank or a branch of a bank, and for banking facilities in all other towns and all rural areas, agriculturists, traders, merchants and small industrialists are dependent entirely on the indigenous bankers and money-lenders. Even in those towns, which have a bank or a branch of a bank, these bankers supply valuable banking facilities to merchants, traders and small middle class industrialists. It will be a long time before the joint-stock banks, the Imperial Bank and co-operative institutions can supply banking facilities to all parts of the country and replace the indigenous bankers.[2]

(2) The rates of these bankers do not compare unfavourably with those of the banks, but they have fallen on bad times and have begun to decline. Although they urgently require more funds to increase the turnover of their business, so as to counter the effects of the narrowing margins between borrowing and lending rates,

1. *Cf.* Jain, *Indigenous Banking in India*, p. 186 and the U. P. Committee Report, p. 275.

2. See Mr. Pochkhanawalla's answers, Central Committee Evidence, Vol. III, p. 107 and the statement of the Indian Chamber of Commerce, Calcutta, Bengal Committee Evidence, Vo. II, Part I, p. 340.

they do not get them, partly owing to their own defective organisation, but partly owing to conditions that they cannot control.

(3) They have been traditionally dealing in hundis, and their experience and organisation regarding them will prove very useful in the development of the bill market that is necessary to make the Indian banking system sound.[1] The fullest use should, therefore, be made of their invaluable knowledge of local conditions, personal contact and relationships extending over several centuries, and banking methods, and by reforming these methods in the light of modern developments, the bankers can be made to play a much more important part in the Indian banking system, to accelerate its progress, and to become a source of great strength and solidarity to it.

The measures of reform, however, must not be compulsory.[2] Compulsion will merely accelerate their transfer from banking to other business activities. The object must be to extend and modernise their banking activities, and to restore them to the position that they held in the country till the middle of the 19th century. Therefore, (1) as recommended by the Central Banking Committee, those indigenous bankers, who already confine their activities to banking proper, and those who are ready to give up their other business and to restrict themselves to banking, should be eligible to be placed on the approved list of the Reserve Bank, and to obtain rediscount facilities from it in the same way as joint-stock banks.[3] They must be restricted to banking business, because the Reserve Bank for its own safety can rediscount only bank-endorsed paper. The Reserve Bank will further lay down that they must own a minimum amount of capital. The standard in this respect, however, should be fixed at a lower level for them than for

1. *Cf.* Foreign Experts' Report, Central Committee Report, p. 656.

2. *Ibid*, p. 655; see also Assam, Bombay and Bengal Committees Reports, pp. 174, 205 and 192 respectively.

3. *Cf.* Central Committee Report, p. 107, Madras Committee Report, p. 238, Bombay Committee Report, p. 204, Bihar Committee Report, pp. 103, 114, 211 and the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 499.

joint-stock banks. They will also have to keep proper books of accounts, to have them audited annually by auditors recognized by Government, and to allow them to be inspected by the Reserve Bank, whenever it desires to do so. Some of the Provincial Banking Committees have suggested that they should be grouped into local associations, and made to conduct their banking business in accordance with the rules framed by the associations, and that they should be made to maintain cash reserves on a prescribed scale.[1]

As regards the question of making them keep a certain percentage of their total liabilities as interest-free balances with the Reserve Bank, as joint-stock banks will be required to do, the Central Banking Committee has recommended the exemption for five years of those indigenous bankers, whose deposits are not more than five times their capital, from this rule of compulsory balances, and the withdrawal of this exemption by the Reserve Bank at the end of five years, if it regards this necessary to carry out its credit policy. The object of the rule is to enable the Reserve Bank to control the credit of its member banks, but as the deposits and operations of individual indigenous bankers are small in the majority of cases, the rule has a much less significance with regard to them than to joint-stock banks. Moreover, it will be difficult for them to make the calculations and to supply the returns that will be needed for the enforcement of this rule, owing to their lack of an elaborate staff.

Some of the Provincial Banking Committees have suggested that the maximum rates of interest to be charged by these bankers for different kinds of business should be fixed by the Reserve Bank from time to time, but the Central Committee sees no necessity for this restriction, because the indigenous bankers' rates already do not compare unfavourably with those of joint-stock banks, and will be voluntarily reduced when the bankers get rediscount facilities from the Reserve Bank. In any case, it should be left to the discretion of the Reserve Bank to see that all institutions receiving rediscount facilities from it, and

1. See Bombay Committee Report, p. 206.

not merely the indigenous bankers, do not charge unduly high rates.

(2) The Reserve Bank, the Imperial Bank and other banks should use those indigenous bankers, who are members of the Reserve Bank, as agents for the collection of bills and cheques, and the Reserve and Imperial Banks should give them the same remittance facilities that are given to joint-stock banks.[1]

(3) The benefits of the Bankers' Books Evidence Act should be extended to them.[2]

(4) A substantial proportion of the indigenous bankers will not be able to give up their business activities other than banking, and will not, therefore, be able to obtain banking facilities from the Reserve Bank. They will have to continue to depend upon the Imperial Bank and joint-stock banks for these facilities. Some of the Provincial Committees and the Central Committee have, therefore, recommended that these banks should grant such facilities to the bankers more liberally in future, and should especially discount their bills more freely, because the Committees have found that the complaint made on behalf of these bankers, that they do not often get all the banking facilities which they deserve to get according to the security offered by them, has some justification.[3] Further, to bridge the gulf between the bankers and banks, to remove from the minds of the former suspicion of unfair or unsympathetic treatment from the latter, to assure them that their applications for financial assistance would receive due consideration from the latter, and to help the banks to assess the financial position of the bankers, local advisory committees consisting of the leading bankers should be appointed by the boards of directors of the banks at centres where they have branches.[4]

(5) The Central Committee has suggested that the indigenous bankers, who are placed on the approved list

1. *Cf.* The statement of the Indian Merchants' Chamber, Bombay, Central Committee Evidence, Vol. II, p. 538.
2. See Madras Committee Report, p. 238.
3. See Bengal Committee Report, p. 192.
4. See Bombay Committee Report, p. 203.

of the Reserve Bank, should be eligible to become full members of the All-India Bankers' Association, when it is established as suggested by the Committee, and that the other bankers should be eligible to become its associate members so as to receive a stimulus for the adoption of modern methods.[1] In addition, local associations of the bankers should be established in different centres for promoting co-operation among the bankers of each centre.

(6) The indigenous bankers should themselves reform their methods so as to make them conform more to those of joint-stock banks in respect of accounts and audit, use of bills and cheques, prompt receipt and payment of money, and conduct of operations strictly according to legal requirements, as this will enable them to occupy the position in the Indian banking system to which they are entitled by their importance.[2]

(7) They and joint-stock banks should carefully consider the feasibility of becoming partners on the German 'Kommandit' system, mentioned before, so as to extend the activities of both and to supply improved and larger banking facilities to the trading community.[3] Those bankers who do not find this suggestion practicable should be entrusted with the agency functions of joint-stock banks.[4] They should also examine the feasibility of amalgamating their business into joint-stock banks. Such banks can prove very useful in developing the banking habit among the people, in mobilising the dormant capital resources of the country and making them available for the economic development of rural areas, in giving accommodation to agriculturists and traders on reasonable terms, and in developing the use of bills in place of cash in the finance of agricultural and trade operations.

(8) The indigenous bankers should consider the practicability of undertaking and developing bill-broking busi-

1. Report, p. 110 ; See also Foreign Experts' Report, p. 658.

2. See Mr. MacDonald's answers, Central Committee Evidence, Vol. III, p. 875.

3. Mr. Subhedar does not feel very hopeful about this suggestion. See his report, p. 104. It was originally made by the Foreign Experts. See their report, Central Committee Report, pp. 629 and 655.

4. See Bihar Committee Report, pp. 210-11.

ness, and performing the same functions in the Indian money market as those which are performed by the bill-brokers in the London money market.[1]

The reports of the Provincial Committees show that the indigenous bankers in spite of their conservatism are not averse to modifications of their methods and practices if they are convinced that the modifications are practicable and profitable. It is for the banking experts, commercial leaders, and captains of industry of the country to induce them to re-organise themselves and to reform their methods on the lines indicated above.

Mr. V. Ramadas Pantulu, a representative of the co-operative movement on the Central Banking Committee, has expressed the opinion in a minute of dissent, that the problem of placing indigenous banking on a sound, stable and solid footing cannot be solved merely by providing facilities to a few indigenous bankers selected for special treatment by the Reserve Bank and the Imperial Bank, and that the indigenous banking classes as a whole must be re-organised and brought into the fold of organised Indian banking. For this purpose, he has suggested that indigenous bankers should be placed on a statutory footing by registering those, who are willing, under the special Bank Act, which the Central Banking Committee has recommended, and which should give them privileges and impose restrictions upon them similar to those that would be enjoyed by, and imposed upon, joint-stock banks.[2]

15. Finance of marketing of crops.

We may now turn to the marketing of crops with which money-lenders and indigenous bankers are closely concerned. Although the bulk of the total agricultural produce of India is consumed in the country itself,[3] making the Indian agricultural producers dependent almost entirely on the internal market, the producers have

1. See the U. P. Committee Report, pp. 282-5 and the statement of the Indian Chamber of Commerce, Calcutta, Central Committee Evidence, Vol. II, p. 522.

2. See Central Committee Report, pp. 523-9.

3. $\frac{5}{6}$ according to the Central Banking Committee (Report, p. 207) and $\frac{10}{11}$ according to the Indian delegates to the World Economic Conference, (Report of the Conference, p. 63.)

to market their produce under very unfavourable conditions, and suffer from various disabilities, such as a diversity of weights and measures, false weights and measures encouraged by the absence of any system of regular inspection, deductions for religious, charitable and other purposes, removal of large samples of produce without payment, secret bargaining between their agents and those of the purchasers, and a further cutting down of the prices at the time of weighing the produce, even after the prices are settled, by declining to take delivery on the excuse of inferior quality. The exported agricultural produce of India is not marketed under more favourable conditions. Its reputation in the world markets is very low, owing to the lack of standardisation and brands, and careless or inefficient packing; and as the prices paid for it depend primarily upon this reputation, even those who produce improved qualities by adopting better methods do not realise better prices for them, and thus the incentive to the adoption of improved methods of production is checked.

To remove these defects the Provincial and Central Banking Committees have suggested improvement of transport facilities and rural communications;[1] reduction in railway freight rates and grant of other railway facilities; establishment of regulated markets under provincial legislation;[2] establishment of marketing boards by Provincial Governments, to bring about the co-operation of the several interests in the building of godowns and warehouses, to help the Co-operative Department in promoting co-operative marketing, to improve the marketing of the products of cottage industries, and to conduct surveys of the conditions governing the marketing of the different products from the farmers to the consumers; creation of chambers of agriculture on a provincial or regional basis to discuss and promote the common interests of agriculturists; holding of auction sales by the Provincial Agricultural Departments to enable the cultivators producing improved varieties to realise

1. See Assam and Bombay Committees Reports, pp. 89 and 107.
2. See Bombay, Madras, Punjab and U. P. Committees Reports, pp, 113, 119, 56 and 162 respectively.

better prices for them; promotion of co-operative sale societies, and liberal grants or advances at low rates of interest to them by the Provincial Governments for the construction of godowns, although the Provincial Committees have reported, either that there has been little progress in introducing such societies, or that they have not yielded the expected results;[1] standardisation of weights and measures;[2] fixation of standards and grades of commodities; careful, efficient and uniform packing; and organisation among traders and merchants for the adoption of measures to obtain better qualities of products and to prevent adulteration.

As the Indian banking system, however, has no direct concern with these problems, they cannot be examined in detail here. The system is directly concerned only with the financing of marketing operations, and we may proceed to consider it in some detail. Firstly, it is a common practice of the cultivators to obtain advances of money against their growing crops. The money-lenders, who are also traders, do not charge interest if the borrowers undertake to sell their crops to the lenders on a fixed date, at a particular price fixed much below the anticipated market price. But in most cases the advances bear high rates of interest ranging from 12 to 75 per cent, and the borrowers bind themselves to sell the crops to or through the lenders, at prices lower by 5 to 25 per cent than the anticipated market prices. The lower the contract price, the lower is the rate of interest charged. If the contract is to sell the produce at the market price, a high rate is charged.

Secondly, even if the cultivators do not borrow money to raise their crops, owing to their previous indebtedness they are pressed heavily by the money-lenders as soon as they have harvested their crops, and are compelled to sell them immediately, with the result that the prices get depressed by the glut in the market. As regards

1. See Bengal, Bombay and Madras Committees Reports, pp. 145-154, 111-2 and 114 respectively.

2. See Bengal, Bombay, C. P., Madras and U. P. Committees Reports pp. 106, 109, 195, 114 and 160 respectively.

the crops that are to be exported, there is no remedy for these evils until orderly marketing is organised. But as regards the crops that are produced for home consumption, the evils can be effectively checked by the creation of co-operative sale societies, which will give advances to the cultivators and enable them to wait for the sale of their produce until favourable prices become available, and which will then act as their agents for the sale of their produce at favourable prices.

To proceed to the methods of marketing finance, and the rates charged for providing it. The village money-lenders and traders buy agricultural produce from the cultivators and usually pay cash. They work partly with their own capital, and partly with funds borrowed from town merchants, commission agents, and indigenous bankers at rates varying from 12 to 24 per cent. In some parts of India the commission agents in turn borrow funds from the indigenous bankers at rates varying from 6 to 12 per cent. These high rates compel them to offer low prices to the cultivators. Most of these transactions are not financed by means of hundis, and so they lose the benefit of direct contact with the money market. If the use of hundis is encouraged to finance these transactions, the hundis can be discounted in the money market, and the finance can be secured at much lower rates.

When produce is sent from one substantial middleman to another, it is frequently financed by drawing hundis, darshani or muddati, which are either clean or supported by railway receipts, and which are discounted with the indigenous bankers, or the joint-stock banks, or the Imperial Bank of India. The use of muddati hundis has diminished in recent years. Banks prefer hundis backed by railway receipts, as they reduce the banks' risks, but many of the receipts have to be sent direct to the consignees, who insist upon getting them direct, to maintain their prestige, or to obtain advances against them to pay the hundis, or to save demurrage. The indigenous bankers supply credit to the middlemen also on pro-notes or personal security.

In some parts of India, some of the joint-stock banks, and especially the Imperial Bank, advance large sums against the security of produce, which is kept in the godowns of the banks. But in other parts, such advances are smaller owing to the disinclination of merchants to pledge stocks with the banks because of the rigidity of the banks' regulations regarding these advances and the publicity given to these advances.[1] But the Provincial Committees have reported that everywhere the disinclination of merchants and traders to pledge their stocks with the banks is gradually diminishing. For their own benefit, merchants and traders should endeavour to use the goods in their possession as much as possible to get cheaper accommodation from banks. The Imperial Bank and the joint-stock banks should also give advances more freely against agricultural produce kept in their godowns.

Further, to enable merchants and traders to obtain cheaper accommodation by way of advances from banks on the security of produce, or by the use of hundis, it is necessary to establish in all parts of the country godowns and warehouses; the receipts given by them can be used as credit instruments to obtain accommodation cheaply from the money market. They will also give the sellers of produce greater freedom to keep it from the market until a fair price can be obtained. It is true that the cultivators object to the pooling of their produce, but the objection can be gradually overcome, and they can be made to appreciate the gains from standardisation, grading and pooling by means of education, propaganda, and the operation of warehouses in selected centres.

The Central and Provincial Banking Committees have, therefore, recommended that the Provincial Governments should take up the question of giving long-term loans at low rates of interest to co-operative societies to construct godowns in centres which provide good markets, as the Government of Madras has started doing, and also of providing warehouses through private agencies, and licensing them, and giving loans for their construction; and that

1. See the statement of the Agent, Imperial Bank of India, Ferozpore, the Punjab Committee Evidence, Vol. II, p. 703.

the Imperial Council of Agricultural Research should co-ordinate this activity of the Provincial Governments.[1] One or more licensing Boards consisting of the representatives of Government, local business interests and agriculture, should be established in each province for granting licenses to warehouses. Those who are licensed as warehousemen should be persons of recognised integrity, substantial capital, and business ability, and should be made to employ trained graders certified by Government to grade the produce. Further, the Central and Bombay Committees have recommended that the railways also should examine the feasibility of establishing and working warehouses in selected centres, or of allowing private agencies to do so, in the immediate neighbourhood of railway stations, and giving them all reasonable facilities.[2]

Finally, the railway receipts that are either attached to hundis or sent direct to the consignees are not negotiable, do not give a full and correct description of the goods, and do not supply safe security to banks by being endorsed in their favour, as bills of lading do.[3] The Central Banking Committee, therefore, has suggested the removal of these defects by legislation so as to make the receipts more useful in financing the marketing of goods.

1. See Central Committee Report, pp. 221-2, Bengal, Bihar, Bombay and U. P. Committees Reports, pp. 110, 70-74, 114-123 and 164, and the answers of the representatives of the Bombay Chamber of Commerce, Central Committee Evidence, Vol. III, p. 41. Mr. MacDonald, the Managing Governor of the Imperial Bank of India, however, is very doubtful of the general success of this scheme. See Central Committee Evidence, Vol. III, p. 936.

2. See Bombay Committee Report, p. 114.

3. See the statement of the Manager, Northern India branches of the Imperial Bank, the Punjab Committee Evidence, Vol. II, p. 676.

CHAPTER III

Rural Finance : Co-operative and Land Mortgage Banks

1. Co-operative credit useful only for short-term needs of agriculturists.

All authorities, including the Provincial and Central Banking Committees, and the Foreign Experts associated with the Central Committee, are now agreed that co-operative credit institutions can supply only the short-term and intermediate credit needs of agriculturists with safety and success, and not their long-term needs.[1] The reasons are as follows :

(1) The resources of these institutions consist mainly of deposits and loans obtained for short periods, and not of share capital and reserves, owing to the limited means of their members, and it is dangerous to use such resources for long-term loans.

(2) Long-term loans can be given only against the mortgage of land, but the substitution of mortgage for personal security may lead to the neglect of co-operative principles.

(3) The enquiry and valuation, that must precede the grant of long-term loans, can be conducted only by trained experts, who must be controlled by a central organisation, and they are not available to the ordinary credit institutions.

(4) Many of these institutions cannot be relied upon for the safe custody of valuable documents and title deeds relating to mortgages.

(5) Their assets will get frozen, if the long-term loans are not repaid when they become due, as the acquisition and execution of mortgage decrees are very difficult.

The reports of the Provincial Committees show that there has been no reduction of the total rural indebtedness through the agency of co-operative credit institutions.

1. See Foreign Experts' Report, Central Committee Report, p. 697.

Long-term credit can be supplied to agriculturists, with any degree of safety and success, only by land mortgage banks, which can obtain the bulk of their resources by issuing debentures.[1]

2. Progress of the co-operative movement.

We shall deal first with the growth of co-operative credit institutions and then with land mortgage banks. Co-operation may be defined as a voluntary organisation of persons, who associate on equal terms to fulfil their economic needs and to promote thrift and self-help among themselves.

Co-operative credit is the simplest and the most urgently needed form of co-operation, and the development of this movement in India has been mainly confined to this form. Its growth may be divided into three periods. The first began with the passing of the Act of 1904, which officially launched the movement in India. The Act freed co-operative credit societies from the elaborate provisions of the Indian Companies' Act, laid down a simple business procedure for them, and provided for the establishment of a Co-operative Department in each province under a Registrar for the guidance of the movement. It, however, did not provide for the registration of more complex and central institutions, like central and provincial co-operative banks, that are needed for financing and controlling the primary credit societies, and also of non-credit societies dealing with co-operative production, sale, purchase, insurance, etc. During this period, therefore, the movement was confined entirely to credit and remained in its infancy.

The above-mentioned drawbacks of the Act of 1904 were removed by the Act of 1912, which ushered in the second period. Progress was better during this period, especially as the Maclagan Committee on co-operation examined the movement and made many valuable suggestions in 1915 for improving it. The third period commenced with the passing of the Government of India Act

1. *Cf.* Foreign Experts' Report, attached to Central Committee Report, p. 691.

of 1919, which made co-operation a transferred provincial subject in charge of a Minister. The Act of 1912 has been replaced by Provincial Acts in Bombay, Burma and Madras since 1925, 1927 and 1931 respectively. In the early part of this period, the number of societies was much increased. More recently, however, greater attention has been paid to the consolidation and strengthening of the existing societies than to the creation of new ones. During this period also valuable suggestions for the development of the movement have been made, after survey, by the Agricultural Commission and Provincial Enquiry Committees in the United Provinces, the Central Provinces, Madras and Burma.

In 1931, the latest year for which figures are available, the total number of co-operative institutions in India was 106,050, made up of 10 provincial banks (one each in all Governors' Provinces except the United Provinces, and in Mysore and Hyderabad), 595 central banks, 1,091 supervising and guaranteeing unions, 93,598 agricultural primary societies and 10,756 non-agricultural primary societies.[1] The total number of members of primary societies was 4·3 million, made up of 3·2 and 1·1 million members of agricultural and non-agricultural societies respectively. Assuming that a family had five members on the average, this membership meant that 16 and 5½ million people benefited from the co-operative movement in rural and urban India respectively.

The total working capital in the movement was Rs. 92·70 crores consisting of Rs. 9·90, 30·62, 35·09 and 17·09 crores of the provincial banks, central banks, agricultural primary societies and non-agricultural primary societies respectively. Agricultural and non-agricultural primary credit societies numbered 83,164 and 5,262 respectively. The total number of societies in Indian States was 16,508. There were 28 co-operative banks with capital and reserves of Rs. 5 lakhs and over, and 178 with capital and reserves of between 1 and 5 lakhs. The movement, however, has made different progress in differ-

1. See Statistical Statements relating to the Co-operative Movement in India, 1931-32, pp. 3-5.

ent provinces. It has been more successful in Bombay, the Punjab and Madras than in other provinces. This is shown by the following figures :—

Province.	Number of members of primary societies per 1000 inhabitants.
Assam	8·1
Bengal	15·4
Bihar and Orissa	6·9
Bombay	25·9
Burma	5·9
Central Provinces and Berar	4·9
Madras	20·1
Punjab	28·8
United Provinces	3·0

But in judging the progress in different provinces, more important than the number of societies and members is the consideration of how far the societies are working on truly co-operative lines and how far they have improved the economic conditions of their members and the families of the members. Applying this standard, it becomes clear from the reports of the Provincial Banking Committees and the annual reports on the working of co-operative societies in different provinces that the movement has made better progress in Bombay, the Punjab and Madras than in other provinces. The chief reason for this is said to be that the agriculturists of these three provinces have as a rule mortgagable rights in their land and can, therefore, offer real, instead of personal, security for obligations incurred by them. Those of the other provinces can offer personal security only, as they are mere tenants holding their land from landlords.[1]

Applying the two tests of the proportion of the rural population that has benefited from it, and the proportion of the rural financial need supplied by it, the progress of the movement must be pronounced to be disappointing in the country, especially in the provinces other than Bombay, the Punjab and Madras. Even in Bombay and the Punjab, after a working extending over nearly three decades, the movement has barely touched

1. See India in 1927-28, pp. 375-6 and Jain, the Monetary Problems of India, pp. 74-5.

the lives of one-eighth of the population. The reports of the Provincial Committees also make it clear that the financial facilities provided by the movement to the rural population supply a very small part of its needs.[1] This is due to several prominent defects in the working of the movement, and these will be examined later.

3. Intrinsic advantages of the co-operative movement.

In spite of these disappointing results the movement cannot be condemned as useless, because there cannot be any doubt about its intrinsic advantages. "A scheme of Government or joint-stock bank finance might reduce the rates of interest, but only co-operation can teach the peasant to borrow at the right time, and in the right amounts and for right ends, and to repay on the right dates; and only co-operation can teach him to save so that he may not have to borrow at all."[2] The movement has proved most beneficial, economically, socially and educationally, not only to a large proportion of the populations of several Western countries, but even to the members of those co-operative societies that have proved successful in India on account of efficient management, and to their families.

They have obtained substantial funds, especially for short-term and intermediate credit needs, at reasonable rates of interest, and have saved much in interest charges. They have obtained improved varieties of seeds and manure, and more efficient implements at reasonable prices, and improved the breed of their cattle, and thus improved their agriculture. They have secured better prices for their produce. Their thrift has been encouraged. They have received practical training in the handling of money, in business matters and in elementary banking principles, and have learnt to keep accounts, to sign pro-notes, and to read pass-books and receipts. They have influenced each other's conduct, have checked bad habits, such as indulgence in drink or gambling, and fostered self-restraint, discipline, self-respect, and punctuality.

1. See Bombay and the Punjab Committees Reports, pp. 169 and 100 respectively.
2. The Punjab Committee Report, p. 103. See also Foreign Experts' Report, attached to Central Committee Report, p. 628.

The hold of the money-lenders over them has been loosened, and this has produced a marked change in their outlook. They have started schools, provided scholarships, improved sanitation, and established benefit funds.[1] In short, the corporate village life, weakened by modern disintegrating influences, has been revived in those villages in which co-operative societies have been working satisfactorily, and the same desirable development can gradually be brought about in other villages by the spread of co-operation on the right lines.

The Agricultural Commission has expressed the opinion that the financial solvency of the movement is beyond dispute, and that it is the working of the societies that is defective. The Provincial and Central Banking Committees have agreed with this statement. The reports of the Provincial Committees show that the further expansion of the movement has been temporarily suspended for the purpose of consolidating it and promoting its financial soundness and stability.[2] The prevailing economic depression and fall of commodity prices have created much economic distress among agriculturists, and increased the arrears and overdues of co-operative credit societies, but the weathering of the storm so far with a fair measure of success shows the inherent soundness of the movement, and there are sound reasons for hoping that when the depression lifts up, it will yield better results.

4. Organisation and working of primary societies.

To proceed to the working of the co-operative machinery, which consists of the primary societies, central banks and provincial banks. The apex of the co-operative organisation in a province is the provincial bank to which central banks are affiliated. The primary societies are mostly affiliated to the central banks. Some of them are grouped into local unions for purposes of supervision. All of them are forbidden to lend to non-members except with the sanction of the Registrar of co-operative societies.

1. See Bengal Committee Report, pp. 135-6.
2. See Bombay and Assam Committees Reports, pp. 162 and 150 respectively.

The primary society is an association of borrowers and non-borrowers who, residing in one locality, know one another, and take interest in one another's affairs. Membership is open to any inhabitant of the same locality who, in the opinion of his fellow-members, possesses a good character, regardless of his caste, creed, or calling. This brings together persons of different status into a common organisation, and promotes a true spirit of co-operative brotherhood. As the movement is essentially moral and individualistic, rather than socialistic, the Registrar registers a society only when he thinks that its prospective members understand co-operative principles and duties. The operations of each society are restricted to a small area, a village, to enable its members to know each other and to watch each other's doings, to prevent the domination of one man, to bring more men to the front, and to facilitate supervision and training.[1]

Rural credit societies are organised on the Raiffeisen model, named after the famous German co-operator, with unlimited liability of members. Unlimited liability provides a good foundation for rural credit by giving better protection to the creditors, and supplies the best incentive to the members of a society to be careful in the selection of their fellows, to select the most competent officers, to be careful in giving loans, to watch the members to whom loans have been given, and to be strict in demanding their prompt repayment on the stipulated dates.[2] The tangible assets of a society consist of the property owned by its members, the details of which must be mentioned in the 'property statement' of the society. Its efficient working depends largely upon the careful preparation and periodical revision of this statement. Some of the urban credit societies are on limited liability.

In some localities members contribute a small share capital, in others they do not. In the former, the rate of dividend and the maximum value of the shares that a single member can hold, are restricted, and every member

1. See Assam and Burma Committees Reports, pp. 134 and 174 respectively.

2. *Cf.* Bengal Committee Report, p. 151.

has one vote only regardless of his holding of shares. The right of a member to transfer or charge his shares is rigidly restricted, and they are exempted from attachment or sale by courts, or in insolvency proceedings. A committee of management, president and secretary, rendering services honorarily, are elected annually and controlled by the general body of members. The general body, however, must take a practical interest in the society's business, which must be transacted with maximum publicity.

The societies have a prior claim, with the exception of that of Government dues, over other creditors of their members, in respect of enforcing their outstanding demands on members for loans given to the latter for agricultural requisites. There is, however, no specific charge, and the prior claim does not apply to all advances relating to crop finance. In Bombay, the prior claim, under the All-India Act, has been converted into a first charge by the Provincial Act, and the Central Banking Committee has recommended that the same should be done in the other provinces.[1]

The funds of the societies are derived from share capital, if any, deposits of members and sympathisers who are non-members, and loans from central banks. Deposits imply thrift, and they interest in the management of the societies men who stand as sentries over their own deposits. Hence, the societies aim at getting as many local deposits as possible at reasonable rates of interest. They have, however, been much hampered in realising this aim by the high rates that can be earned from trading or private lending. They avoid attracting deposits from areas served by other societies or from the clientele of central banks. The maximum borrowing power of all societies is fixed at a definite fraction, varying between ¼ and ⅛ in different provinces, of the value of the net assets of all the members composing them, and no society can borrow in the shape of deposits and loans, beyond this maximum.

The maximum power of individual members of

1. Report, p. 119.

borrowing from the societies to which they belong is fixed at a definite proportion, usually one-half, of their individual assets, and the loans actually given to them within this maximum depend upon the objects for which they need the loans and their repaying capacity. The societies cannot always insist on restricting the loans to productive objects because, by doing so, they would merely encourage their members to misapply loans given for productive purposes, or to resort to money-lenders. Moreover, other members take care that the borrowing members do not spend more money on unproductive objects than is strictly necessary. But loans cannot be given for speculative or wasteful expenditure. The objects of loans are cultivation expenses, the purchase of cattle, fodder and implements, the payment of land revenue, the repayment of previous debt, redemption of mortgages, personal maintenance, ceremonial expenses, and litigation.

Unproductive loans are given much less frequently, on a much smaller scale, and for shorter periods than productive loans. Misused loans are promptly recalled. The primary security for all loans is personal—the guarantee of the borrowers and sureties, but mortgage security is also frequently obtained. Sureties prevent the grant of excessive loans and their misapplication, and facilitate their recovery. Other members also watch the use of the loans and their repayment on the due dates. When the borrowers are unable to repay them and have a good reason, such as the failure of crops, the necessary extension of the period of repayment is given, and no undue pressure is exercised on the borrowers. The rates of interest charged are given below in a separate table. It will be seen that they differ considerably in the various provinces, and within a province itself. Whether they are reasonable or not depends upon their relation to the rates prevailing in the outside local market.

The societies are compelled by law to build up reserve funds out of profits. In societies having no shares, the entire profit is credited to the indivisible reserve. In share societies also the reserve fund is indivisible, and a substantial portion of the profit must be carried to the

reserve fund. Some societies use their reserve funds to give loans to their members, others deposit them with the central banks. The Central Banking Committee has supported the latter practice as making for greater safety, and has recommended that the central banks should give loans to the societies at concessional rates up to the extent of the latter's reserve funds deposited with them.[1]

5. Organisation and working of central banks.

A central bank is a federation of primary societies in a specified area, generally a district, has also individuals as its members, and is located at the headquarters of, or another important town in, a district. Some central banks have a few branches at other towns in their respective districts. The admission of individuals, mainly belonging to the middle class, is necessary at present because, although the representatives of societies are usually given a large voice on the board of management of a central bank, they do not possess sufficient business capacity for its management, which is much more complex than that of a primary society, and cannot, therefore, inspire much public confidence. The managing board, therefore, contains some individuals of influence and business capacity belonging to the middle class. The central banks have consequently secured the confidence of the public, and play an important part in the Indian money market. The Maclagan Co-operative Committee of 1915 and the Central Banking Committee have recommended that the representatives of the societies must be given a preponderating voice in their management. When the representatives develop sufficient influence and business capacity, the individual members of the central banks can be eliminated gradually, and the conflict of interest between their shareholders and borrowing societies can be removed by the identification of both the parties.

The central banks finance the primary credit societies, balance the excess and deficiency in their resources, and do little commercial banking. The primary societies should not lend to one another, as this interlocking of liabili-

1. Report, pp. 119-20.

ties is dangerous to them.[1] The number of the shares of the central banks that an individual can hold is restricted, their dividends are limited to 10 per cent, and their liability is limited. Their resources consist of the share capital and reserve fund; deposits of various kinds, such as current, fixed, recurring, prudent, provident and savings, obtained chiefly from professional men, landowners and other sections of the middle class—a new source which is being tapped by them with hardly any competition with joint-stock banks; the deposit of the surplus funds and reserve funds of primary societies affiliated to them; loans and overdrafts from the Imperial Bank and a few joint-stock banks; and the deposit of surplus funds of municipalities, local boards, Universities and other semi-public bodies in some provinces, in which the central banks have built up a high reputation for stability. According to the Central Banking Committee, they are able to obtain sufficient resources for their present requirements at moderate, and in some provinces even low, rates of interest.

They lend funds to affiliated primary societies, within the limits of the borrowing capacity fixed for each, and on the same principles of co-operative credit as those mentioned above in dealing with the primary societies. The period for which they give loans to the societies depends upon the period for which they get their funds. Their lending rates have to be at least 3 per cent higher than their borrowing rates, to cover expenses, to build up a reserve fund, and to pay a moderate dividend. They maintain a staff of inspectors, who examine the affiliated societies' statements of assets and normal credits, watch over the use of the loans and the progress of recoveries, and keep the banks in touch with the working of the societies.[2] Twenty-five per cent of their net profits must be carried to the reserve fund. They have also to keep sufficient liquid resources in the shape of cash balances, unutilised cash credit with the Imperial Bank, and Government promissory notes, to pay the claims of depositors.

1. See Bengal Committee Report, p. 158.
2. See Bombay Committee Report, p. 170.

To provide for the losses that may be caused by the inability of some of the primary societies to repay the loans given to them by the central banks, the Central Banking Committee has proposed that the latter should build up a bad debt fund with a portion of the annual profits, in addition to the reserve fund. To increase the protection of their depositors and the confidence of the public in them, the Committee has suggested that the limited liability of their shareholders, consisting of societies, but not individuals, should be coupled with a reserve liability restricted to the face value of the shares that they hold.

6. Organisation and working of provincial banks.

In all the Governors' Provinces, except the United Provinces, central co-operative banks have federated themselves into apex banks called provincial co-operative banks. The United Provinces and Central Banking Committees have recommended that a similar bank should be established in the United Provinces.[1] Their share capital is provided partly by the affiliated central banks, and partly by individuals. The latter play an important part in the management of the provincial banks, as it is even more complex than that of the central banks, and requires expert banking knowledge, but they should not be given a preponderating voice in the management.[2]

The banks are managed on ordinary business principles with due regard to the needs of co-operation. They tap the resources of the richer urban classes in the form of deposits, which are not available to the central banks, link up the co-operative organisation with the money market and the commercial banks, act as financing agencies to the central banks, and balance the excess and deficiency in the resources of the central banks. The latter should not lend to one another, as such interlocking of liabilities is dangerous to them.

Provincial banks also serve as central banks in areas

1. See U. P. Committee Report, p. 193.
2. *Cf.* Assam Committee Report, p. 141.

which have no local central banks of their own.[1] The funds of the provincial banks consist of share capital, reserve fund, various kinds of deposits similar to those of the central banks, short-term loans, cash credits and overdrafts from the Imperial Bank and some of the joint-stock banks, and the deposit of the surplus funds of the central banks affiliated to them. Some of them also lend their own surplus funds to one another. They lend to the primary societies, not direct, but through the affiliated central banks, except in areas which have no central banks of their own. Funds thus flow from the provincial banks to the central banks, then to the rural societies, and finally to the individual borrowers.

The provincial banks have no powers of control or supervision over the central banks, except what they may exercise as a condition of granting loans. Such control or supervision is practically non-existent at present. Nevertheless, in some provinces they have, with their efficient staff, played an important part in developing the movement on sound lines, especially in areas in which they finance societies direct.[2] They have also formed the Indian Provincial Co-operative Banks' Association to co-ordinate their work, to promote common interests, and to supply information regarding each other's financial needs. As the Reserve Bank will soon provide them with all the necessary financial facilities, it is not necessary for them to have a separate apex bank.[3]

In addition to this association, there is the All-India Co-operative Institutes' Association, which promotes co-operation through member institutes, that have been established in different parts of the country, by supplying them with advice and assistance on all co-operative problems. Such all-India institutions, and even those working in more than one province, cannot at present be registered under the Co-operative Societies' Act. The Central Committee has, therefore, recommended that the

1. See Bombay Committee Report, p. 156.
2. *Cf.* Bombay Committee Report, p. 172.
3. *Cf.* Madras Committee Report, p. 170.

Act should be amended to provide for the registration of such institutions.[1]

The Act has made special provision for the audit of the primary societies, and the central and provincial banks. It has laid down that in each province the accounts of all of them must be audited at least once every year by persons authorized by the Registrar, and that the audit must include an examination of their overdue debts, if any, and a valuation of their assets and liabilities. The Central Banking Committee has suggested that the audit should include, in addition, an enquiry into all the circumstances which determine the general position of these institutions.

7. Rates of interest in the co-operative organisation.

The following table brings out the rates of interest prevailing in the movement :—

	Primary Societies.			Central Banks.		Provincial Banks.	
	Rate charged on loans to members. Per cent.	Rate paid on deposits. Per cent.	Rate paid to Central Banks on loans. Per cent.	Rate paid on deposits. Per cent.	Rate paid to Provincial Banks on loans. Per cent.	Rate paid on deposits. Per cent.	Rate on accommodation from the Imperial Bank. Per cent.
Assam ...	15½ to 18¾	8	11	8	8½	7½	7
Bengal ...	7½ to 15½	4¾ to 9½	9½ to 12½	2 to 8¼	7 to 8	4 to 6¼	Bank rate.
Bihar and Orissa	12½ to 15½	7 to 9	10½ to 12½	4¼ to 6	6	2 to 5	Bank rate.
Bombay ...	9½ to 12½	2 to 8	6 to 8	1½ to 7¼	5½ to 8	2 to 4½	...
Burma ...	15	6 to 12	10	6 to 9	10	5 to 7½	...
Central Provinces.	12	3 to 10	9 to 10	3 to 7	6 to 6½	2 to 5¼	7
Madras ...	9½ to 11	3 to 6½	7½ to 8	2 to 5½	6 to 6½	2 to 4½	6½
Punjab ...	9½ to 12½	6 to 7	8 to 9	5 to 6½	6½	3½ to 5½	Bank rate
United Provinces.	15	9	12	6 to 7	...	...	...

We have seen above that non-credit co-operative societies have made some progress in India, but that it is

1. Report, p. 125.

small as compared with that of the credit societies. An examination of their organisation and working is beyond the scope of these pages, as they have no direct connection with banking. The Agricultural Commission and the Provincial and Central Banking Committees have recommended that the Provincial Registrars should encourage the development of these societies in the larger economic interests of the masses, especially the agriculturists.

8. Defects in the working of the organisation.

We may now proceed to consider the defects in the working of the movement that have been mentioned by the Agricultural Commission, the Provincial and Central Banking Committees, witnesses before them, and others. They are as follows :—

(1) Official control is excessive, although the avowed policy of Government is to encourage non-official administration as far as consistent with its ultimate responsibility to secure the progress of the movement on sound lines. This has tended to make the working of the movement mechanical, and to check the development of a sense of responsibility among the members.

(2) The inability of the credit societies to supply the short-term and intermediate as well as the long-term credit needs of agriculturists has not been appreciated, and efforts have been directed towards making them supply all these needs.

(3) The understanding of the principles of co-operation and the knowledge of the essentials of rural credit are lacking among a large proportion of the members. The essence of the movement is that its members must learn to manage their own affairs. The task of teaching illiterate peasants to do so is a slow and elaborate process. But the supreme importance of educating and supervising them has not been adequately realised, and the desire to produce quick and extensive results has hampered the real progress of the movement.[1]

(4) Both the official and non-official co-operative

1. *Cf.* The U. P. Committee Report, p. 181.

staffs are, in many cases, handicapped in their work by a lack or deficiency of training.

(5) The audit is defective, and does not conform fully to the statutory requirements, partly owing to the paucity of auditing officers.[1] Moreover, audit, supervision and inspection of societies, which are intimately related functions, are now conducted by two or three different agencies, producing much overlapping of work and waste of effort and money.

(6) On account of the above defects, control over the operations of societies is defective. Many managing committees are inefficient, display a factious spirit, are not properly controlled by the general body of members, and appropriate too large a proportion of the loans for themselves. Members are frequently selected without care. Loans are sometimes given to members recklessly, and their periods are extended without proper reasons. Short-term, intermediate and long-term loans are not clearly distinguished. Accounts are not always correctly maintained. The statement of the assets of societies is not always revised carefully from time to time, and the assets which remain in the possession of members are sometimes frittered away by them, or used by them in connection with outside creditors. Members delay repayment of loans even when they are able to do so. Office-holders neglect taking action against defaulters. Consequently, the overdues of many societies are highly excessive. There is reluctance to liquidate societies even when their condition is beyond repair.[2]

(7) Control in some societies has passed into the hands of a few powerful men, with the result that the interests of small producers are sacrificed to those of their more powerful colleagues. Similar concentration of control in some central banks has led to the overfinancing of societies to keep up dividends, the retention of high interest on deposits, and the receipt of superfluous deposits.

(8) Co-operative finance is often inelastic, dilatory,

1. *Cf.* Bengal Committee Report, p. 151.

2. *Cf* Mr. MacDonald's answers, Central Committee Evidence, Vol. III, pp. 929, and 944-5.

and inadequate, largely owing to the inefficiency or selfishness of managing committees. Members have to put up with much personal inconvenience and delay before they can obtain loans from the societies, and even then they may not get sufficient money for their requirements. Many of them, therefore, have to obtain a part of their finance from money-lenders. Some societies, on the other hand, borrow as much as they can from the central banks once a year, and lend the money immediately to their members in lump sums, in the hope that the latter will make it last for the whole year. But the members manage to spend the whole of it as soon as they get it, and when other needs arise, they borrow money at high rates from the money-lenders. Many members also prefer the more accommodating policy of the money-lenders, who do not insist on punctual repayments, forgetting its ultimate consequences. The result is that in many localities the co-operative societies and the money-lenders exist side by side, and that the cultivators use both of them according to their convenience.[1]

(9) There is a tendency among solvent members to sever their connection with the movement.[2]

(10) Central banks have tended to work in isolation, and there is no co-ordination of their activities.

(11) The credit supplied by the co-operative organisation is much too costly in some provinces. This is inevitable to some extent, because two or three intermediate agencies, *viz.* the primary society, the central bank and the provincial bank, need for their working expenses the difference between the rate of interest at which money is obtained for the movement from outside and that at which it is lent to the borrowing cultivators. Conditions are ideal when the primary societies obtain locally all the funds needed for financing their members, chiefly in the shape of the deposits of members resulting from their practice of thrift. But the actual conditions in India are much more distant from this ideal than in other countries. The majority of the primary societies, except

1. *Cf.* the U. P. Committee Evidence, Vol. III, p. 414.
2. *Cf.* the C. P. Committee Report, p. 253.

in the Bombay Presidency, are almost entirely only agencies for the distribution of funds obtained from the central and provincial banks, instead of being the 'savings and loan' banks of their villages and balancing centres for the demand for and supply of money.[1]

9. Suggestions for removing defects.

The Agricultural Commission, provincial committees on co-operation, the Provincial and Central Banking Committees and the Foreign Experts have made the following suggestions for removing these defects:—

(1) Official control of the movement should be lessened. The primary functions of the Co-operative Departments should be education, supervision and the control of audit, and the financing agencies should be made entirely responsible for internal working, loans and deposits. There should be more self-administration and self-responsibility for the primary societies according to the co-operative idea.[2] This will make the movement more popular in the country, and promote a sense of responsibility among its members.

(2) The primary societies should be restricted to the finance of the short-term and intermediate credit needs of the agriculturists, and a separate organisation, *viz.* land mortgage banks, should be set up for supplying their long-term needs.[3]

(3) Special steps should be taken by the Co-operative Departments and the Institutes for the efficient and adequate training of the official and non-official co-operative staff.[4] Trained secretaries should be secured for the primary societies as far as possible. The experience of other countries shows that school teachers and retired officials living in villages will prove very useful for this purpose.

(4) The co-operative staff should make more persistent efforts to promote the understanding of the principles of

1. *Cf.* Foreign Experts' Report, attached to Central Committee Report, p. 691.

2. *Cf.* Burma Committee Report, pp. 175-6.

3. *Ibid*, p. 173 and U. P. Committee Report, pp. 183-4.

4. See Bengal, Bihar and Madras Committees Reports, pp. 150-52, 154 and 156 respectively.

co-operation and the knowledge of the essentials of rural credit among the members of the societies, and Government should spend more on the provision of such education.[1] The Registrars should be more strict in registering the societies, and should not register them until they are convinced that the prospective members really understand co-operative principles and duties. The efficiency of the societies in a province, and not their number, should be regarded as decisive.[2]

(5) For the efficient audit, supervision and inspection of the societies, district unions should be formed of the primary credit and non-credit societies and central banks located within their areas, and should be registered under the Co-operative Societies Act.[3] The district of the unions should be the administrative district, unless any other area is found more suitable for the control of the societies located in it. The managing boards of the unions should be composed of the representatives of the affiliated societies and a few specially trained Government officials. Their staff should consist of persons licensed by the Registrar, who should be empowered to cancel any license for adequate reasons, but who must not be allowed to interfere in the internal management of the unions. The unions should also supply practical training to candidates for appointment on the auditing, supervising and inspecting staff of the co-operative organisation.

They should work in close co-operation with the central banks, should interchange with them reports and statements on the primary societies, leaving the central banks to arrange only for such inspection of the societies as may be necessary to protect their financial interests. The district unions should be federated into a separate Provincial Union, or affiliated to a specially created audit branch of each of the existing Provincial Co-operative

1. See Bombay, Punjab and Madras Committees Reports, pp. 158, 102, and 162 respectively.

2. See Assam, Bombay and U. P. Committees Reports, pp. 150, 162 and 181 respectively.

3. See Foreign Experts' Report, Central Committee Report, pp. 694-6, and U. P. Committee Report, p. 181.

Institutes. The district unions and the provincial co-operative bank should be represented on the management of the Provincial Union or the audit branch of each Institute, and its staff should be non-official and licensed by the Registrar. Its main work should be the supervision of the district unions, and the audit of the central and provincial banks, the Provincial Institutes, and other central or provincial co-operative organisations that may be established.

(6) At the time of granting loans, the credit societies should carefully scrutinise the economic purposes of the loans and the repaying capacity of the borrowers. Loans should be granted to members of the managing committees only at meetings of the general body of members, supervisors should note at inspections whether they have obtained disproportionately large loans and, if so, the central banks should take this matter into consideration at the time of granting new loans to the societies.[1] The period for the repayment of all loans should vary according to the respective needs of the borrowers, but should not exceed three years. Extensions for repayment should be granted only if the borrowers are in exceptionally difficult conditions, and no tenderness should be shown in dealing with defaulters.[2] If the managing committee of a society gives loans in excess of the limits laid down by the by-laws of the society, or otherwise, the committee members should be held personally liable as guarantors of the loans.

(7) Members of the societies should be taught the necessity of getting rid of unsatisfactory or dishonest office-bearers or committee members.[3]

(8) The property statement of the societies should be prepared with great care and should be kept up-to-date.[4]

(9) Special steps should be taken to eliminate all differences in the status of the members of the societies, and to avoid the danger of the control of the societies and central banks passing into the hands of a few powerful members.

(10) The normal credit system should be introduced

1. See Bengal Committee Report, p. 153.
2. See Assam and Burma Committees Reports, pp. 147 and 173-5.
3. See Assam Committee Report, p. 136.
4. See Assam and Bengal Committees Reports, pp. 146 and 152.

in all societies. According to this system, each society has to fix the credit limit of all its members before the commencement of each season, and to arrange for the necessary finance in time, largely in the form of cash credits in central banks.[1] The amount then would remain available to the society, and members can draw upon it, as and when they need money, and pay interest only from the time the money is drawn.[2] Every central bank should take special care through its inspectors to see that its constituent societies fix this credit limit for their members properly and at the right time. Applications for crop finance can be made and sanctioned beforehand. The grant of credits on current account and cheque transactions should be introduced wherever possible, as this also will help to check the evils of inelastic and dilatory co-operative finance.[3]

(11) To bring about a reduction in the rate of interest charged to the ultimate borrowers, the central banks should borrow urban money at lower rates for short terms, and especially during the slack season, and should reduce their working expenses in those provinces in which they are excessive at present. Further, they will be able to get money at lower rates if their financial soundness is increased by the punctual repayment of loans by members to their credit societies, and a substantial reduction in overdues. The societies should also make strenuous efforts to become self-supporting by tapping the savings of the public direct, instead of through the central banks. Moreover, the profits of the co-operative societies and banks, already exempt from income-tax, should be exempted from super-tax also, and their earnings from investments in Government securities and land mortgage debentures should be exempted from both these taxes, to the extent that such investments are needed for the purpose of their liquid resources and for the investment of their reserve funds as laid down by the rules.[4] It is unfair that such investments

1. *Cf.* Bengal and Bihar Committees Reports, pp. 153 and 135.
2. *Cf.* Bombay Committee Report, p. 159.
3. *Cf.* Foreign Experts' Report, p. 602.
4. *Cf.* Bengal Committee Report, p. 159.

should be taxed at the source, as if the interest earned from them is income from business outside the legitimate operations of co-operative institutions. Further, they should be exempted from court fees as they are from stamp duties. The benefit of these concessions must, however, be passed on by these institutions to the ultimate borrowers in the shape of a reduction in the rate of interest charged to them on loans.

(12) The co-operative societies and banks should endeavour to collect savings deposits and encourage savings in years of plenty for use in periods of scarcity.[1]

(13) The provincial and central banks should be managed by persons well-trained in banking and co-operation, in accordance with business principles adjusted to suit the special needs of co-operation, and the latter should conduct all money transactions with the primary societies by means of cheques in order to speed up their activity.[2]

(14) To stimulate the societies to improve their working, particularly as regards recoveries, the central banks should charge lower rates of interest on loans given to sound societies than on those given to societies less sound.[3]

(15) The working of the central banks should be co-ordinated in each province by a committee consisting of one representative each of the provincial bank and the Co-operative Department and three representatives of the central banks.[4]

(16) There should be fullest co-operation between the Agricultural and Co-operative Departments.[5]

(17) Capital at concessional rates should be made available to the societies and central banks for the construction or purchase of godowns in rural areas, for the purpose of stimulating the financing of the marketing of crops on a co-operative basis.

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1. See the U. P., Punjab, Madras and Central Areas Committees Reports, pp 187, 112, 241 and 240 respectively.
2. *Cf.* Foreign Experts' Report, pp. 693-4.
3. See Central Areas Committee Report, p. 234.
4. See Bombay Committee Report, p. 174.
5. See Assam Committee Report, p. 57.

10. Relations of the co-operative organisation with other parts of the banking system.

We shall now turn to the relations of the co-operative organisation with the other parts of the banking system. The credit societies have been offering strong competition to the money-lenders and indigenous bankers. The deposit rates of the latter are much the same as those of the well-established co-operative banks, but they cannot enjoy as much of public confidence as the banks which are under the protection of Government. The competition has not, however, created any ill-feeling between the two. Many indigenous bankers act as treasurers or directors of co-operative banks, keep a portion of their funds on fixed deposit with the banks, and keep a portion of the cash balances of the latter in current account with themselves. The very existence of some of the banks has depended upon the support of the indigenous bankers. The U. P. Committee has suggested that co-operators should carefully study the methods of money-lenders and utilize fully their knowledge and experience.[1]

The various provincial and central co-operative banks get cash credit and overdraft facilities from the Imperial Bank of India amounting to about Rs. 2½ crores against Government and other authorized securities, and demand promissory notes of borrowers and the credit societies. The Bank, however, is much less willing now to give them such help than it was in the past. The Bank is ready to continue the help against the societies' pro-notes for the purpose of short-term agricultural loans. But its contention is that the co-operative banks regard the overdraft facilities from it as their cash in case of need, and that although, owing to the small use of these facilities by the banks in ordinary times, its profit from this source is small, it has always to be ready to meet their demands for funds. It demands, therefore, the substitution of Government securities for the pro-notes, if the help is needed for the purpose of the liquid resources of the banks, with the object of encouraging the latter to build up these resources within the co-operative organisa-

1. The U. P. Committee Report, pp. 190 and 288,

tion, so that they would not have to depend for this purpose upon outside help, which may not be available in a period of crisis. Another objection of the Imperial Bank to the existing system is that the security provided by the pro-notes of the societies is not first-class, because many societies have excessive overdues, and inefficient audit and control, and because the sale of the land of the members of the societies in the last instance is not practicable.[1]

Co-operators have urged in reply that (1) the pro-notes of the societies are sound security, as they are supported by the joint and unlimited liability of the members; (2) the pro-notes only of sound societies and of short maturity are made available to the Imperial Bank; (3) this Bank grants cash credits and overdrafts only under very stringent conditions; (4) there has yet been no default or delay in the repayment of cash credits and overdrafts obtained from it; (5) as it gets the free use of large Government balances, it is morally bound to give substantial help to the co-operative movement; and (6) if the co-operative organisation is itself to build up its own fluid resources, the cost of maintaining these resources will increase and, therefore, it will either have to put up the rates charged to the agricultural borrowers, or will at least have to abandon its efforts to lower these rates.

The Central Banking Committee and some Provincial Committees have stressed the great importance of the Imperial Bank liberally giving cash credit and overdraft facilities to the provincial and central co-operative banks on proper co-operative paper, fulfilling the standards laid down by the Bank itself[2]; and the Imperial Bank has expressed its readiness to deal with the matter sympathetically, if the paper of sound societies only belonging

1. See Mr. MacDonald's answers, Central Committee Evidence, Vol. III, p. 929.

2. See Report, p. 144, Bengal Committee Report, p. 162, and Bombay Committee Report, p. 177.

to class A is offered to it as security.[1] The Foreign Experts also have emphasized the need of the Imperial Bank giving the co-operative banks financial assistance and expert advice in a more liberal business spirit.[2]

With regard to the complaints that were made about the difficulties created by the Imperial Bank in providing free remittance of funds to the co-operative banks as provided by the rules of the Government of India, the Central Banking Committee has expressed the opinion that, as the success of the co-operative movement vitally depends upon the free remittance of funds for co-operative purposes, the Imperial Bank must not reduce the facilities supplied in this respect under the rules of the Government of India, and that as regards the remittance of funds for other than co-operative purposes, the Bank should charge the co-operative banks the same concessional rates that it charges to the joint-stock banks, *viz.* half of the rates charged to the public.[3] The provincial co-operative banks as members of the Reserve Bank will automatically get whatever concession the Reserve Bank gives in this respect to its members.

The activities of the co-operative banks and the commercial banks are so far apart that at present there is little competition between them. Allegations have, however, been made that the former, on account of the prestige supplied by the protection from Government, have been competing unfairly with the latter in attracting deposits. The reports of the Provincial Committees show that the allegations are not justified.[4] The co-operative banks as a rule do not offer higher rates on deposits than the commercial banks. The Managing Governor of the Imperial Bank has expressed the opinion before the Central Committee that the co-operative banks should be restricted to co-operative

1. See the answers of Sir O. Smith, Managing Governor of the Imperial Bank, Central Committee Evidence, Vol. III, pp. 1104-8.

2. See their Report, Central Committee Report, p. 628.

3. *Cf.* Mr. MacDonald's answers, Central Committee Evidence, Vol. III, pp. 931 and 954 and the answers of the Registrar of Co-operative Societies, Bombay Committee Evidence, Vol. III, p. 263.

4. See Bombay and Punjab Committees Reports, pp. 177 and 115.

banking, and should not be permitted to compete with the joint-stock banks and the indigenous bankers by undertaking other banking work, such as the opening of current accounts, the purchase of drafts, and the sale of remittances, on the ground that they have neither the knowledge, nor the organisation, that are necessary for transacting such business with safety.[1]

Co-operators have strenuously opposed this suggestion, and the Central Banking Committee has agreed with them, and has recommended that co-operative institutions should allow credit on current account and cheque transactions wherever practicable, and that no restrictions should be placed on their remittance business.[2] The Assam Committee has suggested that the provincial and central banks should make more use of the larger commercial banks by depositing with them funds for which they have no immediate need, and that *vice versa* the latter should lend funds to the former during the slack season, and the Central Committee has supported this suggestion.[3] The Burma Committee has suggested that closer connection between the two should be striven for, and the Central Committee has approved of this suggestion also.[4]

The co-operative organisation will be linked up with the Reserve Bank, and the provision of cheap and adequate credit facilities to agriculture through this organisation will be one of the principal functions of the Reserve Bank.[5] For this purpose the provincial co-operative banks will be admitted as members of the Reserve Bank and will be able to rediscount with it agricultural bills drawn for financing seasonal agricultural operations or the marketing of crops, and maturing within 9 months from the date of their rediscount by the Reserve Bank. It will also give them loans and advances repayable on

1. See Mr. MacDonald's answers, Central Committee Evidence, Vol. III, p. 873.
2. Report, p. 148.
3. See Assam Committee Report, p. 152 and Central Committee Report, p. 796.
4. See Burma Committee Report, p. 124 and Central Committee Report, p. 807.
5. See Central Committee Minority Report, p. 98.

demand, or after a certain period not exceeding 90 days, on the security of agricultural paper endorsed by them, or of their promissory notes supported by documents of title to goods which have been transferred or pledged to them.

11. Connection of the co-operative organisation with Government.

In addition to the provision of a staff of officials under the Provincial Co-operative Departments to direct the audit of the co-operative institutions, and to supervise and encourage their activities, Government has helped the movement by giving money grants or loans occasionally to certain societies or banks, by guaranteeing interest on long-term debentures issued by particular banks, and by giving certain general concessions, such as exemption from income-tax, stamp duty and registration fees, free transfer of funds from one co-operative institution to another for co-operative purposes, freedom of the shares or interest of members in the co-operative societies from liability to attachment by a court decree, and prior claim over other creditors in enforcing recovery of their dues in certain cases.[1]

The credit which the co-operative organisation posesses in the money market is largely due to its connection with Government, but the exact nature of this connection has nowhere been explained. In theory Government Co-operative Departments are responsible only for audit, supervision and propaganda, but actually the responsibility has been carried much further in some cases. When the provincial bank in the Central Provinces suspended payment during 1920-1, Government gave financial assistance to a majority of the central banks in this province. The collapse of the Burma provincial bank was prevented recently by an overdraft given by the Imperial Bank under the guarantee of Government, which also contributed a large sum to repay all its depositors fully. Very recently some Provincial Governments have given advances to their provincial banks, because the latter's resources have become insufficient to meet the needs of the societies, owing to

1. *Cf.* the statement of Sir Laliubhai Samaldas, Bombay Committee Evidence, Vol. II, p. 9.

the catastrophic fall in the prices of agricultural produce. The position seems to be that ordinarily Government does not undertake any financial responsibility with regard to the co-operative organisation, but does so only in exceptional circumstances. The Central Banking Committee has approved of this policy, and has suggested that in the interests of the taxpayers, and to promote self-help among the co-operators, such aid should be given temporarily, with the concurrence of the legislatures, and just sufficiently to enable the co-operative organisation to pass through a crisis, and that the aid should be given through the provincial banks.[1]

In the opinion of the Bombay Banking Committee the time has now arrived when the organisation of new societies may be taken up again, at places where conditions are favourable, after careful preliminary enquiry, and with proper safeguards. This is not incompatible with the policy of consolidation and improvement that will have to be continued for some time. The domination of this policy over the movement may be good for a short time, but its continuance for several years can hardly be justified. For the supervision and audit of new societies an increase in staff will be necessary, but the Committee has expressed the opinion that in the interests of the masses Government should not grudge the necessary additional expenditure.[2] It may be mentioned, however, that at present the co-operative societies in all provinces are suffering much from the effects of the heavy fall in the prices of agricultural produce, that many of their members find it very difficult to pay even the interest on the loans obtained by them, and that in a majority of the societies unauthorized arrears are increasing.

12. Present position of co-operative land mortgage banks.

It has been explained before that the co-operative credit societies are not suited to the supply of long-term credit to agriculturists for the purchase of land or costly agricultural appliances, the improvement of holdings, the repay-

1. Report, pp. 149-50. See also Burma Committee Report p. 185.
2. See Bombay Committee Report, p. 162.

ment of past debt, and the redemption of mortgaged land. Commercial banks and indigenous bankers also cannot supply such credit, because they cannot afford to lock up their capital for long periods, or to recover their loans in small amounts out of the earnings of the borrowers. Such credit can be supplied only by a special type of credit institutions, known as land mortgage banks, which are either co-operative, semi-co-operative, or joint-stock.

There are at present 12 land mortgage banks in the Punjab with a working capital of Rs. 23 lakhs, out of which Rs. 14½ lakhs have been advanced by Government; 37 in Madras with a working capital of Rs. 17 lakhs, out of which Rs. 2½ lakhs have been supplied by Government; 5 each in Bombay and Assam, and 2 each in Bengal, Burma and the Central Provinces. The other provinces have none. Although all of them have been registered under the Co-operative Societies Act, strictly speaking, they are semi-co-operative. They are limited liability associations of agricultural borrowers, with a few non-borrowers for obtaining initial capital and the business capacity that is necessary for efficient management. In some cases, members have to contribute to the share capital a certain percentage of their borrowings, but generally the shareholding of each member is limited, and he has a single vote whatever be the number of shares that he holds.[1] Dividends are restricted, and the aim is gradually to eliminate the non-borrowing members. But the work of these banks lacks the personal and human elements which are the main features of co-operation, and the insistence is, not on the members' mutual knowledge of, or control over, one another, but on the business capacity of the management for the purposes of the correct valuation of security, careful enquiries into titles to land, and the correct determination of the credit and repaying capacity of the borrowers.

The working capital of these banks consists of share capital, deposits, and debentures which have been issued in some cases by themselves, in other cases by the pro-

1. See Bombay Committee Report, p. 91.

vincial co-operative banks for their benefit with a floating charge on mortgages of land, and the interest of which is guaranteed, or a portion of which has been purchased, by Government in some cases. In Madras, as it was found that the issues of different debentures by a number of independent banks hampered their successful floatation, a Central Land Mortgage Bank has been established recently to finance primary land mortgage banks by centralised debenture issues.

Loans are given to members on the mortgages of their lands up to 50 per cent of their value in some provinces, or up to 30 times the land revenue payable on them in others, after assessing the value of the lands, and determining the members' title to them, their right to alienate them, their need for the loans, and their repaying capacity. A maximum has been laid down for the total amount that can be lent in this way to individual members. The period of the loans varies up to a maximum of 16½, 20 or 30 years in different provinces, and the rate of interest charged is 8 or 9 per cent. As in some banks the managing committees were too free in granting loans to themselves and to their relatives, the grant of such loans has been either prohibited altogether or subjected to restrictions. Nevertheless, the number of defaults has been appreciable owing to bad harvests and imprudent loans.

13. Suggestions for organising and working co-operative land mortgage banks.

It is thus seen that co-operative land mortgage banking is yet in its infancy in India. The problem of supplying long-term credit to agriculturists has been examined carefully by two conferences of the Registrars of Co-operative Societies, the Agricultural Commission, and the Provincial and Central Banking Committees, and all of them are agreed that such credit can be provided to small agriculturists most suitably through co-operative land mortgage banks, because they cannot secure credit except through organisations based on mutual association, and the collective guarantee of their properties mortgaged

by them.[1] These authorities have, therefore, recommended that these banks should be registered under the Co-operative Societies Acts. They should be organised only after careful enquiries, and their constitution and working should be as simple as may be consistent with adequate safeguards. Their area of operations should be fairly small, consistent with competent management. Their management should be kept entirely separate from that of local credit societies. For some years, there should be a nominee of Government on their committees of management, except where the interests of Government and debenture-holders are adequately safeguarded by the appointment of a trustee acceptable to Government. Their dividends should be restricted until an adequate reserve fund is built up.[2]

Their working capital should be obtained from two sources, *viz.* share capital and debentures. The liability of members should be limited to the amounts actually borrowed by them from the banks, plus their share money. The share capital can be obtained in two ways. The members may subscribe it before securing loans, thereby supplying a good basis of security to the debentures that will be issued by the banks later; or the share capital may be obtained gradually by deducting a certain percentage, not less than 5, of the loans given to the members, thereby increasing gradually the borrowing capacity of the banks also. To enable the banks to start with substantial resources, the Provincial Governments should, wherever necessary, give them interest-free advances on the condition that the advances are repaid out of the proceeds of debentures issued. When their working becomes very large, it may become necessary for the Provincial Governments to supply them a part of their share capital.

The greater part of their working capital should be

1. See proceedings of the Ninth Conference of the Registrars of Co-operative Societies in India, 1926, pp. 83-91, Agricultural Commission Report, pp. 461-6, and Bombay, Madras, Bengal, Burma and the Punjab Committees Reports, pp. 92, 169, 95, 93 and 41 respectively.

2. See Assam Committee Report, pp. 71 and 74 and Central Committee Report, p. 898.

obtained by issuing debentures. The value of outstanding debentures should never exceed the value of the outstanding mortgages given by the borrowers, on which the debenture-holders would have a floating charge. The best assistance that the Provincial Governments can give the banks in the issue of debentures is to guarantee the interest on them for the entire period of their currency, and to include them among trust securities, after adequate arrangements are made by the banks for their redemption at regular intervals.[1] If it appears to a Provincial Government that purchase by it of a portion of the debentures, or the grant by it of long-term loans will be more helpful to these banks, it should do so. The debentures should be issued, not by individual banks, but by a central institution in each province, which should be called the Provincial Land Mortgage Corporation. Their actual sale, however, should be conducted both by the corporation and the primary banks. The latter should obtain funds from the former against a transfer of their mortgage securities, which would serve as the basis for the debentures. The provincial co-operative banks may finance the primary land mortgage banks with long-term capital specially raised by the issue of debentures, only until the Provincial Land Mortgage Corporations are established in their provinces, but not afterwards.

The land mortgage banks should not be allowed to obtain deposits like the co-operative credit institutions.[2] To develop the habit of thrift, however, among the borrowers, the banks may make them contribute annually a certain sum to a provident fund. The banks may be allowed after some years to accept deposits for not less than 5 years, and to issue savings certificates payable after 5, 10 or 15 years, but not at present, because they will have to give most of their loans for the first few years for long periods for the liquidation of old debts, so it will be

1. See Bombay, Madras, Punjab, C. P., Bengal and Burma Committees Reports, pp. 94, 97, 43,175, 102 and 99 respectively.

2. See Madras Committee Report, p. 97.

dangerous for them to finance these loans with such deposits and certificates of much shorter duration.[1]

The amount and period of loans should be determined with due regard to the objects for which they are to be given and the repaying capacity of the borrowers.[2] The amount of loans to individual members should be limited to a maximum of Rs. 5,000 for the present, until the banks obtain better experience, and the amount of loans should never exceed 50 per cent of the value of the mortgaged properties. The maximum period of loans should be 20 years for the present, and may be extended to 30 years, if necessary, after the banks are soundly established. If the borrowers are also members of credit societies, they should be consulted before loans are given. Loans should not be given for purposes that are not economically profitable to the borrowers. They should be given principally for the redemption of the land and houses of agriculturists, the liquidation of their old debts, the improvement of their land and methods of cultivation, the building of houses, and the purchase of land in special cases only, in order to prevent land speculation and indiscriminate borrowing for the purchase of land.[3]

Misapplied loans should be promptly recalled. Punctuality in the repayment of loans should be rigidly enforced by the banks. The repayment should be by a system of equated payments, thereby amortizing the loans within a definite period.[4] The instalments need not exceed the amounts usually paid by borrowers to money-lenders in the shape of interest alone. For instance, an equated payment of 12 per cent of a loan every year will provide for the regular payment of interest at 9 per cent, and for a gradual extinction of the principal of the loan within a period of 16½ years. A system of graduated payments may be introduced, if local conditions need it, so as to provide for extinction by larger instalments,

1. See the C. P. Committee Report, p. 175.
2. See Bombay Committee Report, p. 57.
3. *Cf.* Assam Committee Report, p. 70.
4. *Cf.* The C. P. Committee Report, p. 168 and the statement of the Indian Chamber of Commerce, Calcutta, Bengal Committee Evidence, Vol. II, Part 1 p. 350.

starting after the investment of the loan on the land has begun to yield an increasing profit. The bye-laws of the banks should empower the management to enforce that method which it may regard as more suitable.

These banks should be given summary power of recovering their dues by the foreclosure and sale of mortgaged properties without having to resort to the civil courts, subject to three safeguards, *viz.*, first, that the foreclosure must not be resorted to until the dues bear a substantial proportion to the value of the mortgaged property; second, that the interest of the mortgagor must be protected by preventing any contravention of the provisions of the Civil Procedure Code with regard to the sale of the mortgaged property; and third, that the aggrieved party must be given the right to question in the civil courts the action of the banks. If they are not vested with this power by special legislation, they will have to file suits in the civil courts for the recovery of their dues, and to resort to the elaborate provisions of the Transfer of Property Act and the Civil Procedure Code for obtaining and executing mortgage decrees. This will not only hamper their operations but, by preventing their debentures from being a popular and liquid form of security, will also hamper their efforts to obtain a sufficient working capital by issuing debentures.

Most of the Provincial Banking Committees have expressed themselves against granting this power to the banks on the grounds that it will weaken their sense of responsibility, make them lax in examining the security offered for loans and in determining the amounts of the loans themselves, and make them unpopular with the public, but the Central Committee has stated that it cannot attach much importance to these objections.[1]

It is also necessary to amend the Insolvency Act in order to give greater protection to the banks against avoidance of mortgage by the unsecured creditors of the insolvent. Further, it is necessary to amend the Land Alienation Acts which prevail in the Punjab, and certain

1. See Central Committee Report, p. 173, and Bombay and Bengal Committees Reports, pp. 96 and 102.

parts of the Central Provinces, the United Provinces and Centrally Administered Areas, and which restrict the sale or mortgage of land in the interests of those who are classified as agriculturists, so as to give the above banks the right to take possession of land, through foreclosure, on default of the payment of the instalments of a loan and to sell it to other agriculturists. The banks will not be able to obtain their working capital by issuing debentures unless agricultural land, which is the basis of security for these debentures, can be freely sold in cases of default by the borrowers of the banks. Moreover, the prevalence of restrictions on the sale or mortgage of the land of some members of the banks, and their absence with regard to the land of other members, will destroy that equality of the status of members, which must be a fundamental feature of every co-operative institution.

14. Suggestions for the organisation and working of joint-stock land mortgage banks.

The Provincial and Central Banking Committees are of opinion that the long-term credit needs of the larger landowners and others, who remain outside the co-operative movement, or cannot be served adequately by it, can be supplied suitably by the organisation of joint-stock land mortgage banks, similar to those which have proved successful in France, England, Ireland, Japan and Egypt.[1] The only instance of such a bank in India is Dawson's Bank in Burma, which operated in the Irrawaddy delta, but went into liquidation in June 1931.[2] The necessity for such banks is specially great in Bengal and Bihar in which, on account of the security of return afforded by the permanent settlement of land revenue, large amounts of capital have been invested in Zamindari estates.[3] The owners of these estates have at present to obtain credit from money-lenders, indigenous bankers, or loan offices, on mortgages at high rates of interest and

1. See Burma Committee Report, p 93.
2. For the working of this bank see Agricultural Commission Report, p. 422.
3. See Bihar Committee Report, p. 168.

under exacting conditions, even if the credit is needed for developing the estates.

Provincial Governments should actively encourage the establishment of these banks, and should help them to achieve success by supplying a part of their initial capital and control. Government control, however, should be gradually reduced by making all borrowers subscribe a certain fraction of their borrowings to the share capital, and giving them a voice in the management of the banks. In addition to the share capital, their funds should be obtained by the issue of debentures, the interest on which should be guaranteed by Government, and which should be included in the list of trust securities, on the same conditions as those mentioned before with regard to the debentures of co-operative land mortgage banks. Officers possessing experience of land revenue administration should be appointed on the boards of these banks, as they will prove very useful in supervising the valuation of the security, and in determining the repaying capacity of borrowers. Loans should be given on terms and conditions similar to those mentioned before in connection with the loans of co-operative land mortgage banks.

15. Mr. Subhedar's scheme of land mortgage departments of central co-operative and commercial banks.

Mr. Subhedar sees no special advantage in making land mortgage credit available to small agriculturists through co-operative institutions, for four reasons. First, there would be no unlimited liability; second, attempts to combine saving and borrowing, by compelling borrowers to subscribe to the share capital a portion of the loans obtained by them, would be futile; third, the average agriculturists would not understand their rights and duties as shareholders, in respect of helping and watching the banks to maintain solvency and to increase in strength; and finally, directors, who would be elected by shareholders and would also be borrowers, would find it very difficult to be strict in insisting on the regular repayment of instalments of loans by the latter.[1] In his opinion,

1. See Central Committee Minority Report, p. 59.

separate institutions for granting land mortgage credit are not desirable, unless the turnover of business is very large, because their superior staff cannot be kept fully occupied, and the cost of running them would be unduly high.

He has, therefore, recommended, that in the interests of economy and efficiency, land mortgage credit should be made available by separate land mortgage sections of central co-operative banks and joint-stock banks. Their working capital should be obtained mainly by the issue of debentures, which should be guaranteed, both as regards principal and interest, until redemption, by Government in respect of the larger institutions only, and by obtaining deposits from money-lenders and indigenous bankers, who would serve as guarantors of loans given by the banks. The risk of guaranteeing the debentures would be small to Government, as the land, on the security of which loans would be given by the banks, would be carefully valued by Government valuers, and as the money-lenders and indigenous bankers would serve as guarantors of the loans. A department should be created in the Reserve Bank of India for issuing and placing on the market in India and abroad these debentures on behalf of the banks, for administering the scheme in respect of a sinking fund and other charges, and the distribution of interest, and for exercising the necessary control over the banks which benefit from the scheme.

Securing the co-operation of money-lenders and indigenous bankers as guarantors of loans is an integral part of this scheme of Mr. Subhedar.[1] They would scrutinise the position of the borrowers, the amount of the loans, the value of the security as assessed by Government valuers, and would guarantee to the banks the repayment of the loans on a commission of 1½ per cent. They would deposit with the banks for long terms the funds that they would obtain from their debtors by way of the repayment of old debts, and would be given an attractive rate of interest on them, say 6 per cent. The advantages of this scheme to the guarantors would be that they would get a recognised and respected status in the banking

1. See Minority Report, pp. 69-70.

organisation of the country, that the risks, expenses and worry of their operations would be considerably reduced, and that their decline would be arrested. The advantages to the banks would be that, not only would their land mortgage credit operations be free from the opposition of the money-lenders and indigenous bankers, but they would also be able to utilize that local knowledge and experience of the latter, in selecting borrowers, having regard to their character and repaying capacity, and in scrutinising the value of the security and the amount of the loans, which the banks themselves cannot possess adequately, and without which the success of their operations would be problematical.

16. Debt conciliation and liquidation.

Land mortgage banks can be used for debt redemption only by those who have sufficient landed security to offer, and who have a sufficient surplus income, after meeting their expenses of cultivation, subsistence, and other current needs, to pay the annual instalments of debt redemption for a long period. A substantial proportion of agriculturists cannot fulfil these conditions, and will, therefore, be unable to use land mortgage banks for the redemption of their debts. The danger of progressive and serious deterioration in their economic position, and of the growth of discontent among them, is so great that it is necessary for Provincial Governments to initiate and develop a vigorous policy of effecting conciliation between debtors and creditors, and securing a composition of the debts on a voluntary basis. The Punjab and Central Provinces Banking Committees have stated that many creditors, on account of the increasing difficulties of recovery, would agree to substantial reductions in their claims, if they could be sure of receiving the amounts settled during a certain period, without any further trouble to them. Attempts at debt conciliation have been made in parts of the Central Provinces, the Punjab and Bihar on a moderate scale and with some success.[1] This experience has shown that for the success

1. For accounts of these attempts see the Punjab and C. P. Committees Reports, pp. 173-4 and 149 respectively.

of any scheme of debt conciliation, an organisation must be created, and that Government and co-operative credit societies must come forward to help the debtors. The Central Banking Committee has, therefore, made the following recommendations:—

(1) In each province special officers should be appointed to induce creditors and debtors to agree to a redemption of debts in the form of equated payments spread over a period of years, or of immediate cash payment in part and equated payments for the rest.

(2) The officers should explain to the debtors the facilities provided by the Usurious Loans Act and the Civil Procedure Code for easing the burden of debt; and conciliation boards should be appointed by Government, if necessary, to help them.

(3) The cash and equated payments should be made to the creditors by the debtors through co-operative societies, which the latter should join, so that the societies can meet their short-term and intermediate financial needs in future.

(4) To enable immediate cash payments to be made to the extent insisted upon by the creditors, Government should give advances to the societies, which would gradually repay them as the societies are repaid by the debtors.

(5) The portions of the settled amounts not paid to the creditors immediately in cash should be regarded as deposits by the creditors with the societies, to be repaid to them *pari passu* with the annual instalments fixed for the debtors.

(6) The annual instalments to be paid by the debtors should be fixed on the basis of their paying capacity, after making a sufficient allowance for their expenses of cultivation and subsistence.

(7) Government should help the societies if they suffer loss on account of defaults of the borrowers regarding the payment of their annual instalments, unaccompanied by any negligence or mismanagement on the part of the societies.

(8) This scheme should be put into operation by means of an Act, if necessary.[1]

No objection can be taken to the part that the co-operative credit societies would play in this scheme, because the repayments of debts would be financed by them, not with their own funds but, in effect, with the long-term deposits of the creditors themselves and Government with them.

Whenever the creditors do not agree to a voluntary settlement of debts, they would have to be compelled to accept a settlement, and the Central Committee has recommended legislation for this purpose. It has also supported the recommendation of the Agricultural Commission and the Civil Justice Committee that the case for passing a simple Rural Insolvency Act should be considered in every province, as agricultural debtors find it most difficult to use the complex mechanism of the existing Insolvency Act, which was passed principally for the benefit of the mercantile classes, and as debtors, who are prepared to give up their assets for the discharge of their inherited debts, have a right to be free to make a fresh start in life and to earn a decent living.[2] On the other hand, for the just protection of the creditors, civil courts should be required to deal more expeditiously with insolvency petitions, and should make official receivers and assignees take all possible steps to realise assets and wind up bankruptcies with minimum delay, so as to minimise the scope for debtors to secrete or alienate their property. Moreover, the officials should scrutinize the records of bankrupts, to ensure that the liquidation has not resulted from any culpable action on their part, and should order prosecution. if necessary.[3] Finally, as the real purpose and effect of the Insolvency Act do not appear to be understood by a large section of the rural population, its main provisions should be explained in a pamphlet in the chief vernaculars of each province, and the pamphlet should be widely distributed.[4]

1. See Report, pp. 65-6.
2. See Report, p. 67.
3. *Cf.* Madras Committee Report, p. 178.
4. *Cf.* The C. P. Committee Report, p. 309.

CHAPTER IV

Rural Finance : Commercial Banks, Loan Offices, Nidhis, Chit Funds and Government Tagavi Loans

1. Commercial banks.

The commercial banks and the Imperial Bank of India do not finance agriculturists directly to any appreciable extent, because they are not organised to deal with them. They cannot keep themselves in close touch with the doings of agriculturists; and the uneconomic nature of the majority of agricultural holdings, and the slenderness and non-liquidity of the security that agriculturists can offer, also prevent them from regarding agricultural finance as a part of their general business. A few banks, however, especially the smaller ones, lend direct to landlords and the more substantial cultivators to some extent on the pledge of produce, ornaments, or other valuables, or on mortgage at rates varying between 7 and 10 per cent. The Imperial Bank has recently started doing the same, and also lending to them on personal security with at least two good sureties at 7 or 8 per cent.[1] The Central Banking Committee has recommended that all these banks should lend liberally to agriculturists on the security of precious metals, including ornaments, as this will be helpful in saving them to some extent from the clutches of money-lenders.[2]

These banks, especially the Imperial Bank, finance agriculture indirectly to a larger extent through merchants and dealers. Agriculturists, however, have often to pay high rates for such indirect finance, owing to the intervention of intermediaries. This finance takes the form of advances against produce to approved commission agents and dealers at 7 or 8 per cent; of financing the movement of produce from the mandis (marts) to the con-

1. See Bombay Committee Report, p. 66 and Mr. MacDonald's answers, Central Committee Evidence, Vol. III, pp. 938-41.

2. Report, p. 193.

suming centres, largely by the purchase of demand drafts representing produce despatched by approved customers; and of financing the movement of produce from the collecting centres to the exporting ports by the purchase of drafts or telegraphic transfers drawn on the ports.[1]

2. Loan offices.

Loan offices in Bengal, and Nidhis and Chit Funds in Madras occupy an intermediate position between indigenous bankers and modern joint-stock banks. Whereas in the other provinces banking development began in the sixties and seventies of the last century in the form of joint-stock commercial banking, in Bengal it took the form of land mortgage banking. The first loan office was established in 1865. The loan offices are registered under the Indian Companies Act, are owned and managed by Bengalis, and play an important part in the rural life of Bengal. Their number has almost doubled since 1927, and is at present over 1,000, with total working funds amounting to about Rs. 9 crores. Their paid-up capital is generally small, and barely a score of them have a paid-up capital of Rs. 1 lakh or more. The reserve funds of those established in recent years are very small indeed. They have not issued any debentures, and depend almost entirely on deposits, largely from the middle class population. Interest paid on deposits varies from 4 per cent on short-term deposits to 8 per cent on 7 years' deposits, but usually the maximum period of deposits is 5 years.

Some new loan offices, owing to keen competition with each other and co-operative institutions, use touts to attract deposits, and pay high rates, up to 15 per cent, on them.[2] Their main business is to lend money to Zamindars and their tenant-cultivators against mortgage of land, pledge of ornaments, or personal security, often for unproductive purposes.[3] They seldom finance trade or industry. But some of them have trading departments

1. See the U. P. Committee Report, p. 158.
2. See Bengal Committee Report, pp. 211 and 233.
3. See Bengal Committee Report, p. 61.

for employing their funds profitably during slack periods. The older companies charge from 12 to 18 per cent on secured loans and higher rates on unsecured ones; the newer ones charge from 12 to 56¼ per cent on secured loans and up to 112 per cent on unsecured ones. A large proportion of the loans of the latter are unsecured. In some cases, the same persons have borrowed money from three neighbouring loan offices merely on personal security.

There is much apprehension regarding their ability to withstand bad times, as there are too many small offices, and as they have hardly any reserve funds. Their rapid growth, therefore, must be regulated. The best way of strengthening them would be amalgamation, but they would have to amalgamate voluntarily, and cannot be compelled to do so. The Central Banking Committee, after modifying the recommendations of the Bengal Committee to some extent, has made the following recommendations :--

(1) The larger and well-established loan offices, which are really carrying on joint-stock banking, should be subjected to the provisions of the special Bank Act that the Committee has proposed for all joint-stock banks.

(2) Other loan offices should be regulated by passing a Bengal Loan Offices Act.

(3) All of them should be prohibited under this Act from combining trade with banking, and from dealing in real properties other than those which come into their possession in the course of their business.

(4) New offices established under the Act must have minimum paid-up and subscribed capitals of Rs. 25,000 and Rs. 50,000 respectively and a subscribed capital at least half of their authorized capital.

(5) The existing offices, having a smaller paid-up capital, must deposit with Government, securities of a value equal to the difference between Rs. 25,000 and their paid-up capital.

(6) They must carry to the reserve fund at least 10 per cent of their profits, and must not pay a dividend of more than 10 per cent unless 25 per cent of the profits are carried to the reserve fund.

(7) The reserve fund should be invested in post office savings banks and postal cash certificates; for loan offices the maximum holding in the latter should be raised from Rs. 10,000 to Rs. 20,000; and the surplus should be invested in trust securities.

(8) They should be prohibited from making advances against their own shares.

(9) Their balance-sheets should give more detailed information.

(10) Auditors should be ineligible to audit their accounts, if they are interested in any way in the management of the offices, or in any concerns that have been financed by the offices.

(11) All loan offices should be given 5 years to comply with the provisions of the special Bank Act or the Loan Offices Act.

(12) A special officer should be appointed by the Bengal Government to supervise and guide the loan offices sympathetically.[1]

Mr. N. R. Sarkar, a member of the Central Committee, representing the Federation of Indian Chambers of Commerce and Industry, has stated in a separate note that as many loan offices as possible should take to commercial banking, but that they would find it difficult to do so, on account of the fact that a large proportion of their funds have become more or less frozen, as they have been lent on the security of land, which is difficult to sell, especially in a period of depression. He has, therefore, suggested that Government should take the initiative in establishing a Loan Offices Financing Corporation, as an apex institution, which would lend funds to the loan offices on the security of their assets.

The Corporation should start with a paid-up capital of Rs. 5 lakhs contributed mainly by the loan offices themselves, and partly by individual subscribers. The Corporation should issue debentures of 20 times the amount of its capital on the security of the assets of the loan offices. Government should supervise the issue of the

1. See Central Committee Report, pp. 195-7 and Bengal Committee Report, pp. 214-20.

debentures, purchase a portion of them, and supervise the working of the Corporation. Its initial capital should be increased gradually by contributions of 5 per cent of the amounts paid to the loan offices out of the realisation of the debenture issues, and further debentures may be issued later. The Corporation should also induce the loan offices to re-organise their business, and to carry out amalgamations.

Those loan offices, that prefer to continue their existing business of lending on the security of land, should be made to use for the purpose long-term deposits only, or the proceeds of long-term debentures; or they should be made to join the Provincial Land Mortgage Corporation, which the Central Banking Committee has proposed. Finally, loan offices too small to come under the proposed Loan Offices Act should be established on the lines of the Friendly Societies and Building Societies of England, the U. S. A., and the British Dominions. The Central Banking Committee has commended these proposals of Mr. Sarkar to the consideration of the Bengal Government and Legislature.

3. Nidhis and Chit Funds.

Nidhis were originally started in the Madras Presidency as mutual loan societies from the middle of the last century, but in the course of time they have developed into semi-banking institutions. There are at present 228 of them, all registered under the Indian Companies Act, 5 as banks, and the rest as Nidhis. They receive deposits in the form either of deposits proper, or of withdrawable share capital paid in monthly instalments. Their total paid-up capital is about Rs. 2½ crores, and deposits and reserve funds about Rs. 1½ crores. Their functions are to promote savings, to relieve members from old debts, to deliver them from usury, and to give them loans for all purposes on good security. Loans are given even to outsiders, if the Nidhis have spare funds. The receipt of deposits is seldom a primary function, as funds are obtained mainly in the form of share capital.[1]

1. See Madras Committee Report, p. 33.

The Nidhis usually lend at low rates, 6¼ per cent being a common rate, but they charge high rates on overdue amounts, and these yield a large portion of their profits. According to the Madras Committee, many of them are very well managed, but the management of some is most defective.

Chit Funds are loose organisations of a small number of persons to promote savings and to lend money to members. They exist in the Madras Presidency, and although their exact number is not known, it must be several thousands. A number of persons agree to make periodical payments to one of themselves, who is the promoter of the Chit, and who appropriates the first collection as his remuneration. Each successive collection is given to one of the members according to different methods, the simplest being to give it to the members in rotation, the order being decided by lots.[1] While some of these funds are properly managed, many of them are mismanaged by the promoters, some of whom are unscrupulous and resort even to fraud. Some of them are hardly better than lotteries, and appeal in the main to the gambling tendencies of the members.[2]

For the regulation of Nidhis and Chit Funds the Central Committee has made the following recommendations :—

(1) Those which have become full-fledged banks should be registered under the Bank Act that it has recommended, if they so desire.

(2) Others should be brought under a special Act to be called the 'Nidhis and Chit Funds Act'.

(3) Those which prefer registration under the Bank Act must carry out fully its provisions, which would not permit the withdrawal of any portion of the share capital without the permission of the High Court.

As regards the Nidhis and Chit Funds to be registered under the proposed Nidhis and Chit Funds Act, the Committee has made the following recommendations:—

(1) Nidhis should be allowed to obtain withdrawable

1. For an account of these methods, see Madras Committee Report, p. 229.

2. See Madras Committee Report, pp. 232-3.

share capital, and to lend funds on the security of their share capital as at present and, if they do this, should be prohibited from obtaining deposits or loans from outsiders.

(2) They should be permitted to have share capital paid up in a number of small instalments without the initial payment of a certain percentage.

(3) The liability of their members should be limited to the amount paid or in arrears in respect of shares and should end with the withdrawal of capital.

(4) They should not be allowed to engage in trade.

(5) Their balance-sheets should be properly audited and published.

(6) Each Chit Fund should be separately registered.

(7) Promoters of Chit Funds should be licensed and should possess some property qualification.[1]

Such control may put an end to some of the Chit Funds, but this is no reason for not taking action to check their malpractices and to promote their benefits.[2]

4. Government tagavi loans.

The State provides financial assistance to agriculturists through the Land Improvement Loans Act of 1883 and the Agriculturists Loans Act of 1884. Under the former Act, long-term loans for permanent improvements on land, such as wells and embankments, are granted, while under the latter, short-term loans for current agricultural needs, such as the purchase of seed, cattle, manure, implements, etc., are granted. But the Provincial Governments have no well-planned policy of promoting agricultural improvements by the grant of such loans, which are called Takavi or Tagavi loans, and the assistance given by them so far by these means is a small part of the finance needed by agriculturists. The loans given by all the Provincial Governments under the Land Improvement Loans Act and Agriculturists Loans Act amount to about Rs. 35 and 60 lakhs respectively each

1. See Central Committee Report, pp. 199-200 and Madras Committee Report, p. 219.

2. See Madras Committee Report, pp. 234-5.

year. The rates of interest charged on them vary from 6 to 6¾ per cent in all provinces, except Burma where the rate is 10 per cent. The loans under the former Act are in practice restricted to 20 years or less, although the Act allows a maximum period of 35 years. The loans under the latter Act have to be repaid usually at the next main harvest, or after two main harvests. A longer period is allowed when special loans are given for the purchase of seed and for the relief of distress.

In addition to the serious inadequacy of the amount, this system of State loans is defective in other respects also. Its administration is inelastic, and difficult to supervise. Complaints are frequently made of delay on the part of Government in dealing with applications for loans, of the levy of illegal gratifications by subordinate officials through whom loans are given and repayments are received, and of rigidity and unfairness in realizations.[1] Moreover, these loans are apt to be regarded by cultivators as windfalls, and so, instead of exercising any educative influence upon their character, they are apt to discourage thrift and self-help without which there can be no real improvement in the condition of the cultivators. Finally, the facilities available, and especially the procedure to be followed, are not widely known to the public. The Agricultural Commission expressed the opinion that the working of the two Acts was satisfactory on the whole, but this opinion is not shared by other authorities, including the Provincial and Central Banking Committees.

Although it is true that the executive authority in a district, however capable, cannot satisfactorily perform the duty of financing agricultural improvements within its jurisdiction, owing to the fact that the duty properly belongs to special credit institutions, the Provincial and Central Banking Committees have stated that much can be done to eliminate the defects in the administration of the Acts, and to improve and extend the benefits

1. See Dr. Nehru's statement, U. P. Committee Evidence, Vol. III, p. 85 and the statement of the Bengal National Chamber of Commerce, Bengal Committee Evidence, Vol. II, Part I, p. 367.

available to the cultivators under them. Accordingly, they have made the following suggestions[1]:—

(1) Provincial Governments should take special steps to reduce the delay in dealing with loan applications, as the advances lose a great part of their value, if they are not given at the proper time.[2] They should be given in the earliest stages of a famine to put heart into the cultivators and to give them moral strength.

(2) Special steps should be taken to minimise the scope for illegal gratification, and the distributing officers should be of standing and should watch for instances of exactions.

(3) If Government resources are inadequate, larger loans should be given to a smaller number of cultivators, whose needs are the greatest, so that their needs can be met more or less fully.

(4) The rate of loans per acre should be higher, so as to make it unnecessary for the recipients to resort to money-lenders.[3]

(5) Loans for improvements should be given for a period of years, and their repayment should be insisted upon in a short period only when the amount is small, or the improvements carried out are very temporary.

(6) Suspensions or remissions should be given liberally in cases of real necessity, such as failures of crops.[4] Dates of repayment should be determined with due consideration of the harvest time, and loans advanced for the purchase of cattle, or in times of distress, should be made repayable in more than a single instalment.[5]

(7) The facility of these loans and the procedure to be followed for securing them should be made more widely known to the cultivators.[6]

(8) Loans under the Agricultural Loans Act should be generally given for the relief of distress only, as Govern-

1. See Central Committee Report, pp. 182-5.
2. See Madras, Punjab, and U. P. Committees Reports, pp. 97, 44 and 229 respectively.
3. *Cf.* Bihar Committee Report, p. 30.
4. *Cf.* Assam Committee Report, p. 84.
5. *Cf.* The U. P. Committee Report, 229.
6. See The U. P., Punjab, C. P., and Burma Committees Reports, pp. 230, 44, 161 and 93 respectively.

ment cannot supply the entire requirements of the agriculturists, and as sporadic efforts to supply a part of them cannot succeed. But in backward areas, in which co-operative credit societies cannot succeed, and in those which are specially liable to the failure of rains, the facilities under this act should be made available to the cultivators more freely.

(9) The grant of advances under both the Acts should not be a substitute for help for famine relief.

(10) Co-operative societies may be used as mere agents for the distribution of these advances, but they should not be made responsible for watching the proper application of the loans or for their recovery.

(11) A definite policy of examining and suggesting to the cultivators agricultural improvements, and of famine protection, similar to that which is being followed in the Bijapur District of the Bombay Presidency[1], should be adopted elsewhere, with suitable agencies for advice, guidance and supervision.

(12) In order to provide Government with the information that it requires to pursue a progressive and constructive agricultural policy, a Provincial Board of Economic Enquiry, similar to the Punjab Board of Economic Enquiry, should be established in each province to collect, correlate and analyse all the economic factors affecting agriculturists, and to present the results of its enquiries in a convenient form to those Government departments, which are concerned with the promotion of the welfare of the agriculturists.[2] The Punjab Board is a non-official body consisting of officials and non-officials interested in rural economics, and is financed by an annual Government grant.

In examining the above recommendations for adoption, Government should bear in mind that it is in the position of the great landlord of the country, that its revenues

1. For details see Bombay Committee Report, p. 84.

2. See Madras, U. P. and Central Committees Reports, pp. 3, 338 and 390 respectively. The C. P. Committee has recommended a Provincial Economic Development Board, Report, p. 376, and Bihar and Orissa Committee, a Provincial Banking Council, Report, Chp. XX.

depend vitally upon the prosperity of the cultivators, that its interest in them as citizens must not be less than as payers of its revenues, and that the importance of the above Acts lies as much in their protective as their productive aspects.[1]

1. *Cf.* Report of the Famine Commission (1901), para. 311.

CHAPTER V

Financial needs of Non-Agriculturists

1. Nature of their needs.

In this chapter we shall consider briefly the financial needs of professional men and salaried servants belonging to the middle class, small traders and shopkeepers, small contractors, and industrial and other labourers, leaving to later chapters the needs of industries and larger traders engaged in internal and foreign trade.

Men belonging to the middle class need credit for making a start in different professions and occupations. Small traders and shopkeepers need it for carrying on their operations, and small contractors for carrying out their contracts. In addition, all of them and salaried servants require it for the acquisition of houses and other tangible assets, and for special domestic expenditure necessitated by births, marriages, deaths, sickness and unemployment. Industrial and other labourers also need it for similar domestic expenditure. All of them have to obtain it from money-lenders, and have to pay them high rates of interest, especially if the security offered is personal.

2. Suggestions for the organisation and working of co-operative urban banks.

The Provincial and Central Banking Committees and the Foreign Experts have expressed the opinion that co-operative credit societies of the Schultze-Delitzsch type, known as urban banks, are the most suitable credit agencies for all these non-agriculturists. The scope for, and need of, co-operative urban banking are much greater in India than in Western countries, as the only form of organised banking that can be established in taluka and bazaar towns is co-operative banks, owing to the difficulty of establishing branches of the Imperial Bank or joint-stock banks in such places and making them pay.[1] At present

1. See Bombay and Punjab Committees Reports, pp. 164 and 104.

the number of urban banks in the country is small *viz.* 3,760 with 675,000 members. The above authorities have, therefore, recommended that they should be established in larger numbers wherever favourable conditions exist, and that they should endeavour to do for these non-agriculturists what the commercial banks have been doing for the larger traders and merchants.[1]

The size of their operations should be large, consistent with efficient management. Although the co-operative law gives them the option between limited and unlimited liability, the liability of their members should be limited, as close mutual touch among the latter is difficult owing to scattered and extensive membership, and as their share capital would be sufficient to serve as a guarantee for borrowing. A substantial share capital should be raised in easy monthly or periodical instalments. The liability being limited, the shares need not be fully paid-up, and members may be made to take up a reserve liability up to twice the subscribed share capital, in order to provide a safeguard to creditors in case of failure, and to increase the confidence of the investing public. To prevent the domination of a few men, individual subscriptions have been limited by law, and to prevent dividend-hunting and to build up substantial reserves, dividends have, in most provinces, been limited.

The other main source of the funds of these institutions should be deposits from members and non-members whose thrift should be encouraged by establishing savings bank departments and provident fund deposits, under which members would undertake to deposit certain fixed sums periodically. Further, the co-operative central banks should serve as financing agencies and balancing centres for them as far as possible. If, however, the former happen to be less strong than the latter, or unable to satisfy their special needs, the latter should be allowed to have direct dealings with the provincial co-operative bank. As these urban banks depend largely upon deposits, for their own safety as well as that of the whole organisation,

1. See Central Committee Report, p. 254, Bombay Committee Report pp. 126 and 164, and U. P. Committee Report, p. 191.

they should keep adequate fluid resources in the shape of easily realisable investments, or cash balances with the central or provincial bank, from which they obtain discount, rediscount, or other credit facilities, so as to be able to meet withdrawals of deposits without difficulty.

Owing to the substantial scale of their operations, they need paid establishments. Their managers must be qualified persons trained in banking because, although there is not much need for external supervision, owing to the fact that the members and the managing committees consist of educated persons, the members cannot have the same interest in these institutions that the members of agricultural credit societies can have in their societies. They should be permitted to conduct all kinds of modern advanced banking business to supply the needs of their members, such as opening current accounts, granting cash credits, dealing in cheques, collecting and discounting inland bills, clearing, and remittance business. With the approval of the Registrar of Co-operative Societies, they may be allowed to have accounts with commercial banks, specially to facilitate their discounting, clearing, and remittance business.

Loans to members should not be given for long terms, but if the banks have sufficient funds, they may grant intermediate loans up to half of their share capital and reserves and three-fourths of their long-term deposits. As regards objects, amounts, procedure and security, the loans should be governed by conditions similar to those mentioned before in the case of agricultural credit societies. But in granting loans to wage and salary earners for unproductive uses, greater care must be exercised by the managing committees. Loans may be given on the security of gold and silver ornaments up to 75 and 50 per cent respectively of their value, without the limitation of the maximum borrowing power of each member as fixed by the managing committees.[1] The ornaments, however, must be valued and kept in safe custody, with great care. Loans may be given to traders on the security of good and authorised warehouse receipts.

1. *Cf.* Bombay Committee Report, p. 221.

Loans should be given to salary earners, whose character, income and sureties are good, on the Morris plan as far as possible, by which the borrower pays weekly instalments, and having come to borrow, remains to lend as, once the habit of saving the weekly instalment is created, it goes on.[1] Societies for salary earners should be regarded as primarily thrift societies, and credit given to them should be based on their desire and ability to practice thrift.[2] Municipalities, other public bodies, or companies which employ them should help their societies by deducting instalments from their salaries for the recovery of their dues and subscriptions.

The organisation and success of co-operative credit societies for the benefit of the labouring classes present special difficulties owing to their poverty, lack of thrift and education, migratory habits, lack of adequate security to offer, and the domination of jobbers and sardars who act as money-lenders, or are in league with them. These difficulties can be removed only gradually by education, better organisation, the removal of the domination of the overseers by the appointment of labour officers, the regulation of migration by the grant of leave, and the active assistance of employers, who should provide substantial finance and supervision for the societies of their labourers, and who should obtain recoveries of the loans granted by the societies by means of deductions from the wages of the borrowers.[3] Municipalities and other public bodies employing large numbers of depressed class workers should take the initiative in starting co-operative societies for their benefit.[4] Other depressed class men may seek admission into urban peoples' banks, the doors of which are open to all classes.

3. Suggestions for the organisation of city mortgage banks.

The Central Banking Committee, however, is of opinion that co-operative urban banks by themselves will

1. For details of the Morris plan see Central Committee Report, p. 257.

2. See Bombay Committee Report, p. 166.

3. See the writer's Industrial Labour in India, pp. 200-1 and Bihar Committee Report, pp. 85-6.

4. *Cf.* Bombay Committee Report, p. 167.

not be able to meet adequately the financial needs of the non-agriculturists mentioned above. It has, therefore, recommended that private enterprise on a commercial basis should start banking institutions on the lines of the City Mortgage Institutions in Germany, which are the result of the extension to cities of the principle of Landschaften in rural areas, and which grant amortization loans to owners of real estate, that is already developed, or is in the process of being developed. These institutions can take over from the loan offices in Bengal and urban co-operative banks their land and house mortgage business which does not properly belong to them, and thereby can enable them to increase the velocity of the circulation of their capital, to keep their assets more liquid, and to give larger financial assistance to non-agriculturists in the form of short-term loans.[1]

1. See Central Committee Report, pp. 258-9.

CHAPTER VI

Post Offices, Government Loans, Stock Exchanges and Insurance Companies

1. Postal savings banks.

Post offices supply important banking facilities to a section of the Indian population, and form a part of the money market in India. The facilities take the forms of the acceptance of deposits in savings banks, the issue of postal cash certificates, the purchase and sale of Government securities without charge, and the issue of life assurance policies. Post office savings banks were first established in 1882, absorbed in 1886 the business of district savings banks which had been opened in 1870 in connection with selected district treasuries, and absorbed in 1896 the business of Government savings banks, which had been established in the Presidency towns between 1833 and 1835, and the management of which had been entrusted to the Presidency Banks between 1863 and 1865.

The number and business of the post office savings banks went on expanding, so that at present there are nearly 13,000 of them, with about 25 lakhs of depositors and Rs. 37 crores of deposits. Their progress received a temporary setback at the outbreak of the War when, owing to a panic, depositors withdrew large amounts. But Government soon restored their confidence by a bold policy of meeting their demands in full. Another temporary setback came in 1930-1, when the withdrawals exceeded the deposits of the year. This was due to the economic distress caused by the increase of general depression.

These banks are to be found throughout the country in all head post offices, all sub-post offices, and some branch post offices. Their main object has been to promote thrift among the working and middle classes. The majority of the depositors, however, belong to the middle class—professional men, servants of Government and

public bodies, teachers, etc. The agricultural and industrial workers have not yet begun to use these banks to any extent. These banks must not be used for keeping current accounts, and the Deputy Accountant-General of Posts and Telegraphs can close any accounts, which he thinks are used for a purpose other than that for which they are meant to be used. The net deposits into an account in a single year are limited to Rs. 750, and the total amount that can be kept in it is limited to Rs. 5,000 in the case of an adult and to Rs. 1,000 in the case of a minor, on whose behalf an account can be opened by his relative or guardian. Amounts of 4 annas and above can be deposited at any time, but withdrawals from the account are not allowed more than once a week. A pass book is supplied to every depositor in the vernacular of the locality, or in English, according to his desire, and it must be presented at the time of making every deposit or withdrawal. The rate of interest was 3 per cent per annum, till 1933, when it was reduced to $2\frac{1}{2}$, and is calculated for each month on the lowest amount in an account between the end of the fourth day and the end of the month.

2. Suggestions for improving the facilities given by postal savings banks.

The Bombay and Central Banking Committees have recommended that the limit of Rs. 1,000 in respect of the accounts of minors should be raised, that in selected post offices permission should be given to the public to withdraw money from, and to deposit it into, savings bank accounts by means of cheques, and that this system should be gradually extended according to experience.[1] The Central Committee and some Provincial Committees have further suggested that permission should be given to the public to open joint accounts in the names of two persons, payable to either or survivor, and that a depositor should be allowed to name a nominee to whom payment of the deposit should be made on his death, thereby avoiding the delay

1. See Bombay Committee Report, p. 222 and the Central Committee Report, p. 440.

that is caused by the existing procedure requiring an examination of the legal position of his heirs.[1]

Some of the Provincial Committees and Mr. Subhedar have also made the following recommendations :—

(1) The number of post offices where savings bank business can be transacted should be increased. [2]

(2) Where it would not pay to keep such post offices open throughout the week, they may be kept open for two days of the week, and administered by being grouped with other post offices in the neighbourhood.

(3) The services of the village school masters should be used as far as possible for running them.

(4) Unrestricted withdrawals from savings bank accounts should be permitted as from current accounts with banks and, if this is not possible, at least more frequent withdrawals should be permitted. [3]

(5) Facilities for transfer of money from one savings bank account into another should be given.

(6) The accounts should be kept in English or the local vernaculars, at the option of the depositors. [4]

(7) Heads of factories and offices should arrange to deposit money in, and to withdraw it from, the accounts on behalf of employees who cannot go to postal savings banks during working hours.

(8) A limited number of postal savings banks should be kept open in the larger towns two or three evenings of the week, in order to afford adequate facilities to labourers and small shopkeepers, etc. to make use of them.[5]

(9) A special enquiry should be made regarding the cost of granting these facilities and the need of keeping more cash in post offices in relation to their inward and outward flows of funds under other heads.

The grant of these facilities is said to be necessary, because their absence is said to be partly responsible for

1. See Burma, Punjab, Bengal and Bombay Committees Reports pp. 275, 153, 231 and 222 respectively.

2. See Bihar, C. P. and Madras Committees Reports pp. 240, 391 and 241-45.

3. See Central Areas Committee Report, p. 386.

4. See Bihar and Burma Committees Reports, pp. 240 and 274.

5. See Burma and Central Areas Committees Reports, pp. 273 and 386.

the fact that the number of savings accounts relatively to the population, and the average amount to the credit of a depositor are smaller in India than in most other countries. The post office savings banks should, therefore, become for the masses what the joint-stock banks are for the classes in India.

The joint-stock banks need not be afraid of the competition of the postal savings banks as, the field being vast, they will not be able to occupy it for a long time, as it will not pay them to open branches in so many places, and as the postal savings banks have mostly small accounts, often too small to be attractive to the joint-stock banks.

There is also little chance of competition between the postal banks and the indigenous bankers, because the deposit business of many of the latter is not large, and is chiefly in connection with their other business. The power of co-operative societies to receive deposits, particularly from non-members, is strictly limited. Moreover, the postal banks need not be regarded as existing merely for the safe custody of money, but may be used for familiarising the masses with the use of cheques, and for supplying them with other banking facilities. Mr. Subhedar has further suggested that *bona fide* cultivators should be allowed to deposit small sums in these banks at higher rates of interest, to induce them to save, as the rate allowed by the banks at present is not attractive owing to the prevalence of much higher rates outside.[1]

3. Postal cash certificates.

Post office cash certificates have been issued since the War for stimulating thrift and saving, and have succeeded in drawing out a considerable amount of the savings of persons of moderate means, who desire to obtain a maximum yield with minimum risk, and who are little attracted by other forms of investment. The certificates mature after 5 years from the date of issue, and are payable in Rs. 10 or multiples of Rs. 10. Rs. 10,000 is the maximum limit for the face value of the certificates that a person

1. See Central Committee Minority Report, p. 356.

can hold at any time. The difference between the purchase price and the maturity yield provides interest free from income-tax, and the purchase price has been so altered at intervals according to the conditions of the money market, that the interest yield has varied between 6 and 3½ per cent per annum. At present the purchase price yields about 3½ per cent. The certificates can be cashed at any time before maturity, but no interest is paid if they are cashed within a year from the date of issue, and the interest rate rises progressively from the second year, the full rate being paid only at the end of 5 years.

Investments in the certificates have varied in amount according to the rate of interest obtainable and the economic condition of persons of moderate means. Investments in them have increased much recently, as the yield on them, free from income-tax, has become more attractive on account of the high rates of income-tax, and the decrease in the yield of other Government securities. A substantial portion of the funds invested in them represents the proceeds of sales of gold, and this may prove to be a decisive step in the direction of the abandonment of the hoarding habit. In 1932-33 the value of the certificates outstanding was Rs. 55.63 crores.[1]

The Central and Bombay Banking Committees have recommended that a holder of these certificates should be allowed to nominate a person to whom their value would be paid on maturity, in the event of his death, as this facility would increase their popularity.[2] Some persons have expressed themselves in favour of making the terms of these certificates more favourable, so as to make them more popular. Others have suggested that they should be abolished on the ground that they impede the development of deposit banking, as their terms are more favourable than those that commercial banks can offer to their depositors.[3] The Central Banking Committee has recommend-

1. See Report of the Controller of the Currency, 1932-33, p. 24.

2. See Bombay Committee Report, p. 223.

3. *Cf.* the statement of the Bihar Chamber of Commerce, Bihar Committee Evidence, Vol. II, p. 487.

ed the adoption of the golden mean between these two extremes.[1]

For the special protection of women, the Central Areas Committee has suggested the issue of special certificates, which can be held by women only, the interest on which should be payable to the holders every year through the nearest post office, and the principal of which should be repayable to them only after 10 years. The Central Committee has supported this recommendation in principle.[2]

4. Facilities given by post offices for the purchase, sale, and custody of Government securities.

The post offices also give important facilities to the public for the purchase and sale of Government securities. Any individual, even if he has not previously been a depositor in a post office savings bank, can invest money, free of charge, through a post office in any loan issued by the Government of India up to a maximum of Rs. 5,000 in each official year after deducting any amount sold through the post office. Funds for such investment can be provided either from the amounts previously deposited in the investor's savings bank account, or from money specially deposited by him for the purpose, or from both. The post offices also sell on behalf of an investor at the prevailing prices, and free of charge, the whole or a portion of the Government securities that he has purchased through post offices, whether they are held by him or by the Deputy Accountant-General of Posts and Telegraphs on his behalf, provided that he is a savings bank depositor at the time, and that, if only a portion is to be sold, the balance that would be left has the face value of Rs. 100, or a multiple thereof.

An investor can either take delivery of the Government securities purchased for him by a post office, or leave them in the custody of the Deputy Accountant-General of Posts and Telegraphs. In the latter case, a maximum limit of Rs. 22,500 is imposed, but it applies only to se-

1. Report, p. 441.
2. See Central Areas and Central Committees Reports, pp. 387 and 895.

curities that are issued as liable to income-tax, and does not include securities that have been issued tax-free.

Post offices do not make any charge for the purchase, sale, safe custody, or delivery out of custody, of Government securities bought through them, or for the collection and payment of interest on such securities. As long as the securities remain in the custody of the Deputy Accountant-General, the interest on them is free from income-tax. The Assam and Central Banking Committees have stated that these facilities are not sufficiently known to the public, and that, if greater publicity is given to them, they will be used by a larger number of small investors.[1] The latter has further expressed the opinion that they will be used more widely, if they are given to small investors generally, and are not limited to savings bank depositors.

5. Postal insurance.

Finally, the post offices provide insurance facilities to permanent servants of Government, local bodies, and Universities recognised by Government. They are first, life insurance, *i.e.* payment of a certain amount on the death of an insured person to his legal representatives or assigns; second, endowment assurance, *i.e.* payment of a certain amount to a person when he reaches a particular age, or to his legal representatives or assigns at his death, if he dies before reaching the particular age; and third, monthly allowances commencing at once or from a particular date in future. The minimum and maximum limits of life insurance and endowment assurance policies are Rs. 100 and 10,000 respectively, and those of monthly allowances are Re. ½ and 50. The premia for the policies have to be paid monthly, and for the monthly allowances, either a lump sum or monthly instalments spread over a number of years have to be paid. The premia, or the instalments are deducted from the salaries by the employers, and are remitted to the post office department. Up to 31st March 1931 the number of lives insured was over 108,000 and the amount of insurance was a little less than Rs. 19 crores.

1. See Assam and Central Committees Reports, pp. 216 and 442.

The Assam and Madras Banking Committees have suggested that these insurance facilities should be thrown open to the public, but the Central, Bengal and Bombay Committees have not supported the suggestion on the ground that a large number of local life insurance companies already supply similar facilities to the public.[1] Postal insurance policies would, however, command more public confidence than policies issued by companies, and would stimulate savings in the form of insurance by the public. Insurance companies cannot object to the proposal, if the postal premium rates do not compete unfairly with their rates, and if postal insurance facilities are restricted to persons of moderate means.

6. Government loans.

Government rupee loans also play a fairly important part in the money market in India. They take three forms, *viz.* stock certificates, promissory notes, and bearer bonds. The ownership of stock certificates is registered at the Public Debt Office, and can be changed only by registration in that office. Interest warrants are sent half-yearly to the registered owners, who do not have to present the stock certificates. The ownership of promissory notes can be transferred by endorsement in the space provided for the purpose on the back of the notes, which have to be presented to receive interest warrants. The ownership of bearer bonds can be transferred by mere delivery from hand to hand, and their value is paid to the bearer on the date of maturity without any formality. Interest coupons are attached to the bonds, and are detached and presented for payment by the owners when they become due. These forms of Government securities are interchangeable. The fee for conversion is 4 annas per cent on securities of a face value of not more than Rs. 400, and one rupee per security of a face value exceeding Rs. 400, except in the case of the conversion of promissory notes or bearer bonds into stock certificates, for which no fee is charged. The issue of

1. See Assam, Madras, Bengal, Bombay and Central Committees Reports, pp. 214, 243, 236, 228 and 445 respectively.

bearer bonds has, however, been recently discontinued by Government, as it was believed that they were not popular. These securities are either non-terminable, *i.e.* repayable only at the option of Government after giving notice, or terminable, *i.e.* repayable on a specified date, or repayable not earlier than a specified date and not later than another specified date.

When Government desires to borrow, it publishes a notification in its *Gazette* and newspapers giving all the details of the loan that it wishes to float, such as the issue price, the rate of interest, the dates of issue and closing, the method of repayment, and repayment at par or premium, and inviting applications for subscriptions, which have to be sent to the Controller of the Currency, Calcutta, the Deputy Controller of the Currency, Bombay, Accountant-Generals, Madras and Rangoon, branches of the Imperial Bank and Government Treasuries.

Before the War, the bulk of the loans used to be raised in England on the grounds that the difference between the rates of interest in India and England was so substantial as to more than counterbalance the drawbacks of borrowing in England, and that the resources of the money market in India were so limited that it could not lend more than Rs. 5 crores to Government annually. The War and post-War periods proved that this view was not correct. During these periods Government had to borrow very large amounts to pay India's War contributions and to meet the expenses of the construction of new Delhi, the new capital, and the successive budgetary deficits of 5 years. But it had to borrow most of this amount in the money market in India, as the capacity of the English money market was more or less fully taxed by the English Government for its own exceptional and enormous needs.

The strength of the money market in India was revealed by the fact that it contributed Rs. 53 and 57 crores to the loans that Government floated in 1917 and 1918 respectively. This strength has been largely maintained since then, Government has been able to borrow between Rs. 20 and 30 crores annually in India, and so it

has been doing most of its borrowing in the country itself. The number of investors in these loans has also increased to a considerable extent owing to more effective advertisement and the offer of larger facilities for the administration of the loans at Government treasuries and sub-treasuries. The Bombay Banking Committee has expressed the opinion that the number of investors will increase further, if the procedure for renewing Government bonds and issuing bonds of smaller denominations, etc. is simplified and speeded up, and also if banks reduce their charges for the purchase, sale and safe custody of bonds and offer attractive terms for the purchase of new loans in instalments.[1] On 31st March 1933 out of a total debt of Rs. 1,210·86 crores, Rs. 705·50 crores had been raised in India, and Rs. 505·36 crores in England. Out of this total debt, Rs. 797·08 crores were productive in railways, telegraphs and irrigation ; 206·92 crores were unproductive ; 35·07 crores were on account of cash, bullion and securities held on treasury account ; and 171·79 crores were on behalf of Provincial Governments.[2]

The market prices of Government securities and the interest yield from them have fluctuated considerably in recent years. As banks have large holdings in Government securities, depreciation in their value has appreciably hampered the operations of the banks.[3] For several years before the War the prices ruled high and the yield was low, because Government borrowings were comparatively moderate, and its credit was high. But during the War and post-War periods, the prices went down substantially, the yield increased, and new loans had to be floated at appreciably higher rates of interest, as Government borrowings became large, its credit went down owing to the uncertainties of War and budget deficits, and the counter-attraction of newly issued industrial securities was large.

1. See Bombay Committee Report, p. 225. See also Bihar Committee Report, p. 227.

2. See the Report of the Controller of the Currency, 1932-3, pp. 78-9.

3. See the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 497.

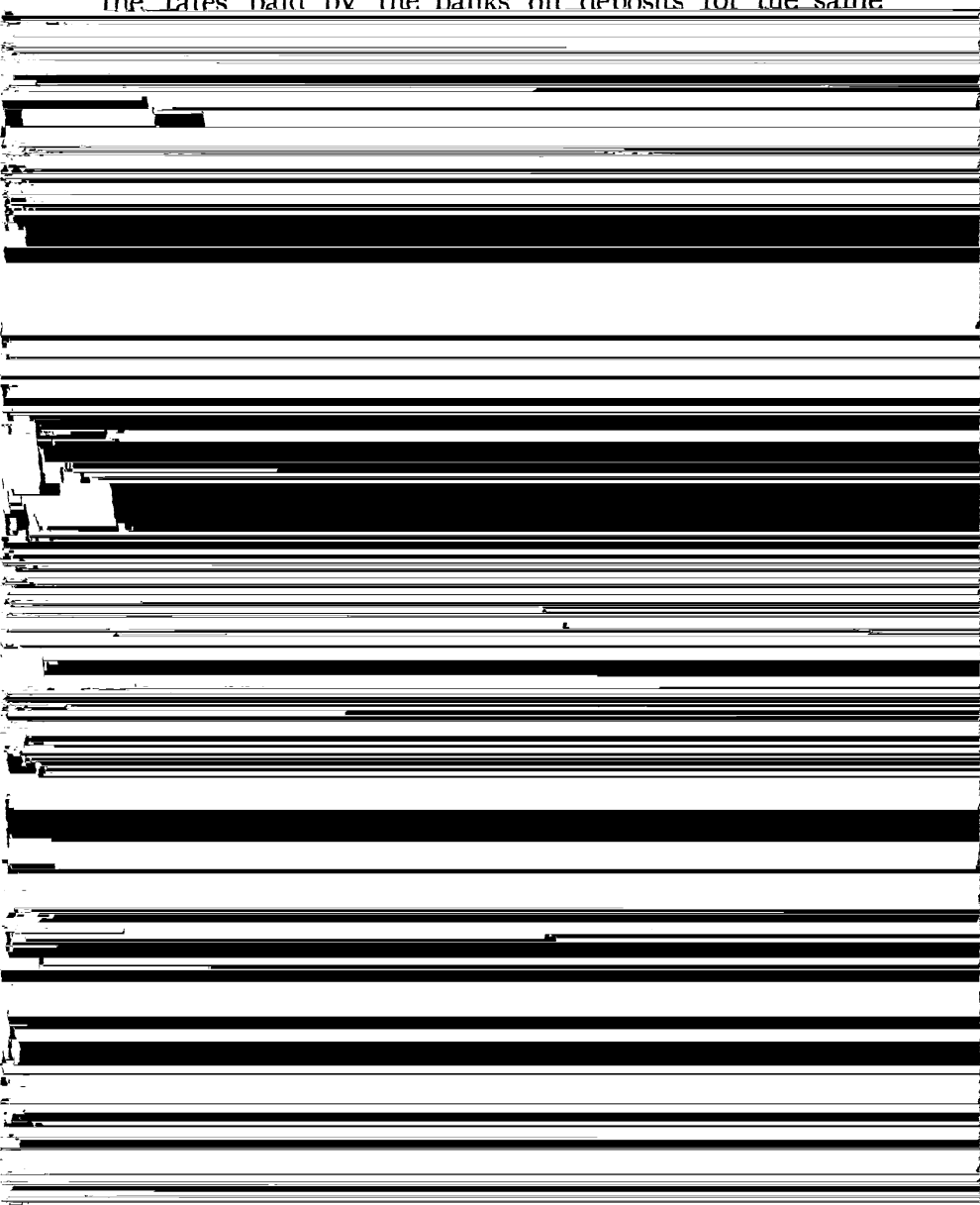
From 1925 to 1929 the prices improved and the yield diminished, as Government credit improved with the balancing of the budgets, and as the counter-attraction of industrial securities diminished much after the failure of many companies. But during 1929-32 the prices fell again, the yield increased, and new loans had to be issued at higher rates, as a wave of dear money swept over the world, and as Government credit deteriorated once more owing to budget deficits and disturbed political conditions in the country. The situation improved very much from the middle of 1932, and throughout 1933 and the first half of 1934 the prices of Government securities were substantially higher than they had been at any time after the outbreak of the War, and Government was able to float a large loan successfully at the pre-War rate of interest, *viz.* 3½ per cent, the other terms being slightly less favourable than the pre-War ones.

7. Government treasury bills.

Since 1917, Government has also been issuing treasury bills at a discount, repayable after 3, 6 or 12 months. During the War they were issued to meet Government's disbursements on behalf of the British War Office. During the post-War period they were issued to meet budget deficits and to repay the old bills. More recently, they have been issued to provide ways and means for current and capital expenditure, repayment of old bills, and conversion of loans.

Tenders for them are invited by Government notification, and are received by the Controller of the Currency, Calcutta, the Deputy Controller of the Currency, Bombay, the Accountant-Generals, Madras and Rangoon, and the Currency Officers, Cawnpore, Karachi and Lahore. The tenders quoting the lowest discount are accepted, and the bills are issued and paid by the head offices of the Imperial Bank in the three Presidency towns and its branches at Cawnpore, Karachi, Lahore and Rangoon. Their issue week by week means that Government competes with banks and industries in securing funds from the limited resources of the money market,

creates a temporary shortage of them in it, and thus exercises a considerable control over it and the bank rate.[1] Moreover, Government often paid high rates on the treasury bills, 1 or 1½ per cent higher than the rates paid by the banks on deposits for the same



chapter.

premium. Many people transferred their energies from other occupations to these exchanges, hoping to amass fortunes quickly by heavy speculation. When the tide turned and the crash came, many of the new companies went into liquidation, many operators failed or suffered heavy losses, and there was great discontent. The orgy of speculation was much more intense on the Bombay Exchange than on the Calcutta Exchange, and public confidence in the former was rudely shaken. In 1923, therefore, the Government of Bombay had to appoint a committee presided over by Sir Wilfred Atlay to investigate the constitution and working of the Bombay Exchange.

The Bombay Stock Exchange, called the Native Share and Stock Brokers' Association, or the Bombay Share Bazaar, formally came into existence in 1897, although informally it functioned much earlier. The majority report of the Atlay Committee, signed by all the members except one, made several recommendations for improving its working, preventing corners, and checking wild speculation, such as the tightening of discipline, facilitating the handling of legitimate complaints made against the brokers by the public, increase of business hours, reduction of holidays, discontinuance of sub-brokers, annual election of the Board, and annual declaration by members of the kind of business they intended to transact. But the Association accepted the minority report which made unimportant recommendations, so that little change was made in the constitution and working of the Exchange. But another orgy of speculation in 1925 brought another crash, public opinion was roused, Government threatened intervention and control, and the Association had to reform its rules for the purpose of checking speculation and preventing similar crises in future, and to get them sanctioned by Government.

Any Indian, or any Britisher who has lived in the Bombay Presidency for ten years previously, can apply for membership of the Association, but to secure a high degree of business morality, admission is severely restricted. The number of members is restricted, and an entrance

fee, called the value of a membership card, is charged, ranging from Rs. 40,000 in 1921 to Rs. 7,000 at present. A prospective member must have substantial property and unimpeachable credit, his application must be supported by at least ⅔ of the members, objections against him are invited and examined, the application can be rejected without giving any reason, and cannot be re-submitted for two years. The number of members at present is 450. All of them are brokers, and they must not have subsidiary business interests in any other association. But nearly a quarter of the active members are also commission agents.[1]

The Association has strict rules for controlling the conduct of its members, and for dealing with default or fraud on their part. The Board of the Association is empowered to fix the prices of securities in an emergency. There is a Committee of Default, which decides whether a member is a defaulter. A member who is declared by it to be a defaulter has to submit to it his account books, papers, balance-sheet, and a statement of his business transactions left incomplete. To prevent fraud, the rules prohibit fictitious orders, and lay down that the members must accept all orders, large as well as small, from their clients, and must have no 'bucket shop' dealings or trading in differences of quotations, and that, although the members may transact business for themselves, they must not make any improper use of their clients' securities that may be in their charge.

To facilitate the detection of fraud, the rules provide that the members must keep uniform registers on the prescribed basis, that they must enter in them all the details of their transactions at the end of every working day, and that the registers must be open to examination by the Board of Directors. An Arbitration Committee exists to consider cases of alleged fraud, and can expel members from the Association if they are found guilty. During the entire history of the Association, however, there has been hardly any case of fraud by a member,

1. *Cf.* Jain, *The Monetary Problems of India*, p. 147 and Indian Year Book, 1933, p. 704.

and a high level of business integrity has been maintained by its members.

Every member is allowed to have four clerks, and conducts his transactions with their help. Every transaction must be entered in a memorandum book as soon as it is made. At the end of each working day, all transactions carried out during its course must be entered in two registers in accordance with the entries made in the memorandum book. The first register is for recording all dealings with the members only, and is very elaborate for the purpose of removing all chances of mistakes. The other register is for recording all transactions carried out on behalf of customers in their names, and is less elaborate. The customers are mainly of three kinds. Firstly, there are the investors whose only object is to invest their savings, and to obtain a more or less steady income permanently. Secondly, there are the rich clients who finance needy brokers for a month at a time at high rates by means of what are known as 'badla' transactions. Finally, there are the speculators who watch the fluctuations in the market quotations from day to day, and operate as 'bulls' or 'bears'. The Bombay Stock Exchange continues to have numerous holidays, which come to about one-fourth of the entire year, although a substantial reduction in them was suggested by the Atlay Committee.[1]

The Calcutta Stock Exchange was established in 1908, but the Association, which has been managing it, was registered under the Indian Companies Act only in 1923. It has at present a paid-up capital of Rs. 2·22 lakhs, with 202 members, consisting of firms with 502 partners and assistants, all of whom act as brokers. The shareholders annually elect a Managing Committee consisting of an equal proportion of Europeans, Bengalees and Marwaris, and the Committee appoints several Sub-Committees and the President and Secretary. This Association also has strict rules for controlling the conduct of its members and for dealing with default or fraud on their part. Its

1. A thesis entitled 'Methods and Machinery of Investments in India' by Mr. Haque kept in the University of Bombay gives detailed information regarding the working of the Bombay Stock Exchange. See also Jain, *The Monetary Problems of India*, pp. 143-5.

Committee settles disputes between the members, making it unnecessary for them to resort to the courts of law.

A stock exchange was established in Madras in 1920, but its working members were few, its business did not expand as there was little speculation, the number of its working members gradually fell off, and so it had to be closed. The business of investment in Government, industrial, and other securities is being conducted by three firms.

No regular stock exchanges exist in the country other than those in Bombay and Calcutta. Their absence hampers the growth of joint-stock enterprise and investors, but without sufficient business, no exchange can be formed in any centre. The commercial banks, co-operative banks, loan offices, Chit Funds and Nidhis can do much to lessen the handicap created by the absence of local exchanges, by taking up the work of purchasing and selling securities for their clients on a commission basis.

9. Insurance companies.

Insurance companies play an important part in the banking system of India, as they hold for long periods a substantial part of the savings of the people, encourage and mobilise their savings like savings banks, and make them available to commercial and industrial companies, public bodies and Government for beneficent purposes. The total number of companies doing life, fire, marine and other classes of insurance business in India is 245, out of which 97 are Indian and 148 foreign, 72 being British. Their total net premium income per year is about Rs. 10 crores, of which a little over one-half goes to foreign companies. The total assets in India of foreign companies are over Rs. 30 crores and those of Indian companies nearly Rs. 25 crores.

The companies lend a portion of their resources to their policy-holders, and invest a considerable portion in Government securities and treasury bills. Some of the Indian companies also purchase shares and debentures of banks and companies and debentures of co-operative banks, invest a portion of their funds in mortgages of land and buildings or in land development, and keep deposits

with, or give loans to, banks and loan offices, which in turn finance cottage industries. There is a vast field for the spread of the operations of life insurance companies in rural areas and among landowners.[1]

The foreign companies invest outside India a large portion of the income that they obtain in the country, so that the savings of the people to this extent are not available for the economic development of the country. In other countries all insurance companies judiciously use the bulk of their funds to promote trade, industries and public utility concerns in the respective countries. The Central, Punjab and Bombay Banking Committees as well as Mr. Subhedar have, therefore, recommended that legislation should be passed to compel all insurance companies in India to keep an initial deposit with Government and to invest a certain minimum proportion of their premium income in approved Indian securities.[2]

1. See Bombay Committee Report, p. 228.

2. See Central Committee Majority Report, p. 445, Minority Report, p. 358, Bombay and Punjab Committees Reports pp. 229 and 154 and the answers of the representatives of the Bengal National Chamber of Commerce, Central Committee Evidence Vol. III, p. 735.

CHAPTER VII

Commercial Banking : Indian Joint-Stock Banks

1. Their organisation.

Indian joint-stock banks are those registered in India under the Indian Companies Act, certain sections of which deal with matters such as registration, audit, and preparation and publication of balance-sheets and statements of affairs, certain other sections of which bearing on the preparation of the annual lists of members and places of business, inspection by Government on the application of a certain proportion of members, the showing of secured and unsecured debts separately in the balance-sheets, etc. apply to banks only, but which imposes no restrictions on their business.

The most important banks are the "Big Five," *viz.* the Central Bank of India, the Allahabad Bank, the Bank of India, the Punjab National Bank and the Bank of Baroda, the deposits of which exceed Rs. 5 crores in each case. The Central Bank was established by Sir Pherozeshah Mehta, has absorbed the Tata Industrial Bank, and has made good progress in spite of the attacks of enemies and the runs engendered by them. The Bank of India, although well-conducted, has not opened many branches, and its management is still largely in non-Indian hands. The Allahabad Bank has been bought out by the P. and O. Banking Corporation, which has been amalgamated with the Chartered Bank of India, Australia and China, so that it is controlled entirely by non-Indians. The Punjab National Bank is the oldest of these banks and has flourished in Northern India. The Bank of Baroda has its head office in Baroda State, but its activities in British India are large.

In addition, the Peoples Bank of Northern India, which is assisted by several Northern India States and the Bank of Mysore have made good progress in recent years. The interests of the former as well as of the Punjab National

Bank are largely concentrated in the Punjab, and their weakness as well as strength lies in this fact. This concentration provides them with first hand local knowledge and thus enables them to exercise effective supervision, but adverse economic conditions in the Punjab are likely to affect them most, and exchange banks and the Imperial Bank, working throughout the country, can underbid them by giving up some of their own profits in the Punjab.[1] The progress of the Bank of Mysore has been due chiefly to the vigorous economic policy of Mysore State.

The Foreign Experts associated with the Central Banking Committee have expressed the opinion that, taking into account the predominantly agricultural character of India and the present stage of its economic development, the number of credit agencies, including indigenous bankers, and the amount available for the granting of credit cannot be said to be insufficient ; that no bank, unless compelled by law in return for benefits conferred, can be expected to extend its activities and to open branches in new places, unless they offer it a fair prospect of reasonable profits in the near future ; that the immediate problem in connection with banking in the country is not one of expansion, but of the organisation, consolidation and co-ordination of the existing banking agencies which are marked off into different classes, each doing a distinct kind of business without sufficiently close relations with the others ; and that it is only later that a considerable increase of banking facilities will be required in accordance with the development of the economic and financial life of the country and, therefore, with the growth of banking possibilities, without which no modern banking facilities can be expected.[2]

The general opinion, however, is that the progress of Indian joint-stock banking has been uneven in the country, and not in keeping with the needs of its different parts, and that the banks have been slow in establishing branches. In 1930 there were only 937 head offices and branches of banks, including the Imperial Bank of India,

1. *Cf.* Central Committee Minority Report, p. 112.
2. See their Report attached to the Central Committee Report, pp. 608-9.

scattered over an area of 1·9 million square miles and serving a population of 353 millions.

Their geographical distribution was as follows:— Madras 170, the Punjab 163, the U. P. 107, Bengal 94, Bombay 78, Burma 60, Travancore 59, Mysore 29, the N. W. Frontier Province 28, Bihar and Orissa 28, Sind 25, Delhi 19, the Central Provinces 15, Baroda 13, Kashmir 11, Hyderabad 8, Assam 5, and other Indian States 25. It is thus seen that the banking offices are fairly distributed in the Punjab, the United Provinces and the three Presidencies, but that banking facilities are very inadequate in other parts of India, especially Bihar and Orissa, the Central Provinces, Assam, and most of the Indian States. The position of the Indian States in this respect would have been worse, if several of them had not assisted the Imperial Bank to open new branches within their territories. The distribution has been uneven, because (1) banking progress has resulted from the initiative and enterprise of a few banking pioneers, and (2) the progress has depended upon the competition of the exchange banks and the Imperial Bank.

The following figures bring out the position of the cash balances of these banks:—

Percentage of cash to liabilities on deposit at the end of each year.

	1918	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931
Banks having capital and reserve of Rs. 5 lakhs and over.	23	21	23	20	20	17	21	19	15	13	13	14	12	12
Banks having capital and reserve between Rs. 1 and 5 lakhs.	24	24	18	13	17	19	13	20	24	15	15	13	12	12

The position, as a whole, need not be regarded as unsound, in spite of the reduction in the percentage. The reduction has been accompanied by an increase in the

holdings of the banks in Government securities. The creation of a forward market in them has helped to reduce the fluctuations in their prices, and to sell them without much loss, and also the practice of the banks of obtaining loans from the Imperial Bank against them, in case of need, has increased. Moreover, when the banks obtain deposits from several areas wide apart from each other, and when they have a reasonable expectation that the growth of public confidence will enable them, not only to renew the deposits, but also to tap new sources of deposits, and to obtain a constant flow of funds, some reduction in the proportion of their cash to liabilities is justified. Finally, the facility of rediscounting bills, which they do not have at present, but which will be given to them by the Reserve Bank, will make their position sounder in this respect.

2. Operations of Indian joint-stock banks.

The main business of these banks is to attract deposits, current, fixed and savings, and to finance trade by giving short-term advances against easily realisable securities, opening cash credits, and discounting inland bills of exchange. They also finance the movement of produce from the villages to the exporting ports and of imports from the ports of entry to the distributing centres. Their business, so far as agriculturists are concerned, is usually confined to the larger landholders, the planters and others who can offer tangible and marketable security. They pay 4 or 5 per cent interest on fixed deposits for a year, and 2 and $2\frac{1}{2}$ per cent on current accounts, during the slack and busy seasons respectively, provided that a minimum monthly balance of Rs. 200 or 300 is maintained.[1]

In the bigger towns, where stock exchange securities are available, a large portion of their advances is made against the hypothecation of these securities. In the interior, where such securities are not available, advances are made against hypothecation of agricultural products,

1. Reduced to 3 per cent on fixed deposits and 1 per cent on current accounts in 1933 on account of the economic depression.

such as grain and cotton. As public warehouses do not exist in India, as in Western countries, the banks have to maintain their own godowns for this purpose, or to take possession of the godowns of the customers to whom advances are given. They also make advances to merchants against the security of piece-goods and other goods, and to factories against the security of their stock-in-trade, or some other tangible and marketable security. Further, they advance money against mortgages of properties, but this is usually a small part of their total business, as properties are not easily saleable.[1]

The banks also make clean advances against personal security with two signatures to the promissory notes given by the borrowers. Promissory notes endorsed by shroffs or managing agents are quite acceptable to them. The hundi, which is even now used to a substantial extent by Indian traders, although its use has diminished in recent years, is also in reality two-name paper, as it is endorsed by indigenous bankers. However, in comparison with the volume of trade and the financial assistance needed by traders, the quantity of two-name paper acceptable to the banks is rather small, and the advances given by them against such security form a small part of their total advances.

The most popular method of lending is the cash credit account, by which an advance is made against a promissory note signed by the borrower and secured by the hypothecation of bonds, shares or commodities. This system is beneficial to the banks as well as their customers. The latter pay interest only to the extent to which they use the credit from day to day, and they can pay back at any time any portion of the credit actually used, subject to a minimum interest clause, which means that they have to pay interest on a minimum sum, usually one-half of the maximum credit allowed to them.[2]

These banks do also agency and safe custody work, and transfer money on behalf of their customers from one place to another. They buy and sell shares and other

1. See Thakur, *Organisation of Indian Banking*, pp. 66-7.
2. See Central Committee Report, p. 381.

stock exchange securities for the public, and thus promote the habit of investment, but their work and organisation in this respect are neither as large nor as systematic as those of banks in Western countries. They do not do any 'trust' business, do not rediscount their bills, and do not do the business of bank acceptances. Most of them also do not do any foreign exchange business, and take no part in the financing of India's foreign trade from the stage at which exports leave her ports, or to the stage at which imports arrive at them. Three of them have begun this work recently, but owing to the special advantages possessed by the exchange banks, have made little progress in this business. The small banks are generally loan offices which advance money to the professional and agricultural classes.

3. Scope for the expansion of Indian joint-stock banks.

That the scope for the expansion of Indian joint-stock banking is large is seen from the facts that out of the 2,500 towns in India, less than 400 have a bank or a branch of a bank, that the total number of banking offices in India was 906 in 1931 as against 25,000 in the U. S. A., 13,100 in Great Britain and Ireland, 4,400 in France, 3,100 in Germany, and 1,200 in Belgium, and that there is a banking office for every 387,000 persons in India as against 3,056, 4,816 and 9,491 persons in the U. S. A., Great Britain and Japan respectively. The 906 banking offices in India are distributed as follows[1]:—

	Head Offices.	Branches.
Imperial Bank	3	163
Exchange banks	...	89
Indian joint-stock banks	159	492
	162	744

If the fact, that the vast bulk of the people live in villages and not in towns, is taken into account, the absence of banking facilities to the people at large in India becomes still more striking. Although the enquiries of the

1. See Statistical Tables relating to Banks in India, 1931, p. 3.

various Provincial Banking Committees seem to show that, apart from ornaments, the hoarded wealth in the country is small, it is clear that the absence of banking facilities must lead to the temporary locking up with individuals of large funds, which they have to spend later, but which they would make available for the development of credit facilities, especially during the busy season, if banking facilities are made available to them.

The volume of deposits of the Presidency, exchange and Indian joint-stock banks increased steadily during the first two decades of this century owing to the expansion of trade and production. They have remained more or less stationary only since the beginning of the third decade on account of depression and a temporary setback caused by several bank failures, especially that of the Alliance Bank of Simla. Moreover, a substantial increase in the deposits of co-operative and postal banks, in the volume of postal cash certificates, and in Government borrowings in the forms of short-term loans and treasury bills point to the existence of large potential banking resources in India. Finally, substantial amounts of capital, which would ordinarily have remained in India, have been exported in recent years.

4. Difficulties and defects of Indian joint-stock banks.

In spite of this large scope for expansion, the progress of Indian joint-stock banking has been slow, because it has to face the following difficulties :—

(1) Indian banks have so far received little encouragement and support from Government, its officials and public bodies, and municipal, Port Trust and University funds, funds of Courts of Wards, encumbered estates and minors' trusts and other trusts, and similar funds have not been kept with them.

(2) They have to face the competition of a number of exchange banks, which have appropriated a large part of the deposits and the more profitable internal banking business of the important trade centres.[1] The less

1. See Mr. Shroff's and Mr. Thakur's statements, Central Committee Evidence, Vol, II, pp. 399 and 433.

profitable business in the smaller centres is left entirely to the Indian banks, but these find it difficult to handle it, if they cannot combine it adequately with the more profitable business, so as to average the lean with the fat.

(3) A large part of the trade and industry in India is controlled by non-Indians who naturally prefer to deal with banks of their respective countries working in India.

(4) Even Indian firms and business men, who are in subordinate relations to non-Indian business firms, as brokers, agents, etc., or who have dealings with non-Indian shipping and insurance companies, are said to be induced to deal with the exchange banks in preference to the Indian banks.

(5) There is the competition of the Imperial Bank, which derives status and gain from the free use of Government balances, while these advantages are denied to the Indian banks. The competition, however, is not acute at present. There is no competition with regard to borrowing rates and that with regard to lending rates has proved advantageous to trade, as it has reduced them. Further, the branches of the Bank have provided trade with facilities for remittance and the easy flow of money from one centre to another. The Central Banking Committee has summed up this situation thus: "On the one hand, they are looked upon as dangerous rivals by the indigenous bankers, and on the other, they frequently find themselves in opposition to the old established exchange banks and the powerful Imperial Bank of India. Placed in this position, therefore, they have been called the Cindrella of the Indian banking system, and have only been able to exist amidst bickerings, suspicions and cut-throat competition."[1]

(6) Numerous bank failures numbering 262 between 1913 and 1931 have discouraged investment in bank shares, which have come to be regarded as highly speculative, and the placing or renewal with banks of the deposits of the public, which in many cases has preferred to place them direct with merchants and industrialists.

1. Report, p. 390.

The failures have also discouraged entrepreneurs from starting new banks.[1]

(7) Some Hindu and Mohammedan laws and customs regarding succession to, and transfer of rights in, immovable property make it unsafe for the banks to give loans on the security of such property.[2] The development of credit is hampered, if a legal system does not enforce a prompt fulfilment of contracts, and the grant of credit at moderate charges is not practicable, if lenders have to provide insurance in their transactions against legal obstacles and the dangers of unjust treatment in the courts.

(8) Although, for short-term loans, mortgages effected by a mere deposit of documents without any mortgage deeds or registration are the most convenient to business men and the banks, under the Transfer of Property Act, such equitable mortgages, as they are called, are valid only in the three Presidency towns and Karachi and any other town which the Governor-General in Council may notify. This restriction has been imposed to prevent the exploitation of illiterate and unbusinesslike persons, but the banks are handicapped in their operations by the fact that equitable mortgages are invalid even in important commercial centres other than the four mentioned above.

(9) Although the Imperial Bank provides them with remittance facilities at the concessional rate of $\frac{1}{2}$ anna per cent for transfers of sums of Rs. 10,000 and over between their branches, as against its usual rate of 1 anna per cent, the Central Banking Committee has found that even this charge is higher than that made in other countries, and that this prevents the banks from making the most of the financial resources of the country and lowering their charges.

(10) Although in the legitimate expectation that Government securities would be promptly convertible into cash in a period of stress, the banks have invested large sums in these securities, they have not been able to borrow readily and fully from the Imperial Bank against such

1. *Cf.* Central Committee Minority Report, p. 329.
2. For details see Central Committee Report, p. 386.

securities. There has also been a prejudice against the rediscounting of bills by them with the Imperial Bank. Moreover, the latter either does not rediscount their bills freely, or charges them the same rate that it charges its own customers for discounting their bills.

Further, the mechanism of the working of these banks suffers from the following defects :—

(1) The development of credit facilities is hampered by the scarcity of trade bills and the absence of bank acceptances, so that the banks are compelled to invest a relatively large proportion of their funds in gilt-edged securities.[1] The absence of bank acceptance credit is due to the popularity of the cash credit system, to the practical absence of documents of title, such as warehouse receipts, and railway receipts in a suitable form, to the high stamp duty on bills, and to the difficulty of introducing a form of bills acceptable in the whole country. The reasons for the scarcity of bills will be examined later.

(2) Whereas clean advances against the personal credit of the borrowers only, without tangible security, or a second signature, occupy a large place in the banking systems of Western countries, their use is very limited in India owing to the absence of the policy of 'one man, one bank' that prevails in the West, to the existence of the managing agency system, to the absence of commercial agencies like Seyd's in England and Dun's and Bradstreet's in the U. S. A. for supplying the banks with information regarding the financial status of the borrowers,[2] and to the provision in the Imperial Bank of India and Indian Companies Acts, laying down that the banks' advances must be shown separately as secured and unsecured in their balance-sheets, coupled with the habit of the Indian public of regarding unsecured advances against properly appraised personal credit of borrowers as unsafe and unsound, whereas they are regarded as the best in the West.

In the opinion of the Foreign Experts associated with

1. *Cf.* Foreign Experts' Report, Central Committee Report, pp. 624-5.
2. See Mr. Shroff's statement, Central Committee Evidence, Vol. II, p. 412.

the Central Banking Committee, the unwillingness of Indian customers to supply their banks with full information regarding their resources and the position of their affairs is an important cause of the small amount of clean advances against the personal credit of the borrowers, but this opinion is not shared by the Central Committee.[1]

(3) All banks conduct their work in English, and their cheque-books, pass-books and paying-in-slips are printed in English. Only a few banks recognise cheques and signatures in the vernaculars. But the proportion of Indians who can read and write English is very small.

(4) The banks have been content to be rather ineffectual imitators of European models, and have not shown originality or initiative in chalking out new lines. They have not combined even that efficiency of the exchange banks and that simplicity and economy of the indigenous bankers, which would have enabled them to withstand the competition of both with equanimity. Many of them have adopted an expensive system of management on the standard set by the Imperial Bank and the exchange banks.

(5) Some of the directors of the banks are not business men or financiers possessing sufficient ability and experience and, therefore, do not inspire much confidence.[2]

(6) They have shown a lack of *esprit de corps*, and have suffered from mutual jealousies. In several cases, Indian banks seeking agents at centres, which have both Indian and exchange banks, have preferred the latter, and have shown a similar preference in selling T.T. on other Indian centres, or placing call money. They have had no associations to consider matters of mutual interest and to decide upon lines of co-operation for improving their standard of banking, removing elements of weakness, and promoting the amalgamation of small with large banks. An important reason for their failure so far to secure a fair

1. See Foreign Experts' Report, Central Committee Report, pp. 392 and 610.

2. *Cf.* Mr. Shroff's answers, Central Committee Evidence, Vol. III, pp. 175-6 and 183.

hearing for their grievances is this lack of co-operation and failure to present a united front.[1]

Newly established Indian joint-stock banks are said to be handicapped by the following two additional obstacles :—

(1) They may be denied entry into clearing houses, which are owned by associations of member banks, under the influence exercised by the exchange banks, and such denial may affect their credit adversely.

(2) The superior officers of some of the exchange banks are said often to endeavour to discredit and disparage the work of these banks in the eyes of the Indian public through the medium of their own brokers and customers.[2]

5. Suggestions for removing defects.

Unless these difficulties are tackled, Indian joint-stock banks will exist only on sufferance and more or less in a moribund condition, and in their backwardness will lie the backwardness of the country. If the difficulties are removed, the banks will progress rapidly because the Central Banking Committee has pointed out that many of them have shown enterprise, persistence and stamina. Most of these difficulties are capable of elimination, or considerable mitigation in the following ways :—

(1) Government should lay down a policy of encouraging the growth of Indian joint-stock banking, and should grant the banks concessions similar to those which have been granted to the co-operative banks. The former can promote the economic progress of the country as much as the latter. Moreover, they have been subjected to regulations, and will be subjected to fresh restrictions, on public grounds, and in return for them they are entitled to concessions. The declaration of this policy by Government will improve the banking atmosphere in this country considerably, and if and when the banks are found securing large profits, the concessions can be reduced or withdrawn, or the profits can be subjected to higher

1. See the statement of the editors of Indian Finance, Central Committee Evidence, Vol. II, pp. 202-3.

2. See Central Committee Minority Report, pp. 122-3.

taxation, or the banks can be made to render services to their customers more cheaply.

Thus, the banks should be given remittance concessions, and freedom from stamp duties and registration fees to the extent that they are enjoyed by the co-operative banks. Moreover, exemption from super-tax should be given for a limited period, if two small banks amalgamate, and any other obstacles that may be found in the way of such amalgamations, such as stamp duties or other taxation, should be removed.[1] Further, Government should conduct its credit operations in ways that would minimise the difficulties of the banks in respect of a rise in the price of credit, or a depreciation in the value of their reserves.

(2) For removing unhealthy competition between these banks and the exchange banks, and substituting a spirit of co-operation, the Central Banking Committee and the Foreign Experts associated with it have suggested the formation of an All-India Bankers' Association, one of whose aims should be the laying down of principles and conventions calculated to prevent unhealthy competition and overlapping among its members.[2] But the Committee, with the exception of Mr. Subhedar and Mr. Sarkar, is not in favour of placing any restrictions on the branch activities of the exchange banks in India, in the larger interests of the country, beyond the restriction included in its recommendation that any bank wishing to open a new branch should be made to obtain for the purpose a license from the Reserve Bank, which should ensure that the provisions of the law and other conditions specified in the license are carried out by the bank.

Mr. Subhedar, Mr. Sarkar, and a number of witnesses before the Committee have suggested that branches of the exchange banks should be confined to port towns only, that they should be made to close their existing branches in the interior, that they should not be permitted to receive deposits from Indians or companies registered in India, and

1. *Cf.* Foreign Experts' Report, Central Committee Report, p. 627.
2. See also the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 498.

that, to prevent them from obtaining controlling interests in Indian joint-stock banks, the foreign element in the shareholders and directors of the latter should be confined to a minority of 40 per cent, or less.

More moderate suggestions of other witnesses have been that the existing branches of the exchange banks in the interior should not be touched, but that they should not be allowed to open any new branches in the interior, and that they should be allowed to obtain only such sums by way of deposits from Indian people and companies as they are prepared to use in the country for the finance of her foreign trade. This subject will be discussed more fully in the next chapter.

(3) The Central Committee has recommended that to encourage Indian joint-stock banks to open new branches the Reserve Bank should place for the first five years with every new branch opened by an approved joint-stock bank at a centre which has no banking office, a deposit of such a sum on such conditions as it may consider necessary;[1] that it should transfer funds on behalf of such banks between centres at which it has branches, free of cost as a national service, so as to help the equalisation of interest rates throughout the country; that it should give these banks facilities for rediscounting their bills, at special rates below the bank rate whenever possible, and for securing financial accommodation on pro-notes against suitable collateral; and that it should develop the use of trade bills in the place of the existing cash credit system.[2]

(4) The Central Committee and some of the Provincial Committees have recommended that the legal impediments to the development of credit presented by certain peculiarities of Hindu and Mohammedan laws which, as seen above, make it difficult for the banks to accept immovable property as a normal security, should be removed, and that the provisions of the Transfer of Property Act relating to equitable mortgages should be

1. The Foreign Experts have stated that the Reserve Bank should not do this except against adequate security. See their Report, Central Committee Report, p. 617.

2. See Central Committee Report, pp. 378, 385, and 389 and Assam, Bihar, Bombay and Punjab Committees Reports, pp. 122, 235, 145-6 and 86 respectively.

extended to a number of commercial centres throughout the country.[1]

The following are some suggestions for removing the defects in the mechanism of the working of the banks :—

(1) They should endeavour to develop the practice of 'one man, one bank', and should launch upon a more progressive policy of giving clean advances against the personal credit of borrowers of undoubted means and character. Banks in Western countries have found such advances just as safe and satisfactory as two-name or collateral paper. With the increase in the number and the scale of production of business concerns, however, Indian banks find it very difficult to keep themselves in close touch with their borrowers and, as stated above, they are handicapped by the absence of special agencies for collecting the required information. Some of the banks have special departments for obtaining information regarding the financial standing of their clients, and sometimes they interchange this information. But in this respect, as in many others, fuller and freer co-operation among the banks is necessary.

The Bankers' Association, suggested above, should, therefore, arrange for a more systematic pooling of such information, and should build up an organisation for the adequate collection of reliable information of this kind.[2] This information can be obtained also from the balance-sheets or financial statements supplied by borrowers. Some witnesses before the Central Banking Committee and the Foreign Experts have expressed the opinion that borrowers in India are unwilling to explain fully their financial position to their banks. The Committee, however, has found that the charge is unfounded, and that the banks have generally no difficulty in obtaining financial statements from their customers before loans are given to them.[3]

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1. See Bengal, Bombay and U. P. Committees Reports, pp. 191, 189 and 207 respectively.

2. See Mr. Pochkhanawala's statement, Central Committee Evidence, Vol. II, p. 49.

3. Report, p. 384.

(2) The banks should permit their clients a free use of the vernaculars in the various fields of banking, including cheques, pass-books and paying-in-slips, and should not impose any special restrictions on their use, as such restrictions would defeat the very object of allowing the use, *viz.* the growth of the banking habit among the Indian people and an increase in the customers of the banks.[1]

(3) The banks can learn much from their competitors on both sides; they should combine the economical management of the indigenous bankers with the efficiency and modern methods of the exchange banks and the Imperial Bank.[2]

(4) If the banks find that the opening of new branches would not pay them owing to inadequate business, they should open in small centres, in the neighbourhood of bigger centres in which they have regular branches, sub-branches, which at first would be kept open for 2 or 3 days of the week, and managed by a small staff spared for these days by the neighbouring regular branches, and which may later develop into regular full-time branches.[3] This system has done much to extend banking facilities in the rural areas of some Western countries, and the Imperial Bank of India also has recently adopted it with benefit to itself and certain localities.

(5) The banks should pay more attention to the recruitment of a well-trained staff with a knowledge of local conditions, and should endeavour to secure the services of members of indigenous banking families.

(6) They should change their business hours in the mofussil during the busy season to suit the convenience of trade, wherever this change is desired by merchants.[4]

(7) Organisations of shareholders in other parts of India on the lines of the Bombay Shareholders' Association will prove useful in inducing shareholders to take a

1. Some banks allow the use of the vernaculars but subject to certain special restrictions. See Bombay Committee Report, p. 232.

2. See the statements of Mr. Shroff and the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, pp. 416 and 501.

3. See Bombay and U. P. Committees Reports, pp. 236 and 319-20.

4. *Cf.* Bombay Committee Report p. 115.

more active interest in the affairs of the banks and in the election of their directors.

(8) It should be borne in mind that the elimination of impediments by law can only develop a healthy atmosphere for the expansion of banking, that Government can give only encouragement and guidance, and that an adequate expansion of banking on sound lines must depend vitally on the initiative and enterprise of banking pioneers and entrepreneurs. The Central Banking Committee has, therefore, rightly stressed the need of carrying on a systematic propaganda for infusing the required optimism and initiative into the enterprising sections of the Indian public, leading to the urgently needed quantitative as well as qualitative development of Indian banking.

6. Need for more branches of existing banks as well as for new local banks.

In a big country like India, the expansion of joint-stock banking should take place preferably by means of the establishment of new branches of the existing banks rather than the creation of more new banks, because large parent banks can distribute their risks among a number of branches, deal with local crises far more effectively than small local banks, and secure an increase in business and prestige. The large joint-stock banks, therefore, should try to follow the example set by the Imperial Bank in establishing a large number of branches. But the expansion need not be only on the basis of the establishment of more branches of large banks; the establishment of small local banks also may be encouraged for the following reasons[1]:—

(1) There is still much local sentiment in India and local well-to-do people would in many cases feel far greater interest and confidence in local banks than in local branches of distant banks.

(2) Local banks would give local wealthy men much incentive to play a prominent rôle as directors, and so to make their resources available to the banks. Such men can be only depositors or shareholders of big banks

1. See Assam Committee Report, p. 218.

operating in large areas. They would, therefore, have little stimulus to interest themselves directly in the working of such banks, and may prefer to engage themselves in trade, industry, or indigenous banking, which would give them profits as well as social status.

(3) The concessions recommended before for joint-stock banks may induce some private bankers, individually or in groups, to form local joint-stock banks to secure the concessions, and yet to maintain their separate identity. But for these concessions, they would have little inducement to transform themselves into joint-stock banks, because the transformation would mean the payment of heavy registration fees, the keeping of accounts in certain prescribed forms, and unwelcome publicity.

(4) Banking development in many Western countries has taken the form of the establishment of small local banks, which have gradually increased in number and size, and which have ultimately found strength and safety by the process of amalgamation as competition became severe. The establishment of small local banks in India will be facilitated, if large banks, and especially the Reserve Bank of India, provide them with the required stimulus and guidance in the spirit of a foster-mother, and a portion of the staff. Some of them may even find it useful to take up shares in the local banks, as this may help them to secure advantageous local connections.[1] The Nidhis of the Madras Presidency and the loan offices of the Bengal Presidency can, thus, be transformed into sound and strong local banks under the stimulus of the concessions, mentioned above, the encouragement of public opinion, and the guidance of the larger banks and Government.

Finally, pending the expansion of joint-stock banks, a substantial expansion of banking facilities can be immediately effected by permitting in each province some of the central co-operative banks, which have suitable staff, to do ordinary commercial banking business, within safe limits and under definite instructions, at those places which do not have any branch of the Imperial Bank or a joint-stock

1. *Cf.* Central Committee Minority Report, p. 125.

bank. There are at present nearly 500 central co-operative banks in the country. Many of them are located at places which have no ordinary banking facilities, and if some of them are permitted to engage in safe commercial banking under suitable restrictions, not only will trade be benefited, but the co-operative movement also will increase in popularity, as the banks will be able to make it known to a wider public.[1]

1. *Cf.* Central Committee Minority Report, p. 138, the Punjab and Bombay Committees Reports, pp. 113 and 236, and the answers of the Secretary of the Bihar Provincial Co-operative Bank, Bihar Committee Evidence, Vol. II, pp. 101-2.

CHAPTER VIII

Financing of Foreign Trade: Exchange Banks

1. Their organisation.

Exchange banks are those which have their head offices outside India. In Western countries this phrase is used to denote "those banks that are specially concerned with financing the trade of India and China, which countries, not having a gold standard, have exchanges peculiarly liable to fluctuations."[1] Some Indian writers regard the phrase as misleading, because these banks do not restrict themselves to the finance of India's foreign trade, and play a large part in financing her internal trade, and because Indian joint-stock banks are free to do exchange business; they have, therefore, proposed to call them foreign banks.[2]

The profits of banking in India have attracted the nationals of a number of countries having important trade relations with India, and there are at present 18 exchange banks, of which 8 have their head offices in England; 3 in Japan; 2 in Holland; 2 in the U.S.A., and one each in France, Portugal and Hongkong. They are divided into two groups, (1) banks doing a considerable portion of their business in India, *i.e.* having 25% or more of their deposits in India and (2) banks which are merely agencies in India of large banks doing a major portion of their business abroad, *i.e.* having less than 25% of their deposits in India.

The Chartered Bank of India, Australia and China, the National Bank of India, the Mercantile Bank of India, the P. and O. Banking Corporation, and the Eastern Bank belong to the first group. Of the 13 banks belonging to the second group, Messrs. Thomas Cook and Sons (Bankers) and the American Express Company deal mostly

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1. Minty, *English Banking Methods*, p. 44.

2. See Thakur, *Organisation of Indian Banking*, p. 70 and Central Committee Minority Report, p. 139.

with tourist traffic. The remaining 11 banks are Lloyds Bank, which has taken over the business of Cox and Co., the Yokohama Specie Bank, the Sumitomo Bank, the Bank of Taiwan, the Nederlandsche Handel-Maatschappij, popularly known as the Netherlands Trading Society, the Nederlandsche Indische Handelsbank, popularly known as the Netherlands Indian Commercial Bank, the National City Bank of New York, with which is amalgamated the International Banking Corporation, the Hongkong and Shanghai Bank, Comptoir National d-Escompte De Paris, Banco National Ultramarino and the Imperial Bank of Persia. The Russo-Asiatic Bank and the Deutsche Asiatesche Bank closed their doors when the world war broke out. But Germany may soon be represented again by one of its banks in India.[1] The only other countries, which have fairly important trade relations with India, but which are not represented by their own banks in India, are Belgium and Italy.

2. Operations of exchange banks.

The main business of these banks is to finance the foreign trade of India. The Imperial Bank is prevented by law from dealing in bills of exchange payable outside India, and is allowed to make remittances outside India only for the *bona fide* personal needs of its customers. The Indian joint-stock banks are not prevented by law from engaging in this business, and a few of them now defunct, such as the Alliance Bank of Simla and the Tata Industrial Bank did engage in it to a substantial extent, and the Central Bank of India now carries it on to a small extent. But the business has now become practically a monopoly of the exchange banks for the following reasons. First, the Indian banks cannot withstand the competition of the far stronger exchange banks, which have far larger capital and reserves, and which obtain large funds from the London discount market at low rates. Secondly, the lack of branches in London and other important foreign centres prevents them from engaging in arbitrage and direct exchange transactions. Finally, their limited

1. See Central Committee Minority Report, pp. 312-313.

financial resources have found more or less full employment in internal business.

They have found it extremely difficult to establish branches at foreign centres owing to the following reasons:—

(1) They must have a large capital to command credit in the money markets of these centres.

(2) They must have large floating resources to allow a large turnover.

(3) The branches must be run at a loss for some time until they become self-supporting.

(4) They must have a dependable staff trained in international exchange work.

(5) They cannot expect to obtain substantial deposits and other business from the public, merchants and industrialists of these centres.

(6) They must face the hostility of the foreign banks.

(7) The existence of their head offices in India rather than in the world's financial centres, especially London, would handicap them in keeping themselves in close touch with the international monetary conditions, and securing import and export bills, and bills for collection.[1]

The exchange banks' work of financing India's foreign trade usually consists of two operations *viz.* (1) the financing of the movement of goods from Indian ports to foreign ports and vice versa, and (2) the financing of it from, or to, Indian ports to, or from, the distributing, or collecting, centres in the interior of India.

To consider the mechanism of the first operation. When exporters from India sell goods to foreigners, *e.g.* in Great Britain, credit is generally opened with the London banks or finance houses and communicated to India through the exchange banks. Bills against such credit are drawn, usually at three months' sight, and they are documentary. However, sight bills as well as those of more than 3 months' sight are sometimes drawn. Most of the bills are D. A. (documents on acceptance), only a small

1. See Central Committee Report, pp. 312-3.

proportion being D. P. (documents on payment). The rate for a 3 months' bill is higher than that for a sight bill, because it includes interest for the duration of the bill at the rate prevailing at the centre on which the bill is drawn.

These bills are sent to London, and presented for acceptance, and after endorsement by the exchange banks, are generally discounted in the open market, thus enabling the exchange banks to receive back in sterling what they paid in rupees in India. They may keep the bills till maturity, if they have ample funds, and if there is little immediate chance of making a profitable use of the funds. But they discount the bills, even at a high rate, if trade is active, or if money is scarce. Most of the bills between India and Europe, the U.S. A. and the Colonies are in sterling. Those between India and Japan are in Yen, and those between India and China are in rupees.

The imports from Western countries are financed in two ways. The first method is generally used in connection with imports by Indians, and consists of Western exporters drawing 60 days' sight D. P. bills on Indian importers and discounting them with the exchange banks. The exporters execute letters of request and hypothecation in favour of the exchange banks, which become holders for value of the bills. The Indian importers generally accept the bills and apply to the banks for the delivery of goods before payment, against trust receipts. The bills of lading and the other documents are then handed over to the Indian importers, who obtain possession of the goods as trustees on behalf of the exchange banks. The former store the goods in godowns, and pay the bills when the goods are sold.

The other method is available to European importers who have London houses of standing, and takes the form of London banks' acceptances of 'house' paper. According to this method, documentary bills are drawn by London exporting houses on the London offices of the exchange banks, which accept the bills and return them to the drawers, which discount them in the London money market. The accepting banks send the relative documents to their branches in India for the collection of the proceeds of the

goods from the Indian offices of the exporting firms, and remittances are sent to London at or before the maturity of the bills.

The bills under both the methods are drawn in sterling. On the former, interest is charged from the date of the drawing of the bills to the approximate date of the arrival of their proceeds in London, at 5% if the Bank of England rate is less than 5 per cent, and at 1 per cent higher than the Bank of England rate if the latter is 5%, or above. The latter bills are discounted in the London market at the prevailing rate of discount, which is always lower than the rate charged by the exchange banks on the former bills. European importers in India, who have London houses of standing, thus get an advantage over their Indian competitors. It is also clear that in both exports and imports by Indians the adjustment of interest between producers and consumers is carried out in India, and that interest has to be taken into account in India in determining prices in both cases.

India has normally a favourable balance of trade, *i.e.* the total value of export bills is greater than that of import bills. The exchange banks finance the excess of the export bills, and enable India to receive payment for her favourable balance, by means of the import of gold and silver bullion, the sale of sterling to the Government of India payable in London—a new method which has replaced the old method of the purchase of Council Bills and Telegraphic Transfers from the Secretary of State in London—transfer of Government rupee paper from London to India, and the sale of drafts and telegraphic transfers payable in London and other foreign centres to private clients in India.

The exchange banks also finance the movement of goods from, or to, Indian ports to, or from, the distributing, or collecting, centres in the interior of India, and for this purpose have 18 branches at 10 up-country centres.[1] There has also been a movement in recent years among the exchange banks to obtain a footing in the interior by obtaining a controlling interest in Indian joint-stock banks

1. See Foreign Experts' Report, Central Committee Report, p. 645.

through the purchase of their shares. For instance, the P. and O. Banking Corporation, soon after its establishment in 1920, purchased the Allahabad Bank with 40 branches in the interior, and the controlling interest in the former was obtained by the Chartered Bank in 1927. With regard to trade between those up-country centres where exchange banks have branches, and foreign countries, merchants can get the banks to finance both the operations mentioned above in a single transaction. For instance, with regard to goods imported into Cawnpore, the import bills drawn by the foreign exporters are forwarded to the Cawnpore branch of an exchange bank, and their value is collected there by the branch from the importers, and is remitted outside India ; and with regard to exports from Lahore, the Indian exporters can draw bills on the foreign purchasers under credits opened by the latter, and sell them direct to the Lahore branch of an exchange bank.

If the up-country centres have no branches of the exchange banks, the movement of goods between them and the Indian ports has to be financed by the importers and exporters through Indian joint-stock banks or other agencies, and the two operations in connection with the finance of foreign trade get definitely separated. The Imperial Bank, Indian joint-stock banks and indigenous bankers finance the movement of produce from the collecting centres to the ports for the purpose of export, by purchasing demand drafts drawn by the exporters' agents on the exporters' firms at the ports ; and Indian joint-stock banks, shroffs and commission agents finance the movement of imported goods from the ports to the distributing centres.[1] The exporters and importers, however, are said to prefer the financing of both the operations in a single transaction by an up-country branch of an exchange bank, as it is found cheaper.[2]

Besides financing foreign trade, the exchange banks do every kind of banking business. They compete with the Imperial Bank and the Indian joint-stock banks by

1. For the details of the working of this mechanism, see Central Committee Report, pp. 319-20.

2. See the Punjab Committee Report, p. 74.

receiving deposits, making advances, negotiating bills, and doing agency business in India. For fixed deposits, they pay a slightly higher rate of interest than the Imperial Bank, and a slightly lower rate than the Indian banks. On current accounts they pay the same rate as the Indian banks, *viz.* 2 per cent in the slack season and 2½ per cent in the busy season,[1] provided that the balances exceed a certain minimum, while the Imperial Bank pays no interest on its current accounts. The table on page 18 shows that they have succeeded in attracting very large deposits in India.

They finance internal trade in several up-country centres. The piecegoods trade in Delhi and Amritsar, the leather trade in Cawnpore, and the jute trade in Bengal are financed by them to a large extent.[2] They make much use of Marwari bankers, and make advances to them on the security of goods or produce, or discount their bills of exchange. They also finance imports of gold and silver bullion. Most of it is imported into Bombay by dealers whose orders are placed generally in London, but some of the orders for silver are sent direct to New York. The dealers give written instructions to the Bombay branches of the banks regarding the payments to be made in London or New York against complete shipping documents, and the London offices or the New York agents of these banks make the payments. The banks clear the consignments when the bullion arrives in Bombay, and the dealers have to take delivery of them within a week after payment, which includes interest at the Bank of England rate, with a minimum of 4 per cent from the date of payment by the banks in London or New York to the date of payment by the dealers in Bombay.

3. Profits of exchange banks.

The exchange banks are prosperous concerns, doing profitable business, and paying substantial dividends at the same rates from year to year in spite of the world-wide trade depression and complaints on their part of falling

1. Reduced to 1 per cent in 1933 on account of the depression.
2. See Ramachandra Rau, *Present Day Banking in India*, p. 137.

profits and of competition among themselves.[1] This is seen from the following figures :—

Dividend rate per cent each year from 1920 to 1929.

Chartered	.... 20·25
National	 20
Mercantile	 16
Eastern	 9
Hongkong and Shanghai	.... 64 reduced to 56 in 1929
Lloyds	.... 16·7
P. and O.	 5

Since 1930, however, they have been hit appreciably by the depression, and the majority of them have been compelled to reduce their dividends, *e.g.* the Chartered Bank to 14 per cent, the Mercantile Bank to 12 per cent, and the Eastern Bank to 6 per cent.

The risk in their foreign exchange business has been largely removed by the establishment of the Gold Exchange Standard, and it can be removed still further by the process of covering, by which cautious bankers can very nearly balance their sales and purchases of exchange. They have also gradually developed their internal business, which some of them find more profitable than their exchange business.[2] The profits explain (1) the absorption of the Allahabad Bank by the P. and O. Bank as mentioned before; (2) the purchase of Cox and King Companies by Lloyds Bank, one of the Big Five in England, which, in addition to acting as army bankers and tourist agency as Cox and King Companies did, is competing with the Imperial Bank and some Indian joint-stock banks at some commercial centres; (3) the acquisition of a controlling interest in Grindlay and Company by the National Provincial Bank, another of the Big Five in England; and (4) the absorption of the International Banking Corporation and the American Express Company by the National City Bank of New York and by the Chase National Bank of

1. See Central Committee Minority Report, pp. 174-5.

2. *Cf.* the speech of the chairman of the Mercantile Bank at the annual meeting in 1929 quoted in the Central Committee Minority Report, p. 192.

New York respectively, two of the largest banks in the U. S. A.

All the exchange banks have established a strong position and a great reputation for themselves,[1] and they are jealous of intruders. The view expressed by J. M. Keynes in 1913 that "Indian exchange banking is no business for speculative or enterprising outsiders and the large profits which it earns are protected by established and not easily assailable advantages,"[2] and that " it would be exceedingly difficult to start a new exchange bank except under the aegis of some important financial house already established in a strong position in India," still holds good to a large extent. In spite of the open door policy maintained by Government for three-quarters of a century, the number of exchange banks is still very small, *viz.* 18, and it is generally believed that the establishment of a new exchange bank would be difficult owing to the opposition of the existing banks.

4. Complaints made against exchange banks and defects in their working.

Indian witnesses before the Central and Provincial Banking Committees have made many complaints against the exchange banks, and the Committees themselves have found some defects in their working. The representatives of the Exchange Banks' Association have mentioned to the Central Committee that some of the complaints were brought to their notice for the first time and could have been easily and quickly dealt with, if they had been brought to their notice earlier.[3] We may now turn our attention to these defects and complaints.

(1) The exchange banks are not subject to any legal restrictions in India, even to the statutory obligations to which the Indian joint-stock banks are subject.[4] Their directors and shareholders are entirely foreign, and the control over them being thus exercised from abroad, their

1. See Mr. Ramachandra Rau's statement, Central Committee Evidence, Vol. II, p. 354.
2. Indian Currency and Finance, p. 208.
3. See their answers, Central Committee Evidence, Vol. III, p. 366.
4. *Cf.* the Bank of India's statement, Central Committee Evidence, Vol. II, p. 32.

accounts need not be audited by recognised auditors. They do not even publish in their balance-sheets separate information regarding their Indian business. The only information available regarding their working is supplied by a single table for all the banks up to 1922, and two tables since that year for the banks belonging to the two groups mentioned above. These tables are supplied to Government once a year, and are published by the latter. The tables give meagre information, and are apt to be misleading owing to the lumping together of their Indian and non-Indian business. The activities and affairs of the banks, therefore, have remained a more or less closed book to the public and the Government of India. They obtain a large portion of their funds from Indians in the shape of deposits. But the depositors are not protected by any regulations regarding the working of the banks, and they have no prior claim even on the assets of the banks in India, if any of the banks get involved into serious difficulties in another country owing to a crisis, fraud, or any other reason.

(2) These banks have worked on the basis of inadequate cash reserves in India, during several years, and have, therefore, been a source of weakness to the money market in India during such periods. Keynes drew attention to this inadequacy in his Indian Currency and Finance in 1913, the banks did get into difficulties owing to it at the beginning of the War, and had to be helped. Getting wiser, they kept a larger proportion for a few years, but recently the proportion has again dwindled. Since their profits have been substantial, they have no excuse for keeping low cash reserves. It is said that they have investments in Government securities and treasury bills, but no information is available regarding them. The position of the cash balances is brought out by the following table :—[1]

1. See Statistics relating to Banks in India 1931, p. 7.

	Banks doing a considerable part of their business in India. Percentage of cash to liabilities in India.	Banks doing only a small part of their business in India. Percentage of cash to liabilities in India.
1880	53	
1890	46	
1900	23	
1910	16	21
1913	19	17
1919	35	67
1920	30	58
1921	28	43
1922	19	33
1923	19	27
1924	20	31
1925	13	15
1926	14	17
1927	11	14
1928	11	11
1929	14	10
1930	13	8
1931	15	9

(3) The exchange banks enjoy the monopoly of financing the foreign trade of India. While the monopoly is exercised largely with Indian funds obtained as deposits, it subjects Indians to a double loss—loss of banking as well as trading profits—and the loss has increased with the growth of India's foreign trade. With the growth of the exchange banks during the last seventy-five years, the handling of the foreign trade has gradually passed from the hands of Indians into those of foreigners, until at present the share of the former in this handling, according to the Indian Chamber of Commerce, Calcutta, is only 15 per cent.[1] This figure has been challenged by the exchange banks, which have supplied to the Central Banking Committee mere percentages of the shares of Indians and foreigners in different centres where the exchange banks have branches. From these figures it is impossible to arrive at percentages for the country as a whole. Mr. Subhedar in his Minority Report says that his request for absolute figures was refused.[2] Moreover, in their percentage figures of the shares of Indians, the banks have included all the

1. See Appendix III, Central Committee Evidence, Vol. II, p. 817.
2. P. 179.

trade with regard to which bills have been drawn on Indian consumers or distributers, although the real importing and profit-earning parties have been non-Indians, and have excluded all the trade carried on by foreign firms like Ralli Brothers, which do not deal with the exchange banks.[2]

The figure 15 per cent, therefore, arrived at by the Indian Chamber of Commerce, Calcutta, from the actual value of trade revealed by certain official and private publications, may be accepted as approximately correct.[2] Assuming that the merchants handling the foreign trade, whose annual value in normal years is about Rs. 570 crores, earn a commission of 2 per cent, the profits of the foreign merchants come to Rs. 10 crores annually. In addition, these merchants enable other non-Indians to earn several crores of rupees annually, in the shape of brokerage on goods sold and purchased, on exchange, on insurance, on freight obtained, and on other incidental transactions. Indian merchants have had to be satisfied principally with handling the movement of produce and imported goods, from, and to, the mofussil, to, and from, the ports, but the foreign firms, with their much larger resources, are said to have begun to compete with the Indian merchants in this business also.[3]

Most of the Indian commercial bodies, which have given evidence before the Central Banking Committee, have complained that the exchange banks have brought about this transfer of trade from the hands of Indians to those of foreigners by means of unfair discrimination of various kinds in favour of the latter, so as to give them unfair advantages in their competition with Indians.[4]

(i) The exchange banks are said to give poor references regarding Indian commercial houses to enquirers abroad and to give better references to foreign houses of

1. See Central Committee Report, p. 580.

2. From enquiries made by him, Mr. Sarkar, a member of the Central Committee, believes that the actual proportion is about 20 per cent. See his Minute of Dissent, Central Committee Report, p. 550.

3. See the statement of the Indian Chamber of Commerce, Calcutta, Central Committee Evidence, Vol. II p. 521.

4. *Cf.* Bombay Committee Report, p. 116, and the statements of the Bengal National Chamber of Commerce and Indian Chamber of Commerce, Calcutta, Central Committee Evidence, Vol. II, pp. 490, 524 and 534.

a lower standing. On behalf of the exchange banks it has been pointed out that this difference is due to the reluctance of the Indian houses to supply the banks with properly audited balance-sheets. It has been said that this means the supply of balance-sheets audited by auditors approved by the banks. This, however, has been denied by the representatives of the exchange banks and the majority of the Central Banking Committee, who have stated that the exchange banks only want the accounts to be audited by auditors, who are on the approved list of Government. Moreover, the practice of 'one firm, one bank' is not yet developed in India, and an exchange bank granting financial accommodation to an Indian merchant infrequently has no right to insist on his disclosing fully to it his financial position. The real reason for this difference, as the representatives of the exchange banks have virtually had to admit, is that the managers of the banks, being foreigners, are not able to keep themselves in close touch with their Indian clients, and have, therefore, to depend for information regarding their financial standing upon the reports of the subordinate members of their staff, or brokers, or shroffs.[1]

(ii) While most of the foreign commercial houses are allowed to import goods on D. A. terms, Indian merchants can usually do so on D. P. terms only. This means that whereas the latter have to do business on a cash basis, the former enjoy extensive credit.[2] The representatives of the exchange banks have pointed out that the terms are settled, not by them, but by the exporters abroad, that they cannot grant D. A. terms without the orders of the exporters, and that their practice of releasing imported goods on trust receipts is more or less equivalent to D. A. terms.[3] In reply it has been stated that the reluctance of the overseas exporters to grant D. A. terms to the Indian importers is due to indifferent references supplied to the former regarding the latter by the banks, and that the

1. *Cf.* Foreign Experts' Report, and Mr. Sarkar's Minute of Dissent, Central Committee report, pp. 645 and 551.

2. See the statement of the Indian Chamber of Commerce, Calcutta, Central Committee Evidence, Vol, II, pp. 532-3.

3. See their answers, Central Committee Evidence, Vol. III, pp. 336-7.

practice of releasing imported goods on trust receipts is not equivalent to D. A. terms, as it involves higher charges on account of loans obtained on the trust receipts. Similarly, the complaint has been made that the banks generally do not discount the bills of Indian exporters without margins and securities, which in most cases they do not require at the time of discounting the bills of non-Indian exporters. The representatives of the exchange banks have explained this by stating that, in the case of the latter, arrangements exist at the other end, which make it safe for the banks to pay the full discounted value of the documentary bills. This may be so, but the fact remains that the Indian exporters are at a disadvantage.

(iii) Whereas in other countries, the banks engaged in the financing of export trade supply their customers with reliable and valuable information regarding foreign markets and prices prevailing there, the exchange banks have done nothing to supply any information of this kind to their customers. Foreign export houses working in India have connections abroad, and they obtain this information therefrom, so that it is the Indian exporters who are handicapped by the failure of the exchange banks to supply the information.

(iv) Some Indian witnesses have stated to the Central Banking Committee that to get a confirmed letter of credit opened, even first class Indian importing firms have usually to deposit from 10 to 15 per cent of the value of goods with the exchange banks, while foreign houses in Calcutta are exempted from such deposits. On behalf of the exchange banks, it has been pointed out that a large part of the import business is carried on without credits, that with regard to that part which is done with credits, no discrimination is made between Indian and non-Indian importers, and that the question of deposits depends upon the standing of the importers. This explanation may be correct, but the fact remains that the Indian importers are handicapped because, as seen above, the exchange banks find it difficult directly to ascertain their standing and, therefore, insist on deposits from them.

(v) Most of the export and import trade is financed

by means of sterling bills. With regard to the export trade, so long as credits can be opened in London, it is advantageous to the Indian exporters to draw bills on London and to avail themselves of the discount facilities provided by the largest money market in the world. With regard to the import trade, however, Indians do not get the benefit of the London discount market, and they are denied the benefit of the Indian market also, as their bills are drawn in sterling. Foreign import houses that have offices in London need not finance themselves by drawing bills on their Indian offices with documents attached to them. They get the advantage of drawing bills on the London offices of the exchange banks, which accept them, and the bills are then discounted in the London market at the low rate generally current there, varying between 2½ and 3½ per cent. The shipping documents are sent to the Indian offices of the import houses which, thus, get an advantage of at least 1 per cent in price over their Indian competitors. The latter are denied this advantage on the ground that they have no London offices. Their bills, being drawn in sterling, must be discounted with the exchange banks which charge a minimum rate of 5 per cent,[1] from the date of the drawing of the bills to the date of their payment plus the period of the remittance of the amount from India to London, although the rate prevailing in the Indian market may be lower.

(4) Another general complaint against the exchange banks has been that they have discouraged Indian enterprise in several directions, *e. g.* Indian brokers, banks, steamship companies and insurance companies.[2] The Indian Merchants' Chamber of Bombay has complained to the Central Banking Committee that Indian exporters are compelled by the exchange banks to insure their goods with foreign insurance companies, and that consequently Indian insurance companies annually lose between Rs. 2 and 3 crores. The Imperial Bank of India had a similar

1. See Central Committee Report, p. 356.

2. *Cf.* Mr. Sarkar's Minute of Dissent, Central Committee Report, p. 556, and Mr. Ramachandra Rau's statement, Central Committee Evidence, Vol. II, p. 353.

prejudice against Indian insurance companies until recently, but it now accepts freely the policies of those Indian companies, which allow it to examine their books in order to satisfy itself that they reinsure a part of the risk, and which supply it with any other information that it may need. The representatives of the exchange banks have stated that they have no prejudice against Indian companies, and that the matter is only a question of the standing of these companies.[1] The banks, however, have not laid down any standards to which the Indian insurance companies can conform. Indian insurance companies have in recent years carried on an agitation for recognition by the exchange banks, and since complaints were made to the Banking Committee,[2] special orders have been issued by the Exchange Banks' Association in London to the banks' offices in India for a more discreet treatment of Indian insurance companies.

(5) The complaint has been made that the rules of the Exchange Banks' Association are altered arbitrarily without the knowledge of the banks' Indian clients, who are not even supplied with copies of the rules, and that this has enabled the superior staff of the banks to show less consideration for their Indian clients and to make different and more difficult business terms for them than for their non-Indian clients. The representatives of the banks have admitted that their clients are not consulted before altering their rules, but have assured the Committee that the banks have no intention of keeping the rules secret, and would publish them. This has been done. The representatives have also admitted that the object of the rules is to secure uniform action by member banks, so as to prevent disorganisation of the market. This has been interpreted to mean that their object is to reduce the range of competition in all directions.[3] Further, the complaint has been made that one of the rules restricts dealings with any one except the members banks, with the object of checking the growth of Indian jobbers who

1. See their answers, Central Committee Evidence, Vol. III, p. 358.
2. See Central Committee Report, p. 587.
3. *Cf.* Central Committee Minority Report, p. 206.

have taken to dealing in exchange, and of preventing Indian banks from getting such exchange business as may come to them in the natural course through their clients.

(6) It is urged that the exchange banks have hampered the development of Indian joint-stock banks. In every country that has a fairly organised banking system, import bills are drawn in home currency, and after being accepted by the drawees are available for discount in the discount market of the importing country. As the financing of the foreign trade of India, however, is entirely in the hands of the exchange banks, the import bills, as mentioned before, are drawn in sterling in the case of imports from Europe and the U. S. A. and in yens in the case of those from Japan. These bills, of a very large value in the aggregate, are a very safe investment, as they are D. P. and have the signature of the drawers and the acceptance of the drawees on them. They are also a profitable investment, because the exchange banks earn interest on them at 5 per cent at least for a period of 2 or 3 months. But being drawn in foreign currency, they are rendered useless for the money market in India, are not available to the Indian banks for investment, and are the exclusive monopoly of the exchange banks. The import bills are in form, substance and nature the same as the indigenous bills, the hundis, which are prominent in India, and had it not been for the strong position of the exchange banks, the change of the import bills from sterling and yens to rupees would have been effected long ago. But as it is, the Indian banks are compelled to confine their activities to the finance of internal trade.

The Central Banking Committee has expressed the opinion that the replacement of the cash credit system by bills in the finance of internal trade, which is at least 15 times as large as the foreign trade, will be far more effective than rupee import bills in supplying the Indian banks with a safe, adequate and liquid form of investment. But even in the finance of internal trade, the exchange banks are said to be offering serious competition to the Indian banks in recent years.[1] Being long and well-established

1. See Mr. Sarkar's Minute of Dissent, Central Committee Report, p. 553,

and enjoying a good reputation, they get deposits from the Indian public at lower rates than the Indian banks, and consequently, they can underbid the Indian banks in the struggle to capture the finance of internal trade by quoting lower lending rates. The lower rates are, no doubt, immediately advantageous to the trade and the public, but the competition is said to be harmful to both in the long run, because their interests are ultimately identical with those of the Indian banks. The representatives of the exchange banks have maintained that there is not much competition between them and the Indian banks as regards internal trade. But Mr. Subhedar has calculated that the funds devoted by the exchange banks to the finance of internal trade are almost equal to those which the Imperial Bank and the Indian banks use for the same purpose.[1]

Moreover, some of the Provincial Banking Committees have found that the competition is substantial, and the Bengal Committee has even stated that the exchange banks are taking up new lines of business, which had been formerly in the hands of the Indian joint-stock banks only.[2] The exchange banks are also said to be encouraging foreigners to compete with Indian merchants in handling the movement of produce from the interior to the ports, and of imported goods from the ports to the interior.

Further, it is urged that these banks, through their majority in the clearing houses of the principal Indian financial centres, have tried to keep the Indian banks out of these houses as long as possible, and that this exclusion has had an adverse and unwarranted effect on their reputation. Moreover, while the exchange banks have freely taken call money from the Indian banks, they have not given it to them with the same freedom.[3] Not only does the device of call money enable a lending bank to obtain interest on its surplus cash while keeping it at call, *i. e.* available to itself when it needs it, but it also enables the

1. See Central Committee Minority Report, p. 188.
2. Report, p. 45.
3. See Mr. Pochkhanawala's statement, Central Committee Evidence, Vol. II, p. 55.

borrowing bank to tide over a temporary shortage of cash at a moderate cost. The device thus helps equal distribution of the available cash in a money market. The explanation given by the representatives of the exchange banks is that the Indian banks are not strong.

This distrust may partly be due to the failure of some of the Indian banks in the past, to continual rumours about their position and working, to resignations of their directors, and to differences of opinion among their shareholders and management leading to protracted litigation. But this explanation is not regarded as satisfactory by Indian witnesses, who have pointed out to the Central Banking Committee that no Indian bank has been admitted a member of the Exchange Banks' Association, that the Association is controlled largely by an inside council directed from London, as the British banks came earliest in the field and have continued to be most prominent in it, and that other exchange banks have been admitted to the membership of the Association mainly for the purpose of fixing business rules, holidays, etc.[1]

Finally, the complaint has been made that the exchange banks do not buy remittance freely from the Indian banks and that they also do not sell it forward to them freely, on the ground of the risk of loss if the latter fail to complete the contracts. But it has been urged that the risk is not large when big Indian banks like the Central Bank of India are concerned, and that even if the risk does materialise, the loss would not be heavy, as it would be limited to the difference between the contract rate and the rate at which the exchange banks would cover the transactions by going into the market.

(7) The strong position of the exchange banks and their monopoly of the finance of India's foreign trade have been partly responsible for splitting up the money market into two, European and Indian. The gulf between the two and their ignorance of the doings and methods of each other have so far shown no signs of diminution, and this hampers the economic progress of the country. It

1. See Minority Report, p. 205 and Mr. Shroff's statement, Central Committee Evidence, Vol. II, p. 411.

is even said that the exchange banks have taken full advantage of their strong position to prevent a proper organisation of the market, and have opposed measures suggested from time to time for this purpose, as the organisation would lower their prestige and their domination of the market.[1]

(8) Although the exchange banks have been working in India for nearly three-quarters of a century, no Indians have so far been appointed in the superior grades of their service, except as cashiers or shroffs. The exception is unavoidable, as non-Indian officers cannot be well acquainted with Indian customers and their financial standing. The only other posts in these banks, to which Indians can aspire, are clerical. In fact, no arrangement has been made by them for the selection of qualified Indians as apprentices for training and appointment in the grades of officers. They have preferred importing their officers from abroad and paying them high salaries to the selection, training, and appointment of qualified Indians as officers with substantially lower salaries. Indian intellect is thus denied an opening to which it has every right, in view of the fact that the exchange banks obtain a large portion of their profits from Indian consumers, merchants, and depositors.[2]

(9) The exchange banks are said to be endeavouring to divert Indian capital to investments in foreign industrial and gilt-edged securities.[3]

(10) The exchange banks as members of the British Chambers of Commerce in India are said to have played a prominent part in opposing Indian opinion and interests, and creating opinions and policies unfavourable to Indians in some vital matters, such as the establishment of the Gold Standard, the administration of paper currency and the mint, the sale of Council Bills and other Government remittances, Government long-term and short-term bor-

1. For the details of this opposition refer to Mr. Sarkar's Minute of Dissent, Central Committee Report, p. 557.

2. *Cf.* Mr. Sarkar's Minute of Dissent, Central Committee Report, p. 558 and Mr. Shroff's statement, Central Committee Evidence, Vol. II, p. 397.

3. See Mr. Pochkhanawala's answers, Central Committee Evidence, Vol. III, p. 54.

rowings and capital programmes, the establishment of a central bank, restrictions on the Presidency banks and the Imperial Bank, fiscal policy, encouragement of Indian insurance and shipping, and the management of Indian railways by British companies.[1]

(11) The exchange banks are also said to have been exercising a large influence upon the policy of the Secretary of State and the Government of India through the Financial Committee of the India Council and retired Government officials who serve as directors of these banks. The officials of the India Office are said to have advocated most of their causes warmly. When they found themselves in difficulties at the beginning of the War, they were helped by Government. They also benefited much from the sale of Reverse Councils, which caused a heavy loss to Government in 1920. Yet they are said to have used most of the opportunities of profiting from currency, exchange and financial embarrassments of Government. Moreover, they have been reluctant to supply definite and detailed information regarding their working to Government and even to public Committees and Commissions appointed by it, and this has increased the difficulties of the task of these Committees and Commissions of recommending, and of Government of working out, sound financial policies for the welfare of the country.[2]

The claim of the exchange banks, supported by the Foreign Experts,[3] that they render cheap and efficient service to India, in a sphere of international finance requiring strong capital and connections, with funds obtained from abroad, mainly England, is also said to be untenable. In spite of the facts that they obtain large deposits in India at low rates and rediscount their bills in the London market at still lower rates, the exporters and importers in India have to pay higher rates for financial accommodation than their fellows in most Western countries.[4] While the discount rate in the latter is lower

1. *Cf.* Mr. Sarkar's Minute of Dissent, Central Committee Report, p. 556.
2. See Central Committee Minority Report, pp. 193-7.
3. See their Report, Central Committee Report, pp. 645-6.
4. See Minority Report, p. 215.

than the bank rate, in India the exchange banks have kept it higher than the bank rate. The rediscounting in the London market, at low rates, of the export bills from India discounted on the basis of Indian money rates, yields large profits to the exchange banks out of proportion to the risks that they run, and at the same time it provides profitable employment to the funds of the London market. The import bills are drawn in sterling, and are discounted by the exchange banks, as seen before, at a minimum rate of 5 per cent, and this is one of the causes of the absence of a bill market in India. These import bills keep the importers in the hands, and at the mercy, of the exchange banks until the last moment.

Moreover, the idea that both the import and export trade of India should be financed by herself is fallacious. The import trade of India is the export trade of some other countries, and *vice versa*, and the foreign trade of India is equally the foreign trade of some other countries. It would, therefore, be foolish to expect India to finance the whole of her foreign trade with her own resources.[1] Further, in periods of tight money abroad, specially in other Eastern countries, the exchange banks remit funds obtained in India to these countries in order to profit from the high rates prevailing there[2]. It is urged that the handling of the financial resources of one country by another can seldom benefit the former's nationals in matters of trade and banking, and in most cases is sure to inflict a loss on them.

Side by side with the fact that these exchange banks get the use of large Indian funds at low rates and make them available largely to foreign traders in India are said to be the facts that capital in the country is shy, scarce and dear, that usury is rampant, that money-lenders flourish and have had to be restrained by law, that new industrial enterprises, even if sound, often do not get adequate or timely financial accommodation, that the money market suffers periodically from considerable stringency, and that the average bank rate is higher than in

1. *Cf.* Central Committee Minority Report, p. 181.
2. *Cf.* Bombay Committee Report, p. 37.

most Western countries. A small class, consisting largely of foreigners, obtains financial accommodation much more readily and cheaply than the people of the country, whose need is far more urgent. The latter are helpless, because the institutions upon which they depend for accommodation have to work under unfavourable circumstances. The economic life of the country, working in these separate compartments, with immobility of its financial resources, must be regarded as lacking in organisation. The problem, therefore, is not merely to co-ordinate the different banking agencies, but also to complete the economic cycle by making available, with proper care, to the people of the country engaged in productive activities, the savings collected from the people of the country.[1]

5. The question of licensing and restricting exchange banks.

The Central Banking Committee is unanimous in the opinion that the policy of the open door to foreign banks in India should be abandoned, that foreign banks should be regulated by the introduction of a system of licensing similar to that operating in various other countries such as Germany, Italy, Japan, and Canada, that no foreign bank should be permitted to establish a branch in India without a license, and that the licensing authority should be the Reserve Bank of India. A licensing system is necessary partly to protect the interests of Indian depositors, partly to give the Reserve Bank the necessary control over all banks working in the country, and partly to secure reciprocal treatment in other countries for Indian banks. The Committee has realised that a bank is a public utility institution, that it stands on a footing different from that of an ordinary business firm or company, that it has certain legal rights which ordinary borrowers and lenders do not enjoy, and that the public has no means of knowing a

1. *Cf.* Minority Report, p. 182. "Thus the exchange banks form a relatively unabsorbable and uncontrolled part of the Indian banking system. Their function is quite specialised and results in the anomaly that the exporter has far better financial facilities than the cultivator. The exchange banks do attract Indian deposits, but on account of their specialised business, drain all the money to the ports in the busy season, when it is quite as much in demand up-country. They have also shown little inclination to co-operate with the Indian joint-stock banks." Baster, *Imperial Banks*, p. 194.

foreign bank's position abroad, or the treatment given by its country to Indian individuals and institutions.

A majority of the members of the Central Banking Committee has recommended that in fairness to the exchange banks already operating in India licenses should be given to them freely, that every license should be given for a definite period, and should be automatically renewed if the licensing authority is satisfied that the provisions of the Indian law applicable to such a bank and other conditions mentioned in the license have been duly carried out, and that these conditions should be that the exchange banks should supply to the Reserve Bank periodical reports showing separately their assets and liabilities in respect of their Indian and non-Indian business as laid down by the Reserve Bank, and that they would be subjected to restrictions on the basis of reciprocity.[1] The Foreign Experts, however, are not in favour of this licensing on the grounds that none of the exchange banks has insufficient capital or standing, and that the country should be free to enjoy all the banking facilities that can be made available to it.[2] Some European commercial bodies also have expressed themselves against such licensing.[3]

The majority of the Committee has also made the following suggestions for improving the working of the exchange banks in India and for removing the complaints that have been made against them :—

(1) The suggestion of the Foreign Experts that the exchange banks should examine the practicability of altering their existing procedure to the extent that they should accept the bills of Indian importers, instead of buying them, in the same way as that in which house paper of London export houses is accepted by them, so as to enable the bills to be discounted in the London market and to enable Indian importers to benefit from the cheap

1. See Central Committee Report, pp. 329-30.

2. See their Report, Central Committee Report, p. 647.

3. See the statements of the Bengal, Bombay, Karachi and Northern India Chambers of Commerce, Central Committee Evidence, Vol. II, pp. 477, 510, 548, and 577 respectively.

funds in that market, has been commended for the careful consideration of the exchange banks.[1]

(2) If Indian importers desire foreign exporters to draw on them in rupee bills, the exchange banks should help them in the matter. The Committee has expressed the hope that when the Reserve Bank is established, and when the average rate of discount in India is reduced by measures dealing with seasonal stringency in the Indian money market, this market will be able to offer as cheap facilities as foreign markets, and that Indian traders will make use of both kinds of bills, rupee bills and bills in foreign currencies, according to their convenience. The Foreign Experts have stressed the importance of developing the bill and money market in India before expecting appreciable progress in the use of rupee bills for settling foreign trade transactions, and have expressed the opinion that, in the absence of this development assuring adequate discount facilities at low rates, the drawing of rupee bills will raise the cost of imported goods and hamper trade and industry.[2]

(3) The Committee has suggested to the Exchange Banks' Association the advisability of consulting commercial bodies and other representatives of Indian as well as foreign merchants before making any alterations in its rules.

(4) The Committee and the Foreign Experts have suggested that the exchange banks in consultation with the representatives of Indian insurance companies should arrive at an understanding with the latter, similar to that arrived at by the Imperial Bank, for the acceptance by the former of the policies of the latter, subject to the supply of certain information to the former regarding the operations of the latter.[3]

(5) The Committee has suggested the appointment of a local advisory board at each branch of every exchange bank for giving advice regarding the grant of advances

1. See Foreign Experts' Report, attached to Central Committee Report, p. 616.
2. See Foreign Experts' Report attached to Central Committee Report, pp. 615 and 656.
3. See Foreign Experts' Report, Central Committee Report, p. 647.

and cash credits. Although the advice given by such boards cannot be binding on the banks, the boards will help to establish a sympathetic contact between the foreign managers of these banks and their Indian clients, and to remove the complaint that the managers favour their own nationals at the expense of their Indian customers.

(6) The Committee has recommended to the exchange banks the working out of a scheme of Indian probationary assistants similar to that of the Imperial Bank and the appointment to responsible posts of such assistants as they find well-trained and efficient.

Mr. Subhedar and Mr. Sarkar, two members of the Central Banking Committee and some Indian witnesses have objected to the principle that licenses should be given freely to all the existing branches of the exchange banks in India, and that they should be renewed as a matter of course if the banks fulfil a few simple conditions.[1] They are of opinion that the issue and renewal of the licenses must be at the absolute discretion of the licensing authority, which must be given wide but definite powers and which, under certain circumstances, may have to be guided by considerations other than those of pure finance. They have pointed out that in Germany, Italy, Japan, Canada and several other countries which have established a system of licensing foreign banks, the Minister of Finance possesses such absolute discretion. They have admitted, however, that the exercise of the powers must be just and moderate, consistent with the economic needs of the country.

Further, according to them, the terms of the licenses for the exchange banks would have to be materially different from regulations imposed upon Indian joint-stock banks, because the very object of establishing a licensing system is to protect the Indian public, banks and other institutions from the unsound working, unfair

1. See Minority Report, Chapters XIV and XV and Mr. Sarkar's Minute of Dissent, Central Committee Report, pp. 559 ff. See also the statements of the Indian Merchants' Chamber, Bombay, and the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, pp. 540 and 593.

competition and anti-national activities of the exchange banks.[1] These banks operate in conformity with the laws and public policies of their respective countries and the control of their respective boards. These laws, policies and control differ from country to country and also from those of India. The features of the licensing system differ from one country to another, and from one kind of institution to another in the same country, according to the prevalent public opinion regarding the need of safeguarding national interests.

The aim of an Indian licensing system, therefore, must be to promote national economic policy in banking, and the fundamental principle underlying its provisions must be that only Indian banks, registered in India and controlled by a majority of Indian shareholders, should be entitled to full and unrestricted banking privileges, to the deposits of the Indian public, and to the help of the Reserve Bank of India, which would be in charge of the currency and banking reserves of the country and, therefore, practically an organ of the State. The imposition of restrictions upon the exchange banks for the sake of imposing them, without endeavouring to promote a definite economic policy, would be interpreted as wanton hostility by foreign interests, without doing any good to India.

Moreover, in the opinion of Mr. Subhedar, Mr. Sarkar and some Indian witnesses,[2] there would be no reality in imposing restrictions on the exchange banks working in India on the basis of reciprocity, because there are no Indian banks working abroad, and because the time is very distant when Indian banks, after occupying the entire field in India, would spread themselves in other countries. Until then India need not be afraid of the retaliation of other countries in the banking field. As regards retaliation in other fields, India's position abroad cannot be worse than it is. Moreover, on the basis of reciprocity, India would have to pass different laws imposing different restrictions on banks belonging to different countries and working in

1. See Mr. Pochkhanawala's Statement, Central Committee Evidence, Vol. II, p. 53.
2. See Mr. Pochkhanawala's answers, Central Committee Evidence, Vol. III, p. 69.

India. But there is no country in the world which gives different treatment, either by law or by executive action, to foreign banks working within its boundaries. All the countries, which have established a licensing system, with the object of warding off dangers from foreign interests, have applied it uniformly to all foreign banks.

Further, the introduction of a licensing system on the basis of reciprocity would not promote the object of establishing it, *viz.* elimination of the domination of foreigners in the fields of banking and trade in India. England, secure in the great strength of its money market and the patriotism of its people, which have prevented foreign institutions from flourishing within its borders, has found it unnecessary to impose more than a few simple restrictions on the working of foreign banks. On the principle of reciprocity, therefore, the British banks working in India would be free from most of the restrictions that would be imposed upon the other exchange banks working in India. But among the exchange banks working in India, the British banks are the strongest, have the largest operations, and most of the up-country branches, offer the most strenuous competition to Indian banks, and help British merchants to do the same to Indian merchants, and thus inflict the largest economic loss on the country.

6. Suggested terms of license for exchange banks.

Mr. Subhedar, Mr. Sarkar and some Indian witnesses have suggested certain terms of license for the exchange banks on the basis that the drain of the profits of trade and banking from the country must be stopped, and that India must be allowed to develop her economic life and institutions to the best of her abilities. The exchange banks must be made to realise that opportunities in the field of banking in India would be no longer unrestricted for them, and that they would no longer be allowed to have their own way in all respects, to the detriment of the Indian banks. The depression of those concerned with the management of the Indian banks must be removed, hopefulness must be instilled into them, and they must be made to feel that their uphill task is being made easier.

The demoralisation of the Indian public which has learnt to despise Indian banks and to esteem foreign ones must be gradually removed. Mr. Subhedar and Mr. Sarkar have stated that many of the restrictions on the exchange banks proposed by them exist in the U. S. A., Japan, Canada, South Africa, Australia and several Continental countries, large and small, and that, as the evils of foreign banking are the greatest in India, more drastic restrictions are needed in this country.

(1) One restriction proposed as a term of the licenses to be issued to the exchange banks is as regards deposits. The suggestions that have been made in this respect are that the banks should be made to bring 50 per cent of their working capital from abroad, that they should be allowed to receive deposits from Indians only to the extent of the funds that they need for financing the foreign trade in Indian hands, that they should be made to pay a special tax of one-half per cent on all fixed deposits received in India,[1] that they should be allowed to receive Indian deposits only if they get themselves registered in India with rupee capital and Indian directorate, or that they should be prohibited from receiving deposits in India from Indian individuals, firms and companies.[2]

The exchange banks are said to attract more deposits than are needed for the finance of India's foreign trade, and the surplus deposits obtained at low rates are said to be used by them to compete unfairly with the indigenous bankers and Indian banks in the finance of internal trade. Indian deposits representing the savings of the Indian people are not fully used to enrich the money market and financial system of the country, and to promote Indian trade, industry, and institutions. The exchange banks are said to obtain these deposits not because they are safer, but because the depositors have hopes of obtaining better business facilities or better bank references for purposes of foreign trade, or fears of the withdrawal or curtailment of the existing facilities if they withdraw or reduce their

1. See Mr. Shroff's answers, Central Committee Evidence, Vol. III, pp. 177-8.

2. See the answers of the representatives of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. III, p. 746.

deposits, and also because of their force of habit and the propaganda conducted by the banks against Indian institutions. Moreover, even to the extent to which these banks are older and larger, and have bigger reserves, the advantages are not inherent in their being foreign, but depend upon transient factors.

In reality, the depositors of these banks have less safety than those of Indian banks, because they have no prior claim even on the Indian assets of the banks, and even if a law is passed giving them this lien, the protection would not be effective as the banks could quickly convert a large part of their assets into cash and remove them out of India by telegrams. It is urged, therefore, that the only effective protection would be to prohibit the banks from receiving the deposits of Indians. Even if the banks are safer, the need of safeguarding the interests of the Indian community as a whole is said to be an infinitely more important consideration than the convenience of a few depositors.

The prohibition would not subject Indian depositors to any hardships because they have ample scope for keeping their deposits with other safe institutions. The Imperial Bank and the provincial co-operative banks, with Government behind them, are quite safe. So are some of the Indian joint-stock banks. Moreover, new institutions for the finance of agriculture, industry and foreign trade, as recommended by the Banking Committee, would come into existence. The depositors can also invest their savings in Government, municipal, and Port Trust securities, and in postal cash certificates.

The prohibition would not cripple the resources of the exchange banks, because the deposits of Indians with them amount to Rs. 39 crores only, *i.e.* about $2\frac{1}{2}$ of their total deposits. The banks would be free to obtain deposits from foreign individuals, firms and companies resident or operating in India, and the loss of the deposits of Indians can be made good by bringing funds from London and other international centres. Moreover, they hold a certain amount of Indian Government securities, and they can borrow funds from the Imperial Bank or the

Reserve Bank against this security, whenever they need additional funds to give loans or advances. In spite of the restriction on the deposits, therefore, the banks would be able to carry on all their functions and activities in respect of the finance of foreign trade, to render banking services to their clients as before, and to earn substantial profits. They would especially be able to render all services to their own nationals with funds, which these nationals are supposed to deposit with them. The only change in their position would be that they would probably have to curtail to some extent their finance of internal trade and the competition that they have been offering to the indigenous bankers and the Indian banks.

A majority of the Central Banking Committee and the Foreign Experts have expressed the opinion that any restriction on the deposits of the exchange banks in India is neither necessary for the development of banking facilities in India, nor desirable in the wider interests of India.[1] They have felt fairly sure that it is not true that the exchange banks on balance take funds out of India for employment abroad, or that the deposits obtained from Indians are used for financing India's foreign trade handled by non-Indians.

Further, the Committee has found that the proportion of the deposits of the exchange banks to the total banking deposits in India has not increased since 1913, and has remained steady at about 34 per cent, the remaining deposits being available to the Imperial Bank and the Indian banks. If the proportion available to the Indian banks, *viz.* slightly less than one-third, has not increased, this is due to their lack of experience and reserves, which take time to secure, and the pace regarding which cannot easily or safely be forced. When the Indian banks acquire them, the public can be persuaded to deposit an increasing proportion of their savings with them. Until then, any attempt to strengthen the Indian banks by diverting the deposits to them would mean putting the cart before the horse, and it is very doubtful, whether any artificial blocking of those channels of deposits, which the public

1. Central Committee Report, pp. 337 and 647

prefers, would succeed in forcing the deposits into the desired channel. Moreover, the realisation of the aim of Indians, that a considerable portion of the work of financing India's foreign trade should be handled by Indian banks, which for this purpose would have to open a number of branches at different financial centres of the world, would be hampered by the imposition of restrictions on the exchange banks regarding deposits and other matters, because the restrictions would provoke retaliation from the countries to which the exchange banks belong.[1]

Further, in the opinion of Mr. MacDonald, the Managing Governor of the Imperial Bank, endorsed by the Committee, the restrictions would compel the exchange banks to bring to India funds borrowed in other countries, and to borrow funds from the Imperial Bank for their exchange business. Exchange operations, therefore, would be hampered, the higher cost of the funds may necessitate larger exchange margins, and the interest on the foreign funds would leave India. Indian depositors would be unwilling to keep their savings with Indian banks in which they have less confidence, except at higher rates and to a limited extent. The bulk of the deposits would be diverted to the Imperial Bank, which would get a semi-monopoly of this business. The shroffs, merchants, etc., who are financed by the exchange banks at low rates, would have to go elsewhere for a large portion of their finance, and as they would have to pay higher rates for it, trade would suffer. The exchange banks would even have to obtain possession of the deposits at a higher cost by borrowing them from the Indian banks and the Imperial Bank, for use in their foreign exchange transactions, and the higher cost would be transferred to the Indian merchants and finally to the Indian producers. The exchange banks would also be compelled to realise their investments in Indian Government securities for repaying their deposits belonging to Indians, and this would depress the prices of the securities, thereby harming the credit of Government

1. Without agreeing to the above arguments of the Committee, Mr. Sarkar is prepared to allow the exchange banks to continue to receive deposits in India, as he hopes that conditions necessitating the drastic step of prohibiting them will not arise. See Central Committee Report, pp. 564-5.

and the Indian banks which have large holdings in these securities.[1]

Mr. MacDonald is opposed even to any interference with the freedom of the exchange banks to use abroad deposits obtained in India on the grounds that trade and industry in India are not starved financially, and that interference with the free play of economic forces would react in ways which would defeat the object of the interference and injure third parties. Interference may compel the banks to reduce the rate of interest that they give to their depositors owing to the insufficiency of suitable investments in India, and this reduction by lowering the spending power of the depositors, would harm trade and industry, which depend on this power. This interference may also lead to retaliation, and so check the flow of capital to India, which has benefited more than most other countries from foreign capital. Finally, it has been urged by Sir Osborne Smith, another Governor of the Imperial Bank, that the depositors have every right to invest their money as they desire, and that the larger the number of banks that compete for their money, the greater would be the facilities that they would get.

A section of Indian opinion, however, has been little impressed by these arguments. It has been pointed out that even if the proportion of the deposits of the exchange banks to the total banking deposits in India has not increased during the last 20 years, it is a large proportion; that only about one-sixth of the deposits are used by the banks in the finance of foreign trade, a substantial part of the rest being used by them to compete with the Indian banks in the finance of internal trade; that the Indian banks have not secured larger deposits, because they have come late in the field; that the benefit of the low rates, at which the exchange banks obtain their deposits, is not transferred to the merchants, the producers, and the public, but is retained by them, the substantial difference between their borrowing and lending rates making up a large part of their profits; and that if, owing to the imposition of restrictions

1. See Mr. MacDonald's answers, Central Committee Evidence, Vol. III, pp. 891-2.

on the receipt of deposits by the exchange banks, more deposits become available to the Indian banks, the latter would be able to reduce their deposit rates, and would either use the reduction to strengthen themselves by keeping the lending rates the same as before or, by competition among themselves, transfer the benefit to the borrowing merchants and the public, by lowering their lending rates.

Moreover, it has been stated that there is really no danger of the Imperial Bank establishing a semi-monopoly of the deposit business, because it would get at the most Rs. 20 or 25 crores of additional deposits; that trade and industry are being handicapped by a shortage of funds, as shown by the fact that high rates rule in the Indian money market; that while other countries conserve their national resources and allow the export of their surplus funds only, the exchange banks enjoy full freedom to export from India her funds which she badly needs at home; that there is little danger of retaliation by other countries; that the support given to Government credit by the holdings of the exchange banks in Government securities is not substantial, as the proportion of the value of these holdings to the total value of the outstanding securities is inconsiderable; that even if the support is substantial, it must not be allowed to stand in the way of an urgent and important measure of economic reform; and that the loss of support from the exchange banks would be made good, at least in part, by the increased holdings of the Indian banks in these securities.

Further, it has been pointed out that the right of an individual to do what he likes with his savings is relative and not absolute; that every well-organised nation is alert to ensure that individual and separatist action does not harm common interests; that the private rights of owners of property are subordinated in all countries to the larger needs of national life, and subjected to laws which the State makes and alters to promote the interests of the community; that these rights are valid against other individuals in the nation but not against the nation itself; that in many advanced countries, in matters of trade,

shipping, insurance, and banking, owners of property have been prevented by the State from doing certain things, or have been compelled to do certain other things, against their individual interests, but for the good of the nation ; that the national economic policies carried on by Germany and Japan and more recently by Italy and Turkey have demonstrated that the pursuit of the enlightened self-interest of the nation promotes the well-being of all far more effectively than the pursuit of individual gain ; and that Indian trade and industry have the first claim on the country's savings, which provide the means for developing the economic resources and well-being of the country.[1]

(2) Another restriction proposed as a term of the license to be issued to the exchange banks is that they should be prohibited from having any branches in the country except in port towns. This proposal has been made for the purpose of protecting Indians engaged in internal trade, from which they are being driven away by foreign merchants who obtain special facilities from the exchange banks, and of protecting the Indian banks which are suffering from the competition of the exchange banks in the interior. The penetration of foreigners in the interior and their direct contact with the Indian producers and consumers are regarded as dangerous, because they mean a transfer of the control of India's economic life into foreign hands. The control should, therefore, be limited, at any rate at first, to the ports.

Out of 88 branches of these banks in India, only 19 are located in the interior at 11 places, out of which four are hill stations and not commercial centres. At the other seven centres, the Imperial Bank has branches, and at most of them the Indian banks also have branches. The 19 branches belong to only 4 of the exchange banks, and it has been proposed that these banks should be given 5 years during which to close the branches, but *pro rata* during each of the 5 years. The banks can employ either the Imperial Bank or one of the Indian banks for their work

1. *Cf.* Central Committee Minority Report, pp. 245-6.

in the interior, so that the proposed restriction would not impose any hardship on traders.

The majority of the Banking Committee, however, is opposed to this restriction on the ground that it may harm those engaged in handling the foreign trade of India.[1] In its opinion, the facility of direct connection with foreign exporters and importers is beneficial to Indian merchants, and it has no right to dictate to Indian exporters and importers the ways in which they should do business, especially as the ways may prove more costly to them. If the Indian public objects to these branches of the exchange banks, it can bring about their closure by transferring its custom to the branches of Indian banks located at the same centres. The Committee's recommendation, however, that, to secure an orderly development of banking in India, every bank should be made to obtain the sanction of the Reserve Bank for the opening of a new branch, applies automatically to the exchange banks, and the Committee has no objection to the curtailment, to this extent, of the freedom of these banks to establish new branches.

A group of this majority of the Committee, consisting of six members, in a minute of dissent, has expressed the opinion that the unjustified encroachments of the exchange banks on the field of the finance of internal trade have assumed such proportions that no non-Indian bank should be allowed to have any branch up-country, *i.e.* at any place other than the main ports of India, *viz.* Bombay, Calcutta, Madras, Karachi and Rangoon.[2]

(3) It is proposed that no exchange bank should be permitted to obtain a controlling interest, directly or indirectly, in any Indian bank. To secure this, Indian banks must be made to keep separate registers of their Indian and non-Indian shareholders, and while their directors can freely allow transfers from the non-Indian register to the Indian one, they must carefully scrutinize every transfer *vice versa*, and must periodically issue a statement to the relevant authority under the proposed Bank Act that not

1. Central Committee Report, p. 340.
2. See Central Committee Report, p. 591.

more than 40 per cent of the shares are held by foreigners. Moreover, a declaration must be obtained from the Indian shareholders as to whether they are holding the shares for themselves or in trust, and in the latter case whether they are trustees for Indians or foreigners, and whether they have mortgaged their shares, or passed out their voting power or proxy to foreigners. Exchange banks found guilty of assisting in the evasion of this restriction should have their licenses cancelled.[1]

This restriction is said to be necessary to prevent the exchange banks from evading the previous restriction regarding branches by transferring them to new or existing banks registered in India, but owned entirely, or to the extent of the controlling interest, by the exchange banks. It is also said to be necessary in order to prevent the exchange banks from vicariously securing the benefit of privileges and preferences given by the State to Indian banks, by registering and owning new banks in India, or by obtaining control over some of the existing Indian banks. The restriction has become inevitable after the acquisition of the Allahabad Bank by the Chartered Bank which, by this means, has penetrated into a new field and obtained great power in a large territory. 94 per cent of the capital of the Allahabad Bank, nominally an Indian bank, is owned by foreigners, and there is only one Indian on its board of directors. The Bank, therefore, possessing 46 branches and sub-branches and rendering important banking service in a large territory has in reality become a handmaid of the Chartered Bank. It is said that unless this avenue of foreign penetration is blocked up, there is every likelihood that it would be used by the exchange banks to increase their domination in India.

This danger to the progress of Indian banking is said to be great, because it means that Indian banks act as pioneers, open up new territory by fostering the banking habit among its people, and build up a clientele, and then a powerful foreign bank would appear, snatch the machinery so laboriously built up, and use it for its own purposes. Indian shareholders and depositors and the Indian public

1. See Central Committee Minority Report, p. 371.

would not have the means of knowing that foreign banks have set about obtaining control of particular Indian banks, and even if they know it, they would not be able to ward off this danger, unless the law comes to their help. It is, therefore, proposed that the Chartered Bank should be made to work out a scheme by which, at a minimum loss to itself, its controlling interest in the Allahabad Bank would be retransferred to Indians.

(4) It is proposed that the exchange banks should be prohibited from engaging in trustee business in India, as it would place Indian money in their hands.

(5) It is suggested that the license should lay down that the whole staff, excepting the manager and one more official in each branch of an exchange bank, must be Indian, but that to prevent hardship, the licensing authority may temporarily relax this term in exceptional cases.[1]

(6) The licensed banks should pay full income-tax on their profits earned in India, and reveal all accounts to the tax authorities to enable them to assess the tax satisfactorily.

(7) For the protection of Indian creditors, possession of the assets of the licensed banks in India should be taken by the Official Receivers of the Indian High Courts, if they happen to go into liquidation, and they should be made to include in their articles of association a provision giving their Indian creditors a complete prior lien on all their assets in India, and to obtain from the High Courts of their own countries certified orders to this effect within one year.

(8) Copies of all returns, reports, balance-sheets and papers regarding their business in India sent by the licensed banks to their head offices abroad must be sent to the licensing authority, and all information regarding their Indian business must be supplied by them to the licensing authority in the form desired by it, the licensing authority having full discretion regarding the publication of this information.

(9) The admission of the branches of the licensed banks to clearing houses and their eligibility for rediscount

1. *Cf.* Mr. Ramachandra Rau's statement, Central Committee Evidence, Vol. I', p. 361.

and other facilities from the Reserve Bank should depend upon the discretion of the licensing authority. A clearing house is a public convenience which should be controlled by the Central Bank of a country in ways most beneficial to the country, and admission to a clearing house cannot be claimed by any bank as a matter of right. Indian banks should also be given a prior and paramount claim to rediscount facilities from the Reserve Bank, as the facilities constitute a direct encouragement, as the Reserve Bank would be set up with State balances and reserves, and as the experience of other countries is that, in its work of regulating the expansion and contraction of credit, foreign banks do not give the same co-operation to the Central Bank that the local banks do. The exchange banks, however, can circumvent the precautionary measures of the Reserve Bank of India by borrowing additional funds from London and other financial centres, to which they owe their allegiance, and on which they depend for financial support and direction, and unless there is a close co-operation between the Bank of England and the Reserve Bank of India, the exchange banks can make it impossible for the latter to obtain a complete control of the money market in India.[1] In spite of the fact that the local banking systems are strong in centres like London and Amsterdam, foreign banks have caused difficulties in these centres and compelled their Central Banks to take strong action.

(10) It is proposed that the licensed banks should be prohibited from forming a ring, pool or combination, or making a working arrangement with any other bank or person, for the purpose of framing business rules, or imposing charges on their Indian customers, or any other object affecting these customers, without the express sanction of the licensing authority.

(11) The licensed banks and their officials should undertake to abide by all the laws of India, in the settlement of disputes between them and Indian individuals, firms and companies, and not to claim any special protection against these laws.

1. *Cf.* Baster, *Imperial Banks*, p. 217 and Central Committee Minority Report, p. 252.

(12) The licensed banks and their officials should undertake to refrain from assisting in any manner any anti-national movement in India.

Mr. Sarkar has suggested that if Government can establish a convention with the exchange banks for carrying out some of the above restrictions, they need not be included specifically in the license to that extent.[1]

Some witnesses have suggested to the Central Banking Committee that, if it is found impracticable to protect Indian depositors and Indian interests in the ways mentioned above, the exchange banks should be prohibited from operating in India unless they register themselves under the Indian Companies Act with rupee capital and have Indian directors.[2] The Committee, however, has not favoured the suggestion for the following reasons :—

(1) It is unnecessary because, for all practical purposes, Indian branches of the exchange banks already work on a rupee basis.

(2) It would destroy their intimate connection with the London money market, their ability to borrow funds from it at low rates and, therefore, their ability to give cheap facilities for the finance of India's foreign trade.

(3) The rupee companies taking over the assets and liabilities of the exchange banks would have to pay for the good-will of the latter, and to cover this cost would have to make higher charges to their customers.

(4) The suggestion is likely to lead to the splitting up of the large exchange banks into smaller rupee banks, with less security to the depositors.

(5) The exchange banks would be compelled to keep balances with the Reserve Bank bearing a certain proportion to their Indian liabilities, and would ultimately find help from the Reserve Bank more useful for a part of their Indian business than help from the London money market.

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1. See his Minute of Dissent, Central Committee Report, p. 560.

2 See the statements of the Indian Chamber of Commerce, Calcutta, and the Indian Merchants' Chamber, Bombay, Central Committee Evidence, Vol. II, pp. 525 and 539.

7. Suggestions for increasing the participation of Indians in the handling and finance of foreign trade.

We may turn now to measures for increasing the participation of Indians in the handling and the finance of India's foreign trade. Even the majority of the Central Banking Committee has admitted that India should not continue to depend on the facilities provided by the exchange banks for the financing of her foreign trade. The extent of a nation's participation in its foreign trade depends vitally upon the banking facilities obtained by its traders. It is but natural that the exchange banks should give better facilities to their own nationals than to Indians. It has been mainly with this object that American, French, Japanese and Dutch banks have been established in India, even after a number of British banks had firmly established themselves in India.

Moreover, British banks all over the world have been very conservative in granting credit accommodation to all non-British customers. They have unduly kept down the period of the grant of credit, and have been unduly strict in the selection of merchants to whom they are prepared to grant credit. Germany and Japan, therefore, established their own banks for the grant of more liberal credit to their own merchants, and the wonderful growth of the foreign trade of both these countries brought about by their own merchants during the last half a century or so has been attributed to the liberal credit facilities provided by their own banks.[1] The Central Banking Committee and the Foreign Experts, therefore, have suggested that well-established Indian joint-stock banks should open foreign connections for the benefit of their customers, as the German banks have done, so as to avoid the heavy cost of establishing branches at foreign centres.[2]

Secondly, the Committee and the Foreign Experts have suggested that when the Reserve Bank is brought into existence, the restrictions that have been imposed

1. *Cf.* Barrett-Whale, *Joint-Stock Banking in Germany*, p. 57, and Parker Willis and Beckhart, *Foreign Banking Systems*, p. 822.

2. See Central Committee Report, p. 645.

upon the foreign exchange business of the Imperial Bank should be withdrawn, and that the Bank should be persuaded to play an important part in financing India's foreign trade.[1] The restrictions have caused much annoyance to a large section of Indians, some of whom have asserted before the Committee that the reason given for imposing them, namely that foreign exchange business is risky and, therefore, unsuitable for the Bank so long as Government keeps its balances with it, is not satisfactory, because the business is not attended with undue risk, and that the real reason for imposing them has been a surrender to the unfair demand of the exchange banks that their monopoly of this business should not be disturbed.

The Managing Governor of the Imperial Bank has expressed the opinion that, although the exchange business is technical, the staff of the Bank can be trained for it in a short time, and that the Bank would have no difficulty in establishing a close connection with the London money market, necessary for transacting this business successfully.[2] The agency business that it does for some of the exchange banks, the large amount of its inland trade finance connected with foreign trade, and the extensive area of its working would also help the Bank to make a success of foreign exchange business.

The Committee has recommended that as an inducement to the Bank to take up this business actively, the Reserve Bank of India should appoint the Bank as its agent for 5 years or such other period as it may consider desirable, in all those places where it has no branches, but the Imperial Bank has. The Committee, however, is of opinion that in the interests of the Indian joint-stock banks, the Imperial Bank should not have a permanent monopoly of this agency business, and that after a certain period the Reserve Bank should be free to appoint any of the Indian banks as its agents and thus to give them status, the confidence of the public, and large

1. Central Committee Report p. 346. *Cf.* also the statements of Mr. Pochkhanawala and the Indian Merchants' Chamber, Bombay, Central Committee Evidence, Vol. II pp. 55 and 542.

2. See Mr. MacDonanld's answers, Central Committee Evidence, Vol. III, p. 878.

amounts of cheap deposits. To remove complaints of the unsympathetic attitude of non-Indian directors and officials of the Imperial Bank towards its Indian clients, the Committee has proposed that the enjoyment by it of the privilege of the sole agency of the Reserve Bank should be made dependent upon its giving Indians a majority on its Central Board, and ¾ of the seats of its Local Boards, of Directors, and its stoppage of all further appointment of non-Indians on its staff, except in special cases and with the approval of the Finance Minister of the Government of India.[1] We shall see in chapter X how far these recommendations have been carried out.

8. Proposal for an Indian Exchange Bank, State or joint-stock.

Further, the Committee has recommended that, if the Reserve Bank is unable to make any satisfactory arrangement with the Imperial Bank, or finds that the latter is unable to take up substantial foreign exchange business within the agreed period, Government should establish an Indian Exchange Bank. The Committee is not in favour of establishing a new bank with Government assistance unless an endeavour is made to achieve the same aim through the existing Imperial Bank, the development of which has cost India much. The Committee is also opposed to the establishment of the new bank until the Reserve Bank comes into existence, because its working would depend vitally upon the advice and assistance of the latter.

The new bank should have a capital of Rs. 3 crores, which should be acquired in the course of 3 years, as far as possible in the form of subscriptions from Indian joint-stock banks; the balance should be supplied by Government, which should gradually sell off its holding to the public. As long as Government owns more than one-half of the capital of the bank, it should be given the right to appoint a majority of the directors of the bank. The capital of Rs. 3 crores would not enable the bank to secure a material share of the foreign exchange business of India,

1. Central Committee Report, p. 347.

and it would not be able to obtain large deposits from the public, until it secures its confidence by means of careful management. For the first few years, therefore, it would have to depend much upon financial assistance obtained from the Reserve Bank by means of the rediscounting of its foreign bills.

The bank should be given a privileged position by its appointment as an agent of the Reserve Bank for Government remittance operations subject to the control of the Reserve Bank, and the condition that the bank does not secure any profit from such operations. The Central Banking Committee is not in favour of the proposal that the bank should be given the sole monopoly of Government remittances to enable it to compete successfully with the powerful exchange banks, because the Reserve Bank would have to buy sterling in the market in order to maintain the stability of the international value of the rupee, and because the Indian Exchange Bank would not be able to secure the full amount of Government remittances as cheaply as the Reserve Bank, owing to the opposition of its competitors, the exchange banks.

Six members of the Committee, consisting of the Vice-Chairman, one representative each of the co-operative movement and the Federation of Indian Chambers of Commerce and Industry, and three representatives of the general public requiring credit facilities, in a minute of dissent, have recommended that Government should establish at once an exchange bank with a capital of Rs. 3 crores, subscribed by itself.[1] They are opposed to the holding up of this scheme till the establishment of the Reserve Bank, because the situation created by the predominance of the exchange banks is so grave and critical that it is necessary to deal with it at once. They are also opposed to the proposal that the Imperial Bank should be induced to develop foreign exchange business on the grounds that so long as more than one-half of its shares continue to be owned by non-Indians, it cannot be regarded as a predominantly Indian institution, and that the preponderance of non-Indians on

1. See Central Committee Report, pp. 590 *et. seq.*

its staff would continue for several years even if further recruitment of non-Indians to the staff is stopped except in special cases, so that Indian merchants cannot obtain from the Bank that attitude of sympathy, help and guidance, which is essential to enable them to secure an increasing share in the handling of the foreign trade of the country.

They have recommended a full-fledged State Exchange Bank, because the situation created by the monopoly of the exchange banks is so difficult that it is essential to bring the full resources and prestige of the State to bear upon it, not only at the beginning, but also for such time as may be found necessary to make the exchange banks appreciate their proper and legitimate place in the country. The bank should function like any other exchange bank, but it should be scrupulously prevented by Government from encroaching upon the sphere of the Indian joint-stock banks concerning the finance of internal trade. It should be directed by a Central Board of 7 directors, and Local Boards of 5 directors at important centres, where it should have branches, and all of them should be nominated by Government. Its staff should be entirely Indian, except when the Finance Minister of the Government of India is of opinion that it is necessary to engage temporarily the services of non-Indian experts.

All Government remittance business should be done through it under the control of the Reserve Bank. The remittances which Government has annually to make abroad to meet its foreign liabilities are large, amounting approximately to Rs. 40 crores. A similar amount has to be remitted, in addition, on private account. It is essential that these enormous remittances should be carried out as cheaply and efficiently as possible, so as to maintain India's credit abroad at a high level. The State Exchange Bank would be the most suitable institution to do this work. The objection of the majority of the Committee that the Reserve Bank would have to operate in the open market to maintain the value of Indian currency is regarded by the dissenting members of the Committee as more technical than real, because the power of the

Reserve Bank to operate in this way would be more of the nature of a safeguard in reserve than one for normal use, and would be used infrequently. The drawback mentioned by the majority of the Committee and Mr. Subhedar that the exchange banks would offer a strenuous fight to the State Exchange Bank would operate with greater force against the successful handling of exchange business by the Imperial Bank or by the Shareholders' Exchange Bank recommended by the majority of the Committee.—

These arguments and proposals of the six members of the Committee have been dealt with by the majority as follows:—

(1) Its recommendations regarding the Indianisation of the directorate and staff of the Imperial Bank are bound to provide greater facilities to Indians engaged in foreign trade, and the grant to India of self-government would compel not only the Imperial Bank, but also the exchange banks, to provide larger facilities to Indians.

(2) It is desirable that Indian joint-stock banks should take part in financing India's foreign trade, but the State Exchange Bank would make it difficult for them to do so.

(3) If the capital of the Exchange Bank is subscribed by the Indian banks, the former would be able to use the latter for financing that portion of the foreign trade, which consists of the movement of goods and produce between the ports and the interior, so as to avoid competition with the latter, and even if the Exchange Bank finds it necessary to finance this portion of the trade itself, the profit from it would go to the member banks which, therefore, would not regard the competition as unfair.

(4) The State Exchange Bank would not be able to supply Government with the amount of remittances required by it for meeting its foreign obligations without approaching the exchange banks for a large portion of their sterling resources abroad.

Mr. Sarkar also has opposed the proposal that the Imperial Bank should be induced to develop foreign exchange business on the same grounds as those urged by

the six members of the Central Committee mentioned above, and on the additional grounds that its experience and resources should be utilised entirely for the expansion of banking facilities in the country, without any diversion towards the business of financing foreign trade, and that, if it is given the status and facilities of the Indian Exchange Bank, it would become impossible for any Indian bank to compete with it to any extent, and banking business in India may even become its monopoly.[1] He has, therefore, recommended that a separate Indian Exchange Bank should be started immediately after the establishment of the Reserve Bank; that its share capital should be Rs. 3 crores; that subscriptions to it should be thrown open not only to the joint-stock banks, but also to the general public, so as to secure the active co-operation of the Indian mercantile community in the working of the scheme; that any portion of the capital not so subscribed within a prescribed period should be taken up by Government which may dispose of it later to the public; that Government should guarantee 5 per cent dividend on the bank's shares for the first ten years; that if the guarantee becomes operative, Government should recoup itself by appropriating later profits of the bank above the guaranteed rate; and that if the profits exceed the guaranteed rate during the period of the guarantee or other Government financial assistance, Government should share in the extra profits.[2]

To safeguard the position of the Indian joint-stock banks he has suggested that the Indian Exchange Bank should not be allowed to engage in inland business, to accept deposits except from its own clients engaged in foreign trade, and to have branches anywhere except in port towns, and that, if it needs representation in the interior, it should use the services of local banks. In his opinion, the bank will require total resources of about Rs. 15 crores, out of which Rs. 3 and 2 crores will be its share capital and deposits respectively, and the remainder

1. See his Minute of Dissent, Central Committee Report, pp. 566-7.

2. See also Mr. Ramachandra Rau's scheme of an Indian Overseas Bank, Central Committee Evidence, Vol. II, pp. 355-6.

should be made available to it by the Reserve Bank at concessional rates, until its own resources grow gradually. He has further suggested that the Reserve Bank, instead of opening its own London branch for the service of the Public Debt and for payments on account of the Secretary of State, should help the Indian Exchange Bank to maintain a London branch without loss by making it its agent and paying it a service charge, and that the Reserve Bank in managing Government remittance business should give preference to the Indian Exchange Bank over the other exchange banks, so far as possible, without loss to the tax-payers. Finally, he has suggested that so long as Government remains financially interested in the bank, it should have the right to nominate at least two of the bank's directors, the rest of whom would be elected in the ordinary way by the shareholders, and that the appointment of the chief executive officer of the bank and his deputy should be subject to the confirmation of Government.[1]

Mr. Subhedar has expressed the opinion that although the Imperial Bank can take up foreign exchange business when it ceases to be the fiscal agent of Government after the establishment of the Reserve Bank, no concrete proposal to achieve this object has been brought up before the Banking Committee, and that there is great uncertainty regarding the attitude that the shareholders and directors of the Imperial Bank would adopt concerning this change. No new Indian bank can come into existence by private enterprise to take up this business owing to the certainty of the strongest opposition of the exchange banks. Even a State Exchange Bank would have to meet with tremendous opposition from the exchange banks, especially the British banks, with their enormous reserves and the support of the London money market, and the British merchants who handle the bulk of the foreign trade would assist them in the struggle against any Indian bank. The struggle is likely to produce a heavy loss on both the sides, and it is doubtful whether the tax-payers would be able to bear the loss

1. For further details, see his scheme of an Indian Exchange Bank, Central Committee Report, pp. 571-3.

on the Indian side. If the State Exchange Bank fails in the struggle and is taken into liquidation, not only would the Indian nation feel very much humiliated, but there would be racial bitterness also. The bank would also find itself in difficulties, if the Reserve Bank Board is unfavourable to it. Further, the scheme of such a bank would probably be either vetoed by the Secretary of State, or shelved by him on the ground that Government cannot find the funds needed for it. Even if it is successful, it would only mean the addition of a nineteenth bank to the 18 already engaged in foreign exchange business, so that it can secure only a fraction of the total business without seriously affecting the domination of the exchange banks, and may even create a greater disharmony than before.

Mr. Subhedar has, therefore, recommended that the foreign exchange business should be taken up by a department of the Reserve Bank, whose accounts of the business should be separate, and whose reserves should be built up separately to meet any losses that may arise from it. In his opinion, the transfer of the business from State to private hands, eminently desirable as soon as possible, would be difficult if a State Exchange Bank rather than a department of the Reserve Bank is entrusted with it. A provision enabling the Reserve Bank to act as the agent of the Indian banks in foreign centres, and a general improvement in the position and outlook of the Indian banks in internal banking, resulting from the adoption of the measures recommended in the previous chapter, would gradually induce them to take up and develop foreign exchange business, and when a sufficient number of them do so, the special department of the Reserve Bank entrusted with this business should be closed, and the Reserve Bank then would approximate to the model in other countries by concentrating entirely on its own proper functions.

The Foreign Experts associated with the Central Banking Committee are opposed to the establishment of a State Exchange Bank, or even to Government financial assistance to an Indian Exchange Bank started under private enterprise, on the grounds that such a proposal is based not on sound banking principles, but on ambitions,

or desires of a political or nationalistic character; that it would be as much unjust to use Government funds in competition with private enterprise in banking as in industry; that such a bank would harm Indian joint-stock banks by attracting a large portion of their deposits and encroaching upon their activities; and that the financing of India's foreign trade by the existing exchange banks meets all requirements.[1]

9. Proposal for 'joint' banks.

It has been suggested to the Central Banking Committee that the real and lasting solution of the problem of Indian foreign trade finance is the establishment of joint banks controlled by Indians and non-Indians belonging to the countries with which India trades, as equal partners. Foreign trade is between two parties, and it is opposed to the interests of both that one of them, either Indian or foreign, should dominate the finance of the trade. The trade as well as its finance need the co-operation of both the parties. The rupee capital of the joint banks would be supplied by Indians, their foreign capital by foreigners overseas, they would be under joint supervision, and their profits would be divided among the partners.

Moreover, owing to the severe competition in internal and foreign trade created by post-War conditions, the Indian joint-stock banks and the exchange banks have been compelled to encroach on each other's preserves in the struggle for profit. To prevent this, it has been suggested that the Indian and exchange banks should evolve schemes of amalgamation, which would replace competition with co-operation, and which would remove all suspicion of confiscation, domination, or absorption. Each bank should be given an equal interest in the other, and the two should work together, not as agents or formal shareholders, but as one establishment managed for the benefit of both. Their expert staffs should be freely interchanged, their policy should be determined by full and frank consultations, and they should accept full responsibility for their mutual welfare.

The Central Banking Committee has approved of this

1. See their Report attached to the Central Committee Report, pp. 612-3.

idea of "joint" banks, as promoting co-operation and goodwill among nations trading with one another, and has expressed the hope that, with the lifting up of the world economic depression and the return to prosperity, the idea would materialise; but it has expressed the opinion that the idea cannot be enforced by means of legislation and is one primarily for the shareholders and directors of the banks to carry out.[1] Mr. Sarkar, however, considers the suggestion to be impracticable on the grounds that the exchange banks would not accept it except under compulsion, and that Indians cannot provide the large amount of capital that would be needed.[2]

In Mr. Subhedar's opinion the best course for those British banks, which do the major portion of their total business in India, would be to get themselves registered in India, to convert their sterling capital into rupee capital, and to transfer their head offices from London to India. This would mean that, according to the restrictions proposed by him, the ownership of more than one-half of their capital would have to be transferred to Indians. This transformation would be in the interest of the British shareholders themselves, because the banks would be able not only to keep all their business and connections, but also to add to them by taking over the Indian deposits and a large part of the Indian business of those exchange banks which cannot get themselves registered in India, and by getting the benefit of the concessions that would be given to the Indian joint-stock banks. But, if they persist in retaining their British registration, they would sooner or later be subjected to drastic restrictions in India, which would cripple their working in India. Mr. Subhedar is of opinion that the British banks, believing that the *status quo* would be maintained, do not appreciate the importance of such honourable as well as profitable partnership, but he feels sure that under the rapidly changing circumstances in India, this appreciation would not be long in coming.[3]

1. Central Committee Report, p 353.
2. See his Minute of Dissent, Central Committee Report, pp. 569-70.
3. Central Committee Minority Report, p. 257.

CHAPTER IX

Financing of Industries

1. Financial difficulties of major industries.

Industries need block capital to finance fixed assets, such as land, buildings, machinery and other durable and permanent apparatus, and working capital to finance floating assets, *i.e.* for the purchase of raw materials, their conversion into finished goods, the purchase of stores, expenses connected with the marketing of goods, financing outstandings concerning goods supplied, and the provision of funds for daily needs. Block capital is needed by new industries to make a start, and by old industries for expansion and replacement, and is more or less permanent. The working capital is partly long-term and partly short-term. The proportion between block and working capital in every industry depends upon its nature; the more roundabout the processes of production in an industry, the greater is the proportion of fixed to circulating capital in it.

The representatives of European Chambers of Commerce, the Exchange Banks' Association and the Imperial Bank of India, in their evidence before the Central Banking Committees, have expressed the opinion that major industries, established on sound lines and giving a fair promise of success, have no difficulty in obtaining the necessary finance for block or working capital from the existing sources of supply; that every industrial concern should obtain its block capital by means of public or private subscriptions to its shares or debentures; that when it can supply a balance-sheet proving its soundness, the commercial banks should supply it with working capital on the security of its stock and other liquid assets; and that it should not, and need not, look to Government patronage or financial assistance.[1]

1. See the statements of the Bengal, Karachi, Madras and Northern India Chambers of Commerce, Central Committee Evidence, Vol. II, pp. 472, 546, 551 and 576, and Vol. III, p. 332.

They have, however, admitted that their experience is confined mostly to the Presidency towns. If European industries in India have no difficulty in obtaining all the finance that they need, this must be due to the close touch that they have maintained with the foreign banks in India. Indian witnesses before the Committee have expressed the opinion that even the major Indian industries have to undergo great difficulties in obtaining finance, and that the general position in this respect is very unsatisfactory, and this is the general opinion in the country also.[1]

Even as regards initial capital for promoting industries the existing financial facilities are very inadequate. The following figures of the net capital invested annually in joint-stock companies show that, except from 1919-20 to 1922-3 which were years of inflated currency and abnormal activity, the funds available for promoting industrial companies, in the shape of private subscriptions to their share capital, have always been small.

	Rs. Crores.		Rs. Crores.
1910-11 ...	2·6	1920-21 ...	41·2
1911-12 ...	5·3	1921-22 ...	66·1
1912-13 ...	2·7	1922-23 ...	29·2
1913-14 ...	4·5	1923-24 ...	5·5
1914-15 ...	4·2	1924-25 ...	10·2
1915-16 ...	4·3	1925-26 ...	1·4
1916-17 ...	5·9	1926-27 ...	—·05
1917-18 ...	8·2	1927-28 ...	—·5
1918-19 ...	7·5	1928-29 ...	2·9
1919-20 ...	16·6	1929-30 ...	7·3[2]

The agricultural classes prefer to use their savings to obtain ornaments, purchase land, extend or improve agriculture, or give loans to neighbours. Even the middle classes who live in the smaller towns, including merchants and professional classes, prefer to invest their savings in loans to neighbours, landed property, or Government, municipal or Port Trust securities, which assure them a safe income free from the vicissitudes of industrial and commercial ventures. The reluctance of

1. See the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 484 and the Minority Report, pp. 325 ff.

2. Statistics of Joint-Stock Companies in India for 1929-30 published by the Director-General of Commercial Intelligence, Calcutta, p. 47.

these classes to invest their savings in industrial securities is partly due to the fact that there are no banks or other financial agencies in the rural areas and the smaller towns to bring them into touch with such securities.

A large proportion of the people of the larger towns even prefer to invest their savings in Government, municipal, or Port Trust securities, partly on the principle of safety first, and partly because there are no organisations to facilitate the purchase and sale of industrial securities with the exception of a stock exchange in Bombay and Calcutta, and no institutions ready to lend freely on the security of industrial shares, so that the shares often become as difficult to sell as immovable property, and investment in them becomes equivalent to a locking-up of savings. Some witnesses before the Central Banking Committee have mentioned that this reluctance to invest savings in industrial shares is also due to the public belief that the industrial and fiscal policy in India is not determined by a Government responsible to the Indian legislature.

2. Inadequate part of commercial banks in financing major industries.

Further, the following information shows that the part played by the existing commercial banks in the finance of Indian industries is very inadequate :—

(1) Although they can give valuable assistance to new concerns by using their own paid-up capital and reserve to purchase the debentures of the latter, so as to transfer them later to the investing public, they do not do so owing to a policy of conservatism. They do not even underwrite industrial shares or debentures, or lend money to a substantial extent against these securities. The Imperial Bank, the largest commercial bank in the country, cannot give loans to concerns for the purpose of block capital, because it is prevented by law from lending funds for more than six months, or on the security of industrial shares or immovable property. The other banks have followed the example of the Imperial Bank in this respect.[1]

1. *Cf.* Bengal Committee Report, pp. 121-2.

(2) In giving loans for the purpose of working capital against the security of liquid assets, such as stocks, the Imperial Bank keeps a margin of 30 per cent or more, so that industrial concerns have to provide themselves with not only the entire fixed capital, but also a large proportion of the working capital, or to borrow it from indigenous bankers at high rates of interest.[1] The other banks have followed the lead of the Imperial Bank in this respect also, and this attitude imposes a great hardship upon industries, especially when prices are low. The hardship is increased by the fact that the banks do not take into consideration the valuable fixed capital of industries, as general security for their loans.

(3) Contrary to the practice of many banks in Western countries,[2] banks in India do not take into consideration the personal credit and honesty of the borrowers at the time of granting loans, and demand the full security of tangible and liquid assets.

(4) As trade and industry in India have to look to the same banks for finance, there is keen competition among them, and in this competition industry has been faring worse.

(5) Banks in India do not get the help of technical experts to value the assets of concerns which apply for loans and to determine whether they are sound.[3] Two witnesses, however, have expressed the opinion before the Central Committee that this does not prevent the banks from giving financial assistance to large concerns, as the banks can judge their financial position from their balance-sheets and reports, and that the difficulty is real only in the cases of smaller proprietary concerns that do not prepare balance-sheets.

1. The Bengal National Chamber of Commerce has stated that these rates vary round a mean of 18 per cent according to the standing of the borrowers. See Central Committee Evidence, Vol. II, p. 484. The rates are high because the loans are given on personal security. See the answers of its representatives, Vol. III, pp. 729-30.

2. *Cf.* Walter Leaf, *Banking*, pp. 170-1.

3. The Bengal and Bombay Banking Committees have laid special stress on this point. See their Reports pp. 122 and 137 respectively. See also Ramachandra Rau's statement, Central Committee Evidence, Vol. II, p. 349 and Mr. Pochkhanawala's answers, Vol. III, p. 94.

(6) The Imperial Bank is compelled by law to insist on two signatures on the promissory notes obtained from the borrowing concerns, and the other banks often do the same as a measure of additional security. This means that the banks compel the borrowing concerns to supply guarantors, however solvent they may be, and that over and above the specific security obtained from them, the banks become the general creditors of both the parties that have signed the promissory notes. The second signature is usually supplied by the managing agents of the borrowing concerns, and those concerns that have no managing agents find it very difficult to obtain loans from the banks. This insistence of the banks has, therefore, lent considerable support to the defective managing agency system.

(7) Whatever industrial finance the banks supply mostly takes the form of short-term loans out of short-term deposits received by them, and although they are willing to renew the loans from time to time so long as the borrowing enterprises continue to be solvent, they may not be able to do so, if an appreciable proportion of the deposits kept with them are withdrawn by their clients. This uncertainty regarding the renewal of the loans makes the position of the borrowing concerns very difficult.

(8) The interest charged on these loans by the banks is at least equal to the Imperial Bank rate, and frequently one or two per cent higher. As the Imperial Bank rate depends upon the seasonal conditions of the money market, the borrowing concerns are hampered by this high interest rate, which is settled with reference to the seasonal stringency of money, but which is not justified by their own conditions and the security given by them. Much higher rates have to be paid to obtain loans from smaller banks on mortgage or personal sureties. Loans obtained from the rulers of Indian States, indigenous bankers and merchants prove still more costly, as a substantial commission has to be paid to the intermediaries that arrange the loans.

(9) Some witnesses have mentioned to the Central Banking Committee that the European officers of the

Imperial Bank can keep themselves in much closer touch with their European customers than with their Indian ones owing to similar manner of living and social habits, and that consequently European enterprises find it easier than Indian ones to obtain financial assistance from the Bank.

(10) The cotton mills of Bombay and Ahmedabad have obtained a larger part of their capital by means of deposits from the public than by means of loans from banks. This is shown by the following figures :—

	Bombay.		Ahmedabad.	
	Crores of Rs.	Percentage of total finance.	Crores of Rs.	Percentage of total finance.
Amount lent by managing agents ...	5·32	21	2·64	24
Amount lent by banks ...	2·26	9	·42	4
Amount of public deposits ...	2·73	11	4·26	39
Amount of share capital ...	12·14	49	3·40	32
Amount of debentures issued[1] ...	2·38	10	·08	1

The deposits are generally obtained for 6 or 12 months, and the interest paid on them varies between 4½ and 6½ per cent according to the standing of the mills and their managing agents. The progress made by the cotton textile industry in these centres has been largely due to this system. The system, however, has weakened recently in Bombay owing to the counter-attraction of the interest obtainable from postal cash certificates and Government loans, the banks' policy of obtaining a charge on the stocks of the borrowing concerns and thereby reducing the security available to the depositors, and the inconvenience and loss sustained by a proportion of the depositors owing to the inability of a small number of mills to repay the deposits on the due dates, or at all.[2] The system is more vigorous in Ahmedabad. But in bad times, in both the centres these deposits may be withdrawn from sound as well as unsound mills, thereby

1. Made up of 46, 53, and 139 lakhs of Rs. from the managing agents, banks and the public respectively.

2. See Minority Report, p. 329.

increasing their difficulties at the very time when they need all resources to tide over a period of bad trade.

Although the industry is the biggest national industry of India, the unwillingness of the banks to give loans to it increases at such a time, because a number of mills cannot earn profits and are compelled to reduce their capital. The ability of the managing agents also to supply the mills with the needed finance gets reduced during a period of depression. Some witnesses have asserted before the Banking Committee that the Indian cotton mill industry, chiefly the part located in Bombay city, has been suffering from these difficulties during the period of post-War depression, and that in other countries banks have been pursuing a vigorous and sympathetic policy of nursing similar national industries during the period.

Although the system of keeping deposits with industrial concerns deserves commendation and maintenance as long as such concerns cannot get adequate finance from banks, it is primitive, unsuited to the conditions and needs of modern industry, and therefore doomed.[1] Not only is a person who has made a small saving unable to judge the soundness of the concern with which he deposits it, but he also becomes an unsecured creditor, because the assets of the concern, on which he must depend for the repayment of his deposit, are handled by the directors of the concern as they like. The intervention of a bank between him and the concern would make his deposit much safer, because the bank with its organisation would know the concerns to which to lend money and the time and period of lending it, and would be able to exercise some control over their assets. The intervention of a bank would benefit the borrowing concerns also, because deposits kept with them are liable to be withdrawn at inconvenient moments, when they may find it very difficult to borrow in other quarters.

3. Difficulties of issuing debentures.

The Foreign Experts associated with the Central Banking Committee have suggested that industrial

1. See Mr. MacDonald's and Mr. Ramachandra Rau's answers, Central Committee Evidence, Vol. III, pp. 914 and 432.

concerns in India should progressively reduce their dependence upon the above-mentioned methods of finance, and should rely more upon the issue of debentures, not only to make good the shortage of block capital for making a start and extending their operations, but also to obtain sufficient working capital. But the issue of debentures by industrial concerns in India is surrounded by the following grave difficulties[1]:—

(1) The issue of debentures adversely affects the credit of the issuing concerns with banks, as the debenture-holders have to be given a prior lien on their assets. Unless, therefore, the issue has a very good chance of succeeding and supplying the issuing concern with all the funds that it is likely to need, no concern would risk this change. Concerns with a small amount of debentures would not only find it difficult to obtain financial accommodation from the banks on the former terms, but would also find it difficult to obtain that credit with regard to their raw materials, which at present plays a prominent part in their finance. The issue of debentures, except by the strongest companies, would be regarded rather as a form of financial reconstruction enforced by the weakness of the issuing concerns than as an improvement placing them on a sounder footing. But the strongest companies have little incentive to carry out the change.

(2) The absence of issue houses to underwrite debenture issues makes the success of these issues very difficult in India. Moreover, in Germany, the experience of which has principally led the Foreign Experts to make the above suggestion, a large portion of the issues of debentures is taken up in advance by the regular customers of banks, on the latter's advice which the customers accept, because they have full confidence in the soundness of this advice. It becomes easy then to dispose of the remainder of the issues to the ordinary investing public. This makes the underwriting of the issues easy and cheap. In India there is no established method by which the

1. See Central Committee Report, pp. 273-4, Mr. Sarkar's Minute of Dissent, pp. 541-2, and the answers of the representatives of the Bombay Chamber of Commerce, Central Committee Evidence, Vol. III, p. 5.

public can get sound advice and guidance in investing its savings.[1] Of course, customers of banks can obtain some advice and assistance from them in this matter, but such advice and assistance are not sought and acted upon freely, especially as they are often given rather half-heartedly. There are some good firms of stockbrokers, but it is not possible to rouse their enthusiasm in debenture issues, as the issues lack speculative attraction, and cannot become the objects of frequent operations on the stock exchanges. Moreover, these brokers and exchanges are confined to the Presidency towns, and mofussil investors find it difficult to get into touch with them.

(3) The liquidation of some concerns in India, and the inability of some others to pay substantial dividends, or any dividends at all, have made the conservative investors nervous, and these prefer the investment of their savings in postal cash certificates, savings banks and other Government securities, which are safer owing to Government backing. Debentures issued in moderate numbers by companies that are little known and have a doubtful future are especially ignored by the investing public, and it is specially difficult to sell them on the stock exchanges.

(4) The heavy duty on the transfers of debentures and the fact that, owing to a fixed return, their market value cannot appreciate much, and that they cannot become the object of speculation, militate against their popularity.

(5) Owing to the uncertainties of Government protective policy resulting from the fact that Government has in several cases failed to carry out the recommendations of the Tariff Board, many investors feel that, even if industrial securities yield a return at first, they may not be able to do so after some time owing to a lack, or withdrawal, or reduction, of protection.

(6) Even the banks in India do not hold a large amount of debentures probably because they cannot always be sold readily. The banks do not always lend readily to

1. *Cf.* the statement of the Bombay Chamber of Commerce, Central Committee Evidence, Vol. II, p. 506.

their clients on the security of debentures. They do not give advances to their clients to help them to subscribe to issues of debentures. Further, whereas in other countries insurance companies invest large funds in first class debentures, in India no insurance company has yet invested any portion of its funds in them. This is said to be due to the absence of first class debentures, the uncertainty caused by the failure of Government to give effect to some of the recommendations of the Tariff Board, the legal compulsion on Indian insurance companies to keep deposits with Government, and the freedom enjoyed by foreign insurance companies working in India to invest outside India the funds that they obtain in India by way of premia. There are also no investment trusts in India to hold industrial debentures and to secure the savings of the public by issuing to it their own debentures.

(7) The cost of securing capital by means of debenture issues is higher than that of obtaining it by means of direct deposits or bank loans, for all but the best concerns. Interest on such issues has to be paid at a rate varying between 6 and 9 per cent. In addition, there are the initial legal, stamp and commission charges, and the underwriting commission or brokerage varies between 2 and 5 per cent.

4. The managing agency system.

On account of the above difficulties of industrial finance, a unique system, known as the managing agency system, has come to be developed in India, and has no counterpart in any other country. The system is the Indian substitute for a well-organised capital market and an industrial banking system of Western countries, and has come into existence by the sheer pressure of economic circumstances. The managing agents are individuals, or groups of individuals who, possessing strong financial resources, carry out the preliminary work of research and experiment precedent to the starting of new concerns, promote joint-stock companies, act as their financiers or guarantors, and generally manage their business. They are also often agents for buying raw materials for, and selling or distributing the products of, the concerns that they manage.

Their main functions can be grouped into the following three classes :—

(1) They serve as promoters of companies. They are rewarded for their risky preliminary operations, involving expenditure of money and exercise of technical and financial talent, by being entrusted with the management of the concerns in establishing which they take the initiative. A majority of the large industrial concerns in India, especially those concerned with the manufacture of cotton, jute, iron and steel, sugar, electricity, lime and cement, and with coal and mica mining, has been established by them and is controlled by them.

(2) They take the place of underwriting houses of the West; by means of their financial reputation they secure the confidence of the investing public, and help new industrial companies to place their shares on the market and to mobilise the savings of the public for industrial uses.

(3) They assist industrial concerns to obtain working capital. The fixed capital is usually supplied by the shareholders. But the provision of this capital even, especially when it is needed for the reorganization of an existing concern, or the addition of new machinery, is undertaken to a large extent by them, in place of the issue of debentures in the West. The working capital can be obtained by means of loans from the banks, or deposits from the public, or loans from the managing agents themselves. The difficulties of obtaining financial assistance from the banks have been already dealt with. Even when the banks do lend money, they are not prepared to lend it only on the security of the stocks in hand, or in process, or the mortgage of the fixed assets of the borrowing concerns; they demand, in addition, solvent and financially strong guarantors, and these happen in practice to be the managing agents. So even in obtaining loans from the banks, industrial concerns need the assistance and guarantee of the managing agents.

The readiness of the public to deposit funds, and the rate at which they deposit them, depend entirely upon the financial standing and reputation of the managing agents of the companies concerned.

Moreover, the managing agents often grant loans out of their own private resources to the concerns that they manage. Considering the importance of these functions, it is strange that the managing agents have no regular constitution and no systematic organisation.

The system, however, has several grave defects, and has outlived its utility. Although many firms of managing agents are free from the defects, they are inherent in the system.[1] They are as follows:—

(1) The system has created a divorce between banking and industry, and has failed to secure a proper co-ordination between the total available savings of the public on the one hand, and the industrial schemes and organising ability available in the country on the other. The dual existence of the system and the banks has retarded industrial progress. The agents tend to work in a groove, their outlook on industry becomes conservative, and they do not give sufficient attention to new industrial schemes. As they do not organise themselves into associations for active co-operation in the promotion of industry, they cannot command the services of technical and economic experts that are necessary for determining the soundness, practicability and profitableness of new industrial schemes. Moreover, as their financial resources are limited, they cannot promote an adequate number of new concerns even in the protected and undoubtedly profitable branches of production.

In any case, they cannot have that close touch with the investing public, which banks can possess, so that they cannot float or underwrite industrial issues readily, or to a considerable extent. The system may work without much financial difficulty in a period of prosperity, but the above drawbacks become prominent, when the system comes up against a period of depression. When the managing agents have to find more money during such a period to support their concerns, they are often unable to do so.

1. *Cf.* a paper on Industrial Finance in India read at the Fourteenth Conference of the Indian Economic Association by V. K. R. V. Rao, and Anstey, The Economic Development of India, pp. 501-2.

(2) The rights of the managing agents are heritable assets, so that it is inevitable that the management of industrial concerns should in the course of time pass into the hands of inefficient persons. These rights can also be sold and transferred without any reference to the shareholders who, having purchased the shares of certain concerns on account of the personal reputation and efficiency of certain members of their managing agents' firms, may find themselves, without any intimation, faced with the transfer of the management of the concerns to new parties, who may be altogether incompetent for the task. They have no legal power to interfere in such cases, even for their own safety.

(3) Not being directly interested in the fixed capital of the concerns that they manage, the managing agents may not properly protect the interests of the shareholders, and may even harm them. Some of them, in addition to managing their concerns, trade and speculate, and the resulting weakness in their financial position adversely affects the financial position of the concerns also, and causes banks to withdraw the cash credits granted to the concerns, although they are inherently sound.[1] Some speculate on the stock exchanges in the shares of their own concerns and produce the same result. Some also take advantage of a rise of prices to boost their shares, and sell their own at top prices, leaving the new holders to bear the loss resulting from a fall in their prices soon afterwards. Some even run their own concerns into voluntary liquidation, after managing them at a loss, or without profit, for some time, form new companies, and take over the assets of the old ones at abnormally low prices. Some convert their loans to the concerns that they manage into debentures, so that the concerns pass into their hands as debenture-holders, and the shareholders practically lose the capital invested in the concerns, as their claims come after those of the debenture-holders.

(4) The management of the undertakings by the agents is apt to become inefficient, because they are often

1. *Cf.* the answers of the representatives of the Bombay Chamber of Commerce, Central Committee Evidence, Vol. III, p. 21.

interested in giving employment to their relatives and friends in the undertakings and thus sacrifice talent and efficiency, and because they are tempted to purchase the raw materials and industrial accessories needed for the undertakings from the firms of their relatives and friends at prices higher than those ruling in the market, thereby raising unduly the cost of production.

(5) Until recently many managing agents received their remuneration in the form of a commission on purchases, production, or sales, or on two or all of these, without any reference to the conditions of the undertakings that they managed. This often tempted them to overproduce blindly without considering the demand. It also enabled them to appropriate an unduly large share of the profits, making the industry concerned less attractive to investors, and checking the flow of capital to it. It is, therefore, fortunate that this practice is being replaced by one of commission on net profits.

(6) The managing agency interest often represents a capitalised good-will, and a new party may purchase it with the idea that it entitles him to profit from the undertaking as much as possible within the law.[1]

These defects of the managing agency system may jeopardise Indian industries in competition with their foreign rivals which are free from such defects. The Central Banking Committee and the Foreign Experts have, therefore, expressed the opinion that attempts should be made to make industrial enterprises less dependent on this system, and to establish direct friendly relations between them and the banks, especially as capital will be needed for the mergers and reconstruction that are likely when the present economic depression is over.[2]

5. Financial difficulties of medium, small, and cottage industries.

The financial needs of medium and small concerns, such as rice, flour, and oil mills, match, cigarette, glass, lac, and leather factories, cotton ginneries and

1. *Cf.* Central Committee Minority Report, pp. 331-2.
2. Central Committee Report, p. 280 and Foreign Experts' Report, p. 635.

presses, printing presses, chemical works, hosieries, and carpet and silk factories were examined by the various Provincial Banking Committees, and they have found that most of these concerns have great difficulties in obtaining the necessary finance, because the Imperial Bank and the joint-stock banks are generally unwilling to provide them even working capital on account of the fact that their promoters, who are mostly middle-class men, are unable to offer the security of approved names or of stock that can be readily disposed of.[1] The promoters cannot obtain sufficient capital from their friends and acquaintances. Consequently, they have to borrow funds at high rates of interest from money-lenders, indigenous bankers, and large dealers.

The Provincial Committees have reported that the Imperial Bank and the joint-stock banks do not provide any finance to cottage industries, such as handloom cotton, silk and wool weaving, gold and silver thread, brass-ware, bell metal, bidi and cheroot making, mat-making, gur-making, extraction of oil, rope-making, carpet-weaving, toy-making, dairy and poultry farming and wood-carving, which are to be found in the different parts of India. The workers in these industries are, therefore, dependent upon money-lenders, who advance them materials at high prices, advance them cash for their bare subsistence, and in return receive their finished goods at low prices, thus making them suffer both ways. This system is an old one, but it has now become so widespread as to be a very serious menace to the welfare of the workers, most of whom can never hope to pay off their debts and are, therefore, rendered liable for life-long service to the money-lenders. The system destroys all incentive for the workers to improve their methods, efficiency or skill, because any improvement would merely serve to pay off an additional portion of their debts, and thus to benefit their capitalists only. Only those workers, who are part-time agriculturists owning land, obtain easier terms from the money-lenders.

1. See Bengal, Bombay and Madras Committees Reports, pp. 121, 137 and 130 respectively.

6. Suggestions for increasing the financial assistance of commercial banks to major industries.

We may now consider what the commercial banks in India can do to provide financial assistance to major industries. Initial block capital for industrial undertakings should generally be obtained by means of private or public subscriptions. Block capital needed afterwards for improvement and expansion, and not obtained out of undistributed profits, should be secured by issuing debentures or more shares. But until conditions become favourable for placing such issues on the market, the commercial banks should give temporary advances to undertakings for this purpose against sufficient security. The undertakings should obtain a minimum of working capital out of their initial capital, and extra working capital should be supplied to them in the form of short-period advances by the commercial banks, which should see that the undertakings keep a safe proportion between their own and borrowed capital.[1]

Well-established and well-conducted commercial banks in India should follow the example of the German banks in helping industrial enterprises to issue shares and debentures. As investors are generally unwilling to subscribe to the issues of industrial enterprises before they are in a full working condition, the German banks supply a large part of the initial capital to those enterprises with the promoters of which they are in permanent banking relations, and then help the promoters to place it afterwards among the investing public in the form of shares or debentures. In order to diminish the risk and to increase the success of the issues, a number of German banks often form a pool called a Konsortium, each bank undertaking to accept a portion of the issues. But this investment is not a long-period one, and is regarded by the banks only as a sound and liquid investment possessing excellent security. Occasionally, the banks may have to nurse such investments for a long time, owing to the failure of certain issues to attract the investing public. But this is regarded as exceptional and uncontrollable.

Moreover, these banks allow German enterprises to use

1. *Cf.* Central Committee Report, p. 296.

their current account advances, not only for the purpose of obtaining working capital, but also for obtaining block capital for expansion, pending the issue of debentures or additional shares. Although the ordinary commercial banking work of these banks is far more important, they have an industrial banking department, to which a portion of their funds is turned over for conducting the above work that arises at intervals in the course of their financial relations with industrial enterprises.

Many of the joint-stock banks in India are not strong and experienced enough at present for this work, and even the larger and stronger banks must develop it gradually and cautiously as members of syndicates. The Imperial Bank, however, should commence this activity and give a lead to the other large banks, as soon as the Reserve Bank is established, as it has a wide experience and a large capital.[1] Its capital and reserve amount to Rs. 11 crores, and those of the nine large Indian joint-stock banks, to Rs. 7½ crores. Even if no more than 10 per cent of these amounts are used in the way suggested above, industrial enterprise in India will receive valuable assistance, especially as the growing connection of the banks with the issues of industrial shares and debentures will increase the confidence of the investing public in these issues.

Further, it is necessary for the banks to keep themselves in close touch with industries, so as to maintain an attitude of sympathy towards them, and to develop an atmosphere of mutual confidence for the benefit of both. This has been the keynote of the success of the association of the German banks with industries. Their managers serve on the boards of directors of the companies that they have financed. This close connection enables the companies to profit from the wide financial experience of the bank managers, and the banks to keep themselves in touch with the working of the companies, and to protect themselves from losses. Banks in India undertaking the finance of industries should follow this practice of the German banks. To achieve the same object, it is necessary that

1. *Cf.* Foreign Experts' Report, Central Committee Report, p. 635.

the whole banking business of an industrial enterprise needing finance from a bank should be entrusted to a single bank, and should not be distributed among a number of banks. The board of directors of every bank should also appoint local advisory committees for its branches from among the leading local business men and industrialists, enjoying the confidence of the public and the bank's customers, for the purpose of assisting the bank to determine the financial standing of its customers, and of convincing the latter of the fair and sympathetic attitude of the former, the functions of the committees being, of course, of a purely advisory nature.

Some witnesses have complained to the Banking Committee that the banks in India, contrary to the practice of banks in Germany, Japan and a few other countries, are not prepared to accept at all even valuable block capital as security for loans, and generally demand the full security of liquid assets. The banks should endeavour to follow a more liberal policy in this respect, and also to supply a large part of the working capital required by industrial undertakings, if adequate security is forthcoming, the banks, of course, retaining the right to demand repayment of the whole or a part of the loans, if it becomes really necessary.

The complaint has also been made that the banks in India are far less willing to lend to industrialists on personal security than banks in other countries. Of course they cannot increase such loans indiscriminately, as even in other countries banks give loans on personal security only to big concerns enjoying a high financial reputation, but they should increase such loans gradually as the number of similar large concerns increases in India.[1] Government also can help in the solution of the problem of financing industries by pursuing a vigorous fiscal policy, and by removing other impediments in the way of the development of industries, as this will undoubtedly make industrial securities more popular with the investors of savings.

1. See Central Committee Report, p. 229.

7. Suggestions for the organisation and working of provincial industrial corporations.

The Central Banking Committee, all the Provincial Committees and most of their witnesses, however, have agreed that the foregoing measures, although possessing much utility, cannot deal adequately with the problem of industrial finance, and that it is necessary to establish either an all-India industrial bank or a number of provincial industrial banks in order to provide industries with a larger volume of finance, for longer periods, and at lower rates. The Central Committee and six of the Provincial Committees have recommended that those Provincial Governments, which find it necessary to provide better financial facilities to industries within their jurisdiction, should take the initiative in establishing provincial industrial corporations, with branches if required, and should supply them a part of the initial capital.[1] Some witnesses also have recommended the establishment of an industrial corporation in each major province.[2]

Their reasons for recommending provincial corporations in preference to an all-India corporation are as follows:—

(1) As industrial development is a provincial subject, and will probably continue to be so, any measure to promote it should be shaped and controlled by Provincial Governments.

(2) Each Provincial Government can provide financial assistance to its own provincial corporation more easily than the Government of India can do to an all-India institution.

(3) Provincial corporations would find it easier to obtain capital by way of subscriptions to their shares and debentures from the public by appealing to its provincial patriotism than an all-India corporation would do by a centralised issue of shares and debentures.

(4) Provincial institutions would be better able to

1. See Bengal, Bihar, Bombay, C. P., Assam and U. P. Committees Reports, pp. 122, 104, 138, 224, 106 and 258 respectively.

2. See the statements of the Bengal National Chamber of Commerce and Mr. Shroff, Central Committee Evidence, Vol. II, pp. 391 and 487 and Vol. III, p. 734.

provide for the needs of the industries of their own provinces, especially of the cottage industries, than an all-India institution. The economy and efficiency of the management of the latter would be more than offset by the danger of its neglecting the smaller industries and industrially backward regions.

(5) While the economy of employing full time technical experts would be problematic to the all-India institution, as it might not have sufficient work to keep the experts fully engaged, the provincial institutions would find it cheaper and more useful to employ the services of the best experts for definite tasks.

The provincial corporations should obtain as large a portion of the needed capital as possible by issuing shares to the public, but it is clear that at present they cannot obtain all the required capital in this way. Provincial Governments, therefore, should provide the portion of the share capital that is not taken up by the public. This will create larger public confidence than Government guarantee of the corporations' share capital or of the dividends on it. The corporation for the Bombay Presidency, with its industrial possibilities, would need a paid-up share capital of about Rs. 1 crore at the outset.[1] Others may be able to make a good start with less share capital.

Some witnesses have suggested to the Central Banking Committee that non-Indians should not be permitted to subscribe to this share capital beyond a certain proportion, on account of the burden, borne by the taxpayers, of Government assistance to the corporations. The share capital should be supplemented by the issue of debentures, the value of which to start with should not be larger than double that of the shares. The public would very probably take up all the debentures, if the management of the corporations proceeds on sound and cautious lines. If necessary, Provincial Governments should guarantee interest on the debentures for a limited period, or take up a portion of them until a regular market comes into existence for them. It would, however, be undesira-

1. See Mr. Shroff's answers, Central Committee Evidence, Vol. III, p. 172.

ble to give them the status of trust securities until the working of the corporations becomes quite safe.

The corporations may obtain more funds by accepting fixed deposits from the public for not less than two years.[1] Deposits of a shorter duration should not be accepted as they would lead to competition with the commercial banks, and would prevent the corporations from providing long-term finance to industries, which can obtain their short-term finance, *i.e.* working capital, from the commercial banks. It is also undesirable that institutions receiving direct financial assistance from Government should be allowed to compete with the commercial banks, which also need to be fostered, by accepting short-term deposits.

As long as the corporations receive Government financial assistance in the shape of subscriptions to their share or debenture capital, or a guarantee of interest on the debentures, Provincial Governments should nominate a representative to serve on the boards of directors of the corporations to protect their interests, and he should be empowered, if he dissents from the decisions of the majority of his board in important matters, such as an increase or reduction of capital, the appointment of chief officers, and the grant of loans, to demand the reference of these matters to Government. To secure the conduct of their business on sound and impartial lines, the corporations should be made to frame bye-laws laying down the conditions for the grant of loans to industries, and they should require Government sanction as long as the corporations continue to receive financial assistance from Government.[2]

The considerations that should guide the corporations in giving financial assistance to industrial concerns should be the extent to which the concerns would benefit the public, increase the productive capacity of the province, and create employment for its population, and not primarily the extent to which they would benefit their promoters. Some

1. Some witnesses have suggested 3 years. See Mr. Pochkhanawala's answers, Central Committee Evidence, Vol. III, p. 49.

2. *Cf.* the answers of the representatives of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. III, p. 739.

witnesses have suggested to the Central Banking Committee that on account of the burden, borne by the taxpayers, of Government assistance to the corporations, they should not be allowed to finance those concerns, the majority of the shares of which are owned by non-Indians, or the majority of the directors of which are non-Indians.[1] When loans are given out of the funds obtained in the form of deposits, their period should not exceed that of the deposits. The corporations should not be allowed to lend more than a certain proportion[2] of their paid-up capital and reserves to a single industry, or a group of connected industries, or to lend any amount to any concerns until the latter have obtained a certain proportion of their capital from the promoters and the public; both of these proportions should be fixed by the Provincial Governments.

Further, loans should be given only to those enterprises the prospects of which have been pronounced to be good by technical experts, and the corporations should make sure that the enterprises are being managed by honest, competent and experienced persons. They should make careful enquiries regarding the purposes for which the loans are required, should assess carefully the security offered, and should keep a margin of safety on the loans. Following the example of German banks, the corporations may appoint representatives on the boards of directors of the concerns to which they have made advances, so as to maintain a permanent and continuous touch with them. These measures will reduce their risks to a minimum.[3]

The chief aim of the corporations should be to supply finance for a part of the initial or block capital of industrial enterprises, and for the capital needed by the latter for expansion later on, or the replacement of old by

1. See the answers of the representatives of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. III, p. 740.

2. 10 to 25 per cent have been suggested by different witnesses. See the statement of the Indian Merchants' Chamber, Bombay, Central Committee Evidence, Vol. II, p. 540.

3. See the statements of the Bengal National Chamber of Commerce, and Mr. Shroff, Central Committee Evidence, Vol. II, p. 488 and 393.

new machinery, as the commercial banks will continue to supply working capital to the enterprises out of their short-term deposits against the security of the liquid assets of the latter. But whenever enterprises find it difficult to secure even working capital from the commercial banks, the corporations may supply it to them on such security as they can offer, after valuing the security properly and keeping a safe margin. The corporations may further help them to float their debentures, and may be empowered to underwrite such debentures and to hold them as a part of their investments, until they can be gradually sold to the public.

The Central Banking Committee, however, has realised that certain industries of a national importance can be financed better by an all-India Industrial Corporation with the assistance of the Central Government, and that the Provincial Governments themselves may desire its creation in order to give industries a proper liaison regarding finance, or a close contact with the big spending departments of the Government of India, or a direct correlation with railway rates, customs, stores purchase, and other policies of the Central Government. It has, therefore, suggested that an all-India Corporation may be established, if the Central Government and Legislature are convinced of its need, and that, until it is established, the provincial corporations should form a Central Association to safeguard and promote their common interests.[1] To secure these objects—

(1) The Central Association may lay down general principles for the guidance of the provincial corporations.

(2) It may co-ordinate their work, and check any tendency on their part to give too much assistance to certain industries and too little to others.

(3) It may help them to secure subscriptions from the public for their shares and debentures by means of propaganda and advertisement.

The Foreign Experts associated with the Central Banking Committee have recommended an all-India institution in their report, but in their later discussion

1. Report, p. 304.

with the Committee, have supported the idea of provincial institutions on account of the constitutional difficulty arising from the fact that industrial development is a provincial subject, but are definitely of opinion that a central organisation to co-ordinate the work of the provincial institutions is essential. They, however, regard the Central Committee's above scheme of industrial corporations as unsound and sure to involve the tax-payers in serious losses. In their opinion, the work of these corporations should be restricted to pioneering enterprises of a non-competitive character, and the opening up of mineral resources and large public utilities, chiefly electrical power schemes ; the corporations should not give financial assistance to small industries; and Government financial assistance to the corporations should be restricted to subscriptions to their share capital.

Some of the European commercial bodies have expressed the opinion that conditions in India are hardly ripe for the establishment of specialised institutions for financing industrial development. These opinions, however, run counter to the views not only of the Central Committee, but also of the Provincial Committees, most of the witnesses who have dealt with the question, and above all, the Indian Industrial Commission of 1916-18.[1]

Mr. N. R. Sarkar, a member of the Central Banking Committee representing the Federation of Indian Chambers of Commerce and Industry, in a minute of dissent, has pronounced the recommendation of the Committee regarding the provincial industrial corporations as rather weak and halting, and has expressed the opinion that the immediate establishment of such corporations in Bombay, Bengal and Madras at least is absolutely necessary.[2] In addition to the functions suggested for them by the Committee, he has recommended that they should guarantee interest on approved industrial debentures or loans.

1. See Foreign Experts' Report attached to Central Committee Report, pp. 612, 639 and 305 ; the statements of Mr. MacDonald, the Bengal, Bombay and Madras Chambers of Commerce, and the Exchange Banks' Association, Central Committee Evidence, Vol, II, pp. 227, 473, 507, 551, and 625 ; and the Report of the Indian Industrial Commission, paras 293-301.

2. See Central Committee Report, pp. 535 ff.

In addition to the measures suggested by the Committee for minimising their risks, he has recommended that they should scrupulously refrain from giving any financial assistance to speculative ventures, or to industries which are threatened with overproduction or have otherwise become unsound; and that they should provide adequate sinking funds for the redemption of their debentures, should make industrial concerns, with which they are connected, do the same in respect of their own debentures, and should build up substantial reserves out of their profits.

Pending the establishment of an all-India Industrial Corporation, which will take time, as industries of a national importance cannot be numerous in the immediate future, he has recommended the creation of an all-India Industrial Board consisting of the representatives of Government, the provincial corporations, and business men, to co-ordinate the work of the provincial industrial corporations, to advise and assist them in their operations, and to advise Government and industries for protecting and promoting the interests of the latter.

8. Suggestions for the organisation and working of an all-India Industrial Corporation.

Mr. Subhedar and some witnesses have expressed themselves in favour of an all-India Industrial Bank with branches at the important industrial centres.[1] In their opinion, the constitutional difficulty and the autonomy of the provinces in industrial matters have been exaggerated; provinces do not exist as separate industrial units; and it is not desirable in the larger interests of the country to encourage the idea of the separate industrial interests of the provinces. With regard to the administrative organisation under which industrial development is a provincial subject, and with regard to the assistance to cottage industries, adjustments would be necessary between the Central and Provincial Governments and the branches of the all-India bank. These adjustments should be made through Industrial Boards which should be created

1. See Minority Report, p. 340 and the statements of Mr. Pochkhanawala, the Indian Chamber of Commerce, Calcutta, and the Indian Merchants' Chamber, Bombay, Central Committee Evidence, Vol. II, pp. 42, 530 and 539 respectively.

in the provinces and at the centre, and should consist of an economist, a business man and a technologist, with the Director of Industries as secretary and member, wherever this officer exists. The administrative organisation ought to be elastic, and adjustable to the economic needs of the country. Administrative conveniences should not be permitted to create artificial divisions in the economic life of the country and to encourage separate provincial interests in this life.

Moreover, an all-India institution will possess the following important advantages :—

(1) The financial position of the Provincial Governments is not favourable at present to the establishment of provincial institutions. The Central Government will be in a better position to assist the creation of an all-India bank, and if it is unable to provide all the assistance itself, a part of the burden may be distributed by it among the Provincial Governments on an equitable basis to be determined in consultation with them.

(2) It will be easier for an all-India bank to get the public to subscribe to its shares and debentures, because the guarantee of, or the connection with, the Central Government will create a greater confidence among the public than the guarantee, or connection, of the Provincial Governments for, or with, their respective banks. The selection of its directors from the best men in the country, possessing wide knowledge, experience, and outlook, will also increase the public confidence, and enable it to obtain its funds at lower rates. If and when it becomes practicable and desirable to place its debentures on foreign markets, the guarantee of the Central Government will prove more effective than that of the Provincial Governments. Thus, a scramble and competition among the industrial corporations of the different provinces for obtaining funds will be avoided, provinces other than Bombay and Bengal that have no money markets of their own will not be handicapped, and their industries will receive as much financial support as those of Bombay and Bengal.

(3) An all-India bank with much larger funds and a much wider area of operations than provincial banks

will be able to distribute its funds among a greater variety of industrial concerns, and will, therefore, be in a better position to pass through a difficult period of economic depression.

(4) As regards important questions affecting industries, such as tariffs, railway rates and the purchase of stores by the spending departments of the Central Government, an all-India bank can secure adjustments from the Central Government in favour of industries more easily, more quickly, and to a larger extent than provincial banks. It has also to be borne in mind that the laws regulating trade and industries are central, that all industrial concerns in the country are registered under a single law, that many concerns located in one province are controlled from another province, and that this will make the determination of the jurisdictions of provincial banks difficult.

(5) It will be more convenient and economical for a central institution to employ technical experts, full time or for definite pieces of work, to report on industrial schemes, to value industrial plant, or to advise the concerns that are assisted, throughout the country than for each provincial bank to engage independent experts. Moreover, experts, who serve a central institution and obtain experience in different parts of the country, can give better advice than those who, in the service of a provincial bank, have experience in one province only. In the selection and training of the ordinary staff also a central institution will secure greater economy and convenience. Further, it can use the experience acquired in one part of the country in promoting industries in another part. It can obtain better information, more economically, from other countries regarding their means and methods of industrial progress, and can give better help, at a lower cost, to those concerns which it assists, in the matters of selecting and purchasing machinery, and recruiting technical staff in other countries.

(6) Although there is a large scope for industrial progress in different parts of India, and in various directions, it will be limited by the available resources, and only a central bank, with knowledge and experience acquired from all parts of the country, will be able to turn

the resources to the best account by promoting the most promising industrial projects, and postponing the less promising ones until larger resources become available in the country as a whole, disregarding uneconomic provincial sentiment.

To enable the bank to give reasonable financial assistance to industries in the different parts of the country and to have a turnover sufficiently large to cover its expenses, it should start with a share capital of Rs. 5 crores. Government will have to supply a large part of this capital for the first few years, because the public is not likely to subscribe to a large portion of the capital for some time owing to the uncertainties of the enterprise. Mr. Subhedar does not regard it desirable to try to make the shares more attractive to the public by a Government guarantee of dividends from the shares, because it will weaken the stimulus to the shareholders to watch over the working of the institution.

The public will be more willing to take up the debentures issued by the bank on account of their greater safety. Mr. Subhedar regards the restriction of the value of the debentures to double the value of the shares as undesirable, because it may prevent the bank from securing sufficient funds and from having a sufficiently large turnover to cover its expenses. The board of directors of the bank should work in close co-operation with that of the Reserve Bank, some of them may serve on both the boards, and the amount of the debentures to be issued should be left to their judgment. They can be depended upon to issue an amount within the limits of safety provided by the amount of the share capital and the safe loans given out of the funds raised in this manner.

To make the debentures popular it has been suggested that Government should guarantee their principal as well as interest; that they should be given the status of trust securities; that the Reserve Bank should promote a scheme for the payment of subscriptions to them in instalments; that the Reserve Bank should be permitted to keep a certain amount of them in its reserves; and that

a definite provision should be made for their redemption after 25 or 30 years, the sinking fund provided for the purpose being deposited with the Reserve Bank and then invested in trust securities maturing at the required time. The head office of the bank should be wherever that of the Reserve Bank is located.

Mr. Subhedar is not in favour of preventing the bank from having current accounts and short-term deposits, because its clients may find this prohibition inconvenient under certain circumstances. For instance, they may arrange for loans from the bank, but may not require the whole amount for some time, or the assistance that they need may be in the form of an acceptance to secure the movement of raw materials to them, or a discount against manufactured goods in stock or in movement. But, in order to protect the commercial banks, he has suggested that the industrial bank should be prevented from paying interest rates on current accounts and short-term deposits that compete with those paid by the commercial banks, and that any complaint received from them in this respect should be carefully attended to by the bank and Government.

As regards the working of the bank, the Central Government, in consultation with the Provincial Governments, should secure the co-operation of the best business men in the country at its head office as well as its branches. Mr. Subhedar has further suggested that Government should subscribe to slightly more than one-half of the share capital of the bank, so as to be able to appoint a majority of its directors, and thereby to prevent its management from getting into the hands of any section of the public likely to frustrate its aim, and also to make up for the deficiencies of election by the shareholders; and that the Managing Governor at its head office and the managers of its branches must be men possessing not only proved integrity and sound judgment, but also a national outlook. It is essential that the bank should be free from complaints of undue favours to non-Indian clients similar to those that have been made against the Imperial Bank and the exchange banks. In other respects, the working of the

central corporation should be similar to that of the provincial corporations, as outlined above.

9. Suggestions for improving the finance of cottage industries.

It is necessary to rescue the workers in cottage industries from the clutches of rapacious and short-sighted money-lenders. The small size and scattered nature of the industries will always prevent banks or big financiers, possessing enlightenment and vision, from interesting themselves in their development. But these very features make the industries admirably fitted for the application of co-operation, and the Provincial and Central Banking Committees and the Foreign Experts have expressed the opinion that the salvation of these industries depends largely upon the development of co-operative institutions.[1]

Small industries are thriving in other countries with the help of co-operation, and a great future lies in front of India's cottage industries, if only co-operation succeeds in providing them with loans at reasonable interest, and raw materials of good quality and improved tools and appliances at reasonable prices, in removing the existing defects in their character, such as ignorance, conservatism, and a lack of ambition and of proper business sense, by propaganda and education, and in helping them to dispose of their products, as it has succeeded in doing in other countries. It is true that the few co-operative societies that have been so far established among the artisans have not on the whole proved successful, but this has been due to under-capitalisation, ineffective bye-laws, business inexperience and bureaucratic irresponsibility of the officers of the Co-operative Departments, and a want of sufficient contact between them and the artisans, in contrast to the experience, interest and contact of the money-lenders.

These defects, however, can be gradually removed, if the following principles are borne in mind[2]:—

1. See Central Committee Report, pp. 251 and 640 and Assam, Bengal, Bombay, U. P., Punjab, Madras, Central Areas and Burma Committees Reports, pp. 150, 123, 131, 245-256, 81, 136-7, and 245, respectively.
2. See the writer's *Industrial Labour in India*, pp. 291-4.

(1) Co-operation, to start with, should take the form of credit, which is the simplest, the most readily acceptable, and the most educative of all the forms of co-operation.

(2) After the ground is prepared in this way, other forms of co-operation, such as purchase and sale, should be started. Separate societies should be created for the purpose, and the credit societies should not be saddled with these functions. For the formation of co-operative societies there must be close co-operation between the Industries Departments and the Co-operative Departments.[1] Selected officers of these departments should be deputed by the Provincial Governments to Germany to study the working of its co-operative organisation for small industries, as the organisation has achieved a remarkable success.

(3) Co-operation should be attempted at first in those industries whose products are readily saleable at more or less stable prices, and the co-operative treatment should be applied to other industries only after success has been achieved and experience has been gathered in the easier cases.

(4) If the urban artisans find it difficult to co-operate under unlimited liability, they may be brought together in the Schultze-Delitsch type of society, which works on limited liability, and lends to members on the security of two other names.

(5) The officers of the Industries Departments should help the societies with advice on technical matters, the provision of new markets, and the commercial aspects of new schemes.[2] These officers should make a special study of different markets in India and abroad, as this will enable them to give the artisans of their respective areas proper advice regarding the types of articles, which may be in demand, or for which markets may be created.

(6) Government should undertake greater financial responsibilities to foster the movement, and should, on the recommendations of the Industries Department, give grants to the societies for operations of an experimental

1. For the details of this co-operation see the writer's *Wealth and Welfare of the Bengal Delta*, p. 273 and Bengal Committee Report, p. 123.

2. See Bengal Committee Report, p. 124.

nature or for purposes of demonstration, give them loans for specific purposes, and give a guarantee to central banks financing them for operations in new directions expected to yield a considerable public advantage.[1]

Further, stores similar to the Bombay Swadeshi Stores should be established in the towns and cities of India for the distribution of the products of cottage industries by bringing them to the notice of the inhabitants; more central trading organisations similar to the Arts and Crafts Emporia at Lucknow and Lahore should be created to establish co-ordination and co-operation between isolated cottage industries, and to introduce their wares to suitable markets at home and abroad; licensed warehouses, co-operative wholesale depots, and co-operative sale societies should be established for the storing and sale of the products of cottage industries in commercial centres under the competent guidance of provincial marketing boards; and the Central and Provincial Governments and local bodies should purchase their stores from cottage industries wherever possible.

10. The part of Government in financing industries and suggestions for improving it.

Finally, it is necessary to consider the part which Government has been taking in the provision of finance to industries. Under the State Aid to Industries Acts that exist in Madras, Bihar and Orissa and Bengal, and the Industrial Loans Act in the Punjab, the Governments of these provinces can assist new and nascent industries, that are registered in India with rupee capital and comply with certain requirements with regard to the constitution of the boards of directors, and also cottage industries. The aid can take the forms of loans at low rates of interest, subscriptions to shares or debentures, guarantee of interest on them, guarantee of cash credits with banks, supply of machinery on the hire-purchase system, grant of land or other Government property and raw materials on favourable conditions, and subsidies for research. The Acts also provide for propaganda, demon-

1. See Bengal Committee Report, p. 124.

stration and technical assistance by the Provincial Governments concerned. Although there is no such Act in Bombay, the Government of Bombay has provided industrial finance in a few cases through co-operative societies in the forms of loans, and the provision of implements on the hire-purchase system.

From the reports of the Provincial Banking Committees of these provinces, it appears that the success of the Acts, so far, has been small. The finance provided under them has been small, and a part of it has had to be written off, or its recovery is regarded as doubtful. The attempts of the Provincial Governments to aid industries are also said to have received little response. The chief reasons seem to be that (1) the Departments of Industries, through which the aid is given, are not sufficiently equipped for the work, and are afraid of the heavy banking responsibilities placed on them by the working of the Acts, and that (2) industrialists dislike the publicity and formality attending Government assistance that are regarded as necessary in the interests of the taxpayers, as they affect the credit of the applicants for aid, especially if the applications are rejected.

The Bombay, the Central Provinces and the Central Areas Banking Committees, however, have recommended that similar Acts should be passed in their respective provinces, and the Central Banking Committee has supported this recommendation.[1] The latter Committee has suggested that Government assistance under these Acts should be given through the provincial industrial corporations that it has recommended, if they exist. The Bombay Committee has recommended that the assistance should be given through the Departments of Industries, which should be well equipped for the purpose and given definite duties, and which should act in close co-operation with the Departments of Agriculture and Co-operation. The Bihar and Orissa Committee has suggested that the Departments of Industries should enlist the co-operation of banks and approved shroffs in the work

1. See Bombay, C. P. and Central Areas Committees Reports, pp. 139, 240 and 245.

of dealing with applications for financial assistance to industries, and that the banks and the shroffs should be given a commission for this help as well as for their share of the risks of such finance.

CHAPTER X

The Imperial Bank of India

1. Its organisation.

This Bank was established in 1921 under the Imperial Bank of India Act of 1920 by the amalgamation of the three Presidency Banks, the Banks of Bombay, Bengal and Madras. Its authorised capital is Rs. 11½ crores, of which a half is paid up, and the other half is a reserve liability of its shareholders. Of the paid-up capital, Rs. 3¾ crores consist of fully paid-up shares of Rs. 500 each, and the remainder of quarter-paid contributory shares of Rs. 500 each, the remaining ¾ value of the shares being the reserve liability of their owners. The Bank's reserve fund amounts to Rs. 5 crores and 20 lakhs. It paid a dividend of 16 per cent from its inception until 1931, and has paid 12 per cent since then. The shares are consequently at a high premium.

To safeguard regional interests, and to give the Bank a large freedom in banking, the local head offices of the Presidency Banks in Bombay, Calcutta and Madras, under Local Boards elected separately by the shareholders, whose names stand on the Bombay, Calcutta and Madras registers, have been retained and, with the Secretary and Treasurer as their chief executive officer, administer the business of their respective territories. The general superintendence of the affairs and business of the Bank and the general control of the Local Boards have been handed over to a Central Board of Governors. Its functions are determined by bye-laws, and it deals only with matters of general policy, such as the movement of funds from one part of India to another, the fixing of the bank rate, and the publication of the Bank's weekly statement. The actual executive work is conducted by two Managing Governors who are appointed by the Governor-General in Council, after considering the recommendation of the Central Board, for

such a period as he may direct. The Central Board consists of 16 Governors as follows :—

(*a*) Nominated by the Governor-General:—

(*i*) Two Managing Governors.

(*ii*) Four Governors, who must be non-officials, and who represent the interests of the Indian community in general.

(*iii*) Three Secretaries of the three Local Boards of Bombay, Calcutta and Madras.

(*iv*) The Controller of the Currency who represents the Government of India.

The Governors mentioned in (*iii*) and (*iv*) attend all the meetings but cannot vote.

(*b*) Elected by the shareholders. The Presidents and Vice-Presidents of the three Local Boards.

On account of the difficulties of holding frequent meetings of the full Central Board, much of its work is delegated to a Managing Committee consisting of the two Managing Governors, the Controller of the Currency, and the President, Vice-President and Secretary of the Local Board of the place where the Committee meets. To avoid provincial jealousies, the Central Board has no fixed location, but sits alternately in Bombay and Calcutta, and meets at regular intervals, additional meetings being held when necessary. The Managing Committee meets more often.

Government exercises control over the Bank in the following ways:—

(1) It appoints the Managing Governors, the Controller of the Currency, the Secretaries of the Local Boards, and four Governors, as mentioned above. The Controller of the Currency is empowered to hold up any action of the Board affecting the financial policy or the safety of the cash balances of Government, and to refer the matter to Government for its decision.

(2) It can issue instructions to the Bank in any matter which, in its opinion, vitally concerns its financial policy or the safety of its cash balances.

(3) It is empowered to make the Bank supply any information regarding its affairs, produce any of its documents, or publish a statement of its assets and liabilities at such times and in such a form as Government may think necessary.

(4) It can appoint any auditors to examine, and to report on, the accounts of the Bank.

2. Functions of the Imperial Bank.

The Bank acts as the sole banker to Government. It is the custodian of Government funds, and does the treasury work of Government free of charge. It receives all Government dues from the public, and Government draws upon it for Government disbursements. It also manages the public debt of the Government of India, and provides the machinery for the issue of Government loans. There is, however, a separate public debt office which acts as the actual registrar of the debt. This has brought about the abolition of Government Reserve Treasuries and the fructification of Government balances, which the Bank can use for assisting the money market.

Moreover, it acts as the bankers' bank, and most of the leading banks in India, including the exchange banks, keep a portion of their cash balances on deposit with it. Further, it supplies the supervising staff to, and manages the 11 clearing houses that are established in the principal cities of India. It also provides remittance facilities between its numerous branches to the other banks and the public at rates which are controlled by Government, and which vary between $\frac{1}{4}$ and $\frac{1}{32}$ per cent according to the amount remitted and the purchaser of the remittance—a member of the public or a bank. In return the Bank is given the concession of transferring its funds from one place to another within India through the Government Treasury Department free of charge.

To enable it to assist the money market in the busy season, when the bank rate usually rises to 6 per cent, the Paper Currency Department of Government can grant loans to it up to a maximum of Rs. 12 crores at the bank rate subject to a minimum limit of 6 per cent for the first

Rs. 4 crores and 7 per cent for the remaining 8 crores, on the security of internal bills of exchange or hundis of an equivalent amount. For increasing banking facilities in the country and promoting the banking and investment habit among the people, the Imperial Bank Act provided for the establishment of 100 new branches by the Bank within 5 years. This obligation has been carried out, and one-half of the branches have been opened at places which had no banking office at all, although some of the branches do not yet yield any profit. In return, the Bank has obtained the use of Government balances free of charge. At those places, where it has no branches, it uses the services of other banks or leading local merchants or shroffs for the collection of bills and cheques.

Other functions, which the Bank is authorised by the Act to carry on, are as follows :—

(1) Advancing money and opening cash credits on the security of—

(*a*) Securities in which a trustee is authorised by law to invest trust money.

(*b*) Securities issued by State-aided railways notified by the Governor-General in Council.

(*c*) Securities issued under any Act of a Legislature in British India by, or on behalf of, a District Board.

(*d*) Goods, or documents of title thereto, deposited with or assigned to the Bank.

(*e*) Accepted bills of exchange and promissory notes endorsed by the payees.

(*f*) Fully paid-up debentures or shares of companies with limited liability, or immovable property, or documents of title relating thereto as collateral security, where the original security is one of those specified in (*a*), (*b*), (*c*) and (*d*) above, and if authorised by the Central Board, where the original security is of the kind specified in (*e*).

(2) Advancing money to Courts of Wards upon the security of estates in their charge, with the previous sanction of the Provincial Government concerned.

(3) Drawing, accepting, discounting, buying, and selling bills of exchange and other negotiable securities payable in India and Ceylon and, subject to the directions

of the Governor-General in Council, the discounting, buying, and selling of bills of exchange, payable outside India for, from, and to such banks as the Governor-General in Council may approve.

(4) Investing the Bank's funds in the securities mentioned in (1) (*a*) (*b*) and (*c*).

(5) Making, issuing and circulating bank-post-bills and letters of credit payable in India and Ceylon.

(6) Buying and selling gold and silver, coined or uncoined.

(7) Receiving deposits and keeping cash accounts.

(8) Receiving securities, plate, jewels, title-deeds or other valuable goods for safe custody.

(9) Selling such properties, movable or immovable, as may come into the Bank's possession in satisfaction of claims.

(10) Transacting pecuniary agency business on commission.

(11) Acting as administrator for winding up estates.

(12) Drawing bills of exchange and granting letters of credit payable out of India for the use of principals in connection with (7) and also for private constituents for *bona fide* personal needs.

(13) Buying, for the purpose of meeting such bills or letters of credit, of bills of exchange payable out of India, at any usance not exceeding 6 months.

(14) Borrowing money in India for the Bank's business.

(15) Borrowing money in England for the Bank's business upon the security of the assets of the Bank, but not otherwise.

The Bank is prevented by the Act from transacting any other business and in particular—

(1) from making any loan or advance;

(*a*) for a longer period than six months;

(*b*) upon the security of the shares of the Bank;

(*c*) save in cases of estates specified in (2) above, upon mortgage or security of immovable property, or documents of title relating thereto;

(2) from discounting bills for, or advancing money to, individuals or partnership firms, beyond such sums as may be prescribed, except upon a security of the kind specified in (*a*), (*b*), (*c*) and (*d*) of (1) above;

(3) from discounting or advancing money on personal security, unless such discounts or advances carry with them the several responsibilities of at least two persons or firms unconnected with each other in general partnership;

(4) from discounting or advancing money on the security of any negotiable security having a longer period to run than 6 months;

(5) from dealing in foreign exchanges, except for the *bona fide* requirements of its constituents for their personal requirements; and

(6) from opening accounts at the London branch for persons who, within the previous three years, were not the customers of the Bank in India or of one of the Presidency Banks.

The London branch of the Bank acts as the custodian of the cash balances of the Secretary of State, and transacts such business as may be entrusted to it by him. While the management of the Government of India rupee debt in London has been transferred to it from the Bank of England, it has not been entrusted with the floatation and management of the sterling loans of the Government of India. But it can float sterling loans on behalf of Indian public bodies, and although it is not allowed to compete with the exchange banks by engaging in general foreign exchange business, it can rediscount bills of the exchange banks. It can also borrow money in the London money market on the security of its assets. The general policy of the Bank has been to keep more or less equal assets and liabilities at this branch.[1] An advisory committee has been established in London to assist it.

3. Balance-sheet of the Imperial Bank.

The following balance-sheet of the Bank on 23rd March 1934 brings out the nature of its work:—

1. See Rau, *Present Day Banking in India*, p. 35.

Liabilities: crores of rupees		Assets: crores of rupees	
Subscribed capital ...	11·25	Government securities ...	50·76
Paid-up capital	5·62	Other authorised securities under the Act	·15
Reserve	5·22	Ways and means advances to the Government of India ...	6·00
Public deposits	7·92	Loans	2·54
Other deposits	74·23	Cash credits	16·59
Loans against securities per contra	Nil	Inland bills discounted and purchased	2·61
Loans from the Government of India under sec. 20 of the Paper Currency Act against inland bills discounted and purchased per contra ...	Nil	Foreign bills discounted and purchased	·29
Sundries	1·17	Dead stock	2·54
		Liability of constituents for contingent liabilities per contra	Nil
		Sundries	·37
		Balances with other banks ...	·26
		Cash	12·06
Total	94·17	Total	94·17

The above balance-sheet includes :—
Deposits in London £ 137,600.
Advances and investments in London £ 1,678,100.
Cash and balances at other banks in London £ 201,300.
Percentage 14·47.
Bank rate 3½.

Some of the items in the above balance-sheet need an explanation. Reserve is the reserve fund of the Bank built up out of profits. Public deposits are the deposits of Government for which the Bank pays no interest. Their amount depends upon the collection of taxes. Other deposits are the deposits of exchange and Indian joint-stock banks, public bodies, companies, firms, traders, and customers of the Bank. The Bank does not pay interest on current accounts, and pays 3 and 3½ per cent[1] on fixed deposits not below Rs. 500 for 6 and 12 months respectively. It also pays 3 per cent on ordinary savings bank deposits repayable at a week's notice, and 3½ per cent[2] on savings bank deposits of Rs. 10,000 and over fixed for 3 months. Loans against securities per contra are the borrowings of the Bank against some of its authorised securities shown on the assets side of the balance-sheet. Cash credit is an advance given against a promissory note signed by the

1. Reduced temporarily to 2 per cent on fixed deposits for a year in 1933 on account of the increase of the economic depression, deposits for 6 months being declined.

2. Reduced temporarily to 2½ per cent in 1933,

borrower and another approved party and secured by the hypothecation of self-liquidating stocks. The borrower pays interest only to the extent to which he draws upon the credit from day to day subject to a minimum amount, and he can reduce his obligation at any time. The Bank also can curtail or withdraw the credit at any time.

The Bank finances internal trade to a large extent by discounting the hundis of approved indigenous bankers. It is primarily a commercial bank. It also provides short-term finance to textile industries to some extent by means of clean loans granted on promissory notes signed by two persons or on the personal guarantee of some of the shareholders, and gives loans on the security of produce stored in godowns controlled by itself. Dead stock means buildings, furniture and other movable property owned by the Bank. Balances with other banks are the accounts opened with other banks to facilitate the collection and payment of cheques.

The percentage at the foot of the balance-sheet refers to the percentage of cash in the possession of the Bank to its outside liabilities, *i. e.* deposits, loans and sundries. The bank rate is the rate at which the Bank is prepared to lend money against Government securities. It usually ranges between 6 and 8 per cent during the busy season from November to March when the movement of produce from the interior to the ports has to be financed, and between 3 and 5 per cent during the slack season.[1] The rate in the busy season is usually substantially higher than similar rates in the money markets of Western countries. This is due to the insufficiency of funds. It also shows that the Imperial Bank does not effectively control the money market, as the central banks of Western countries do their money markets. The bank rate should not be confused with the Bank's hundi rate, which is the rate at which the Bank discounts first class hundis of approved indigenous bankers maturing after 60 or 90 days. Its hundi rate again is different from the bazaar rate, *i. e.* the rate at which indigenous bankers discount the hundis of merchants.

1. On account of the trade depression the bank rate remained stationary at 4 per cent from 7th July 1932 up to 15th February 1933 and at 3½ per cent from 16th February 1933 up to 1st June 1934.

4. Benefits expected and realised from the Imperial Bank.

At the time of the establishment of the Bank, Government expected it to confer the following great benefits upon the public, the trading community, other banks and Government itself[1] :—

(1) The pursuit by the Bank of a definite policy of establishing an increasing number of branches throughout India, conducting Government treasury and public debt business and possessing undoubted stability, was expected to supply the urgently needed expansion of banking facilities, to inspire confidence in the public, to induce it to deposit its savings with the branches, and to get into the banking habit, and thus to mobilise the capital of the country.

(2) With its numerous branches, with a larger and better distributed working capital, and with a fuller and more elastic use of Government balances, it was expected to be able to finance the internal trade to a larger extent and in a better way, by employing more funds in the rediscount of hundis, and by reducing and steadying the high rate of discount that prevailed during the busy season.

(3) It was expected that the development of Indian joint-stock banks for the finance of the country's trade, agriculture and industries would be stimulated, because they would have behind them the Imperial Bank, with its numerous branches, upon which they would be able to rely for guidance and assistance, which would train Indians in banking business and make them available to the banks, which would exercise an effective control over their discounts and advances and the creation of deposits, thus minimising the possibilities of a crisis and mitigating its severities if it took place, and which, in short, would serve effectively as a bankers' bank.

(4) While the exchange banks were protected from the competition of the Imperial Bank in their foreign exchange business, they were expected to benefit from the

1. See the despatch of the Government of India to the Secretary of State on the Imperial Bank scheme, 1919.

levelling up of the banking standards in India by the latter, and from the facilities for rediscounting their bills afforded by the London branch of the Bank.

(5) It was expected that an increasing proportion of Government balances would be kept with the Bank, that ultimately all the balances would be kept with it, and that this would enable it to give increasing help to the money market of the country.

(6) Government hoped gradually to transfer to the Bank an increasing proportion of its financial and banking work, for which its officers did not possess adequate training and experience, thereby relieving them of much financial responsibility, worry, and public criticism.

(7) It was hoped that the management of the paper currency would be handed over to the Bank when currency conditions became stabilised, and that this would enable the Bank to make Indian currency more elastic, efficient and economical, and to amalgamate the various reserves.

So far these hopes have been realised to a very moderate extent only. It is true that the Imperial Bank has pursued a vigorous policy of opening new branches, especially in places which had no banking offices before, that the total number of its branches is now 163 as against 59 in 1920, and that the new branches have attracted substantial deposits. But no new branches have been opened since March 1926, as some of the branches have not yet reached a profit-earning stage, and as the Bank desires to consolidate and strengthen its existing branches before venturing upon new ones. Moreover, the total private deposits of all the head offices and branches of the Bank taken together, far from showing any increase over those of the three Presidency Banks in 1920, have continued to be less as shown by the table on page 9.

This seems to be the result of the general economic depression, and the management of the Bank should not be blamed for it. The conclusion drawn by Mr. Thakur that the commercial public finds the services of Indian joint-stock banks more suitable is not correct, because the deposits of these banks also have declined during the

period.[1] The amount of the inland bills discounted and purchased by the Bank has also failed to show any increase since 1920.

However, the Bank finances the movement of a large portion of crops by means of advances against stocks, the discount of bills, and the purchase and sale of demand drafts and telegraphic transfers. Moreover, the Bank has succeeded in reducing the difference between its own hundi rate and the bazaar hundi rate, reducing their fluctuations, and removing the variations in the rates of the Bombay, Calcutta, and Madras markets, thereby giving some elasticity to the credit system and stability to the business of the country.[2] The indigenous bankers have been compelled to lower their rates for discounting hundis, because the Imperial Bank has been discounting them at lower rates. They have done this even in some of the localities in which the Bank has no branches, owing to the fear that the Bank may be induced to open branches there.

The rate for borrowing money from the indigenous bankers has shown a much smaller tendency to decline, because the Imperial Bank cannot lend freely in the mofussil owing to the restrictions on its lending, and because the principles on which the indigenous bankers do business are different from those of joint-stock banking. Further, the competition of the Imperial Bank has compelled other joint-stock banks also to reduce their rates not only in those places in which the Imperial Bank has branches, but in some other places also, owing to their fear that the Bank may establish branches there. This has benefited the cultivators, because the smaller the cost to merchants of borrowing money, the lower is the cost to them of marketing produce, and competition leads them to offer better prices to the cultivators for their produce.[3] Moreover, the facilities given by the Bank for

1. See Thakur, *Organisation of Indian Banking*, p. 56 and Dadachanji, *A Reserve Bank for India and the Money Market*, p. 189.

2. *Cf.* Rau, *Present Day Banking in India*, p. 48.

3. *Cf.* the evidence of the Manager of the Allahabad Bank before the Indian Currency Commission of 1926, Vol. V, Q. 11870 and 12053-77.

the transfer of funds between its local head offices and branches at very low charges have proved beneficial to the public, and they have been extensively used by the latter, although there has been a decrease in their use since 1926.

Finally, the Bank has served as a bankers' bank to some extent, and has given assistance, with due regard to sound banking methods, to other banks that may get into difficulties.[1] When the Alliance Bank of Simla failed, it averted a panic in the country by supplying at once funds to pay off one-half of the demands of the creditors of the Alliance Bank. It, however, did this according to the orders of the Government of India. But, when there were runs on the Tata Industrial Bank, the Bengal National Bank and the Central Bank of India at different times, the Imperial Bank promptly came to their assistance without any orders from Government. Further, the exchange banks obtain from the Imperial Bank loans against authorised securities when necessary, and are, therefore, able to economise considerably in their idle money. Indian joint-stock banks also generally receive the same facility, and some of them are given cash credit facilities according to their needs. Both the classes of banks keep substantial balances with the Imperial Bank.

The Bank also discounts bills endorsed by approved indigenous bankers within limits fixed for each banker, and gives them loans on demand pro-notes bearing two names.[2] It has also built up close relations with the provincial co-operative banks of different provinces, and allows them overdrafts. It is, however, too much to expect the Bank to function fully as a true bankers' bank, because it is a competitor of the other banks in different classes of business. Moreover, the Bank is not bound by the Imperial Bank Act to make advances to the other banks against Government or other securities.

1. See the statements of the Bengal and Bombay Chambers of Commerce, Central Committee Evidence, Vol. II, pp. 481 and 518.
2. *Cf.* the statement of Mr. MacDonald, the Managing Governor of the Imperial Bank, Central Committee Evidence, Vol. II, p. 232.

The competition of the Imperial Bank, however, with the other banks has often been exaggerated. In nearly one-half of the places where the Imperial Bank has branches, there are no other banking offices at all. The question of competition, therefore, arises only in the other places in which there are branches of the Imperial Bank and other banking offices. A lowering of the rates of interest in these places shows that the joint-stock banks have lost their semi-monopoly, and that the business community has benefited correspondingly. Moreover, the advantage, which it has over the other banks from the interest-free use of Government balances, is largely offset by the special restrictions that have been imposed on its working, and by its increased expenditure connected with its free services to Government.[1] Further, some of the Central Banks of Continental Europe do transact ordinary commercial banking business to an appreciable extent. Finally, the relations between the Imperial Bank and the other banks appear to have been fairly cordial on the whole[2] and, as mentioned before, most of the latter have kept substantial balances with the former.

5. Defects in the organisation and working of the Imperial Bank.

We may now proceed to the defects in the organisation and working of the Bank. They are as follows :—

(1) Its administration, with three permanent head offices in Bombay, Calcutta and Madras, is top heavy. Considerable savings can be made by giving it a single head office.

(2) Although the Legislature and the Government of India have already accepted the principle that, when an institution receives help from the State, its management should be preponderatingly in the hands of Indians, there is no provision in the Imperial Bank Act to secure a majority of Indians among the Bank's shareholders, and Central and Local Boards, and of the paid-up capital of the Bank amounting to Rs. 5,62,50,000, Rs. 2,84,41,750 belong to non-Indians and Rs. 2,78,08,250 to Indians.

1. *Cf.* Foreign Experts' Report, Central Committee Report, p. 627.
2. *Cf.* Jain, *The Monetary Problems of India*, p. 120.

(3) Government nominates the majority of the members of the Central Board.

(4) The superior staff of the Bank is still predominantly non-Indian, and it has been asserted that the rate of its Indianisation has been too slow, and that further recruitment of non-Indians was continued until 1930. The Managing Governor of the Bank has stated that a vigorous policy of Indianisation is now being pursued by the Bank.[1]

(5) It has been said that as a result of all these factors the Bank has been resorting to racial and political discrimination to some extent, in granting financial accommodation, that Indians do not always get the accommodation to which their assets entitle them, and that non-Indians have frequently been given larger credit than that to which they have been entitled on business principles.[2]

(6) Although in the past the exchange banks were jealous of the Presidency Banks and prevented them from doing foreign exchange business by making Government prohibit them from engaging in it, they were shrewd enough not to carry their differences too far, and in recent years a close understanding has been developed among them and the Imperial Bank. The basis of the understanding during the War was the difficulties of the exchange banks, and the basis since the end of the War has been the difficulties of Government in carrying out its exchange policy, which have necessitated a frequent contraction of currency to maintain exchange, a high bank rate to support the contraction, and large sales of treasury bills to the exchange banks. Moreover, the Imperial Bank has on deposit much larger balances from the exchange banks than from the Indian banks, gives them larger overdrafts, acts as their agent in the interior for the collection of bills and cheques and for other business, and manages the clearing

1. See his answers, Central Committee Evidence, Vol. III, p. 874.

2. *Cf.* Mr. Goswami's Minute, External Capital Committee Report, p. 24, Mr. Thakur's statement, Central Committee Evidence, Vol. II, p. 431 and the answers of the representatives of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. III, p. 730.

houses, the majority of the members of which, in many cases, are the exchange banks. Finally, the fact that the staffs of the Imperial Bank and the exchange banks are non-Indian and, in respect of the British exchange banks, have a common nationality, has provided a bond between them. It is said that the attitude of the Imperial Bank to the Indian joint-stock banks has been much less friendly.[1]

(7) The Imperial Bank is prevented from conducting general operations outside India and Ceylon. Its operations in London through its London branch are special, and it is debarred from conducting foreign exchange operations on the ground that they are precarious and speculative. But the Secretary of State and the Government of India conduct them every year on a large scale, and the feeling is said to be widespread that the Bank is prevented from engaging in exchange business to safeguard the vested interests of the exchange banks, which possess the monopoly of financing India's foreign trade.[2]

(8) The Bank cannot borrow money or receive deposits outside India except in an emergency, and it is, therefore, virtually debarred from obtaining money in London or other financial centres for use in India. In 1877 and 1899, the Presidency Banks memorialised the Secretary of State for permission to borrow outside India, but it was refused on the grounds, that " borrowing in London would involve the banks in dealings in foreign exchanges, a class of business which the Bank of England does not transact, and which is not banking but speculative commercial business ", that " the position of the banks should be strengthened by an increase of capital before they could safely be allowed to resort to the London market," and that " while access to London might be given to one amalgamated bank it could not be given conveniently to three separate banks."

But these objections disappeared with the amalgamation of the three Presidency Banks into a single

1. See Central Committee Minority Report, pp. 274-77.

2. See Mr. Pochkhanawala's answers, Central Committee Evidence, Vol. III, p. 57.

institution, the Imperial Bank, with an enlarged capital. Moreover, the Secretary of State and the Government of India, as mentioned above, engage in this business on a large scale, and under a Gold Standard, or even under a Gold-Exchange Standard in ordinary times, the business is not more speculative than dealings in inland bills of exchange. Further, although the Bank of England does not deal in foreign exchanges, it is not prohibited by law from doing so, and it has frequently borrowed large sums from abroad to meet its needs. Furthermore, all other central banks also possess the power to borrow money outside their own countries, and are not crippled by any prohibition to borrow in any part of the world. Even the most powerful banks sometimes have to borrow abroad by pledging their securities to meet special requirements.

The objection, that permission to borrow money in the London market may lead to the Imperial Bank locking up a part of its resources at such a great distance from India as to make them unavailable if any emergency were to occur in India, is not valid, because mere borrowing cannot lock up a bank's resources, unless it invests them in securities which cannot be sold readily. It is, therefore, generally felt that this restriction also has been imposed upon the Imperial Bank in the interests of the exchange banks. But it has prevented the Bank from having elastic resources and, therefore, from controlling adequately the money market in India.

In periods of financial stringency and specially large trade demands for funds, the Imperial Bank, like the Presidency Banks in the past, has not been able to borrow funds sufficiently, although it has possessed first class investments which it could offer as security for loans, because the power of Government to lend funds to it has been limited to Rs. 12 crores against internal bills of exchange by the Paper Currency Amendment Act, because no other institution in India can lend to it, and because it has not been allowed to borrow funds outside India. This has unnecessarily hampered the finance of trade in India. The relaxation of the restrictions, to which the Presidency Banks were subject before amalgamation, has been

confined to commercial banking, and the services which the Imperial Bank has rendered to the country have been confined mainly to commercial banking.[1]

(9) Although the proportion of cash to liabilities maintained by the Imperial Bank is higher than that maintained by the Indian joint-stock banks and the exchange banks in India, partly due to the fact that the Imperial Bank pays no interest on current accounts and pays lower interest on fixed deposits than the other banks, the following table shows that the proportion has tended to decline in recent years:—

Proportion of cash to liabilities on deposits of the Imperial Bank on 31st December each year.[2]

Year.	Per cent.	Year.	Per cent.
1921	19	1927	14
1922	21	1928	13
1923	18	1929	18
1924	18	1930	16
1925	21	1931	15
1926	26		

The pressure of the exchange banks may ultimately compel the Imperial Bank to give interest on current accounts and to pay higher interest on fixed deposits, and this may lead to a further deterioration of its cash position. The position is important, as other financial agencies in India look up to it for relief, and it is the barometer which explains and justifies alterations in the bank rate, except when they are made for currency purposes.[3]

(10) Its volume of cash credits has increased and that of bills has diminished. This has prevented the growth of a bill market in India which, as mentioned later, is essential for the sound development of banking in India. The increase in the Bank's investments, which can be only in authorised securities, has not helped trade and industry, and most of it has been made available to Government

1. *Cf.* Wadia and Joshi, *Money and the Money Market in India*, pp. 316-20.

2. See Statistical Tables relating to Banks in India, 1931, p. 7.

3. *Cf.* Central Committee Minority Report, p. 268.

finance in various forms. These changes are brought out by the following figures :—

	March 1921.	March 1931.
	Crores of Rs.	Crores of Rs.
Bills	9·62	5·32
Cash credits	22·34	29·33
Loans	16·38	12·11
Investments	13·17	29·74

(11) The method employed to secure the extension of banking facilities in India, *viz.* providing the Bank exclusively with interest-free Government balances and encouraging it to establish new branches, is regarded as unduly costly by some, and it is asserted that if this privilege is withdrawn, the Bank would be compelled to shut up some of its branches. It is also felt by some that the Bank is using the branches more for collecting deposits in the interior and withdrawing them for use to the few financial centres in India than for financing the trade of the interior which supplies the deposits.[1]

6. Why the Imperial Bank will not be developed into a Central Bank.

We may now proceed to the question, why the Central Legislature has decided, by passing the Reserve Bank of India Act, that the Imperial Bank, which has been performing some of the functions of a Central Bank, should not be developed into a full Central Bank, and that a new institution should be established for performing all the functions of such a bank. The chief reason for this decision is that the Imperial Bank cannot be converted into a Central Bank without depriving it of its commercial banking functions. The working of a Central Bank must be absolutely safe, and its assets must have a maximum of liquidity. These requirements would be endangered by the performance of commercial banking functions by

1. *Cf.* Minority Report, p. 274, Bombay Committee Report, p. 123 and Central Areas Committee Report, pp. 371 and 374.

a Central Bank. The acceptance of deposits from the public and the payment of interest on them would increase its liability and risk, and endanger the liquidity of its assets, as it would have to pay great attention to its earnings, and so it might have to engage in risky business, which it ought to avoid.

Moreover, it would find it difficult to function as a true bankers' bank and to give help to other banks when they need it, because the bank might have to repay the deposits and to give loans to its customers at the same time, although many of its securities might not be liquid. Further, it would be unfair on the part of a Central Bank to use its special privileges to enter into competition with the commercial banks of the country. Finally, the managers of the bank should not be prevented from concentrating themselves on central banking functions by having to deal with commercial banking, which would strain their energies and judgment and cause them distraction.

If the Imperial Bank had been given the functions and status of a Central Bank without depriving it of its commercial banking functions, it would have become far more powerful, would have been able to offer more serious competition to the other banks in the country, and might even have threatened their existence. In this connection Mr. Kisch, the Financial Secretary at the India Office expressed the opinion to the Hilton Young Commission on Indian Currency and Finance that the holder of the ultimate reserves of the country should not itself be the channel through which credit was given to individuals and firms.[1]

Moreover, the Bank could not have functioned adequately as a bankers' bank, if it had become an active rival of the other banks, because it might have been tempted to withhold sufficient help from its rivals even if they needed and deserved the help, and because they, far from regarding it as their saviour in their time of need, would have been always suspicious of its attitude towards them, and jealous of its special privileges. Further, the Bank would have

1. See Minutes of Evidence of the Commission, Vol. V, p. 132.

been suspected generally of managing the currency more in its own interests than those of the country. Furthermore, loading the Bank with commercial, as well as central, banking functions would have thrown upon it a heavy burden, and would have made its working cumbrous, difficult and inefficient.[1]

It was suggested that the Bank should be divided into two separate departments, the Issue and Banking Departments, that the former should be entrusted with central banking functions, including the issue of notes, and that the latter should be free to conduct commercial banking. This formal separation would not have removed the difficulties and risks mentioned above, because both the departments would have had to be under the control of the same authorities. As Mr. Kisch explained to the Hilton Young Commission, "we must have an absolute assurance that the Issue Department is never made the handmaid of the Banking Department, and as the control of the note issue involves, rightly, discretionary power, and the exercise of judgment and wisdom, one wants that those powers should be exercised under the most favourable circumstances for their proper discharge."[2]

It was asserted that unless the Reserve Bank in India transacted commercial banking work, it could not get sufficient business and, therefore, could not earn adequate profits. It may, however, be pointed out that the bank's work of rediscounting the bills of other banks would develop gradually, and that in the meanwhile, its special privileges, including the right of note issue, would yield it a fair margin of profits. Moreover, a national institution like the Reserve Bank must subordinate the question of profits to the development of a sound banking system in India.

It becomes clear, therefore, that if the Imperial Bank were to be developed into a Reserve Bank, it would have been necessary to deprive it of its commercial banking functions, although it has been performing them successfully.

1. See Dadachanji, op. cit. p. 207 and Mr. Gubbay's evidence before the Hilton Young Currency Commission, Vol, V, p. 117.

2. Minutes of Evidence, Vol. V, p. 67.

India would then have been deprived of the advantages of the widespread and elaborate organisation that has been built up throughout the country to provide it with vitally required commercial banking facilities, and to help it to develop the banking and investment habit. It is, therefore, necessary not only to leave the present functions of the Bank entirely undisturbed, but also to remove the restrictions that have been imposed upon them owing to the Bank's performance of a few central banking functions. When the latter are handed over to a new and separate Reserve Bank, there would be no difficulty in removing the restrictions upon the commercial banking functions of the Imperial Bank, and allowing it to conduct its activities as freely as any commercial bank in the country, and thus to provide larger, better and cheaper banking facilities to the Indian community. The Central Legislature has decided, therefore, to adopt the proper course, *viz.* to establish a new bank, to be called the Reserve Bank of India, to hand over all central banking functions to it, and to make it a true Central Bank.[1] With this object, it has already passed the Reserve Bank of India Act.[1]

7. The Imperial Bank Amendment Act of 1934.

The Central Legislature has also passed the Imperial Bank Amendment Act of 1934, and it will come into force from a date which will be notified by the Governor-General after the establishment of the Reserve Bank. It will make the following changes in the organisation and working of the Imperial Bank :—

(1) The Central Board of the Bank will consist of the following Directors :—

(i) the Presidents and Vice-Presidents of the Local Boards ;

(ii) one person to be elected from among themselves by the members of each Local Board ;

(iii) a Managing Director, who will be appointed by the Central Board for a period not exceeding 5 years on such terms as the Central Board may direct, and may be

1. *Cf.* the Report of the Hilton Young Commission on Indian Currency and Finance 1926, pp. 34-5.

continued by the Board for such further periods not exceeding 5 years in each case as the Board may think fit;

(iv) such a number of persons not exceeding 2 as may be nominated by the Governor-General in Council. They will hold office for one year, but may be renominated;

(v) a Deputy Managing Director who will be appointed by the Central Board;

(vi) the Secretaries of the Local Boards;

(vii) a Government officer nominated by the Governor-General in Council;

(viii) if any Local Board is established afterwards, such a number of persons to represent it as the Central Board may prescribe.

The Directors mentioned in (v), (vi) and (vii) will not, however, be entitled to vote on any question at any meeting. But the Deputy Managing Director will be entitled to vote in the absence of the Managing Director.

(2) The Imperial Bank will cease to be banker to Government, but it will act as the sole agent of the Reserve Bank in places where the latter has no branches, under an agreement the terms of which will be explained in the chapter on the Reserve Bank, as the Imperial Bank has a larger number of branches spread throughout the country than any other bank.

(3) The Imperial Bank will be freed from the power of the Governor-General to issue instructions to it in matters vitally affecting his financial policy or the safety of Government balances, and from the necessity of obtaining his previous sanction for establishing more local head offices and local boards and for certain operations.

(4) The Bank will be freed from some of the restrictions that have existed on its working. Thus, it will be free—

(i) to establish branches or agencies at such places in India or elsewhere as it deems advantageous;

(ii) to buy and sell foreign bills of exchange of usance not exceeding 9 months if they relate to the financing of

seasonal agricultural operations, and 6 months in other cases;

(iii) to open cash credits, to receive deposits and to borrow money outside India;

(iv) to make advances against goods hypothecated to it instead of being restricted to advances only against goods, which are in its possession, or the documents of title to which are deposited with it; and

(v) to make advances and to open cash credits on the security of the shares of the Reserve Bank, or debentures issued under the authority of a municipal board or committee, or with the sanction of the Governor-General in Council, debentures issued under the authority of the ruler of an Indian State, or subject to the directions of its Central Board, debentures or fully paid shares of companies, with limited liability, registered in India or elsewhere.

It will be seen from this that some of the restrictions on the operations of the Bank imposed by the Act of 1920 will be continued. This is due to the fact that the Bank will continue to occupy a special position as the sole agent of the Reserve Bank.

Some authorities have objected to the working of the Imperial Bank under any special Act after the Reserve Bank is established, and have suggested that it should be brought under the same legislation that will be applied to other joint-stock banks, and should take its rank among them as the premier Indian joint-stock bank.[1] Their reason is that the special Act will give the Bank a position and prestige which will be opposed to the interests of the other joint-stock banks in India, and that its special privileges will enable it to continue to offer severe and unfair competition to the other banks. On the other hand, if it is left in an unsheltered and unprivileged position, it will be able to appreciate the difficulties against which the other banks are struggling. It will then throw its weight to remove the difficulties, and in seeking to promote its own interests, will also promote those of the

1. See Central Committee Minority Report, pp. 279 and 283-5 and Mr. Thakur's statement, Central Committee Evidence Vol. II, p. 431.

banks that will belong to its class. These authorities have further suggested that the Reserve Bank should be free to appoint any joint-stock banks as its agents, and to give them the benefit of the use of its balances free from interest.

These suggestions have not been accepted by the Legislature because, since the Imperial Bank is the only bank that has branches throughout the country, it has thought it necessary to make the Bank the sole agent of the Reserve Bank ; and as the Bank's agency business will include Government treasury business, it has thought it desirable to continue to regulate the working of the Bank by means of a special Act.

8. Future policy of the Imperial Bank.

The continuance of its special position and privileges will make it all the more necessary for it to do its best to remove defects in its working, to give larger and better assistance to the trade and industries of the country, and to help the Reserve Bank in its task of establishing a sound banking system in the country. The following suggestions have been made to secure these objects :—

(1) It should cut down its top-heavy administration. Considerable savings can be made, if it has a single head office, instead of three. Whether Bombay or Calcutta is selected for this purpose, there is bound to be opposition from the vested interests of the other two centres, but Government and the Legislature should decide this matter, as it possesses much public importance.

(2) No further recruitment of non-Indians to the staff of the Bank should be made, except in special cases with the approval of the Finance Minister of the Government of India.[1]

(3) The local agents of the Bank should pay special attention to the removal of the suspicion from the public mind that they resort to racial and political discrimination in granting financial assistance. They should know thoroughly the languages of the districts in

1. See Central Committee Report, p. 372.

which they serve, and should make the best efforts to keep themselves in touch with the commercial community of the districts. They should regard the progressive development of local channels of investment as an important duty. To enable them to establish and maintain a close touch with their local clientele, the Bombay Committee has suggested the establishment of local advisory committees as an experimental measure in a few selected centres.[1] The committees will supply points of contact between the Bank and other local banks, trade and industries, will remove the existing hesitation of indigenous bankers and local traders in applying to the Bank for financial assistance on account of the uncertainty of the treatment that they receive from it, and will be useful in bridging the gulf that exists between the Bank's branches and the commercial community in need of credit. Mr. MacDonald, the Managing Governor of the Bank, however, has stated in his evidence before the Central Committee that such advisory committees are unnecessary, as the efficiency and knowledge of local conditions of the Bank's agents have been steadily improving.[2]

(4) The Bank should endeavour to remove the scarcity of commercial bills by pursuing a liberal policy in discounting the bills of indigenous bankers.

(5) It should use the indigenous bankers as agents for the collection of cheques and bills in the same way as it uses joint-stock and co-operative banks.

(6) It should give advances more freely against agricultural produce stored in godowns.

(7) It should give cash credit and overdraft facilities more freely to co-operative banks against sound security.

(8) It should not make any attempt to curtail the facilities for free remittance of funds for co-operative purposes that it has been giving to the co-operative banks, and for other than co-operative purposes, it should give them remittance facilities on the same terms as those on which it gives the facilities to joint-stock banks.

1. See Bombay Committee Report, p. 234.
2. See Central Committee Evidence, Vol. III, p. 934.

(9) It should extend its practice of giving loans against gold ornaments, so as to save the fairly well-to-do among the cultivators to a larger extent from the clutches of the money-lenders.

(10) Within safe limits it should give larger financial assistance to industries on the lines followed by German joint-stock banks, as explained before.

(11) It should take up and develop the work of financing India's foreign trade, and overcome the exchange banks' monopoly of this line of business.

CHAPTER XI

The Money Market and Relations between the Different Parts of the Banking System.

1. Inadequate connection between the component parts.

The money market in India may be divided into two parts, the European or central part, consisting of the Imperial Bank of India and the exchange banks, and the Indian or bazaar part, consisting of the money-lenders, indigenous bankers, loan offices, chit funds, nidhis, etc., the Indian joint-stock and co-operative banks occupying an intermediate position. The connection between these parts is incomplete, as the Indian banking system is loosely organised and without cohesion, and lacks a central co-ordinating agency. The central part is largely dominated by Government which controls the currency, and through it influences the bank rate decisively. The money market in India, therefore, is defective, and cannot be compared with the highly developed money markets in Western countries.[1]

Owing to the absence of a Central Bank, the Imperial Bank performs some of the functions of a bankers' bank. The other banks are not bound to keep balances with it, but in practice the exchange banks and the larger Indian joint-stock banks keep a substantial part of their cash balances with it. Its grant of loans to the joint-stock banks against Government securities at the bank rate proves very useful to them, but the high bank rate frequently reduces to a considerable extent the benefits of such loans. On account of the special concessions that the Imperial Bank receives from Government, the joint-stock banks regard it more as an unfair competitor than as a friendly supporter, and there is no close connection between it and them. They also consider the exchange banks as

1. See Foreign Experts' Report, Central Committee Report, p. 648 and the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 495.

powerful competitors owing to the latter's large resources, ability to secure deposits at lower rates of interest, and encroachment upon the field of the finance of internal trade at the ports as well as in the interior. The provincial co-operative banks maintain small current accounts with the Imperial Bank, and also get cash credit and overdraft facilities from it. The central co-operative banks also keep small current accounts with the Imperial Bank and some joint-stock banks. But the primary co-operative societies have connection with other co-operative credit institutions only.

The co-operative banks have no connection with the indigenous bankers and money-lenders beyond the fact that a few of them are depositors or directors of the central co-operative banks. The joint-stock banks feel that the co-operative banks also have begun to compete with them by undertaking business that does not really form a part of co-operation, such as opening current accounts, the purchase of drafts and the sale of remittance, and the indigenous bankers also have the same feeling.

There is not much contact between the indigenous bankers and the money-lenders, and both of them usually do not maintain accounts with the Imperial Bank. During the busy season, when the supply of hundis is greater than the resources of the indigenous bankers, a temporary connection is established between a number of them who are selected and placed on an approved list, and the Imperial Bank and the joint-stock banks, and the banks rediscount the hundis drawn and endorsed by the approved indigenous bankers up to certain maximum limits determined according to the financial standing of the bankers, or give them advances against demand promissory notes signed by two of them.[1]

2. Rates in the money market.

On account of this loose organisation of the Indian banking system, the bank rate has a much less importance in the money market in India than in those of Western countries. In the London money market, for instance, the banks, whose resources are derived mainly from

1. *Cf.* Central Committee Report, p. 395.

current and deposit accounts, do not pay interest on balances in the current accounts, and pay interest on time deposits at a rate which is 2 per cent less than the bank rate. In addition to cash, their liquid assets consist chiefly of bills discounted, and money at call or short notice. Of the latter, the major portion is lent to the discount market, either for a night or for a week, against bills accepted by first class banks and finance houses. The interest charged on call loans is low, and that on loans given for a week is 1 per cent less than the bank rate.

The market rate for loans in the London money market is the rate charged for loans given to bill-brokers for a week. The resources of the bill-brokers for discounting bills are made up of loans given by the banks at call or short notice and loans given by finance houses and merchants. Whatever money is not lent by the banks to the discount market at call or short notice, is lent by them to operators on the stock exchange for financing the latter's fortnightly settlements. If the discount market for any reason cannot obtain sufficient funds from the banks to finance the bills, the bill-brokers make up the deficiency either by discounting approved bills at the Bank of England at the bank rate, which is the official minimum rate at which the Bank is prepared to discount bills, or by securing loans from the Bank at ½ per cent higher than the bank rate.

The conditions of the money market in India are in a marked contrast to those described above. The banks pay interest on balances in current accounts as well as time deposits, but there is no definite connection between these rates and the Imperial Bank rate. Stock exchange operations seldom play an important part in the distribution of the resources of the various banks. Their holdings of bills are never large, and those that are held are regarded as a definite investment, and are seldom rediscounted. As explained before, the exports bills have to be immediately sent out of India for acceptance, and are rediscounted, if necessary, in the London market, and the import bills are held by the exchange banks until they mature. Some of the inland bills get into the hands of the Imperial Bank

through the indigenous bankers, but owing to the lack of warehouse receipts it is difficult to separate inland trade bills representing the movement of goods internally from finance bills drawn merely to raise funds, and a properly organised market for dealing in such bills does not exist.

The bank rate in Western countries is the rate at which their Central Banks are prepared to discount first class trade bills. But the bank rate in India means the rate at which the Imperial Bank is ready to give demand loans against Government securities. The movements of this rate have more connection with the loan operations and exchange policy of Government and its balances with the Bank than with the requirements of trade and industry. The rate is often lowered when Government issues a loan, and may be raised to tone up a dull exchange. A reduction in Government balances with the Bank reduces the Bank's cash percentage, and compels it to raise its rate. This is the result of the powers which Government has under the Imperial Bank Act, owing to its responsibility for the management of the currency. The bank rate is thus a true indicator of the cash position of the Imperial Bank, and it is not always a reliable index of conditions in the money market.[1]

As the security afforded by Government securities is at least as good as that of first class trade bills, the Imperial Bank rate should have been the lowest rate at which loans could be obtained from the Bank against Government securities. But actually the Imperial Bank hundi rate, *i.e.* the rate at which it discounts or rediscounts first class bills running for 61 days or less, is sometimes higher and sometimes lower than its official bank rate, although there is a close connection between the two. Moreover, the bazaar rates, *i.e.* the rates charged by indigenous bankers for discounting small traders' bills, differ from the official bank rate. The bazaar rates are different in Bombay and Calcutta, and in Bombay city itself the rates are different in the

1. See the statements of the Bengal and Bengal National Chambers of Commerce, and Mr. Shroff, Central Committee Evidence, Vol. II, pp. 479, 500 and 413.

Gujarati, Marwari, and Multani bazaars. The simultaneous existence of an inter-bank call money rate of ¾ per cent, a hundi rate of 3 per cent, a bank rate of 4 per cent, a Bombay bazaar rate of 6¾ per cent and a Calcutta bazaar rate of 10 per cent shows a surprising sluggishness in the movement of credit between the different money markets in India.[1]

The call money rate is the rate for surplus funds needing employment for a minimum period of 24 hours, and call money is repayable at the option of both the borrower and the lender. But the bank rate is the rate charged for the use of funds for a definite period, and loans against securities at the bank rate are generally repayable at the option of the borrower only. The call money rate, therefore, should be lower than the bank rate. In Western countries the former tends towards a demand deposit or current account rate, while the latter denotes a lending rate, as the supply of currency and credit is effectively regulated by the Central Banks, which withdraw surplus funds from, or supply additional funds to, the market as required. But in India, during the slack season, sometimes call money cannot be lent at any rate in the absence of Government treasury bills, and in the busy season it may not be available even at the bank rate. The difference between the two rates does not ordinarily call for any special action, but may need the attention of the Reserve Bank of India in conditions of exceptional ease or stringency in the money market in connection with the exchange.

The cause of the difference between the bank rate and the bazaar rates is the existence of the European or central and the Indian or bazaar money markets. The proper connection between the two markets would be a continuous supply of trade bills endorsed by reliable firms or discount houses, which would keep themselves in close touch with both the markets, and which, on the one hand, would supply the needs of the merchants who rely upon the elastic methods of the bazaar money market, and on the other, would benefit from operations in the central

1. See Central Committee Report, p. 400.

money and discount markets; but such a connection does not yet exist. The aim must be to mobilise all the floating funds of the country, into which bills can find an entry with a minimum delay and a minimum intervention of middlemen, and the Reserve Bank of India can render valuable services in the gradual realisation of this aim. The absence of a fixed relation between the deposit rate and the bank rate is due to the poor organisation of the money market in India, the sound organisation of which on modern lines can be brought about only by the Reserve Bank of India.

3. Inelasticity and instability of the money market and suggestions for removing them.

Another characteristic of the money market in India is its inelasticity and instability. The fluctuations in the bank rate are rapid and large. It falls to 3 per cent during the slack season, and may rise up to 7 or 8 per cent at the height of the busy season.[1] The instability and uncertainty increase business risk, impose serious hardship upon the business community, and check industrial development, which has been dependent, to a considerable extent, upon funds borrowed for short periods. Agriculture and trade in the interior suffer more than business in port towns, as the latter is in a better position to pay high money rates, so that at the height of the busy season money is drained to these centres, and the banks are disinclined to do much business in the interior, in order to have the bulk of their funds at the port towns. The cause of the instability is the seasonal stringency of money. The demand for money during the busy season, when the collection and movement of the harvests have to be financed, is abnormal owing to the predominance of agricultural production in India, and the normal volume of currency proves insufficient to meet the demand. But the same volume becomes excessive during the dull months of the summer and the monsoon,

1. On account of the economic depression the bank rate remained stationary at 4 per cent from 7th July 1932 up to 15th February 1933, and at 3½ per cent from 16th February 1933 up to 1st June 1934.

when productive activity of all kinds is necessarily restricted by unfavourable weather conditions.

Until the Imperial Bank of India was established in 1921, Government maintained separate and independent treasuries which withdrew from circulation and locked up large amounts of money received as revenue, at the very time when more funds were needed for financing the movement of crops, and thus aggravated the seasonal stringency. Government finance was thus completely divorced from the money market, and the latter was left to find its own salvation. Most of the Government balances are now kept with the Imperial Bank, which gives the trading community their use until they are required by Government. This has helped to alleviate the stringency to some extent. The Government of India and the Secretary of State, however, have continued to do independently a substantial amount of banking business, and this has produced at times considerable disturbances in the money market.

Another measure which has helped to alleviate the stringency is the Indian Paper Currency Act of 1923, which has empowered the Government of India to issue additional currency notes up to a maximum of Rs. 12 crores in the form of loans to the Imperial Bank against internal bills of exchange maturing within 90 days from the date of their issue. The procedure laid down for this issue is that it cannot be made until the bank rate rises to 6 per cent, and that the entire amount outstanding at any time must yield interest at the bank rate, subject to a minimum limit of 6 per cent for the first Rs. 4 crores, and 7 per cent for the remaining Rs. 8 crores. This fixing of arbitrary rates and limits for the issue unnecessarily handicaps trade and industry in the country.

The suggestion that has been made to the Central Banking Committee, that the issue should be made at the prevailing bank rate without fixing any minimum, would not remove the above handicap as long as the issue of additional currency depends upon the discretion of Government, because Government may decline to issue additional currency at any time on the ground that the bank rate is

lower than the rate that monetary conditions justify, thereby compelling the Imperial Bank to raise the rate. The suggestion, that the arbitrary limit of Rs. 12 crores for the issue should be raised to at least 10 per cent of the circulation, has no practical significance at present owing to the shortage of the requisite bills in the hands of the Imperial Bank, which has, therefore, to induce firms, which have hitherto financed themselves by cash credits, to substitute trade bills for them.[1]

The crux of the problem is the absence of a bank rate policy due to the fact that, among the great trading countries of the world, India is the only country in which a dual control is exercised over currency and credit. Government controls currency. The Imperial Bank controls credit to the extent that it is controlled at all. Divided control means divided counsels and failure to coordinate. If production and trade increase, the demand for credit increases, but the ability of the banks to supply it depends largely upon the amount of currency in their hands. If the amount is insufficient, they have to curtail credit, and this in turn curtails the activities of the producers and traders. There is, thus, no connection between the issue of paper currency and the need of the public to get their bills or commodities converted into media of exchange.

The Imperial Bank has some of the privileges of a Reserve Bank, such as a free use of Government balances and a portion of the balances of the other banks, but it does not perform the task of a Reserve Bank. Being primarily a commercial bank, and having no responsibility for the supply of currency, it has no stimulus to keep such large cash reserves during the slack season as to be able to meet the stringency of money during the busy season without raising the bank rate unduly. It invests large amounts in Government securities, while trade and industry have to pay high rates owing to the raising of the bank rate.[2] This dual control is a fundamental cause of the lack of elasticity and stability in the money market

1. *Cf.* Central Committee Report, p. 403 and Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, p. 112.

2. See Foreign Experts' Report, Central Committee Report, p. 648.

of India. The elasticity of paper currency based on Government securities is very limited, because the amount of the latter that the banks can hold is not quickly expansible, and because it is neither easy for them suddenly to liquidate their holdings in the securities nor desirable for Government that they should do so. The development of the deposit and cheque system also has not been commensurate with the elasticity needed by the country. Further, Government exercises a large control over the bank rate through its power of expanding and contracting currency, as the rate depends to a considerable extent upon the supply of currency. Government cannot be deprived of this control over the bank rate and the money market so long as the management of the currency continues to be in its hands.

Moreover, recently Government has been influencing the money market through large issues of treasury bills for 6 or 12 months, which compete with banks for available deposits. While bank deposits have remained almost stationary for the last 12 years, the net borrowings of Government in the shape of loans, treasury bills and cash certificates since 1925 have been very large. This has tended to raise the price of credit and to handicap trade and industry. The issue of treasury bills has caused a scarcity of money in the market, when the proceeds have been used to contract currency by cancelling *ad hoc* securities. The issues have also brought about during certain periods a considerable depreciation in the market value of ordinary Government securities, inflicting losses on the banks, insurance companies and others who hold long-dated securities, and producing nervousness among investors in new Government loans. The banks especially have too large a proportion of their investments in Government securities, and the Foreign Experts have recommended that they should be replaced by commercial bills to a large extent.

The inelasticity and instability of the money market are also due to the fact that there is no mobilisation of reserves, on the basis of which a credit policy can be made effective. Under the existing decentralised system all the banks keep separate reserves. The cur-

rency reserve, in the shape of the Paper Currency and Gold Standard Reserves, is locked up with Government. Consequently, these reserves of the country cannot be used to the fullest extent for the building up of credit, and their capacity to carry out their function of stabilisation most economically and efficiently gets reduced.

To remove these difficulties, currency and credit must be co-ordinated, and control over both must be in the hands of a single authority. Government cannot be that authority because, not being engaged in banking, it cannot keep itself in close touch with trade and industry, and cannot possess an adequate knowledge of their varying needs for currency and credit. Moreover, the working of the Government currency mechanism is slow, cautious, and not quickly responsive to sudden changes, and this may produce disastrous results in an emergency, when producers and traders may urgently need additional cash. The controlling authority, therefore, must be the Reserve Bank, which can readily adjust the volume of currency to the needs of production and trade, because it can base the circulation of its notes directly on business transactions by issuing them in connection with the discounting of bills of exchange.

The Reserve Bank will also do away with the existing separation of currency and banking reserves by concentrating them in its own hands. A centralised system, with a single central reserve, will enable the Reserve Bank to keep during the slack season a higher percentage of gold reserve against its notes than that required by statute, so that during the busy season the Bank will be able to issue more notes for financing the movement of crops without increasing the gold reserve. The supply of additional currency by the Bank against proper cover will then become automatic, and there will be no need to raise the rate of discount to a penal level on this account. The extension of banking facilities throughout the country that will be promoted by the Reserve Bank will also increase the rapidity of the circulation of money, and help to relieve the seasonal stringency. Such stringency is not inevitable even in a predominantly agricul-

tural country, and it has been effectively relieved in agricultural countries like Canada and Australia by a sound banking organisation. Finally, Government will secure the close co-operation of the Reserve Bank in conducting all its borrowing operations and other banking business, and this will effectively check the adverse effects of these operations upon the money market.

4. Scarcity of commercial bills in the money market and suggestions for removing it.

Another characteristic of the money market in India is the scarcity of commercial bills of exchange, which form a much smaller proportion of the assets of the banks in India than in Western countries.[1] The scarcity is not due to the ignorance of the public regarding their utility or its reluctance to use them, because *darshani* or *mudati* hundis, *i.e.* demand or time bills, have been in use since the 12th century. The scarcity is the result of the following causes:—

(1) Banks in India have preferred investment in gilt-edged securities owing to the need of keeping a stronger liquid position in India than in other countries having more developed banking systems, and owing to the better yield from these securities. A tendency to the equalisation of this yield with that from discounted bills, however, has already begun to operate, and this, combined with the gradual growth of public confidence in the banks, will in the course of time lead to a reduction in the banks' investments in gilt-edged securities.

(2) Banks in need of funds prefer obtaining loans from the Imperial Bank against Government securities to rediscounting their bills with that Bank for the following reasons:—

(i) While that Bank rediscounts only those bills of which it approves, it has not laid down any standards for determining such bills for the guidance of the other banks, with the result that the latter have to run the risk of

1. *Cf.* Foreign Experts' Report, Central Committee Report, pp. 625 and 651.

having the bills presented by them for rediscounting rejected by the former.[1]

(ii) As such rediscounting is regarded as an indication of weakness by the money market, the banks are afraid that it will affect their credit adversely in the market.

(iii) The Imperial Bank does not give the other banks any concession in the rate of discount, but charges them the same rate that it charges ordinary indigenous bankers.[2]

(iv) As the Imperial Bank is a competitor in commercial banking, the other banks are unwilling to divulge to it the contents of their bill portfolios.

(3) The banks sometimes have difficulties in ascertaining the financial standing of the signatories of bills.[3]

(4) Many of the internal bills are finance bills representing money-lending transactions, and are not trade bills drawn in respect of particular business transactions in goods on the conclusion of which they get automatically paid off.[4]

(5) The scarcity of bills is also due to the wide prevalence of the system of cash credits, which is advantageous to the borrowers as well as the lending banks, as the borrowers need pay interest only on the portion of the cash credits that they actually use, and as the banks can withdraw the credits, if the financial position of the borrowers goes down.[5] Bills, however, should be preferred by both, because they would give the borrowers certainty regarding a definite amount of credit during the currency of the bills, and at a lower rate, and because, with proper rediscount facilities, they would supply the banks with most liquid assets.

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1. See Mr. MacDonald's answers, Central Committee Evidence, Vol. III, pp. 882 and 928.

2. See Mr. Pochkhanawala's answers, Central Committee Evidence, Vol. III, p. 50.

3. See the statement of the Bengal Chamber of Commerce, Central Committee Evidence, Vol. II, p. 480.

4. See the statement of Mr. MacDonald, Managing Governor of the Imperial Bank, Central Committee Evidence, Vol. II, p. 231.

5. See the statement of the Bombay Chamber of Commerce, Central Committee Evidence, Vol. II, p. 516.

The organization of the banking system in India cannot be sound unless the use of commercial bills is developed and an active and efficient discount market is built up. The Reserve Bank of India will gradually bring about this development by co-ordinating the different elements of the money market, establishing a unified control of currency and credit, removing the existing prejudice of the other banks against the rediscounting of bills by operating fully as a bankers' bank and not as a rival institution, and giving them detailed information regarding the bills which will be acceptable to it, and encouraging the more prominent indigenous bankers and their wealthy depositors to organise themselves into discount houses under its protection, rediscounting their bills as freely as those of member banks, and thereby linking up the indigenous bankers and money markets with the large centres where surplus funds accumulate.[1]

Further, the mere issue by the Reserve Bank of additional currency freely during the busy season against trade bills, without raising its rate to an artificial height, will stimulate traders to take an increasing advantage of this cheap and most convenient form of credit. The Reserve Bank should buy or rediscount first class trade bills or promissory notes of member banks and bankers arising out of *bona fide* commercial transactions, at its published bank rate as the lowest operative rate, and it should exercise its discretion to charge higher rates for discounting the bills of traders lacking bank endorsement, and for giving demand loans against gilt-edged securities, so as to stimulate the use of bills by the banks and bankers.[2] Educational work should be conducted to make traders and producers realise that they would serve their own interests best by fully disclosing their true financial position to their banks, so as to create that knowledge and confidence with regard to the genuine trade character of bills and the financial standing of their signatories, which are lacking in India in many cases at present, but which are the foundations of the bill market in Western countries, especially in England.

1. *Cf.* Central Committee Report, pp. 410-12.

2. *Cf.* Foreign Experts' Report, Central Committee Report, p. 654 and Bhatter and Nemenyi, the Reserve Bank of India and its Functions, pp. 120-1.

Warehouses and godowns should be established under proper management in different parts of India, as they would help the replacement of finance bills drawn at present by shroffs and merchants by genuine trade bills accompanied by documents, and thereby extend the use of bills, as the latter would be preferred by the banks.[1] The use of bills can be encouraged also by abolishing or reducing substantially the stamp duty on them, as recommended by the Young Currency Commission of 1926 and the Central and Provincial Banking Committees[2], by keeping for sale in post offices bill forms printed in English and the vernaculars,[3] and by passing legislation providing an expeditious procedure for disposing of suits based on negotiable instruments in places in which hundi business is large, validating the noting of dishonour and protest by recognised associations of banks, shroffs or merchants, so as to save trouble and expense to the owners of hundis, and standardising the essential features of hundis and the customs affecting them in particular areas, so as to promote their circulation under well-defined conditions.[4]

There is much scope for extending the use of bills in several transactions in the country in which they are little used at present.[5] The divorce of agriculture from the money market is an important weakness of the Indian banking system. Co-operative godown societies can be formed, and cultivators can obtain finance on harvested produce by joining them and allowing them to draw usance bills on themselves (cultivators). The societies may then discount the bills with the central co-operative banks, and the latter in turn with the joint-stock banks. The cultivators can also obtain finance on harvested

1. See the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 502.

2. See Assam, Bengal, Bihar, Bombay, Burma, C. P., Madras, Punjab and U. P. Committees Reports, pp. 119, 129-223, 113, 151, 156-7, 244, 146, 94 and 290 respectively.

3. See Madras and C. P. Committees Reports, pp. 142 and 245.

4. See Assam, Bengal, Bihar, Bombay, Burma, C. P., Madras, Punjab and U. P. Committees Reports, pp. 121, 130, 116, 150, 158, 245, 128-142, 91 and 290 respectively.

5. See Central Committee Report, pp. 413-15 and Mr. MacDonald's statement, Central Committee Evidence, Vol. II, p. 230.

produce by allowing village bankers to draw usance bills on themselves. The village bankers may then discount the bills with shroffs, and the latter in turn with the joint-stock banks. The joint-stock banks should encourage the use of such bills, as they are the best means of promoting co-operation between themselves and the indigenous bankers.[1] As the cultivators' ability to pay the bills would depend upon the sale of the produce, the dates of maturity of the bills should be fixed approximately with reference to the probable dates on which the produce would be sold, always maintaining a safe margin.

With regard to the use of bills in marketing finance, warehouses licensed by Provincial Governments can be established, and with their assistance the village traders can create documented agricultural mudati hundis, *i.e.* usance bills, which can be accepted by the indigenous bankers recognised by the joint-stock banks or the Reserve Bank, and which can later be discounted in the central money market. In respect of the movement of goods from the ports to the interior, the conversion of the open account credit, that is given at present by commission agents to merchants in the interior, into bills will enable the former to obtain credit from the Indian joint-stock banks. As regards the finance of foreign trade, the desirability of creating rupee bills and promoting bankers' acceptances has been considered in the chapter on exchange banks. Finally, banks should prefer the investment of their funds in discounting bills to the system of cash credits because, as mentioned before, with proper rediscounting facilities, the former would supply them with liquid assets. This discounting can take the form either of buying bills held by customers or discounting bills accepted by other banks for their clients.

5. Suggestions for developing bankers' acceptances.

The development of bankers' acceptances will prove very useful in building up a bill market in India.[2] The

1. *Cf.* Bihar Committee Report, pp. 72-112-146-207 and Bombay Committee Report, p. 153.

2. See Sir Basil Blackett's statement, Central Committee Evidence, Vol. II, pp. 450-4 and Bhatter and Nemenyi, the Reserve Bank of India and its Functions, pp. 131-4.

U.S.A. until 1913 had practically no bill market, but the country has now a highly developed bill market, owing to the promotion of bankers' acceptances under her Federal Reserve system. A banker's acceptance is a bill of exchange accepted by a bank or firm engaged in the business of granting bankers' acceptance credit. Under this system a purchaser of goods, on whom the seller draws a bill of exchange, arranges beforehand with his bank to have the bill accepted by it, so that the seller can readily discount it with his own bank.

A banker's acceptance is superior to an ordinary bill of exchange for the following reasons :—

(1) It proves to be a better security, carrying as it does the guarantee of a bank and not of an individual. Consequently, another bank is more willing to discount it and at a lower rate, so that the drawer gets ready money and cheap money.

(2) The lending capacity of the accepting bank is much increased by the fact that it lends merely credit and not money and, therefore, has not to depend upon the amount of cash with it. For the same reason it charges a very small commission for the service of acceptance, so that its customer obtains credit at a small expense. As the customer provides the money at or before the maturity of the acceptance, he is allowed to turn over his business more quickly.

(3) A banker's acceptance is more self-liquidating than other short-term paper, because the accepting bank scrutinises carefully the transaction on which it is based, and offers all its assets as security for paying its value on maturity. For the same reason it is more readily negotiable and at a lower rate in the market.

(4) Owing to its ready negotiability, it can be sold and resold rapidly among a number of banks and bankers, and thus proves very useful in connecting the up-country money market with the central city market, and in widening the money market and making it more uniform in a country.[1]

1. See Dadachanji, *A Reserve Bank for India and the Money Market* p. 232.

Banks in India, therefore, should gradually change their methods and develop acceptance credit as the safest form of lending credit.[1] It will yield them a lower rate of interest than the time-honoured system of overdrafts and cash credits, but as it will increase their lending capacity to a large extent, with the growth of the acceptance business, their profits will not be curtailed. Accepting banks should be supplemented by acceptance associations of indigenous bankers wherever the former find it difficult to establish branches. Both must be registered by the Reserve Bank, which must control their working and regulate their commission charges.

It will take some time to develop bankers' acceptances among agricultural producers owing to their illiteracy and conservatism. But a beginning should be made by organising them into co-operative sale societies, or if this is found difficult, into temporary produce sale societies for the busy season. The societies will draw drafts for acceptance by the banks or acceptance associations of indigenous bankers, and furnish security in the form of produce stored in warehouses belonging to district and taluka boards, banks, Government, or the Reserve Bank, and regulated by the Reserve Bank. The establishment of such warehouses is essential, as they will enable the pooling of the produce, and thereby stimulate the creation of the above societies, and as, without such security, the banks or associations will not be in a position to accept the drafts. They will also enable the agriculturists to wait until better prices become available for their produce.

6. Importance of rediscounting facilities from the Reserve Bank.

It may be emphasised here that a bill market cannot exist without a Central Bank. No bank, banker or dealer will be willing to buy or discount bills, unless he feels confident that there exists an institution which will always be willing to buy or rediscount them even in periods of monetary stringency. In India, the Reserve Bank alone will give him the confidence that, when in a period of stringency he is pressed for money and cannot

1. See Bombay and Bengal Committee Reports, pp. 153 and 127.

obtain it by disposing of the bills in his portfolio elsewhere, he can take them to the Reserve Bank and be sure of obtaining the urgently needed funds at the current rate of discount. At such a time the Reserve Bank will buy bills according to the extent of the stringency, and relieve it by pouring its credit into the market smoothly and effectively without causing any panic or even apprehension in the market. When the bills mature, the funds provided by the Bank will automatically return to it.

The foundations of the credit organisation, on which the development of banking vitally depends, cannot be solid unless the Reserve Bank supplies rediscounting facilities, which alone will enable the other banks to convert into cash a maximum of their assets with a minimum of disturbance in the conditions of the money market. Without rediscounting facilities the most legitimate assets of the banks in the shape of short-term advances against goods represented by commercial bills cannot become quick assets readily convertible into cash in an emergency.[1] The second advantage of rediscounting will be that it will increase the lending power of the banks rediscounting the bills, and give elasticity to deposit currency in periods of stress. Rediscounting will increase the balances of the banks with the Reserve Bank, and as the balances will constitute their reserve, they will be able to lend much more to their customers on the basis of the increased balances.

Finally, rediscounting will secure the automatic expansion and contraction of the note currency and thus make it elastic. When the banks rediscount bills and obtain cash, notes of the Reserve Bank will get into their hands and, through them and their customers, into circulation to meet the increased demand for currency. When the bills mature, they will be paid in Reserve Bank notes by the banks which accepted them, and the notes will thus return to the Reserve Bank ; the banks will get the notes back from the customers, who had borrowed money, and who will have completed their transactions by the time the need for additional currency comes to an end.[2]

1. *Cf.* the Report of the Royal Commission on Indian Currency and Finance 1926, p. 33.
2. *Cf.* Dadachanji, op. cit., p. 69.

7. Suggestions for the organisation of an All-India Bankers' Association.

For a sound working of the money market and the banking system it is essential that its various constituents should be in a close touch with each other, so as to secure a proper understanding of their common problems and interests, and an effective co-operation for solving the problems and promoting the interests. The present organisation in this respect is very defective. In some large centres, as mentioned before, the indigenous bankers have associations according to the different castes to which they belong. Each association has its own regulations, examines problems of common interest to its members, and settles their business disputes. But the associations have no touch with one another, and there is no organisation for the exchange of information regarding the financial position of constituents, for the promotion and regulation of inter-shroff business, and for the adoption of a common policy and uniform methods of business.

The exchange banks have associations of their own at the principal port towns for keeping uniform standards in business transactions, and protecting the rights of members. But only foreign banks doing exchange business in India are their members. Further, although the Managing Governor of the Imperial Bank of India has stated to the Central Banking Committee that there is co-operation between his Bank and the Indian joint-stock banks, and that the senior officers of the former frequently discuss in a friendly spirit questions of common interests with the managers and directors of the latter, several witnesses have informed the Committee that there is little co-operation between the Imperial Bank and the other banks.

The Committee has, therefore, suggested the creation of an All-India Bankers' Association to include as members not only the Imperial Bank, exchange banks and Indian joint-stock banks but the indigenous bankers also.[1] The inclusion of the latter will be very helpful in bringing them into the fold of organised banking. Its membership should be of two kinds, full membership for

1. See Report, p. 428.

all banks and bankers getting rediscounting facilities from the Reserve Bank, and associate membership for all the other banks and bankers. The Association will be very useful for discussing matters of common interest, deciding upon common action, carrying out reform and improvement of standards, removing elements of weakness, and promoting the amalgamation of smaller banks. The headquarters of the Association should be wherever the Reserve Bank has its head office, but as its central body will not be able to deal effectively with local problems arising in the different parts of the country, it should have branches at the important centres to deal with such problems, the central body disposing of matters affecting all the members as a body.

8. Clearing houses and their development.

There are eleven clearing houses at important centres in the country for simplifying and facilitating the daily exchange and settlement of the debits and credits of banks. Their actual business is carried on in the offices of the Imperial Bank at these centres, and the Bank provides the necessary supervision and staff. A bank can become a member of a clearing house by the consent of the existing members, and the Imperial Bank has no greater authority in the matter than any other member. New members are admitted after a close scrutiny of their balance-sheets by a committee of the existing members. Complaints have been made to the Central Banking Committee that admission to them is severely restricted, and that Indian banks find it very difficult to secure admission, because the majority of their members are foreign banks.[1] The Managing Governor of the Imperial Bank, however, has denied the complaints, and explained that heavy responsibilities are attached to the membership, that each application for the membership is dealt with on its own merits, and that even in England such membership is closely restricted, non-member banks doing their clearing through the 10 member banks.[2]

1. See the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 499.

2. See his answers, Central Committee Evidence, Vol. III, p. 922.

It is desirable that the clearing houses should be managed in all details in India, as in other countries, by incorporated associations of their members having their own regulations.[1] Moreover, the supervision of all clearing houses will be one of the functions of the Reserve Bank, and it will take steps to investigate and remove legitimate complaints regarding their organisation and working. Further, the Reserve Bank will not only serve as the central clearing house for the country, but will also develop a system of collecting and clearing cheques throughout the country by promoting the creation of a network of clearing houses throughout the country under its supervision.

The few clearing houses that exist at present clear locally payable cheques only, and cheques payable in any other town have to be sent there for collection.[2] This involves business men into inconvenience, delay, risk of non-payment, and the expenses of transmission of cash. As the Reserve Bank will hold the balances of all banks in the country, it will be able to carry out the prompt collection and clearing of such cheques itself, or through the Imperial Bank which will be its agent, by means of a simple book-keeping entry and the mere transmission of a message of credit in place of the actual transmission of currency between the place where the cheque is received and the place where it is payable. This will remove the above-mentioned existing drawbacks of such cheques and will, therefore, stimulate the growth of the cheque habit in the country and the deposits of the banks. The system of mutual settlements will reduce the pressure on the cash balances of the banks, and this, combined with their larger deposits, will enable them to give larger and cheaper credit to their customers. Even distribution of money in the country will be promoted, and money rates will tend to be steadier.

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1. See Mr. MacDonald's answers, Central Committee Evidence, Vol. III, p. 876.

2. *Cf.* Bengal Bihar, U. P. and C. P. Committees Reports, pp. 237, 235, 321 and 247 respectively.

CHAPTER XII

The Reserve Bank of India

1. Many-sided need of it.

All authorities have been unanimous in expressing the opinion that the most important step to take to remove many of the defects of the Indian banking and credit system, and to secure its development on a sound basis, is to establish a Central Bank in India.[1] We have seen in the previous chapter how the Bank can remove some of the defects. The following are other important defects for removing which the establishment of the Bank has been found necessary :—

(1) The Reserve Bank is needed for maintaining the purchasing power of the rupee stable internally and externally. Internal instability of the rupee on account of natural causes, such as the failure of the rains, or world causes, such as a war or economic depression, may be unavoidable at present, although the international co-operation of the central banks will be helpful in dealing with such causes even. But internal instability caused by a maladjustment of the supply of, to the demand for, monetary circulation can be prevented by the Reserve Bank. The purchasing power of the rupee will remain stable so long as the volume of the monetary circulation is adjusted to the amount of the media needed at any time for the exchange of the quantity of goods and services that have to be exchanged, taking into account the velocity of the circulation of the media and the frequency with which the goods and services are exchanged. The external stability of the rupee depends mainly upon its internal stability. If prices in India rise relatively to the world gold prices, India will be a better market in which to sell goods, but a worse one from which to buy them. This will stimulate imports and check exports, so that the balance of trade

1. See Bengal, Burma, Punjab, Madras and U. P. Committees Reports, pp. 126, 350-1, 156, 195 and 322 respectively, and the statements of the Bengal National and Bombay Chambers of Commerce, Central Committee Evidence, Vol. II, pp. 502 and 519.

will become unfavourable, the exchanges will be upset, and the internal depreciation of the rupee will soon lead to its external depreciation. The reverse will happen, if prices in India fall relatively to the world gold prices.[1]

The Reserve Bank can maintain this stability to a considerable extent, if it is given control over the volume of the monetary circulation in the country by means of the monopoly of the note issue and the power to impose on the country a judicious and appropriate credit policy. It will then base its note issue partly on commercial bills which are self-liquidating assets, and the circulation will expand on the strength of the bills when they are drawn against trade transactions, and will contract when they mature and are liquidated. The experience of other countries, however, shows that a Central Bank cannot achieve this stability unless the monetary circulation is based on gold.

The Reserve Bank can maintain the external stability of the rupee to a considerable extent by buying gold from members of the public when they get it from abroad by way of the payments of claims due and wish to obtain currency in exchange for it, and by selling gold to them when they need it for making foreign payments of claims against them. Although the external stability of the rupee depends mainly upon its internal stability, the note issue must be backed in a substantial degree by assets which can deal with temporary disequilibria in the balance of foreign payments. Such disequilibria are sure to occur now and then owing to seasonal causes, a bad harvest, or internal or external financial stringency. At such times the balance of trade will become unfavourable to India, and she will have to pay other countries for it. Gold and gold securities are the most useful assets for the purpose, and the Reserve Bank can use them quickly to pay the foreign liabilities until the adoption by it of an appropriate credit policy, or the raising by it of the rate of discount corrects the disequilibria. The sale of gold by the Bank will lead to a con-

1. See the Report of the Royal Commission on Indian Currency and Finance, 1926, p. 46,

traction of the currency and a fall in prices, which will encourage exports and check imports and thereby tend to correct the disequilibria.

(2) The Reserve Bank is necessary for removing the structural instability of the banking system in India. The system at present has no solid basis, and is much liable to be upset by sudden demands for the withdrawal of funds or by financial crises. This vulnerability is due to the existence of the multiple reserve system, without the support of adequate cash reserves. Many of the Indian joint-stock banks have been conducting business of a magnitude not justified by their cash reserves and liquid assets. Considering their immense liabilities, it must be said that even the exchange banks have not made adequate provision of cash reserves for runs or financial crises.

If a run takes place on a bank, its only way to restore the public confidence is to satisfy the demands of the depositors for the withdrawal of money fully and promptly. To be able to pursue this policy it must receive help from other banks, as the liquid assets of every bank are limited, and if it does not receive help from other banks, these assets will soon get exhausted, and its position will become desperate. When one bank is exposed to a run, other banks are afraid to come to its rescue and to help it with cash, because the panic, like an infectious disease, may spread to their depositors, and so they remain aloof and strengthen their own liquid resources. Moreover, in the absence of a co-ordinating agency, the banks, far from regarding their interests as common, are apt to consider each other as rivals, not deserving support in difficult times.[1] We have seen in the first chapter that these factors aggravated the banking crisis of 1913-17. Although since 1921 the Imperial Bank of India has served as a co-ordinating agency to some extent, it is not altogether a bankers' bank, as the other banks keep their reserves with it to a small extent only.

The creation of a single reserve system under the Reserve Bank will remove these dangers. When the

1. *Cf.* Dadachanji, *A Reserve Bank for India and the Money Market*, p. 61.

cash reserves of the other banks are pooled with that of the Reserve Bank so as to form a concentrated reserve in the hands of the latter, the insurance principle of distributing the risks of runs and similar emergencies will come into operation. The Reserve Bank will then occupy the position of an insurance company to which all banks contribute, so that no bank has to meet the entire risk, which is distributed among all the contributing banks.[1] The concentrated reserve will be large enough to meet the needs of a bank fully and promptly in an emergency. Even if a run is made on several banks, such a reserve will be more effective in making payments. Further, the Reserve Bank can use it, without paying it out, by making it the basis of the issue of additional notes, or of the grant of more credit. Moreover, the knowledge that the Reserve Bank possesses adequate cash reserves will quickly restore the public confidence, and will minimise the intensity of the panic, and the demand for cash, except what is needed for the demands of foreign trade.[2] The Reserve Bank in virtue of its position as the custodian of the banking reserve of the country will also be able to impose a prudent credit policy on the other banks, and thus to mitigate the intensity of the panic, and to give them more strength to meet it.

A second advantage of the single reserve system under the Reserve Bank will be its mobility. Money can be moved quickly from a centre where it is abundant to another where it is scarce. This is not possible when the reserves are scattered and managed independently by different banks. A third advantage of the system will be its elasticity. The need of the other banks for funds in an emergency will be met by loans from the Reserve Bank. These loans will lead to the creation of more deposits or the issue of additional notes by the Reserve Bank, which will have to keep only a certain percentage of cash reserve against these liabilities. The Bank, therefore, will be able to lend to the other banks at least twice as much as the value of the cash reserve, without overstepping the

1. *Cf.* Burgess, *The Reserve Bank and Money Market*, p. 26.
2. *Cf.* Kemmerer, *The A. B. C. of the Federal Reserve System*, p. 39.

normal limit of the percentage of the cash reserve to its liabilities laid down by law; and it will be able to lend much more in an acute emergency, if the borrowing banks can furnish the necessary security and are prepared to pay an increasing price for the accommodation, by overstepping the normal limit of the cash reserve, subject to the payment of a graduated tax, as provided by law.

Finally, owing to its greater efficiency, a centralised reserve need not be as large as the total of the scattered reserves. The single reserve system will, therefore, set free a large amount of capital, which the banks will be able to use to extend their business, with profit to themselves and the business community.[1]

In the countries of Europe the amount of the balances, which the other banks keep with their respective Central Banks, is not regulated by statute, but is determined by an agreement between them, as the number of banks is comparatively small, and some concentration of reserves had already been in existence. In the U. S. A., however, the amount of the balances is regulated by law as a certain minimum percentage of the demand and time liabilities of banks. In India, regulation by statute is regarded necessary, as seen below, although the number of banks is small, in order to strengthen the position of the Reserve Bank and to enable it to fulfil adequately its duties as a bankers' bank. The reason is that the foundations of the banking system in India are very unstable at present on account of the lack of the banking habit among the people, and the indifference of the banks towards each other caused by the division of banking functions among them.

(3) India needs a Reserve Bank to carry out a judicious and appropriate credit policy, which will keep the volume of currency and credit in proper adjustment with the volume of business, as well as the gold reserve, so as to maintain the stability of the value of the monetary unit, and to prevent instability and uncertainty in the money market and business of the country. The chief instrument for carrying out the policy will be the bank rate of discount, *i.e.* the Reserve Bank's official

1. See Dadachanji, *op. cit.* p. 65.

minimum rate for discounting first class bills. The raising or lowering of this rate, by bringing about a similar rise or fall in the market rate of discount, *i.e.* the rate at which the other banks discount bills, will enable the Reserve Bank to control the money market satisfactorily.

The Reserve Bank will raise the bank rate to stop the drain on its gold reserve that may be caused by an excessive expansion of credit, excessive speculative transactions, adverse exchanges, or a rise in bank rates in other countries. The raising of the bank rate will make borrowing from the Bank dearer, cause business men to resort more to other banks for discounting their bills, and thus check the extension of the credit granted by the Bank. As a larger number of bills is presented to the other banks for discounting, they will be compelled to raise the market rate of discount in order to prevent the proportion of their cash reserves to their liabilities from falling below the margin of safety. If the market rate does not respond readily to the bank rate on account of the possession of ample reserves by the other banks, the Reserve Bank will withdraw funds from the money market by borrowing them, until the banks are compelled by the resulting shortage of funds to raise the market rate.

A rise in the bank rate will also increase the rate of interest that the banks will have to pay on their deposits, and to the extent that they need these deposits, they will be compelled to put up the market rate, so as to maintain the difference between the rate of interest on deposits and the market rate of discount. Further, the increase in the price of accommodation will compel business men to unload their stocks of goods at lower prices, and the consequent fall in prices will increase the exports from the country and reduce its imports, and will, therefore, help to correct the adverse trade balance. Moreover, the raising of the bank rate will not only postpone the contemplated transfer of credits from the country to other countries, but will also lead other countries to transfer credits to this country in order to profit from its higher bank rate. The net result will be that the export of gold will stop, gold will be attracted to the country,

and the Reserve Bank will be able to replenish and protect the gold reserve of the country.

The Reserve Bank will lower the bank rate if it finds that the gold reserve is abundant, that credit is unnecessarily restricted, and that trade is inactive. This will compel the other banks to lower the market rate; otherwise business men will find it cheaper to discount their bills with the Reserve Bank. The other factors in the situation, mentioned above, will operate in the opposite direction, until ultimately gold may begin to flow out of the country and the Reserve Bank may have to raise the bank rate once more.

Of course the Reserve Bank will require some time to make its rate effective in India in the above manner, but with a proper organisation of the money market and the banking system in India, it will ultimately be able to do so, as Central Banks in other countries have done. It is, however, necessary to point out that the Bank must be very careful in altering its rate, and must do so only after a close study of the different factors, such as changes in the volume of business and of credit, changes in production and trade in relation to consumption, and changes in money rates in the market, the credit position in other countries, and the financial needs of Government, has convinced it of the need of altering the bank rate; otherwise, unnecessary and harmful disturbances will be created in the money market, and these will harm the economic interests of the country. Further, the open market operations of the Bank, *i.e.* its dealings directly with the market and not through commercial banks, such as the purchase and sale of bills and securities, should be conducted with care for the purpose of controlling the credit position in the country, and not for earning profits and competing with the other banks.

The establishment and management of a central clearing house by the Reserve Bank will also enable it to control the working of the other banks. Admission to the clearing house as a member will be a very valuable privilege to the other banks, as it will give them a first class status and enable them to present their claims

against each other with the utmost despatch, and the Reserve Bank can make the membership conditional upon their obedience to its instructions regarding the nature of their business and the credit of their customers. Moreover, if a bank expands its credit unduly, the Reserve Bank will be able to detect it in the clearing house through the demands for settlement that will be made upon that bank by the other banks.

(4) It will be an important function of the Reserve Bank to arrange for the compilation of proper and extensive statistics regarding the working of banks and indigenous bankers, and operations in the money market, and their prompt publication. Government should co-operate with it in carrying out this function. The position in this respect is very unsatisfactory at present. No statistics are available regarding the operations of the indigenous bankers. The exchange banks do not publish separately any statistics regarding their business in India, and merely supply, out of courtesy, consolidated figures of their Indian deposits and cash balances lumped together for all the banks, belonging to each of the two classes mentioned in Chapter VIII, to the Director-General, Commercial Intelligence, Calcutta, through the India Office. Even as regards Indian joint-stock banks, the Director-General's publication 'Statistical Tables relating to Banks in India' does not supply sufficiently detailed figures, and gives no information at all relating to banks whose capital and reserve are less than Rs. 1 lakh. Moreover, the value of such statistics as are supplied is much reduced by the excessive delay that always takes place in publishing them.

(5) The Reserve Bank will benefit Government directly by acting as its fiscal agent. The Bank will promote the success of Government loans and of the short-dated treasury bills, that Government has had to issue in recent years, by suggesting to Government the proper time and terms for their issue, when the money market will be easy and the banks will have surplus funds awaiting investment, as it will be in the closest contact with the money market, and by exerting its influence on banks and other investors to induce them to subscribe to

the issues, and by giving them facilities for this purpose. By cautioning Government against such issues at a time when the money market shows a tendency to tightness and higher rates, it will not only protect the interests of Government, but will also prevent an increase in the tightness and rates on this account, with consequent benefit to the business community.

The Reserve Bank will also conduct remittance operations on behalf of Government that are necessary for the annual payment in London of the Home Charges amounting to £35 millions approximately. For this purpose, the Secretary of State used to sell Council Bills and Telegraphic Transfers in London to the exchange banks which were paid in rupees in India by the Government of India; but since 1923, the Government of India has been operating directly in the exchange market by purchasing sterling in India, by public tender or privately, from the exchange banks through the Imperial Bank. The latter method is preferable, because it is in India that bills are drawn for India's surplus of exports over imports of goods and that the liability for making the remittances arises, and because the Government of India knows much better than the Secretary of State its own day to day cash position, the conditions of the money market in India, and the other factors influencing the course of exchange.[1]

But as Government remittances form a large proportion of the total remittance business of India, these operations of Government produce a considerable influence on the money and exchange markets in India and India's currency system.[2] As the Reserve Bank will be made responsible for maintaining the stability of the value of Indian currency and for organising and controlling the money market, it is essential for it to conduct the remittance operations on behalf of Government. Their management by the Bank will do much to reduce their disturbing influence, as the Bank, possessing better knowledge of the conditions of the money and exchange

1. See Dadachanji, *op. cit.* p. 138.

2. See the Report of the Royal Commission on Indian Currency and Finance, 1926, p. 42.

markets than Government, will be able to time them better, and to conduct them more smoothly in normal times when the balance of trade is in India's favour. The remittance operations of the Bank will be restricted to the *bona fide* needs of its customers and the requirements of Government in respect of the Home Charges. If an Indian Exchange Bank is established, as recommended by certain members of the Central Banking Committee, and if Government remittances are handed over to it, the Reserve Bank will control the operations.

(6) The establishment of the Reserve Bank is necessary for the improvement of the finance of agriculture. Through a special department, which may be called the Agricultural Credit Department, and which may be managed by a committee consisting of one of the provincial Registrars of co-operative societies nominated by the Government of India, a representative of the provincial co-operative banks and one of the Directors of the Bank under the general supervision of the Bank's Central Board of Directors, the Bank can not only serve as an apex institution for co-ordinating the activities of the provincial co-operative banks, but can also provide the following valuable financial facilities for agriculture[1] :—

(i) The Bank can purchase, sell or rediscount bills of exchange or promissory notes drawn by co-operative societies for financing seasonal agricultural operations or the marketing of crops, and endorsed by a provincial co-operative bank.

(ii) It can grant advances at the time of cultivation against the promissory notes of co-operative societies, endorsed by a provincial co-operative bank, and giving a lien on crops. Endorsement by provincial co-operative banks and a limitation of the total amount of the advances will minimise the risk of granting advances not secured by the hypothecation of goods, and the Bank should undertake this much risk, if the cultivators, whose financial needs are the greatest at or just before the time of cultivation, are to obtain reasonable credit.

(iii) The Bank can allow the co-operative societies to

1. See Dadachanji, *op. cit.*, p. 280.

draw upon the resources of the central money market by buying the bankers' acceptances created by the societies.

(iv) The Bank can make a portion of the Government balances available to the provincial co-operative banks free from interest.

(v) Warehouses controlled by the Bank will be very useful to co-operative sale societies for stocking agricultural produce in them and obtaining credit cheaply and promptly against it.

(vi) The Bank, on account of its close contact with the money market, can render valuable help to provincial land mortgage corporations, the creation of which has been recommended before, to float debentures successfully, and at as low rates as possible, on behalf of agricultural land mortgage banks, when they are established in the provinces.

(7) The Reserve Bank can supply better credit facilities to agriculture and internal trade, make the supply of credit more elastic, and make its credit policy effective, by making use of those mofussil indigenous bankers, who are willing to be placed on its 'approved list' as its agents, wherever no branch of a bank exists or can exist owing to insufficient business. The qualifications for being put on this list should be the possession of a certain minimum of working capital and volume of banking business, restriction of activities to purely banking business, depositing a certain proportion of capital and deposits with the Reserve Bank, and periodical examination of accounts by the Reserve Bank. If one banker is unable to supply these qualifications, some of them can form associations for this purpose. The Reserve Bank can provide the agents with banking and agency business, and pay them commission, lend them money according to the business guaranteed by them, readily discount the hundis certified by them, and place them in charge of some of its godowns.

This connection with the Reserve Bank will strengthen the position and credit of the indigenous bankers, who in turn will provide an increasing number of hundis to the Reserve Bank. Further, they will gradually help the Reserve Bank to develop a bill market in India, to link up the

country market with the city market, and to bring the former market also under its credit control, by forming themselves into Acceptance Associations, so as to increase the use of bankers' acceptances, which are the simplest and the most advantageous credit instrument for the needs of trade in India. The Reserve Bank should be given discretionary power to lay down the maximum rates within which the agents must lend their money and the Bank's money, and to prevent them from using the latter money for their private business.

(8) The Reserve Bank is needed, because there is no authority charged with the duty of watching the development of banking in this country and of taking steps to promote its advancement on the right lines in the interests of the nation as a whole.

The economic history of the great trading countries of the world during the last half century proves far more clearly than the above theoretical explanation the great efficiency of a Central Bank and its great influence upon the economic progress of a nation. Even the U. S. A., with her predilection for decentralisation, was compelled to adopt a centralised banking system in 1913, as the frequent gigantic and disastrous financial upheavals in the country were attributed to the weakness of her decentralised banking system. The adoption of the Federal Reserve system has enabled her to build up the strongest position in the world of finance, next only to Great Britain.

2. State Bank versus Shareholders' Bank.

Realising this many-sided need for a Central Bank in India and the dependence of the creation of a Federation and Responsible Central Government in India upon the establishment of this Bank, the Central Legislature in India passed the Reserve Bank of India Act in 1934 in accordance with the recommendations of a representative committee that had been set up in London, and the Reserve Bank of India will be established under it as early as possible. It is generally expected that the Bank will start functioning by the middle of 1935. It will be a Shareholders' Bank, although a certain section of public opinion in the

country and of the Central Legislature has expressed itself in favour of making it a State Bank, and of giving the Central Legislature the right to elect a proportion of the directors of the Bank from among its own members.

The arguments that have been advanced to support the view that the Bank should be a State Bank are as follows :—

(1) It is dangerous to entrust the control over the very important functions of the Bank to private shareholders and their directors belonging largely to the capitalist class, as their interests would not always coincide with those of the people of India.

(2) The profit derived by the Bank from the use of large public funds and from the issue and management of the nation's paper money should revert to the public treasury for the benefit of the country at large.

(3) The tradition of State ownership of large commercial undertakings of national importance has been firmly established in India. As regards railways, for example, the people have an implicit faith in State management and are suspicious of private capitalistic ownership and control; and the State management of Indian railways has proved successful as a purely economic proposition.

(4) The very nature of the functions of the Reserve Bank, *viz.* central banking functions, including the management of currency, makes Government control inevitable.

(5) Even in the countries which have Central Banks owned by shareholders, Government appoints their Governor and Deputy Governor, who exercise a preponderant voice in shaping the general policy of the banks.[1] Moreover, in practice it is Government which has the last word in shaping the policy.[2]

(6) The fear has been expressed that a Shareholders' Bank would come under the predominant control of European business men and that, therefore, Indians would not receive a fair treatment from the Bank.[3]

1. See Kisch and Elkin, Central Banks, p. 57.
2. *Cf.* Mr. Keynes' answers, Royal Commission on Indian Currency and Finance, 1926, Oral Evidence, Questions 13054-61.
3. See Legislative Assembly Debates, 1933, Vol. VI, No. 6, pp. 1305, 1320 and 1332, Vol. VIII, No. 5, pp. 2219-20 and 2227-8 and No. 6, pp. 2283-4.

The reasons given for the demand that a proportion of the directors of the State Bank should be elected by the Central Legislature are as follows :—

(1) As the Executive is not responsible to the Legislature in India, the representatives of the people in the Legislature ought to have a voice in the directorate of the Bank, to ensure that the powers given to the Bank are exercised by it to promote the interests of the people in the best manner.

(2) To ask the Legislature to create the Bank and to make it responsible to the people for the good working of the Bank, without giving it any hand in the supervision or control over the working of the Bank, is constitutionally unsound.

It has, however, been decided to make the Reserve Bank of India a Shareholders' Bank for the following reasons:—

(1) Twenty-two out of the twenty-eight Central Banks that exist at present in different countries of the world are shareholders' banks, and even as regards the six that are State Banks, there are limitations on Government interference with their working.

(2) It is of fundamental importance that the Reserve Bank should be free to conduct its business on the lines of prudent finance, and in accordance with the provisions of the Act which brings it into existence, without being subjected to any political influence from Government or the Legislature. The function of raising and using money should be kept separate from the function of producing the actual tokens of money which are put into circulation. The largest user of money in a country is its Government, and when it wants money to spend, it should have to raise the money by fair and honest means in the same way as a private individual. If Government controls the Reserve Bank, which must be responsible for exercising the latter function, it will be tempted, as experience has abundantly shown since the War, to abuse its powers and to compel the Bank to supply it money easily by using the note-printing press, especially if it is a democratic Government dependent upon the popular vote. It is essential, therefore,

that currency and credit operations should be in the hands of an authority independent of Government, and that there should not be even room for suspicion of any intermixture of politics with the business of controlling currency and credit.

(3) The shareholders' plan has the merit of making the directors responsible for money which they themselves have contributed, and responsible to the shareholders for the money which the latter have contributed, and not responsible merely to their own consciences. The shareholders can exercise a decisive influence on the management of the Bank.[1]

(4) It has the further merit of providing a ready-made constituency wide enough to secure the representation of the whole country in the form of representative directors, capable, Indian in outlook, largely Indian in composition, fully conscious of their great responsibilities, and prepared to devote themselves wholeheartedly to the business of making the Bank successful.[2]

(5) It is unconstitutional for a legislature to take part in making appointments to special posts, as thereby it oversteps its proper functions and usurps those of the executive.

(6) If members of a legislature serve as directors of the Bank, they would not have the time and energy required to attend adequately to their double duties, and they should decide to serve the country either in the first capacity or in the second, but not in both.

(7) The fear of the predominance of capitalists over the Bank can be obviated by a wide distribution of the Bank's shares in the country and by a limitation of the voting rights attached to the shares.[3]

3. Organisation of the Reserve Bank under the Reserve Bank Act of 1934.

The original share capital of the Bank will be Rs. 5 crores divided into fully paid-up shares of Rs. 100

1. *Cf.* Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, pp. 157-60.
2. *Cf.* Dadachanji, op. cit. pp. 326-7.
3. See Legislative Assembly Debates, 1933, Vol. VI, No. 7, p. 1411, No. 8, pp. 1526-7, Vol. VIII, No. 8, pp. 2417-8 and Vol. IX, No. 11, p. 3732.

each. Separate registers of shareholders will be maintained at Bombay, Calcutta, Delhi, Madras and Rangoon, and the value of the shares originally assigned to the areas served by these registers will be Rs. 140, 145, 115, 70 and 30 lakhs respectively, but the shares will be transferable from one register to another. A shareholder will be registered as such in the area in which he is ordinarily resident or has his principal place of business, and must be a person domiciled in India, or a British subject ordinarily resident in India, and domiciled in any part of the British Empire, the Government of which does not discriminate in any way against Indians, or a company registered under the Indian Companies Act, or a company incorporated under a law of any part of the British Empire, the Government of which does not discriminate in any way against Indians, and having a branch in British India.

In allotting the shares the Central Board of the Bank must give preference to applications for five shares each, so as to distribute the shares and the voting rights attached to them as widely as possible. If the shares assigned to the Delhi register are not fully taken up by the public at the first allotment, the Central Board will transfer any shares not applied for up to a maximum value of Rs. 35 lakhs from that register in two equal portions to the Bombay and Calcutta registers.

If any shares remain unallotted in any area after this transfer, they will be taken up by the Government of India, and will be sold by it at not less than par, as soon as possible, to residents of the areas served by the registers concerned, but it cannot exercise any vote on account of the possession of the shares. The share capital of the Bank can be increased or reduced on the recommendation of the Central Board, with the previous sanction of the Governor-General and with the approval of the Central Legislature, to such an extent and in such a manner as may be determined by the Bank in a general meeting. The additional shares must be allotted in the same way as the original ones.

The Bank will have offices in Bombay, Calcutta, Delhi, Madras and Rangoon and London, and can have

offices at any other places in India and, with the previous sanction of the Governor-General in Council, outside India, and its head office will migrate from one office to another in India at the discretion of the Central Board, in order to secure evenly balanced consideration of the varying interests of the different parts of the country. The general superintendence of the business of the Bank will be entrusted to a Central Board of Directors consisting of—

(*a*) a Governor and two Deputy Governors appointed by the Governor-General in Council after consideration of the recommendations made by the Board in that behalf;

(*b*) four Directors nominated by the Governor-General in Council;

(*c*) eight Directors (two each for the Bombay, Calcutta and Delhi registers and one each for the Madras and Rangoon registers) elected by the Local Boards from among themselves to represent the shareholders; and

(*d*) one Government official nominated by the Governor-General in Council.

The Deputy Governors and the Government official, however, will not be entitled to vote. The Governor and Deputy Governors will hold office for such a term not exceeding five years as the Governor-General in Council may fix, and will be eligible for re-appointment. Their salaries and allowances will be determined by the Central Board with the approval of the Governor-General in Council. The other nominated Directors will hold office during the pleasure of the Governor-General in Council. The elected Directors will hold office for five years, and will be eligible for re-election.

A Local Board for each of the areas assigned to the five registers will consist of five members elected from among themselves by the shareholders registered in each area at least six months previously and holding at least five shares, and not more than three members nominated by the Central Board. Each shareholder will have an additional vote for each additional five shares, subject to a maximum of ten votes. Fresh election or nomination of the members of each Local Board will take place at any

time determined by the Central Board within three months preceding the date on which the Directors of the Central Board representing the shareholders are due to retire, but the outgoing members will be eligible for re-election or re-nomination. A Local Board will advise the Central Board on such matters as are referred to it, and will perform such duties as are delegated to it by the Central Board by means of regulations.

No person can be a Director of the Central Board or a member of a Local Board, who—

(1) is a Government official or an official of an Indian State,

(2) or is, or at any time has been, adjudicated an insolvent, or has suspended payment, or has compounded with his creditors,

(3) or is an employee of any bank, or is a director of any bank other than a co-operative bank,

(4) or does not hold unencumbered shares of the Bank of a nominal value of not less than Rs. 5,000 at any time after six months from the date of his nomination or election,

(5) or is a member of the Central Legislature or a Provincial Legislature in India.

The first and third restrictions, however, will not apply to the Governor, Deputy Governors and the official representing Government on the Central Board.

The Central Board will meet at least six times each year. A general meeting of the shareholders will be held annually within six weeks from the date on which the annual accounts of the Bank are closed, and additional general meetings may be convened by the Central Board at any other time. All the Directors of the Central Board constituted for the first time will consist of the nominees of the Governor-General in Council.

4. General functions of the Reserve Bank.

The Bank will be authorised to transact the following business :—

(1) The accepting of money on deposit without interest from, and the collection of money for, the Secretary of State in Council, the Governor-General in Council,

Provincial Governments, Indian States, banks, local authorities and any other persons;

(2) (a) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn and payable in India and arising out of *bona fide* commercial transactions, bearing two or more good signatures, one of which must be that of a scheduled bank and maturing within 90 days from the date of such purchase or rediscount;

(b) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn and payable in India, and bearing two or more good signatures, one of which must be that of a scheduled bank or a provincial co-operative bank, and drawn or issued for financing seasonal agricultural operations or the marketing of crops, and maturing within nine months from the date of such purchase or rediscount;

(c) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn and payable in India, and bearing the signature of a scheduled bank, and issued or drawn for holding or trading in securities of the Government of India, or Provincial Governments, or such securities of Indian States as may be specified by the Governor-General in Council on the recommendation of the Central Board, and maturing within 90 days from the date of such purchase or rediscount;

(3) the purchase from, and sale to, scheduled banks of sterling in amounts of not less than the equivalent of rupees one lakh and of bills of exchange (including treasury bills) drawn in or on any place in the United Kingdom and maturing within 90 days; and the keeping of balances with banks in the United Kingdom;

(4) the making to States in India, local authorities, scheduled banks and provincial co-operative banks of loans and advances, repayable on demand or on the expiry of fixed periods not exceeding 90 days against the security of—

(a) trust securities;

(b) gold or silver, or documents of title to the same;

(c) such bills of exchange and promissory notes as are eligible for purchase or rediscount by the bank; or

(d) promissory notes of a scheduled bank or a provincial co-operative bank, supported by documents of title to goods which have been transferred, assigned, or pledged to any such bank as security for a cash credit or overdraft granted for *bona fide* commercial transactions, or for financing seasonal agricultural operations, or the marketing of crops;

(5) the making of advances to the Governor-General in Council and Provincial Governments repayable not later than three months from the dates of the making of the advances;

(6) the issue of demand drafts made payable at its own offices or agencies and the making, issue and circulation of bank-post-bills;

(7) the purchase and sale of Government securities of the United Kingdom maturing within ten years from the date of such purchase;

(8) the purchase and sale of securities issued by, or guaranteed as to principal and interest by, the Government of India or a Provincial Government of any maturity, or of such securities issued or guaranteed by a local authority in British India or by Indian States as may be specified by the Governor-General in Council on the recommendation of the Central Board: provided that the total value of such securities held in the Banking Department does not exceed the aggregate amount of the share capital and reserve fund of the Bank and three-fifths of the liabilities of the Banking Department in respect of deposits; and provided that the value of such securities maturing after one year and ten years does not exceed the aggregate amount of the share capital and reserve fund of the Bank plus two-fifths and one-fifth respectively of the liabilities of the Banking Department in respect of deposits;

(9) the custody of money, securities and other articles of value, and the collection of principal, interest or dividends of any such securities;

(10) the acting as agents for the Secretary of State in Council, the Governor-General in Council, or any Provincial Government, or Indian State for—

(a) the purchase and sale of gold or silver;

(b) the purchase, sale, transfer or custody of bills of exchange, or securities or shares in any company;

(c) the collection of principal, interest or dividends of any securities or shares;

(d) the remittance of such proceeds, at the risk of the principal, by bills of exchange payable in India or elsewhere; and

(e) the management of the public debt;

(11) the purchase and sale of gold coin and bullion;

(12) the opening of an account with, or the making of an agency agreement with, and the acting as agent or correspondent of, a bank which is the principal currency authority of any country, or any international bank formed by such banks, and the investing of the funds of the Bank in the shares of any such international bank;

(13) the borrowing of money from a scheduled bank in India or a bank which is the principal currency authority in any other country, for a period not exceeding one month for the purpose of the business of the Bank and the giving of security for money so borrowed: provided that the money borrowed in this way from a scheduled bank in India does not exceed the amount of the share capital of the Bank; and

(14) the making and issue of bank notes.

When in the opinion of the Central Board, or of its Committee or Governor, if the Board delegates this power to it or him, it is expedient to regulate credit in the interests of Indian trade, industry and agriculture, the Bank will be allowed by the Act, notwithstanding any limitations stated above—

(a) to purchase, sell or discount any of the bills of exchange or promissory notes specified in (2) (a) or (b) or (3) (b) mentioned above, although they do not bear the signature of a scheduled bank or a provincial co-operative bank, or

(b) to purchase or sell sterling in amounts of not less than the equivalent of Rs. 1 lakh; or

(c) to make loans or advances repayable on demand or on the expiry of fixed periods not exceeding 90 days against the various forms of security specified in (4) above,

The Bank will establish a special Agricultural Credit Department, the functions of which will be—

(1) to maintain an expert staff to study all questions of agricultural credit and to be available for consultation by the Governor-General in Council, Provincial Governments, provincial co-operative banks and other banks; and

(2) to co-ordinate the operations of the Bank in connection with agricultural credit and its relations with provincial co-operative banks, and any other banks or organisations engaged in the business of agricultural credit.

Further, the Bank will submit to Government within three years from its inauguration a report with proposals, if it thinks fit, for legislation on—

(1) the improvement of machinery for dealing with agricultural finance and methods, for effecting a closer connection between agricultural enterprise and the operations of the Bank; and

(2) the extension of the provisions of the Act relating to scheduled banks to persons and firms engaged in British India in the business of banking.

Moreover, when the Bank is of opinion that the international monetary position has become sufficiently clear and stable to make it possible to determine what will be suitable as a permanent basis for the Indian monetary system and to frame permanent measures for a monetary standard, it will report its views to the Governor-General in Council.

Except as otherwise provided above, the Bank will be prevented by the Act from—

(1) engaging in trade, or otherwise having a direct interest in any commercial, industrial, or other undertaking, except such interest as it may acquire in the course of the satisfaction of its claims: provided that all such interests are disposed of as early as possible;

(2) purchasing its own shares, or the shares of any other bank or company, or granting loans upon the security of any such shares;

(3) advancing money on the mortgage of, or otherwise on the security of, immovable property, or becoming the

owner of immovable property, except so far as is necessary for its own business premises and residences for its employees ;

(4) making unsecured loans or advances ;

(5) drawing or accepting bills payable otherwise than on demand ; and

(6) allowing interest on deposits or current accounts.

5. Central banking functions of the Reserve Bank.

We may now turn to the central banking functions provided for the Bank by the Act. The Bank must accept money for the account of the Secretary of State in Council, the Governor-General in Council and Provincial Governments, make payments on their behalf, carry out their exchange, remittance and other banking operations, and manage the public debt. The Governor-General in Council and Provincial Governments in turn must entrust the Bank with all their money, remittance, exchange and banking transactions in India, the management of the public debt, and the issue of new loans in India, and deposit free from interest all their cash balances with the Bank. But these Governments will be free to carry on money transactions at Government treasuries or sub-treasuries at places where the Bank has no branches or agencies, and to hold at them such balances as they may require.

The Bank will have the sole right to issue paper money in British India and may, for a period which will be fixed by the Governor-General in Council on the recommendation of the Central Board, issue currency notes of the Government of India supplied to it by the Governor-General in Council, who must not issue any paper money after this provision comes into force. The Bank will issue notes from the Issue Department, which will be kept wholly separate from the Banking Department, and the assets of the Issue Department will not be subject to any liability other than the liabilities of the Department in respect of the notes issued and in circulation. The Department will not issue bank notes to the Banking Department or to any other person except in exchange for other bank notes or for such coin, bullion or

securities as are permitted by the Act to form a part of its reserve.

Every bank note will be legal tender throughout British India in payment for the amount stated therein, and will be guaranteed by the Governor-General in Council, who may, however, declare by a notification in the Gazette of India that a particular series of bank notes will cease to be legal tender from a specified date, except at an office or agency of the Bank. If at any time the Bank fails to comply with any provisions of the Act, the Governor-General in Council may declare by a notification that the Bank has forfeited the right of note issue, and will thereupon take over the liabilities of the Issue Department together with such a portion of the assets of the Bank as will be required to meet these liabilities, and thereafter the business of the Issue Department will be carried on by such agency as the Governor-General in Council may determine. When he takes such action, he must report it fully to the Central Legislature within three months.

The assets of the Issue Department will consist of gold coin and bullion, sterling securities, rupee coin and rupee securities of a total value not less than the amount of the liabilities of the Issue Department. Of the assets not less than $\frac{2}{5}$ must consist of gold coin and bullion and sterling securities, and the value of the gold coin and bullion must not be less than Rs. 40 crores. The rest of the assets will consist of rupee coin, Government of India rupee securities, and such bills of exchange and promissory notes as are eligible for purchase by the Bank, as stated before. But the value of the Government of India securities must not exceed $\frac{1}{4}$ of the total assets, or Rs 50 crores, whichever amount is less. The gold coin and bullion will be valued at 8·47512 grains of fine gold per rupee, and securities will be valued at their market rate. Of the gold coin and bullion not less than $\frac{17}{20}$ must be held in British India, and the whole amount must be held in the custody of the Bank or its agencies, but gold belonging to the Bank which is in any other bank, or in any mint, or treasury, or in transit may be reckoned as a part of the assets. Sterling securities have been defined by the Act as—

(1) balances at the credit of the Issue Department of the Reserve Bank of India with the Bank of England;

(2) bills of exchange bearing two or more good signatures, payable in the United Kingdom, and having a maturity of not more than 90 days; and

(3) Government securities of the United Kingdom maturing within 5 years.

As soon as these provisions of the Act come into force, the Issue Department will take over from the Governor-General in Council the liability for all the currency notes of the Government of India for the time being in circulation, and the Governor-General in Council will transfer to the Issue Department gold coin and bullion, sterling securities, rupee coin and rupee securities of a total value equal to the amount of the liability so transferred, in such a proportion as to comply with the reserve requirements mentioned above, but the total amount of the gold coin, gold bullion and sterling securities transferred must not be less than $\frac{1}{2}$ of the whole amount transferred, and the amount of the rupee coin transferred must not exceed Rs. 50 crores.

After the close of any financial year in which the minimum amount of rupee coin held in the assets, as shown in any of the weekly accounts of the Issue Department, is greater than Rs. 50 crores or $\frac{1}{6}$ of the total assets, whichever may be greater, the Bank may deliver to the Governor-General in Council rupee coin up to the amount of such excess, but not exceeding Rs. 5 crores without his consent, against payment of legal tender value in the form of bank notes, gold or securities. After the close of any financial year in which the maximum amount of rupee coin held in the assets, as so shown, is less than Rs. 50 crores or $\frac{1}{6}$ of the total assets, whichever may be greater, the Governor-General in Council may deliver to the Bank rupee coin up to the amount of such deficiency, but not exceeding Rs. 5 crores without his consent, against payment of legal tender value.

The Bank may, with the previous sanction of the Governor-General in Council, for periods not exceeding 30 days in the first instance, which may, with the

same sanction, be extended from time to time by periods not exceeding 15 days, hold as assets gold coin, gold bullion or sterling securities of a total value of less than $\frac{2}{5}$ of the assets, as provided above, subject to the payment of a tax at 1 per cent more than the bank rate if such holding exceeds 32½ per cent of the total assets, and at a further 1½ per cent in respect of every further decrease of 2½ per cent or part of such decrease, with a minimum rate of 6 per cent per annum ; but the value of the gold coin and bullion held as assets must not be reduced below Rs. 40 crores, as long as any sterling securities are held as assets.

The Governor-General in Council must not put into circulation any rupees except through the Bank, and the Bank must not dispose of rupee coin otherwise than for the purpose of circulation, or by delivery to the Governor-General in Council, as mentioned above. The Bank will issue rupee coin on demand in exchange for currency notes of the Government of India, and will issue currency notes or bank notes on demand in exchange for rupees or other coins, which are legal tender under the Indian Coinage Act of 1906. It will in exchange for currency notes or bank notes supply currency notes or bank notes of lower values, or rupees, or other legal tender coins, in such quantities as may, in its opinion, be required for circulation. The Governor-General in Council will supply rupees or other legal tender coins to the Bank on demand in the way mentioned above. If he fails at any time to discharge this duty, the Bank will be released from its obligation to supply such coins to the public.

The Bank must sell to any person at its offices in India sterling amounting to not less than £10,000 for immediate delivery in London at a rate not below 1*s.* $5\frac{49}{64}$*d.* per rupee, and must buy at its offices in India from any person sterling amounting to not less than £10,000 for immediate delivery in London at a rate not higher than 1*s.* $6\frac{3}{16}$*d.* per rupee.

The Governor-General in Council will direct the inclusion into a schedule of every company legally incorporated in or outside British India, so long as it carries on

banking business in British India and has a paid-up capital and reserve amounting to not less than Rs. 5 lakhs. Every bank included in this schedule will have to maintain with the Reserve Bank a balance amounting to at least 5 and 2 per cent respectively of the daily average of its demand and time liabilities in India computed in respect of each period ending on the 15th and last day of each month.

Every such bank will have to send to the Governor-General in Council and the Reserve Bank a monthly return not later than 14 days after the end of each month showing (*a*) the amounts of its demand and time liabilities in India (*b*) its holding of Government currency notes and bank notes (*c*) its holding of rupees and subsidiary coins (*d*) the amounts of advances made and bills discounted by it in India, and (*e*) the balance held by it at the Reserve Bank, and stating whether it has maintained with the latter the required minimum balance. Failure to send this return will make it liable to a penalty of Rs. 100 for each day during which the failure continues. If it fails to maintain the required minimum balance, it will be liable to a penalty at the rate of 3 per cent above the bank rate on the amount of the deficiency for each day of the first week during which the default has continued, and 5 per cent above the bank rate after the first week of the deficiency.

6. Agreement of the Reserve Bank with the Imperial Bank.

The Reserve Bank will enter into an agreement with the Imperial Bank of India, which will be subject to the approval of the Governor-General in Council, and which will run for 15 years, and thereafter until terminated after 5 years' notice on either side. The agreement will be conditional on the maintenance of a sound financial position by the Imperial Bank. If in the opinion of the Central Board of the Reserve Bank, the Imperial Bank has failed to do this or to fulfil the conditions of the agreement, it will make a recommendation to the Governor-General in Council, who may issue instructions to the Imperial Bank with reference to the agreement or to any matter involving the security of Government money or

the assets of the Issue Department of the Reserve Bank in the custody of the Imperial Bank and, if it disregards the instructions, may terminate the agreement.

Under this agreement, the Imperial Bank will be the sole agent of the Reserve Bank at all places in British India where, at the commencement of the Reserve Bank Act, there is a branch of the Imperial Bank and no branch of the Reserve Bank. In consideration of the performance by the Imperial Bank, on behalf of the Reserve Bank, of the functions which the former has been performing on behalf of the Governor-General in Council at these places, the Reserve Bank will pay it a commission on the total of the receipts and disbursements dealt with annually by it on account of Government at the rate of $\frac{1}{16}$ per cent for the first Rs. 250 crores and $\frac{1}{32}$ per cent for the remainder during the first 10 years, and at rates to be determined afterwards for every 5 years after examining the cost to the Imperial Bank of performing these functions.

Further, subject to the condition that the Imperial Bank keeps open branches not less in number than those existing at the time of the commencement of the Reserve Bank Act, the Reserve Bank will, until the expiry of 15 years from the coming into force of the agreement, pay the Imperial Bank Rs. 9, 6 and 4 lakhs per annum during the first, second and third period of 5 years each respectively. The Imperial Bank must not, without the approval of the Reserve Bank, open any branch in substitution of a branch existing at the time at which the agreement comes into force, and the Reserve Bank will be free to open its own offices at any places, notwithstanding the fact that the Imperial Bank has up to then acted as its agent at those places.

7. Dividends and reserve fund of the Reserve Bank.

As regards the payment of dividends to the shareholders of the Reserve Bank and the share of Government in the Bank's profit, the Act has provided that after payment out of the net annual profits of a cumulative dividend on the share capital at such a rate not exceeding

5 per cent, as the Governor-General in Council may fix at the time of the issue of the shares, a portion of the surplus will be allocated to the payment of an additional dividend according to the scale laid down in a separate schedule, and the balance of the surplus will be paid to the Governor-General in Council: provided that, so long as the reserve fund is less than the share capital, not less than Rs. 50 lakhs of the surplus, or the whole of the surplus, if less than that amount, is allocated to the reserve fund.

The Bank will announce to the public from time to time the minimum rate at which it is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under the Act. It will also submit weekly and annual accounts of the Issue and Banking Departments to the Governor-General in Council, who will cause them to be published in the Government Gazette.

8. Exclusion of certain recommendations of the Central Banking Committee from the Reserve Bank Act.

The Act, however, has not carried out the following important recommendations of the Central Banking Committee:—

(1) On the ground of practical difficulties, it has excluded the Committee's scheme of bringing indigenous bankers into direct relations with the Reserve Bank by placing on the approved list of the Bank such indigenous bankers as are prepared to restrict their activities to banking, and giving them rediscount facilities from the Bank in the same manner as joint-stock banks. If a large body of indigenous bankers is brought into the Reserve Bank system in this way, in the opinion of the Committee, a substantial proportion of the agricultural population will come within the purview of the Bank's operations, and the bankers will provide the Bank and the commercial banks with a gradually increasing number of genuine trade bills.[1] The Act has merely provided for an examination of this scheme at a future date.[2]

1. See Central Committee Report, pp. 107 and 421.
2. *Cf.* the Finance Member's speech, Legislative Assembly Debates, 1933, Vol. VIII, No. 5, pp. 2200-1.

(2) The Act does not empower the Reserve Bank to purchase, sell and rediscount rupee import bills, the introduction of which has been suggested by the Committee, and which would be drawn out of India. It permits the Bank to deal only in such bills as are drawn and payable in India.

(3) The Act does not permit the Reserve Bank to make loans and advances on the security of movable goods, wares and merchandise as well as against warehouse warrants or receipts representing such goods. The Committee has admitted that the Bank should not use this power ordinarily to compete with commercial banks for profit, but in its opinion the Bank must possess this power, in order to make its discount policy effective by operating in the open market and competing with the commercial banks in this way. The Bank need not make use of this power to a large extent, as its mere possession will increase the Bank's influence over discount rates.

(4) The Act has not carried out the Committee's suggestion that the total face value of agricultural bills and notes, which the Bank can purchase or rediscount, should be limited to the amount of the Bank's share capital, or ¼ of the value of all the bills and notes purchased or rediscounted by the Bank, whichever amount is greater.

The Act has not also carried out the suggestion made by some Indian commercial bodies and financial experts that, to give the Bank a truly national character, at least 75 per cent of its share capital must be in the hands of natural-born Indians, or companies registered in India, 75 per cent of whose capital is held by natural-born Indians, and that not less than 75 per cent of the Directors of the Central Board of the Bank must be natural-born Indians. The reason given is that, while it may be confidently expected that in practice more than 75 per cent of the shares of the Bank will be held by Indians and that more than 75 per cent of its Directors will be Indians, so far as the statutory provisions are concerned, no distinction can be drawn in this matter between Indian-born subjects of His Majesty and United Kingdom—not Dominion—British subjects

resident in India.[1] The suggestion that Government should reserve the right to acquire the whole capital of the Bank has also not been accepted.

9. Policy of the Reserve Bank.

The establishment of the Reserve Bank may not be welcomed by all the existing banks. It may be regarded by them as an engrafted and extraneous body. Its privileges as the fiscal agent of Government, its free funds provided by Government and other banks, its monopoly of note issue and its potential competitive power may produce in them a feeling of suspicion against it at first, and delay that co-ordination and co-operation between the component parts of the money market in India, to secure which the Reserve Bank of India is needed.

It is essential, therefore, that the Reserve Bank should endeavour from the beginning to secure the confidence and willing help of the other banks, so that when it has to exercise control to the temporary disadvantage of any section of the money market, in the interests of the money market and the banking system as a whole, the control may be accepted without opposition and ill-will by all the banks and bankers. If its policy is directed on the right lines, it will not be long before it is universally regarded as a natural and healthy development which has evolved from, and for the benefit of, the banking system of India as a whole.[2]

Some authorities have, therefore, suggested that the power given by the Reserve Bank Act to the Bank to accept deposits without interest from the members of the public should be withdrawn, and that, as the Act empowers the Bank to have dealings with them, *i.e.* open market operations, to some extent, the Act should clearly lay down that the Bank should have such dealings, only when they are absolutely necessary to make its credit or exchange policy effective, and that it must liquidate them as early as possible.[3]

1. *Cf.* the Finance Member's speech, Legislative Assembly Debates, 1933, Vol. VIII, No. 5, p. 2196-7.

2. See Central Committee Report, p. 426.

3. See Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, pp. 65-6 and 73.

It should also endeavour to secure the goodwill of the public by making its management free even from a suspicion of being influenced by interests other than those calculated to promote the economic welfare of India. To help the Bank to build up this goodwill, it has been suggested that the powers given to the Governor-General in Council by the Reserve Bank Act should be exercised by the Governor-General acting on the advice of his responsible ministers belonging to the coming Federal Government.

CHAPTER XIII

Regulation of Banking

1. Inadequacy of the Indian Companies Act.

Joint-stock banks in India are at present registered under the Indian Companies Act of 1913, and are governed by its general regulations, with the exception that in a few matters the Act makes a distinction between banks and other companies, and contains a few special regulations applicable to banks only, prohibiting a partnership of persons exceeding ten in number from carrying on the business of banking unless it is registered as a company, or is formed according to an Act of Parliament or the Government of India, or to Royal Charter, requiring banks to file with the Registrar a list of all their places of business, and to supply him periodically with their balance-sheets drawn up in a certain form in which secured and unsecured debts must be shown separately, but exempting them from the necessity of divulging the provision made for bad and doubtful debts, and providing that the Provincial Government concerned may appoint one or more inspectors to examine the position of a bank on the application of members holding not less than $\frac{1}{5}$ of its issued shares, the proportion being $\frac{1}{10}$ in the case of other companies.[1]

The general opinion in India is that this Act has provided very inadequately for the regulation of banking, and has left many banking institutions altogether free from regulation. In all countries, banking business is regarded as semi-public in character, as banks serve as the repositories of the savings of the people and influence their economic life deeply and, therefore, special banking legislation is regarded as essential for protecting the depositors on whose confidence the whole banking system vitally depends, and for promoting the growth of the banking system on sound lines.[2] Such legislation has been

1. See Bombay Committee Report, p. 219.
2. *Cf.* Bengal Committee Report, p. 222.

enacted in most Western countries. It is true that in England there is no special banking legislation apart from the Companies Act, but its object is served by the tradition, convention and case law that have been developed in the course of centuries.

2. Need of a special Bank Act.

It is true that no banking regulation, however elaborate, can prevent unsound management, losses and failures[1]; that banks and bankers cannot be made by mere Acts of the Legislature; that elaborate restrictions and regulations may do more harm than good, by hampering the activities of banks and the sense of responsibility of their managers and directors; and that many banking matters are best left to the discretion and the sense of responsibility of bank managers and directors and the supervision of auditors, or to the control of the Reserve bank, or to suitable provisions in the memorandum and articles of association of banks according to their needs. Nevertheless, certain matters must be provided for by legislation which, although incapable of preventing mismanagement or fraud, will ensure a minimum standard of efficiency and integrity in the conduct of the business of banks. The Central Banking Committee has, therefore, recommended that a special Bank Act should be passed comprising the provisions of the Indian Companies Act, with certain modifications and additions, and that even foreign banks should be brought under its operation to a certain extent.[2]

The Foreign Experts, however, have expressed a preference for the improvement of the Indian Companies Act itself, especially of its provisions relating to banks, on the grounds that it would not hamper useful activities of banks, that special banking legislation is rarely a real protection, that numerous banks have continued to fail in the U.S.A. in spite of such legislation, and that, if it is evaded, or if it does not prevent bank failures and mis-

1. See Foreign Experts' Report, Central Committee Report, p. 657.

2. See Report, p. 451. See also the statements of the Bengal National Chamber of Commerce and Mr. Shroff, Central Committee Evidence, Vol. II, pp. 593 and 401.

management, it is liable to reduce respect for law among the population.[1]

The task of framing a definition of the term "bank" or "banker," which has been found most difficult in other countries, is more so in India on account of the existence of indigenous bankers. The only safe course, therefore, is to frame an authoritative and conclusive register of banks and bankers without attempting an exact definition of these terms, and the situation presented by the indigenous bankers should be met by providing for their enrollment, under certain conditions, as mentioned in a previous chapter, as members of the All-India Bankers' Association, with the privilege of affixing to their names the title 'Member of All-India Bankers' Association.' When this title comes into general use in India, the terms "bank" and "banker" will lose much of the prestige that they enjoy at present.

The indigenous bankers, who finance a large part of the internal trade of India, would not be willing to come under the operation of the special Bank Act. Compulsion in this matter would only accelerate the process of driving them from banking to other spheres of business, as stated in a previous chapter, and organised banking cannot develop in the immediate future to such an extent as to permit them to withdraw from the field of banking without causing serious harm to the internal trade of the country. Banks registered under the Co-operative Societies Acts, or under any special charter or enactment, such as the Imperial Bank of India Act, will also be free from the operation of the special Bank Act. Banks registered under the laws of other countries will be exempt from many of the provisions of the Act. Any firm or individual will be able to use the term bank or banker without getting itself or himself registered under the Act, and it will be impossible to prevent them from doing so.[2] So joint-stock companies in India, existing as

1. See their Report, Central Committee Report, pp. 628 and 657.

2. *Cf.* Bengal, Bombay and C. P. Committees Reports, pp. 223, 220 and 366.

well as new, using the term 'bank' or its equivalent, will have to get themselves registered under the Act, and will be subject to its provisions.

3. Provisions suggested for the Act.

(1) All banks, Indian and foreign, wishing to do banking business in India, should be made by the Act to obtain a license from the Reserve Bank, which would ensure that the provisions of the Act and any other conditions mentioned in the license are duly carried out. This is necessary partly for the protection of the depositors, and partly to enable the Reserve Bank to exercise some control over the other banks. Before issuing a license to a new bank, the Reserve Bank would see that its financial position and the standing and reputation of its directors are good, but, of course, it can undertake no responsibility for the efficiency or integrity of the future management of the licensed bank. The policy of the Reserve Bank in granting licenses would be determined entirely by the economic interests of India. The licensing system would enable it to pursue the policy of stimulating a systematic expansion of banking in areas which suffer from a shortage of banking facilities, to check its further expansion in those localities in which the facilities are already adequate, to obtain a measure of general control over all the banks, in addition to the control obtained by means of its discount rate and open market policy, and to make them conform to certain requirements with regard to the preparation and publication of statements of their accounts.

Mr. Subhedar, however, is opposed to the institution of a licensing system for banks registered in India on the grounds that it will serve no useful purpose except as a consolation to foreign banks that Indian banks also are subjected to the same system, and that Indian concerns, after conforming to the general provisions of the Bank Act, are entitled to unrestricted freedom to conduct their business. In his opinion, membership of the Reserve Bank, which every Indian bank will seek as a valuable privilege, will provide the Reserve Bank with the required

machinery for securing information regarding the working of banks in the country.[1]

The Foreign Experts are generally not in favour of the introduction of a licensing system on the grounds that banking ought to be left to free competition, and that its development must not be hampered by artificial restrictions. They recognise, however, that the Reserve Bank, as the licensing authority, would handle the licensing system soundly and impartially. But they are strongly of opinion that, as regards the banks working already in India, licenses should not only be freely granted, but should also be automatically renewed, so long as the banks comply with the provisions of the law, without imposing any additional restrictions, and that they should be free to open new branches without any interference from the licensing authority.[2]

(2) The Act should lay down that all banks, except foreign banks, must have a majority of Indian directors, and that no new bank, other than a foreign bank, would be allowed to operate in British India unless it has a majority of Indian shareholders. Unless non-Indians are prevented in this way from dominating the management of banks, it would be difficult to carry out any national policy that might be laid down in the interests of Indians for the development of banking, which is a service of national importance. Eight out of the twenty members of the Central Banking Committee and the Foreign Experts, however, have not supported this recommendation on the ground that banks established by private enterprise, without concessions from the State, should be free from legislative restrictions on the rights of their shareholders to elect their directors and on the free transfer of their shares, and that the protection of national interests in this matter should be left to their voluntary action, and should be provided for in the articles of association of the banks, as is done in most other countries.[3]

(3) The Act should prohibit the organisation of a

1. See Central Committee Minority Report, p. 376.
2. See their Report attached to Central Committee Report, p. 619.
3. See Central Committee Report, pp. 458 and 622.

bank on the managing agency system, as the need of such an agency ought never to be felt in the business of banking.

(4) To prevent the starting of mushroom banks, with a large authorised capital but a small paid-up capital, so as to remove one of the causes of the banking crisis of 1913-17, without preventing, however, the starting of fairly small banks in areas which at present have no banking facilities, the Act should lay down that a bank registered under it must start with a minimum paid-up capital of Rs. 50,000, that its paid-up capital must not be less than 50 per cent of its subscribed capital, and that the latter must be at least half of its authorised capital.[1]

(5) The Act should provide for keeping a separate index of the names of the shareholders of a bank and attaching it to the register of the shareholders, for ready reference and inspection by the shareholders, and for keeping a separate register of the bank's shares held by non-Indians.

(6) To prevent undue delay in the registration of transfers of shares, the Act should require the directors of a bank to decide within two months after the date of the presentation of the transfer deeds to them, whether the transfers will be registered or not.

(7) The Act should require a bank, which has created certain mortgages and charges on its own assets, to file their particulars with the Registrars of the provinces in which it has branches, in order to enable those who deal with the branches to find out fully the nature of such transactions, upon which the credit of the bank vitally depends. The Act should also require a bank to register certain prior charges that may exist on immovable property that it may acquire, and to record the satisfaction of a mortgage before the Registrar.

(8) The Act should prohibit a bank registered under it from declaring dividends in any year, unless it has previously carried to its reserve fund, which must be built up to enable it to meet losses without depleting its capital, an amount equal to at least 2½ per cent of its paid-up

1. *Cf.* Foreign Experts' Report, Central Committee Report, p. 629.

capital, until the reserve fund becomes equal to the paid-up capital. It is true that the primary requisite for a bank is good management, and that, in its absence, any legislative provision for the building up of a reserve fund cannot be of much use. Nevertheless, the Central Committee is of the opinion that this provision will serve a good purpose in the early stages of the development of Indian banking, as it has done in many Western countries.

Bank directors, however, should not be satisfied with this minimum annual addition to the reserve fund, but should review their position every year, and should, in addition to the statutory reserve fund, build up from annual profits, as prudent directors do in other countries, a secret reserve fund, which is not shown in the balance-sheet and which is used to meet unforeseen losses, so as to retain intact the reserve fund shown in the balance-sheet, and to prevent a fright among depositors and shareholders. Mr. Subhedar has recommended that the Act should prohibit banks from declaring a dividend exceeding 6 and 9 per cent, until their reserve fund equals half and the whole of their capital respectively, on the ground that compulsion to carry to the reserve fund a part of their profits bearing a fixed proportion to their paid-up capital may come to be regarded as the maximum, and would be an unwarrantable interference with the discretion and responsibility of their directors.[2]

(9) The Act should prohibit banks registered under it from creating a mortgage or a charge on any part of their uncalled capital, so as to retain intact the security afforded by the uncalled capital to the depositors and other creditors of the banks.

(10) The Act should prohibit them from giving advances to their auditors,[3] or giving them remuneration beyond the amount sanctioned by the shareholders, and should make officers and auditors of banks liable to punishment for omission to state material facts in their reports and

1. See Report, p. 463.
2. See Central Committee Minority Report, p. 378.
3. Mr. Pochkhanawala sees no objection to loans being given to auditors against good security. See his answers, Central Committee Evidence, Vol. III, p. 76.

in the presentation of bank accounts. In other respects, in the opinion of the Central Banking Committee, the present arrangements regarding audit, as provided by the Indian Companies Act, need not be disturbed.[1] They are that the auditors are appointed by the shareholders who can make the best possible selection, that the auditors must hold a certificate of the Provincial Government concerned, or must be recognised by the Governor-General in Council as entitled to act as auditors of companies, that the auditors need not audit the accounts of a bank's up-country branches, but can depend upon certified returns supplied by the managers of the branches, and that whoever, in any return, report, balance-sheet, or other document, deliberately makes a statement false in any material particular, is punishable with imprisonment, or fine, or both.

Mr. Subhedar is of the opinion that, to prevent fraud, the accounts of up-country branches must be audited by local auditors, who are available, and whose charges would not be heavy.[2] The Committee has not supported the suggestions of witnesses that only auditors of long standing and experience should be allowed to audit the accounts of banks, that a restriction should be imposed on the period of the appointment of the same persons as auditors of banks, and that there should be two auditors, one appointed by the directors and the other by the shareholders. The Foreign Experts have pointed out that auditing becomes much more efficient, if the selection of auditors is backed by the common interest of a community desiring to improve the professional standard.[3]

(11) The Act should prescribe a more detailed balance-sheet than that prescribed in form F by the Indian Companies Act, as a full and accurate statement of assets and liabilities operates as an automatic check against irregularities and abuses.[4] The balance-sheet should show separately loans granted by a bank to its directors,

1. See Report, p. 468.
2. See Minority Report, p. 379.
3. See their Report, Central Committee Report, p. 629.
4. See Bengal Committee Report, p 222, and Mr. Shroff's answers, Central Committee Evidence, Vol. III, pp. 184-6.

manager and secretary, loans for the repayment of which a director is responsible as a guarantor or otherwise, and doubtful debts not fully provided for. It should classify investments into (*i*) gilt-edged and trust securities, (*ii*) debentures, and (*iii*) other items, and should show their valuation at cost or market price, whichever is lower, so as not to remove from a bank the option of building up a secret reserve fund. But bad debts should be written off, and if a full provision is made for doubtful debts, the amount of loans and advances should be mentioned in the balance-sheet after deducting the amount of this provision. The distinction between secured and unsecured book debts should be done away with, as the latter, although not necessarily unsafe, are apt to frighten the shareholders and creditors of the bank concerned.

The Act should require a bank to display a copy of this balance-sheet instead of the statement in form G prescribed by the Indian Companies Act, and to continue to display it in a conspicuous place in its head office and branch offices until the display of a copy of the next balance-sheet. The question whether a bank should be made to publish additional periodical statements of its assets and liabilities should be left to the judgment of the Reserve Bank. The exchange banks should be made to supply the Reserve Bank with an audited annual statement, showing their assets and liabilities relating to their Indian business, in a form prescribed by the Reserve Bank, as a condition of the grant of licenses to them, and to display the statement along with their balance-sheet at all their offices.

(12) The Act should lay down that the annual general meeting of a bank must be held not later than three months after the close of each year.

(13) The Act should authorise the Reserve Bank to grant a temporary moratorium to a bank, which may be in difficulties, so as to give it time to try to reconstruct itself or to amalgamate itself with a stronger bank, and to prevent its untimely and compulsory liquidation. One of the functions of the Reserve Bank will be to give its advice and assistance for these purposes.

(14) To safeguard the interests of the creditors of banks, the Act should provide that in the case of the liquidation of a bank, compulsory or voluntary, the liquidator or liquidators must be appointed by, or with the approval of, the Reserve Bank, and that their work must be supervised by a committee of inspection consisting of the representatives of the bank's creditors.

(15) The Act should give the Indian creditors of a non-Indian bank taken into liquidation a prior claim on its assets in India, and some arrangement should be made under which they can share in the distribution of its assets outside India, if its assets in India prove insufficient to meet their claims fully.[1] The Foreign Experts have opposed this suggestion on the grounds that it would be incompatible with international law, that if every country adopted it, foreign banks would have to split up their assets against their liabilities in several countries, thereby weakening their position and that of their creditors, and that the suggestion would result in a shrinkage of the outside resources of the banks available to India at present.[2]

(16) The Act should lay down that every seller of a bank's shares must give the actual numbers of the shares at the time of selling them, so as to prevent any attempt to injure a bank's credit by a bear raid on its shares.[3]

(17) The Act should lay down that a bank registered under it must include adequate provisions in its Memorandum and Articles of Association—

(*i*) prohibiting activities other than banking;

(*ii*) prescribing the period for which a person should have held the bank's shares before being entitled to participate in its proceedings ;

(*iii*) prohibiting loans on the security of the bank's own shares, as a large portion of the bank's capital would be borrowed from the bank itself, if such loans were given and were used for purchasing additional shares of the bank;

1. See Mr. Shroff's statement, Central Committee Evidence, Vol. II, p. 407.
2. See their Report, Central Committee Report, pp. 622 and 647.
3. See the statements of the Bengal Chamber of Commerce and Mr. Shroff, Central Committee Evidence, Vol. II, pp. 478 and 408.

(*iv*) limiting loans to the directors, manager and officers of the lending bank[1];

(*v*) laying down the qualifications of the directors, and the procedure regarding their appointment, and retirement, or removal from office;

(*vi*) prohibiting the employees of the bank from holding proxies for the purpose of voting on behalf of any other shareholders, without, however, depriving them of the right to vote in their own capacity as shareholders;

(*vii*) prohibiting the general form of proxy, and if this is not done, limiting its validity to three months; and

(*viii*) laying down that copies of the directors' report and the balance-sheet must be posted to the shareholders not later than ten days before the day of the meeting called for considering them.[2]

In addition, the Memorandum and Articles of Association of a bank may, if its promoters so desire, lay down a definite relationship between its total borrowings and paid-up capital, limit its total clean advances, or its advances against immovable property, to the amount of its paid-up capital, limit its total advances to a single individual or concern to a fixed proportion of its paid-up capital, restrict the power of its directors to refuse to register transfers of shares, without assigning any reason, for the purpose of keeping out unfriendly parties, and restrict the principle of one vote for each share in order to prevent individuals or groups of them from obtaining a controlling interest in it.

Several witnesses have suggested to the Central Committee that the Bank Act should require banks to hold minimum cash reserves. The Central Committee and the Foreign Experts have not approved of the suggestion on the grounds that—

(1) the U. S. A. is the only important country that has laid down such a statutory requirement;

(2) it can be evaded in a variety of ways;

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1. Mr. Subhedar is of the opinion that loans to directors should be prohibited altogether.

2. See Foreign Experts' Report, Central Committee Report, p. 659.

(3) there is the danger of the statutory minimum being considered the necessary maximum with regard to a bank's position, which alters at short intervals, and must be regulated with wisdom and foresight, and not by the rule of the thumb ;

(4) the maintenance of an adequate cash reserve is, therefore, best left to the discretion and judgment of the manager and directors of a bank; and

(5) that the member banks of the Reserve Bank will have to deposit with it cash bearing a certain proportion to their liabilities, besides the cash in their own tills.[1]

The Central Committee has not approved also of the suggestion that a non-Indian bank should be prevented by the Bank Act from obtaining a controlling interest in any bank registered under it, on the ground that it is a matter for the shareholders to decide.[2]

Mr. Subhedar has recommended legislation incorporating the suggestions, which he has made for restricting the operations of foreign banks in India in the interests of Indian banks and the economic life of the country, and which have been explained in the chapter on exchange banks.[3]

Several witnesses have made many suggestions for a more detailed and meticulous regulation of banking in many directions, but the Central Committee has rightly rejected them, as legal provisions cannot decide safe and unsafe business, cannot be a substitute for business judgment, would hamper this judgment and the legitimate activities of banks if they are elaborate, and must not be enacted in a spirit of panic arising out of an isolated catastrophe.

1. See Report, p. 464 and Foreign Experts' Report, p. 659.
2. See Report, p. 481.
3. See Central Committee Minority Report, pp. 370-1.

CHAPTER XIV

Saving and Investment

1. Their present position.

The progress of banking in a community depends vitally upon the growth of saving and investment in it. The latter in turn depend on the saving capacity of the people, their will to save, and facilities for investment. Most of the Provincial Banking Committees have mentioned that the saving capacity of the agriculturists, who make up the larger portion of the Indian community, is very small even in good years. The few well-to-do agriculturists, who can save substantially in good years, use their savings for the purchase of land or ornaments, or for money-lending operations. A large proportion of the landlords are said to be in financial difficulties. Moreover, their wealth, consisting chiefly of land, cannot materially increase the resources of the capital market in India.

The salaried and professional sections of the middle class are generally satisfied with a low but secure yield from their investments, and so prefer deposits in post office savings banks or commercial banks, postal cash certificates, or Government securities to joint-stock securities. A large proportion of the well-to-do classes show a similar preference. The commercial classes invest their savings to some extent in joint-stock securities, but a substantial proportion of them also prefer short-term deposits in banks, Government treasury bills, and the purchase or mortgage of land and buildings. Orthodox Mohammedans generally invest their savings in land, because their religion prohibits receipt of interest.

Next to land, ornaments are the most popular form of investment throughout the country. This is so, because they have always played an important part in social ceremonies sanctioned by religion or custom. Moreover, this preference was promoted by the absence of banking faci-

lities, of facilities for safe investment, of quick realisability of other investments, and of security of property. The Hindu law of inheritance, which makes women ineligible for receiving any share of immovable property, has also led to the practice of giving *stridhan* to women in the form of ornaments at the time of marriage. Most of the Provincial Committees, however, have mentioned that with the growth of education, and the expansion of banking and investment facilities, this ancient custom of putting savings into ornaments has already commenced to decline, and that with the further growth of these favourable factors, combined with a widespread propaganda for turning individual savings to productive uses, the decline of this custom will be accelerated in the immediate future, making an increasing share of the community's savings available for increasing the resources of the Indian banking system.[1]

2. The extent of hoarding.

Several persons in and outside India still believe that from ancient times India has been absorbing an undue proportion of the world's gold supply and making it disappear permanently into hoards. The External Capital Committee (1924), the Royal Commission on Indian Currency and Finance (1926), and the Gold Delegation of the Financial Committee of the League of Nations (1929) have supported this belief to some extent.[2] The Babington Smith Committee on Indian Currency and Finance (1919) exposed the fallacies underlying this belief,[3] and most of the Provincial Banking Committees and the Central Banking Committee have stated that the extent of hoarding in India is greatly exaggerated,[4] that the practice of putting the precious metals out of use by burying them underground, or concealing them somewhere, has almost died out, that almost the whole of India's consumption of the precious metals is for ornaments or use in the arts,

1. See the Punjab Committee Report, p. 150.
2. See Report of the Committee, para. 8, of the Commission, paras. 64 and 68, and of the Delegation, pp. 13-14.
3. See Smith Committee Report, para. 63.
4. See Central Committee Report, p. 436.

and that there is hoarding only in the sense of investment in ornaments, the value of which per head of population is already very small, and has begun to decline further.

The figures supplied by Mr. Joseph Kitchen to the Royal Commission on Indian Currency and Finance (1926) show that, of the world's output of gold and silver from 1493 to 1924, India has absorbed only 14 and 34 per cent respectively. As India's population is approximately $\frac{1}{5}$ of the world's population, this absorption cannot be said to be excessive. Mr. Kitchen also calculated that 30 per cent of the gold output was consumed by Europe and America for non-monetary purposes, and India's consumption of 14 per cent for similar purposes does not compare unfavourably with this.

3. Suggestions for developing saving and investment.

Although the hoards of wealth in the country are not large, the commercial and co-operative banks have already succeeded in tapping a portion of them and of the current savings of the people. A substantial portion of both, however, still remains to be tapped and, therefore, it is necessary to conduct an extensive and systematic propaganda for promoting the saving and investment habit among the people, and to increase the facilities for investment. The Provincial and Central Banking Committees are confident that, if this is done, the response of the people will be large and quick. They have, therefore, suggested the establishment of thrift and savings associations all over the country similar to the National Savings Associations in England.[1] They will be able to develop the saving habit among persons of small means, to remove their timidity, and to make them familiar with safe yet paying investments, by systematic education and propaganda for small savings, by supplying means for their collection, and by pooling them for profitable investment in sound securities. Lessons on thrift and investment should also be included in school curricula, and home savings safes should

1. See Bengal, Bihar, Burma, Central Areas and C. P. Committees Reports, pp. 236, 237, 291, 293 and 395 respectively.

be made available to the public by the above associations and by joint-stock and co-operative banks.[1]

A substantial increase in the use of cheques is another indication of the expansion of the banking habit among the people of India. The Provincial Committees have obtained evidence of this increase from various directions. A large proportion of the people, however, cannot use cheques, or understand the facilities and the security that they offer, owing to their ignorance of the English language. There is, therefore, a general demand for the use of vernacular scripts in the various fields of banking, including cheques, pass-books and paying-in-slips, and this reform will do much to expand the banking habit among the people.[2] The Imperial Bank should arrange a conference of all banks to decide upon the adoption of a common policy in this matter. It is not reasonable to postulate that the growth of the cheque habit should be *pari passu* with the spread of English education in India.

The banks should also endeavour to reduce the delay involved in cashing cheques[3], and should induce traders and merchants to use cheques as far as possible in the settlement of up-country market transactions in respect of the movement of crops. Further, they should provide adequate facilities for the transfer of funds from one centre to another, because the circulation of cheques in the money market and the mobility of banking resources depend much upon these facilities. Finally, Government should allow the payment of land revenue and other dues by cheques into district treasuries and taluka sub-treasuries in the same way in which it allows such payment at present into the branches of the Imperial Bank, and it and local bodies should make all payments by cheques as far as possible.[4]

1. See C. P., Bihar and Bengal Committees Reports, pp. 393, 236 and 231.

2. *Cf.* Foreign Experts' Report, Central Committee Report, p. 625 and Assam, Bengal, Bihar, Bombay and C. P. Committees Reports, pp, 217, 223, 235, 232-3, and 397 respectively.

3. See Mr. Macdonald's answers, Central Committee Evidence, Vol. III, p. 957.

4. See Central Committee Report, p. 447 and Assam, Bengal, Madras, Bombay, Punjab and Bihar Committees Reports, pp. 217, 238, 244, 233, 155 and 241 respectively.

In Chapter VI we have examined the scope for extending investment facilities by means of post office savings banks, postal cash certificates, purchase and sale of Government securities through post offices, and insurance companies. The Central and Provincial Committees have supported the recommendation of the Royal Commission on Indian Currency and Finance (1926) that gold savings certificates should be sold for legal tender money, should be redeemable at the end of 3 or 5 years in gold, or legal tender money, at the option of the holders, and should be redeemable earlier in legal tender money only, at a discount calculated at varying rates according to the date of encashment.[1]

Further, to induce women to convert their ornaments into profitable investments, the Central and Bihar and Orissa Committees have recommended that a new type of gold certificate, to be called *stridhan* certificate, should be issued to women by post offices at a slightly lower price than that of the postal cash certificate.[2] The banks also can increase the popularity of investment in trust securities, by lowering their charges to the public for the purchase and sale of these securities, and for the collection of interest, safe custody, and other services regarding them, and by offering favourable terms to the public for the purchase of newly issued securities in instalments, as the Imperial Bank has been doing. The Imperial Bank also should reduce its charges for the above services.[3]

1. See the Commission's Report, paras 67-8 and Assam, Bengal, Bombay and U. P. Committees Reports, pp. 219, 235, 231 and 318-9. For drawing gold out of hoards, the editors of the *Indian Finance* have suggested that in exchange for the deposit of gold, Government should issue gold certificates of a duration of 5 years, analogous to postal cash certificates, that at any time within the 5 years the holders should be allowed to obtain for them gold equal to the amount originally deposited *plus* interest on a scale graded according to the length of the deposit, and that at the end of the 5 years the holders should be given gold worth the amount originally deposited *plus* the full interest. The editors believe that, even if in the earlier stages there are withdrawals of gold in order to test the *bona fides* of Government guarantee, the portion of gold on which Government will be able to rely absolutely as a minimum will be considerable. See their statement, Central Committee Evidence, Vol. II, p. 205.

2. See Central Committee Report, p. 441 and Bihar Committee Report, p. 243.

3. See Bihar Committee Report, p. 227. In the opinion of the Managing Governor of the Bank its present charges are reasonable. See Central Committee Evidence, Vol. III, p. 933.

As regards investment in industrial securities, although joint-stock companies offering a reasonable guarantee of good management and prospects do not have much difficulty in securing the required capital in normal times, there is no regular investment market in India, and investment banks, with an organisation for examining the soundness of new industrial securities, and underwriting and marketing them, do not yet exist in the country. Such banks can help much in the establishment of sound companies, in promoting the sale of their securities, and in creating public confidence in such securities. Until such institutions are established on the lines indicated before, and more stock exchanges are brought into existence, the existing banks should take up the purchase and sale of these securities for their clients on a commission basis.[1]

The debentures issued by well-conducted companies enjoying a good standing and reputation are readily marketable at a good price, but the demand for them is only from a small class of investors, who want a little higher yield on their investments than that given by Government securities, but who are not prepared to go in for risky investments, such as the shares of companies. Moreover, even this demand fluctuates with the varying fortunes of the industries concerned. The Central Committee has recommended that the transfer duty on the debentures, varying at present from 8 to 12 annas per cent in different provinces, should be reduced to a uniform level of 4 annas per cent.

Provident funds are very useful in promoting thrift and savings of employees. Until recently, the employees of Government, railways and other public bodies only enjoyed the benefits of these funds. But now they are being granted to the employees of charitable and educational institutions, and commercial and industrial concerns all over India. Some of the banks give special rates of interest on the deposit of these funds. They should give all possible help to ensure the success of such schemes. Provident or benefit societies, which collect small sums regularly from their members, hold them in safe

1. See Bengal Committee Report, p. 235.

investments, and give their benefit to the contributors in some form, have come into existence in some provinces. In Madras, several Nidhis and Chit Funds perform this function. But difficulties have arisen owing to the absence of a definite legal regulation of such societies, and they will increase in future. An All-India Act, therefore, should be passed to regulate their working on the lines of the English Industrial and Provident Societies Act.

Some witnesses and the Bengal, Central Areas and C. P. Committees have suggested the formation in India of investment trusts, on the lines of those which have proved so useful in England and the U. S. A., for promoting the saving and investment habit among the people.[1] They act as intermediaries between the primary investors and the borrowing industries, secure adequate information regarding the prospects and working of the latter, watch their working continuously, and spread out the risks in various classes of investments far more effectively than the primary investors can do. Such trusts in India, if properly organised, may be able to obtain considerable capital from abroad by offering their own intermediate guarantee, which does not exist at present. They can thus enrich the money market in India doubly. The Assam and Bombay Committees, however, do not regard them to be a practical proposition at present.[2] The Central Banking Committee has expressed the opinion that they can be established only as private enterprises, and may be formed as the banking and investment habit increases in the country.[3] Mr. Subhedar has suggested that two model trusts should be established in Bombay and Calcutta as early as possible, and that, if necessary, Government should promise their promoters a reasonable

1. See Mr. Dinshaw's statement, Central Committee Evidence, Vol. II, p. 456, and Bengal, Central Areas and C. P. Committees Reports, pp. 235, 293 and 395 respectively.

2. See their Reports, pp. 216 and 227.

3. Report, p. 446. See also the answers of the representatives of the Bombay Chamber of Commerce and Mr. MacDonald, Central Committee Evidence, Vol. III, pp. 2 and 868.

measure of assistance and exemption from the super tax.[1]

A scarcity of intermediate securities is one of the defects of the Indian situation regarding saving and investment. In between safe Government and trust securities with their low yield on the one hand, and highly speculative shares on the other, Indian investors have little choice. We have seen above that industrial debentures play a small part in the investment market in India. The situation, however, will be improved materially in the near future by the issue of debentures by the land mortgage and industrial corporations recommended by the Central Committee and by investment trusts, and by the issue of debentures by industrial companies with the support, and under the guidance, of the industrial corporations and investment trusts.

Government has hitherto borrowed from the savings of the Indian community without considering the effects of such borrowing upon private enterprise. The volume and the rate of Government borrowing, owing to its greater security, affect the volume and rate of the savings available to banking, trade and industry. Correlation between the capital needs of Government and private enterprise is, therefore, desirable, and Mr. Subhedar has suggested that Government borrowing in future should be in consultation with the Reserve Bank, that the balances from the postal savings banks and the sale of postal cash certificates should be made available to trade and industry through the Reserve Bank, and that the capital requirements of Government should be examined by a small committee of the Central Legislature, so as to make adequate funds available for the debentures of the land mortgage and industrial corporations that have been recommended.[2]

1. Minority Report, p. 365. See also Mr. Ramachandra Rau's answers, Central Committee Evidence, Vol. III, pp. 436-7.

2. See Minority Report, pp. 309 and 365-7.

CHAPTER XV

Education in banking

1. Its present position.

Until the close of the last century commercial education, and banking education which forms a part of it, were neglected in India. Since the beginning of this century, however, the educated public has shown much interest in the matter, and a substantial provision has been made for imparting teaching in commercial subjects, including banking. Most of the Universities have instituted a Bachelor of Commerce degree, theoretical instruction for which is provided either in special departments of unitary and teaching Universities, such as those of Lucknow, Allahabad and Dacca, or in separate institutions, such as the Sydenham College of Commerce in Bombay, and the Hailey College of Commerce in Lahore, which are affiliated to the Universities of Bombay and the Punjab respectively. Moreover, in some Universities, such as those of Calcutta and Dacca, currency and banking are special subjects for the M. A. degree in economics. The University of Madras has a post-graduate course leading to a diploma in economics and banking, and co-operation and rural economics are included in this course.

Further, in most of the provinces, commercial subjects, including banking, are optional subjects for the examinations that are held at the end of the intermediate college, and secondary school, courses. In addition, some of the provinces have commercial schools, Government and private, providing teaching for certificates or diplomas which are granted by Government, the London Chamber of Commerce, the Indian Merchants' Chamber, Bombay, and the English and Indian Institutes of Bankers, after holding special examinations for the purpose. There are Government commercial institutes in Calcutta, Madras and Calicut. Commercial classes are attached to Government high schools in Bombay and Broach, and to

seven high schools in the Province of Delhi. Post-Matriculation commercial classes have been opened at nine centres in the Punjab. There is a number of private commercial schools at different centres in the country. The United and Central Provinces, Bihar and Orissa and Assam, however, have few commercial schools.

2. Its defects.

There is, however, no co-ordination of effort between these educational institutions and the banks in India.[1] The former have not given much attention to the problem of making their courses more practical. The latter have a poor opinion of the theoretical instruction provided by the former, and yet have not provided any facilities for supplementing it by means of practical training.[2] No bank in India, excepting the Imperial Bank and the People's Bank of Northern India, has any scheme for giving a practical training to young men with a view to employing them in its service.[3] These two banks alone annually select a few young men of good education, give them training, and employ them on their staff, if they are found satisfactory. On account of this lack of co-ordination, there are many men, who have received a practical training in banks, but who are not regarded as fit to hold responsible posts in banks, as they are deficient in general education and knowledge of the theory of banking, and there are also many graduates, who have received a sound theoretical training, but who are not readily given employment by the banks owing to their lack of a practical training.

3. Suggestions for improving it.

The Central Banking Committee has, therefore, recommended, as suggested by the Bombay Chamber of Commerce,[4] that the Indian Institute of Bankers should serve as a liaison between educational institutions

1. See Mr. Shroff's statement, Central Committee Evidence, Vol. II, p. 395.
2. See Central Committee Report, p. 488.
3. *Cf.* the statement of the Indian Chamber of Commerce, Calcutta, Central Committee Evidence, Vol. II, p 537. For details of the Imperial Bank scheme, see Mr. MacDonald's statement, Central Committee Evidence, Vol. II, pp. 233-4.
4. See its statement, Central Committee Evidence, Vol. II, pp. 512-3.

and banks, and establish co-ordination between them to make the commercial courses more practical, to supplement them by practical training and to provide employment to trained youths in banks. The Institute should make suggestions to the Universities for making their courses more practical. It should make arrangements with them and other educational institutions, at different centres, for lectures on, and courses of instruction in, the subjects included in the curriculum of the examination that it conducts for granting its own certificate, and also in other subjects of special interest to bank employees.[1] It should also arrange to obtain information regarding vacancies in banks and to pass it on to educational institutions, which will then recommend suitable candidates for the vacancies. The Central Committee has further recommended that every University should arrange with recognised institutions for imparting instruction for a degree in commerce, including banking.

In the opinion of the Central Committee, a sound training can be given to bank employees in general in the country itself, and nothing would be gained by sending them abroad for it, because in banks outside India they would be given more or less routine work, and would not ordinarily be given facilities for obtaining an insight into higher banking problems.[2]

The Imperial Bank should extend the working of its scheme of giving a practical training to young men of good education, as it has a large number of branches all over the country, and receives support from Government and other public bodies. The joint-stock banks should launch and work out similar schemes, according to their capacity. The practical training given must be of a nature and variety which will give the probationers at the end of their training a full knowledge of the routine work and general banking practice of the various departments, so

1. *Cf.* Mr. Ramachandra Rau's statement, Central Committee Evidence, Vol. II, p. 366.

2. See Report, p. 490 and Mr. Pochkhanawala's and Mr. MacDonald's statements, Central Committee Evidence, Vol. II, pp. 56 and 230 and Vol. III, p. 91.

as to enable them to take up responsible work afterwards.[1] A few specially selected Indians, however, after securing high qualifications and a good practical training in banks in India, may be sent to Europe, with scholarships granted by Government and banks, for the study of advanced banking, especially the practical study of international exchange in banks in Europe. Government should make special arrangements with these banks for providing the training, and exchange banks operating in India should be made to provide it in their offices in Europe, in return for the facilities that are granted to them in India.

The Central Committee, and the C. P. Committee have further recommended that, wherever possible, systematic instruction should be provided in secondary schools in elementary accounting, banking and co-operative principles, as it will prove very helpful to youths desiring to take up indigenous banking as their profession.[2] The Indian Institute of Bankers also should arrange in various centres of the country lectures on, and courses of instruction in, these subjects for the benefit of local indigenous bankers in their vernaculars, should conduct examinations in these subjects in the vernaculars, and should grant certificates to those who pass them. Finally, sons of indigenous bankers should be induced to serve in joint-stock banks for a period, before devoting themselves to their family business, as this training will quicken the pace of the modernisation of the methods of indigenous banking, without destroying its identity. Some of them may prove willing to serve in joint-stock banks permanently and, with their hereditary aptitude for banking, will make efficient branch managers.[3]

Some facilities for education in co-operative banking are already provided. The Co-operative Departments of the Provincial Governments supply them to some extent. Co-operation is one of the subjects of the B. A. economics course of most of the Universities. It is also an optional

1. *Cf.* Mr. Shroff's statement, Central Committee Evidence, Vol. II, p. 395.
2. See C. P. Committee Report, p. 370.
3. See the statements of Mr. MacDonald and the Indian Chamber of Commerce, Calcutta, Central Committee Evidence, Vol. II, pp. 230 and 523.

subject of the Intermediate course in most provinces. The Bombay Provincial Co-operative Institute holds examinations on the results of which it awards diplomas. It conducts classes for these examinations, has established three co-operative schools in Gujarat, Maharashtra and Karnatak, and has arranged with the Bombay Provincial Co-operative Bank and the central banks affiliated to it to provide a practical training in them to candidates. In Madras city there is a co-operative training school for graduates, and there are seven such schools for graduates and matriculates in other parts of the Madras Presidency. Their activities are co-ordinated by a central committee, and Government subsidizes them, and lends them the services of a few officers to teach some of the subjects. The Madras Provincial Co-operative Bank trains a few candidates every year. Co-operative training classes are conducted for officers in a few centres in the Punjab and the United Provinces. In spite of these facilities, the Agricultural Commission and most of the Provincial Banking Committees have complained of the scarcity of trained men for employment on the staffs of co-operative institutions.[1]

The Central Banking Committee, therefore, has recommended that—

(1) co-operative educational institutions should be established in all provinces, and should impart instruction in co-operative principles, propaganda, progressive farming methods, banking, accountancy, rural economy, marketing methods, and rural industry;

(2) an All-India Co-operative College should be established for the higher study of co-operation and allied subjects, and for research work;

(3) all these institutions should be established and conducted by organisations of co-operators, Government assisting them merely by means of grants;

(4) only those who have obtained a complete training at, and passed the examinations of, these institutions

1. See Report of the Agricultural Commission, p. 449 and the Bombay Madras, Punjab and Bihar Committees Reports, pp. 158, 162, 101-2 and 154 respectively.

should be recruited as officers of the provincial and central co-operative banks;

(5) the Indian Institute of Bankers should include co-operative banking in the curriculum of studies for its examinations, at least as an optional subject; and

(6) co-operators of every province, official as well as non-official, should be given every facility for the study of co-operative developments in the other provinces of India and in Europe.[1]

1. See Report, p. 495. See also Agricultural Commission Report, pp. 455 and 473.

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