

(continued from front flap)

The history was compiled under the guidance of an Editorial Committee with Dr C.D. Deshmukh, the first Indian Governor of the Bank and later Union Finance Minister, as Chairman, and Shri R.G. Saraiya, Dr Bhabatosh Datta and Shri J.J. Anjaria as members. The drafting of the history was undertaken by Shri S.L.N. Simha. The Committee endeavoured to compile a history that is 'comprehensive, authentic, accurate and objective, while at the same time scholarly and eminently readable, so that it may have the widest possible appeal to those interested'.

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Volume 1
1935-1951

THE
RESERVE BANK
OF INDIA



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The Reserve Bank of India, though only thirty-five years old, is one of the oldest central banks in the developing countries. Its formative years have been eventful. Its efforts to adapt central banking functions and techniques to a developing economy make the Bank's initial years of special interest. This volume is more than a history of the Reserve Bank; it is also, to some extent, a financial history of India. Wherever relevant or interesting, comments of the press, university professors and concerned interests like cooperative institutions, on important developments in the Bank, have been given, so that the history contains not merely the official point of view, but also an indication of representative public opinion. The Bank's working has been given in a detailed manner so that it may be of practical use to those on whom may fall the responsibility of shaping and administering India's monetary policy in the years to come.

It was decided that this volume should cover the first sixteen years of the Bank's working, 1935-51; 1951 constitutes a watershed in the country's annals, since it witnessed the launching of India's first Five Year Plan. The volume is divided into four parts. In the first part, entitled the 'Preparatory Years', a brief and yet comprehensive account is given of the developments in money, banking and exchange in India for almost a century prior to the establishment of the Bank in 1935. A detailed account is also given of the Reserve Bank of India Act. The sixteen years covered in this volume divides itself into three distinct sub-periods - 1935-39 (the Formative Years), 1939-45 (the War Years) and 1945-51 (the Post-War Years).

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**HISTORY OF THE
RESERVE BANK OF INDIA**

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HISTORY OF THE
RESERVE BANK OF INDIA
(1935-51)



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BOMBAY

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SHRI R.G. SARAIYA

DR. BHABATOSH DATTA

FOREWORD

The Reserve Bank of India is now 35 years old. Relatively to some of the oldest Central Banks, such as the Riksbank of Sweden and the Bank of England which date back to the 17th century, the Reserve Bank is still a very young institution indeed. However, it is one of the oldest central banks in the developing countries. Its formative years have been eventful. Its efforts to adapt central banking functions and techniques to an economy in which modern banking was neither deep-rooted nor widespread, the special responsibilities including those of exchange control that it was called upon to shoulder with the outbreak of World War II in the very first decade of its existence, its transformation from a privately owned institution to a nationalized undertaking, its new role in the economy with the advent of independence -all these make the Bank's initial years of special interest. The Bank therefore felt that it would not be too soon for a history of its earlier years to be written.

A factor influencing this decision was that at this stage it was possible to draw upon the knowledge of those who were connected intimately with the Bank in its early years. We were fortunate in being able to secure the assistance of Dr. C. D. Deshmukh, the first Indian Governor of the Bank, to chair the Editorial Committee, which included Shri R. G. Saraiya who had for long been associated with the Bank as a Director and otherwise and is currently the Chairman of the Banking Commission, Dr. Bhabatosh Datta, an eminent economist from the Calcutta University, and Shri J. J. Anjaria who had joined the Bank many years ago and thereafter been the Chief Economic Adviser to the Government of India, the Executive Director for India on the International Monetary Fund and retired only recently as Deputy Governor after the work of the Editorial Committee was duly completed. The Bank made available the wholetime services of Shri S. L. N. Simha, a senior economist within the Bank, with long standing and experience, to be the Member-Secretary of the Committee and to undertake the writing of the history under the guidance of the Editorial Committee.

A question which had to be faced at the very outset was how many years of the Bank's existence the first volume of the history should cover. In consultation with the Editorial Committee it was decided that this volume should cover the first 16 years of the Bank's working, 1935-51. 1951 constitutes a watershed in the country's annals, since it witnessed the launching of India's first Five Year Plan. It was also felt that the period that followed was too close for it to be viewed in the kind of time perspective that history needs.

I am happy that this work has been completed before I lay down office as Governor. The preparation of this comprehensive volume in about two years' time owes much to Dr. Deshmukh's dynamic and wise leadership. I wish to record the Bank's gratitude to him and to the other members of the Committee. I trust that the volume, which in some ways, is a chapter in the financial history of the country, will prove to be both interesting and useful not only to students and practitioners of central banking but also to those in India and abroad who are concerned, one way or another, with the problems of a developing economy. I hope in due course this volume will be followed by others covering the later periods of the Bank's working.

**RESERVE BANK OF INDIA,
BOMBAY, March 13, 1970**

**L. K. JHA
Governor**

PREFACE

When the Governor of the Reserve Bank consulted me regarding the value of compiling a history of the Bank, I welcomed the Bank's initiative. When he invited me to be Chairman of the History Committee, with three distinguished colleagues, apart from the Member-Secretary, I readily consented. For with my long association with the Bank, first as Government Director, Secretary, Deputy Governor and Governor and later as Union Finance Minister, extending over a period of seventeen years from 1939, I considered it my duty to give such assistance as I could to what I considered was a worthy project. Actually, the chairmanship of the Editorial Committee to compile an authentic and comprehensive history of the Reserve Bank of India has been for me an extremely interesting and responsible assignment.

Perhaps I should mention at the outset that the Bank gave the Committee complete freedom as regards the scope, the pattern and size of the volume. In turn the Committee gave the fullest freedom to the Officer entrusted with the compilation of the history, Shri S. L. N. Simha (who, incidentally, was among the first batch of Officers I recruited for the Bank's Department of Research and Statistics, in 1945). Our endeavour has been to compile a history that is comprehensive, authentic, accurate and objective while at the same time scholarly and eminently readable, so that it may have the widest possible appeal to those interested. Since the History Committee comprised mostly persons who have had close associations with the Bank, we took special care to ensure that the facts given or quotations cited served these objectives, irrespective of any possible unpleasantness or embarrassment to the individuals concerned.

At its first meeting held towards the close of March 1968, the Committee reached decisions on the scope of the history and its work programme. For the objectives in view the Committee did not consider it necessary to attempt any systematic assessment of the Bank's working. All that it attempted as a matter of duty to the public was to place all the relevant material before the readers in a manner that would readily

assist them to form their own judgement. For this purpose, the Committee decided to give, wherever relevant or interesting, the comments of the press, university professors and concerned interests like cooperative institutions, on the important developments in the Bank, so that the History contains not merely the official point of view but also what might be called an indication of representative public opinion.

It was agreed that Shri Simha would circulate the synopsis of individual chapters to members of the Committee and later the drafts of the chapters. The drafts of the individual chapters were considered in detail-in fact, page by page-at the various meetings of the Committee. The Committee's suggestions regarding modification of substance and arrangement as well as language were incorporated by Shri Simha, who circulated a revised draft in each case for the Committee's final approval some of these drafts were considered again at a Committee meeting. The Committee held in all ten meetings, in Bombay, New Delhi and Hyderabad. Our continuous concern has been to conduct our deliberations in a spirit of academic detachment and objectivity combined with a judicious pragmatism. It is my hope that the readers will share our views that the Committee has succeeded in setting up the very high standards that a compilation of this nature calls for.

Perhaps I should make some observation on the scope of the volume. Readers will note that we have given a brief and yet comprehensive account of the developments in money, banking and exchange in India for almost a century prior to the establishment of the Bank in 1935. This we regarded as essential to an understanding of the rationale of the central bank for India. We have also given a very detailed history of the efforts to establish a central banking institution in India, leading to the passage of the necessary legislation in 1934. Perhaps very few central banking Statutes have a longer period of gestation than that of the Reserve Bank of India ; it is hoped that the readers will find the description of the Statute in Chapter 3 of special interest.

It is not entirely fortuitous that this piece of legislation immediately preceded the Government of India Act, 1935. The course of the historical developments that were leading to India's independence, and to consequential new set-up of Government, was held up by World War II. But by that time the Reserve Bank of India, with substantial non-official

participation and control had already been in existence for some years and was in a position to watch vigilantly India's interests in the vital monetary sphere, as also to handle complex technical problems like exchange control after the actual outbreak of war. What is more, it had already matured enough to make a significant contribution in the new world of international finance, in which the two special agencies of the United Nations, viz., the World Bank and the International Monetary Fund, were to take their place and towards joining which India had to take a decision. This decision, the Bank influenced materially. India's membership has helped in innumerable ways³ beginning with the postwar development of her currency and the advance of the first development loans. The Bank also gave valuable technical assistance in straightening out the numerous currency tangles arising out of the partition.

The period of sixteen years covered in this volume divides itself into three distinct sub-periods, namely, 1935-39 (the formative years), 1939-45 (the war years) and 1945-51 (the post-war years). The treatment of the matter is both chronological and subject-wise. Extracts from official papers have been given extensively not only for the benefit of the scholar but also that of the general reader.

I must say a final word regarding the size of the volume. Perhaps it will be a matter of some surprise to many that a sixteen year history should have run into over 850 pages. The Committee took the view that the account of the Bank's working must be sufficiently detailed to be of some practical use to those on whom may fall the responsibility of shaping and administering India's monetary policy in the years to come. Moreover, on several aspects of the Bank's functioning in those years the public have had inadequate information. Further, a briefer volume would have done scarce justice to the rich material available on the subject. Also, in describing the numerous developments, for instance, the Reserve Bank's advice on the International Currency Plans, we have given considerable background material for a clear understanding of the issues involved. Finally, in judging the size of the volume, readers will take into account the fact that this is something more than a history of the Reserve Bank and that it is also, to some extent, a financial history of India.

On behalf of the Committee I wish to thank the Governor of the Reserve Bank for associating us with this interesting and important work and for his hospitality to us.

The satisfactory completion of our task owes a great deal to the remarkable capability, diligence and dispatch of the Member-Secretary, Shri S. L. N. Simha. My other colleagues and I should like to record here our great appreciation of his consistently competent work in this assignment.

**INDIA INTERNATIONAL CENTRE,
NEW DELHI, February 28, 1970.**

C. D. DESHMUKH
Chairman, Editorial Committee.

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A Volume of this nature is a co-operative endeavour and I wish to record my sincere thanks to all those who have contributed to its compilation.

I must first mention the various libraries, which went out of their way in loaning to us books and reports, namely, the Bombay University Library, the Asiatic Library, Bombay, the Nehru Memorial Museum and Library, New Delhi, and the National Archives, New Delhi. The officials of the Ministry of Finance promptly complied with our requests for papers and reports. Shri R. G. Saraiya was good enough to make special arrangements with the Nehru Museum for studying the papers of Sir Purshotamdas Thakurdas.

Thanks are due to the India Office Library for arranging to send us a photostat copy of the 'Extract of the proceedings of the Council of Revenue, held at Fort William the 13th April 1773, containing the plan for the Establishment of the general Bank in Bengal and Bahar' and to the Nederlandsche Bank for supplying us with a copy of the Bank Act of 1863.

I have derived much benefit from discussions with several distinguished persons, who have had close connections with the Bank in some capacity or other, namely, Sarvashri T. T. Krishnamachari, Benegal Rama Rau, B. M. Birla, Kasturbhai Lalbhai, Satya Paul Virmani, K. G. Ambegaokar, N. Sundaresan, Ram Nath and J. V. Joshi. I am grateful to them for having spared their valuable time. I should also thank Shri C. S. Narasimhan, Editor of the Swadesamitran, for making available to me, for perusal, the papers of his father, Shri C. R. Srinivasan, relating to the Bank.

Several of my colleagues in the Bank have seen individual chapters and given valuable comments and suggestions. In this connection I must thank Sarvashri N. D. Nangia, D. N. Maluste, M. S. Nadkarni, R. M. Halasyam, R. P. Chatterjee, S. Narayanswamy and K. MadhavaDas.

In the writing of the History, I have received very valuable assistance from the Officer staff associated with me in this project, namely,

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Piloo S. Mirza, Vimala Visvanathan, K. N. Ramanathan, R. V. Varadarajan and S. Krishnamurthy. In preparing the preliminary drafts of chapters, in checking and rechecking the innumerable facts and figures and in comparing the many proofs, their work was of a high standard. I cannot thank them adequately for the contribution they have made to the volume by their very hard and dedicated work.

Shri R. Krishnan was of much help in drafting Chapter 24. Shri Nispat Desai rendered valuable assistance in locating the innumerable files relating to the Bank's policies and operations. I must also place on record my appreciation of the dedicated work of K. G. Kurup, A. Qavi, Kundabala V. Phadnis, L. P. J. D'Souza, N. V. Ganesan, V. N. P. Nair and V. B. Shikarkhane. I also thank the Graph Section of the Bank for preparing the design of the jacket.

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Finally, I must express my gratitude to the members of the Editorial Committee and in particular the Chairman, Dr. C. D. Deshmukh, for their valuable guidance, uniform courtesy and sense of appreciation, which enabled my staff colleagues and me to complete the work on schedule.

**RESERVE BANK OF INDIA,
Central Office, Bombay, April, 1, 1970.**

**S. L. N. SIMHA
Member-Secretary.**

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THE PREPARATORY YEARS

Genesis of Central Banking in India

LEGISLATION to set up the Reserve Bank of India was first introduced in January 1927, though it was only seven years later, in March 1934, that the enactment became an accomplished fact. There is, however, a long history, which has been traced to as far back as 1773, of the efforts to set up in India a banking institution, with some elements of a central bank, and the history of such efforts is given in this chapter. It must be mentioned that in India, as in many other countries, matters relating to currency and exchange, such as the question of the monetary standard and the exchange rate, received far more attention than the subject of banking, especially central banking. Also, for long, the inter-connection between currency and banking does not appear to have been grasped widely.

The schemes for such a banking establishment drawn up from time to time reflected, to some extent, the gradual evolution of central banking which had been taking place in other countries during those years. Though it cannot be said precisely when the term 'central banking' originated, history shows that the two oldest functions of a central bank, viz., those of 'note issue' and 'banker to Government', were carried out in several countries by either an existing bank or a new one set up for the purpose, even before such a bank came to be known as the 'central bank'. These banks, which were called 'banks of issue', were doing general banking business as well.

In course of time, the banks enjoying a monopoly of note issue and the sole right to act as bankers to Government acquired other functions, such as holding cash reserves of commercial banks, rediscounting their bills and managing clearing houses. A clearer concept of central banking later emerged, and central banking came to be regarded as

a special category of business, quite distinct from commercial banking. While some of the 'central banks', as they had come to be called, gave up commercial banking business, some others, notably the Bank of France, carried on, for some years, both types of business.

Turning to efforts made in India to set up a banking institution with the elements of a central bank, we find that up to as late as 1920, the functions envisaged for the proposed bank were of a mixed type, reflecting the practices abroad. Also, it was only towards the close of the nineteenth century and the beginning of the twentieth that the term 'central bank' came to be used in India in the official despatches. It was proposed at that time to amalgamate the three Presidency Banks into one strong institution; the central banking functions envisaged for the new institution were not only those of note issue and banker to Government, as in the earlier proposals, but also maintenance of the gold standard, promoting gold circulation as well as measuring and dealing with requirements of trade for foreign remittances. The new bank was to perform commercial banking functions as well, as the Presidency Banks had been doing till then. Even the 'State Bank' proposed by John Maynard Keynes in 1913 was to engage in both central banking and commercial banking functions.

The amalgamation of the Presidency Banks took place in 1921, the new institution being called the Imperial Bank of India, but it was not entrusted with all the central banking functions; in particular, currency management remained with Government. All the same, a brief history of the amalgamation should be of interest. In this matter, not only were there divergent views, but the views of the same authority or institution also underwent a change from time to time. For instance, in 1867, the Bank of Bengal approached Government with a proposal for amalgamation of the three banks, but Government were not in favour of one strong institution. There was concern that a single all-India institution might become too powerful; there was also the view that personnel for managing such an institution might not be available. In 1899, however, it was the Government that took the initiative and proposed the absorption of the three existing banks into a 'central' bank, while opposition came from the Presidency Banks, Chambers of Commerce, as also the Government of Bengal. But by 1919 the wheel had turned full circle and the Presidency Banks, on their own, came together and submitted to Government a scheme for their amalgamation, which on this occasion was accepted by Government.

In the early twenties of this century, central banking came to be treated as a separate class of business, distinct from commercial banking; it was considered that a single institution could not suitably perform both types of functions. Thus, in 1926, the Hilton Young Commission recommended the setting up of an institution the

Reserve Bank of India -which was to be entrusted with pure central banking functions; it was to take over from the Imperial Bank such of the central banking functions as that institution had been performing till then, and the Imperial Bank was to be left free to do only commercial banking business. However, support for the 'mixed' type of institution was by no means lacking, among either non-officials or officials. Sir Purshotamdas Thakurdas, a member of the Hilton Young Commission, in his minute of dissent appended to the Report, had expressed the view that 'the ends in view, for as far ahead as we can see will be better served by developing the Imperial Bank of India into a full-fledged central bank'. Sir Purshotamdas quoted the example of the Bank of France which was discharging both types of functions successfully. It is stated that Sir James Taylor, the second Governor of the Reserve Bank, had held a view similar to Sir Purshotamdas's. It is perhaps permissible to conjecture that the support to mixed banking was prompted by the desire to make the Imperial Bank the country's central bank.

In the main the controversy on proposals for a central bank related to the questions of ownership -State versus private ownership -and management of such a bank. The interesting thing about this controversy, which had an element of shadow boxing about it, was that both the schools of thought desired 'independence' of the bank from Government control in its day-to-day working. It was more a matter of difference of approach with regard to the method of selection of the Directors of the Governing Board, an element of nomination by Government being present in all the schemes. Even in the proposals where the whole of the capital was to be provided by Government, not all the Directors were to be nominated by Government: there was provision for an element of election or selection. The consensus among the Indian leaders was against any scheme of selection of the Directorate by private shareholders. Some other arrangements, such as selection by Chambers of Commerce and the Legislature, were proposed. But the active participation of the Legislature in the selection of the Board had its own snags. These arrangements were not acceptable to the British Government in India, who preferred to keep the Legislature out of the scheme and retain residuary powers with the Governor-General. In the end, this view prevailed. Anyway, this controversy was responsible for considerable delay in the establishment of the Bank.

Another matter on which something should be said at the outset is the concept of 'State Bank'. The account given below shows that the term was used in different senses from time to time. For instance, Sir S. Montagu, in his evidence before the Fowler Committee in 1898, stated that by 'State Bank' he did not mean a Government

bank, but an Indian national bank doing the local business of the country and having branches which offered remittance facilities and which could also be entrusted with the function of note issue. In 1913, though Keynes did not define the term 'State Bank', he used that expression for his proposed bank, presumably to convey the responsibility the State was to have in respect of the functioning of that bank. In August 1927, when the Reserve Bank Bill as amended by the Joint Committee came up before the Legislative Assembly, the term 'State Bank' was used in 'a very loose sense' by Members speaking on the Bill. It was used to convey two meanings, viz., (i) a bank wholly owned by the State and not by shareholders and (ii) a bank to be managed under the complete control of the State. The Finance Member expressed the view that the natural meaning of a 'State Bank', according to him, was a bank under the control of the Government and the Legislature. In that sense, the Reserve Bank, as proposed by the Joint Committee, was not a 'State Bank', because while it was to be wholly owned by Government, it was to be completely independent of the Government and the Legislature.

The debates in the Legislature on this matter were 'acrimonious'. They reflected, to no small extent, the feeling of mistrust and suspicion towards the British rulers. However, eventually, anxiety to have in existence a central banking institution led to compromises in regard to its constitutional features and although what was finally incorporated in the Reserve Bank law was the principle of a shareholders' institution, safeguards were provided to allay the apprehensions of the opponents to the shareholders' rule, so called.

These various developments in the genesis of the Bank are described in the following pages.

Plan of Warren Hastings

The earliest reference that has been traced regarding an attempt to set up in India a bank which had some characteristics of a central banking institution of today dates as far back as January 1773, when Warren Hastings, Governor (later Governor-General) of Bengal, placed before the Board of Revenue his 'Plan' for a 'General Bank in Bengal and Bahar'; Bengal and Bihar, it may be mentioned, comprised, at that time, the main British territory in India. The plan for the proposed bank was approved by the Board, with some changes, and the bank was set up in April 1773, but it proved to be only a short-lived experiment.

Before describing the constitution and functions of the bank, it is necessary to say something about the circumstances which led Warren Hastings to draw up the plan for a bank

Firstly, in those days remittance of money was expensive and risky on account of highway robbery and also the dishonesty of those who were entrusted with the transportation of treasure. Government thus faced considerable risk of loss in bringing land revenue collections from the outlying districts to the capital. The proposed bank, it was considered, could act as a Treasury for revenue collections in districts and thus the transportation of specie could be minimised. Apart from facilitating Government revenue collections, the bank could undertake remittances on behalf of merchants, who could also be saved the risk and the expense involved in making remittances to the aurguns, i.e., depots for manufactured goods.

Secondly, though the rupee was the common currency, there were several species of rupee coins of different values in circulation. The authorities, however, endeavoured to evolve a standard coin. For many years, the Sicca of Murshidabad was, in theory, the standard coin, and the rates of exchange of the various rupees in terms of the Sicca rupee varied, the discount being called the batta. It appears that the batta charged was based neither on the length of the period the coin was in circulation nor on the diminution of weight by wear, but was 'regulated merely by the capricious wills of the ministers or the designed impositions of the Shroffs'. The Government received enquiries from the Collectors as to the batta they should charge on the different species they received from zamindars and farmers, and it was proposed that the Collectors should adopt 'the fixed and ancient batta of the Khazana Aumera or Royal Treasury'; tables of batta rates were to be affixed in every cutcherry of the districts for the information of the farmers. The proposed bank was to fix the value, in Sicca rupees, of the bills it had to issue in return for the money received from the Collectors, on the basis of the same batta. Thus, the bank was expected to assist in stabilising inland exchange and in enforcing the Sicca coin as the standard coin of the Provinces.

The third consideration in the plan for a bank was to remedy the situation arising from the contraction of the currency in circulation at the time of the collection of revenues. To quote a minute from the extract of the proceedings of the Council of Revenue held at Fort William, on April 13, 1773, containing the 'Plan' for the establishment of the 'General Bank in Bengal and Bahar':

the great complaints which are made from all the northern districts of the two provinces, of the inability of the Farmers to pay their rents, on account of the uncommon plenty and cheapness of grain, are primarily owing to the great drains, which have been made of the current coin in the districts by the collections, which for some years past have centered in Public Treasuries of the City of Moorshedabad, and at the Presidency, and to the want of an equal Trade to carry It back again into circulation.

It was considered that 'to provide an effectual remedy to this growing evil' mature experience was needed; what was proposed by Warren Hastings was to be in the nature of a 'palliative or a temporary expedient'. The bank was intended to secure the revenue without 'injuring the circulation'.

It is interesting to note that even in those days the question of public versus private bank was discussed, and it was decided to set up the bank as a private corporation, but under the patronage of the East India Company. The Company authorities did not want to establish a bank 'on their own immediate account' for two reasons, these being (i) that the official emoluments arising out of such a system in the hands of the Company's agents would far exceed the moderate profits of the bank and (ii) that 'the want of time and ability in the Government, either to superintend or control so complicated and extensive a business' was an 'insuperable' objection.

The plan provided for the setting up of a 'principal House' or bank at Calcutta, to be managed by one or more responsible shroffs, and 'inferior houses' or branches in each of the collectorships. The Collectors were required to pay the revenue collections into the local branch of the bank, in the same species of coin as were received from the landlords and farmers. In return, they were to take bills on the head office of the bank in Sicca Rupees at the prescribed batta (discount). The land revenue from the farmers was to be received by the Collectors at the same rate of batta. The 'hoondian', or the rate of commission on the bills, was to be fixed in consultation with the manager of the bank, according to the distance, risk and charge of transporting the sums in specie.

Apart from facilitating revenue collection of Government, the bank was to render useful service to private merchants also by allowing them to make remittances to aurguns through the agency of the bank, at certain fixed rates of commission. To prevent the bank from charging heavy commission, tables of commission rates were to be affixed at each cutcherry and also at most public places in Calcutta and Murshidabad.

The bank had two chief offices, one at Calcutta and the other at Murshidabad; there were fourteen branches and also some sub agencies. Two distinguished shroffs, Baboo Hazzurimull*, an 'ancient' merchant of Calcutta, and Roy Dalchand*, a banker of Murshidabad, were appointed Managers of the bank. The Managers complained of lack of co-operation from the Collectors, the main count of their complaint being that the Collectors did not pay into the branches the revenues as they were received, but paid them only at the time the

* These names have been spelt differently in different publications.

bills were required. The non-cooperation of the Collectors was mainly due to the loss of income as a result of the new arrangements for remittance; besides, their Treasury staff were rendered superfluous. In December 1773, new regulations were framed by Government to meet the situation.

On April 13, 1774, the Court of Directors of the East India Company wrote to the Governor-General in Council recommending certain changes in respect of the bank. Hastings and Barwell opposed the changes, but they were overruled by their other three colleagues, Francis, Monson and Clavering, who succeeded in getting passed a resolution on February 15, 1775, providing for the closure of the bank ; however, the managers were given five or six months to wind up the bank's affairs.

In regard to its actual working, one view held is that 'the bank does not appear to have afforded the relief which was expected'. It is stated that the Court of Directors regarded the commission charged by the bank for transmission of money as rather high. In a letter dated March 30, 1774, they were reported to have remarked:

that for every 100,000 sunauts* paid to the agents of the bank in the various districts of Bengal, there will only be repaid to the Governor-General and Council at Calcutta Rupees 94,828 of the same weight and real value and therefore this regulation cannot be confirmed by us. (Economic Annals of Bengal, by J. C. Sinha, 1927).

The general view, however, is that the closure of the bank was not on economic grounds. M. E. Monckton Jones, for instance, had the following to say (in Warren Hastings in Bengal, 1772-1774):

Although, to judge from an inquiry held into the effects of its working, the bank appears to have achieved its objects, it was abolished in February 1775. It granted bills first at the Company's rate of exchange and later at par instead of at the exorbitant rates formerly exacted, and the only sufferers from its institution seem to have been the private moneylenders. In addition to the simplification of the revenue business, it proved of value to private merchants, whose remittances could be made quickly and without risk; it confined the use of local coins to their own districts and obviated the loss involved in frequent exchanges, besides offering the natives an introduction to the advantages of a more extended credit system.

Even during the short period of its existence, it is reported, the bank made considerable profit, of which the Government took a half share!

Robert Rickards's Scheme

The next attempt in the direction of a central bank was made in 1807-08, when Mr. Robert Rickards, a Member of the Bombay Government,

* On account of the changes in the coinage of the rupee, the Sicca rupee used to be known as Sunaut, after the year in which it was minted, with a slight depreciation in value.

submitted a scheme for a 'General Bank'. The bank was proposed more as a means to pay off, through it, the then large public debt, than with the object of deriving from it the usual benefits likely to be realised from the establishment of a central bank. The objective of the scheme was explained by Mr. Rickards as under:

Having since my re-appointment to India, reflected much on the financial state of the Indian Government, the amount of the public debt, the difficulties it is likely to entail, and the danger of its increase, a Plan has suggested itself of diminishing the weight of this heavy burden, connected with other public advantages; which I venture to submit to the favorable consideration of Government, and that of the Court of Directors.

Unlike the 'General Bank in Bengal and Bahar', the proposed General Bank was to be owned jointly by the public and Government in the proportion roughly of 2:1. Of the proposed 8 per cent capital stock of £12.5 million, £8.5 million or about two-thirds was to be offered to the public; the balance of £4 million was to be taken by Government. Subscriptions in respect of the stock offered to the public were to be either in coin or in the Company's Paper in the hands of its creditors; subscriptions paid in coin were also to be used to pay off a corresponding proportion of the debt. Thus, £8.5 million of the then public debt was to be converted into bank stock in the hands of the public. The management of the bank was to be entrusted to a Board of Directors, comprising both Europeans and Indians, elected from among the stockholders, and also one Government official or a Member of Council. The Board was thus intended to be independent; at the same time it was ensured that the Government member would look after the interests of the public. The bank was to be split up into three, one in each Presidency, and was also to have 'subordinate banks' or offices round the country. It was to enjoy the right of note issue; to ensure note convertibility; 'territory or territorial' revenue amounting to £1 million was to be paid, in coin, to the bank every year. As regards the functions the bank was intended to perform, Mr. Rickards observed:

The Bank thus constituted to be conjoined with the Company's Treasury in the receipt and payment of sums on account of Government, to be a Bank of discounts, to grant credit on unexceptionable security, and at such times only as the Bank shall in their own judgement deem perfectly unobjectionable, and also to engage in the business of exchange by granting bills at a more reasonable rate than can be procured from individuals, in favour of merchants applying for the same on any part of the Company's territories. . . .

Not only did Mr. Rickards's scheme provide for conversion into bank stock of £8.5 million of public debt, but it also envisaged substantial

repayment of debt through creation of a Sinking Fund and through issue of bank notes. It was proposed to pay salaries to the Company's servants in the form of bank notes 'issued on the responsibility of Government, but with the consent of the associated Bank Directors', and an equal amount in coins was to be deposited by Government with the bank out of the revenue collections. The coins, when sufficiently accumulated, were to be used to redeem public debt.

The Governor-General in Council of Bengal, to whom the scheme was submitted for consideration, expressed the view that:

the ideas of Mr. Rickards appeared to us to resolve themselves into mere speculation, without embracing objects capable of being realised, while the machinery proposed by that gentleman for the performance of a very simple operation, was extremely cumbrous and complicated; . . .

The scheme was rejected by the Directors of the East India Company.

Proposal for a 'Great Banking Establishment for British India'

In 1836, another proposal for a 'Great Banking Establishment for British India' was submitted to the Court of Directors of the East India Company by a body of merchants in England having trade relations with India. The memorandum stated that the Bank of Bengal -which was the only Presidency Bank* in existence at that time- was prevented from being as efficient and as useful 'as a Bank ought to be and might be made', because of its 'immediate connection' with Government. 'The Great Banking Establishment', the merchants proposed, was to be set up under an Act of Parliament and was to have adequate resources. The establishment of such a bank would, according to the memorandum, facilitate 'the employment of a portion of the redundant capital of this country (England) for the general improvement of Indian commerce, giving stability to the monetary system of India. . . .' The bank was to transact public business at a moderate charge, manage public debt and facilitate revenue receipt and expenditure.

The sponsors of the scheme were of the view that the bank's connection with the Government 'should not be one of partnership, but of superintendence on the part of the latter' and that while at times Government required assistance from the bank 'the primary object of its establishment should not be to afford assistance to the Government'. Apparently, the sponsors had the experience of the Bank of England in mind! The proposal was dropped mainly on account of the unfavourable opinion of the Bank of Bengal, to whom it was referred for comments. The Bank of Bengal was ready to take

* An account of the Presidency Banks is given later.

over the management of Government business and extend banking facilities in India without interference or assistance from London. Some Directors of the bank even favoured establishment of branches at Bombay and Madras.

Constitutional Changes of 1858

Before passing on to the next proposal in 1859 for 'a national banking establishment' in India, a brief reference may be made to the constitutional changes following the Mutiny of 1857, and their bearing on the consideration of Indian monetary and banking matters thereafter.

After the Mutiny, the control over the territories in India passed from the East India Company to the British Crown. A Secretary of State for India was appointed in England to handle all matters relating to India; he was assisted by a Council of fifteen members. In India, the Governor-General, who came to be designated as Viceroy and Governor-General, continued to administer with the help of his Council. The subjects currency and finance received special attention, and for the first time, a 'Financial Member of the Council' -an expert on the subject -was appointed to deal with all currency and finance problems. This was, indeed, a very favourable development, for much initiative came to be taken by the Financial Member in fiscal and monetary matters. For the first time, the budget was framed on the English model, a new taxation scheme was introduced, military and civil expenditure were reviewed with a view to cutting down extravagance, and effective audit was carried out.

Proposals for a large 'National Banking Establishment'

Mr. James Wilson, India's first Financial Member and 'the greatest of India's Financial Members in the nineteenth century', in his speech in the Indian Legislative Council on March 3, 1860, on the Bill for the establishment of a Paper Currency in India, remarked:

I refer to the proposals which have been made for the purpose of establishing upon a scale, and with an adequate capital, a national Banking establishment capable of gradually embracing the great Banking operations in India, and of extending its Branches to the interior trading cities as opportunity might offer. That there is a growing want for such an institution and a rapidly increasing field for its operations no one can doubt.

It is not known who made the proposals; nor are there any details of the proposed banking establishment. The proposed bank was to be on the model of the Banking Department of the Bank of England and was

to perform all types of business that that Department was doing for Government and the public. The function of note issue was thus not to be entrusted to the bank, but was to be the responsibility of the Government. Mr. Wilson died in August 1860, barely nine months after his arrival in India as the Financial Member.

Mr. Wilson's successor, Mr. Samuel Laing, also supported the establishment of a bank on the above lines; in his view, such an institution would be of advantage to Government besides its usefulness to commerce and industry.

The convenience to the State in ordinary times is obvious, and history shows what an important resource a Bank may be to the Government in times of difficulty. The advantages to commerce, though less obvious, are not less real.

The proposals, however, remained only on paper.

Proposed Amalgamation of Presidency Banks

At this stage, it is necessary to say something about the Presidency Banks of Bengal, Bombay and Madras, as the period beginning with 1866 was marked by efforts to bring about their amalgamation, an important object of which, at some stage or the other, was the performance of at least some central banking functions. The Presidency Banks were set up as quasi-Government institutions. They were incorporated under Charter from the local Government, who contributed a part of their share capital; Government Directors were appointed on the Boards of these banks.

The first Presidency Bank to be established was the Bank of Bengal, which was set up originally as the Bank of Calcutta in 1806, with an initial capital of Sicca Rs. 50 lakhs, of which one-fifth was taken up by Government. The initiative for setting up the bank came from the Government of Bengal. In those days, 'treasury bills' constituted an important mode of raising money by Government, and at times these bills could not be encashed except at substantial discounts. The establishment of a bank, it was considered, would check this 'depreciation' of Government bills, as it would introduce 'a new customer into the market, who would always be provided with a store of specie'. The setting up of the Bank of Calcutta was, however, on a provisional basis, pending approval of the Court of Directors of the East India Company, as in one of their despatches, the Court of Directors had expressed themselves 'against the establishment of a public Bank, in which it is proposed that their Government should have an interest, without their previous sanction'. The consent was given, though 'reluctantly', in September 1807. The bank received its Charter of

Incorporation in 1809 and came to be called the Bank of Bengal. Government appointed three of the nine Directors of the bank's Board. With a view to preventing the bank's shares from falling into the hands of a few 'monopolists', the Charter restricted individual shareholding to Rs. 1 lakh. Advance to any individual or partnership was also restricted to Rs. 1 lakh and advance to Government to Rs. 5 lakhs. The bank was prohibited from holding, in its own right, Company's Paper exceeding Rs.25 lakhs.

The Bank of Bombay was set up in 1840 with a capital of Rs.52 lakhs and the Bank of Madras in 1843 with a capital of Rs.30 lakhs. The local Government contributed Rs.3 lakhs in respect of each. As the Presidency Banks were semi-Government institutions, it was considered essential to put certain restrictions on their activities.

All the three banks were permitted to issue notes up to certain specified limits. This privilege lasted only till 1862, when under the Paper Currency Act, the sole right to issue notes came to be vested in the Government of India. However, the banks were entrusted with the cash balances of Government, free of interest at the Presidency towns and at places where the banks had branches, and also with the management of the public debt. A number of restrictions placed earlier on the banks' activities were also removed.

The Bank of Bombay got into financial difficulties in 1865, and a run on the bank could only be stopped by the Government of India's undertaking to advance Rs.1.50 crores to it, if necessary. By the end of 1866, 'the Bank was ruined and virtually in liquidation'. There was another run on the bank in February 1867, and Government once again gave assurance to support the bank, if necessary. In January 1868, it was decided to wind up the bank, and a new Bank of Bombay was set up. A commission was appointed, with Sir Charles Jackson as the President, to enquire into the failure of the Bank of Bombay and according to its Report published in 1869, the main causes were:

- (i) removal of many of the earlier restrictions on the bank's activities ;
- (ii) 'abuse of powers' by weak and unprincipled Secretaries;
- (iii) young and inexperienced commercial Directors;
- (iv) neglect of their duty by Government Directors; and
- (v) 'the very exceptional nature of the times'.

According to Sir Charles :

the great lesson the failure taught was that Banks should not lend money on promissory notes in a single name or on joint promissory notes when all the parties were borrowers and not any of them sureties for the others.

The new Bank of Bombay also experienced troubles between 1870 and 1874, and Government were unable to draw on their cash balances

with that bank. The Government of India, in their despatch dated June 30, 1874 to the Secretary of State, expressed doubt whether the keeping of large Government balances in the hands of Presidency Banks was of any real advantage to trade. According to them, it introduced an element of uncertainty into the market and sudden withdrawal by Government of their balances at a time of tightness was likely to 'precipitate a crisis which otherwise might not occur'. In their view, the Government of India 'ought not to be without a reserve, and that this reserve should be in its own hands'. They therefore suggested cutting off their connection with the Presidency Banks and instead re-establishment of their Treasuries, adding, however, that:

We are unwilling to take this course unless forced to do so: the banks are useful institutions, and the Bank of Bengal especially has upon several occasions been of great assistance to the Government.

As an alternative, the Government of India suggested a change in the agreements with the Presidency Banks, so that instead of giving the banks the right to hold all the Government balances, the Government of India would undertake to pay them interest when Government balances were reduced below certain amounts. If necessary, Government, they said, would go further and stipulate that: 'the banks should have the use of our balances up to certain limits, after which we should be unfettered as to their employment'. While broadly approving the Government's suggestion, the Secretary of State remarked:

Capital supplied by Government, and not representing the savings of the community, is a resource on whose permanence no reliance can be placed, and which therefore tends to lead traders into dangerous commitments. It gives ease for a time, and produces a prosperity which is at the mercy of an accident. A political exigency suddenly withdraws the adventitious resource and the commerce which trusted to it finds itself pledged beyond what its own resources can make good.

The Presidency Banks were reconstituted by the Presidency Banks Act of 1876. New agreements were entered into with the Presidency Banks, under which Government agreed to maintain certain minimum balances with these banks, and to pay interest on the shortfall, if any. Reserve Treasuries were constituted at Presidency towns for keeping funds not required for any immediate purpose. The Government also disposed of their holdings of the shares of these banks which thus became private institutions in 1876.

Turning to the subject of the amalgamation of the Presidency Banks, it appears that it was in 1866 that Sir Bartle Frere, Member of the Viceroy's Council, made the first proposal in this behalf; Sir Bartle observed:

It seems very desirable as far as Government is concerned, that the question of an amalgamation of the Government Banks should be seriously entertained with a view to ascertain whether there is any insuperable difficulty in amalgamation. It is obviously quite impossible that the Government of India should go on much longer with three Banks of which one is in intimate confidential direct relation with the Government of India, but has no direct control over banking operations in the great mart of Western India, while another Bank, placed in a position of influence in a large, rapidly increasing, and sensitive money market like Bombay, has no direct communication at all with the Government of India, but is subjected to indirect influences sometimes through Departments directly under the Government of India, at other times through the Local Government, and generally more or less affected by rival views and interests.

The Government of India, however, took no action on the proposal.

In March 1867, when it appeared that the Bank of Bombay, which had been acting as the agent of the Bank of Bengal in Bombay, might have to go into liquidation, the Directors of the Bank of Bengal submitted to the Government of India a scheme drawn up by Mr. G. Dickson, Secretary and Treasurer of that bank, providing for the amalgamation of the three Presidency Banks into a 'Central Bank for all India'. The proposed amalgamation was thus primarily for the convenience of the Bank of Bengal and did not have the direct object of forming a central bank; all the same, Mr. Dickson's scheme was well conceived.

Mr. Dickson was of the view that:

the proposed united Bank would be equal at all times and under all circumstances not only to meet the legitimate requirements of commerce, but by unity of action and under the eye of the supreme Government (i.e., the Government of India) to control those recurring monetary crises . . . Government would have . . . uniform management of the public debt under the same safeguards, but with enlarged security, and a powerful agent in aiding them in all their financial measures not only at the seat of Government but by combined action throughout the whole country.

The 'proposed united Bank' was to have an authorised capital of Rs.10 crores and a paid-up capital of Rs. 5 crores. The bank was to do the same business as transacted earlier by the Presidency Banks; Mr. Dickson, however, hinted that he hoped that Government would return to 'sounder views' in respect of the function of note issue, which they had taken over from the Presidency Banks in 1862.

As regards the organisation of the bank, the supreme control was to be vested in the (Central) Board in Calcutta, which was to lay down rules and regulations for the conduct of business. There were to be Local Boards at Bombay and Madras. Mr. Dickson's scheme was unanimously approved by the Directors of the Bank of Bombay. It

was, however, opposed by the shareholders; the Bank of Bengal, therefore, withdrew from the negotiations. The Viceroy, Sir John Lawrence, in his minute dated July 12, 1867, also threw cold water on the scheme. He feared that the amalgamated bank would become very powerful, its influence overshadowing that of Government themselves. He doubted if really able persons could be found in India to manage such a bank. It was safer, he felt, to have Government balances distributed among three banks, which would also be more convenient to traders.

A Bank on the Model of the Bank of France and the Netherlands Bank

Besides amalgamation, other proposals cropped up from time to time. In 1870, Mr. Ellis, Member of the Viceroy's Executive Council, suggested the setting up of 'one State Bank for India' under complete Government control, with branches at the Presidency towns, generally on the model of the Bank of France. The Government of India, at about that time (1871) wrote: 'We look upon the establishment of a State Bank in India as a matter of great uncertainty, perhaps of impossibility'. They took the view that it might not be possible to induce really able and experienced men to come to India and manage such a bank.

In 1884, a suggestion was made for the setting up of a 'central bank of issue' on the model of the Netherlands Bank, but it was not pursued 'on the ground that India possessed a sound banking and currency system'. It may, however, be of interest to say something as to what the Bank of France and the Netherlands Bank models were, since these are not sufficiently known.

The Bank of France commenced business in February 1800, but it was only in 1803 that it obtained its first official Charter conferring on it the sole right to issue notes in Paris. By a decree of 1808, the Bank was authorised to open discount offices in 'departmental' towns, while by another decree issued in 1810, the Bank's monopoly to issue notes in Paris was extended to all towns where the Bank had offices.

The Bank was owned by private shareholders prior to its nationalisation in January 1946.

The management comprised a Governor, two Deputy Governors and a General Council comprising fifteen regents and three censors; the censors did not have the voting right. The Governor and the two Deputy Governors were appointed by the Minister of Finance; the regents and the censors were appointed by 200 shareholders with the largest shareholding. Of the fifteen regents, three were to be officials, while five other regents and the censors were to be chosen from

amongst shareholders engaged in business. The censors were inspectors or auditors; they attended meetings of the General Council and had access to all records, and their duty was to point out irregularities to the shareholders.

The Managers of the branches were also appointed by the Minister of Finance, out of three candidates nominated by the Governor. The Governor had the right of veto which, though rarely used, ensured 'the ultimate authority of the State over changes in policy or regulation unimpaired'. The Governor had also a casting vote, with the result that the Governor, the two Deputy Governors and the three 'official' regents enjoyed, between themselves, seven votes out of a total of eighteen. Thus, in practice, 'nothing of any description which concerns the great interest of the public, or the larger duties which the Bank has to perform towards commerce and industry, is left to the discretion of what is called the interested party (i.e., the shareholders)'.

The Netherlands Bank was set up in 1814 in terms of a Royal Decree, which was renewed several times. In 1884, when the suggestion was made for a similar institution in India, the legal status and activities of the Netherlands Bank were governed by the Act of December 22, 1863.

In terms of that Act, the Netherlands Bank was to be a company with limited liability. Shareholders who were nationals of the Netherlands and who held five or more shares for at least six months were entitled to vote; the maximum number of votes to which any shareholder was entitled was six.

The management of the Bank was to be in the hands of a Board consisting of a President, five Directors and a Secretary. The President and the Secretary were to be nominated by the King for a period of seven years, while the Directors were to be nominated by the shareholders from among the nationals of the Netherlands for a five-year period; one Director was to retire every year.

The supervision over the management of the Bank and the checking of the annual accounts were the responsibility of a Board of fifteen Commissaries, elected by shareholders for a period of five years; one-fifth of the Commissaries were to retire every year. The Commissaries could demand from the management explanations and ask for production of all documents concerning the Bank.

In addition to the Board of Commissaries elected by the shareholders, the King was to appoint a Royal Commissary to supervise the operations of the Bank. The Royal Commissary had the right to attend all the meetings of the shareholders and of the Board of Commissaries, could ask for any information and could speak in an advisory capacity.

The Fowler Committee and Schemes of Rothschild & Hambro

The question of the amalgamation of the Presidency Banks was not taken up again till 1898, when several witnesses before the Indian Currency Committee (Fowler Committee) drew attention to the inadequate banking facilities in India and the sharp fluctuations in the rate of discount. A few favoured the amalgamation of the Presidency Banks into a 'State Bank'.

One witness, Mr. A. de Rothschild, outlined a scheme for the creation, in India, of a bank with privileges similar to those of the Bank of England, by absorbing the Presidency Banks. It was to have a capital, the same as that of the Bank of England, viz., £14 million, to be held partly in gold and partly in sterling securities. The bank was to have the right to issue notes. Government were to use the bank and its branches as their Treasury. The proposed bank was not to conduct any foreign exchange transactions. The bank was to make advances to the Indian Government, when necessary, against 'deficiency' bills. The management of the bank was to be vested in a Board comprising representatives of merchants and bankers and also those of Government. Government representation was regarded as necessary to ensure that the policy of the bank and that of Government were in 'absolute harmony'. It is not known whether any consideration was given to this proposal.

One of the members of the Fowler Committee, Mr. Everard Hambro, urged the establishment of a strong bank in India, despite the fact that the question of banking facilities in India had not been referred to the Fowler Committee. Mr. Hambro stated that such a bank would be able to carry out the currency regulations more effectively and more in harmony with the trade needs of the country than any Government Department could possibly do, and, that, moreover, such a bank alone with ample facilities at its disposal, would be in a position to expand the supply of capital in times of pressure and contract it in times of slackness.

In a despatch dated July 25, 1899, the Secretary of State invited the attention of the Government of India particularly to 'the important recommendation with regard to the improvement and concentration of banking facilities contained in the separate report of Mr. Hambro'. The Government of India, who, till 1871, had doubted the possibility of inducing really capable persons to come to India to manage such an institution, gave their whole-hearted support to Mr. Hambro's suggestion. Such a bank, they stated, would be a powerful support to the State for effective maintenance of the gold standard and it could be entrusted with the management of Government paper currency. The Government of India, however, felt that as the Presidency Banks

had given good service to the country, Government owed them full consideration and therefore an attempt should be made in the first instance 'to absorb the three existing banks in one strong establishment, constituted on a sterling* basis'. Thus, at this stage, the object was not mere amalgamation, but the entrusting of central banking functions to the new institution. It was thought necessary to elicit the views of the Presidency Banks and the business community on the subject.

The question of amalgamation was examined in a wider context, viz., (i) whether banking resources in India had kept pace with the growth of trade in India, and (ii) whether the basis on which the entire trade was carried on was not narrow. The discussions with the representatives of Local Governments, banks and Chambers of Commerce which followed revealed 'a remarkable unanimity of opinion' that though the banks found it difficult to employ their resources fully during the slack season, the banking resources were found inadequate in the busy season and some temporary accommodation was absolutely necessary. One of the measures suggested for temporary accommodation was to allow the banks to borrow money in London, against the pledge of securities. The Government of India, in their despatch dated January 18, 1900 to the Secretary of State, stated that though it was desirable to have facilities for temporary expansion of resources, it was actually to an increase in the 'permanent capital' of the bank that trade had 'a right to look primarily for adequate relief'. Also, it would be more difficult, in their view, 'to follow the operations of three banks than of a single institution'.

Amalgamation was, however, opposed, among others, by the Bombay Chamber of Commerce and the Lieutenant-Governor of Bengal. The Chamber considered India and Burma too vast to be effectively served by one central bank. Also, the Presidency town where such a bank would have its seat of management would have an advantage over the other two. The Lieutenant-Governor's thinking was on the same lines. He added that a huge monopoly was not in the public interest, and that credit was 'a matter of local knowledge and experience'.

About a year later, in the winter of 1900-01, the matter was again discussed by Sir Edward Law, the Finance Member, with the Presidency Banks, exchange banks and leading merchants. He expressed views akin to those of Sir Roger de Coverley:

the conclusions which have forced themselves on my mind are that there is under present conditions no real necessity for the foundation of such a bank in the interests of trade, and that although, in my opinion, the existence of a strong bank with abundant resources would be useful

* A bank on sterling basis was preferred because it was felt that such a bank would be in a better position to command confidence and attract capital than one on a rupee basis.

in connection with possible exchange difficulties, and . . . from other points of view, be convenient to Government, the direct cost of its establishment would be greater than I venture to recommend for acceptance.

I am still of opinion that if practical difficulties could be overcome, it would be distinctly advisable to establish such a bank so as to relieve Government of present heavy responsibilities and to secure the advantages arising from the control of the banking system of a country, by a solid, powerful, Central Institution.

One of the 'very great practical difficulties' Sir Edward Law had in mind was 'securing a thoroughly suitable Board of Directors having the necessary leisure to devote to the business'.

The Government of India, in their despatch dated June 13, 1901 to the Secretary of State, stated that they accepted Sir Edward Law's 'final deduction that sufficiently strong reasons have not been shown for carrying out the amalgamation scheme at the present time'. The despatch further said:

We are therefore regretfully compelled to advise that the scheme should be held in abeyance, although we desire at the same time to record our deliberate opinion that it would be distinctly advisable, if practicable, to establish a Central Bank in India

The Secretary of State while accepting this view reluctantly, added in the despatch of July 26, 1901, 'I request that this object may be kept in view and that the scheme may be revived, whenever there is a probability of its being successfully carried out'.

Thus, serious efforts made by Government over a period of about two years to amalgamate the three Presidency Banks proved infructuous.

Chamberlain Commission and Question of State/Central Bank

The question of absorption of the three Presidency Banks into a central bank was thereafter lost to view, so far as Government were concerned. Even when the Royal Commission on Indian Finance and Currency (Chamberlain Commission) was appointed in 1913 to study and report on certain aspects of the working of the currency and exchange system, the question of the desirability of setting up a central bank was not specifically referred to it. However, at a very early stage of the enquiry, the Commission felt that it could not possibly deal adequately with the subjects referred to it, unless it considered the question of establishment of a State or central bank also. As no concrete proposals regarding a State or central bank came forth from the witnesses and in the absence of even general agreement among the witnesses as to what was implied by 'a State or Central Bank', the Commission requested two of its

members, Sir Earnest Cable and Mr. J. M. Keynes, to prepare a detailed scheme for its consideration. Mr. Keynes submitted to the Commission his memorandum on 'Proposals for the establishment of a State Bank in India' after collaboration with Sir Ernest Cable. Another memorandum on 'Proposals for the establishment of a State Bank for India' was prepared by Mr. L. Abrahams, Assistant under Secretary of State for India, with the concurrence of the Secretary of State.

Keynes's Proposals for a State Bank

According to Mr. Keynes, the 'nucleus' of the new bank was 'to be obtained by the amalgamation of the capital and reserves of the three Presidency Banks'. He named the proposed bank 'the Imperial Bank of India'. Government subscription to the capital, he considered, was not necessary, as it would 'complicate rather than simplify the relations between the Government and the shareholders'. As regards control, the 'supreme direction' of the bank was to be vested in a Central Board, consisting of the Governor of the bank (who was to be the Chairman), the Deputy Governor, a representative of Government and three or more assessors. The assessors were to be the Managers, or their deputies, of the Presidency Head Offices or of other Head Offices. The assessors were to have no vote. The Governor was to be appointed by the Monarch, on the Secretary of State's recommendation, while the Deputy Governor, the Government representative and the Managers of the Presidency Head Offices were to be appointed by the Viceroy; the appointment of the Managers of Presidency Head Offices was to be subject to the approval of the Presidency Boards. The Presidency Boards were to consist of the Manager (who was to be the Chairman and so have the casting vote), Deputy Manager, a representative of the Local Government and three or four non-official members.

The 'State Bank' proposed by Mr. Keynes was intended to put a little more responsibility on Government, while at the same time providing them with a 'thoroughly satisfactory machinery' for the discharge of the responsibility. To quote:

It cannot be maintained that some responsibility for banking, seeing that it is in fact undertaken by nearly all civilised Governments, is inherently undesirable. The undesirable features in the Government's present degree of responsibility for these things in India are rather due to the lack of suitable machinery.

It seems clear that Government cannot entrust any of its existing duties to private hands. It has also become plain that, whether a State Bank is established or not, Government, so far from relinquishing old duties, must bend itself to new ones.

The choice lies between a good deal of responsibility without thoroughly satisfactory machinery for the discharge of it; and a little more responsibility with such a machinery. The balance of advantage is with the second alternative.

The Secretary of State would be behind the Bank, but his authority would only come into play on rare and important occasions. On important changes of policy and on alterations of clauses in the Bank Act, the Secretary of State would have the last word and with it the responsibility But for the ordinary daily work of the Bank he would necessarily disclaim responsibility to a far completer extent than is at present possible in the case of any of the financial business now conducted by the Government.

The Bank, though ultimately dependent on the State, would lie altogether outside the ordinary Government machine; and its executive officers would be free, on the one hand, from the administrative interference of Government and free also, on the other hand, from too much pressure on the part of the shareholders, in cases where this might run counter to the general interest.

The main functions of the proposed bank included:

- (i) same functions as performed by the Presidency Banks, with relaxation of some restrictions;
- (ii) management of note issue;
- (iii) management of public debt in India;
- (iv) effecting remittance for the Secretary of State through the London Office; and
- (v) acceptance of payments and making of disbursements on behalf of Government at all places where the bank had a branch.

As Government banker, the bank was to hold free of interest all Government balances at Reserve Treasuries and in London with the exception of (i) £1 million to be held as emergency reserve by the Government in India, and (ii) balances held directly in the name of the Secretary of State at the Bank of England.

The management of the Mint and the custody of the Gold Standard Reserve were not to be entrusted to the bank.

Mr. Keynes also recommended in his scheme a proportional reserve system (though he did not use this expression) of a flexible type, for regulation of the note issue. As regards its relations with other banks, the bank was intended to do rediscount business 'to the greatest possible extent'. The 'State Bank' proposed by Mr. Keynes was thus to perform central banking as well as commercial banking functions.

Mr. Abrahams's Scheme

The scheme for a 'State Bank' submitted by Mr. L. Abrahams was not as comprehensive as that of Mr. Keynes. The functions to be entrusted to such a bank were about the same as under the Keynes's

scheme. Mr. Abrahams's scheme was also based on the amalgamation of the three Presidency Banks. As regards the bank's relationship with Government, Mr. Abrahams preferred that Government should directly or through Government Directors take part in its management, following the practice of several European central banks including the Bank of France, the German Reichsbank, the Bank of Russia and the Bank of Japan, rather than that the bank should act under rules sanctioned by Government.

The Chamberlain Commission's Recommendations

The Chamberlain Commission, which studied the memoranda submitted to it by Mr. Abrahams and Mr. Keynes, stated in its Report that it was not in a position to report either for or against the establishment of a State bank in India. However, it thought that the subject deserved early and careful consideration and suggested the appointment of a small expert committee to examine the whole question in India and either to pronounce against the proposal or to work out in full detail a concrete scheme capable of immediate adoption.

In the meantime the First World War broke out and no action was taken on the Commission's recommendations.

Establishment of the Imperial Bank of India

The war-time experience influenced the attitude of the Presidency Banks in favour of amalgamation. As bankers to Government, they had worked in close co-operation during the war years, and they realised that it would be in their own interest as well as that of the country if they were to amalgamate. They also feared that if they did not amalgamate, powerful banking interests abroad might secure control over Indian banking. The banks therefore came together and, soon after the Armistice was declared, approached Government to find out how they would view the amalgamation proposal. After some informal discussion, the banks submitted to Government a scheme for amalgamation.

The Government of India, in their despatch of June 25, 1919 to the Secretary of State, stated as follows on the amalgamation scheme:

we consider it important to emphasis that the present movement is purely spontaneous, that it is the natural growth of banking evolution, and that though it would be unwise to attempt to force the process, what is now happening will be a most valuable foundation for any later movement which may eventuate in the direction of a State Bank.

The decision of the Presidency Banks to amalgamate was announced in the Indian Legislative Council in September 1919 by the Finance

Member, Mr. H. F. Howard, while replying to a resolution moved by Rao Bahadur B. N. Sarma, recommending to the Governor-General that 'a State Bank on the lines suggested by Professor Keynes in his annexure to the report on the Indian Currency be established in India at a very early date'.

As the Members who spoke on the resolution were of the view that the question of establishment of a State or central bank should be taken up without further delay and that amalgamation of the three Presidency Banks was not likely to solve the problem, Mr. Howard explained that Government had agreed to amalgamation because as a commercial proposition it seemed they should use the machinery which they had, which was in 'running order' and which commanded 'public confidence'. However, he made it clear that this initial step would not commit Government 'for all eternity to a private bank as compared with a State bank'. To quote Mr. Howard :

it is quite clear that however we start, we must, if we wish to get a move on at all, start with some existing institutions, so that we can get on with the minimum of delay. When we have once proceeded as far as an amalgamation and have secured some closer co-operation with Government than is practicable under present conditions, the new institution, the Imperial Bank of India, can then be allowed to develop in the way in which development seems to be best required; whether in the direction of a State Bank or not I should not like to commit either Government or the Banks or anybody else now; but there is nothing to prevent it from developing as necessary.

The Imperial Bank of India Bill, providing for the amalgamation of the three Presidency Banks, was introduced in the Indian Legislative Council on March 1, 1920, and was passed in September 1920; the amalgamation came into effect in January 1921. The Imperial Bank was primarily a commercial bank, transacting all the business formerly carried on by the Presidency Banks; however, the bank was also entrusted with certain central banking functions. In terms of an agreement signed between the Bank and the Secretary of State, which was for a period of ten years in the first instance, the bank was appointed as sole banker to Government. The Reserve Treasuries were abolished and all Treasury balances were kept with the bank at its headquarters and at branches. The bank also managed the public debt of the Government of India. To an extent, the Imperial Bank of India also acted as banker to banks. Leading banks in India kept a major portion of their cash balances with it, though there was no such provision in the Statute; the Imperial Bank also granted accommodation to banks. The bank conducted clearing houses in the country and provided remittance facilities to banks and the public.

As regards its business outside India, the bank was allowed to open a branch in London and transact business entrusted to it by the Secretary of State, rediscount bills of exchange for banks, float sterling loans on behalf of Indian public bodies, etc.

With a view to developing banking facilities in India, the bank was required to open not less than 100 branches within the first five years.

In view of the Imperial Bank's position as sole banker to Government, Government exercised a certain amount of control over it. Of the sixteen members on the Central Board, ten were appointed by Government. These included two Managing Governors, four Governors, the Secretary of each of the three Local Boards and the Controller of the Currency. Government had also powers (i) to issue instructions to the bank on important financial matters, including safety of their funds, (ii) to compel the bank to furnish any information regarding its working, and (iii) to appoint auditors.

While the Imperial Bank was formed by the amalgamation of the three Presidency Banks, as suggested by Mr. Keynes, it was not a full-fledged 'State Bank' as he wanted it to be. It performed only two important central banking functions, viz., banker to Government and to some extent, bankers' bank; the other central banking functions, notably regulation of note issue and management of foreign exchange, were not entrusted to it. These continued to be performed by Government. The working of this central banking diarchy, which was far from satisfactory, in the years prior to the establishment of the Reserve Bank is discussed in the next chapter.

Meanwhile, the International Financial Conference held at Brussels in 1920 passed a resolution to the effect that 'in countries where there is no central bank of issue, one should be established'. The second Conference convened at Genoa (1922) made a similar recommendation. Since then several countries set up central banks, for instance, South Africa (1921), Colombia (1923), and Hungary and Poland (1924). However, when the next Royal Commission on Indian Currency and Finance was appointed, the question of setting up a central bank was not specifically referred to it.

Hilton Young Commission Report

The currency and exchange policies of the Government of India in the early 'twenties were severely criticised by the public, especially the efforts of the Government to maintain the high exchange rate of 2s. for the rupee. When the ratio stood at 1S. 4d. in 1924, Sir Purshotamdas Thakurdas wanted to introduce a Bill in the Legislative Assembly to stabilize the ratio at that level. This was opposed by the Finance Member who, however, agreed to the appointment of a commission

to examine the question, but felt that 'the time for it is not yet'. The return of England to the gold standard, at the old parity, in April 1925, was perhaps considered to be the right time to appoint a commission to go into the whole question and make recommendations. The Hilton Young Commission was appointed in August 1925 'to examine and report on the Indian exchange and currency system and practice ; to consider whether any modifications are desirable in the interests of India ; and to make recommendations '. The question of the need for a central or State bank was thus not referred to it. The Commission, however, examined this matter and in its Report, submitted in July 1926, strongly recommended the establishment of a central bank. The bank was to be called the 'Reserve Bank of India', and all central banking functions were to be entrusted to it. Pointing out the 'inherent weakness' of the Indian system, where the control of currency and credit was in the hands of two different authorities, the Commission remarked:

The Government controls the currency. The credit situation is controlled, as far as it is controlled at all, by the Imperial Bank. With divided control, there is likelihood of divided counsels and failure to co-ordinate. . . . The only certain way to secure co-ordination is to concentrate the controls in one hand. In other countries the single controlling hand is that of a Central Bank.

For development of banking also, the Commission considered a central banking system with facilities of rediscounting as essential because it felt that only then commercial banks could treat commercial bills held by them as their secondary reserves, capable of immediate realisation.

By that time, opinion abroad had also undergone a change in regard to the business of a central bank. The view taken was that a central bank's business should be of a very sound character, and that it should not do commercial banking business. The Hilton Young Commission too recommended the setting up of a new institution to perform solely central banking functions. In the Commission's view, the benefit of the elaborate and widespread organisation which the Imperial Bank had already built up should not be lost to India and the bank should be left free to attend to its essential task of giving India a network of banking facilities; in the Commission's view India needed not only a central bank, but a central bank and a great commercial bank.

This was the view expressed by Mr. (later Sir) Cecil Kisch, an authority on the subject of central banking, as also by Mr. (later Lord) Montagu Norman, Governor of the Bank of England, in their evidence before the Hilton Young Commission. When asked by the Commission whether the central banking functions could be entrusted to the

Imperial Bank, in case there should be any difficulty in constituting a central bank, Mr. Montagu Norman said, 'I think it would be most undesirable'.

On the other hand, Sir Purshotamdas Thakurdas, a respected leader of the business community, in his minute of dissent to the Report, recommended the evolution of the central bank from the existing Imperial Bank, the strongest banking institution in the country. He remarked as follows:

No rival therefore should be allowed to impair the prestige and authority of the Imperial Bank of India, and no division of the Government funds between it and another institution should be permitted to restrict its capacity to open new, and even temporarily unprofitable, branches which are essential to the mobilisation of the resources of the country.

Scheme of the Reserve Bank of India

The Hilton Young Commission Report made detailed recommendations on the set-up of the Reserve Bank. The Bank was to be a shareholders' Bank, with a paid-up capital of Rs. 5 crores and the Imperial Bank shareholders were to be given the first preference to subscribe since the Imperial Bank was to give up some of its privileges. The bank was to have Local Head Offices in the chief business centres, which were to be managed by Local Boards, elected by shareholders on the respective registers. As regards the Central Board, nine members were to be elected by the shareholders, while the Governor-General in Council was to nominate five, comprising a Managing Governor, a Deputy Managing Governor and a maximum of three other members. In addition, an official member was to attend the meetings and advise, but without the right to vote. For eliminating the danger of political pressure, it was recommended that Members of the Governor-General's Council and Members of the Legislature should be debarred from being nominated as members of the Central Board or appointed as President or Vice-President of a Local Board.

1927 Reserve Bank Bill

The Gold Standard and Reserve Bank of India Bill, to implement the recommendations of the Hilton Young Commission, was introduced in the Legislative Assembly on January 25, 1927. The Bank was to take over the management of the currency from the Governor-General in Council and was to carry on the business of banking in accordance with the provisions of the Act. The Bill was referred to a Joint Committee of 28 members, in March 1927. The Bill did not have a smooth sailing. During a period extending over one year, the Bill was taken up for

consideration twice and on both occasions it was decided to postpone further consideration after some clauses/sub-clauses had been approved. The controversy on the Bill was confined only to certain aspects of constitution and management rather than objectives.

The Report of the Joint Committee was not unanimous. Of the twenty-five members who signed the Report, seventeen including the Finance Member Sir Basil Blackett, appended minutes of dissent, while three members (one of whom had appended a dissenting minute also) stated that they would move amendments in the House on the points on which they disagreed. The minute of dissent signed by the Finance Member and six others was mainly in respect of the controversial clauses relating to the ownership of the Bank and the composition and constitution of the Board. They, however, made it clear that they had confined their observations only to clauses to which they attached 'special importance', and had refrained from commenting on other provisions with which also they were not in entire agreement. Three other members in separate minutes of dissent broadly supported the Finance Member in respect of the controversial clauses. Important changes made by the Joint Committee in respect of these clauses are mentioned below.

The Joint Committee recommended that the capital of the Bank should be wholly subscribed by Government; in other words, the Bank was to be a 'State' bank. The majority considered that a shareholders' bank would

tend to be controlled by vested interests, and would therefore fail to secure the confidence of the Indian public; and that its utility to the public might even be endangered by a conflict of interest with in the management of the Bank between Indian and external capital.

As regards the composition and the constitution of the Board of Directors, the Joint Committee made the following changes/recommendations:

- (i) The Committee dropped the provision prohibiting Members of Indian or Local Legislatures from being appointed as Directors of the Central Board of the Bank. In its view, such a provision would deprive the country of the services of really able men;
- (ii) The Committee inserted a new clause, on the lines of clauses contained in certain other enactments establishing central banks, providing that only persons who were or had been actively engaged in agriculture, commerce, finance or industry should be eligible for appointment as Directors; and
- (iii) As regards the constitution of the Central Board of sixteen members, the Committee recommended as under:

- (a) a Governor and a Deputy Governor, of whom one was to be an Indian, to be appointed by the Governor-General in Council;
- (b) two Directors, both Indians, also to be nominated by the Governor-General in Council;
- (c) two Directors to be elected by the Associated Chambers of Commerce
- (d) two Directors to be elected by the Federation of Indian Chambers of Commerce;
- (e) one to be elected by the provincial co-operative banks; (f) three to be elected by elected Members of the Central Legislature, of whom one was to represent the interests of commerce and industry;
- (g) three to be elected by elected Members of the Provincial Legislatures, of whom two were to represent the interests of agriculture and one of commerce and industry; and
- (h) one Government officer (not entitled to vote) to be appointed by the Governor-General in Council.

Thus, of the fifteen Directors with the right to vote, six were to be elected by elected Members of the Central and Provincial Legislatures. According to the Committee:

the said elected members represent together all the various interests of the people as a whole; and that it is reasonable and just that on the Reserve Bank of the country there should be some Governors elected by such general electorates, in addition to those who will be elected by the Chambers of Commerce and the provincial Co-operative Banks, which bodies represent special interests.

Speaking in the Legislative Assembly on August 29, 1927, on the motion that the Bill as reported by the Joint Committee be taken into consideration, the Finance Member stated that there was 'practical unanimity' between him and the Committee, as to what the Reserve Bank was to do. The differences of opinion were in regard to the constitution of the Bank and the method of constituting its Directorate. Sir Basil also emphasised that while the Joint Committee opposed a 'shareholders' bank, it shared the Government's view that the Bank should be completely independent of Government. Sir Basil, however, questioned 'how the Board of a Bank, the whole of whose capital is subscribed by the Government, can be made entirely independent of it'. According to him, such a Bank was 'likely in the end to become subservient to the Government and the Legislature'.

The Finance Member also strongly objected to the Joint Committee's recommendation regarding election of three members of the Board of Directors by the Central Legislature and three members by the Provincial Legislatures. In his view, it was a serious departure from

the straight constitutional path in proposing to use Members of the Central and Provincial Legislatures for purposes entirely foreign to those for which they were elected’.

The Finance Member made it clear that Government were not prepared to accept the scheme framed by the Committee. In Government’s opinion, ‘it would be preferable to lose the Bill altogether rather than to accept that proposal as it stands’.

Sir Basil then put forward a compromise scheme. While the Bank was to be a shareholders’ bank as proposed by Government and provided in the original Bill, changes were suggested in the original scheme with a view to ensuring (i) a wide distribution of shares, and (ii) predominantly Indian ownership. The original proposal to give preference in the allotment of shares to Imperial Bank shareholders was dropped. The nominal value of each share was to be reduced from Rs. 500 to Rs. 100 and preference was to be given to shareholders domiciled or ordinarily resident in India. The dividend was to be fixed lower at 6 per cent, as against 8 per cent originally. As regards the constitution of the first Board, Sir Basil proposed that instead of nine shareholder Directors being nominated by Government, only five should be nominated, and that two each should be allotted to the Federation of Indian Chambers of Commerce and the Associated Chambers of Commerce.

The debate on the Bill which followed showed that, by and large, the general opinion was against a shareholders’ bank, notable among those who opposed being Messrs. Madan Mohan Malaviya, R. K. Shanmukham Chetty, Jamnadas Mehta, Purshotamdas Thakurdas and Lala Lajpat Rai, but there were differences as to what this meant in respect of Government control. Thus, while Mr. Jamnadas Mehta said that a ‘State Bank’ had ‘no charm’ for him, unless it was under ‘national control’, others like Mr. (later Sir) R. K. Shanmukham Chetty and Sir Purshotamdas Thakurdas were very emphatic that the Reserve Bank should be free from Government control and also from any influence of the Legislature. Lala Lajpat Rai, on the other hand, wanted the House to have a voice in the management of the Bank and favoured election of some Board members by the Legislature, as recommended by the Joint Committee. Pandit Madan Mohan Malaviya favoured election of the Directors by and from the Legislatures. Sir Victor Sassoon and Mr. (later Sir) Kikabhai Premchand were against the Legislature’s electing the Directors.

On the third day of discussion, viz., August 31, 1927, Sir Basil, in his concluding speech on the general debate on the Bill, announced that though Government felt that the shareholders’ scheme was the best, they were ready to give it up if, by making that concession, they could secure ‘that the Bill will finally reach the Statute-book

in a shape acceptable to them '. At the same time he made it very clear that Government strongly objected to election of the Bank's Directors by the Legislature.

Referring to a system of ' Electoral Colleges '* in place of shareholders as electors (as suggested by Mr. S. Srinivasa Iyengar, Member of the Legislature and later President of the Indian National Congress), Sir Basil said that it seemed to be a better solution than any put forward till then and Government were willing to accept it in principle.

The clause by clause consideration of the Bill was then taken up. When the clause relating to share capital came up, the Finance Member stated that Government were yielding on the question of a shareholders' bank, but this was conditional on making provisions for a satisfactory directorate, for which amendments to the Bill were necessary.

On Thursday, September 1, 1927, Sir Basil Blackett moved an amendment to clause 7, which had the effect of prohibiting Members of Indian or Local Legislatures from serving as Directors on the Reserve Bank Board, but it was lost by 70 votes to 51. Sir Basil then moved an amendment to clause 8(1)(a) of the Bill, the purpose being to omit the provision inserted by the Joint Committee that the Governor or the Deputy Governor must be an Indian. The discussion was not concluded. When the House met the next day, Sir Basil submitted a proposal for adjournment of the debate on that day. No agreement had been reached on Mr. S. Srinivasa Iyengar's scheme of electoral colleges, and the Finance Member felt that Government and leaders of the parties ' should have a period over the week-end to consider whether this seemingly threatening cloud can be dispersed without an undue storm '. The item was, however, not included in the next working day's agenda. On September 8, 1927, Sir Basil announced in the Assembly that:

the Government have regretfully come to the conclusion that the best course in the interests of all concerned is not to proceed with the Bills at present.

On September 13, 1927, a motion censuring the Government of India for withdrawing the Gold Standard and Reserve Bank Bill, before the Assembly had had an opportunity of discussing the remaining clauses

* The scheme based on the electoral college principle came to be known as 'Stock-holders' Scheme '. Under this, the Government of India 5 per cent Reserve Bank stock was to be issued at par in amounts of Rs. 100 and multiples thereof. The maximum holding was limited to Rs. 10,000, and every holder had one vote and had to be either domiciled or ordinarily resident in India. A register of stockholders was to be kept in each of the major Provinces, and where there were at least 1,000 stockholders on the register, they were to be allowed to elect, triennially, sixty trustees who were to elect ten Directors on the Bank's Board. (Central Banking in India, 1773-1934, by O. P. Gupta.)

of the Bill, was introduced and adopted. The Finance Member-defended Government's action, thus:

As regards the withdrawal of the Bill, what the Government have done is to come to the conclusion that, in view of the time available during this Session and the complexity of the problem still to be solved, it was not desirable to attempt to complete the Bill this Session.

The view was widely expressed in the press and even in the Legislature that Sir Basil's colleagues in India and the India Office were unhappy at the compromise regarding State ownership of the proposed Reserve Bank and that therefore they withdrew support to the measure.

1928 Reserve Bank Bill

In January 1928, the Government of India published a new Gold Standard and Reserve Bank Bill. The Bill broadly followed the 1927 Bill, as amended by the Joint Committee, important exceptions being the provisions relating to the ownership of the Bank and the constitution and composition of the Board. As regards the ownership of the Bank, the new Bill, like the original 1927 Bill, provided for a shareholders' bank. The clauses in the 1928 Bill relating to the share capital of the Bank and the constitution and composition of the Directorate are dealt with here.

(i) **SHARE CAPITAL.** The nominal value of shares was to be Rs. 100 each; individual shareholding was restricted to a maximum of Rs. 20,000.

(ii) **THE BOARD OF DIRECTORS.** Provision was made for a much bigger Board of twenty-four members, of whom eight members (comprising the Governor, two Deputy Governors, four Directors and one Government official) were to be appointed/nominated by the Governor-General in Council. Two Directors each were to be elected by the Associated Chambers of Commerce and by the Federation of Indian Chambers of Commerce; one Director, representing the interests of agriculture, was to be elected by the provincial co-operative banks, and eleven Directors were to be elected on behalf of the shareholders on the various registers relating to the different geographical areas. The Bill also laid down the manner in which Directors representing shareholders were to be elected. Briefly, the shareholders on the various registers were required to elect a certain number of delegates, from among themselves, once in five years, and the delegates for each register were to elect, from among the shareholders on the respective register, a certain number of Directors.

The Bill specifically debarred a Government official, an officer or employee of any bank or a director of any bank, from being appointed

as Director. It also provided that the election or appointment as Director of any person who was a Member of the Indian or a Local Legislature would be void unless he ceased to be such Member within one month of his election or nomination. Also, if any Director was elected as Member of a Legislature, he would cease to be a Director.

On February 1, 1928, when the Delhi session of the Legislative Assembly commenced, the new Gold Standard and Reserve Bank of India Bill was on the agenda, but a point of order was raised by Mr. M. S. Aney (i) whether it was in order to introduce a new Bill when a Bill on the same subject was pending before the House; and (ii) whether the Finance Member would be in order in calling upon the House to reopen such points as had been decided earlier and on which the opinion of the House had already been recorded and give further opinions on those points. Further, he pointed out that according to certain provisions in the Standing Orders and Legislative Rules, Members who desired to dispense with further progress of Bills introduced by them and deal with them afresh could do so only after withdrawing the earlier Bills or allowing them to lapse.

The President of the Assembly in his ruling stated that:

the method proposed to be adopted by the Finance Member violates the proprieties of the House and is an abuse of its procedure and I, therefore, regret I must decline to call upon him to introduce his Bill.

The Government bowed to the Chair's ruling and decided on February 6, 1928, to proceed with the consideration of the old Bill from the point reached in the August-September 1927 session. The Finance Member, Sir Basil Blackett, was successful in getting approval for some amendments introduced by him in clause 8 of the Bill, the more important of these being (i) providing for two Deputy Governors and omitting the statutory requirement that either the Governor or the Deputy Governor should be an Indian, and (ii) deletion of the sub-clause providing for election of three Directors by the Central Legislature.

Another amendment providing for deletion of sub-clause (1) (f) of clause 8, empowering Provincial Legislatures to elect three Directors, was proposed by Sir Victor Sassoon and adopted. However, when the motion that 'clause 8, as amended, do stand part of the Bill' was put to the House for vote, it was rejected by 50 votes to 49. The Finance Member thereupon requested the President not to proceed further with the Bill that day, stating that:

Government desire to reconsider their position and consider whether in view of the voting it does not show that the House does not desire to have a Reserve Bank at all.

Two days later, i.e., on February 10, 1928, the Finance Member announced Government's decision not to proceed further with the Bill. He stated:

Government had reason to believe, and still believe, that informed opinion in the country is generally in favour of the establishment of a Reserve Bank, and the House has on more than one occasion affirmed the principle But the decision to omit clause 8 was in any case quite clearly a wrecking amendment and it renders any attempt to proceed with the Bill, if not impossible, at any rate unseemly. This would be true even if both the Government and the House were unanimous in desiring to proceed further. The vote in favour of the omission of clause 8 is in fact very little different in its consequences from a rejection of the principle of the Bill. The Government feel, therefore, that they must construe the course of events on Wednesday as an indication of the absence of that measure of general support for the Bill among representatives of public opinion within the Assembly which they think they ought to have behind them in carrying through so important a financial reform . . . the Government do not now propose themselves to take any further steps with a view to the introduction of the reforms which the Reserve Bank Bill was designed to bring about . . . in the absence of any easy means by which we can usefully continue our consideration of the remaining clauses, I would suggest to you Sir, that the debate should be adjourned.

The further consideration of the Bill was thus postponed sine die.

On February 6, 1929, when a question was asked in the Legislative Assembly whether Government intended to bring before the Legislature a Reserve Bank Bill in the near future, Government's reply was in the negative. Government were convinced that a central bank was in the country's interest, but they could only proceed subject to their being satisfied as to two conditions : 'first, that the organisation of the Bank is to be securely settled on sound lines ; secondly, that there is an adequate measure of general support among the representatives of public opinion for the proposals'.

Constitutional Reforms and the Question of Central Bank

From 1930-31 onwards, the question of establishing a Reserve Bank for India received fresh impetus, in connection with the consideration of constitutional reforms for the country. In their dispatch dated September 20, 1930 on proposals for constitutional reforms the Government of India 'stated in unambiguous terms that the formation of a Reserve Bank on sound lines was in their view to be a condition precedent to any transfer of financial responsibility from the agents of Parliament to a minister answerable to the Indian Legislature'.*

* O. P. Gupta, op. cit.

In the discussions of the Federal Structure Sub-Committee of the First Round Table Conference in London in December 1930-January 1931 on the constitution, character, powers and responsibilities of the Federal Executive, the question of an early establishment of a Reserve Bank on sound lines and free from political influences received particular attention. When Lord Sankey, the Chairman of the Sub-Committee, observed that something should be done 'to secure the credit and stability of the country', leading members of the British India Delegation like Sir Tej Bahadur Sapru, Sir B. N. Mitra and Mr. M. R. Jayakar and of the Indian States Delegation like Sir Mirza M. Ismail, expressed themselves strongly in favour of establishing a Reserve Bank on non-political basis. Sir Mirza Ismail was of the view that:

There should, however, be no interregnum between the present method of control and the establishment of a Reserve Bank; nor should the establishment of the bank be left in doubt. It should therefore be considered whether the Statute setting up the constitution should not include a provision for the establishment of a Reserve Bank with a non-political board.

He was fully supported by Sir Tej Bahadur Sapru, who added that 'the establishment of the Reserve Bank must be a matter of vital concern to the Government and that no time should be lost in establishing it'.

With a view to ensuring confidence in the management of Indian credit and currency, the Sub-Committee recommended that:

efforts should be made to establish on sure foundations and free from any political influence, as early as may be found possible, a Reserve Bank, which will be entrusted with the management of the currency and exchange.

The Sub-Committee also recognised that:

it may be difficult in existing conditions to set up a Reserve Bank of sufficient strength and equipped with the necessary gold and sterling reserves immediately, and that, therefore, until this has been done some special provisions will be found necessary to secure to the Governor-General adequate control over monetary policy and currency.

Another development, meanwhile, was the submission of the Report of the Indian Central Banking Enquiry Committee (1931) which also strongly recommended the establishment of a Reserve Bank 'at the earliest possible date'. The foreign experts advising the Committee endorsed the recommendation observing:

The paramount interests for the country involved in the establishment, within the shortest time possible, of such an independent institution, free from political influence, can hardly be over-estimated.

While the Federal Structure Sub-Committee of the First Round Table Conference had recommended an early establishment of the Reserve Bank and provided that until this could be done, the Governor-General should be vested with adequate control over monetary policy and currency, the Financial Safeguards Committee of the Third Round Table Conference took the view that proposals to be submitted to Parliament should be based on the assumption that a Reserve Bank would be created prior to the inauguration of the Federal Constitution ; the Committee, therefore, recommended that steps should be taken to introduce the Reserve Bank of India Bill in the Legislative Assembly as early as possible. The Committee also mentioned that the Secretary of State had agreed that 'Indian opinion would be consulted in the preparation of the proposals for the establishment of the Reserve Bank.....'

The White Paper on the new Constitutional Reform, which was presented to Parliament in March 1933, thus assumed that a Reserve Bank, free from political influence, would have been set up and would be already successfully operating before the first Federal Ministry was installed.

India Office Committee

Meanwhile, a Departmental Committee was appointed in London by the India Office, with Mr.R.A.Mant as the Chairman, to advise upon the nature of Reserve Bank legislation. The Committee, in its Report dated March 14, 1933, strongly recommended a shareholders' bank, observing that 'State capital, however safeguarded, is a direct incentive to political interference'. The Committee favoured a Board 'as small as practicable', as a large Board tended 'to weaken the sense of individual responsibility'. The Committee also regarded the election of Directors by Chambers of Commerce and provincial co-operative banks as inappropriate and unnecessary. The Board, as recommended by the Committee, was to comprise a Governor, a Deputy Governor and four Directors to be nominated by the Governor-General at his discretion, eight Directors representing the shareholders, and an officer representing Government, but with no voting power.

The Committee was against any Member of the Legislature or any officer of the Government from becoming a member of the Board. As regards appointing shareholders' Directors, in the Committee's view, neither the 1927 nor the 1928 Bill would secure the desired objectives, viz., (i) to secure qualified persons as Directors, (ii) to ensure the representation of all principal interests and all parts of India, and (iii) to guard against the predominance of any sectional or political influences. Instead, the Committee recommended reversion to the

procedure recommended by the Hilton Young Commission*, with some modifications.

London Committee

The India Office Committee's Report was followed up by the appointment in London of another committee to draft a Reserve Bank Bill. This 'London Committee' comprised** authorities on central banking, financial administrators from India and Great Britain, Members of the Indian Legislature and representatives of the business community. The Committee, which met in July 1933, adopted the 1928 Bill as the basis, and proposed certain definite amendments to that Bill. Certain points were left for further consideration in India.

This Committee also took the view that the Reserve Bank should be free from any political influence and that the best method to attain this objective was to have a Bank with capital held by private shareholders. As regards the constitution of the Central Board, the Committee, like the India Office Committee, suggested that it 'should be as small as practicable', of fifteen or sixteen members. The Committee did not consider any special provision necessary for representation on the Board of commercial bodies.

Reserve Bank Bill, 1933

The Reserve Bank of India Bill, 1933, drafted on the basis of the recommendations of the London Committee, was introduced in the Legislative Assembly by the Finance Member, Sir George Schuster, on September 8, 1933. In his speech introducing the Bill, the Finance Member explained the significance of a Reserve Bank in the constitutional plan as follows:

It has generally been agreed in all the constitutional discussions, and the experience of all other countries bears this out, that when the direction of public finance is in the hands of a ministry responsible to a popularly elected Legislature, a ministry which would for that reason be liable to frequent change with the changing political situation, it is desirable that the control of currency and credit in the country should be in the

* The Hilton Young Commission had recommended that the Reserve Bank should have Local Boards at Bombay, Madras and Calcutta, elected by the shareholders registered on the respective branch registers; the Presidents and Vice-Presidents of the three Local Boards and one other member, selected from among its members, by each Local Board were to constitute the shareholders' representatives on the Central Board.

** The Committee comprised: R. A. Mant, Deputy Chairman, N. N. Anklesaria, E. C. Benthall, C. C. Biswas, Ram Saran Das, H. Denning, A. Hydari, Mirza M. Ismail, Cowasjee Jehangir (jun.), L. J. Kershaw, C. Kisch, V. T. Krishnamachari, H. P. Mody, A. Ramaswami Mudaliar (who signed the Report on behalf of Iyengar), Campbell Rhodes, George Schuster, Firoze Sethna, H. Strakosch, Purshotamdas Thakurdas, S. D. Waley, Mohd. Yamin Khan and Zafrulla Khan.

hands of an independent authority which can act with continuity . . . Further, the experience of all countries is again united in leading to the conclusion that the best and indeed the only practical device for securing this independence and continuity is to set up a Central Bank, independent of political influence.

The Bill was referred to a Joint Select Committee on September 13, 1933, and as amended by the Committee was introduced in the Legislative Assembly on November 27, 1933, at a special session. This session was not attended by the Congress party, which had vigorously and successfully championed the principle of State ownership of the proposed Reserve Bank, when the 1927 Bill came up before the Legislature. The Bill was passed by the Assembly on December 22, 1933, and by the Council of State on February 16, 1934. The Bill received the assent of the Governor-General on March 6, 1934. The main features of the Act, with the legislative background of the principal sections, are described in Chapter 3. The Act was more or less in the form in which Government wanted it.

2

Currency, Exchange and Banking Prior to 1935

Prior to the establishment of the Reserve Bank of India in 1935, the principal functions associated with a central bank were performed, however inadequately, by the Government of India primarily, and to a smaller extent, by the Imperial Bank of India, since its establishment in 1921. The regulation of note issue, the management of foreign exchange and the custody of the nation's metallic and foreign exchange reserves were the responsibilities of the Government of India. The Imperial Bank acted as banker to Government and to a limited extent as a bankers' bank, in addition to its primary functions as a commercial bank. By the time the Reserve Bank came to be established, organised banking in India had developed to an extent by no means insignificant, though an important element of this sector comprised foreign banks, which were generally referred to as exchange banks. There was in addition a fairly extensive indigenous banking sector, having rather loose links with the organised banking system, which itself was not an integrated one. Principally on account of the dual system, the Indian money market was characterised by inelasticity, bringing with it deficiencies and defects, such as seasonal and regional imbalances between the need for and supply of currency and credit and marked variations of interest rates. The currency and exchange arrangements were such that the principal channel through which expansion or contraction of money occurred was foreign remittance, though this was to an extent inevitable on account of adherence to an international monetary standard with a fixed exchange rate. This feature was predominant in India owing to the absence of a central bank for co-ordinating the external and internal sectors of the money market so as to meet the varying requirements of domestic industry and commerce

and the country's international transactions. As already explained in Chapter 1, the disadvantages of the absence of a central banking institution had long been recognised, although corrective action came slowly.

The object of this chapter is to give a brief account of the history of Indian currency and exchange during the hundred years or so prior to the establishment of the Reserve Bank, and to describe briefly the structure and organisation of the Indian money market as it stood prior to the establishment of the Bank. The history of Indian currency and exchange is highly complicated. Even the brilliant John Maynard Keynes, who did considerable work on problems of Indian currency and finance, was constrained to remark that ' Indian currency is too complicated a subject to be mastered at a moment's notice '. Several committees and commissions considered Indian currency and exchange problems. The evolution of policies in these matters was the result not so much of Statutes as of notifications and administrative practice. In the words of Keynes :*

The evolution of the Indian currency system since 1899 has been rapid, though silent. There have been few public pronouncements of policy on the part of Government, and the legislative changes have been inconsiderable. Yet a system has been developed, which was contemplated neither by those who effected nor by those who opposed the closing of the Mints in 1893, and which was not favoured either by the Government or by the Fowler Committee in 1899, although something like it was suggested at that time. It is not possible to point to any one date at which the currency policy now in force was deliberately adopted.

HISTORY OF INDIAN CURRENCY AND EXCHANGE

The principal issues that figured in the various discussions and deliberations on Indian currency were the appropriate monetary standard for India, the exchange rate of the rupee and the composition and location of monetary and exchange reserves of the country. In these matters there were, not infrequently, fairly sharp differences of opinion between the Government of India, that is to say, the representatives of the British Power in India, and the Home Government, as represented by the Secretary of State for India ; needless to say, the ultimate decision lay with the latter. Undoubtedly, many of the decisions of the Secretary of State were guided by what were considered to be the interests of British trade and industry, but there is no doubt that, to some extent, the decisions were in accordance with contemporary thinking on matters

* Indian Currency and Finance, 1913.

of monetary standard, exchange rate and reserves. Notwithstanding the long period of experimentation with currency and exchange, it would appear, if one overlooks the shortcoming of inelasticity, that the monetary arrangements were reasonably stable and coherent.

SILVER STANDARD: 1835-93

The Uniform Rupee

Although the Directors of the East India Company had given their approval for the introduction of a uniform currency in India in 1806, the era of such currency began only in 1835 when, in terms of Act XVII of that year, the silver rupee of 180 grains troy, 11/12ths fine, was declared the sole legal tender throughout British India; this was, in fact, the coin that had been in circulation in parts of the country, such as, Madras and Bombay. The mints were opened to the public for free coinage of the metal; thus, India was put on a monometallic silver standard. It should be mentioned that although the Directors of the East India Company favoured a silver standard, they were by no means opposed to the circulation of gold coins. The Act of 1835 permitted the minting of gold coins (i) of the same weight and fineness as the silver rupee, that is, 180 grains troy, 11/12ths fine, and this was to be the gold mohur equivalent in value to Rs. 15, and (ii) of five, ten and thirty rupee pieces. It was declared that gold coins would not be legal tender, but, the public Treasuries, in terms of a notification issued in 1841, were to accept the coins on the basis of Rs. 15 for one gold mohur, in payment of taxes and other public dues.

Besides the silver and gold coins, currency notes were also in circulation, these being issued mainly by the Presidency Banks -of Bengal from 1809 and those of Bombay and Madras from 1840 and 1843, respectively. These notes were not, however, legal tender and their circulation was practically confined to the Presidency towns.

Paper Currency Act, 1861

Some years later, on account of the discovery of new gold mines in the U.S.A. and Australia, the price of gold fell relative to that of silver, and, effective January 1, 1853, Government cancelled their earlier order regarding the acceptance of gold at any public Treasury on the basis of Rs. 15 per gold mohur. There were representations from Chambers of Commerce for the introduction of gold currency, but Mr. James Wilson, the first Financial Member, was opposed to it. He saw no reason to change the silver standard and in his view the defects of the currency system would be remedied by a well-regulated

paper currency system. In 1860, he introduced the Paper Currency Bill, but did not live to see it enacted. This was carried out in 1861 by Mr. Laing, Mr. Wilson's successor. In terms of this Act, the sole right to issue notes rested with Government. As regards reserves against the note issue, whereas Mr. Wilson had favoured the proportional reserve system, Mr. Laing based the issue of currency on the British model, as embodied in the Bank Charter Act of 1844, in terms of which there was to be a very limited fiduciary issue against Government securities and the rest was to be backed wholly by metallic holdings, in coin and bullion. The Paper Currency Reserve was to consist of silver coin and bullion and of Government securities up to a maximum of Rs. 4 crores initially. Provision was also made for the inclusion of gold coin and bullion in the reserve, up to a limit of 25 per cent of the note issue; this was done to facilitate the introduction, at a later stage, of gold currency, which Mr. Laing favoured.

Mansfield Commission

However, the demand for the introduction of gold currency continued in business circles. Sir Charles Trevelyan, the Financial Member, who studied the situation in 1864, recommended that gold sovereign and half sovereign, minted in England, Australia or India, should also be declared legal tender in India, besides the silver rupee. The Government of India approached the Secretary of State for his consent, but all that the latter permitted was (i) acceptance of gold coins by Government in payment of public dues, a practice which had been in existence from 1841 to December 1852, and (ii) issue of notes in exchange for gold coin or bullion as provided for under Section IX of the Paper Currency Act of 1861. The Government of India issued the relevant notifications in November 1864, the rates fixed being Rs.10 for a sovereign and Rs. 5 for a half sovereign.

In January 1866, the Bengal Chamber of Commerce urged the Government of India to hold an enquiry into 'the whole currency question'. The Government of India thereupon appointed a commission, with Sir W. R. Mansfield (later, Lord Sandhurst) as President, to inquire, in the first instance, into the operation of the Paper Currency Act and suggest improvements in the system. The Commission was also to report upon any extension of the monetary system considered necessary to meet the increased currency requirements of the country, the intention being that it should deal with the question of gold currency.

The Commission submitted its report in October 1866. On the working of the Paper Currency Act, it suggested certain administrative changes and also the introduction of a 'universal note' encashable anywhere in the country rather than in a particular geographical area,

called circle. As regards introduction of gold in the currency system, the Commission was satisfied that the demand for gold currency was unanimous throughout the country, that gold coins of Rs. 15, 10 and 5 would be preferred by the people to notes of equivalent value and that the currency should, therefore, consist of gold, silver and paper.

Decline of Silver -1874-93

No action was taken on the Mansfield Commission's recommendations, though the indications were that the Government cherished the hope of making gold legal tender. But these hopes were belied by a very important announcement which the Government of India made in May 1874, to the effect that the Governor-General in Council was not then prepared to take any step for the recognition of gold as legal tender in India.

In the next 20 years, the price of silver recorded a sharp and continuous decline in relation to that of gold. As a result, the exchange rate of the rupee fell steadily from 1S. 10.351d. in 1873-74 to 1S. 2. 985d. in 1892-93. Much light on the changes in the relative values of precious metals was thrown by the British Royal Commission, specially appointed for the purpose, in 1886. The Commission pointed out that while the annual average production of silver rose from 1.34 million kgs. during 1866-70 to 1.97 million kgs. during 1871-75 and further to 2.86 million kgs. during 1881-85, gold output declined from an average of 0.20 million kgs. during 1866-70 to 0.17 million kgs. during 1871-75 and further to 0.15 million kgs. during 1881-85. As against the reduction in output, there was considerable increase in the demand for gold as a result of the adoption of gold standard by a number of countries. As regards silver, while the demand for the white metal for currency purposes diminished in some countries, there was large silver coinage in the United States, with the result that it was doubtful, the Commission stated, whether there was any great reduction in the use of silver for coinage purposes. According to the Commission, the fact that despite vast changes in the relative production of the two metals prior to 1873 there was no corresponding disturbance in their market value, indicated the existence of some steadying influence, which had since been removed. That influence was the existence of the bimetallic law in the Latin Union countries, with a fixed ratio of 15½ to 1 between silver and gold. When that link was broken in 1874 by the suspension of free mintage of silver by the Latin Union, 'the silver market was open to the influence of all the factors which go to affect the price of a commodity'.

Apart from other effects, the depreciation of the rupee also created a budgetary problem for the Government of India, as the burden of

meeting the 'Home Charges' -payment in sterling for meeting the various obligations such as interest on debt, pensions, payments to the War Office, cost of Government stores, etc. -increased. However, little action was taken to meet the situation, the Secretary of State's view being 'it is better to sit still, than to have recourse, under the influence of panic, to crude legislation the result of which cannot be foretold, and the effect of which cannot be measured'. Meanwhile, the U.S. Government, under the pressure of their silver producing interests, made efforts to restore the monetary status of silver through the establishment of bimetallism. There was more than one international conference for this purpose, in which India also participated, but they did not bear fruit. The fate of bimetallism was sealed in 1892, after the Fourth Conference, and thereafter the U.S. Government gave indications that they might discontinue silver purchases.

Herschell Committee

In these circumstances, the Government of India proposed that the mints should be closed to the free coinage of silver and urged the early establishment of a gold standard. To consider the situation afresh and suggest appropriate measures, the Secretary of State appointed, in October 1892, a committee presided over by Lord Herschel, the Lord Chancellor. In its report made next year, the Committee endorsed the Government of India's recommendation that the mints be closed to the public for free coinage of silver, but with the modification that an announcement should be made to the effect that Government might coin rupees, if required by the public, in exchange for gold at a ratio to be fixed, in the first instance not much above the then prevailing rate,* say, at 1S. 4d. per rupee (against Government's recommendation of 1S. 6d.) and arrange for Government Treasuries to receive gold at the same rate, in satisfaction of public dues. Thus, the Herschell Committee recommended neither the demonetisation of silver nor the introduction of a full-fledged gold currency. The rupee was to continue to be unlimited legal tender. The Committee's proposals were intended for a period of transition and were to be regarded as providing the first step towards the eventual introduction of the gold standard. The Government accepted the recommendations and effected legislation on June 26, 1893 amending the Indian Coinage Act, 1870 and the Indian Paper Currency Act, 1882. The amending Act provided for the closure of the Indian mints to the free coinage by the public of both gold and silver; however, Government retained the power to coin silver rupees on their own account. Notifications were issued on the same day announcing that (i) the mints would accept gold in exchange

* The rate was Is. 2 5/8,d.on May 31, 1893, the date of the Herschell Committee's Report.

for rupees at the rate of 7.53344 grains of fine gold, corresponding to an exchange rate of 1S. 4d. per rupee, (ii) sovereigns and half sovereigns would be accepted at the rate of Rs. 15 for a sovereign, in respect of payments due to Government and (iii) currency notes would be issued to the Comptroller-General in exchange for gold. It is to be noted that while it was thus binding on Government to accept gold and give rupees/notes in exchange, there was no obligation on them to provide gold against rupees/notes. Consequently, the rupee became a token coin, its intrinsic value, of course, varying with the international price of silver.

System of Council Drafts

An attempt was made by the Secretary of State to raise the exchange rate to 1S. 4d., by a temporary cessation of sale of Council Drafts (Bills and Telegraphic Transfers) or the practice of supplying rupees in India against sterling tendered in London, at a price below 1S. 3 ¼ d. per rupee ; but the effort did not succeed and was given up, as intending buyers of Council Drafts instead shipped silver to India, which worked out to be a cheaper means of remittance.

It has to be explained that the sale of Council Drafts (and Reverse Councils or sterling against rupees tendered in India) 'was the flywheel of the machinery for the management of Indian currency, exchange, and finance '. Remittance of funds through this arrangement was a unique operation for a Government to perform, this being a legacy of the East India Company. Normally, India ran a surplus on trade account; on the other hand, payment had to be made in sterling to meet the 'Home Charges'. The arrangement mentioned above provided a convenient mechanism for offsetting the receipts and payments thereby avoiding unnecessary shipments of gold between England and India. The basic procedure was for the Secretary of State in Council (hence Council Drafts) to invite tenders for delivery of sterling in London against payment in rupees from Government funds in India. While originally the system of Council Drafts was used only to enable the acquisition of sterling by Government for meeting the Home Charges, the system was extended in 1898 and further in 1904 to meet the requirements of others for Indian currency.

In 1904, the Secretary of State announced a standing offer to sell Council Bills, that is rupees, at specified rates which were within narrow limits of the exchange rate; this ensured an upper limit to the exchange value of the rupee. Thus, in 1904, the rate was fixed at 1S. 4 1/8 d. per rupee, the theoretical gold export point corresponding to the ratio of 1S. 4d. The Government also provided sterling for rupees, by the sale of Reverse Councils. Of course, the occasions for this were not many,

as, by and large, India had a surplus trade balance and so exchange remained strong. Presumably for this reason, there was no standing commitment on the part of Government to sell Reverse Councils. When exchange turned weak, generally speaking, Government supplied sterling by sale of Reverse Councils, subject to Government's reserves position, at rates slightly below the lower point of exchange for sale of Council Bills. However, prior consent of the Secretary of State had to be obtained for the sale of Reverse Councils.

EFFORTS TO ESTABLISH A GOLD STANDARD

Fowler Committee

Notwithstanding the closure of mints to the free coinage of silver, the exchange rate fell steadily, reaching a low of 1S. 013/32 d. in January 1895. Thereafter there was a steady rise, and the rate of 1S. 4d. was reached in January 1898, that is, after an interval of about six years. Meanwhile, there had developed a widespread feeling in official as well as non-official circles that steps should be taken, without further delay, to establish a full-fledged gold standard and a stable exchange. To ensure the stability of the exchange value of the rupee, Government intended to withdraw redundant rupees from circulation. A gold reserve was to be established in India and for this purpose a loan not exceeding £20 million was to be raised in England, of which one-fourth in the form of sovereigns was to be shipped to India in the first instance.

There were other schemes, prominent among which was one put forward by Mr. A.M.Lindsay, Deputy Secretary of the Bank of Bengal. Briefly, Mr. Lindsay recommended not a conventional gold standard but a scheme similar to what later came to be known as the gold exchange standard, under which gold was not to circulate as currency in the country, but there would be an obligation on the part of the Government to provide sterling, which being on the gold standard was as good as gold. To consider these matters, the Secretary of State appointed, in 1898, a committee, presided over by Sir Henry Fowler. This Committee recommended the introduction of a full-fledged gold standard. The Committee favoured the declaration of the British sovereign as legal tender and current coin in India and recommended that the mints should be thrown open to the unrestricted coinage of gold. The Committee, by a majority, suggested the fixation of the exchange rate of the rupee at 1S.4d. which was the prevailing rate. As regards the status of the rupee coin, the Committee expressed the view that while under an effective gold standard the rupee would be a token coin, the then existing conditions in India did not warrant the

imposition of a limit on the amount for which rupees should constitute legal tender. The Committee recommended that fresh rupees should not be coined so long as the proportion of gold in the currency did not exceed the requirements of the public. Another recommendation of the Committee was that the profits on coinage should be kept in gold in a special reserve, entirely separate from the Paper Currency Reserve. This reserve, the Committee suggested, should be freely available for foreign remittances, when the exchange rate fell below specie point. In the Committee's view, Government should not be bound by law to give gold for internal purposes, as such an obligation made them liable 'to find gold at a moment's notice to an amount which cannot be defined beforehand'.

The Committee's recommendations were accepted by the authorities in India and England, but what emerged in due course was not a gold standard but broadly the gold exchange standard of Mr. Lindsay, who had always maintained that 'they must adopt my scheme despite themselves'. Whether deserved or not, in course of time India got bouquets for being the first country 'to adopt it in a complete form'. Sovereigns and half sovereigns were made legal tender at Rs.15 to the £, but Government's efforts to popularise the circulation of gold coins were unsuccessful, since there was little demand from the public for these coins. One explanation for this was the prevalence of famine conditions in the country about that time; another was that the value of English gold coins was too high for convenient use for an average Indian with low income.

Steps were taken towards setting up a mint in India for gold coinage, but the scheme was dropped in 1902 mainly at the instance of the U.K. Treasury which argued that the failure or only partial success of a gold mint, on account of the poor demand for gold coins, would 'be pointed to by the opponents of the gold standard policy (although without justification), as evidence of the breakdown of that policy'.

Gold Reserve

The recommendation to constitute a reserve out of the profits on coinage was implemented, not by the keeping of gold in India as the Government of India desired, but by investment in sterling securities, for which purpose, gold was shipped to London, this gold being taken out of the Paper Currency Reserve in exchange for the freshly coined rupees. The new reserve though saw gold, came to be known as the 'Gold Reserve'! Later, it was realised that shipment of gold from India to augment the reserve was 'needlessly expensive' and it was decided to use the device of Council Bills. In 1904, the Secretary of State announced a standing offer to sell Council Bills, without limit,

at 1S. 4 $\frac{1}{8}$ d. Later, in 1906, a branch of the Gold Reserve was established in India, called Silver Branch, consisting of coined rupees, to meet the demand for rupees and prevent the rupee going above 1S. 4d. The London reserve was intended to prevent the rupee from going below 1S. 4d. and also to enable the Government of India and the Secretary of State to meet their sterling obligations, in the event of an inadequate demand for Council Bills. The name of the reserve was changed to 'Gold Standard Reserve', with two parts, sterling and rupee.

Chamberlain Commission

A few years later, i.e., in 1907-8, the exchange arrangements were put to severe test with the balance of trade turning against India. Government were requested by exchange banks to issue telegraphic transfers on London, but they refused to accede to the request, as in view of the low Treasury balances the request could only be met by drawing on the gold in the currency reserve in London, and that would have been contrary to the purposes for which the gold was maintained. Government also restricted the issue of gold for export to £ 10,000 to any individual in one day; they, however, continued to give gold for internal purposes. In the result, the exchange rate declined to 1S. 3 $\frac{23}{32}$ d. on November 23, 1907. In the meantime, on November 21, 1907, the Secretary of State urged the Government of India to ascertain from the banks the amount of gold they wished to take and to allow them to have it, if it was not excessive; such an action, he observed, would restore confidence in the exchange position. The Government agreed to meet the banks' requirements of gold, but they feared that a serious position would arise, if the further demands were substantial and they were unable to meet them. In this context, the Secretary of State suggested that Government, in addition to releasing gold, should invite tenders for telegraphic transfers of £ 250,000 on London at rates not exceeding 1S.3 $\frac{27}{32}$ d. However, it did not become necessary to implement this suggestion, as the exchange rate improved in the meantime. Later, the exchange rate again weakened and so, in March 1908, weekly sale of Reverse Councils on London at the rate of 1S.3 $\frac{29}{32}$ d. was resorted to and this went on till September 1908, by which time the exchange became strong. Following this crisis, steps were taken to make the Gold Standard Reserve more liquid and an earlier decision to spend half of the coinage profits on capital expenditure on railways was also rescinded.

Thus, by 1913, when another commission was appointed, no definite standard had been established in India. The proposals for gold coinage and a gold mint were revived in India in 1911-12 and a resolution to this effect was also moved in the Legislative Council. A Royal

Commission, headed by Mr. (later Sir) Austen Chamberlain was appointed to enquire into this and other currency matters; Mr. J. M. Keynes was a member of this Commission. On the Indian currency and exchange arrangements the Chamberlain Commission remarked:

The system actually in operation has accordingly never been deliberately adopted as a consistent whole, nor do the authorities themselves appear always to have had a clear idea of the final object to be attained. To a great extent, this system is the result of a series of experiments.

But the Commission went on to endorse the prevailing system! In other words, the Chamberlain Commission recommended the continuance of what around this time came to be labelled by Keynes as the gold exchange standard, as in its view the people of India neither desired nor needed 'any considerable amount of gold for circulation', and the currency generally suitable was one consisting of rupees and notes. The Commission made detailed recommendations on other matters too. In the Commission's view, the profits from coinage should continue to be credited exclusively to the Gold Standard Reserve, a much larger proportion of which should be held in actual gold; the Indian branch of the Gold Standard Reserve should be abolished, that is to say, the whole of the Reserve was to be located in London. With a view to imparting greater elasticity to the paper currency system, the Commission recommended an increase of the fiduciary issue from Rs. 14 crores* to Rs. 20 crores, with adjustments in the future to a level equivalent to the notes held in the Reserve Treasuries plus one-third of the note circulation. In the Commission's view, the independent Treasury system was not an ideal one; it was responsible, to some extent, for the recurrence of stringency in the Indian money market, and compared unfavourably with the system of keeping Government balances at a bank. The busy season in India coincided with the season of maximum revenue collection, and as the funds were not immediately needed by Government, the Commission suggested grant of secured loans to the Presidency Banks with a view to relieving stringency. Finally, the Commission recommended that Government should definitely undertake to sell Reverse Councils (that is, sterling on London) at the rate of 1S.3 29/32d., to the full extent of their resources.

Impact of World War

Soon after the Commission's report was submitted, war broke out and so action could not be taken on all the recommendations. The war had a tremendous impact on the currency mechanism. Initially, the

* The fiduciary issue had been raised from time to time from Rs. 4 crores in 1862 to Rs. 14 crores by 1911.

exchange weakened and the situation was met by sale of Reverse Councils between August 1914 and January 1915. Thereafter, the system worked smoothly, on the whole, till about the end of 1916, when it broke down. There was exceptional demand for rupees on account of a favourable trade balance and the large expenditure in India on behalf of the Imperial Government. In normal times, imports of precious metals would have played an important part in liquidating a favourable trade balance, but during the war, restrictions were imposed on exports of gold by belligerent countries, while there was a shortage of silver. As the Indian rupee was a silver coin, there was a phenomenal increase in the demand for the metal, the price of which in the international market shot up from 27 ¼ d., the highest in 1915, to over 43d. per standard ounce by August 1917 -the point at which the exchange value of the rupee at 1S.d. became equivalent to the value of the bullion contained in it. The price of silver rose further to 55d. by September 1917, and reached 79d. by December 1919. The rise beyond 43d. in the price of silver had to be followed by a corresponding stepping up of the exchange value of the rupee, as sale of Council Drafts at the old rate would have involved considerable loss to Government ; also, the rupee, undervalued at 1S. 4d would have disappeared from circulation for melting and export. In these circumstances, in August 1917, the Government abandoned the old rate and, shortly afterwards, announced that in future the price at which Council Drafts would be sold would depend on the price of silver. Consequently, the rate of exchange was stepped up until it reached the level of 2s.4d. (for T.Ts.) in December 1919. The rapid increase of the currency circulation and the difficulties of obtaining sufficient quantities of precious metals for coinage purposes and as backing for note issue also called for substantial increases in the fiduciary portion of the note issue, which was taken to Rs. 120 crores by 1919. Measures were taken to economise the use of silver, through the issue, for the first time, of Rs. 2 ½ and one rupee notes and by extending the use of nickel for the small coins. Further, facilities for encashment of notes at district Treasuries were withdrawn in a large measure. Despite these measures, large quantities of silver had to be imported. Also, gold mohurs and sovereigns were coined and issued to supplement the silver currency. Government also effected substantial gold sales. Several fiscal measures were also taken to mobilise resources through taxation and extensive borrowing; from October 1917, short-term Treasury bills were issued.

Babington Smith Committee

In the meantime, in May 1919, the Secretary of State appointed another expert committee under the chairmanship of Sir Henry

Babington Smith to examine the effects of the war on the Indian exchange and currency system and practices and to make recommendations for 'ensuring a stable gold exchange standard'. In other words, the terms of reference precluded the Committee from considering alternative monetary standards, its main responsibility being to suggest measures for the re-establishment of the gold exchange standard, which had been overthrown during the war period by the steep rise in the price of silver. The main recommendation of the Committee (Majority Report) was the stabilisation of the rupee at 2s. gold ; the rupee was to have a fixed exchange value in terms of gold at the rate of 11.30016 grains of fine gold, i.e., 1/10th of the gold content of the sovereign. The view was that the high exchange rate of the war time had mitigated a rise in Indian prices and had resulted in substantial saving in Home Charges in terms of rupees. The Committee recommended that the Government of India should be authorised to announce, without previous reference to the Secretary of State as was the practice till then, their readiness to sell Reverse Councils (i.e., sterling bills) during periods of exchange weakness. It should be noted that the exchange rate on the eve of the appointment of the Committee was IS. 8d.; it had risen to 2s.4d. by December 1919. The Committee agreed with the Chamberlain Commission that it was not in India's interest to encourage the use of gold coins. Further, in view of the then shortage of silver, it recommended that the obligation on the part of Government to give rupees for sovereigns should be withdrawn. With a view to imparting elasticity to the note issue, the Committee recommended that Rs. 5 crores of additional note issue, based upon commercial bills of exchange, should be made by way of an experiment; the issue was to take the form of loans to Presidency Banks on the collateral security of bona fide commercial bills endorsed by them and having a maturity not exceeding 90 days. Mr. Dadiba Merwanjee Dalal, who disagreed with his colleagues 'on vital currency principles', and, in particular, the 2s. ratio, submitted a Minority Report; he advocated 1s.4d. ratio. The recommendations of the Majority Report were accepted by the Secretary of State, but the efforts to implement them proved disastrous. There was apparently little faith among the public in the ability of the authorities to maintain the high rate of exchange and so there was strong demand for remittance to the U. K. As a result, Reverse Councils had to be offered by Government on a large scale; the rate varied from 2s.3 29/32d. sterling to 2s.10 29/32d. sterling, corresponding to 2s. gold. The attempt to fix the price of sovereign at Rs.10 was a failure; the coins disappeared from circulation. As the efforts to hold the rupee at 2s. gold failed, Government attempted, from June 24, 1920, to maintain the exchange rate at 2s. sterling, but even this effort had to be given up in September

1920, and the rupee was allowed to find its own level. Applications for sterling continued to be substantially in excess of the amounts offered; as against the weekly offer generally maintained at £ 2 million up to April 22, 1920, and at £ 1 million thereafter, the amount applied for was over £100 million in several weeks. Reverse Councils sold since the beginning of the year till September 28, 1920 aggregated £ 55.4 million; the resultant currency contraction was insufficient to arrest the downtrend in the exchange rate, which fell even below 1S. 3d. sterling or 1S. gold in early 1921. But gradually, conditions began to improve and the rupee reached 1S. 4d. sterling in January 1923 and rose further to 1S. 6d. sterling (or 1S. 4d. gold) by October 1924. With the return of sterling to gold in April 1925, the exchange rate of the rupee (1S. 6d.) came to be on a sterling cum gold basis.

Hilton Young Commission

After a period of what has been called ‘masterly inactivity’, the Government appointed in August 1925 a Royal Commission on Indian Currency and Finance, under the chairmanship of Lt. Comdr. Edward Hilton Young, ‘to examine and report on the Indian exchange and currency system and practice, to consider whether any modifications are desirable in the interests of India, and to make recommendations’. The report of the Commission, submitted in July 1926, was a very comprehensive one; the Commission’s recommendations were also of a far-reaching character. On a review of the Indian currency system, it came to the conclusion that the system as it existed was far from simple and that there was:

a cumbrous duplication of reserves, with an antiquated, and dangerous, division of responsibility for the control of credit and currency policy.

The Commission characterised the Indian system as inelastic and remarked:

the system does not secure the automatic expansion and contraction of currency. Such movements are too wholly dependent on the will of the currency authority.

Further, the Commission observed:

India is perhaps the only country, among the great trading countries of the world, in which the Government exercises direct control over currency in general and over the note issue in particular. The banking and currency reserves of the country are thus separated, which diminishes their capacity to effect their specific purpose of stabilization in the most economical and efficient manner.

After considering the various alternatives, the Commission came to the conclusion that:

in order to secure public confidence in India, the currency of the country must be linked with gold in a manner that is real and conspicuously visible, or, in other words, that it is necessary to establish a true gold standard.

What the Commission recommended, however, was not the traditional gold standard, but a gold bullion standard, that is to say, gold would not circulate as money, but the currency authority would be under an obligation to buy and sell gold, without limit, in quantities of not less than 400 fine ounces 'at rates determined with reference to a fixed gold parity of the rupee'. The legal tender feature of the sovereign and the half sovereign was accordingly to be removed.

The Commission was against putting gold into circulation, for a number of reasons ; the more important of these were: (i) if gold in the reserve was transferred to circulation, it would result in a reduction in the structure of credit that could be built on the reduced reserve and the elasticity of the currency system would thus be lessened; (ii) any large extra demand for gold from India would increase competition for gold among the leading gold consuming countries and would lead to a substantial fall in gold prices of commodities and a curtailment of credit; and (iii) the amount of gold needed for currency purposes could not be estimated. The last of the reasons just mentioned requires some explanation. In view of the great attraction the Indian public evinced for gold, it was feared that even those in the habit of using notes might turn to the use of gold coins. Further, the fall in the value of silver, which was expected to result from the introduction of gold currency, might shake public confidence in the white metal as a store of value and enhance the demand for gold.

As regards the rates at which the currency authority should buy and sell gold, the Commission remarked that though the obligation on the currency authority to buy and sell gold at a price equivalent to the par value of the currency was implicit in a sound gold standard, India's case was different. India needed gold not only for monetary purposes, but absorbed large quantities for purely social uses,, and there was an organised bullion market through which the demand for gold could be met. Hence, the conditions governing sale of gold by the currency authority had to be so framed as to free it from supplying gold for non-monetary purposes in normal times. The Commission, therefore, recommended the fixing of the selling price of gold above Rs. 21-3-10 per tola the fixed parity of the rupee-when the telegraphic transfer rate on London was below the upper gold point. If this was not done, the currency authority would become the cheapest market

for gold in India. Also, sale of gold at above the parity price would enable the currency authority to replenish its gold stock without loss by importing from London.

The Commission recommended the amalgamation of the Paper Currency Reserve and the Gold Standard Reserve.* The composition of the combined reserve was to be fixed by Statute, gold and gold securities forming not less than 40 per cent of the reserve. The silver holdings in the reserves were to be gradually reduced and the legal obligation to convert the paper currency into silver rupees was to be terminated in respect of new notes to be issued. Another of the Commission's recommendations was to reintroduce one rupee notes, which were to be full legal tender but were not to be convertible by law into silver rupees. With regard to the parity of the rupee, the Commission recommended 1S. 6d., to which rate, in its view, prices in India had adjusted substantially vis-a-vis the world at large. Finally, the Commission also recommended the establishment of a central bank for India and made detailed proposals in this behalf; this has been dealt with in Chapter 1.

There was a minute of dissent by Sir Purshotamdas Thakurdas, covering a wide ground; in particular, it opposed the 1S. 6d. ratio, advocating instead 1S.4d. Sir Purshotamdas considered that the level of 1S. 6d. attained for some time past was an artificial appreciation. He was also, as mentioned in Chapter 1, in favour of developing the Imperial Bank of India into a full-fledged central bank instead of setting up a new institution.

The Commission's recommendations were accepted by Government and, in January 1927, the Government published three Bills embodying the recommendations, namely, the Gold Standard and Reserve Bank of India Bill, a Bill to amend the Indian Coinage Act, 1906, and the Indian Paper Currency Act, 1923, and finally a Bill to amend the Imperial Bank of India Act, 1920. The fate of the first Bill has already been described in the preceding chapter. The third Bill is not of direct relevance for our purpose here. So far as the Currency Bill was concerned, progress was rapid; it was passed in March 1927 and came into effect on April 1. In terms of the Act, the exchange value of the rupee was established at 1S. 6d., the gold equivalent of the rupee being

* On March 31, 1926, that is, a little prior to the submission of the report the Gold Standard Reserve of E40 million was all held in sterling securities; the composition of the Paper Currency Reserve, amounting to Rs. 193 crores, was as follows :

| | Rs. crores. |
|-------------------------|-------------|
| Gold Coin and Bullion | 22.32 |
| Silver Coin and Bullion | 84.91 |
| Sterling Securities | 29.00 |
| Rupee Treasury Bills | 47.11 |
| Rupee Securities | 10.00 |

See Tables at the end for the composition of the two Reserves for some selected years till 1935.

8.47512 grains fine. Sovereigns and half sovereigns were demonetised, but Government were to receive them, at all Currency Offices and Treasuries, at their bullion value. A statutory obligation was imposed on Government to purchase gold at Rs. 21-3-10 per tola fine in the form of bars containing not less than 40 tolas (equivalent to 15 oz.) fine gold and to sell, in exchange for Indian legal tender currency, gold for delivery at the Bombay mint, at the rate of Rs. 21-3-10 per tola, or, at the option of the Controller or the Deputy Controller of the Currency, sterling for immediate delivery in London at an equivalent rate, in amounts of not less than 1,065 tolas (approximately 400 oz.) fine gold, or the corresponding amount of sterling, respectively. This was the first time that a statutory obligation was imposed on the currency authority to buy and sell gold at a fixed parity. As regards sales, it will be noticed that an option was given to Government to give gold or sterling. So long as sterling was on the gold standard, it made little difference. It may thus be said that the Currency Act of 1927 established a gold bullion cum sterling exchange standard.

The fixation of the rupee at 1S.6d. was effected in the face of strong opposition from the Legislature as also the public at large. Sir Basil Blackett, the Finance Member, justified the 1S.6d. rate on the ground that :

The de facto ratio holds the field, has held the field for nearly two years, is working reasonably well, has brought about stability and increased confidence all round, has helped enormously to restore balance and stability to budgets and in a special degree to secure for the agriculturist a fair price for his produce. And the onus of proof that some other ratio ought to be substituted for it rests with the advocates of that other ratio.

Sir Purshotamdas Thakurdas, who gave the toughest fight to Government on the ratio question, in the Legislature and outside, questioned why Government did not fix the rate at 1S.4d. in October 1924 when 1S.4d. gold was the prevailing rate at that time, pointing out : ‘ If you leave exchange uncontrolled whenever there is a balance of trade in favour of India, exchange must go up ‘. He also asked Government whether it was a fact that they had accelerated the policy of working up the ratio beyond 1S.4d. gold by starving the country of normal expansion of currency during 1921 to 1927. According to Sir Purshotamdas :

We ask for 1S. 4d. because 1S. 4d. was on the Statute-book till 1914 India’s is the only currency which got least disturbed because 1S.4d. gold was only disturbed for a period of three years, and even then it was 1S.5d. and not 1S.6d.. . . .1S.4d. gold was longest in existence during the last 12 years and as a matter of fact it was exceeded only for about 18 or 20 months.

Sir Purshotamdas, however, lost the battle; the 1S.6d. ratio was put on the Statute-book by the Currency Act of 1927. The ratio controversy, however, did not subside. It went on even after the Reserve Bank was set up.

TOWARDS AN EXCHANGE STANDARD (1927-35)

The subsequent events relating to money and exchange till the establishment of the Reserve Bank may be referred to briefly. In the first three years or so, with substantial favourable trade balance, exchange remained on the whole strong and the 1S.6d. rate appeared to work all right. From 1930, however, India also shared in the world-wide economic depression. Prices of agricultural commodities registered a steep fall, while redundancy of floating money characterised the economy, resulting in severe strain on foreign exchanges. Politically also the situation was quite disturbed on account of the civil disobedience movement launched by the Indian National Congress. There was a tendency on the part of investors to remit their money abroad; a contributory factor was anticipation of a lowering of the exchange rate of the rupee as a result of political pressure. Consequently, Government had to effect sales of sterling in some months. Attempts were also made by Government to withdraw short-term money through issues of Treasury bills.

Abroad, the economic situation changed from bad to worse. The Bank of England, which had made liberal credits abroad, found itself in difficulties. The British Bank rate was raised in stages from 2 ½ to 4 ½ per cent in July 1931, substantial credits were obtained from abroad, and an emergency budget providing for drastic taxation and retrenchment was introduced. Finally, on September 21, 1931, Great Britain was forced to abandon the gold standard; the Bank rate was raised further to 6 per cent and a system of exchange control was introduced.

Earlier, in India, Government had to sell sterling, amounting to £11million, between the beginning of August and September 19, 1931, to maintain the rupee at the lower exchange point. Following the British Government's decision to abandon the gold standard, the Governor-General in Council issued on the same day (September 21) an Ordinance removing the obligation placed by the Currency Act of 1927 to sell gold or sterling. This was followed by an announcement on September 24 that the rupee would be linked to sterling at 1S.6d. On the same day, another Ordinance, called the Gold and Sterling Sales Regulation Ordinance*, was promulgated, repealing the Ordinance issued on September 21 and practically restoring the Currency Act of 1927. However, gold or sterling was to be sold only to recognised

* This was repealed on January 30, 1932.

banks for financing (i) genuine trade requirements, (ii) contracts completed before September 21, and (iii) reasonable personal or domestic needs, and was not to be made available for financing imports of coin or bullion or for liquidation of over-sold exchange position. The control was to be exercised through the agency of the Imperial Bank of India.

Following the departure from gold, sterling depreciated in terms of gold. Since the rupee-sterling ratio remained unchanged, this meant depreciation of the rupee too in terms of gold, or, in other words, a rise in the price of gold in terms of rupees. The price in Bombay rose from around Rs. 21-4 per tola in August 1931 to Rs. 30-12 in December 1931. In the next three and odd years, while there were fluctuations in the quotations, the trend was upward, the highest quotation before April 1935 being Rs. 36-12. However, the price of gold in India, on the basis of the exchange rate of the rupee around 1S.6d., was lower than the price prevailing abroad practically throughout; the disparity in prices made the export of the metal profitable, which phenomenon continued for almost a decade. Thus, in 1931-32, there were net exports of 7.7 million ounces, valued at Rs. 57.98 crores. In the following year, both the quantity and the price rose further, net exports totaling 8.4 million ounces, valued at Rs.65.52 crores. In the ten years ended March 1941, total net exports were of the order of 43 million ounces valued at about Rs. 375 crores, or an average price of Rs. 32-12-4 per tola.

There was a great deal of controversy on the reasons for this unprecedented export of the metal. One view was that it reflected the economic distress following the depression; another view was that the sales were commercial transactions intended to benefit from the rising trend of prices. There was also a view that the rupee was undervalued in terms of gold on the basis of the prevailing price of the metal abroad and the exchange rate of 1S.6d. Whatever be the reasons-and undoubtedly these various factors were at work-public opinion in India was extremely critical of the failure of Government to check the exports and its unwillingness to buy the gold to build up the country's metallic reserves. The official view was that, while it was probably true that a certain proportion represented distress sales, the larger proportion was sold to realise profits from exports, it was not proper for Government to interfere with this and that in any event, the exports had strengthened the country's foreign exchange reserves, exchange rate and credit abroad.

Unfortunately, Government did not take advantage of the improved external reserves position to initiate a policy of reflation which the Indian economy needed badly. Had there been such a policy, it could have been argued by the authorities that sterling accruals from

the export of gold were as helpful as direct purchases of gold by the authorities in India. It needs to be pointed out, however, that in those years of uncertainty, gold possessed certain advantages over holdings of sterling as currency reserve and some increase in official gold stocks would have been in order. It turned out later, during World War II, that gold had to be imported at substantially higher prices, in order to restrain inflation. In the midst of these controversies, one thing was clear, viz., that Indian gold exports contributed to a substantial extent to the strengthening of the Bank of England's reserves.

Following sterling's departure from gold, the price of silver in terms of sterling and rupees also recorded some rise after the continuous fall for several years. Government sales, mainly in the form of rupee coins, were made in larger quantities. The bulk of it was exported. In the four years 1931-35, India was a net exporter, for the first time, to the extent of 117.7 million ounces, valued at Rs. 14.2 crores.

SUMMING UP

In the hundred years prior to the establishment of the Reserve Bank of India, the country remained on a silver standard for a period of almost sixty years, that is, until the closure of Indian mints to the free coinage of silver in 1893. During this period, there was also the introduction of paper currency, in 1862. From 1893 onwards, while efforts were made by Government towards the establishment of a gold standard, in response to the persistent demand from Indian interests, none of the systems which were adopted in practice fulfilled the essential requirements of a gold standard. The 'effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold' envisaged by the Fowler Committee in 1899 did not materialise. Government's efforts to popularise circulation of gold coins were largely infructuous. Perhaps, the public demand for a gold standard in India was motivated more by the desire to ensure free availability of gold for investment of savings and a stable exchange rate for safeguarding its commercial interests than by the desire to have gold coins in circulation. With sterling on a gold basis and the maintenance of the rupee at 1S. 4d. for a fairly long period, the system, which emerged in due course, operated as a gold exchange standard. Of course, gold could be procured freely through imports which were at no time, except during the war, subjected to restrictions. However, the price of silver continued to be the dominant factor in determining the external value of the rupee as was clearly demonstrated during the First World War. Although the Hilton Young Commission (1926) recommended a full-fledged gold bullion standard, it was whittled down in the Currency Act of 1927 by freeing the currency

authority from the obligation to sell gold without limit. Since Government had the option of giving gold or sterling against rupees, in terms of that Act, and since sterling was on a gold basis, the system continued to work, in effect, as a gold exchange standard, until September 1931. With the departure of sterling from gold, only the link with sterling remained and the currency system came to be on a sterling exchange standard.

The controversies and debates on monetary matters in the years prior to the establishment of the Reserve Bank of India hardly referred to the sterling link. Rather, they centred round the matters of reflation of the economy from the slump and of the exchange rate of the rupee. The two were inter-connected, in that, after the depression set in, a lowering of the exchange rate would have assisted recovery of the economy. The Indian national opinion was near unanimous in the view that the 1S. 6d. ratio meant substantial overvaluation of the rupee and was responsible for deepening and prolonging the economic depression. A lower ratio, such as, 1S. 4d., if not an even lower one, was widely favoured. The unwillingness of the Government to heed the national sentiment in the matter of the exchange rate would appear to be due to a number of reasons. Perhaps, to an extent it was a prestige issue. Having accepted, rightly or wrongly, the recommendation of the Hilton Young Commission for 1S. 6d. ratio, apparently Government were reluctant to lower it, preferring to sustain the ratio through downward adjustment in domestic prices and costs mainly by fiscal devices. But it would seem that two other factors were at work in support of the 1S. 6d. ratio. One was the interests of the British officials in India, civil and military. Since their salaries were fixed in terms of rupees, a high ratio enabled them to obtain a larger remittance in sterling. They were not exposed to the hazards of any resultant unemployment! A higher rupee ratio was also favoured by the India Office, obviously in the interests of British manufacturers. In those years, when the British economy was trying to recover from the effects of world depression, some overvaluation of the rupee provided an incentive to British exports, though an expanding Indian economy would have provided an even better stimulus to British exports. Government spokesmen also argued about the budgetary difficulties that would arise from a lowering of the exchange rate, as it would have meant larger rupee requirements for meeting the Home Charges. This was, however, a restricted view since, with an expanding economy, it would not have been difficult to mobilize sufficient resources for meeting the Home Charges. It should be added that the exchange rate controversy not always ran in terms of pure economic issues; politics and economics were mixed up a great deal.

It should, however, be noted that not always was there identity of views between the British Government at home and the British Government representatives here, especially the Finance Members. For instance, in respect of the 2s. ratio, Sir Chintaman Deshmukh, in an address* delivered in 1948 at the Gokhale Institute of Politics and Economics, Poona, stated: 'It is not so well known that Sir Malcolm Hailey, the then Finance Member, was bitterly opposed to the idea and yet had no alternative, short of resigning his office, but to defend it in the Assembly and the country generally'. Gradually there was some shift of responsibility, in monetary and exchange matters, from the Secretary of State to the Governor-General (and his Finance Member). An example of this was the substantial modification made in the system of sale of Council Bills in the year 1923-24. While the Secretary of State continued to invite weekly tenders in London, the sale of intermediate Bills was discontinued, its place being taken by purchase of sterling, in India, from exchange banks and recognised firms, through the agency of the Imperial Bank. Later, purchase of sterling in India became the normal method of remittance from India. From April 1927, the purchases were made through public tender, intermediates being accepted between the tenders. The object underlying the new system was 'that the factors influencing the immediate course of exchange can be gauged more accurately and more promptly in India, and by regulating the purchases with reference to the varying conditions of the market, the operations of Government could be conducted so as to avoid violent fluctuations in rates with benefit both to trade and to the country generally'. In these and other ways there was a gradual modification of the system under which 'the India Office was blind to the impossibility of conducting business in this fashion after the introduction of the Reforms, and unfortunate Finance Members had to stand up in the Assembly and defend policies to which they were themselves opposed and the absurdity of which was often locally manifest'.**

MONEY MARKET AND THE BANKING SYSTEM

Characteristics of the Money Market

Attention may now be turned to a brief account of the Indian money market and the banking system, prior to the establishment of the Reserve Bank of India. A substantial volume of literature is available on the subject thanks to the exhaustive enquiry into the organisation

* Central Banking in India-A Retrospect.

** Quoted by Sir C. D. Deshmukh, op. cit.

and functioning of the Indian money market and banking carried out in 1929-31 by the Provincial (including some of the princely States) Banking Enquiry Committees and the All-India or the Central Committee. The Central Committee's Report covered wide ground. It traced the development of banking in India, described at length the functioning of the banking system and the money market, including, in particular, the working of the Imperial Bank, and considered in detail the subject of regulation of banking. It also made a detailed survey of rural finance and the financial requirements of industries and trade. On all these matters, the Committee made detailed recommendations. This Report is still the most comprehensive single source of information for the period and is a fairly well-known document too. It is not necessary, therefore, to give here a detailed account of the growth and structure of Indian banking.

The outstanding feature of the Indian money market was its dichotomy; it consisted of two fairly distinct sectors, the organised and the unorganised. These two were not entirely unconnected, but the links were rather loose. The constituents of the organised sector of the Indian money market were the Imperial Bank of India, the exchange banks and the Indian joint-stock banks. The unorganised sector comprised the indigenous bankers, moneylenders, chit fund, nidhis, etc., etc. The co-operative credit institutions occupied a somewhat intermediate position. In the absence of a central bank, the Indian money market suffered from certain defects and deficiencies. On account of the loose links between the several constituents of the money market and the absence of elasticity in the note issue system, the market was characterised by fairly sharp imbalances between the supply of and the demand for money and credit, both regionally and seasonally. The spread in interest rates between the busy and the slack seasons, for instance, was quite sharp, as much as 5-6 percentage points. Similarly, the regional variations in interest rates were also marked.

It was mentioned in Chapter 1 that the Imperial Bank was also a quasi-central bank. However, as will be explained later, there were severe limitations to the Imperial Bank's role as a bankers' bank, in meeting the residual requirements of the money market for funds. To an extent, the requirements of the busy season were met by the inflow of funds through the exchange banks. Although there was an inter-bank call market, it was not an integrated one. The Imperial Bank operated in a world of its own. Likewise, the exchange banks and the Indian joint-stock banks had not much contact with one another.

If the links within the organised money market were weak, they were even weaker as between the organized and the unorganised sectors. The main channel of transmission of funds from the organised sector

was the discounting of hundis*, done on a modest scale, by the Imperial Bank of India and some leading Indian joint-stock banks. The cooperative institutions also provided some link between the two sectors; primarily they channelled resources to the unorganised sector, especially the rural sector, and, to some extent, got credit facilities from the organised sector, especially the Imperial Bank of India.

GROWTH OF COMMERCIAL BANKING

Imperial Bank of India

A brief account may now be given of the growth of Indian banking, which may well begin with the Imperial Bank. Something has already been said, in various contexts, in the previous chapter, on the organisation and functioning of this bank, and its predecessor institutions, the Presidency Banks. Some further aspects of the bank's working may be briefly mentioned now. The table below sets out the data relating to the Imperial Bank, in 1921 (its first year), 1928 and 1934 (the year prior to the Reserve Bank's establishment).

| As at the End of | (Rs. crores) | | |
|-----------------------|--------------|-------|-------|
| | 1921 | 1928 | 1934 |
| Capital and Reserves | 9.64 | 10.85 | 10.98 |
| Deposits | 72.58 | 79.25 | 81.00 |
| Government : | 6.80 | 7.95 | 6.72 |
| Others | 65.78 | 71.30 | 74.28 |
| Credit Extended | 53.90 | 61.60 | 29.01 |
| Investments | 12.46 | 21.76 | 41.56 |
| Government Securities | 11.17 | 19.04 | 41.56 |
| Other Securities | 1.28 | 2.72 | |
| Cash | 13.68 | 10.65 | 19.03 |

The sharp decline in the credit extended by the bank, between 1928 and 1934, was largely due to the economic depression.

The Imperial Bank was permitted under its Statute to engage in nearly all types of commercial banking business, except dealing in foreign exchange. The bank also functioned as a bankers' bank, in the sense that voluntarily most banks maintained balances with it and could obtain accommodation from it. The Imperial Bank also managed clearing houses and provided remittance facilities between its branches, to other banks and the public. The bank's obligation to open 100 branches within five years of its establishment was also of considerable help to the banks and the public generally. Reference has already been made to the bank's acting as banker to Government.

* Loosely referred to as indigenous bills of exchange, these are really promissory notes, generally of an unsecured character, repayable mostly within 90 days.

There were severe limitations to the Imperial Bank's role as a bankers' bank. The fact that the Imperial Bank was a commercial bank was a deterrent to other institutions obtaining accommodation from that bank. Further, since the Imperial Bank did not have the power of issuing notes, it had to turn to Government now and then for replenishing its resources, but the arrangements in this behalf were not elastic. Some provision was made for this through advances from the Paper Currency Reserve. Originally, the Imperial Bank could borrow notes up to Rs. 5 crores against bills of exchange; in 1923, this was raised to Rs. 12 crores. The bank had to pay interest at its current Bank rate, subject to minima varying from 6 to 8 per cent on the different slabs of borrowing. Later, there was some lowering of the upper limit of the minima to 7 per cent. Besides the high cost of this accommodation, there was another difficulty, namely, that the bank had to get the demand promissory notes of its constituents converted into usance bills, since the credit had to be against trade bills, and there was a dearth of these bills. This meant some expenditure on stamp duty apart from the reluctance of the constituents to make this change. In 1931-32, on account of the paucity of trade bills, the Government advanced monies to the Imperial Bank from the Paper Currency Reserve against Government of India rupee securities bought from the bank under a repurchase agreement.

A feature of the Imperial Bank's lending operations was the wide seasonal fluctuations in its Bank rate and Hundi rate. The Bank rate was the rate at which the Imperial Bank was prepared to grant demand loans against Government securities and the Hundi rate was the rate at which the Imperial Bank would discount or rediscount first class commercial bills with a maturity of not more than three months. The Hundi rate was generally equal to or a little higher than the Bank rate. Up to the end of 1932, the rates charged generally varied widely every year ; in the period 1921-32, the Bank rate ranged from 4 to 8 per cent. During the busy season, the practice of the bank was to raise the Bank rate up to 7 or 8 per cent in order to cope-with the heavy pressure on its funds. The level of the bank's busy season rates was dictated partly by the high rate at which the bank itself had to borrow from the Government, as explained in the previous paragraph, and partly by its policy of maintaining a high level of cash. However, from 1933 onwards, the Imperial Bank rate was altered not more than once in a year, if any, its range in the period 1933-51 being between 3 and 4 per cent.

In one respect, however, the Imperial Bank was of assistance to the money market, that is, in mitigating, on a modest scale, the impact of budgetary operations, by virtue of the bank's being banker to Government. Thus, for instance, in times of large payments to Government by

the public, the bank came in possession of interest-free balances, which it could put back at the disposal of the money market through lending.

The only other matter concerning the Imperial Bank, which should be referred to here, is that there was considerable public criticism about its functioning. While obviously much of it was unwarranted, there was a general belief that the bank's operations favoured the European business interests in India and that small industrialists and traders had little access to it. These views, in fact, persisted for many years even after the establishment of the Reserve Bank of India.

Following the passing of the Reserve Bank of India Act, the Imperial Bank of India Act was also amended. Under the amended Act, the Imperial Bank ceased to be banker to Government; it was, however, authorised to enter into an agreement with the Reserve Bank providing for its appointment as sole agent of the Reserve Bank in places where it had a branch but where there was no branch of the Banking Department of the Reserve Bank. The amended Act made certain changes in the constitution of the bank, modified government control over it and also removed some of the restrictions on its activities, such as engaging in foreign exchange business, imposed by the original Act. A few restrictions, like those on land mortgage business, period of loans and advances, loans against shares, etc., however, were retained, since the bank was to continue to conduct Government Treasury business in many places as the sole agent of the Reserve Bank.

Indian Joint-Stock Banks

Turning to the growth of joint-stock banks generally, other than the Presidency Banks, it may be said that banking in India on modern lines was started by the English Agency Houses of Calcutta and Bombay. As in the West, for quite some time these institutions were functioning on the basis of unlimited liability. They also issued currency notes until the privilege was withdrawn in 1862. Though some of the banks were successful, several of the early banks failed on account of speculation and mismanagement.

In 1860, the principle of limited liability was permitted under Indian law. This and the boom conditions in the cotton trade generated by the American Civil War led to a spurt in the establishment of banking companies. Most of them, however, went into liquidation in the wave of speculation and crisis which followed the boom; the sharp fall in the price of silver from 1873 onwards was another contributor factor.

The Swadeshi movement of 1906 gave a fillip to Indian joint-stock banking and several of the present leading banks were established in the next seven or eight years. The period 1913 to 1918 was again a

bad one for Indian banks, with many failures. In the 13 years prior to the establishment of the Reserve Bank, while there was a fair increase in the number of banks, there was hardly any net increase in deposits ; a substantial decline occurred between 1921 and 1928, which was made up later. The growth of joint-stock banks in India since the turn of this century is given in the table below.

(Rs. crores)

| On Dec 31 | | Banks with Paid up Capital and Reserves of Rs.5 lakhs and over | | Banks with Paid-up Capital and Reserves of Rs.1 lakhs and over but less than Rs.lakh | | |
|-----------|-----|--|----------|--|------------------------------|----------|
| | No. | Paid up Capital and Reserves | Deposits | No. | Paid up Capital and Reserves | Deposits |
| 1900 | 9 | 1.28 | 8.08 | .. | .. | .. |
| 1910 | 16 | 3.76 | 25.66 | 23* | 0.50* | 1.51* |
| 1921 | 27 | 12.40 | 76.90 | 38 | 1.00 | 3.26 |
| 1928 | 28 | 11.10 | 62.85 | 46 | 1.20 | 3.50 |
| 1934 | 36 | 12.67 | 76.77 | 69 | 1.49 | 5.11 |

* Data relate to 1913.

The size and standing of the banks varied quite considerably. In the main, like commercial banks in the U.K., Indian joint-stock banks specialised in the provision of short-term credit, mostly for trade. Bank credit was mainly extended in the form of cash credits and overdrafts, rather than bills. The Indian joint-stock banks played very little role in providing finance for agriculture except for the movement of crops in the urban and semi-urban areas. They did not also undertake foreign exchange business, which was the virtual monopoly of the exchange banks.

The matter of bank failures received considerable attention at the hands of the Central Banking Enquiry Committee. After analysing the principal causes, such as insufficient capital and reserves, inadequate liquidity of assets, payment of exorbitant interest rates to attract deposits, injudicious advances, speculative investments, and dishonest and incompetent management, the Committee recommended that a special Bank Act be passed, incorporating the existing provisions of the Indian Companies Act in regard to banking and including new provisions relating to (i) organisation, (ii) management, (iii) audit and inspection and (iv) liquidation and amalgamation. This object was not, however, accomplished till 1949, though efforts in this behalf were made from 1939 onwards.

Exchange Bank

The exchange banks, which numbered 17 on the eve of the establishment of the Reserve Bank, were engaged predominantly in the financing

of foreign trade ; but their share in the financing of internal trade requirements, especially for moving goods between port towns and the interior, was not insignificant. In point of deposit resources, it is interesting that the exchange banks, the Indian joint stock banks and the Imperial Bank were, more or less, on par -around Rs. 70 to 80 crores (see table below).

| (Rs. crores) | | | | | |
|---------------|---------------|---------------------------|----------|----------------|----------|
| On Dec 31. | Imperial Bank | Indian Joint-Stock Banks* | | Exchange Banks | |
| | Deposits | No. | Deposits | No. | Deposits |
| 1900 | | 9 | 8.08 | 8 | 10.50 |
| 1910 | | 16 | 25.66 | 11 | 24.79 |
| 1921 | 72.58 | 65 | 80.16 | 17 | 75.20 |
| 1928 | 79.25 | 74 | 66.35 | 18 | 71.14 |
| 1934 | 81.00 | 105 | 81.88 | 17 | 71.40 |

* Relate to banks with paid-up capital and reserves of Rs. 5 lakhs and over up to 1910 and to Rs. 1 lakh and over thereafter.

Originally, the exchange banks, i.e., all branches of foreign banks, depended primarily on funds from home for meeting their requirements of additional funds in India and this was criticised as unsound and undesirable for the Indian money market. Later, however, these banks developed their Indian deposit business substantially, and this led to complaints of unfair competition vis-a-vis the Indian joint-stock banks!

There was a widespread feeling in the country that all possible steps should be taken for encouraging Indian banks to engage in foreign exchange business and that the restriction on the Imperial Bank's financing of foreign trade should be removed. There was also the suggestion that an Indian Exchange Bank should be established.

The feeling was also strong that national interests demanded some regulation of the operations of the exchange banks. The Central Banking Enquiry Committee made several recommendations for this purpose. Apart from those relating to their method of operations, an important suggestion was the licensing of Indian offices of the exchange banks by the proposed Reserve Bank, with a view to giving the latter some control over the foreign banks operating in the country. For obtaining a licence, the banks were to be required to satisfy certain conditions, viz., (a) furnishing the Reserve Bank with annual statements showing the assets and liabilities relating to their Indian business and periodic reports of Indian and non-Indian business handled by them, and (b) fulfilling such other stipulations as might be imposed on them on the basis of reciprocity.

Banking Offices

A word may be said regarding the number of banking offices in India on the eve of the establishment of the Reserve Bank of India. The distribution of offices among the major categories of banks was as follows:

| | Head Office | Branches |
|----------------------------|-------------|----------|
| Imperial Bank . | 3 | 160 |
| Exchange Bank | --- | 98 |
| Indian Joint- Stock Banks. | 320 | 688 |
| | 323 | 946 |

This gave roughly one office per 3 lakhs of the population. The position was, in fact, worse, as these 1,269 offices were located in only about 475 towns *. The remaining 2,100 or so towns and the villages where the bulk of the population lived were not provided with banking facilities, other than the limited services provided by co-operative institutions and indigenous bankers. The scope for expansion of banking facilities was thus immense.

CO-OPERATIVE INSTITUTIONS

For some decades, that is, since long before the organisation of the Reserve Bank, great faith has been placed in India in the potentialities of the co-operative organisation to serve the credit needs of the country, especially of the rural sector. The Royal Commission on Indian Agriculture (1928), while talking about the co-operative movement, observed that 'if Co-operation fails, there will fail the best hope of rural India'. The Central Banking Enquiry Committee agreed wholeheartedly with the opinion of the foreign banking experts on commercial banks, expressed in the following terms:

The co-operative movement in spite of imperfections and of unavoidable set-backs deserves every possible assistance from all quarters, because there is no better instrument for raising the level of the agriculturist of this country than the co-operative effort, and a strong appeal to the banking interests of the country to assist this movement seems not at all out of place.

* The census code provided for the treatment as a town of every municipality, all civil lines not included in municipal limits, every cantonment and every other continuous collection of houses, inhabited by not less than 5,000 persons, which the Superintendent of Provincial Census Operations decided to treat as urban. In making this decision the Census Superintendent was instructed to take into consideration the character of the population, the relative density of the dwellings, importance in trade and historic associations, and to avoid treating as towns overgrown villages without urban characteristics.

Though a few co-operative institutions had been organised in the closing years of the 19th century and registered under the Companies Act, it may be stated that the real start to the co-operative movement was given by the passing of the Co-operative Societies Act of 1904. It became evident that no real advance in the organisation of cooperative societies was possible without legislation and that the Companies Act, with its 256 sections and elaborate provisions was wholly unsuited for this purpose. The Act of 1904 was simple and elastic, the aim being to lay down merely the general outlines and leave the details to be filled in gradually on the lines which the experience of failure or success and the natural development of the societies might indicate as best suited to the different parts of the country. The Government of India also advised the local Governments that, until further experience had been gained, their intervention should be limited strictly to essentials so as to permit spontaneous growth of the societies. The Act enabled the formation of thrift and credit societies by any 10 or more persons over the age of 18 and living in the same town or village. Such societies were given a legal personality and authorised to raise funds and carry on their business in a corporate capacity. The societies registered under the Act were classified as rural or urban according to the composition of their membership. The liability of a member in a rural society was to be unlimited while in the case of an urban society the choice was given to the society to have unlimited or limited liability. Loans could be made only to members on personal or real security but not on chattel security. The interest of a member in the share capital of a society was strictly limited. The societies were subject to audit and inspection by officers deputed by Government and were exempt from income-tax, stamp duties and registration fees.

The example of credit societies registered under the Act led to the setting up of co-operative societies for purposes other than credit, in particular distribution, and also to the formation of various central agencies for financing and controlling the credit societies registered under the Act. These institutions, which did not come under the purview of the 1904 Act, ran all the risks attendant on a status unprotected by legislation. A new Act was, therefore, passed in 1912 to give legal recognition to these types of societies and also to solve many of the problems which arose while administering the earlier Act. It was observed that the immediate effect of the 1912 Act was to infuse a fresh energy into the movement. It also led to a rapid growth in the number of central institutions.

The next important development in the growth of the co-operative movement was the publication of the Report of the Maclagan Committee on Co-operation in 1915. One of the recommendations made by the Committee was the establishment of provincial co-operative banks.

By 1930, such banks had been established in all the major Provinces in India except the United Provinces, where it was established in 1944. The co-operative organisation for agricultural credit thus came to be established in three tiers, namely, the provincial co-operative banks at the apex level, the central co-operative banks at the intermediate level and the primary credit societies at the base, the last constituting the pivot of the movement,

Co-operation became a Provincial subject in 1921, in terms of the Government of India Act, 1919. In the early years after the transfer, the Development Ministers of the Provincial Governments evinced much interest in the movement and by the time the Central Banking Enquiry Committee submitted its report in 1931, there had been a large addition to the number of societies all over India. Some of the Provincial Governments passed their own Co-operative Acts in replacement of the all-India Act of 1912. After the initial enthusiasm, somewhat indiscriminate expansion, exploitation by a few influential members and widespread failures, the Provincial Governments found that attention should be directed towards the consolidation and rectification of existing societies rather than to a further rapid expansion. For this purpose, they instituted committees of enquiries into the working of the co-operative movement in their respective Provinces.

An important feature to be noticed about the co-operative movement in India was that it was largely Government-sponsored. As Sir Horace Plunkett, a co-operator of international repute, remarked:

the widely spread and numerous supported Indian Co-operative Movement would more accurately be called a Co-operative Policy. It was created by 'resolutions' (to all intents and purposes laws) of the Central Government and has been administered almost wholly by the ablest civil service in the world. A huge posse, now nearly all Indian, of Registrars, Assistant Registrars, Auditors and Accountants, inspects, supervises, and largely controls the co-operative societies scattered over the continent.

Right from the beginning up to the Second World War, the co-operative movement was predominantly of the credit type and confined to rural areas. The Central Banking Enquiry Committee had this to say on the subject:

It must, however, be mentioned that in spite of the removal of the limitations imposed by the original Act (Act of 1904), and the creation of scope for several forms of non-credit activities, the preponderating element in Indian co-operation is still credit. This appears to be natural not only because credit is the simplest example of co-operative endeavour that can be introduced among a rural population which is largely illiterate, but also because credit continues to be the most

insistent need of the Indian cultivator, who is weighed down by the burden of usury and chronic debt which crush the "life and thought" of rural India.

The growth of the co-operative institutions between 1916 and 1934 is given in the table below. The figures reveal a rapid growth up to 1930, while the growth thereafter was slow. In some respects there was even a decline, which should be attributed largely to the 'great' depression. The figures also indicate that the magnitude of funds handled by the co-operative sector was small in relation to those handled by the commercial banks.

(Rs. lakhs)

| <i>As on June 30</i> | 1916 | 1920 | 1930 | 1934 |
|--|--------|--------|--------|--------|
| <i>Provincial Co-operative Banks</i> | | | | |
| Number of banks | 5 | 7 | 10 | 10 |
| Capital and reserves. | 13 | 30 | 1,01 | 1,30 |
| Loans and deposit resources | 64 | 2,12 | 7,61 | 9,71 |
| Loans advanced during the year | 46 | 1,55 | 7,63 | 6,07 |
| <i>Central Banks</i> | | | | |
| Number of banks | 239 | 393 | 588 | 603 |
| Capital and reserves | 57 | 1,22 | 4,71 | 5,83 |
| Loans and deposit resources | 2,66 | 5,21 | 26,19 | 25,04 |
| Loans advanced during the year | 1,42 | 4,00 | 17,79 | 9,38 |
| <i>Agricultural Co-operative Societies</i> | | | | |
| Number of Societies. | 17,729 | 36,299 | 91,786 | 92,226 |
| Capital and reserves | 1,37 | 2,51 | 10,07 | 12,94 |
| Loans and deposit resources | 3,79 | 7,14 | 24,86 | 21,05 |
| Advances. to individuals during the year . | 2,28 | 4,96 | 12,05 | 4,21 |
| Outstanding credit to individuals | 4,55 | 8,18 | 29,73 | 27,03 |
| <i>Non-Agricultural Co-operative Societies</i> | | | | |
| Number of Societies | 1,019 | 2,662 | 10,255 | 11,118 |
| Capital and reserves | 50 | 1,17 | 5,43 | 7,07 |
| Loans and deposit resources | 66 | 1,74 | 9,63 | 12,79 |
| Advances to individuals during the year .. | 1,11 | 2,55 | 10,57 | 12,18 |
| Outstanding credit to individuals | 95 | 2,20 | 11,58 | 14,51 |
| Overdues | 13 | 19 | 1,34 | 2,29 |

The Royal Commission on Agriculture, which examined the position of the movement in 1926-27, found that 'so far as numbers go, the movement has made remarkably rapid progress'. It summed up the result of the spread of the movement in the following terms:

The main results achieved may be said to be the provision of a large amount of capital at reasonable rates of interest and the organisation of a system of rural credit, which carefully fostered, may yet relieve

the cultivator of that burden of usury which he has borne so patiently throughout the ages. Knowledge of the co-operative system is now widespread; thrift is being encouraged; training in the handling of money and in elementary banking principles is being given. Where the co-operative movement is strongly established, there has been a general lowering of the rate of interest charged by moneylenders; the hold of the moneylender has been loosened, with the result that a marked change has been brought about in the outlook of the people.

The Commission, however, noted that except in the Punjab, Bombay and Madras, the movement had reached only a small part of the rural population, though in all the Provinces there were districts where considerably greater progress had been made than in others.

Enquiries made by the Commission revealed that the increase in the number of societies had not always been accompanied by improvement in quality. It found that in the Central Provinces and Berar, 'a thoroughly unsound system was allowed to develop into a top-heavy organisation'. In the United Provinces, 'the condition of a large number of societies gave cause for anxiety'. In Madras 'considerable anxiety has been caused by the steady increase in overdue loans'. According to the Commission, the financial solvency of the movement was generally beyond dispute and that it was the working of the societies that was defective. It found that:

The members of societies delay the repayment of loans even when able to repay; understanding of the principles of co-operation and knowledge of the essentials of rural credit are lacking; office-holders refrain from taking action against defaulters and the spirit of self-help is not as prominent as it should be, if the movement is to be a live force in village life. Even where defects are obvious and admitted, there is reluctance, as dangerous as it is regrettable, to liquidate societies whose condition is beyond remedy.

The situation deteriorated considerably during the period 1930-34 an account of the economic slump. Advances declined while over dues increased considerably, not only in respect of principal but also of interest.

Mr. (later Sir) Malcolm Darling, who was deputed by the Government of India to submit (i) a report on the condition of the co-operative movement in the major Provinces in 1935 and (ii) proposals for the organisation of the Agricultural Credit Department of the Reserve Bank, summarised the effects of the depression on the movement in the following terms:

the fall in prices has had a shattering effect upon every form of agricultural credit except advances against gold and ornament. Whether we look to the Imperial Bank in Burma or to the Loan Offices in

Bengal, the effect has been the same -an almost complete paralysis repayment with a corresponding restriction of credit. Making, however, full allowance for this, it must, I fear, be admitted that co-operation has not answered early expectations. Almost everywhere it is weak and halting and unequal to its task, and it is difficult to resist the conclusion that agricultural co-operative credit cannot stand on its legs, except perhaps in a period of rising prices. It requires the support of some ally which will either prevent waste, increase resources, or secure punctual payment. Thrift will do the first, and thrift and credit should always go hand in hand, but in India they have been the barest acquaintances. . . .Thrift has not been entirely ignored, but it has been far from playing its appropriate part in the movement.

Overdues of principal were everywhere high and in four major Provinces, namely, Bombay, Central Provinces and Berar, United Provinces and Madras, the over dues formed 69, 82, 58 and 6r per cent, respectively, of the outstanding loans. Owing to poor recoveries, which were mainly due to the fall in prices, advances had to be restricted considerably. Also, in a large number of cases, liquidation of societies had to be resorted to ; altogether, in eight major Provinces, over 25,000 societies, or roughly one-fourth, had to be liquidated since the movement was organised, representing ' a prodigious waste of time, money and effort'.

Such was the state of the co-operative movement on the eve of the establishment of the Reserve Bank of India. Mr. Darling anticipated that on account of the unsatisfactory position of the co-operatives, the financial accommodation which the Reserve Bank could provide for agricultural purposes through the co-operatives would only be of modest dimensions, for some years. To quote him:

One reason why high hopes have been raised in many minds by the proposed Agricultural Credit Department of the Reserve Bank is the belief that the Bank will be able to relieve the peasant of his burden of debt and raise his whole standard of living, to everyone's advantage* . . . all I need say here is that for some years the help that the Reserve Bank will be able to give to the agriculturist is likely to be of the most modest description, and if there were no co-operative movement, it would probably be unable to help him at all. This then is a further reason for strengthening the movement, for it is no use attempting to fit an old bullock cart with a powerful engine.

The co-operative movement also attempted to provide long-term credit to the agriculturists through special institutions called land mortgage banks. The first of such banks was started in the Punjab in 1920 and a few banks had been established in the Punjab, Madras and Bombay by 1930, but progress in the field was noticeable only much later, i.e., in the late 'thirties. Even so, the progress was confined mainly to Madras, which passed a special Co-operative Land Mortgage

Banks Act in 1934. The ninth and tenth Conferences of the Registrars of Co-operative Societies held in 1926 and 1928, the Royal Commission on Agriculture (1928), and the Central Banking Enquiry Committee (1931) all emphasised the need for organisation of a network of land mortgage banks under the co-operative system and made many recommendations indicating the guidelines for their working. These formed the basis for the organisation of co-operative land mortgage banks (now called land development banks) in India.

A brief reference may also be made to the role of the Government themselves in the provision of agricultural finance. Even as early as in 1793, the British administration in India framed various Regulations for the issue of taccavi advance to proprietors, farmers, subordinate tenants and ryots, for embankments, tanks, water courses, etc. These Regulations were followed by the Land Improvement Loans Act of 1883 and the Agriculturists Loans Act of 1884, which are still in operation. The former Act enables the Government to provide long-term loans, repayable within a maximum period of 35 years, for effecting permanent improvements in agriculture, while under the latter Act, short-term loans are granted, especially during periods of distress, for current agricultural needs, such as purchase of seed, cattle, manure, implements and any other purpose not specified in the former Act, but connected with agriculture. The extent of loans provided by Government under these Acts, in the years prior to the Second World War, formed a very small part of the finance required by the agriculturists, the annual loans given being less than Rs. 1 crore.

The Royal Commission on Agriculture found the working of these Acts to be satisfactory on the whole, but suggested that steps should be taken to make the benefits available under them more widely known to the cultivators, and also to avoid delay in sanction of loans. It suggested the retention of the second Act on the Statute-book until the spread of thrift or co-operative credit or both of them rendered it obsolete. Though there has been considerable progress in the co-operative movement since then, the stage of rendering this Act obsolete has not yet been reached. Government finance under these Acts has still an important part to play in supplementing co-operative finance, especially in areas where the co-operative movement is not adequately developed.

THE UNORGANISED SECTOR

The unorganised sector of the money market may be divided into two broad categories, namely, the indigenous bankers (known by such names as Multani Shroffs, Marwari Shroffs, Gujarati Shroffs and

Chettians) and the moneylenders. This sector was in itself heterogeneous, with a few indigenous bankers of fairly large resources, at one end, and the smallest of moneylenders financing petty personal needs, at the other. The extent of the unorganised money market has always been a matter of conjecture and was particularly so 30 or 40 years ago; it was generally believed that this was, at least, as large as the organised sector. In a large number of towns and the villages generally, the indigenous bankers and moneylenders constituted the main channels of credit.

The main features of the operations of indigenous bankers, as distinct from those of moneylenders, were as follows. They received deposits and had also credit arrangements with joint-stock banks, generally in the form of discounting of hundies. They financed mainly trade and small industry and also provided general banking facilities through buying and selling of remittances. The advances of indigenous bankers were mostly on a secured basis; their lending (discounting) rates were higher than the rates charged by the commercial banks, but were not by any means extortionate. The moneylenders, on the other hand, did not generally receive deposits, had very little borrowings from the organised banking sector and primarily financed nonproductive expenditure, the loans being generally unsecured and carrying exorbitant rates of interest. Many of the moneylenders in the rural areas were prosperous landholders, while the majority of indigenous bankers combined banking with some form of trade and the capital employed by them in banking was hardly distinguishable from that employed in trade. The operations of the indigenous bankers and the moneylenders were characterised by flexibility and easy accessibility, features which drew towards them the small borrower, rural and urban.

The Central Banking Enquiry Committee, which made a detailed study of the unorganised sector, noted a decline in the banking business of indigenous bankers, largely as a result of competition from joint-stock and co-operative banks. The Committee, however, considered that their activities should not be allowed to decline further and that 'some action should be taken to improve the position of the indigenous banker and to make him a useful member of the Indian banking system', the aim being 'to try to restore these bankers to the place which they enjoyed in India until the middle of the last century'. It, therefore, suggested that as soon as the Reserve Bank of India was established, the indigenous bankers should, along with joint-stock and co-operative banks, be brought into direct relationship with the Reserve Bank and thereby provided with rediscount facilities. The Committee, however, recommended that only such of the indigenous bankers, as were engaged in banking proper or were prepared to shed their non-banking business, should be brought into such direct relationship

with the Bank. Accordingly, one of the first activities to be undertaken by the Reserve Bank after its establishment was the preparation of a scheme for implementing this suggestion of the Central Banking Enquiry Committee.

The moneylender remained the most important constituent in the rural credit machinery of the country, both from the point of view of number and volume of business. The main reasons for his importance in the credit system are best stated in the words of the U.P. Banking Enquiry Committee:

It is to him that the needy peasant turns for help in every trouble. It is he who finances the marriage ceremonies and law suits -one almost as inevitable as the other. He does not keep the borrower waiting for his money till the time for its profitable spending has passed. He does not press for repayment at due date, if he knows such repayment is inconvenient. He does not conduct embarrassing enquiries into his client's haisiyat (financial condition) ; for what it is worth, he knows it already, and the element in it to which he attaches most importance is the client's reputation for prompt and regular payment.

This almost indispensable position occupied by the moneylender made him really extortionate; his rates of interest were unconscionably high. The rates, which varied a great deal from Province to Province, ranged between 12 and 24 per cent, though after 1931, under the impact of the economic depression, they declined to some extent. Besides, he indulged in malpractices of various sorts. To quote, again, from the report of the U. P. Banking Enquiry Committee:

He is certainly no philanthropist, his object is to make money, and he is always not particular regarding the means by which he does it. He will deduct future interest from the principal before he pays it; he will debit his client with all incidental expenses. We will cause an illiterate borrower to put his thumb impression on a blank form and subsequently fill it with a sum in excess of the amount actually lent. He charges a rate of interest which is always high and often extortionate and compounds it at frequent intervals.

The protection of agriculturist debtors from the malpractices of moneylenders and the provision of relief to them engaged the attention of Government right from 1879. The Deccan Agricultural Debtors' Relief Act of 1879 authorised the courts of law to examine the history of a farmer's debt and determine the amount due from him, to withhold payments of unreasonable rates of interest, and to protect the agriculturist from arrest and sale of land, unless the land was specifically mortgaged. This was followed by Land Alienation Acts passed in some Provinces, for instance, the Punjab, United Provinces and Central Provinces & Berar, with similar provisions. The Usurious Loans Act

of 1918 sought to protect the debtors against hard and unconscionable bargains by allowing courts to reopen, on their own, old cases and settle the terms equitably. The rule of Damdupat, under which no debtor was liable to pay by way of interest an amount exceeding the principal of the loan, also came to be applied.

While the above steps represented the early attempts to protect the agriculturists from the malpractices of the private lending agencies, the problem of the accumulated debt burden, most of which was inherited, remained to be tackled. The Royal Commission on Agriculture felt strongly that the 'worst policy towards debt is to ignore it and do nothing'. In this connection, it recommended a simple Rural Insolvency Act, the object of which was to relieve the debtor of what he could not pay, whilst insisting on his paying the utmost he could within a reasonable time. It also suggested the appointment of debt conciliation boards or committees, but left it to the Governments to decide whether they should be in addition to the Rural Insolvency Act or as an alternative to it. The problem became acute during the period of the depression, when on account of the steep fall in agricultural prices, the agriculturists were unable to meet even their current debt obligations, not to speak of old debts. A spate of suits for attachment of land and execution of decrees followed. The Provincial Governments considered that special steps were necessary to protect the agriculturists from these conditions; the United Provinces, Punjab, C. P. and Berar and Madras Governments issued notifications declaring a moratorium on the execution of decrees. Taking the clue from the recommendation of the Royal Commission on Agriculture referred to above, the C. P. and Berar Government took the lead in passing a Debt Conciliation Act in 1933, followed by the Punjab (1934), Assam (1935) and Bengal and Madras (1936) Governments. These Acts facilitated the adjustment of debts and their repayment in a reasonable number of installments, although certain debts like rent, debts to Government, co-operative institutions and banks were either partially or wholly exempted from their purview.

Legislation was also undertaken during this period to regulate the activities of moneylenders. The Punjab Regulation of Accounts Act of 1930 and the Moneylenders Acts passed by the various Provincial Governments fall under this category. These laws, though not uniform in all respects, generally provided for the maintenance of proper registers of transactions by moneylenders, furnishing debtors with statements of accounts in respect of each transaction with the principal and interest shown separately, and issue of receipts for all payments made by the debtor. Some of the later Acts provided for the compulsory registration and licensing of moneylenders, the unregistered moneylenders being debarred from recourse to courts of law for the recovery

of their dues. The regulation (i.e., fixation of maximum) of rates of interest charged by moneylenders was carried out by the Provincial Governments under the Usurious Loans Act of 1918, with suitable adaptations.

The legislative measures referred to above had many loopholes and the moneylenders took advantage of them. Further, the agriculturists were generally unwilling to expose the offending moneylenders, to whom they had to go back again, in the absence of an alternative credit agency. However, as the Central Banking Enquiry Committee noted, there was a gradual decline in the business of professional moneylenders mainly as a result of the agricultural slump and the growth of co-operative societies. The Committee was not in favour of either voluntary or compulsory licensing of moneylenders, and felt that a rigorous enforcement of existing legislation, together with the extension of joint-stock and co-operative banking and better education of the people, would bring about a reduction in the rates of interest charged by moneylenders. In regard to their future role in the credit system of the country, the Committee desired consideration of their suggestions that (i) moneylenders be brought within the fold of the co-operative movement, and (ii) their activities be dovetailed to those of the banking system on an agency basis or through development of partnership on the lines of the 'Kommandit' * practice prevalent in Germany.

POSTAL SAVINGS BANKS

Before concluding this account of Indian banking, a brief reference may be made to postal savings banks, which also played some role in mobilising savings and developing the banking habit. Savings bank business in India was conducted by Government right from the time of the East India Company. Government savings banks were established first in the three Presidency towns between 1833 and 1835 and later at selected district Treasuries in 1870. In 1882 and 1883, savings banks were opened at post offices throughout the country and these took over the business of the district savings banks in 1886 and of Presidency savings banks in 1896. The rate of interest on these deposits was reduced steadily from 4 1/6 per cent in 1879 to 3 per cent in 1905 and to 2 1/2 per cent in 1933. The growth of postal savings banks, which were particularly meant to mobilise the savings of the middle and lower classes, is indicated in the following table.

* Under this system, a bank, instead of opening a branch, became the financing partner of a local moneylender whose advantages of unlimited liability and local knowledge were thus retained without involving the bank in the expense and heavy liabilities of a new branch.

| As on March 31 | No. of Banks | No. of Accounts | Deposits balance Outstanding (Rs. Crores) | Deposits* of Commercial Banks (Rs. Crores) |
|-------------------|-----------------|--------------------|---|--|
| 1900 | 6,479 | 7, 86 | 9.65 | 34.27 |
| 1910 | 8,767 | 13, 79 | 15.87 | 86.99 |
| 1921 | 10,713 | 18, 78 | 22.86 | 227.93 |
| 1928 | 12,326 | 26, 06 | 32.67 | 216.74 |
| 1935 | 12,679 | 31, 00 | 58.30 | 234.28** |

* Figures relate to end-December; those for 1900 and 1910 include joint-stock banks with paid-up capital and reserves of Rs. 5 lakhs and over, while figures for the remaining years cover joint-stock banks with paid-up capital and reserves of Rs. 1 lakh and over.

** Relate to end-December 1934.

It will be seen that postal savings deposits were not insignificant in relation to commercial bank deposits. It will also be observed that between 1928 and 1935 the expansion of postal savings deposits was very considerable, unlike that of the commercial banks. The official view was that a substantial part of this increase represented the proceeds of large gold sales during this period.

The majority of the depositors belonged 'to the agricultural class, professional classes and the intelligent middle-class people'; industrial workers had not started making much use of the savings facilities provided by these banks. The Central and the Provincial Banking Enquiry Committees made a number of recommendations for improving the facilities given by postal savings banks. These included, increase in the number of savings bank offices, raising of the limit of deposits in respect of accounts of minors, introduction of a system of cheques both for withdrawing and for depositing, permitting the opening of joint accounts and the incorporation of a provision for the designation of nominees of account-holders.

INDUSTRIAL FINANCE

Prior to the establishment of the Reserve Bank, there had been from time to time discussions on ways and means of ensuring availability of adequate finance, especially medium and long-term, for the development of Indian industries and the role of commercial banks in this sphere. In this connection, there were also reviews of the role of the managing agency system, a form of management cum financing organisation unique to India.

There was a general aversion on the part of the commercial banks to engage in industrial financing. This was due not only to the influence of British banking practices but also to the lessons conveyed by the failure of certain banks, which had financed industrial enterprises

on a long-term basis, without being equipped for judging the business prospects of a concern or its commercial value. Several committees since 1907 had considered the question of 'State aid to industry' and 'mixed banking', but had not arrived at any definite or satisfactory conclusion. The various 'State aid to industry' Acts, which were in operation in the Provinces, and special institutions set up by two Provinces, viz., the U. P. and Bengal, had failed to achieve the objects they were designed to serve.

The Central Banking Enquiry Committee generally favoured close ties between industry and commercial banking. It recommended, in the light of the constitutional position then in prospect, under which the promotion of industry was expected to be a Provincial subject, the creation of Industrial Credit Corporations in the Provinces to ensure supply of financial assistance to industries. The Corporations were to obtain the share capital from the public as far as possible, Government taking such portion as could not be raised by public subscription. At the same time, the Committee did not rule out the formation of an all-India institution for the purpose of meeting the requirements of industries of national importance, the development of which might fall within the scope of a Federal or Central Government. The Committee also recommended that such of the existing commercial banks, as were well established and carried on their ordinary banking business on conservative and sound lines, might with advantage follow, so far as possible, the German system of 'mixed banking', the Imperial Bank giving a lead in this direction; the banks could participate in the issue of share and debenture capital. In fact, there had been a tendency already for some of the bigger groups of industries to have a trust company, an insurance company and a bank within their controlling fold. The Committee envisaged the appointment by banks of their Managing Directors or Managers as directors of the companies assisted by them.

Progress in the direction of establishing adequate institutional facilities for industrial finance was made only after the attainment of freedom. Although, eventually, the desire of the Central Banking Enquiry Committee for industry-banking relationship of the German type was not realised, the role of commercial banks in the provision of finance for industry, mainly loan finance, increased gradually, both directly and indirectly. However, the provision of institutional finance for industry came to be organised mainly through special long-term financing agencies with Government/Reserve Bank participation at the all-India level as well as in the various States, the Reserve Bank taking considerable initiative in this matter. The first of these institutions was the Industrial Finance Corporation of India, established in 1948. In 1949 a financial Corporation was set up in the Madras State,

under the Indian Companies Act ; financial Corporations in the other States were set up from 1953 onwards, under a special Statute.

CONCLUSION

To conclude the brief history of money and banking in the hundred years prior to 1935, it will be seen that there was the necessary framework for a central bank to begin operations although the Indian money market was deficient in several respects. Even though banking habit had not developed extensively, the use of bank money was not insignificant. About the time the Reserve Bank was inaugurated, deposit money of the order of Rs. 100 crores constituted 40 per cent of total money supply -a somewhat higher proportion than at present.

In many countries, including, in particular, Sweden and the U. K., where central banks have been in existence for about 275 years or over, the evolution of central banking has been slow, haphazard and controversial. In the case of the very old central banks, it was only after several decades that it came to be accepted that the central bank should have a monopoly of note issue, that it should be a banker to Government and a bankers' bank. For a long time, therefore, the so-called central banks were functioning in that capacity only partially. In India too, there was experimentation in respect of the monetary standard and banking arrangements for Government, but when the establishment of a central bank came to be pursued actively in the years 1927-34, there was hardly any controversy with regard to objectives and functions of the proposed institution. The Statute for the Indian central bank was an amalgam of the country's experience and aspirations in monetary and banking matters; central banking principles and organisation evolved abroad and devices intended to safeguard the interests of the foreign power in India. This forms the subject matter of the next chapter.

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1951 confirming the restoration of the Reserve Bank's freedom of operations which had been taken away in August 1947. This was, of course, to be subject to prior consultation between the Reserve Bank and the Bank of England as in the past, so as avoid any undue disturbance in the Landon market as also to enable the former to avail itself of the advice of the Bank of England

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The Reserve Bank of India Act

An account of the principal features of the Reserve Bank of India Act should be of interest. The effort, spread over so many years, that went into the making of the Act was massive; the product of this effort deserves careful study.

Notwithstanding the years of controversy that had raged around the constitutional set-up of a central bank for India, and the fact that the country had twice had an opportunity to discuss legislation for its establishment, the 1933 Bill aroused strong and mixed feelings of hope, doubt, distrust and positive opposition, which were reflected in the debates both in the Legislature and in the press. The wide divergence of views did not, however, wreck the Bill; in respect of several clauses, satisfactory compromises were reached between Government and Opposition Members.

As mentioned in Chapter 1, the basis of the 1933 Bill was the Bill unsuccessfully introduced in 1928 by Sir Basil Blackett, as modified by the London Committee. The Bill was referred to a Joint Select Committee* for the reason not only that a precedent had been established in the case of the 1927 Bill but also that the London Committee desired further consideration being given in India to certain vital issues like the initial proportion of gold and sterling assets to be held against the note issue, the valuation of the gold reserves to be taken over by the Reserve Bank from Government, the power of the Bank to take part in open market operations, the relations of the Reserve Bank with the Imperial Bank of India and the compensation to be

* Its members were George Schuster, Cowasji Jehangir, Sant Singh, Mohd. Yamin Khan, Homi Mehta, L. Hudson, G. Narayanaswami Chetty, S. R. Pandit, S. R. M. Annamalai Chetty, J. S. Henderson, S. M. Padshah, Mahmood Suhrawardy, Charanjit Singh, Mohd. Hayat Noon, B. K. Basu, Nripendranarayan Sinha, Mathura Prasad Mahrotra, S. C. Mitra, Bhuput Singh, Abdulla-Al-Mamun Suhrawardy, Mohd. Azhar Ali, Gaya Prasad Singh, Hossain Imam, Nihal Singh, Ram Saran Das, Vidya Sagar Pandya, B. Das and J. B. Taylor.

paid to the Imperial Bank for the loss of some of its functions. The Committee submitted a report signed by all the 28 members but with 15 minutes of dissent attached as well. None of the changes made by the Select Committee (reference to which will be made later at the appropriate places) was, however, as far-reaching as those made by the Committee which sat on the 1927 Bill. Of the minutes of dissent, the one that went the farthest was perhaps that signed by 7 members suggesting that the Bill be not proceeded with in view of the unsatisfactory provisions in the White Paper on the new Constitutional Reforms, leaving legislation on the coinage and currency of the Federation to be under the virtual control of the British Cabinet.

The Act consisted of 61 Sections with 242 clauses and 5 Schedules. It took the Legislative Assembly 24 days for discussions on the motions to commit/recommit the Bill to the Select Committee, the clause by clause discussions and the third reading. As many as 373 amendments were initially tabled, the largest number by Dr. Ziauddin Ahmad. The detailed provisions of the Act as originally passed are described below.

Applicability

The Act extended to 'the whole of British India, including British Baluchistan and the Sonthal Parganas ', i.e., it extended to all territories governed by His Majesty through the Governor General of India or through any Governor or officer subordinate to him [S.1 (2)]. With regard to Burma, to which the Act applied as Burma was then part of British India, the London Committee hoped that if separated from India, it would continue to utilise the Indian currency system so that few changes in the Act would be necessary. Although the Act did not specifically apply to the Indian princely States, in actual practice, the provisions were effective in these territories also.

Ownership of the Bank

The question whether the Reserve Bank of India should be a Government-owned bank or a bank owned by private shareholders was, as in 1927, one of the most extensively discussed issues during the passage of the 1933 Bill. It was, however, quite clear that no central bank could in practice be either the one or the other in its purest form. With the unfortunate experience of countries with State-controlled banks during and after the First World War behind them, the trend in many countries which had set up new central banks or reconstituted existing ones was to provide the bank with private capital

and make it free from active political control in its day-to-day management. The Government were simultaneously vested with sufficient powers for intervention in the bank's policies should the national interest require it at any time, the idea being that the advantages of private management should be combined with those of State control while avoiding the disadvantages of both as far as possible.

The Reserve Bank of India Bill, 1933, provided for a private shareholders' bank, in consonance with the spirit of the times, The Finance Member's reply to the debate on the motion to refer the Bill to a Joint Select Committee adequately summed up the reasons why a private shareholders' bank was proposed. Said Sir George Schuster:

in modern life and in modern economic organisations, there are two important functions: they are the functions of those who have to raise and use money and there are the functions of those who are responsible for producing the actual tokens of money, the money in circulation. The basis of the whole proposal for setting up an independent Central Bank is to keep those two functions separate. The largest user of money in a country is the Government, and the whole principle of the proposal is that the Government, when it wants money to spend, should have to raise that money by fair and honest means in just the same way as every private individual has to raise money which he requires to spend for his own maintenance. If the Government is in control of the authority which is responsible for exercising the other function, then all sorts of abuses can intervene.

It is not necessary to go over the ground of State versus shareholders' bank; this matter has figured much in Chapter I. Rather, mention may be made of the built-in checks and counter-checks to secure the best of both the worlds. The arrangement effectively met the fears of Members of the Legislature, who had cited the experience of the Imperial Bank of India as an unhappy one as, according to them, a few big industrialists entrenched themselves in office as directors by getting re-elected and manipulated its policies to suit their own interests. The broad details of the relevant statutory provisions are given in the following paragraphs.

Dispersal of Ownership

A very wide distribution of the ownership of the Bank's share capital was envisaged through the demarcation of the country into five geographical areas as defined in the First Schedule to the Act and by assigning a specified portion of the capital to each of these areas [S.4(2) and 4(5)]. In order to bring the shares within the reach of the common man, the value of each share was fixed at Rs. 100 [S.4(1)].

Concentration of the share capital, even in any one register, in the hands of a few was sought to be made unattractive. Firstly, there was restriction on voting power. There was also to be limitation of dividend on the Bank's share capital; a cumulative rate not exceeding 5 per cent per annum was to be fixed by the Governor General in Council at the time of the issue of the shares. A further dividend was payable on a graduated scale out of the remaining surplus, if any, as indicated in the Fourth Schedule and the balance was to be made over to Government (S.47). However, the additional dividend was to be a modest one, since the maximum dividend payable was 6 per cent; in fact, the provision was for an asymptotic approximation to 6 per cent from a variable initial base. The limitation of dividend was intended to ensure that the Bank's business activities were not governed by considerations of profit.

The role of the shareholders was limited to serving as electoral colleges; they could not directly exercise a controlling influence on the management of the affairs of the Bank. At the annual general meeting, besides the election of the auditors, the shareholders had the limited function of discussing the Bank's annual accounts and the annual report (S. 14).

Government's Powers

Provision was made for close co-operation between the Bank and the Government in vital policy-making spheres and for the exercise of a measure of Government influence in the composition of the Directorate of the Bank, including its chief executives, namely, the Governor and the Deputy Governors. The Governor and the Deputy Governors were to be appointed by the Governor General in Council on the recommendations of the Central Board of Directors. Besides Government's representation (through one of their officials) on the Bank's Central Board, four Directors were to be nominated by the Governor General in Council [S.8(1)]. There was no indication, however, that the Government nominees were expected to reflect only Government's line of thinking.

The Governor General in Council had also the power to remove from office the Governor, the Deputy Governors and any of the nominated or elected Directors [S. 11 (1)]. These powers were apparently intended to ensure that 'the direction of the Bank is in the hands of men in whose judgement it (Government) has confidence'. In the case of the nominated or elected Directors, however, this could be done only on a resolution passed by the Central Board by a majority of not less than nine Directors; the application of this procedure to the nominated Directors was to ensure that they would not be mere 'puppets' of

Government. It is interesting to recall that a Member (Mr. A. Ramaswami Mudaliar) moved an amendment to provide that the Governor and the Deputy Governors also could be removed by the Governor General in Council only with the concurrence of the majority of the Central Board, i.e., in the same manner as any other Director. Both the 1927 and 1928 Bills had such a provision. The clause as it stood, it was commented, would hamper the sense of independence of any Governor and make him a mere instrument in the hands of Government. The amendment was, however, not pressed, after both Sir Cowasji Jehangir and the Finance Member took pains to explain what would happen in actual practice in regard to the removal of the Governor from his post. The Board had the right, when it wanted to remove the Governor, to pass a resolution by an ordinary majority, requesting the Governor General in Council to dispense with his services. On the other hand, the Central Board could make it impossible for the Governor General in Council to remove a Governor whom they did not want to have removed: they could even resign en masse. In either case, therefore, it was explained, there was no necessity to provide statutorily that there should be unanimity of views between the Governor General in Council and the Central Board before action was taken.

Even the salaries and allowances of the Governor and the Deputy Governors, which were to be determined by the Central Board, required the prior approval of the Governor General in Council [S.8(2)]. As the Select Committee put it, 'In view of the Government's interest in the financial earnings of the Bank we consider that it should have a voice in fixing the salaries paid to the chief executive officers'.

The Governor General in Council was also entrusted with a more sweeping power-that of superseding the Central Board if, in his opinion, the Bank failed to carry out any of the obligations imposed on it under the Act, and entrusting the conduct of its affairs to an agency determined by him (S.30). Such action was, as early as possible, to be reported to the Central Legislature for obtaining its confirmation. In this respect, the 1933 Bill as it was finally passed went a good deal farther than the 1928 Bill on which it was based. In the 1928 Bill, in such a contingency, the Bank was to forfeit only its right of note issue-the primary central banking function-which was to be taken over by another agency decided upon by the Governor General in Council; however, the Joint Select Committee considered this remedy inappropriate.

For safeguarding the national interest there were also various other powers vested in the Governor General in Council-to which references will be made at the appropriate places-in connection with the discharge by the Bank of its central banking functions.

Another important aspect of Government control was the provision requiring the Central Board to obtain the prior approval of the Governor General in Council for making regulations for giving effect to the provisions of the Act (S.58).

Under the Government of India Act, 1935, some of the functions of the Governor General in relation to the Reserve Bank were exercisable by him in his discretion ; in the discharge of some other functions, he was to exercise his individual judgement (Sections 9 and 152). The appointment and removal from office of the Governor and Deputy Governors, the approval of their salaries and allowances and the fixing of their terms of office, the appointment of an officiating Governor or Deputy Governor, the supersession of the Central Board of the Bank and any action consequent thereon, and the liquidation of the Bank, fell under the former category. The nomination of Directors of the Central Board and the removal of any such Director from office were functions which required him to exercise his individual judgement.

The 1935 Constitution conferred another wide power on the Governor General, namely, no Bill or amendment which affected the coinage or currency of the Federation or the constitution or functions of the Reserve Bank could be introduced into or moved in either Chamber of the Federal Legislature without the previous sanction of the Governor General in his discretion (Section 153). The constitutional proposals in the White Paper of 1933 had limited this requirement to legislation affecting that portion of the Reserve Bank Act which regulated the powers and duties of the Bank in relation to the management of currency and exchange. The Joint Select Committee of the British Parliament considered it necessary to enlarge its scope. Its recommendation was incorporated in the Government of India Act. Mention has already been made of the minute of dissent to the Select Committee report on the Reserve Bank Bill protesting against the relatively less arbitrary proposals contained in the White Paper; referring to the influence the British Cabinet would be able to exercise over the Governor General, the dissentients had stated that an institution 'which will have at its inception such obvious limitations . . . will fail to work in India, for India and by Indians ' and that in the absence of any satisfactory assurance in this regard, the Bill should just be dropped. The actual provisions in the new Constitution turned out to be more severe.

The day-to-day administration of the Bank's affairs was, however, to be free from Government influence. As indicated elsewhere, the Government official nominated to be a Director of the Central Board had no power to vote. Nor could a salaried Government official or a salaried official of any State in India be nominated or elected to a Directorship of the Central Board or become a member of the Local

Board [S.10(1)]. Furthermore, Members of the Local or Central Legislatures were, on becoming a Director or member of a Local Board, required to relinquish their membership of the Legislature within two months of their appointment, nomination or election as such; conversely, when a Director or a member of a Local Board got elected or was nominated to any such Legislature, he ceased to be a Director or member of the Local Board on the date of his election or nomination as the case might be [S. 11 (5)].

The debate on the clause to provide for a shareholders' bank was, it is needless to say, the lengthiest. It stirred up the emotions of Members to a feverish pitch and brought out their literary talents in the stories they narrated or the poems they recited to emphasise their points. Despite the strength of opinion voiced in favour of a State-owned Bank or the Stockholders' scheme, the amendment moved to provide for the capital being supplied by the State was rejected by a substantial majority, of 76 votes to 33. Amendments moved to arm the Government with power to acquire all the shares at any time after 15 years from the inception of the Bank or to purchase them at any time at par were also negatived.

Management

The Act provided for the setting up of a Central Board of Directors to be entrusted with 'the general superintendence and direction of the affairs and business of the Bank' (S.7). The 'Board was to consist of 16 Directors -a Governor and two Deputy Governors to be appointed by the Governor General in Council after consideration of the recommendations made by the Board in that behalf, four Directors to be nominated by the Governor General in Council, eight Directors to be elected on behalf of the shareholders on the various registers on the basis of a specified number for each register and one Government official to be nominated by the Governor General in Council (S.8). In respect of the size of the Board, the Act was in accord with the provisions of the 1927 Bill rather than the 1928 Bill which had proposed a Board of 24 members, including five Directors elected by commercial and agricultural interests. This was the result of a recommendation made by the London Committee which felt that the Board should be 'as small as practicable' and that the majority of the Directors should 'derive their mandate from the shareholders'. The Committee did not consider it necessary that provision should be made for the representation of commercial bodies as such.

Nominated and Elected Directors

Amendments to reduce the number of nominated Directors-partly to provide for representation of agricultural interests and partly to

curtail Government's influence on the Board -or to provide specifically for the Governor General's nomination of Directors to represent particular interests, were either withdrawn or negatived. The Joint Select Committee had, however, gone into this question of proper representation for all groups on the Board and was satisfied that the provisions in the Bill were adequate and that the deficiencies, if any, would be remedied through the Governor General's power of nomination. In the Committee's words:

We have been assured that it is intended that this power shall be used to ensure that territorial or economic interests which have not secured adequate representation in the elections shall have such inadequacy corrected by this means. We do not consider it appropriate to embody in the statute any specific provision for the fulfillment of this intention, but we consider that in the instrument of instructions to the Governor General a passage should be inserted making it clear that this power should be exercised in the general manner indicated above and in particular to secure adequate representation of the interests of agriculture and co-operative banking if these interests had not secured such representation among the elected directors.

Thus, while no statutory provision was made for representation of various economic interests, the Governor General in Council was relied upon to remove any under-representation or non-representation of the important interests. The practice in this behalf in other countries was varied, but the aim was generally to secure that the governing body had the benefit of the experience and special knowledge possessed by representatives of special interests.

It is also of interest to note that a Provincial Government (Madras) had urged that some provision be made in the Bill for their representation on the management of the Bank. This was rejected by the Central Government on the ground that the 'representation either of the Central or local Governments as such would be inconsistent with the whole scheme of a Central Bank free from Government and legislative control'. While there was provision for the Central Government to nominate an official as a Director, it was stipulated that he was not to have a vote.

Election of Directors through Local Boards

The Act stipulated the establishment of a Local Board for each of the five geographical divisions, for the primary purpose of electing Directors of the Central Board. The shareholders on each register were required to elect from amongst themselves five members for that particular Local Board. These members would then elect one or two, as the case might be, of themselves as Directors to represent that area. The

scheme was modelled on the pattern adopted by the Imperial Bank of India. The Local Boards were also to have not more than three members nominated by the Central Board, from amongst the shareholders on the registers for the respective areas, to secure adequate representation of territorial or economic interests (S. 9).

The Act visualised the usefulness of Local Boards in other directions also by providing that they could be entrusted with such duties as the Central Board thought it fit to delegate to them. They could also advise the Central Board on such matters as were generally or specifically referred to them. It was hoped that these Local Boards would 'have, in the course of evolution, some useful functions of their own to perform '.

Employees or officers of any bank or directors of any bank other than a co-operative bank were debarred from becoming a member of a Local Board or a Director [S.10 (1)], in line with provisions in the central banking legislation abroad, the underlying idea being that central banks should not allow themselves to be influenced by the commercial banks in the formulation of their policies.

A sub-clause that was dropped from the Bill, on an amendment moved by Mr. A. Ramaswami Mudaliar, was one stipulating that no person could be a Director or a member of a Local Board unless he was or had at some time been engaged in agricultural, commercial, financial or industrial activities.

The minimum share qualification for Local Board members and the elected or nominated Directors (other than the Government Director) was fixed at Rs. 5,000 as against Rs. 10,000 in the 1928 Bill [S.11 (2)].

The First Central and Local Boards

The first Governor and Deputy Governors were to be appointed by the Governor General in Council on his own initiative. The first Central Board was to be constituted by nomination by the Governor General in Council of not only the four Directors to be nominated by him in the usual course but also the eight Directors to represent the shareholders on the various registers, to be replaced by elected Directors in stages (S. 15). The first Local Boards were to be constituted by election/ nomination as soon as possible (S. 16).

Meetings of the Central Board

The Central Board was to meet not less than six times in a year and at least once in every quarter. Any three Directors could, however, call for a meeting at any time. The Governor was to preside over these meetings and had a casting vote (S.13). An amendment authorising

the Governor General in Council to appoint a President from amongst the elected and nominated Directors to preside over these meetings was not accepted by the Legislative Assembly.

Governor and Deputy Governors

The London Committee considered that the method of appointing the Governor and Deputy Governors was 'a matter of the highest importance'. The majority of the members held the view that when the new Constitution came into force, these appointments should be made by the Governor General in the exercise of his discretion; while suggesting this; they expected him to ascertain the views of the Board before making his decisions. This view was not shared by the minority who felt that it was the Board of Directors which should make the appointments, subject to the approval of the Governor General. As a compromise proposal, the Committee finally suggested that the Governor and the Deputy Governors should be appointed by the Governor General after considering the Central Board's recommendations in this regard. In recommending this, the Committee stated it was following the pattern of the Statute of the Imperial Bank with regard to the appointment of the Managing Governors. One of four dissentients to this proposal, Sir Purshotamdas Thakurdas recorded a minute of dissent in which he argued that the final recommendation of the London Committee was contrary to the intention of the agreement reached at the Third Round Table Conference, regarding the setting up of a Reserve Bank 'free from any political influence'. The Governor General was, he stated, constitutionally bound to act under the orders of the Secretary of State for India, himself a member of the British Cabinet, and was, therefore, subject to the political influence of the majority of the Imperial Parliament for the time being; making him the appointing authority would clearly undermine the Bank's freedom of operation. The final shape which this provision took in the 1933 Bill was for the appointments to be made by the Governor General in Council after consideration of the recommendations made by the Central Board in that behalf. The Joint Select Committee accepted this proposal on the understanding that there must be prior consultation between the Governor General in Council and the Central Board before any recommendation was made, as in the case of the Imperial Bank. This clause was approved by the Legislature.

The question whether the Bank should have one or two Deputy Governors was also the subject matter of some controversy. During the debates in the Assembly, this question also led to the cognate issue regarding the appointment of Indians to one or both of these posts. It was suggested that the number of posts of Deputy Governors be

reduced to one and statutory provision made for appointing an Indian to this post. An alternative proposal was that, of the Governor and two Deputy Governors, two at least should be Indians. The Joint Select Committee considered that two Deputy Governors were necessary from the very outset; as for Indian representation on the Bank's executive, it was satisfied with the assurance given by the official members that it would be Government's policy to ensure that at least one of the three was a qualified Indian. Sir George Schuster repeated this assurance in the Assembly. The amendments were negatived.

The Act also laid down [Section 10(3)] that some of the disqualifications that were attached to the appointments of Directors of the Central Board and members of the Local Boards did not apply to the Governor and the Deputy Governors. That is to say, a salaried Government official, or a salaried official of an Indian State, or an employee, official or director of any bank was eligible to hold these posts. However, in regard to officiating appointments to the post of Governor and the Deputy Governors, the only exemption specified in the Act [Section 12(1)] was in respect of the appointee being an officer of the Reserve Bank; in other words, a Government official, or a salaried official of an Indian State, etc., was not, it would appear, eligible for such appointments. Before the Bill, as approved by the Legislative Assembly, was considered by the Council of State, the Deputy Controller of the Currency suggested that the full exemption granted in Section 10(3) be repeated in Section 12(1) also, but no action was taken on this. In his noting for the Finance Member, Mr. (later Sir) J.B.Taylor, who was intimately connected with the drafting and piloting of the Reserve Bank Bill, observed as follows:

Clause 12(1) -The meaning in the Bill as it stands seems quite clear and I am not in favour of tinkering with it. The suggestion of the Deputy Controller of the Currency might make the meaning somewhat clearer, but on the other hand it might create a discussion on the general question, and this seems undesirable.

The then Controller of the Currency, Mr. J. W. Kelly, put forth the following explanation in regard to this matter:

The point presumably is that if a salaried Government official were appointed permanently to the post of Governor or Deputy Governor he would cease to be a Government servant and would become an independent officer of the Bank in no way subject to Government control. On the other hand, if a salaried Government official were allowed to officiate as a Governor or Deputy Governor, the intention being that he would revert to Government service after the period of his appointment with the Bank was over, he would be placed in an invidious position in the case of a conflict of opinion or interest between Government and the Bank. Public opinion would not give an officer placed in

such a position credit for independent judgment regarding the Bank's policy.

Qualifications of the Governor

The question as to what the qualifications of the Governor should be and to what extent they should be provided for statutorily also exercised the minds of Members considerably.

While the London Committee confined itself to saying that it was essential that 'this officer should command general confidence, both in India and abroad', the Joint Select Committee had a good deal more to say :

We consider that one of the most vital points affecting the successful operation of the Bank will be the personality and qualifications of the Governor. It is in our view essential that he should be a man who will command the confidence of the public generally and particularly of banking and commercial circles, so that the policy of the Bank which will largely depend on his guidance, may be accepted as authoritative. We do not consider that these conditions will be fulfilled unless he is a man who has established a position in the business world and we have therefore recommended the insertion of a provision in a new sub-clause(2), to cover appointments made both under clause 8 and clause 15, that he must be a man 'of tested banking experience covering a period of at least five years'. We have given full consideration to the arguments put forward by the Government members who, while not differing from our general appreciation of the position as stated above, have warned us that the actual definition of the qualifications which we have recommended may, on the one hand, prove ineffective for excluding unsuitable appointments, and, on the other hand, prove unduly hampering to the discretion of the appointing authorities and by their very rigidity exclude a man who might be exactly fitted for the post. They have pointed out to us that commercial banking experience is not necessarily an adequate qualification for the head of a Central Bank, and that recent experience of other countries affords many examples of extremely successful appointments of men who would have been excluded by the words of our proviso. While recognising the force of these arguments, we think it necessary definitely to provide in the statute for the exclusion of certain types of appointment which we should consider undesirable, and we are prepared to face the necessity for amending legislation in the event of our words proving in practice to be unduly hampering.

The Select Committee did not consider it necessary that the persons to be appointed as Deputy Governors should also possess such a qualification; on the contrary, they felt that these appointments would give otherwise well-qualified men a suitable opportunity for acquiring practical banking experience.

Understandably enough, in a minute of dissent, Sir George Schuster and Mr. J. B. Taylor, Government members on the Select Committee, stated:

We find it necessary to dissent from the proposal that it shall be provided in the Act that the Governor of the Reserve Bank must be a man of 'tested banking experience covering a period of at least five years'. While we fully endorse what has been said in the main report as to the importance of the Governor being a man who can command the confidence of the business community in India, we feel that the qualifications proposed as actually worded will not necessarily ensure this result and may prove extremely embarrassing in practice. The qualifications and experience required for the head of a Central Bank are quite different from those which are necessarily acquired in commercial banking, while if experience of the latter is the only qualification, a five year period would be quite inadequate. The experience of many countries goes to show that men of quite different training have been selected for and proved successful in central banking, and the present heads of the important Central Banks would have been excluded as ineligible under the qualifications proposed by the Committee.

An amendment to drop this clause was moved by an official Member Mr. V. K. Aravamudha Ayangar who, in addition to the points urged in the minute of dissent, felt that the term 'tested banking experience' was far too vague to allow its inclusion in the Statute. But he went further to remark that 'experience as a joint-stock banker, whose outlook has been cribbed, cabined and confined by the narrowness of profit-earning pursuits cannot always secure that breadth of vision and that appreciation of broader national interests that are essential in the head of a central banking institution'. Opposition Members, who agreed with the Select Committee's reasoning, suggested alternative amendments for omission of the reference to a five-year period or for making provision that it would be the responsibility of the Governor General in Council and the Central Board to see that the person to be chosen was a man of tested banking experience, in order to get round the difficulty in the interpretation of the term.

The term 'tested banking experience' was drawn from the Statute of the South African Reserve Bank. A similar provision was also stated to have been recommended for the proposed central bank for Canada.

Mr. Aravamudha Ayangar's motion was adopted, by a big majority. Sir George Schuster explained, among other things, that the provision in the South African Act could be attributed to the fact that bank was originally intended to do some commercial banking business and that since the power of appointment of the Governor and Deputy Governor was vested in the Governor General, it was considered necessary to guard against the possible danger that purely political appointments might be made to these posts.

It is interesting to record that there was also a move to provide specifically that no member of the English or Indian Civil Service should be considered eligible for appointment as a Governor or Deputy Governor! In a minute of dissent to the report of the Joint Select Committee, Messrs. Vidya Sagar Pandya and B. Das mentioned the existence of a 'strong public feeling' against the appointment of members of the I.C.S. to these posts. Sir Cowasji Jehangir, a signatory to the Select Committee's report, was opposed to Government servants taking charge of the Bank unless they had, at least for five years, been 'out of Government office, out of this red-tapism, out of this groove into which they get, out of that system which makes their visions narrow, which clouds their horizon'. In this connection, a similar opinion of Keynes, expressed in his memorandum on the proposals for the establishment of a 'State Bank' in India, was also referred to. Mr. Keynes's view was that the Governor and Deputy Governors 'should invariably be persons of commercial or banking, not of administrative or official, experience'; it should, however, be noted that the 'State Bank' proposed by Keynes was to perform commercial banking functions too.

The amendment was however negatived by the Legislature. As a matter of fact, on six out of eight occasions, members of the Indian Civil Service were considered eligible for appointment as Governor,

The Governor and the Deputy Governors were to be whole-time employees of the Bank. They were to be appointed for a period not exceeding five years, the period being fixed by the Governor General in Council when appointing them. They were, like the other Directors who were also to hold office for five years, eligible for reappointment. The Deputy Governors (as well as the Government official nominated to be a Director on the Central Board) could attend all the Board meetings and take part in their deliberations, but had no power to vote except when a Deputy Governor was specifically authorised by the Governor to vote for him in his absence.

Share Capital

The Bank was to have, at its commencement, a share capital of Rs. 5 crores, the shares of Rs.100 each being fully paid up [S.4(1)]. Provision was made for its increase or decrease, by the Bank's shareholders, on the recommendation of the Central Board, with the previous sanction of the Governor General in Council and with the approval of the Central Legislature (S.5).

There was in some quarters the feeling that the Reserve Bank did not need any capital at all as it was itself going to be 'the manufacturer of money'. The proposed capital was expected to be an 'embarrassment' to it, as it would be hard put to it to find avenues for its employment

in order to pay dividends to its shareholders. The reply to this was that the argument was fallacious as the Bank could certainly not 'conjure money out of nothing'. It was, of course, necessary to guard against its being loaded with an excess of capital. As the Hilton Young Commission put it, a central bank need not, and should not, be provided with 'any very great amount of capital' for both the reasons that the bank might be lured into unsound business activities in order to earn sufficient profits and it would be more difficult to reduce the share capital than to raise it later if found necessary. On these considerations, the Commission felt that a fully paid-up capital of Rs. 5 crores was sufficient, 'allowing even for a material expansion of banking in India'. This figure was incorporated in the 1927, 1928 and 1933 Bills. The proposal of a Member (Mr. Vidya Sagar Pandya) to raise the capital to Rs. 7.5 crores did not find favour with the Legislature. The capital has remained unchanged at Rs. 5 crores to this day.

Offices of the Bank

The 1928 Bill provided that the Head Office of the Bank should be established in Bombay and that branch be opened as soon as possible in Calcutta, Madras, Rangoon, Delhi and London. The centres in India at which offices were proposed coincided with the headquarters of the five areas which the London Committee suggested for the purpose of geographical distribution of shares. Hence, the Committee had no difficulty in endorsing this provision. It did not, however, agree to the obligatory nature of the clause insofar as the opening of the branch in London was concerned, The Committee stressed the fact that it was 'the recognised practice of Central Banks to conduct their operations in another country through the agency of the Central Bank of that country' and recommended, therefore, that the establishment of the London branch should be made optional. The arrangement the Committee visualised was one of reciprocity between the Bank of England and the Reserve Bank of India, each appointing the other as its agent in the other country.

The 1933 Bill retained the provisions of the earlier Bill in regard to the Head Office and Indian branches of the Bank, but differed from both that Bill and the London Committee's recommendations in regard to the establishment of the London branch in that its opening required the previous sanction of the Governor General in Council. In other words, the 1933 Bill merely dropped the word 'London' and made no other change in the provision in the 1928 Bill allowing the Bank discretion to establish branches or agencies in any other place in India or, with the previous sanction of the Governor General in Council, elsewhere.

The Select Committee took the view that it was desirable that the Head Office of the Bank was migratory, as in the case of the Imperial Bank, as 'otherwise there might be some risk of failure to secure evenly balanced consideration of the varying interests of different parts of the Indian continent'. This clause was, therefore, modified by providing that the Bank should have offices at the five centres named earlier, and leaving it to the discretion of the Central Board as to 'how they should move their headquarters between them'.

So far as the London branch was concerned, the Joint Select Committee, while appreciating the London Committee's point of view and the importance of international Co-operation between central banks, considered that the practice of other countries did not afford an exact parallel to the case of India. The matter was one to be left to the absolute discretion of the Central Board of the Bank. The Committee recommended in its turn the deletion of the provision requiring the prior assent of the Governor General in Council. Thus, the clause as amended by the Select Committee read as under:

The Bank shall, as soon as may be, establish offices in Bombay, Calcutta, Delhi, Madras and Rangoon, and may establish branches or agencies in any other place in India or in London or, with the previous sanction of the Governor General in Council, elsewhere.

Members of the Legislature moved several amendments during the debate on the clause, proposing the opening of branches at other places such as Lahore, Cawnpore (Kanpur) and Karachi; a suggestion was also made for having a branch at each of the capital towns of all the 12 Provinces. Sir George Schuster, replying to the debate, explained that the two objectives that Members had in mind, namely, the interests of the public and the interests of the currency staff in the places where there were Currency Offices, would be achieved by the existing provisions of the Bill. It was best to leave the matter to the discretion of the Central Board. If there were branches in a great many places, there would be a tendency for the Reserve Bank to get into competition with other banks. There was no serious risk that facilities which were really needed would not be given to all the localities. It was also made quite clear that in the agreement with the Imperial Bank nothing should be said which would operate as a restriction on the liberty of the Reserve Bank to open branches wherever it might desire. The field for the Reserve Bank was entirely open and every area would get a fair chance. The amendments were negatived.

Members were particularly vociferous in their demand for making it obligatory for the Bank to open a branch in London. The mover of the amendment was Mr. S. C. Mitra, who advanced three reasons to support it: first, it would facilitate the training of Indians in

the London branch where they would come in touch with the international market; secondly, the influence of the Bank of England on the Reserve Bank could be minimised; and thirdly, it would enable the Reserve Bank to handle more effectively the large payments on account of Home Charges, etc., that the country had to make in the U.K. annually. Sir Cowasji Jehangir, a member of both the London Committee and the Joint Select Committee, also favoured the amendment, though he added that there could be no dispensing with the services of the Bank of England altogether. Much was also said in the debate about protecting the Reserve Bank from 'the political influence' of the Bank of England, which led the Finance Member to remark, 'If there is one non-political body in the world, I think it is the Bank of England'. Although the Finance Member argued cogently that the matter be left to the discretion of the Central Board which would examine it in all its aspects, the amendment to have a London branch was adopted, by a margin of just one vote, 46 against 45 (S. 6).

The India Office was keen that Government should move an amendment in the Council of State to delete the provision. However, the Finance Member was able to persuade India Office not to press this. The Finance Member stated:

Taking a long view it seems probable that actual experience will demonstrate the disadvantage of India not following the practice of other countries as regards foreign branches and that the legislature of the future may willingly amend the present provision. This is one of the occasions on which it may be sound policy to allow Indian opinion to gain wisdom by its own experience.

Prophetic words indeed; the Act was in fact amended in 1955 and the London branch closed in 1963.

Central Banking Functions

The Preamble of the Reserve Bank of India Act defined the objects of establishing a Reserve Bank for India as the regulation of the issue of bank notes and the keeping of reserves 'with a view to securing monetary stability in British India and generally to operate the currency and credit system of the country to its advantage'. In this, it followed the Preamble of the 1928 Bill. Unlike the earlier Preamble, however, it did not envisage 'the establishment of a gold standard currency for British India', for the international monetary situation had undergone great changes in the intervening period, following Great Britain's departure from the gold standard in September 1931, and the position was fluid. The Preamble reflected this, the wording being:

And whereas in the present disorganisation of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system;

But whereas it is expedient to make temporary provision on the basis of the existing monetary system, and to leave the question of the monetary standard best suited to India to be considered when the international monetary position has become sufficiently clear and stable to make it possible to frame permanent measures;

It is interesting that these paragraphs remain in the Bank's Statute even today!

The Reserve Bank's functions can be classified into the following broad categories: (a) to serve as banker to Government, (b) to issue notes, (c) to serve as banker to other banks, and (d) to maintain the exchange ratio.

While the Bank's obligations in each sphere were spelt out in clear-cut terms, there was also an amount of built-in flexibility, secured through the provisions for suspension of normal requirements or those endowing the Bank with extra powers and manoeuvrability in extraordinary circumstances; these special powers could, of course, be exercised only with the prior approval of the Governor General in Council or the Central Board of the Bank as might be prescribed in each case.

Banker to Government

The Bank was obliged to accept monies for account of Government, viz., monies not only of the Government at the Centre but also of such Local (that is to say, 'Provincial') Governments as had independent budgets and managed their own finances, and to make payments up to the amounts standing to the credit of their respective accounts. The Bank was also required to carry out their exchange, remittance and other banking operations, manage their public debt and arrange for issue of their new loans. At the time the Bill was on the anvil, no Local Government had the custody and management of their own provincial revenues, but such an arrangement was envisaged under the new federal Constitution. The Governments were, in their turn, obliged to deposit, free of interest, all their cash balances with the Bank, and to entrust it with their remittance and other transactions in India, the management of their public debt and issue of new loans. The terms and conditions subject to which the work was to be undertaken by the Reserve Bank were to be mutually settled (S. 20 and 21). In order to meet the contingency of a deadlock arising through the Bank's refusal to agree to conditions acceptable to Government, a clause was added to the effect that in the event of any failure to reach agreement, the terms and conditions would be decided by the Governor General in Council.

The Madras Government objected to the Reserve Bank being entrusted with the management of public debt and the issue of new loans

on the ground that it constituted a restriction on the financial powers of the Local Government. The Government of India clarified that this was not so; on the other hand, the Governments would be 'provided with expert advice on the matter by the Reserve Bank which they should find exceedingly helpful'.

At centres where the Reserve Bank did not have an office of its own to handle Government business, but which were served by branches of the Imperial Bank of India, it was obliged to entrust the work to the Imperial Bank branches in terms of an agreement, valid initially for 15 years, to be entered into between the two banks with the approval of the Governor General in Council (S. 45). Although there was a lot of ill-feeling against the Imperial Bank, it was decided to entrust the agency functions to this bank rather than scheduled banks generally on the considerations of safety of public funds and the bank's elaborate network of branches and adequate and trustworthy staff.

It was provided in the Act that the agreement between the Reserve Bank and the Imperial Bank should be conditional on the maintenance of a sound financial position by the Imperial Bank. In the event of this condition not being fulfilled, the Governor General in Council, on the recommendation of the Central Board of the Reserve Bank, could issue instructions to the Imperial Bank. The broad terms of remuneration payable to the Imperial Bank for acting as the Reserve Bank's agent were enumerated in the Third Schedule. The agreement could be continued after the expiry of 15 years until it was terminated by a notice of five years on either side.

At places where there were no branches either of the Reserve Bank or of the Imperial Bank, it was open to the Governor General in Council and the Local Governments to make their own arrangements for maintaining their balances and conducting their money transactions [S. 21 (1)]. In actual practice, however,- and this was confirmed by the Finance Member during the debates in the Assembly on the Reserve Bank Bill-the position would be that the Government would request the Reserve Bank to appoint any other bank as its agent, so as to enable Government to have dealings with it through the Reserve Bank, the responsibility for the funds continuing to be with the Reserve Bank.

As a corollary to acting as Government's banker, the Reserve Bank was authorised to grant to the Central and Local Governments short-term advances repayable not later than three months from the date on which each advance was made [S. 17(5)].

On the basis of the Hilton Young Commission's recommendation the earlier Bills had provided that the Reserve Bank's loans and advances to Governments should be repayable in each case not later than three months after the close of the financial year during which the advance was made. Such a provision, the Select Committee felt,

‘might lead to undue latitude’, as in an extreme case, Government could borrow in this way for a period of 15 months. The period was therefore, limited to three months. No ceiling was, however, prescribed in the Act on the quantum of loans that the Bank was authorised to make.

Besides the grant of short-term accommodation, the Reserve Bank could also purchase the securities of the Central and Local Governments of any maturity subject to the following proviso : the amount of such securities held at any time in the assets of the Banking Department was to be so regulated that its total value did not exceed the aggregate of the share capital of the Bank, the Reserve Fund and three-fifths of the liabilities of the Banking Department in respect of deposits and that the value of short-dated and long-dated securities of which it was composed was not in excess of certain prescribed ceilings [S. 17(8)]. The Government of India preferred not to have such restrictions as they might constitute an ‘irritating and unnecessary embarrassment’, but they did not press the India Office for their deletion. They tried unsuccessfully to relegate the restrictions on the size and composition of the Bank’s holdings of Government securities to rules to be framed by the Bank, with the approval of the Governor General in Council, or alternatively to cover the matter in a Schedule to the Act. Securities fully guaranteed as to principal and interest by the Central Government or any Local Government were deemed to be the securities of such Government for the purposes of this provision.

The reason for fixing such limits on the Reserve Bank’s holdings of Government paper could perhaps be traced to the experiences of central banks the world over in the matter of financing of Governments during the First World War and its aftermath as well as during the world wide depression of the early ‘thirties, when they were forced to grant almost unlimited accommodation to the State. Contemporary Statutes of central banks contained, in varying degrees, restrictions on the extent to which the institutions could buy Government securities as part of their investments.

The Bank could likewise hold Government of India rupee securities in the Issue Department, but subject again to a specified ceiling which is discussed later.

The Reserve Bank was also obliged to accept monies on deposit and make payments there from and undertake the banking, remittance and exchange transactions and the management of the public debt on behalf of such of the Indian States as were approved of and notified by the Governor General in Council in the Gazette of India, in the same way as in the case of the Central and Local Governments. There was, however, no corresponding obligation on the part of the States to entrust their banking and other financial transactions to the Reserve

Bank. The Bank could also act as agent of the States for the kinds of business for which it was authorised to act as- agent for the Central and Local Governments [S.17 (11)]. The Indian States were also entitled to short-term accommodation, against eligible security of the type prescribed for borrowing by the scheduled and provincial co-operative banks, whereas the ways and means advances to the Central and Local Governments were in the nature of unsecured credit. Besides, the Bank could purchase and sell the securities of such Indian States as might be specified in this behalf by the Governor General in Council on the recommendation of the Central Board ; these securities .could be held in the Banking Department within the ceiling prescribed for the Bank's holding of Government securities. Securities fully guaranteed as to principal and interest by any State were also considered to be the securities of such State, under this provision.

Sole Right of Note Issue

The Reserve Bank was entrusted with the sole right .to issue bank notes in British India (S.22). The expression in the 1928 Bill was 'paper money'. The Act prescribed the denominations in which the notes were to be issued, viz., 5,10,50,100,500,1000 and 10,000 rupees, 'unless otherwise directed by the Governor General in Council on the recommendation of the Central Board' (italics supplied) (S. 24). Any series of bank notes of any denomination could be deprived of their legal tender character by the Governor General in Council on a recommendation of the Central Board [S.26 (2)].

Clause 24, as it stood in the 1933 Bill*, had made it obligatory on the Bank to issue notes of all the denominations specified therein, but the Bank could issue notes of such other denominations as might be directed by the Governor General in Council. The Select Committee considered, however, that ' the clause in its original form was unduly rigid and might have proved inconvenient' and inserted the words quoted in italics above in substitution of the words ' and of such other denominational values, if any, as may be directed by the Governor General in Council '. The clause was passed in this form. While thus discretion could be used in respect of denominations specified in the Act, ambiguity seems to have crept in with regard to issue of other denominations. When the issue of notes of the denomination of Rs. 2 was considered desirable in 1942, the Governor, Sir James Taylor, who had been associated more closely than anyone else with the passage of the Reserve Bank Bill, found it sufficient that

* '24. Bank notes shall be of the denominational values of five rupees, ten rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees and ten thousand rupees, and of such other denominational values, if any, as may be directed by the Governor General in Council.'

the Central Board recommend to the Government of India, under Section 24 of the Act, that they (the Government) issue a direction to the Bank for its issue. In later years, the view has been taken that Section 24 permitted the Government of India to direct (on the recommendation of the Central Board) only the non-issue of any of the denominations mentioned in it and that issue of notes of any new denomination would require amendment of the Act. It is, however, significant that during the debate on the Bill in the Legislative Assembly, on a motion to amend clause 24 further by restricting the Bank's power to issue notes of any denomination below Rs. 5, Sir George Schuster stated:

We are merely discussing whether the Bank's hands should be tied as regards future issues. Sir, I must oppose this amendment. We think it desirable that the Bank should have a free hand.

The notes were to be guaranteed by the Governor General in Council. The Hilton Young Commission had recommended such guarantee, but the notes under its scheme were to be convertible into gold bars. The object of the guarantee was perhaps only in respect of the legal tender character of the notes.

The issue of notes was to be conducted by the Bank in an Issue Department which was to be 'separated and kept wholly distinct from the Banking Department' (S. 23). It may be mentioned that the distinction between the Issue and Banking Departments was modelled mechanically on the Bank of England pattern, though informed opinion in the U.K., including the Macmillan Committee, had voiced serious objections to such an arrangement, as being artificial and even misleading.

The system of note issue which the Reserve Bank of India Act adopted was the one known as the proportional reserve system; in this respect, mainly on considerations of elasticity the Act departed from the Bank of England model, which was the fixed fiduciary system. However, unlike the case of some other central banks, including in particular the U.S. Federal Reserve, the Reserve Bank's charter did not specify the maintenance of any reserves against its deposit liabilities; strictly speaking, there is little difference in principle between a central bank's note issue and its deposit liabilities.

The assets of the Issue Department were to consist of gold coin, gold bullion, sterling securities, rupee coin* and rupee securities. Of the total assets, not less than two-fifths was to consist of gold coin, gold bullion or sterling securities, with the proviso that the value of gold

* 'Rupee coin' was defined in the Reserve Bank Act as silver rupees which were legal tender under the provisions of the Indian Coinage Act, 1906.

coin and bullion should not fall below Rs. 40 crores in value at any time [S. 33(2)]. However, as a measure of caution, it was stipulated (in Section 35) that the total amount of gold coin, gold bullion and sterling securities to be transferred by Government to the Reserve Bank at the outset should be not less than one half of the value of the Government currency notes then in circulation (the liability for which was to be taken over by the Bank) with the proviso that the whole of the gold coin and gold bullion held by Government in the Gold Standard Reserve and the Paper Currency Reserve at the time of transfer should be made over to the Bank. This provision was the same as in the 1928 Bill, except for the condition regarding the transfer of the entire gold holdings in Government's reserves which was added by the Joint Select Committee on the 1933 Bill. In other words, the intention was that the entire gold reserve held by Government, at the time of transfer of the currency liability, should be passed on to the Bank. The sterling securities could consist only of cash balances with the Bank of England, bills of exchange of not more than go days' maturity or British Government securities maturing within five years. The remainder of the assets could be held in rupee coin, Government of India rupee securities of any maturity and certain categories of such bills of exchange and promissory notes as were eligible for purchase by the Bank. However, securities guaranteed as to principal and interest by the Central Government were not eligible for being held in the Issue Department. The amount of rupee securities was not to exceed one-fourth of the total amount of assets or Rs. 50 crores, whichever was higher, an increase in the ceiling by Rs. 10 crores being permissible with the previous sanction of the Governor General in Council. Gold was, for this purpose, to be valued at 8.47512 grains of fine gold per rupee, on the basis of the weight of the sovereign (of 113 grains of fine gold) and at the equivalent of 1S.6d. per rupee which was the external par value of the rupee in terms of sterling then obtaining; rupee coin was to be valued at its face value and rupee securities at their market value [S. 33(4)].

It would be useful to mention very briefly the background of the different proportions provided for the components of the reserve against note issue. The Hilton Young Commission had proposed that gold and gold securities should constitute a 'safe' minimum of 40 per cent, 'in the light of the experience of other note issuing banks which are working this system'. This figure of 40 per cent was supported throughout, though later a minimum backing in gold coin and bullion, of Rs. 30 crores initially and later Rs. 35 crores, was proposed primarily 'to secure the confidence of the Indian public in the stability of the Bank'. The Joint Select Committee raised the minimum holding of gold to Rs. 40 crores, close to the Government's currency reserves then held. It would appear that more than anyone else Sir Purshotamdas

Thakurdas played an outstanding role in getting the minimum gold holding fixed at as high a level as possible. As for the valuation of the gold, although the market price was almost 50 per cent higher than the old official parity of 8.47512 grains per rupee, it was considered prudent to adopt the practice of the Bank of England and have it valued at the old parity. This, as the Finance Member indicated in the Assembly, would start the Bank with a hidden reserve of about Rs. 22 crores. The Bank was also empowered to purchase and sell gold coin and bullion [S. 17(12)] ; obviously, any gold transferred to the Issue Department could only be valued on the basis of 8.47512 grains of fine gold per rupee in terms of Section 33(4).

As regards the restriction on the holding of Government of India rupee securities in the reserve, the Hilton Young Commission had been of the view that such holdings should be of limited amount as they lacked the characteristic of automaticity with regard to expansion and contraction of currency. In other words, the objective was to develop a commercial bill market. This recommendation was incorporated in the Act. As in the case of the holdings of the Banking Department, the Government of India tried unsuccessfully to get the Secretary of State to agree that there be no restriction with regard to the holding of Treasury bills and to prescribe a limit of 10 per cent to holdings of securities with a maturity longer than six months. One of the objections of the Secretary of State was that the likelihood of Government supplying the Bank with ad hoc bills made the arrangement unsatisfactory. An amendment permitting Local Government securities also being held as part of the reserve was negatived after a brief reply from the Finance Member that while these securities could be held in the Banking Department, they would be ' unsuitable forms of investment ' in the currency reserve.

Government were to transfer to the Reserve Bank at its inception rupee coin not exceeding the value of Rs. 50 crores, as part of the assets against the liability in respect of the currency notes of the Government of India taken over by the Bank (S.35). The Act also provided for further transfer of rupee coin from the Government to the Bank or vice versa, under certain circumstances (S.36). This arrangement was intended to ensure that the Bank was, at all times, able to discharge the obligation imposed on it by the Act, to issue rupee coin on demand in exchange for notes (S.39), without at the same time being saddled with such coins to an extent of being surplus to the needs of the country. Simultaneously, to ensure the Bank's position as the sole currency authority, the Act prohibited the Governor General in Council from issuing rupee coin to the public except through the medium of the Bank (S. 38).

The Bank was empowered to suspend, with the prior sanction of the Governor General in Council, the reserve requirements in respect of the aggregate of gold coin, gold bullion and sterling securities as also the requirement regarding the minimum gold holding, for a period not exceeding 30 days initially, which might be extended by 15 days at a time. This was, however, subject to the condition that as long as there were any sterling securities remaining in the reserve, the amount of gold coin and gold bullion should not fall below the minimum of Rs. 40 crores prescribed for this holding. During the period the first requirement was suspended, the Bank was to pay to the Governor General in Council a tax, on the amount of the shortfall, at the Bank rate in force at that time plus 1 per cent per annum so long as the aggregate holding was above 32 ½ per cent of the total assets with an additional 1 ½ per cent per annum for every 2 ½ per cent further deficiency in the holding, subject to a minimum of 6 per cent per annum (S.37). Provisions such as these existed in many central banking Statutes, the object being to provide for flexibility and to ensure at the same time that the deficiency was neither large nor prolonged, though often the tax was not in fact much of a deterrent. The provisions in this respect in the Act were identical with those of the 1928 Bill except that the Joint Select Committee on the 1933 Bill added the proviso regarding the minimum holding of gold at Rs.40 crores ; this was, however, to be reconsidered when ‘ permanent ’ provisions were made for the monetary standard. The Government members on the Select Committee disagreed with this recommendation of a minimum gold reserve at all times; a Government amendment to delete the proviso was, however, negatived.

Bankers' Bank

The provisions of the Act relating to the Reserve Bank's role as a bankers' bank may now be dealt with. An important function of a central bank is to regulate the banking system of the country, holding custody of the cash reserves of banks, granting them accommodation in a discretionary way and regulating their operations in accordance with the needs of the economy, through instruments of credit control. In accordance with general central banking practice, the relations of the Reserve Bank with the money market were to be largely conducted through the medium of member banks, namely, the ‘scheduled’ banks and the provincial co-operative banks.

The ‘scheduled’ banks were banks which were listed in the Second Schedule to the Act and those banks in British India which subsequently became eligible for inclusion in this Schedule by virtue of their paid-up capital and reserves being not less than Rs. 5 lakhs

in the aggregate. * The power to include or exclude banks in or from the Schedule was vested in the Governor General in Council. These banks were required to maintain with the Reserve Bank a cash balance of not less than 5 per cent of their demand liabilities and 2 per cent of their time liabilities in India as at the close of business on any day (S.42). The provision for compulsory maintenance by the commercial banks of cash reserves with the central bank followed the pattern of the Federal Reserve Act of the U.S.A., rather than that of the U.K. and the Continent of Europe. However, unlike the U.S.A., the reserve requirement-in respect of each category of liabilities was a fixed one; this was because the maintenance of minimum reserves was regarded primarily as providing a source of funds for the Bank to operate, rather than as a credit control measure. The reserve requirements were fixed by the Joint Select Committee on the 1933 Bill after discussion with representatives of banks. (In the 1927 Bill as amended by the Select Committee, as well as in the 1928 Bill, the reserve requirements were 7 ½ and 2 ½ per cent respectively.) The Act imposed a penalty (the rate of which could go as high as 5 per cent above the Bank rate) on banks-whose cash balance with the Reserve Bank fell below the prescribed minimum figure on any day. The Act also contained a provision for a penalty of Rs.100 per day for non-submission of the prescribed weekly returns. A provision in the Bill that the penalties would be payable only by a court direction, to be made on application by the Governor General in Council, was modified by the Select Committee to the effect that the penalties would be payable on demand made by the Reserve Bank and that recourse to a Civil Court would be had only in the event of a refusal by the defaulting bank to pay on such demand.

The provincial co-operative banks were not, however, placed under a legal obligation to maintain cash reserves with the Reserve Bank as the Government felt that 'that was going rather too far at the present stage'. In the prevailing circumstances, it was considered sufficient to empower the Reserve Bank to call upon any provincial co-operative bank with which it had any transactions (by way of rediscount of eligible bills or grant of loans) to submit returns in the same manner as the scheduled banks with regard to its deposit liabilities, etc. In fact, this was the view of the Joint Select Committee also:

* It would appear that the criterion of Rs. 5 lakhs was adopted for the selection of banks to be listed in the Second Schedule when the Act was passed. The Second Schedule of the 1933 Bill had contained the names of 69 banks on the basis of the criterion, copied from the 1928 Bill, of aggregate paid-up capital and reserves of Rs. 3 lakhs; the Schedule was amended by the Select Committee to conform to the revised criterion proposed by it, viz., Rs. 5 lakhs of paid-up capital and reserves, although it was added that the list was not exhaustive. The amended Schedule, which was regarded as provisional, included the names of 50 banks only; this list was approved by the Legislature.

We considered whether provincial co-operative banks should be included in the Schedule, but came to the conclusion that though there may be considerable advantages in such a course, the time is not yet ripe for it. We consider, however, that if co-operative banks are to be given the facilities indicated in clause 17, they should submit the same returns as those prescribed for scheduled banks so as to enable the Reserve Bank to see that they are maintaining a satisfactory position.

Accordingly, a suitable provision was incorporated in the Bill by the Select Committee (S.44). In effect, while the provincial co-operative banks were exempted from the main obligation imposed on the scheduled banks, they could enjoy nearly all the privileges of scheduled status. That is to say, except in the matter of rediscount in respect of which the provincial co-operative banks could get accommodation against agricultural paper only, the credit facilities they could obtain from the Reserve Bank were identical with those admissible to the scheduled banks. The Government were not prepared to go beyond this.

Credit Facilities available from the Reserve Bank

Accommodation from the Reserve Bank was provided in the form of both rediscounts and advances, besides purchase of securities by the Bank. The Bank was authorised to purchase, sell or rediscount (i) bills of exchange and promissory notes drawn on and payable in India and arising out of bona fide commercial or trade transactions, bearing two or more good signatures, one of which was to be that of a scheduled bank, and maturing within 90 days of the date of purchase or rediscount exclusive of the grace period, (ii) bills of exchange and promissory notes drawn and payable in India and bearing the signature of a scheduled bank, and issued or drawn for the purpose of holding or trading in Central or Local Government securities or such securities of the Indian States as might be specified in this behalf by the Governor General in Council on the recommendation of the Central Board, and maturing within 90 days of the date of purchase or rediscount exclusive of the grace period, and (iii) bills of exchange and promissory notes drawn and payable in India and bearing two or more good signatures, one of which had to 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 (an amendment to extend this to twelve months was rejected) from the date of purchase or rediscount exclusive of the grace period [S.17 (2) (a), (b) and (c)]. The Bank could also purchase, sell and rediscount sterling bills of exchange (including Treasury bills)

maturing within 90 days from the date of purchase, such transactions in India being, however, confined to scheduled banks [S. 17(3) (b)].

The Bank could also grant loans and advances to scheduled banks and provincial co-operative banks repayable on demand or on the expiry of fixed periods not exceeding 90 days against the security of (a) stocks, funds and securities (other than immovable property) in which trustees could invest trust monies (b) gold or silver or documents of title to the same (silver was added by the Select Committee on the 1933 Bill) (c) bills of exchange and promissory notes eligible for purchase or rediscount by the Reserve Bank and (d) promissory notes of any scheduled bank or a provincial co-operative bank, supported by documents of title to goods pledged to such bank as security for a cash credit or overdraft granted for bona fide commercial or trade transactions, or for the financing of seasonal agricultural operations or the marketing of crops [S.17(4)(a) to (d)]. It is also interesting that in the original Bill there was a proviso (copied from the 1928 Bill) that loans against the last-mentioned security should not be made after a period of five years from the commencement of the Act; the Select Committee felt that there was 'little likelihood of the bill habit developing within five years to such an extent as to make it possible to discontinue this practice within that time'.

The desirability of including some provision, on the lines of that in the Imperial Bank of India Act, giving the Reserve Bank power in certain special circumstances to make advances to a bank in difficulties by means of some sort of a general lien on all its assets was also examined by Government but the idea was given up.

The Act did not indicate the margins that the Bank had to retain against the value of each class of collateral while granting loans and advances, as was the case with some of the foreign central bank Statutes. The Act did not also place any ceiling on the total volume of bills that the Bank could hold under any category or on the amount of loans and advances that could be granted against any eligible security: the ceilings that the Hilton Young Commission had proposed and were incorporated in the earlier Bills were deleted by the Joint Select Committee as being 'undesirable in the present conditions of India'.

Instruments of Credit Control

The instruments of credit control available to the Reserve Bank under the Act were primarily the Bank rate and open market operations. The provision for the former was made in Section 49 which read as follows : ' The Bank shall make public from time to time the standard rate at which it is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under this Act '. The

word 'standard' was substituted for the word 'minimum' by the Select Committee, as it considered it desirable that the Bank should have power to discount agricultural 'paper' at concessional rates, which might be below the rate for the purchase or rediscount of commercial paper.

The other instrument of credit control available to the Bank was open market operations, that is to say, the buying or selling of securities or bills of exchange in the open market with a view to putting additional funds into the market or withdrawing funds there from and thus expanding or contracting credit. Although there were certain limitations concerning the quantum and maturity of the Government securities the Bank could hold in its portfolio (vide S.17 and 33), the scope for the Bank to engage in open market operations was wide. Also, these operations could be carried on with parties other than scheduled and co-operative banks. Its power to purchase and sell sterling from and to scheduled banks (in amounts of not less than the equivalent of Rs. one lakh) was another tool which enabled it to regulate the available cash with these banks.

Direct Discount

Although ordinarily the Reserve Bank's relations with the money market were through the medium of the scheduled and provincial cooperative banks, provision was made for the Bank to deal directly with the market during times of emergency, through the purchase, sale or discount of commercial and agricultural bills of exchange and other paper not bearing the second signature of a bank, the sale and purchase of sterling and the grant of loans and advances against eligible collateral. Such action could be initiated only by the Central Board, or by a committee of that Board or the Governor if duly authorised by the Board in that behalf (S.18).

Mention must be made here of the history of the efforts made to invest the Bank with powers to grant direct loans and advances to agriculturists. The Central Banking Enquiry Committee had felt that, in the absence of an extensive and well-developed bill market in India, it was necessary to authorise the Reserve Bank to make loans and advances on the security of movable goods, wares and merchandise, as also against the warehouse warrants or warehouse receipts representing such goods, in order to enable it to effectively control the wide disparity in interest rates between the slack and busy seasons. During the debates an amendment was moved (by Raja Bahadur G. Krishnamachariar) suggesting the incorporation of a clause to give effect to this recommendation, but it was rejected. Sir George Schuster's observations were as follows:

It would be impossible for the Central Bank to undertake work of this kind unless it had a very large number of branches all over the country and unless there were well-regulated warehouses which would issue reliable warrants. Now, that is a condition which does not exist in India, and, if business of this type is to be encouraged, the first step that has to be taken is to create an organization of warehouses where goods and merchandise can be stored in such a way that money could be raised easily upon that security. If we were to put a provision of this kind into the Reserve Bank Bill now, I submit it would have very little effect, and there are the two grave objections, first of all, that it involves the Bank getting into direct relations with private clients, outside its own and proper sphere of business and in competition with commercial banks, and, secondly, that the financing of goods which are stored in warehouses is not merely the financing of the marketing of goods which are moving towards the market and going to be liquidated within a reasonable period. That kind of financing leads to frozen credits and must tend to get the Bank into a very unliquid position After very careful consideration and discussion with the banking experts in London, we decided to reject this recommendation.

Linking of the Indigenous Bankers with the Reserve Bank

The Joint Select Committee recognised the importance of the unorganised sector of the Indian money market and the need to bring it within the ambit of the Reserve Bank's scheme of rediscounts and its loan operations as early as possible, in order that the Bank's credit control policy was able to influence effectively the rates of interest prevailing throughout the money market. So, a clause was inserted in the Act (S.55), making it incumbent on the Bank to make a report as early as possible and in any case within three years and to prepare legislation also, if considered necessary, on the inclusion of indigenous bankers and other parties doing banking business in British India, not covered under the Second Schedule, within its scope. Sir George Schuster explained the significance of the provision thus:

It is impossible to over-estimate the importance that the indigenous banker plays in the whole of the banking and credit machinery of India his part of the organisation represents, if anything, more than 90 per cent, of the whole; and it is unfortunately true that the links between the whole of this system and the modern banking system of India, in spite of the development of rural co-operative societies and in spite of the opening of one hundred new branches by the Imperial Bank of India, are still rudimentary and incomplete we recognise that until the vast portion of India's banking and credit machinery, which is represented by the indigenous bankers, is put into gear with the relatively small machine of the modernised money market, with the Reserve Bank as its central control, it will be impossible for the Reserve Bank to exercise that full control

of currency and credit of India which is understood as the function of a central bank in western countries; and it will be equally impossible for the masses of the people who populate the countryside of India to get the full benefits of credit and banking facilities on reasonable terms which a well organised system of banking ought to give. That, I believe, is one of the greatest problems of the future for India, and it is a problem which I at any rate personally feel must be thought of, not in terms of displacing the vast masses of indigenous bankers throughout the country, but of making the fullest use of them by adapting their methods so that they may fit in with the modern banking system and the central bank.

Agricultural Credit Department

Closely allied with the problem of linking the indigenous bankers with the Reserve Bank was that of improving the machinery for dealing with agricultural finance to which the Legislature attached considerable importance. The need to empower the Reserve Bank to grant accommodation by way of rediscount facilities as well as loans and advances to banks to enable the latter to finance 'current transactions for agricultural purposes' was recognised even by the Hilton Young Commission in 1926. The 1927 and 1928 Bills contained provisions vesting the Bank with the authority to rediscount bills of exchange and promissory notes drawn or issued for the purpose of financing seasonal agricultural operations or the marketing of crops and to grant loans and advances against such bills or notes. These provisions were left almost intact in the 1933 Bill and adopted by the Legislature with few changes. The Central Banking Enquiry Committee of 1931 had not only endorsed the provisions of the 1928 Bill but gone a step further in suggesting the grant of direct accommodation to agriculturists; mention of this has already been made.

However, while much stress was laid throughout on the central bank's role in the sphere of agricultural finance, it was only at the final stage of the passage through the Legislature of the 1933 Bill that it was recommended that the central bank should handle this work in a separate and distinct department to be established for this purpose. The Joint Select Committee on the 1933 Bill came nearest to the suggestion when it said that the statutory report, which it had recommended that the Bank should make regarding the indigenous bankers (of which mention has been made earlier), 'should also include proposals for the closer linking of agricultural enterprise with the machinery of the Reserve Bank, possibly by the establishment of a separate rural credit department' and amended the Bill accordingly. Section 54 of the Act requiring the Bank to create a special Agricultural Credit Department forthwith was really a last-minute

inclusion by the Legislature, being the result of a lengthy debate on an amendment moved by Mr. B. Sitaramaraju.

This Member had, even during the debate on the motion to take up the Bill as returned by the Select Committee for consideration, proposed that the Bill be recommitted to them for the purpose of making adequate provisions therein to serve rural credit. During the clause by clause discussion stage, he moved an amendment for the setting up of a Rural Credit Department by the Bank as a 'distinct' department as early as possible and, in any case, within two years of the Bank's inception, 'on such terms and conditions regarding the financing and the method of working of the Department as the Bank and the Governor General in Council may agree upon'. There was general support to this proposal from all sections of the House.

Mr. Sitaramaraju quoted in support of his amendment the analogy of the Commonwealth Bank of Australia which was undertaking a similar function. He suggested that the proposed Rural Credit Department should have two branches, one for dispensing short-term credit and the other for long-term credit. The Department was also expected to function as an apex institution for co-ordinating various activities in the field of agricultural finance. Other Members who agreed with Mr. Sitaramaraju felt, however, that the problems of rural indebtedness and ensuring an adequate supply of rural credit admitted of no easy solution and stressed the difficulties involved in bringing the agriculturists in touch with the Reserve Bank.

Recognising the importance of a statutory provision for a separate department to deal with the whole range of problems involved, Government were not opposed in principle to the inclusion of a clause broadly on the lines proposed by Mr. Sitaramaraju. However, it was considered to be clearly undesirable to saddle the Bank with the duty of providing long-term credit, which would 'tie up its funds. Again, there was need to distinguish between the type of measures that were required for dealing with accumulations of past indebtedness and the provisions for establishing a credit machinery for the future. There was also a difference in the needs of the poor cultivators and those of larger cultivators, the zamindars and the landlords. The Finance Member stated that the Reserve Bank could not itself possibly deal directly with all the needs:

We all hope that the Reserve Bank will perform an important function in the country. But let us not exaggerate the importance of the function which it can perform. It is there to provide proper co-ordination, control, and support by means of reserves, for the general banking system of the country. It is not intended to go out itself and to usurp the functions of the banks or other organisations which are dealing direct with individuals for credit. It is there, rather to stand behind them, to co-ordinate them and support them.

..... it is no use lightening the load of existing indebtedness or providing better facilities for cheap credit in the future unless you put the cultivator into a position of being able to take advantage of that improvement in his conditions. And that means a great many things outside credit machinery that means a complete revolution in the countryside, better education, better marketing methods, better methods of agriculture and the acquisition of habits of thrift, which are all extremely desirable and for which we all ought to be working and every Government authority ought to be working, but which are far beyond the scope of anything which the Reserve Bank can do.

All that the Bank could do, he went on, was to take a part in the scheme of agricultural finance conjointly with the co-operative credit movement. Charged as it was with working the currency and credit system of the country, it would be most undesirable for the Bank to undertake any business, whether it be rural credit or industrial credit, otherwise than on the lines laid down in the earlier clauses of the Bill. Besides, unless the Reserve Bank could ' somehow or other get into gear with all the rather primitive credit machinery which exists in the country, the indigenous bankers and their whole business of rural finance, . . . it will remain the centre of an important machine no doubt, but out of touch with the main financial business of India'. On the other hand, the Bank could perform a very useful function by acting as a guide and an adviser to the whole of the co-operative financing machinery. With these objectives in view, and drawing support for them from the comments made by Mr. Macpherson, the co-operative expert from the Punjab who had given evidence in this regard before the Joint Select Committee, the Finance. Member moved an alternative amendment in terms of which a special Agricultural Credit Department was to be established immediately but with the limited functions of maintaining an expert staff to study all questions of agricultural credit and advising the Central and Local Governments, the provincial co-operative banks and other banking organisations on matters pertaining to agricultural credit, and of co-ordinating the Bank's operations with those of other institutions purveying such credit. The alternative clause was adopted by the House (S.54) along with the clause recommended by the Select Committee, viz., that the Bank should make a report, with proposals for legislation, within three years on 'the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the Bank' [S. 55(1) (b)].

Exchange Obligation

The provisions of the Act imposing on the Bank the obligation to preserve the ruling exchange parity of the rupee with sterling were perhaps the most controversial.

Consistently with the obligations placed on the Government of India under the Currency Act. of 1927 to purchase and sell gold at the rate of Rs. 21-3-10 per tola, of fine gold (corresponding to 8.47512 grains of fine gold per rupee, which again was the same as the amount of gold corresponding to an exchange rate of 1S. 6d. per rupee), both the 1927 and 1928 Bills proposed to make it incumbent on the Bank to take over this function with a view to preserving the external stability of the rupee.

When the 1933 Bill was drafted, however, the Indian monetary situation was entirely different. The London Committee had been of the view that the best course for India then was to remain on the sterling standard, although sterling had been divorced from its gold basis. The Committee went on to say:

On this basis the exchange obligations incorporated in the Bill must necessarily be in accord with the rupee-sterling ratio existing at the time when the Bill is introduced. This statement does not, however, imply any expression of opinion on the part of the Committee on the merits or demerits of the present ratio. The ratio provisions in the Bill are designed to make it clear that there will not be any change in the de facto situation by the mere coming into operation of the Reserve Bank Act.

The Select Committee accepted the views expressed by the London Committee. Accordingly, the Bill as returned by the Committee proposed that the Bank should sell and purchase sterling at any of its offices for immediate delivery in London, at rates not below 1S. 5 49/64d. and not higher than 1S. 6 3/16d. per rupee, respectively (S. 40 and 41). It may be mentioned here that the first draft of the Bill prepared by Government retained the obligation to buy gold also, while omitting all reference to its sale! This was deleted under instructions from India Office ' for tactical reasons since there might be a danger of provoking introduction in Select Committee of an amendment altering rate and stirring up controversy about Gold ratio of rupee'.

The ratio question provoked a good deal of heated discussion and several amendments were moved. These were of three kinds-some wanted to leave the rupee to take its own course and not to fix a value, the second type sought to fix a lower value than that fixed in the clauses and the third proposed that the value should not be decided in the Assembly but provision should be made to fix it at that level which existed on the date the relevant clauses came into operation. The sponsors of the first group of amendments did not, however, move them. Mr. B. Sitaramaraj moved an amendment representative of the second group: it proposed reduction of the ratio to 1S. 4d.

The discussions on the amendments lasted nearly three days. However, none of the Members who spoke opposed the system of the sterling exchange standard itself. In a lengthy reply to the debate, Sir George Schuster explained that the ratio question was not before the Legislature at all. In fact, even at the time he introduced the Bill as returned by the Select Committee for detailed consideration, he had told the Assembly:

this is a Bill to create the machinery of a central bank for India, and not a Bill to deal with the ratio. The ratio clauses are merely incidental. If we had thought that our introduction of this measure was to be made an occasion for attempting to revise the present position, we should never have introduced the Bill at all. We do not seek to get any new confirmation of that ratio from the Legislature. That already has statutory force, and we do not seek or need to strengthen it.

Moreover, if and when a change was necessary, the matter was one for immediate executive action as it was obviously impossible to have a discussion in the Legislature before giving effect to it. The amendments were lost. It would seem that the authorities had decided to withdraw the Bill if the Legislature did not approve the ratio clauses.

It may be mentioned that during this period the agitation against the ratio clauses of the Reserve Bank Bill was carried on under the banner of the Currency League supported by stalwarts like Mr. F.E.Dinshaw, Mr. Walchand Hirachand, Seth Mathuradas Vissanji Khimji, Mr. Chunilal B. Mehta, Mr. S. N. Pochkhanawalla, Mr. A. D. Shroff and Sir Purshotamdas Thakurdas.

The Joint Select Committee thought it desirable to include a provision embodying in a more concrete form the principle recognised in the Preamble, concerning the provisional character of the monetary arrangements, by placing a definite obligation on the Bank's Central Board to put up proposals for a more permanent currency system for India when it considered that the pre-requisites indicated in the Preamble had been fulfilled. The new clause, which was passed by the Assembly, provided that when, in the opinion of the Bank, the international monetary position had become sufficiently clear and stable to make it possible to determine what would be suitable as a permanent basis for the Indian monetary system, it was to frame proposals for a permanent monetary standard and submit them for the consideration of the Governor General in Council [S. 55(2)].

Returns and Reports

Under the Reserve Bank of India Act, weekly accounts of the assets and liabilities of the Issue and Banking Departments were to be

compiled by the Bank in the forms set out in the Fifth Schedule* or in such other forms as might be prescribed by the Governor General in Council and transmitted to him; these accounts were to be published in the Gazette of India. Similarly, the Bank was required to submit to Government within two months of the close of each year the annual accounts accompanied by a report from the Central Board on the Bank's working. An amendment was moved to provide statutorily that the Bank's annual report and balance-sheet should be placed before the Central Legislature 'for discussion on a day to be specially reserved for this purpose by the Governor General in Council'. † The Finance Member considered this proposal 'unnecessarily elaborate' and said that if the Legislature wished to discuss any report of the Bank 'they surely will not be denied the opportunity'.

The Bank was also required to publish a weekly statement showing, in a consolidated form, the aggregate of the amounts of the demand and time liabilities, cash balances, etc., of the scheduled banks.

A clause was also added to provide for amendment of the Indian Companies Act to prevent the nomenclature of the Bank from being misused as there was a tendency to set up banks with grandiose titles to deceive a more than usually credulous public.

In the Council of State, the Government submitted only a few verbal amendments, rather than seek a review of the Assembly's verdict on such issues as the London Office for fear that the upper House which was then 'by no means in the acquiescent mood which could formerly be relied upon' might reopen other issues, leading to further delay in the passage of the Bill.

As already mentioned, the above description refers to the Act as it stood at the beginning. Through the years, the Act has undergone many and substantial changes, e.g., with respect to the Bank's transformation from a shareholders' bank into a State-owned bank, the substitution of the proportional reserve system by a minimum reserve requirement in absolute terms consequent on the large expansion of currency and the heavy drafts on the foreign assets with the rising tempo of economic development, and the enlargement and diversification of the Bank's functions in various spheres for effectively catering to the growing needs of the various sectors of the economy and in particular agriculture, the Bank endeavouring to strike out new paths in this sphere. Important amendments to the Act made till 1951 are covered in the chapters that follow.

* The Schedule was deleted by the India and Burma (Burma Monetary Arrangements) Order, 1937.

† In this and the subsequent chapters, the words Governor General are used without a hyphen between them, in accordance with the text of the Reserve Bank of India Act.

THE FORMATIVE YEARS: 1935-39

The Beginnings

The Reserve Bank of India Act was placed on the Statute-book on March 6, 1934. It was, however, not before another year had passed that the Bank was inaugurated. The Government of India were keen on starting the Bank as early as possible, especially in view of the fact that the Reserve Bank Bill had been rushed through the Legislature in a special session. It would also appear that Sir George Schuster, who had piloted the Bill, was keen to establish the Bank at an early date since he was laying down office. As Finance Member shortly, that is to say, sometime in the spring of 1934. The Government's proposals were that the appointments of the Governor, Deputy Governors and the Central Board should be made early in 1934 to enable the issue of shares in that summer, which was regarded as likely to be particularly favourable for such an operation. However, the Secretary of State for India favoured a somewhat leisurely time-table, for several reasons. In the first place, apart from the time necessary to make the preliminary arrangements, some of the pre-conditions envisaged for the establishment of the Bank, such as improvement of the budgetary position of the Government and the return of the normal export surplus, required to be fulfilled. The Home authorities also desired that the international monetary situation should clear up, a consideration that had been fully recognised in the Preamble to the Act! Further, the Secretary of State was of the view that 'it would be unfair to hasten the opening of the Reserve Bank until he (the new Finance Member) has had an opportunity of acquainting himself personally with the situation on the spot and been able to form his own judgment on matters'. A suggestion emanating from the Government of India that the Bank should start without the function of currency regulation was rejected by the Secretary of State. In the end, a compromise emerged in that the Bank started functioning not as early as the Government of India had desired but not so late as the Secretary of State had envisaged.

The provisions of the Act relating to the constitution of the Bank, issue of share capital and establishment of Central and Local Boards became operative from January 1, 1935, under a notification issued by the Government of India on December 20, 1934. The appointment of the first Governor and the nomination of the first Central Board of Directors were also made under the same notification and became effective simultaneously. The first two Deputy Governors were designated in October 1934, but assumed office only from the middle of February 1935. The Central Board of Directors held its first meeting on January 14, 1935, in Calcutta, and considered matters relating to staff, premises, issue of share capital, agreements with the Government and the Imperial Bank of India, regulations regarding scheduled banks and a host of other matters relating to the organisation of the Bank. The Board finalised the organisational preliminaries at its second meeting held in Delhi, on February 23, 1935. The Board also decided to issue the share capital of the Bank at par, after discussing at length proposals for a premium issue mooted by the Government. The issue of shares to the public was made in March and the Bank was formally inaugurated on Monday, April 1, 1935. The launching of the Bank on the first day of the fiscal year was also influenced by considerations of administrative convenience for the change over of Government accounts from the Imperial Bank to the Reserve Bank.

On the occasion of the inauguration of the Bank, the Secretary of State for India sent the following message to the Governor:

As Reserve Bank commences active operations today I take opportunity to convey to you and your colleagues on the Board my most cordial good wishes and to express my confidence that this great undertaking will contribute largely to the economic well-being of India and of its people.

Replying on behalf of the Deputy Governors, the Board and himself, the Governor assured the Secretary of State,

that their utmost endeavour will be to promote the economic wellbeing of India and thereby completely justify the institution of the Reserve Bank of India.

The Bank began operations by taking over from the Government the functions hitherto performed by the Controller of the Currency and from the Imperial Bank of India the management of Government accounts and public debt. The then existing Currency Offices in Calcutta, Bombay, Madras, Rangoon, Karachi, Lahore and Cawnpore became the branches of the Issue Department of the Bank. As the Currency Offices in Lahore and Cawnpore were considered to be

adequate for the Northern Area, the Office of the Deputy Controller of the Currency in Delhi had been abolished before the Reserve Bank took over. Hence it was not considered necessary to open an office of the Issue Department in Delhi. Offices of the Banking Department* were established in Bombay, Calcutta, Madras, Delhi and Rangoon, which took over the conduct of Government Treasury business at all those places and the management of public debt in Bombay, Calcutta and Madras, from the Imperial Bank of India. At other places where branches of the Imperial Bank were then doing Treasury business, the Reserve Bank appointed the Imperial Bank as its agent for the conduct of such business. The management of Government Treasuries operating at places where the Imperial Bank had no branches also came under the control of the Reserve Bank.

The Bank's first statement of its affairs, as at the close of Friday, April 5, 1935, is given on page 124. The formal assumption of the functions of a bankers' bank came a little later, on July 4, 1935, when the first official Bank rate was announced, followed by the lodgement with it the next day of the statutory deposits of scheduled banks in accordance with the provisions of Section 42 of the Reserve Bank of India Act; the latter was deliberately timed to take place in the slack season, so as not to cause 'considerable and unnecessary embarrassment' to the scheduled banks. However, some banks had begun maintaining balances with the Reserve Bank even earlier, particularly the Imperial, which did so from the beginning, that is, April 1.

Governor and Deputy Governors

The appointment of the first Governor was regarded as 'a point of vital importance'. It would seem that, as early as December 1933, the Viceroy had sent his personal recommendation in this matter to the Secretary of State. What that recommendation was is not known. Even in February 1934, officials in Delhi connected with the Reserve Bank matters did not know whether the Governor to be was a person who had Indian experience or not. Anyway, on November 29, 1934, the post was offered to and accepted by Sir Osborne Arkell Smith, then one of the two Managing Governors of the Imperial Bank of India, the term of office being three and a half years.

An Australian national, Sir Osborne, then in his late fifties had behind him a life time devoted to banking service; after nearly 20 years in the Bank of New South Wales, the largest Australian trading bank, he joined the Commonwealth Bank of Australia, which he served in

* The Bank also created agencies, i.e., restricted branches of its Banking Department in the branches of the Issue Department at Cawnpore, Lahore and Karachi.

(Rs. crores)

| <i>ISSUE DEPARTMENT</i> | | | |
|--------------------------------------|---------------|---|---------------|
| LIABILITIES | | ASSETS | |
| Notes held in the Banking Department | 19.05 | A. Gold Coin and Bullion: | |
| | | (a) Held in India | 41.55 |
| | | (b) Held outside India | 2.87 |
| Notes in circulation | <u>167.00</u> | Sterling Securities | <u>48.63</u> |
| Total Notes issued | 186.05 | TOTAL OF A | 93.05 |
| | | B. Rupee Coin | 49.95 |
| | | Government of India Rupee Securities | 43.05 |
| | | Internal Bills of Exchange and other commercial Paper | |
| Total | <u>186.05</u> | Total | <u>186.05</u> |

Ratio of Total of A to Liabilities: 50.013 per cent.

| <i>BANKING DEPARTMENT</i> | | | |
|---------------------------------|--------------|-----------------------------------|--------------|
| LIABILITIES | | ASSETS | |
| Capital paid up | 5.00 | Notes | 19.05 |
| Reserve Fund | 5.00 | Rupee Coin | 0.04 |
| Deposits: | | Subsidiary Coin. | 0.01 |
| (a) Government | 18.36 | Bills Purchased and Dis-counted | |
| (1) Central Government of India | | (a) Internal | |
| (2) Government of Burma | | (b) External | |
| (3) Other Government Accounts | | (c) Government Treasury Bills | |
| (b) Banks | 7.82 | Balances held abroad* | 11.95 |
| (c) Others | 0.01 | Loans and Advances to Governments | |
| Bills Payable | | Other Loans and Advances | |
| Other Liabilities | 0.02 | Investments | 5.00 |
| | | Other Assets | 0.16 |
| Total | <u>36.21</u> | | <u>36.21</u> |

* Includes Cash and Short-term securities

various responsible positions for over a decade, and learned his lessons in central banking. He was its London Manager when he joined the Imperial Bank of India as a Managing Governor in 1926. The circumstances under which he was appointed Governor are described by Sir C. D. Deshmukh, as follows:

Plans, characteristic of the foresight that the British bring to bear on public affairs in order to preserve what they regard as their own legitimate interests, were made to ensure that the first Governor of the Reserve Bank would be a person on whom the Bank of England could rely and of whom they could expect unquestioning co-operation. With

this object in view, Sir Osborne Smith was first introduced to the Imperial Bank as the Managing Governor in 1926 in order to familiarise himself with the conditions of commercial banking in India and was, after a period of waiting which must have appeared irksome to him self and his sponsors, appointed first Governor of the Reserve Bank in 1935.*

According to Lord Norman's biographer, Sir Henry Clay, Sir Osborne Smith's appointment as a Managing Governor of the Imperial Bank and later as the Governor of the Reserve Bank, had been recommended by Lord Norman. Sir Osborne's reputation as a banker was quite high; his successful stewardship of the Imperial Bank through the difficult years of depression and the salutary reforms he carried out for remodelling its working had received wide recognition. The testimony of the contemporary press indicates that his appointment as Governor of the Reserve Bank was well received in financial and business circles. 'The choice of Sir Osborne Smith is the one aspect of the Reserve Bank in which the entire newspaper world, both at Home and in India, English and vernacular, has been unanimous', was the comment of the Capital†; the Indian Finance‡ echoed the same sentiment when it stated 'Here is just the round peg in the round hole'. There is, however, an element of amusing irony in the first Governor of the Reserve Bank happening to be a man of 'tested banking experience' when one recalls the acrimonious debates on the Reserve Bank Bill in the Legislative Assembly, and the uncompromising stand taken by Government spokesmen to have this provision deleted. Apparently, while a British Governor could have been picked from the higher administrative ranks of the appropriate services of the Government of India (indeed Mr. Taylor himself), there was a desire to have as the first Governor someone outside the Government, in order to demonstrate the principle of independence of the Bank about which very strong sentiments had been professed by Government. However, as it happened, Sir Osborne was not destined to stay for long.

The first Deputy Governors of the Bank were Mr. (later Sir) James Braid Taylor and Sir Sikander Hyat-Khan, appointed for terms of office not exceeding five years. Sir James belonged to the Indian Civil Service; after working in the C. P. and Berar Government for some time, he moved to the Government of India, which he served for over a decade mainly as Deputy Controller and Controller of the Currency. Later, as Additional Secretary in the Finance Department, he was intimately associated with the preparation and the piloting of the 1933 Reserve Bank Bill. The task of planning the organisation and administration of the Reserve Bank was entrusted to Sir James, whose

* Central Banking in India -A Retrospect.

† March 14, 1935.

‡ March 8, 1935.

knowledge of the details of administration was extraordinarily close. The appointment of Sir Sikander Hyat-Khan fulfilled the assurance given in the Legislature by Sir George Schuster, Finance Member, that one of the top executive posts of the Bank would be filled by a qualified Indian. Sir Sikander was a distinguished political figure and an administrator, having been a Member of the Punjab Legislative Council for long and Acting Governor of the Punjab. However, he did not continue in office for long.

One of the terms of appointment of Mr. Taylor was that he should resign from the Indian Civil Service with effect from the date on which he would take up duty as Deputy Governor. It would appear that this condition was proposed by the Secretary of State for India. Apparently, this was done to ensure the independence of the Governor and the Deputy Governors, in conformity with the prevailing philosophy.

In 1953, the Government desired that this requirement be waived in the case of persons appointed to the post of Deputy Governor, but the proposal did not find favour with the Central Board of the Bank and the Government did not pursue the matter.

It was also a condition of appointment that Mr. Taylor's pension as a Government servant would be held in abeyance so long as he was an executive of the Bank. This condition has also remained operative to this date. But here again, several years later, consideration was given to amending the provision to enable the appointee to draw the pension with an equivalent reduction in the salary drawn from the Bank, but it was decided to make no change, except that permission was to be given for commutation of a portion of the pension. The significance of this requirement has been explained thus:

The principle underlying this stipulation is apparently that officers holding the post of Governors and Deputy Governors should draw their entire salaries from the Bank and should devote their whole attention to the affairs of the Bank, in the conduct of which they should be able to act independently.

Central Board of Directors

Under the Bank's Statute, apart from the four Directors to be nominated under Section 8(1) (b), the first eight Directors representing shareholders on the various registers were also to be nominated by the Governor General in Council from the areas respectively served by these registers [Section 15(3)]. At the end of each successive year after the first nomination of the Directors representing the shareholders, two of them were to retire and be replaced by Directors elected in the manner provided under Section 9. The Joint Select Committee on the Reserve Bank of India Bill had indicated in its report that the power of nomination

by the Governor General under Section 8(1)(b) should be exercised with a view to securing representation of territorial or economic interests, and in particular the interests of agriculture and co-operative banking, if these did not secure adequate representation from among the elected Directors. As regards the nomination to the first Board, of Directors representing shareholders, the Committee had made no specific recommendation as it was satisfied with the assurance given on behalf of the Government that such nomination would provide for proper representation of Indians. The Committee had also made it clear that it did not consider anything less than 75 per cent of the voting Directors as constituting a proper representation of Indians.

Although there were no specific stipulations regarding the manner in which the Governor General should exercise his power, the nomination of the first Directors representing the shareholders was done after consultation with the Governors of Provinces and their respective Governments. The choice of persons appears to have been largely influenced by the desirability of affording representation to the various prominent business classes as well as communal interests. While these considerations were kept in view, the choice of individuals was based on their competence and suitability for fulfilling their responsibilities.

The consultation with the Provincial Governors was no mere formality and their views appear to have been given due weight in the final nomination of persons. In one instance, the person suggested by the Government of India was not favoured by the Governor as he did not consider that he 'could be trusted to be impartial as a Director in respect of any issue affecting the interests of himself, his class or his family'. The same Governor found it difficult to approve of another person as he was 'a staunch Congressman and a member of the All India Congress Committee who had used the co-operative machine in order to strengthen the hold of the Congress over the population of. . . . 'As an alternative, another person was suggested who would be 'an admirable representative of the interests of the co-operative movement'.

The Directors of the first Central Board, other than the Governor, the Deputy Governors and the Government official (Mr. J. W. Kelly, Controller of the Currency), were as under:

Directors nominated under Section 8(1) (b)

Sir Homi Mehta, Kt., Bombay.

Mr. A. A. Bruce, Rangoon.

Lala Shri Ram, Delhi.

Khan Bahadur Adam Hajee Mohammad Sait, Madras.

Directors nominated under Section 15(3)

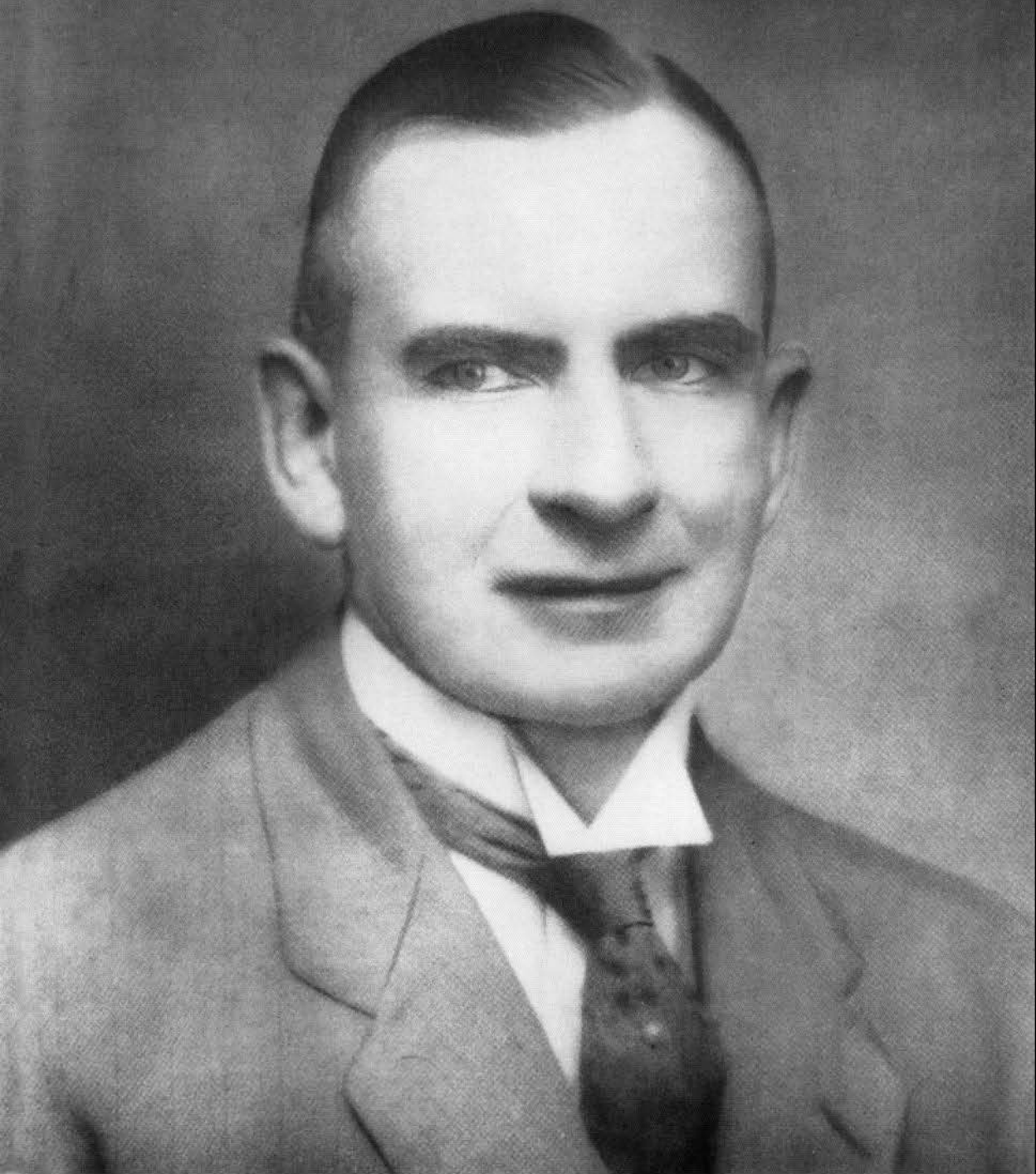
- (1) *Bombay register*
Sir Purshotamdas Thakurdas, Kt., C.I.E., M.B.E.
Mr. F. E. Dinshaw.
- (2) *Calcutta register*
Sir Edward Benthall, Kt.
Rai Bahadur Sir Badridas Goenka, Kt., C.I.E.
- (3) *Delhi register*
Khan Bahadur Nawab Sir Muzammilullah Khan, K.C.I.E.,
Aligarh.
Sir Sundar Singh Majithia, K.C.I.E., Amritsar.
- (4) *Madras register*
Dewan Bahadur M. Ramachandra Rao, Kt.
- (5) *Rangoon register*
U Bah Oh.

On the first Board, the comment of Indian Finance* was as follows:

The composition of the first Board is one on which the Government do deserve to be congratulated. They have brought together as fine a team as is possible in India. There are at least four or five members of that Board who will exercise such influence and have such a big say that the country may rely upon the functioning of that Board in a way that will prove beneficial to India.

In terms of the Bank's General Regulations, a Committee, to be called the Committee of the Central Board, was constituted to attend to the current business of the Bank. The Committee was vested with full powers to transact all the usual business of the Bank except in such matters as were specifically reserved by the Act to the Governor General in Council, a general meeting of shareholders or the Central Board. The Committee consisted of the Governor, the Deputy Governors, the Directors representing the shareholders of the area in which the meeting was held, the nominated Director resident in such area and the Government Director. The weekly meetings of the Committee were generally held on Wednesdays, this being a convenient day for consideration of the weekly statement of affairs of the Bank of the preceding Friday; this practice continues to this day. The first meeting of the Committee was held on April 10, 1935 in Calcutta. Likewise, a Committee was constituted for each of the Local Boards.

* March 8, 1935.



Sir Osborne A. Smith
Governor, 1935-37

Issue of Share Capital

The Memorandum of Procedure for the issue of shares of the Bank was adopted by the Central Board of the Bank at its meeting on February 23, 1935, in consultation with the Committee of the Legislature appointed under sub-section 5 of Section 4 of the Reserve Bank of India Act and consisting of Hon'ble Mr. Hossain Imam, Mr. Sri Prakasa and Seth Hajee Abdoola Haroon. The announcement of the issue was made on March 8, 1935 and given wide publicity through the medium of English as well as Indian language papers and journals. The shares were issued at par, the cumulative dividend-payable in accordance with the provisions of the Act having been fixed at 3 ½ per cent under a notification dated March 2, 1935, issued by the Governor General in Council. The actual floatation of shares was entrusted to the Imperial Bank of India on a commission of 1/8 of 1 per cent of the nominal value of shares receiving allotment; a brokerage of not more than 1/16 of 1 per cent was also allowed. Arrangements were made for receiving applications at 574 centres, comprising offices and branches of the Imperial Bank of India, Treasuries and head post offices.

The Bank's share issue appears to have evoked widespread interest. This was in large measure due to the propaganda carried in the nationalist press urging the people to acquire as large a number of shares as possible so as to avoid control of the Bank- a symbol of India's growing financial autonomy-getting into the hands of 'an exploiting group or caucus'. One Bombay journal wanted every Indian with the money 'to make an effort to secure the minimum of 5 shares that will entitle him to a vote and hold it as a public trust, refusing to part with it to others on any terms'. Appeals of this sort naturally led to widespread expectation that the shares would appreciate in value at no distant date. Indeed, there were rumours that some brokers were dealing in shares of the Reserve Bank at a premium ranging up to Rs. 25 even before the issue of shares had been completed.

The lists remained open for four days from March 22 to March 25, and the issue was oversubscribed to the extent of nearly Rs. 5 crores or 100 per cent, the total number of applications received being 1,34,558. The number of applications for five or more shares in respect of the Bombay, Delhi and Madras registers exceeded the limit of 1/5th of the total number of shares assigned to each of those registers. Accordingly, all applications for less than five shares became ineligible for allotment, while applications for five or more shares which were successful in the drawing of lots received only a minimum allotment of five shares. The position was different in respect of the Calcutta and Rangoon registers, where the number of applications for five or more shares fell short of the limit of 1/5th of the number of shares assigned

to those registers. As a result, all such applicants received at least a minimum allotment of five shares; applications for less than five shares also did not involve drawing for allotment. The entire share capital was allotted to the public, with the exception of shares of the nominal value of Rs. 2.2 lakhs which were assigned to the Central Government under Section 4(8) of the Reserve Bank of India Act, to be held for disposal at par to Directors seeking to obtain the minimum share qualification. The number of original shareholders on the various registers was as follows: Bombay 28,000, Calcutta 23,890, Delhi 23,000, Madras 14,000 and Rangoon 3,157.

Organisational Preliminaries: Senior Staff

The initial task in organising the activities of the Bank was to engage suitable personnel and locate premises. Obviously, the most convenient solution to the problem of manning the new institution was to utilise the services of staff of the Currency Offices of Government and the Imperial Bank of India engaged in the performance of functions taken over by the Bank. The junior staff of the Currency Offices were taken over on a permanent footing while those of the Imperial Bank came over initially on a temporary basis and were subsequently absorbed. The transfer of staff in both cases was arranged on the existing conditions of pay and service. By and by, new staff, at the clerical level, were recruited. The employment situation was such that there was a tremendous rush of applications for jobs in the Bank.

For manning the higher positions, the Bank secured the services of Currency Officers from the Government of India and senior officials from the Imperial Bank. Currency Officers whose services were lent by Government were posted to take charge of the branches of the Issue Department of the Bank, while a senior Government official of the rank of a Currency Officer was assigned for the periodical inspection, audit and verification of those offices. Senior officers from the Imperial Bank were appointed as Secretary to the Central Board and the Managers of the five offices of the Banking Department. Mr. S. S. Rachhpal, who was appointed to the post of Secretary to the Central Board in January 1935, went back to his parent institution-the Imperial Bank-in June 1935. The Secretary's work came to be looked after by Mr. K. G. Ambegaokar, I.C.S., who had been earlier appointed as Officer-in-Charge of the Agricultural Credit Department. Messrs R. A. B. Allan, W. T. McCallum, W. J. Lutley, A. J. Elder and J. N. Ahuja became the Managers of Calcutta, Bombay, Delhi, Rangoon and Madras Offices, respectively. The position of the Chief Accountant of the Bank was taken over at the beginning of 1935 by Rai A.C. Mukherji Bahadur, who was then Deputy Controller of the

Currency at Calcutta, and on his resignation for reasons of health, shortly before the formal inauguration of the Bank, Mr. (later Sir) C. R. Trevor, a senior official of the Imperial Bank, was appointed in his place.

The only official to be brought in from abroad was Mr. E. V. M. Stockdale of the Bank of England, who was appointed temporarily as Personal Assistant to the Governor, for introducing in the Bank up to date central bank book-keeping methods. Later, in October 1937, another official of the Bank of England, Mr. P. S. Beale, was brought in as Secretary of the Bank, on account of his experience as a practical banker. This was at a time when the search for a European Deputy Governor was being pursued. It is not unlikely that Sir James Taylor intended this appointment to satisfy to some extent the protagonists of a European Deputy Governor. Mr. Beale returned to the Bank of England soon after the outbreak of war in September 1939.

Office Accommodation

As in the case of the staff, the accommodation of Bank's offices at the various centres was also arranged by leasing the premises of the Government and the Imperial Bank, where the staff taken over from them were wont to function; it is, however, interesting to mention that the India Office had been keen that in respect of accommodation and staff the Bank should be quite independent of commercial banks, to impress on people that the Reserve Bank was a different institution altogether. In Calcutta, the Issue Department of the Bank started functioning in the old Currency Office, while the premises of the Alliance Bank, leased from the liquidators by the Imperial Bank of India, were utilised to house the Banking Department and the Central Office of the Bank. In Bombay, the Issue Department opened in the erstwhile Currency Office building at Esplanade Road and the Banking Department in the Imperial Bank building. More or less similar arrangements were made at other centres also. Soon the Bank embarked on a comprehensive building programme; the Bombay and Rangoon buildings were completed in March 1939, and the Lahore building in January 1940. Construction of the Bombay building was begun in 1937; the work was entrusted to Messrs Shapoorji Pallonji & Co., who worked under the supervision of Messrs Palmer & Turner, Consulting Architects, and Messrs Gregson, Batley & King, Supervising Architects. The building cost Rs. 25.55 lakhs, exclusive of the cost of land. The Rangoon and Lahore buildings cost about Rs.10 lakhs and Rs. 6 lakhs, respectively.

The Bank's Seal

A brief account of the selection of the Bank's common seal should also be of interest. Special care was taken to choose the sketches for the seal

as, at a later stage, it was to be used as the emblem of the Bank on currency notes, cheques and publications. The Government's general ideas on the seal were as follows:

- (1) the seal should emphasise the Governmental status of the Bank but not too closely;
- (2) it should have something Indian in the design ;
- (3) it should be simple, artistic and heraldically correct ; and
- (4) the design should be such that it could be used without substantial alteration for letter heading, etc.

For this purpose, various seals, medals and coins were examined. The East India Company Double Mohur, with the sketch of the Lion and Palm Tree, was found most suitable; however, it was decided to replace the lion by the tiger, the latter being regarded as the more characteristic animal of India!

To meet the immediate requirements in connection with the stamping of the Bank's share certificates, the work was entrusted to a Madras firm. The Board, at its meeting on February 23, 1935, approved the design of the seal but desired improvement of the animal's appearance. Unfortunately it was not possible to make any major changes at that stage. But the Deputy Governor, Sir James Taylor, did not rest content with this. He took keen interest in getting fresh sketches prepared by the Government of India Mint and the Security Printing Press, Nasik. As a basis for good design, he arranged for a photograph to be taken of the statue of the tiger on the entrance gate at Belvedere, Calcutta. Something or the other went wrong with the sketches so that Sir James, writing in September 1938, was led to remark:

. . . . 's tree is all right but his tiger looks too like some species of dog, and I am afraid that a design of a dog and a tree would arouse derision among the irreverent 's tiger is distinctly good but the tree has spoiled it. The stem is too long and the branches too spidery, but I should have thought that by putting a firm line under the feet of his tiger and making his tree stronger and lower we could get quite a good result from his design.

Later, with further efforts, it was possible to have better proofs prepared by the Security Printing Press, Nasik. However, it was eventually decided not to make any change in the existing seal of the Bank, and the new sketches came to be used as an emblem for the Bank's currency notes, letter-heads, cheques and publications issued by the Bank.

Regulations and Agreements

The early months of the Bank were taken up by activities of a preliminary nature, such as the preparation and conclusion of agreements with the Central Government for the management of public debt and

Government accounts and with the Imperial Bank of India for undertaking the work as the agent of the Reserve Bank. Besides, the Bank formulated detailed rules and regulations relating to matters covered under Section 58 of the Reserve Bank of India Act. These related mainly to General Regulations regarding the functioning of Central and Local Boards, Regulations regarding the relations of scheduled banks with the Reserve Bank and returns to be submitted by the former and Staff Regulations pertaining to service conditions of staff to be recruited by the Bank in future.

Elections to Local and Central Boards

The first elections to the Local Boards were held in November 1935 and these Boards were constituted soon after the Central Board of the Bank had nominated the remaining members from the panel of names furnished by the concerned Provincial Governments. In December, it fell to the lot of the elected members of the Local Board of the Western Area (Bombay) to elect two Directors to the Central Board for replacing those nominated by the Governor General in Council to represent that Area. Sir Purshotamdas Thakurdas and Mr. F. E. Dinshaw, who happened to be the erstwhile nominated Directors, were unanimously elected to the Central Board.

London Office

The London Office of the Bank (located at 31-33, Bishopsgate) was formally opened on October 14, 1935 and from April 1, 1936 it took over, from the Imperial Bank of India, the management of the rupee debt of the Government of India enfaced for payment in London and the accounts of the High Commissioner for India. The safe custody and investment of currency reserves held in London, which were being managed by the Bank of England on account of the Secretary of State, also became its responsibility. The Bank of England, however, continued to act as bankers to the Secretary of State on behalf of the Indian Government, and all transfers to the Home Government were to be paid by the Reserve Bank to the account of the Secretary of State with the Bank of England. The original arrangement was to appoint Sir Sikander Hyat-Khan, Deputy Governor, as the first Manager of the London Office for about a year, mainly, it would appear, to enable him to get training in finance and banking in this international centre. This, however, did not materialise and Mr. Ram Nath, who had joined the Bank from the Imperial Bank service, was its first incumbent. The significance attached to the London Office lay not so much in the handling of the routine banking and debt management functions, as in

its vantage position for studying world finance and watching India's interests, in the centre of the sterling area with which India had the bulk of her foreign trade. With the co-operation of the 'Old Lady of Thread needle Street', the Bank's Office succeeded in keeping in close touch with events in the London money and capital markets.

Internal Organisational Set-up

The internal organisation of the Bank comprised two broad wings, namely, (i) Central Office units, constituting the direction of the Bank, under the immediate charge of the Governor and Deputy Governors and (ii) operational units, comprising the offices and branches of the Banking and Issue Departments. *

The Central Office of the Bank was divided into the Secretary's and the Chief Accountant's Sections and the Agricultural Credit Department. The Secretary's Section dealt primarily with the work which the Governor and the Central Board were directly concerned with (such as Board and Committee meetings, annual general meetings, correspondence with Central Government on matters of policy), the management of public debt, ways and means requirements of Central and Provincial Governments and all matters affecting the policies of the Bank. It is interesting to find that for over thirty years, that is to say, till July 1967, it was not the practice for the Secretary to attend meetings of the Central Board and its Committee!

The Chief Accountant's Section looked after the maintenance and supervision of the Bank's accounts in its Issue and Banking Departments. It also dealt with a variety of other matters such as Bank's expenditure, remittance of treasure and indent and distribution of notes and coin. Matters relating to staff and premises were also looked after by the Chief Accountant's Section. The set-up and functions of the Agricultural Credit Department, a statutory Department, are discussed in Chapter 7.

While the Central Office of the Bank was initially located in Calcutta, it was the practice for the Governor to spend his time about equally between Calcutta and Bombay, a portion of the Central Office moving with him to Bombay. Commenting on this practice, the Governor observed in August 1937 that:

the experience of the last two years has shown that the present practice of migrating from one centre to another throws an impossible burden on the administration of the Bank and involves great waste of time and duplication of work.

* The offices of the Banking Department were located in Bombay, Calcutta, Delhi, Madras, Rangoon and London. The Issue Department had branches in Bombay, Calcutta, Madras, Rangoon, Cawnpore, Karachi and Lahore; restricted branches of the Banking Department were also maintained in the three last-mentioned places.

He suggested that the Central Office should be stationed permanently in Bombay and that the touring portion should be confined to the Governor's staff who would be responsible merely for keeping his personal correspondence and the records of the Committee and the Central Board. Accordingly, in December 1937, the Central Office was permanently transferred to Bombay.

As regards the operational units, the offices of the Banking Department, each under a Manager, were entrusted with transactions arising from the Bank's duties as banker to Government as well as to scheduled banks and were organised into five departments, viz., Public Accounts Department, Deposit Accounts Department, Public Debt Office, Securities Department and Share Transfer Department.

The Public Accounts Department received and disbursed monies on behalf of Central and Provincial Governments and maintained accounts of these transactions in the manner prescribed by the Treasury and account codes and the orders of the Accountants General. The Department collected cheques on behalf of Government and encashed interest warrants and repayment orders relating to Government loans. Government Treasury bills were also issued and repaid by this Department.

The Deposit Accounts Department maintained the statutory accounts of scheduled banks and received their statutory returns under Section 42 of the Act. It made remittance of funds by telegraphic transfer for banks between their accounts maintained with the Bank's offices and dealt with sterling purchases and sales, part of the work relating to Treasury bill tenders as well as discounts and advances to scheduled banks. Under the Scheduled Banks' Regulations framed by the Reserve Bank, every scheduled bank was required to intimate to the Bank the name of the Banking Office (of the Reserve Bank) at which the scheduled bank desired to maintain its principal account and to which it desired to submit its statutory returns. The scheduled banks were also allowed to maintain accounts with the Reserve Bank at its other offices, if the banks concerned had offices at such places. With the establishment of the Reserve Bank and the opening of the statutory accounts by scheduled banks with it, it was arranged that the member banks of regional clearing houses should settle their clearing differences through their accounts with the Reserve Bank. The Bank took over the supervision of clearing houses at most centres where it had offices, although the autonomous functioning of the clearing houses was allowed to continue.

The management of the rupee debt of the Central and Provincial Governments and the maintenance of the relative accounts devolved on the Central Public Debt Office at Calcutta. The regional Public Debt Offices at Bombay, Delhi and Madras were entrusted with certain

functions of the Central Public Debt Office, to facilitate decentralisation of operations. The functions of the Public Debt Offices related to making the necessary arrangements for the floatation of new Government loans, payment of interest on Government securities, enforcement of securities for payment of interest at Treasuries or sub-Treasuries, repayment of maturing loans and various operations connected with renewal, conversion, consolidation and sub-division of different kinds of Government securities. The investigation of disputed claims pertaining to securities and the issue of duplicates of lost, stolen or destroyed scrips also formed part of their responsibilities. The Indian Securities Act, 1920 as amended by the Indian Securities (Amendment) Act, 1937 contained the law relating to Government securities, while the procedure for dealing with the issue, conversion, renewal, payment of interest, etc., of Government loans was laid down in the Government Securities Manual.

The Securities Department dealt with the purchase, safe custody, collection of interest and sale of securities on behalf of local bodies and Government officials in their official capacity. It also undertook the safe custody of securities held by the Bank on behalf of the Issue and Banking Departments as well as those which insurance companies had to deposit with the Government of India under the Indian Insurance Act.

The Share Transfer Department dealt with the maintenance of share registers, issue of share certificates, share transfers, payment of dividends, etc.

The Bank maintained, as indicated earlier, seven branches of its Issue Department, one for each currency circle into which the territory of India and Burma was divided. Each branch of the Issue Department functioned directly under the Currency Officer with general supervision by the local Manager and was divided into the Treasurer's Department and the General Department. The Treasurer's Department comprised the Issue Branch and the Exchange Branch. The Issue Branch was concerned with the receipt, safe custody, examination and issue of fresh bank notes to the Exchange Branch and the currency chests within the circle as also to other circles, receipt and disposal of foreign circle notes and taking over cancelled notes from the Exchange Branch pending verification by the General Department. The Exchange Branch dealt with the exchange of notes and coin of various denominations tendered by banks and the public, the examination of note remittances, the receipt and examination of coin remittances from currency chests and Treasuries and the sorting and listing of defaced notes.

The General Department was sub-divided into a number of branches. The Registration Branch maintained registers of issues of notes exceeding

the denomination of Rs.10 and recorded cancellations in these registers. The Cancelled Note Verification Branch took over paid and cancelled notes, subjected them to quality and quantity checks, and issued warrants of destruction. The verified notes were taken over by the Cancelled Note Vault Section which arranged for their safe custody and eventual destruction. The Claims Branch dealt with applications for the payment of the value of lost, stolen, mutilated, altered and other imperfect notes in accordance with the Bank's Note Refund Rules, and also with cases of forged and unclaimed notes. The Resource Branch arranged for the supply of currency at the different centres through the mechanism of the currency chests and for the removal of currency in excess of normal requirements. The Accounts Branch maintained accounts of note circulation and balances of the Issue Department as also the accounts of small coin depots.

Cumency Arrangements

The operations of the Bank in the initial stages were largely confined to its functions as currency authority and banker to Government. The Bank continued the administrative arrangements and operational procedures evolved by its predecessors in the discharge of these functions with the necessary changes required under the new dispensation. The provision of adequate supply of currency for facilitating transactions of the Government and the exchange and remittance requirements of the public required elaborate arrangements, particularly in a vast country like India. Besides the branches of the Issue Department, the Bank also maintained currency chests* at the branches of the Imperial Bank of India carrying on Government Treasury business and at Government Treasuries and sub-Treasuries. The offices of the Issue Department also maintained small coin depots belonging to the Government for supply of subsidiary coin to the public.

Under Section 22 of the Reserve Bank of India Act, the Bank was empowered to continue to issue currency notes of the Government of India till its own distinctive notes were ready for issue. Since the Central Board of the Bank was statutorily responsible for making recommendations to Government in regard to the form and design of

* Currency chests are receptacles in which stocks of new or reissuable notes are stored along with rupee coin. The Treasury or agency of the Bank provided with the currency chest can withdraw funds according to requirements when its payments on any day exceeded its own balances or deposit into it excess funds received. The availability of currency chests obviates the necessity for physical transfer of cash at frequent intervals from one place to another. The mechanism also enables exchange of rupee coin for notes and supply of notes of lower denominations for higher denominations and vice versa, or issue of new notes for old and soiled notes. The currency chests also serve as the basis for the provision of remittance facilities to banks and the public. The number of currency chests maintained was about 1,300 at the end of 1939.

Bank notes, the subject was considered quite early, at its meeting on April 25, 1935. It was resolved to retain the general size, appearance and design of the existing Government currency notes subject to appropriate modifications, namely, the substitution of the words ' Reserve Bank of India ' for 'Government of India' and the superscription of the words 'Guaranteed by the Governor General in Council ' or alternately 'Guaranteed by the Government of India '. The notes were to be signed on behalf of the Bank by the Governor and 'senior' Deputy Governor. It was decided to discontinue currency notes of Rs. 50 and Rs. 500 denominations as they had not proved popular. The Central Board also recommended a slight increase in the size of the Rs.10 note and a slight decrease in the size of the Rs.100 note. Subsequently, certain modifications of the proposals made by the Board became necessary; the design of the Rs. 100 note was materially changed on expert advice to give it greater security and a minor alteration was made in the Rs.1,000 note by replacing the agricultural view on its reverse by a Himalayan view. It was also decided to have the signature of only the Governor of the Bank as the Reserve Bank of India (Note Issue) Regulations, 1935, provided for the signature of only one officer of the Bank. The final proofs of the notes embodying these alterations were approved by the Board at its meeting held on December 1, 1936. It was hoped to make the first issues of new notes in the summer of 1937, but the abdication of King Edward VIII delayed this programme by some months, as the King's head appearing on the notes and in the watermark of the paper had to be changed to that of King George VI. The revised specimens of the notes were approved by the Committee of the Central Board on May 26, 1937; approval of the Government of India, under Section 25 of the Act, was accorded on June 24, 1937.

The Bank made its first issue of currency notes in January 1938 in denominations of Rs. 5 and Rs. 10. Later during the year the Bank issued notes of the denominations of Rs.100, Rs. 1,000 and Rs. 10,000. Although Bank notes in denominations of Rs. 50, and Rs. 500 were not issued, the Government of India notes of these denominations continued to be legal tender.

Banker to Central Government

The Reserve Bank was responsible, under its Statute, for transacting all general banking business of the Government of India, such as, receipt and payment of monies, remittance and exchange, as well as the management of public debt and issue of new loans including Treasury bills. The Government, on their part, were required to entrust these functions to the Bank and to keep all cash balances in the form of

interest-free deposits with it. Accordingly, an agreement was entered into between the Reserve Bank and the Secretary of State for India in Council on April 5, 1935, setting out the terms and conditions under which the Bank was to carry out its functions as banker to Government. The agreement laid down that the Bank should discharge its responsibilities and maintain books of accounts in accordance with the orders and directives of the Government. The Bank was not entitled to any remuneration for the conduct of ordinary banking business other than the advantage accruing to it from holding Government cash balances free of interest. For the management of public debt, however, the Bank was entitled to a half-yearly commission at the rate of Rs. 2,000 per crore per annum on the amount of the public debt outstanding at the close of each such period, subject to the exclusion of certain specified items. * The Bank was also entitled to a fixed annual remuneration of Rs. 2,000 in respect of stock certificates falling under the excluded items referred to above.

The agreement enjoined the Bank to maintain currency chests at places prescribed by the Government, with adequate supplies of notes and coin, for carrying out Government transactions and providing reasonable remittance facilities to the public. The Bank was also obliged to meet the exchange requirements of the Government for remittances between India and London at the market rate of the day for telegraphic transfers or at a mutually agreed average rate based on a longer period in the case of large transfers. Since the agreement did not contain any provision regarding remuneration payable to the Bank for the issue of new loans, the terms of such payment were fixed pursuant to arrangements subsequently concluded by the Bank with the Central Government. Under these provisions, which still continue without substantial modifications, the Bank was entitled to a fee at the rate of Rs. 1,000 per crore of all new issues with a minimum of Rs. 5,000 in respect of each loan in addition to renewal fees on applications for conversion (at rates prescribed in the Indian Securities Rules, 1935), brokerage, commission charges and incidental expenses.

Agreement with Imperial Bank

In terms of Section 45 of the Act, the Bank also entered into an agreement with the Imperial Bank of India for the latter's continuing to undertake the work relating to Government transactions as agent of the Bank. The original duration of the agreement, which came into effect on April 1, 1935, was for a period of fifteen years after which it could

* The excluded items covered outstandings of discharged loans after one year from the date of discharge, stock certificates for Rs. 50,000 and above held by the Central and provincial Governments, the amount of public debt outstanding in the London register, and Government of India rupee securities held in the Issue Department of the Bank.

be terminated with five years' notice on either side. It was conditional on the maintenance of a sound financial position by the Imperial Bank, which became the sole agent of the Reserve Bank at all places in British India, where there were branches of the Imperial Bank but no branch of the Banking Department of the Reserve Bank at the time of coming into force of the agreement. The Reserve Bank was to pay a commission on the total of the receipts and disbursements dealt with annually by the Imperial Bank on account of Government at the rate of 1/16 per cent for the first Rs. 250 crores and 1/32 per cent for the remainder, during the first ten years and thereafter at rates to be determined for every five years on the basis of the actual cost to the Imperial Bank of India, as ascertained by expert accounting investigation, of performing these functions. Besides, the Reserve Bank was to make lump sum payments to the Imperial Bank of Rs. 9 lakhs, Rs. 6 lakhs and Rs. 4 lakhs per year, during the three successive five-year periods of the agreement, on condition that the latter continued to maintain branches not fewer in number than those existing at the commencement of the agreement. The Imperial Bank was also not to open any new branch in substitution of an existing branch without the approval of the Reserve Bank.

The agreement provided for the maintenance of currency chests and small coin depots by the Reserve Bank at branches of the Imperial Bank managing Government accounts and situated in places where there was no office of the Banking or Issue Department of the Bank; such facilities were also to be provided at any local head office or other branch of the Imperial Bank in India if the two institutions so agreed. These facilities could be availed of by the Imperial Bank for exchange of notes for coin and coin for notes as also for making deposits and withdrawals of currency, subject to any general or special directions of the Reserve Bank. Besides, the Imperial Bank enjoyed under the agreement facilities for free transfer of funds between its offices through the medium of the Reserve Bank's offices or currency chests or small coin depots. The Imperial Bank was also obliged to provide to all scheduled banks remittance facilities as prescribed by the Reserve Bank from time to time and also to give the general public all possible facilities for transfer of funds at rates not exceeding those specified by the Bank.

The basis for the payment of commission and brokerage to the Imperial Bank in respect of loans issued by the Central and Provincial Governments was agreed upon in April 1938. The terms of remuneration were: (i) full brokerage on allotments in respect of applications lodged by the Imperial Bank on its own account or on behalf of its customers with the Reserve Bank at Bombay, Calcutta, Delhi, Madras and Rangoon; (ii) commission at 1/16 per cent on allotments, either by

cash or conversion, in respect of applications handled by the offices of the Imperial Bank of India at places other than those mentioned above. In respect of cash applications, the above commission of 1/16 per cent was double the commission which the Reserve Bank was entitled to recover from Government. However, this difference of 1/32 per cent was set off by the Bank against the general turnover commission payable to the Imperial Bank; and (iii) full brokerage on allotment in respect of applications lodged by other banks and brokers at Imperial Bank offices other than at Bombay, Calcutta, Delhi, Madras and Rangoon; the brokerage was to be passed on by the Imperial Bank to the banks and brokers concerned. Besides, in regard to provincial loans, if the rate of brokerage was higher than the rate of commission (1/16 per cent), the Imperial Bank was entitled to brokerage at the rate of such excess, on the bank's own and its customers' allotments, at places other than those referred to above.

Banker to Provincial Governments

Before the inauguration of provincial autonomy on April 1, 1937, the Government of India held all the cash balances in the Public Account for British India and were responsible for the ways and means requirements of Provincial Governments. Under this system of centralised accounts, there was no need for the Reserve Bank to act as banker to Provincial Governments separately. Accordingly, the obligation placed on Local (Provincial) Governments under the Reserve Bank of India Act to entrust the Bank with all their banking transactions and to maintain their cash balances with it was conditional on their having custody and management of provincial revenues as envisaged under the new constitution. Provincial Governments were also required under the Act to entrust the Bank with the management of their public debt and the issue of new loans. In the pre-autonomy period, however, Provincial Governments generally had recourse to borrowings from the Central Government, which set up in 1925 a Provincial Loans Fund for the purpose. Even so, in the period prior to the establishment of the Bank, some of them (Bombay, the U.P. and the Punjab) had raised loans in the open market under the provisions of Section 30(1a) of the Reforms Act of 1919. Soon after commencing operations, the Bank entered into agreements with these Governments for the limited purpose of management of their public debt and issue of any new loans.

Provincial autonomy entailed the separation of provincial balances and the assumption of responsibility by Provincial Governments for their ways and means requirements. The major alterations in accounts and important questions of principle associated with these changes were settled at a meeting of the representatives of the Government of

India and the Reserve Bank with the Finance Ministers of the various Provinces, held in Simla in August 1936. In order to afford Provinces the necessary experience in framing their ways and means requirements, it was decided that the Central Government should remain responsible for these requirements during the financial year 1937-38. Hence, it was only from April 1, 1938 that Provincial Governments assumed full responsibility for their ways and means requirements.

With the separation of provincial balances and decentralisation of accounts, it became necessary for Provincial Governments to enter into direct relationship with the Reserve Bank as their banker and to maintain their cash balances with the Bank. To meet their short-term requirements, they were required to obtain ways and means advances from the Bank or to issue their own Treasury bills. Besides, as the Provincial Loans Fund was wound up, they were also obliged under the new set-up to meet their long-term financial requirements by raising market loans and to entrust the issue and management of their public debt to the Bank. The terms and conditions governing the performance of these various functions to be undertaken by the Bank were set out in separate agreements entered into with each of the Provincial Governments.

The agreements entered into by the Bank with the various Provincial Governments were more or less similar to its earlier agreement with the Central Government and covered both general banking business and public debt management. The Bank was not to receive any remuneration for the conduct of their ordinary banking business, but the Provincial Governments had to maintain with the Bank interest-free cash balances at an agreed minimum level. The Bank was entitled to charge the Governments for extra-territorial remittances at rates not exceeding those applicable to scheduled banks, subject to a minimum of four annas for each single remittance. The Provincial Governments could also avail of ways and means advances from the Bank; the out-standings under such advances were not at any time to exceed the amount of minimum balances provided in the agreements and had to be paid off at intervals not exceeding three months from the date of initial advance. The investment of Government owned or managed funds was to be entrusted to the Bank as sole agent on a commission of 1/16 per cent on sales in addition to brokerage and other charges. The terms of remuneration payable to the Bank for the management of public debt and the issue of new loans were the same as those provided for in the agreement with the Central Government except for the minimum fee payable in respect of each provincial loan which was to be Rs.1,000. The agreements also contained identical provisions covering currency chest arrangements and exchange obligations of the Bank.

Central Banking Functions in Burma

The Reserve Bank continued to function as the central banking authority for Burma even after its political separation from British India on April 1, 1937. The Indo-Burma monetary settlement embodied in the Order in Council known as the India and Burma (Burma Monetary Arrangements) Order, 1937, provided for the Bank continuing to manage the currency of Burma and to perform the functions of banker to the Government of Burma. To facilitate the division of currency profits between India and Burma, the Reserve Bank was required to issue as soon as possible after separation distinctive notes for Burma. The profits payable to Burma were to be based on the proportion of the Reserve Bank notes in circulation in Burma to total note circulation in the two countries. The Bank was also required to provide remittances between India and Burma at such fixed rate of exchange, and subject only to such rates of commission, as might be approved by the Governments of India and Burma; however, as long as the Bank was bound, under the Order, to issue on demand India rupee coin in exchange for legal tender notes, the rate of exchange was to be par.

The Bank entered into a separate agreement with the Burma Government in April 1937 for the discharge of its functions as banker to Government on the lines of the earlier agreement with the Government of India. The Bank started issuing new Burma notes of distinctive design from May 1938.

The Burma Monetary Arrangements Order, which could be terminated by either Government on a two-year notice given after March 31, 1938, also detailed the manner in which certain assets and liabilities of the Government of India and the Reserve Bank were to be transferred to the Government of Burma in the event of full currency separation. On such separation, the Bank's liability for Burma notes was to cease completely, and any guarantee thereof of the Government of India had to be deemed to be that of the Government of Burma. Simultaneously, from the Bank's Issue Department, assets, i.e., gold, sterling securities, India rupee coin and rupee securities, equal to the total liability in respect of Burma notes outstanding on the date of the currency separation, were to be transferred to the Government of Burma in the proportions in which they were held in the Issue Department on that date. The Government of Burma were also to be given credit-as a capital payment in reduction of the Burma debt to India-for an appropriate portion of the Bank's surplus assets (including a share of the Reserve Fund).

Public Debt Function

The responsibilities of the Reserve Bank as banker to Government, apart from the performance of the ordinary banking transactions,

related to the issue and management of Government loans, sale of Treasury bills, provision of ways and means advances and purchase of sterling for meeting exchange requirements. In these matters, the Bank's role was not merely one of carrying out the Government's instructions but also of advising the Government on all matters connected therewith, for instance, the quantum, the terms of issue and the timing of floatation of Government loans.

During the period 1935-39 the Government of India floated one sterling loan in London and four new rupee loans, mainly to provide for the repayment of maturing obligations. The first loan operation to be handled by the Reserve Bank was the issue of the 3 per cent sterling Loan, 1949-52, for repaying nearly £ 12 million of the 6 per cent sterling Bonds, 1935-37. The terms and timing of the issue were settled by the Governor, who was in London, in consultation with the Bank of England and the India Office. The details of the loans floated during the period were as under:

| Date | Maturity | Type | Interest | Issue Price | Amount offered | Amount allotted |
|----------------------|----------|---------------------|----------|-------------|--------------------|------------------|
| <i>Sterling Loan</i> | | | | | | |
| July 1935 | 1949-52 | Cash | 3% | £98 | £10 million | £10 million |
| <i>Rupee Loans</i> | | | | | | |
| Aug. 1935 | 1951-54 | Cash cum Conversion | 3% | Rs. 96 1/2 | Rs. 15 crores | Rs. 15-13 crores |
| May 1936 | 1948-52 | Cash | 2 3/4% | Rs. 100 | Rs. 12 crores | Rs. 12-01 crores |
| May 1938 | 1963-65 | Cash cum Conversion | 3% | Rs. 98 | Rs. 15 crores | Rs. 26-31 crores |
| July 1939 | 1963-65 | Cash cum Conversion | 3% | Rs. 98 | Rs. 15 crores plus | Rs. 15-72 crores |

The loan operations met with success in nearly all cases. The sterling loan evoked very good response; subscriptions amounted to more than £ 72 million and only 14 per cent of the applications over £ 500 could be allotted.

Total subscriptions to the first rupee loan amounted to Rs. 29.6 crores and the loan was closed within about twenty minutes of its opening on the first day, that is, August 5, 1935. Cash subscriptions totalled Rs. 16.5 crores ; subscriptions in the form of the 5 per cent Bonds, 1935 and the 6 1/2 per cent Treasury Bonds, 1935, amounted to Rs. 8.4 crores and Rs. 4.6 crores, respectively. It was planned that the Reserve Bank and the Imperial Bank should subscribe about Rs. 3.5 crores and Rs. 6 crores, respectively, but it is not known as to what they actually tendered. Conversions were accepted in full and the allotment in respect of cash subscriptions amounted to Rs. 2.1 crores only. Reporting to the Government on the loan, the Controller of the Currency remarked that 'this was the first loan which the

Reserve Bank had to handle, but the manner of the handling left little to be desired ‘.

The medium-term cash loan of 1936, the terms of which reflected the easy conditions in the money market (the rate of $2\frac{3}{4}$ per cent being the lowest recorded for a Government loan in India) was designed for institutional investors and it was heavily oversubscribed, the applications amounting to Rs. 30 crores. About half the loan allotment of Rs. 12 crores was made to the Imperial Bank and the Reserve Bank. The Finance Member as well as the Governor of the Bank of England congratulated the Governor on the success of the loan. The next loan, a cash-cum-conversion issue, came two years later, in May 1938. This was the 3 per cent Loan 1963-65 and was also heavily oversubscribed. Cash subscriptions amounted to Rs. 12.2 crores ; conversions in respect of the $5\frac{1}{2}$ per cent Loan, 1938-40 and the 5 per cent Loan 1939-44 totalled Rs. 20 crores. Total allotment was for Rs. 26.3 crores (of which the cash portion was Rs. 6.3 crores); the Reserve Bank and the Imperial Bank were allotted to the extent of Rs. 5.7 crores and Rs. 3.7 crores, respectively. The second issue of the 1963-65 Loan made in July 1939 was not, however, a success, mainly on account of the troubled international situation. The amount offered was Rs. 15 crores in cash or conversion of the 5 per cent Loan 1939-44, while subscriptions in the form of the 5 per cent Loan 1940-43 were to be without limit. Subscriptions in the form of cash and the 5 per cent Loan 1939-44 amounted to Rs. 1.3 crores and Rs. 8.2 crores, respectively, or a total of Rs. 9.6 crores; subscriptions in the form of the 1940-43 Loan amounted to Rs. 6.1 crores. Thus, the total amount subscribed and allotted was Rs. 15.7 crores. The Reserve Bank alone tendered Rs. 10 crores by way of conversion, while the Imperial Bank accounted for Rs. 1 crore of the cash subscription.

In those days, as now, subscriptions to Government loans came mainly from institutional investors; apart from the princes, subscriptions from individuals generally were of a small magnitude. Thus, in respect of the 3 per cent Loan 1963-65 issued in 1938, out of the total subscription of Rs. 22.6 crores in regard to applications of Rs. 1 lakh and above, the contribution of individuals amounted to Rs. 36.3 lakhs only. Statistics of subscriptions in the various slabs, namely, up to Rs. 10,000, Rs. 10,000 to Rs.1,00,000 etc., also support this conclusion.

The floatation of new loans was undertaken after careful consultation and preparation of the ground. In the interests of secrecy, the matter was also handled at the highest level. During the initial phase of the Reserve Bank's regime, detailed consultations on these matters had to take place among five parties, namely, the Reserve Bank, the Imperial Bank, the Controller of the Currency, the Finance Department of the Government of India and the Secretary of State for India, who was

no doubt consulting the Bank of England. In the beginning, the consultations were prolonged and there used to be lengthy discussions on paper relating to the various items of the loan programme, 'for the satisfaction of the Secretary of State'. But, progressively an endeavour was made to curtail these, since, in the words of Sir James Taylor, 'such discussions were always rather platitudinous and their most usual and undesirable result was premature leakage'. As a result of these discussions and in the light of the situation in the gilt-edged market, reflecting domestic as well as international conditions, appropriate changes were made in the amount as well as the price of issue. Thus, in respect of the first rupee loan, the original idea was to issue it for an amount of Rs. 18 crores, but finally it was reduced to Rs. 15 crores, partly on account of the disturbance to the market arising from Italy's attack on Abyssinia. Moreover, the Finance Member was keen on a relatively high issue price. Similarly, in the case of the 1963-65 Loan issued in 1938, the original suggestion was to raise a loan of Rs. 20-25 crores but the offer was reduced to Rs. 15 crores, on account of the disturbed political situation in Europe. In the prewar years, the terms of issue of rupee loans in India had to take note of the prevailing conditions in the London gilt-edged market, which was naturally sensitive to international political and financial developments.

When the Bank took over the management of the public debt, it made appropriate modifications to simplify the procedure for floatation of Government loans. Thus, the arrangement for receiving loan applications at Treasuries and sub-Treasuries was discontinued and applications were to be received only at the offices of the Reserve Bank and branches of the Imperial Bank of India. Since the 2 $\frac{3}{4}$ per cent Loan 1948-52 issued in 1936 was intended mainly for institutional investors like banks, applications were received only at the offices of the Reserve Bank. The second change related to the discontinuance of the practice of issuing scrip over the counter in exchange for cash on application. Apart from the fact that this was not always found practicable in the larger centres, it also tended to result in premature leakage of information about the loan and also wastage of forms. According to the revised procedure, subscribers were required to put in regular applications for which they were initially to be given a receipt which was to be exchanged for the new scrip in due course. The receipt of applications through the post offices was also discontinued, except in regard to conversion of loans deposited with the postal department by investors. Other matters, such as, how long to keep a loan open and the scale of brokerage and commission payable to the Reserve Bank, the Imperial Bank, scheduled banks and recognised brokers, were also settled by the Bank in consultation with the Imperial Bank and Government.

As already mentioned, the Reserve Bank also became responsible for the management of market borrowings by the autonomous Provinces under the agreements entered into with them. The first borrowing programme of Provincial Governments was announced on August 24, 1937; loans aggregating Rs. 460 lakhs were issued by five Provincial Governments, namely, Madras, Rs. 150 lakhs; the United Provinces, Rs. 100 lakhs; the Punjab, Rs. 100 lakhs; the North West Frontier Province, Rs. 60 lakhs and the Central Provinces and Berar, Rs. 50 lakhs. The loans were offered on uniform terms and consisted of 3 per cent Stock 1952 at an issue price of Rs. 99. The Punjab loan was a cash-cum-conversion issue, while the other four were purely cash loans. In fixing the terms of the issue, the idea was that the yield on provincial loans should be approximately $\frac{1}{4}$ per cent above that of Central Government issues of comparable maturity. The original intention was to float twelve to fifteen year -loans, but in view of, the improvement in market conditions, a maturity of fifteen years was fixed. With a view to ensuring the success of all loans, subscribers were asked to state whether, in the event of the loan specified by them being oversubscribed, they wished their applications to be transferred to other loans. The issues were on the whole successful, particularly as there was no loan floatation by the Central Government during the year; the lists opened on August 31 and were closed within two hours. The Madras, U.P. and Punjab loans were oversubscribed, while the other two were fully subscribed after the transfer of options from other loans.

During the early years of provincial autonomy, the Bank had a specially useful and effective role to play as adviser to Provincial Governments on public debt matters owing to their comparative inexperience in this behalf. It was necessary to restrain the general tendency among these Governments to pitch their loan requirements somewhat high without due regard to their borrowing capacity, in their eagerness to undertake various productive schemes. While the Central Government on their part sought to ensure a detailed screening of provincial loan proposals which came up to them for approval under the Government of India Act, 1935, the procedure of an annual conference of representatives of Provincial Governments enabled the Bank to assess their loan requirement in the light of their budgetary position, the requirements of the Central Government and the conditions in the gilt-edged market.

The diversity in the budgetary position of various Provincial Governments also posed a problem for the Bank in fixing the terms of individual loan issues. Whereas in the case of the Central Government loans, the issue price and other terms were fixed by the Government on the advice offered by the Reserve Bank in the light of prevailing market

conditions, the Bank felt that the same procedure would not prove adequate in the case of provincial loan issues, as an important consideration in their case was the possible variation in the market assessment of the credit of different Provinces. It was considered necessary to devise a system whereby the market itself could be the judge of the terms on which it was prepared to lend to the Provincial Governments, so as to preclude the possibility of an open failure of loans. During his visit to London in the spring of 1937, Sir James. Taylor studied loan procedures in the U.K. and in other Empire countries, particularly those with Federal Constitution.

Accordingly, in June 1937, the Bank drew up a scheme for underwriting loan issues and forwarded it to Provincial Governments for their views. On the basis of their replies and after discussion with the market, the scheme was modified in certain respects and put into operation beginning with the loan floatations for 1938. There were again some modifications in 1939. The main features of the underwriting scheme were: (i) enrolling of scheduled banks and stock brokers of standing as underwriters on the Bank's list, subject to their complying with standing instructions drawn up by the Bank; (ii) advising underwriters regarding proposed loan floatation and calling for tenders ; (iii) fixing the issue price on the basis of the lowest tender necessary to complete underwriting; and (iv) distributing the unsubscribed portion of the loan among the underwriters in proportion to their allotment, subject to some adjustments.

Provincial Governments desiring to float loans made a formal approach to the Bank, which, in consultation with the Government concerned, fixed the terms of the loan and called for tenders from underwriters. On receipt of tenders, the Bank took instructions from the Provincial Government whether to float the loan or drop it or issue for a reduced amount. In 1939, when the scheme was revised, the option to the Provincial Governments of reducing the loan amount was withdrawn formally, but it was open to any Provincial Government to reintroduce a provision for reducing the amount of a loan through the letter to underwriters. The underwriting arrangement devised by the Bank did not impose any obligation on a Provincial Government to have their loans always underwritten and they could make a direct issue, if the underwriters' terms were not satisfactory. The Bank was also willing to provide assistance in bridging the gap in cases where a loan could be underwritten at a fair and reasonable price except for a very small shortfall in the amount. During 1938, the Madras and the Punjab Governments issued loans for a total of Rs. 2.50 crores, while in 1939 these two and the C.P. and Berar Governments floated loans for Rs. 4.70 crores. The amounts of acceptable tenders exceeded the amount offered in all the issues except for one where the

Bank had to underwrite a small amount. The issue price fixed ranged between Rs. 98 and Rs. 99. All the loans, except one, were oversubscribed; in regard to the one loan which failed to evoke adequate public response, the underwriters were called upon to take a substantial amount.

Another aspect of the Bank's role in the sphere of public debt related to Treasury bill issues. The Reserve Bank conducted sales of these bills *, whenever considered necessary, on behalf of the Central and Provincial Governments, by calling tenders. The first sale of Central Government Treasury bills was made in April 1935; the first sale of Provincial Treasury bills was effected in April 1938 by the C. P. and Berar Government. The Central Government bills were all three months bills. In the case of Provincial Governments, bills were generally of three months maturity; however, bills of longer maturities were also sold by some Governments during 1938 and 1939.†

Treasury bills from the holdings of the Bank's Issue Department were made available on tap to the Provincial Governments, semi-Government institutions and foreign holders like the Board of Commissioners of Currency, Ceylon, at a price 1/64 a rupee higher than the bulk tender rate (that is. carrying a fractionally lower yield) of the preceding auction. The bills were sold from the Reserve Bank's holdings, to be replaced, if necessary by special bills created by Government. The idea was that such funds should not compete with the usual money market funds for the auction, but at the same time the rate of these tap bills should not be different from that established at the auction. There were also practical difficulties in the Government of India's varying their Treasury bill offerings to suit the surplus position of the Provinces. Hence the sale of tap bills, but this was regarded as a temporary arrangement. On October 30, 1937, the Bank informed the Provincial Governments, after obtaining the concurrence of the Central Finance Department, that from January 1, 1938, the Provinces must obtain their requirements of Central Government Treasury bills through tenders, in competition with other investors and that the Bank would not be in a position to suggest to them the rates at which they should tender, since 'it would obviously not be fair either to the market or to the other Provinces if it assumed this responsibility'. The Provincial Governments in general preferred the continuance of the then existing arrangement, though they did not state this in strong terms. The Madras Government, however, sent a strong representation. After consulting the Finance Department, the Bank decided in November 1937 to continue the system of tap sales.

* The system of sale of Treasury bills by tender, by the Government of India, has been in vogue from October -1917.

† The longer maturities were for periods of four, six, eight and nine months.

The Bank also sold bills between auctions to non-Government investors at a price 1/64 a rupee above the bulk rate of the last auction; these were referred to as 'intermediate' bills. But, unlike the tap sales to the Government and semi-Government institutions, the sales were entirely at the discretion of the Bank. These sales enabled the unsuccessful tenderers at the auction to buy the bills at a discount rate fractionally below the auction rates; also, funds that accrued after the auction could be invested. The intermediate bills system provided an elastic method of relieving the market of surplus funds. The device of intermediate bills also enabled the Government to obtain, within limits, larger funds, without forcing the discount rate upwards. It should be mentioned that the main response to Treasury bills came from institutional investors, especially commercial banks. The Imperial Bank of India was the largest supporter, followed by the exchange banks and a few leading Indian joint-stock banks. The Reserve Bank also held Treasury bills in the Issue Department; in the Banking Department it rediscounted bills for the account of banks and Provincial Governments. On special occasions, such as in connection with the repatriation of sterling debt, Government also sold ad hoc bills to the Bank.

Ways and Means Advances

The Bank was authorised under Section 17(5) of the Act to make to Central and Provincial Governments ways and means advances which were repayable in each case not later than three months from the date of making the advance. There were no statutory provisions as regards either the rate of interest to be charged or the maximum amount of the advance. These matters were regulated by the respective agreements or arrangements between the Bank and the Central and Provincial Governments. This position has remained unchanged. According to the agreements with the Provincial Governments, the Bank undertook to make ways and means advances at rates not exceeding the Bank rate provided the total of such advances outstanding at any one time did not exceed the minimum balance of deposits agreed to between the Bank and the Government concerned. These advances were granted without any collateral. The minimum balance of the Provincial Governments varied from Rs. 5 lakhs in the case of Orissa, N.W.F.P. and Sind to Rs. 40 lakhs in the case of Madras; the aggregate of the minimum balances was Rs. 1.95 crores. The minimum balance prescribed for the Central Government was Rs. 4.25 crores (in terms of an exchange of letters rather than a formal agreement) and for the Government of Burma Rs. 85 lakhs, including Rs. 10 lakhs on account of that Government's requirements in London. The aggregate

of the minimum balances was about the same as what the Government of India had agreed to maintain with the Imperial Bank. In the case of the Central Government there was no limit with regard to the amount of ways and means advances granted by the Bank, but in practice these advances were neither large nor continuous. In fact, it was a clear understanding between the Bank and the Government that ways and means advances should be a temporary arrangement, mainly to enable Government to spread their Treasury bill maturities as conveniently as possible, the idea being that Government's short-term requirements would be met principally through sale of Treasury bills. Estimates of Government's ways and means position used to be sent to the Bank in advance to enable it to plan Treasury bill issues and ways and means advances. All along, the rate of interest on the ways and means advances has been 1 per cent below the Bank rate (except for a short period between October 1939 and April 1940, when the rate was $\frac{1}{2}$ per cent below Bank rate). The records do not contain any discussion of the grant of these advances below Bank rate. In September 1935, when the Controller of the Currency approached the Bank for ways and means advances, he presumed that the lending rate would be 3 per cent (the Bank rate then was $3\frac{1}{2}$ per cent) ; in a telegram, Deputy Governor Taylor replied that 'in this case ' he would make the advances at 2 per cent. Apparently, this rate continued, this being per cent below Bank rate consequent on the reduction of Bank rate to 3 per cent in November 1935. This arrangement along with other procedural matters was standardised effective April 1, 1938. It would appear that the intention was to base the rate on ways and means advances on the prevailing discount rate on Central Government Treasury bills. In September 1935, when the advance was first asked for, the Treasury bill rate for several months past had been in the neighbourhood of 1.75 per cent. The Bank, as already mentioned, agreed to lend ways and means at 2 per cent. That the intention was that the rate should be close to the Central Treasury bill rate is also evidenced by the fact that when the ways and means rate was raised to $\frac{1}{2}$ per cent below Bank rate in September 1939, the reason given was the rise in the Treasury bill rate and likewise when the old rate was restored in April 1940, the reason was the decline in the rate.

Sterling Transactions

The responsibility for sterling purchases and remittances to the Secretary of State was also transferred to the Reserve Bank. Prior to its establishment, the purchases of sterling by competitive tender used to be conducted by the Central Government through the Imperial Bank. Purchases were made from the scheduled banks from time to time,

ordinarily in amounts of not less than the equivalent of Rs. 1 lakh, by calling for tenders once a week and also by accepting intermediate offers which were made by banks during intervening days. The purchases were made at all offices of the Banking Department of the Bank and also at the branch of the Issue Department at Karachi. The tenders were to be for multiples of £1,000 subject to a minimum of £ 7,500 and the rate of exchange was to be expressed in pence or in pence and a fraction of a penny per rupee, such fraction being expressed in multiples of $\frac{1}{32}$ of a penny. The allotment was made on the basis of the best rates offered and the payment of the rupee equivalent was made to the scheduled bank on presentation of a receipt for having issued telegraphic instructions to its agents in London to pay the sterling to the credit of the Reserve Bank. When a scheduled bank was prepared to sell intermediate sterling to the Reserve Bank, it made an offer and the rate at which the Bank was prepared to buy was communicated to it. The offers of intermediate sterling were accepted for amounts of not less than £ 25,000 at Bombay and Calcutta and £ 10,000 at Delhi, Madras, Rangoon and Karachi and in multiples of £ 1,000.

The Bank also sold sterling to scheduled banks in amounts of not less than the equivalent of Rs.1 lakh. Whenever there was likely to be a demand for sterling from the banks, the Central Office of the Bank informed the various offices of the rate at which they were to effect sales of sterling. Sales were to be for ready telegraphic transfers only and in amounts forming multiples of £ 1, 000 subject to a minimum of £ 7,500. On a scheduled bank tendering the equivalent amount in rupees, the Bank issued a memorandum in token of having received a specified sum of rupees being the equivalent of the amount of sterling payable to the bank on demand at the Bank of England. The scheduled bank then telegraphically arranged with its agent in London to receive the sterling.

Early Central Banking Policies and Operations

The Reserve Bank of India came on the scene when the Indian economy, like that of the rest of the world, was gradually recovering from the severe depression of the early 'thirties, which hit in particular agricultural countries. In India, the lowest price level since the commencement of the depression was recorded in March 1933, when the Calcutta index of wholesale prices (base: July 1914 = 100) touched 83 as against the average level of 141 for 1929, representing a fall of more than 40 per cent. Thereafter, although the price level steadied itself, the recovery in the initial stages was painfully slow and it was not till the closing months of 1936 that prices started registering any appreciable rise. This rising phase in commodity prices continued more or less uninterrupted till August 1937, when the Calcutta wholesale price index attained its post-depression high of 105. The main factors responsible for the recovery of prices during this period were the growing demand for agricultural raw materials in the context of world-wide rearmament efforts and the emergence of speculative stockpiling of commodities. Indian export trade in consequence made a considerable recovery and the balance of trade in merchandise in favour of India and Burma showed a remarkable improvement during the years 1936 and 1937, amounting to Rs. 60.77 crores and Rs. 66.32 crores, respectively, as against Rs. 24.84 crores in 1935.

The process of partial recovery of prices, however, received a setback with the emergence of recessionary conditions in the U.S.A. and other countries of the world about the middle of 1937. This had a depressing effect on prices in India due to the slackening of foreign demand for her products. The wholesale price level declined from September 1937 in sympathy with the general fall of prices in world

markets and touched a low of 94 in April 1938; in particular, the price of raw cotton, the most important item of export, recorded a sharp fall in sympathy with the fall in the price of the commodity in the U.S.A. The downward trend in prices and business conditions in India was aggravated by the continuance of Sino-Japanese hostilities, which seriously curtailed the trading capacity of Japan, India's principal customer for raw cotton. These developments brought down the export surplus in favour of India and Burma to Rs. 39.80 crores in 1938.

The depression, however, had spent its force by the end of 1938 and, in early 1939, prices started rising by slow degrees and the wholesale price index moved up to 101.5 in May 1939, although the growing uncertainties of the international situation militated against a sustained recovery. Besides, during this period the cotton textile industry experienced one of the worst slumps in its history and as a result of this as well as of lower exports, raw cotton prices suffered a sharp decline. However, the declaration of the war in September 1939 radically altered the situation and led to a sharp rise in commodity prices and improvement in the prospects for Indian agriculture and industry generally. The revival of exports of India and Burma, which had started earlier in the year, was strengthened with the emergence of war conditions and the increased demand from Allied countries for war purchases ; consequently, the surplus on merchandise trade improved from Rs. 39.80 crores in 1938 to Rs. 59.12 crores in 1939.

In addition, during these years there were fairly large gold exports on private account. Net exports of gold totalled Rs.52.54 crores in value in 1934-35. They declined steadily to Rs.13.07 crores in 1938-39, but again rose sharply to Rs. 36.56 crores in 1939-40.

It is difficult to provide any clear indication of the progress made by the economy during the period in the absence of adequate statistical information relating to agricultural production, which constituted an overwhelming proportion of economic activity in the country. The data relating to industrial production are also not available for the entire period; the interim index of industrial production compiled by the Office of the Economic Adviser to the Government of India commenced only from 1937 as the base year. These figures indicate a tardy pace of growth or an actual decline in some of the major industries like cotton textiles, jute and sugar.

The monetary data relating to the period would also seem to bear out the impression of an economy at a low ebb of activity. During the four-year period August 1935-July 1939, currency with the public, exclusive of rupee coins of which statistics are not available, recorded a rise of Rs. 21 crores to Rs. 170 crores. However, as there was a return of rupees from circulation to the extent of Rs. 33 crores during the period, there was an actual decline in currency circulation to the tune

of Rs. 12 crores. There was, on the other hand, a rise of Rs. 39 crores in deposit money during the same period, so that overall money supply showed an expansion of Rs. 27 crores only in the four years ending July 1939. The actual increase in money supply would have been even smaller than indicated above, since part of the rise in deposit money may be attributed to the increased coverage of banks.

In retrospect, the economic and financial policies of the Government of India, during the period 1935-39, reflect scant concern for the basic problem of reviving the economy and, in this respect, afford a somewhat sad contrast to those of major countries abroad, which were consciously geared to the task of promoting sustained recovery. In the United States, for instance, the New Deal initiated by the first Roosevelt Administration represented a spectacular attempt to provide a fillip to the economy through a deliberate reflationist policy. Devaluation of the dollar by about 40 per cent in early 1934, provision of cheaper credit and net Government spending through budgetary deficits constituted the main arms of this policy. The American economy showed a substantial measure of recovery under this programme and, but for the short-lived recession of 1937-38, the progress was maintained. In the United Kingdom, too, the de facto depreciation of the pound sterling by about 30 per cent following the abandonment of the gold standard in September 1931 and the policy of cheap money pursued since the middle of 1932 constituted the main planks of official policy towards recovery. A curious aspect of British economic policy of the period was that the Government, supported by powerful sections of public opinion and the majority of economic experts, rejected a policy of budgetary deficits as 'unsound' and public works as 'ineffective'. However, in the special circumstances of the U.K. as an export economy, the devaluation of the pound and the policy of cheaper credit enabled recovery to be achieved to a remarkable extent. In France, the economic programme of the Blum Government, formed in 1936, also attempted a reflationist policy through the devaluation of the franc, the raising of money wages and the launching of public works financed through budgetary deficits.

In India, on the other hand, official views on the role of Government in the economic sphere were still largely dominated by the doctrine of laissez-faire. Accordingly, the pursuit of socio-economic welfare policies or the undertaking of nation-building activities were still considered to be outside the scope of Government's responsibilities. Further, influenced by the prevailing prejudice of the Home authorities against budgetary deficits, the financial policy of the Government was guided by a firm belief in the virtue of balanced budgets. The Government of India were rather anxious to put their finances in good shape by providing for small surpluses through economy, taxation and borrowing

from the public. Actually, achievement of budgetary equilibrium had been regarded as a pre-condition for the establishment of the Reserve Bank of India and the inauguration of the new Constitution of India. The other major fixation of the Government at this time was their persistence in maintaining the exchange rate at 1S. 6d., regardless of the many arguments deserving of consideration in favour of the view that a lower rate would benefit the economy greatly. Naturally, the prevailing attitudes and policies, not to say prejudices, of the Government very largely determined what the policies of the central banking authority were to be in the circumstances. Thus, although the Indian economy was on the whole stagnant and the Indian financial press and the economic intelligentsia of the country advocated a reflationist policy, the horizon of economic and monetary policy was limited and current policy concepts were not attuned to the problems of developmental or anti-cyclical fiscal or monetary management. The limited objective of official policy is brought out in the following extract from Prejudice and Judgment, representing the personal and public recollections of Sir James Grigg, who was Finance Member of the Government of India during almost this entire period:

To sum up, I should say that, during my five years, the exchange was preserved in spite of some ferocious attacks on it by all the various forms of Congress agency, open or concealed; that notwithstanding bad world conditions, especially as regards primary products, the credit of India was preserved and even enhanced; that the finances of India were kept in balance after meeting all the claims upon them -whether they were foreseeable or unforeseeable, . . . Over and above satisfying these claims I was able to repay a substantial amount of debt and to provide worthwhile sums for social services and rural development.

The ‘ worthwhile sums ’ for social services and rural development, referred to above, it should be noted, signified no more than an occasional central grant of a crore or two to the Provinces for providing relief in times of distress to rural areas or assistance to a few village industries !

Monetary Management -General Aspects

Monetary management in the early years of the Bank had both potentialities and limitations. Much of the period was characterised by extremely easy money conditions but these reflected primarily the low tempo of economic activity. Easy conditions were also largely confined to the organised sector of the money market. There was the task of taking the benefit of cheap credit to the large unorganised sector, but the Bank's links with this sector were, if anything, remote. The freedom

of movement of funds across the country in the absence of exchange control, the need to find foreign exchange to meet Home Charges and the obligations placed on the Bank to maintain a fixed exchange parity, acted as constraints on the Bank's freedom and called for considerable skill and finesse on its part. The Bank had also to keep a sensitive ear to monetary and exchange developments abroad, especially in the U.K. While, on the whole, monetary management called for a great deal of vigilance, skill and adaptability, the scope for active policies to influence the range or level of economic activity was not large. It must also be recognised that the prevailing views on the subject in central banking circles generally were not oriented to any positive action bearing on the course of the economy.

The principal problems before the Bank, it was recognised, were the integration of the organised and the unorganised sectors of the money market and a substantial narrowing of the seasonal and regional variations in money rates. The rural sector, by far the largest segment of the economy, relied for its requirements principally on the moneylenders. In the urban areas, production credit to a small extent and marketing credit to an important extent depended on the indigenous bankers. Official policy was not to supplant these agencies but make use of them for the channelling of credit to the country at large. However, this involved a radical reform of these agencies, while the indigenous bankers and the moneylenders were not prepared for any reform, let alone a radical reform; so very little could be achieved in this direction. The primary emphasis came to be placed on the development of co-operative institutions for solving the problem of rural credit. But here again, very little progress was made in effect; much had to be done to reform and rehabilitate the co-operative movement in order to make it creditworthy in the first place, before the Reserve Bank could deal with it in the matter of providing financial assistance. However, a great deal of preliminary work was done in these areas, the details of which are given in Chapter 7.

The Reserve Bank's contacts were in effect confined to the commercial banks, in particular the scheduled banks. So far as this sector was concerned, by and large, there was adequacy of funds, having regard to the comparatively subdued tempo of economic activity and demand for funds. The growth in scheduled bank credit in the four years since July 1935 was only of the order of Rs. 16 crores. The banks had plenty of resources of cash (this was especially so in the case of the Imperial Bank) and Government securities, the credit-deposit ratio in those days being relatively low, generally in the range of 40 to 50 per cent. In the second half of 1935, the first year of the Bank's operations, there was in fact a substantial decline in scheduled bank credit, from Rs. 107 crores to Rs. 87 crores, part of this being seasonal. In the subsequent year,

there was a fair measure of recovery and in 1937 too there was moderate expansion. In 1938, while there were seasonal variations in credit, there was no appreciable expansion over the year as a whole. Following the outbreak of war, there was of course a marked expansion in bank credit. Throughout, the resources of banks were, by and large, adequate to meet the seasonal expansion; they drew upon their substantially excess cash balances and also sold from their Government securities portfolio. Thus, during the busy season of 1936-37 (October-March), credit expansion was somewhat pronounced as the usual seasonal activity was reinforced by a wave of speculative buying of shares. Scheduled bank credit rose from Rs. 89 crores to Rs. 103 crores in the last quarter of 1936; this was largely met by banks by reducing their excess cash balances with the Bank from Rs. 19 crores to Rs. 6 crores. During the first quarter of 1937, there was a further rise in bank credit of Rs. 25 crores to Rs. 128 crores, which the banks financed mostly by running down their investments. Similar trends were also noticeable in the busy season of 1938-39, when excess balances came down significantly.

The general abundance of funds did not mean that there were no occasions when banks did not need some outside assistance temporarily. Apart from inter-bank call loans, the market in which was well developed, banks obtained their short-term accommodation mainly from the Imperial Bank of India. In July 1935, the Imperial Bank announced that it would extend to banks day-to-day loans against Government securities on a call loan rate basis; this rate, before long, came to be about $\frac{1}{2}$ of 1 per cent above the inter-bank call loan rate. If the banks did not want to borrow on the basis of a fluctuating call rate, they could borrow at the Imperial Bank general advances rate, which was on par with the Reserve Bank rate. Moreover, from June 1, 1935, that is, about a month prior to the establishment of the statutory relationship between the Reserve Bank and the scheduled banks, the Imperial Bank removed the stipulation of a seven-day minimum interest. The presence of the Imperial Bank's branches all over the country also favoured the other banks' borrowing from the Imperial.

Of course, the Imperial Bank itself replenished its cash resources, mainly by discounting Treasury bills with the Reserve Bank. The Imperial was the largest tenderer at the Treasury bill auctions; the amount for which the Imperial tendered and the rate were also fixed in consultation with the Reserve Bank. In fact, even with regard to major matters relating to the Imperial's operations, there appears to have been full consultation with the Reserve Bank. In other words, the Imperial Bank's role as a bankers' bank did not imply a curtailment of the Reserve Bank's authority. It was an arrangement which the

Reserve Bank itself did not look upon with any disfavour. Further, insofar as the rates of the Imperial Bank were linked to the Reserve Bank rate, the central banking institution possessed initiative and a controlling voice.

If there had been a fairly well established system of genuine trade bills, there is no doubt that there would have been a larger resort to the central bank for accommodation. But this was not the case. The inland bills portfolio of the scheduled banks as a whole was in the range of Rs. 2 to 8 crores only; obviously, bills of good quality would have been of even smaller magnitude. Although a lot of lip service was paid to the development of a genuine bill market, the Bank management was very clear that in the prevailing conditions there was little scope for this and that, in fact, it was a risky business to engage in the discounting or purchase of bills. Hence the main channel of assistance from the Bank was to be through advances against Government securities or open market operations, besides discounting of Treasury bills. Little attention was given in those days to the Reserve Bank's giving advances to scheduled banks against the security of their advances converted into usance bills, an expedient put into operation early in 1952. The Bank's view was that its advances could be given only against documents of title to goods and not on the security of goods themselves. Since licensed warehouses had hardly developed, there was extreme paucity of documents of title to goods. The 'general approach of the Bank to credit extension, not only for trade and manufacturing but even for agricultural operations, was that the Reserve Bank's credit could only be of an emergency character, besides some assistance to mitigate seasonal pressures of demand for credit.

An important constraint on the freedom of the Bank in its operations was the need to maintain the exchange rate of the rupee at 1S. 6d. any marked expansion of credit and lowering of the interest rate pattern would have affected the acquisition of sterling and the inflow of banking funds. Since in the pre-war years there were no exchange controls, movements of funds between London and India were free and also sensitive to fluctuations in the exchange rate within the officially prescribed limits, and the money rates in India. That is why, except for a reduction in November 1935, the Bank rate was kept constant.

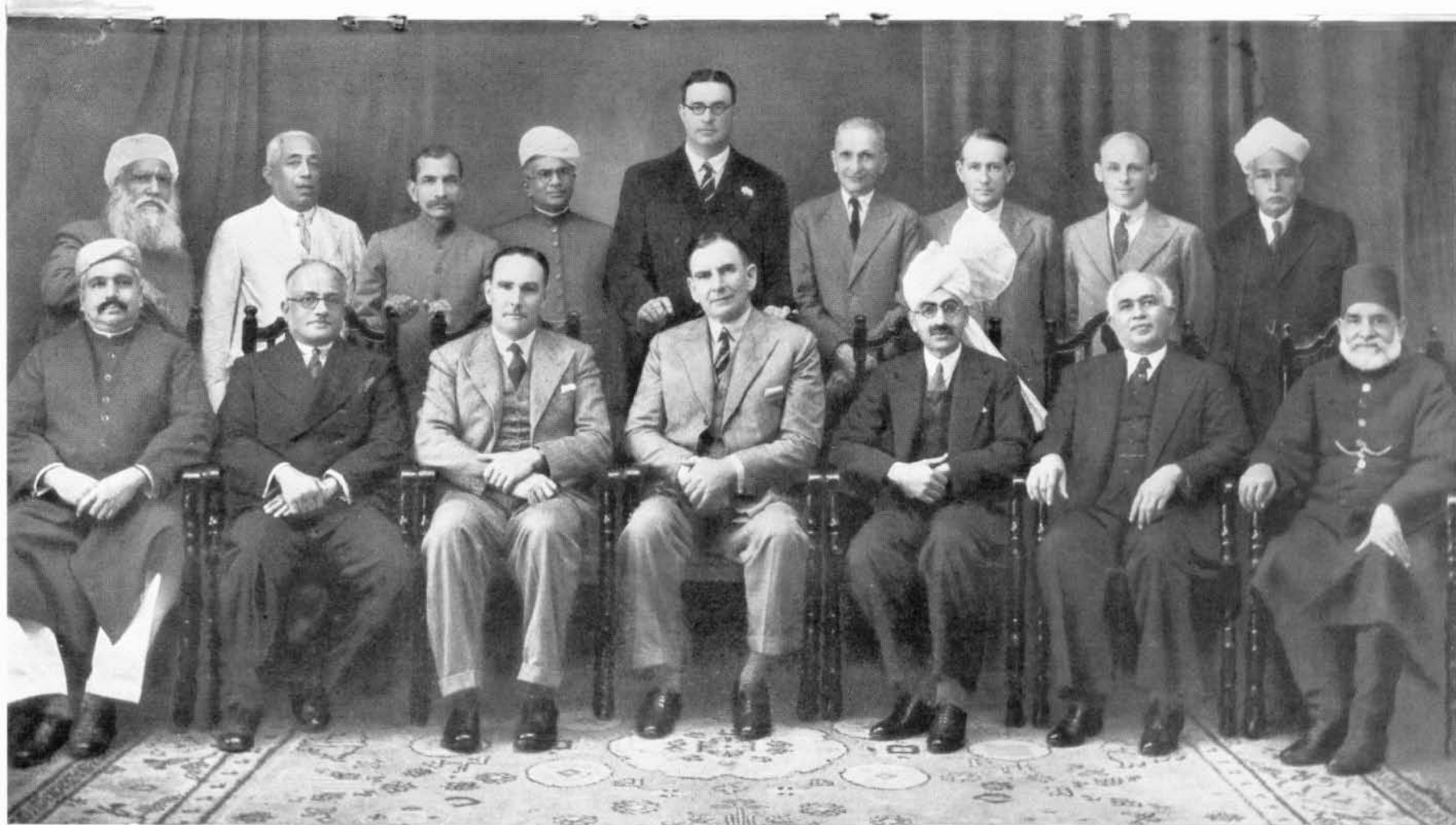
All this only indicates that in the light of the prevailing circumstances and views there was not much scope for monetary action. That is not to say that things were the same as in the days prior to the establishment of the Reserve Bank. There was of course, greater concentration on central banking functions than might have been expected from an institution which was essentially a commercial bank. There was considerable improvement and refinement in the handling of the

money market and the foreign exchange. Also, while not much central bank credit was extended; a detailed study of the problems in this behalf was initiated. Perhaps something concrete would have emerged but for the outbreak of the war.

Nevertheless, the role of the Reserve Bank in maintaining orderly conditions in the money market and eliminating seasonal extremes of rates was not without significance, even in its early phase. In the context of the low level of demand for loanable funds and the restricted volume of private investment activity, the financial operations of the Government had greater importance. The centralisation of these operations in the Reserve Bank, which was also the sole authority for the issue of currency, enabled it to intervene effectively in the money market. There were three principal instruments through which the Bank brought about adjustments in the market. The first related to its responsibility for the purchases of sterling for meeting the exchange requirements of the Government. In discharge of this, the Bank had to buy sterling from scheduled banks which were engaged in the financing of exports from India. Thus, by adjusting the amounts of sterling purchases from week to week through tenders and intermediaries and through the rates at which these were purchased, the Bank was in a position to influence the Indian cash reserves of banks. The second instrument was the sale of Treasury bills by weekly tender and their rediscounting by the Bank, for which standard arrangements were introduced. The Bank was in a position to regulate the size and timing of these operations to suit not only the requirements of Government finance but also the exigencies of the money market. Thirdly, the Bank engaged, on its own account as well as on Government's, in open market operations that is, purchase and sale of Government securities in the market, with a view to meeting the seasonal requirements of the money market.

It should be added that while there were no dramatic developments in these spheres, the day-to-day work of the Bank called for much attention and skill. Much ingenuity was required in deploying the few instruments that were available, as the rigid exchange rate, freedom of the movement of funds into and outside the country, the virtual absence of foreign or international lines of credit that are such an accepted feature of the present day world and the general philosophy of the Government with regard to budgetary equilibrium imposed severe limitations on the Bank's freedom. The day-to-day monetary management of the Bank also seems to have evoked considerable interest in the financial press and banking circles.

In the following pages, a detailed exposition is given of the Bank's policies and operations concerning Bank rate, open market operations and the management of the exchanges.



First Central Board of Directors

STANDING (LEFT TO RIGHT): *Sundar Singh Majithia, U. Bah Oh, Shri Ram, Badridas Goenka, Edward Benthall, F. E. Dinshaw, J. W. Kelly, A. A. Bruce, M. Ramachandra Rao;*

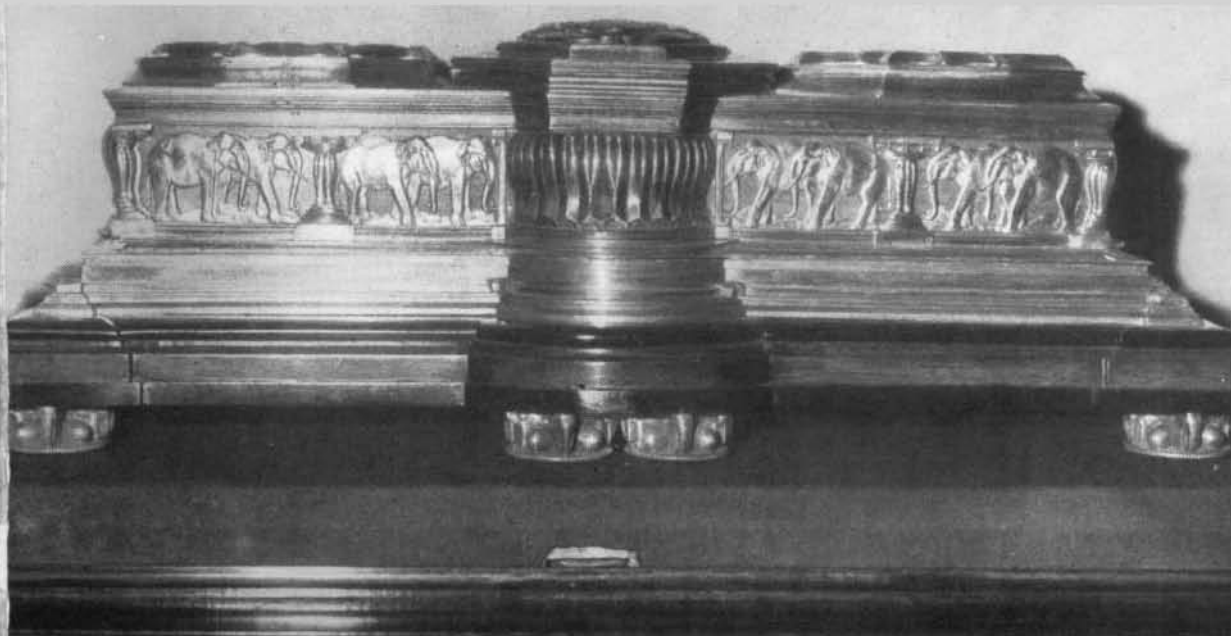
SITTING: *Adam Hajee Mohammad Sait, Purshotamdas Thakurdas, James B. Taylor, Osborne A. Smith, Sikander Hyat-Khan, Homi Mehta, Muzammilullah Khan,*



Bombay building of the Bank.

Mr. Manilal B. Nanavati, Deputy Governor, inspecting a vault at the Lahore Office, in 1940.





Ceremonial Ink Stand presented by the Bank of England on the opening of the Bombay building of the Reserve Bank.

Rs. 1,000 First issued in May 1938 under Governor T-ylor's signature. Actual size, 8" x 5". In the middle is a picture of an Indian landscape, with the value in eight Indian languages at the left.





Group photo taken on the occasion of transfer of Mr. M. K. Bhattacharyya, an Officer, from Kanpur, in January 1940.

Bank Rate Procedures and Policy

The initial task of the Reserve Bank was to establish contact with the money market in its role as the lender of last resort through the normal channels of discounts and advances. The Reserve Bank fixed its first Bank rate at $3\frac{1}{2}$ per cent; the decision was taken at a meeting of the Committee of the Central Board held on July 3, 1935. The announcement of the Bank rate was timed just before the day (July 5, 1935) fixed for the scheduled banks to lodge their statutory deposits with the Reserve Bank, so that, in the event of some banks requiring advances to meet their obligations, the Reserve Bank would be in a position to make advances to them at the Bank rate.

The procedure for the fixation of Bank rate was settled at a meeting of the Committee of the Central Board held on June 12, 1935. Under Section 49 of the Act, the Bank rate is the standard rate at which the Reserve Bank is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under the Act. Unlike the Imperial Bank of India rate, which was a rate on advances against Government paper, the Reserve Bank rate was conceived to be a discount rate, though, on account of the paucity of bills, it has all along been obvious that, in effect, it is a rate on advances. It was decided that the Bank rate should be the rate at which the Bank was prepared to discount first class trade bills presented by a scheduled bank of a maturity not exceeding 28 days. This limit was decided on as, at such times, for instance, as at the end of December when money was tightening, the rate at which the Bank would be prepared to purchase bills of a maturity of three months- the maximum limit under the Statute -might be considerably higher than that at which it was prepared to purchase bills of shorter maturity. The Bank envisaged the bulk of its accommodation to take the form of advances against Government securities owing to the paucity of trade bills. Under the circumstances, it was considered an unduly restrictive measure, which would create a misleading impression, to base the rate for advances against Government securities on its discount rate for three months' bills. The Bank management took the view that no scheduled bank had a right to discount bills with the Reserve Bank and that to begin with, no bills were to be discounted except after reference to the Central Office of the Bank. The Managers of regional offices were given discretion only to make advances, at Bank rate, to scheduled banks against Government securities repayable on demand, with a minimum interest period of seven days, subject to the usual conditions of margin.

It would be of interest to know how the Bank rate of $3\frac{1}{2}$ per cent stood in relation to the prevailing money rates in India and the U.K.

The principal official rates in the money market prior to the Reserve Bank's establishment, namely, the Imperial Bank of India Bank rate and the Imperial Bank of India Hundi rate, both stood at $3\frac{1}{2}$ per cent, having remained unchanged since February 1933. The inter-bank call money rate in Bombay moved in the range of 2 to 4 per cent in the first half of 1935, though the most usual rate was in the range of 3 to $3\frac{1}{2}$ per cent. The three months Central Government Treasury bill rate varied in the first half of 1935 between Rs. 1-8-7 and Rs. 2-0-0 per cent. In London, the Bank rate was 2 per cent, having remained at this level since June 1932. The most important market rate in the U.K., namely, the Treasury bill rate, was as low as 0.2 per cent at the beginning of 1935, rising to 0.75 per cent by the end of the year; the average for 1935 was 0.55 per cent as compared to 0.73 per cent in 1934.

In India, the only change in Bank rate during the period under study was in November 1935, when it was reduced from $3\frac{1}{2}$ to 3 per cent, effective the 28th. The relevant minutes of the meeting of the Committee of the Central Board held on November 27, were as under:

The Committee considered the question of Bank Rate and also a statement made by the Controller of the Currency on behalf of Government. On a review of Bank's position and the state of money market, it was resolved - that the Bank Rate be fixed at 3 per cent.

In the Bank's annual report for 1935, the Directors stated that:

easy conditions and the weight of money awaiting investment compelled a reduction to 3 per cent.

From press reports and statements of knowledgeable persons in later years, it would appear that the initiative for the Bank rate cut came from the Bank; Sir Osborne Smith was a supporter of cheap money. It would also appear that the Finance Member was not happy about a reduction in Bank rate, an important consideration with Government no doubt being its impact on the rupee-sterling exchange rate, pegged at 1S. 6d. Difference of opinion over the question of Bank rate was an important cause of friction between the Governor and the Finance Member, leading to the former's resignation in October 1936.

The lowering of the Bank rate, which appears to have been widely anticipated, reflected a marked easing of monetary conditions and a sharp decline in money rates during the latter part of 1935. Call money rate in Bombay, for instance, was quoting at $\frac{1}{4}$ per cent in November, as compared to 2 to 4 per cent in January-June 1935; the Treasury bill auction rate was quoting at about 1 per cent as compared to $1\frac{1}{2}$ to 2 per cent in January-June 1935. There had also been a marked contraction of scheduled bank credit since July.

The reduction in Bank rate was very well received in the press. The Times of India reported that the 'laconic' comment in financial circles was 'better late than never'. The Commerce remarked that 'the reduction is in consonance with existing conditions in the money market in which abnormal easiness has been an unrelieved feature during the past few months'. Commenting on the unusual phenomenon of a reduction in Bank rate on the eve of the busy season, the weekly also stated that it was believed that the Governor had been desirous of introducing and retaining a uniform rate throughout the year. In earlier years, there used to be several changes in the Imperial's Bank rate during the year; in the busy season, the Bank rate used to go up invariably. It was left to the Indian Finance, which had persistently argued for cheaper money, to go into ecstasy on the Bank rate reduction -although the paper thought that a 2 ½ per cent rate would have been appropriate; it sang: *

As the earth bringeth forth her bud and as the garden causeth the things that are sown in it to spring forth, so the three per cent rate will cause health and bloom to spring forth before all the cities and the country-side.

The continuance of cheap money conditions appear to have led to some move to reduce the Bank rate further. While there are no official records on the subject, we have it on the authority of Governor Deshmukh † that :

In 1936, the then Governor, possibly at the instance of some of the Directors, thought of making a further reduction to 2 ½ per cent, but preliminary discussions with Government revealed that they strongly opposed any such move, in view of the glut of money which then seemed to be in evidence in the money market. The proposal was, therefore, dropped.

This is confirmed by a report in the Indian Finance, which was very knowledgeable in matters relating to the money market; in May that year, pleading for a reduction of Bank rate to 2 ½ per cent, the journal remarked with a sigh that:

if the Bank had absolute discretion in this matter, there is every likelihood of a 2 ½ per cent Bank rate in the very near future.

The paper's impression was that Government were opposed to the reduction, because the exchange was not as strong as it ought to be, the sterling purchases of the Bank being rather small. It is difficult to say whether there was a strong case for a 2½ per cent Bank rate;

* November 30, 1935.

† op. cit.

3 per cent was by no means a high rate, everything considered. The more important requirement was the percolation of easy money conditions to the entire economy.

Low Volume of Loans and Discounts

The volume of advances and discounts of the Bank during this period was very low. The following table presents an analysis of these operations at three-month intervals.

(Rs. crores)

| <i>Average of Friday Figures</i> | <i>Loans and Advances to Govts</i> | <i>Other Loans and Advances</i> | <i>Bills Discounted (Treasury bills)</i> | <i>Bills Discounted (Internal)</i> |
|--------------------------------------|--|-------------------------------------|--|--|
| April 1935 | .... | .... | .... | .... |
| July 1935 | .... | .... | .... | .... |
| October 1935 | .... | .... | .... | .... |
| January 1936 | 4.4 | .... | .... | .... |
| April “ | 3.5 | .... | .... | .... |
| July “ | 1.8 | .... | .... | .... |
| October “ | 0.4 | .... | .... | .... |
| January 1937 | 0.6 | .... | .... | .... |
| April “ | 0.6 | .... | .... | .... |
| July “ | 1.0 | .... | .... | .... |
| October “ | .... | .... | .... | .... |
| January 1938 | 2.2 | .... | .... | .... |
| April “ | 0.4 | .... | 0.2 | .... |
| July “ | .... | .... | 0.1 | .... |
| October “ | 5.8 | .... | 0.2 | .... |
| January “ | 5.4 | 0.1 | 7.8 | .... |
| April “ | 0.4 | 0.9 | 2.2 | .... |
| July “ | 1.8 | .... | 0.1 | .... |
| October “ | 1.9 | .... | 1.2 | .... |

The data show that the Bank's loans and advances were mostly to Governments and that even these were not substantial except on some occasions. The highest level of outstanding advance to Governments as on a Friday was Rs. 8 crores, on January 10, 1936.

Loans and advances to scheduled and co-operative banks (that is, the item 'other loans and advances') were insignificant; very small amounts were borrowed by them at irregular intervals. Such loans outstanding during the period April 1935 to September 1939 did not exceed Rs. 2 lakhs at the end of any month, excepting on nine occasions, when they ranged between Rs. 3 lakhs and Rs. 14 lakhs. Similarly, the outstanding amount of bills discounted by the Reserve Bank during the period makes a poor showing. The amount was very small, except in January 1939, when the amount discounted (outstanding) averaged Rs. 7.8 crores. This amount consisted entirely of Treasury bills discounted, apparently at the initiative of the Imperial Bank when it was hard pressed for funds.

Open Market Operations

As compared to discounts and advances, the Bank was somewhat active in the sphere of open market operations. Open market operations constitute an important weapon of monetary regulation in the armoury of central banks. In a broad sense, open market operations may be said to cover purchases and sales by the central bank of not only Government securities including Treasury bills, but a variety of assets such as gold, foreign exchange, commercial bills and, in rare cases, even corporate securities. In the conventional sense, however, the operations cover purchase and sale of Government securities. Open market operations are conducted having regard not only to the state of the money market but also the requirements of the Treasury; indeed, often, the latter objective is the predominant one. In other words, open market operations are usually integrated with a central bank's debt management policies. This was very much so in India in the formative years. These operations have also to be integrated with loans and discounts policies and operations ; that is to say, these operations are intended to bring about desired changes not only in the flow of credit but also in the pattern of interest rates.

The relative importance of the various instruments of credit regulation has tended to vary in different countries and at different times. But open market operations ' provide a continuously available and flexible instrument of monetary policy for which there is no substitute '. These operations produce a direct effect on the liquidity of the economy. Open market operations can be a continuous process, carried on unobtrusively, on a day-to-day basis, on even the smallest scale. Also, these operations can be conducted with any party in the open market and not merely member banks or institutional agencies. They constitute a very elastic type of credit control.

The capacity of the Reserve Bank to undertake open market operations depends, in part, on the statutory provisions regarding assets held in the Issue and the Banking Departments. At present there are no restrictions as to either the quantity or the maturity of Government securities which the Reserve Bank can buy; the Bank enjoys full discretion in this respect. In the earlier years, however, as indicated in Chapter 3, there were statutory restrictions on the aggregate amount of securities which the Reserve Bank could hold. Thus, to recapitulate, the amount of Government and other approved securities which the Bank could hold in the Banking Department was limited to its share capital, Reserve Fund, and three-fifths of its liabilities in respect of deposits. There were also restrictions on the maturity distribution of the securities held by it. Thus, the value of securities maturing after one year was not to exceed the aggregate of share capital, Reserve

Fund, and two-fifths of its deposit liabilities. This was further subject to the condition that the value of securities maturing after ten years should not exceed the aggregate amount of share capital, Reserve Fund and one-fifth of its deposit liabilities. As regards the Issue Department, rupee securities eligible for holding were only those of the Government of India. While there was no limitation regarding their maturity, the total amount of rupee securities was subject to the limitation that it should not exceed one-fourth of the total amount of assets or Rs. 50 crores, whichever was higher; with the previous sanction of the Governor General in Council, an additional sum of Rs.10 crores could be held. Notwithstanding these restrictions, there was enough scope for the Bank to engage in open market operations.

The procedure adopted by the Reserve Bank in regard to open market operations may be indicated briefly. The Bank conducted purchases and sales of securities generally through a limited number of approved brokers selected on the basis of reputation, financial standing, volume of business done, etc. In Bombay, for instance, about 10 firms were included in the Bank's list. To begin with, the Bank's choice of brokers was made from those of the Imperial Bank of India. The list of brokers was revised now and then and new names were included, while those who failed to maintain the standard were deleted. Open market operations in the early days of the Bank were the intimate concern of the Governor or the Deputy Governor, who dealt personally with brokers.

In the beginning, all the transactions in securities were effected through the medium of brokers on the Bank's approved list. But several years later, the facility of making direct sales and purchases for amounts of Rs. 25 lakhs or over was allowed to scheduled banks in respect of their investments. It was not the practice of the Bank to allow any brokerage on sales or purchases of Government securities made on its own investment account or on behalf of the Central or Provincial Governments.

In those years, the gilt-edged market was fairly wide and active. Besides banks, the most important constituents of the market, the numerous life insurance companies, princes and princely State Governments and the large number of private trusts took active interest in the gilt-edged market. Because of the low level of short-term money rates and the spread between the call loan rate and the yield on Government securities, it was possible for firms engaged in Government securities business to act as dealers too, though they were not numerous.

For an appreciation of open market operations of the Bank in the pre-war years, it is also necessary to refer briefly to the Government's loan operations in those years.

In the four fiscal years ending with 1938-39, the funded rupee debt recorded no net change at Rs. 438 crores. There was a decrease of Rs. 12 crores in 1935-36 and more or less an equal increase in the following year. In 1937-38 and 1938-39, there was hardly any change. Except in 1937-38, there was a loan issue in every year, with a coupon rate of $2\frac{3}{4}$ or 3 per cent, the proceeds being used to pay off earlier loans with coupon rates ranging from 5 to $6\frac{1}{2}$ per cent. Also, there was a net decline in outstanding Treasury bills in the first two years, from Rs. 54 crores to Rs. 29 crores and an increase to Rs. 46 crores by 1939 March end.

In these circumstances, there was not much need for the Bank to extend any persistent support to the Government's borrowing programme or for the maintenance of Government security prices. Moreover, from the year 1936-37 onwards rupee securities were quoting at a premium as compared to the corresponding sterling securities issued by the Government of India. As a result of this disparity, there was in fact a considerable remittance of funds to the U.K., and large scale open market purchases were ruled out for this reason also. The sterling security prices were influenced by political developments in Central Europe, Far East and Spain, tending to depress the market. These influences also affected the Indian securities market; during 1938-39 and 1939-40, gilt-edged prices witnessed a phase of continued decline. This was accentuated to some extent by the sales of Government securities by scheduled banks whose advances recorded a substantial increase in these years. During 1938 and 1939, the Bank made net purchases. In particular, it intervened as an active purchaser in the busy season and helped keep down the pattern of money rates. Except in 1935, the Bank made net purchases of securities in all the pre-war years, in the range of Rs. 2 to 4 crores.

An aspect of open market operations worth recording here is that they were not restricted to short-term securities, as in the case of some central banks. Right from the beginning, the Bank dealt in all maturities; there appeared to have been some doubts if the Bank could deal in the non-terminable loans, but after consulting legal experts the view was taken that it was in order- to buy and sell those securities. The quantum of purchase and sale naturally varied considerably from security to security.

There was hardly any purchase and sale operation with regard to Treasury bills, 'since in India, as already mentioned, these bills do not have wide institutional appeal even among banks. What the Bank did was to vary the amount of Treasury bills offered for the weekly tender (in the period 1935-39 this ranged between Rs. 1 crore and Rs. 3 crores) and also to let the auction rate fluctuate as was considered necessary. Besides, the Bank provided facilities for the discounting of

Treasury bills, not only to the Imperial but also to the other scheduled banks. For the Imperial, a special arrangement was made in February 1938 with regard to the rate, namely, the same as the average rate of the last preceding auction. This was in view of the fact that the Imperial was the main supporter of the Treasury bills, the quantum of its tender and the rate being guided by the Reserve Bank. At the same time, it was decided to extend facilities for discounting Treasury bills to other scheduled banks also. Accordingly, later in the same month (February 1938), the Bank informally notified those scheduled banks which had been regular tenderers for Central Government Treasury bills that it would be prepared from time to time to purchase Treasury bills at fine rates ascertainable on application from the offices of the Bank. In actual practice, however, this rate was $\frac{1}{8}$ per cent above the previous week's average allotment rate, rounded off to the next anna above. Similar facilities were also available to Provincial Governments. In December 1938, Provincial Government Treasury bills were also made eligible for discount at suitable rates, these being somewhat higher.

Exchange Management and Policy

Attention may now be turned to another very important aspect of the Bank's operations, namely, that concerning the management of foreign exchange.

The story of the establishment of the sterling exchange standard in India and the incorporation of the 1s. 6d. exchange rate in the Reserve Bank of India Act has been told in earlier chapters. The Bank was placed under the legal obligation to maintain the sterling rate through purchases and sales of sterling at specified rates. * It was also the Bank's responsibility as banker to Government to meet the exchange requirements of Government for remittances to London and repayment of sterling obligations. An account of the Bank's exchange management and policy during this phase is full of interest in view of the revival of the exchange rate controversy occasioned by the vicissitudes in the course of the foreign exchange market.

Within the narrow horizon of monetary management then in vogue, the Bank encountered no difficulty during the initial three years (1935-37) in discharging its responsibility to maintain the external parity of the rupee and procuring the necessary sterling exchange for meeting Government's requirements. The exchange rate remained consistently firm throughout this period as a result of the continued improvement in

* The Bank was required to sell sterling at a rate not below 1s. 5 49/64d. and to buy sterling at a rate not higher than 1s. 6 3/16d. These represented the lower and the upper points of the parity.

the balance of merchandise trade, despite the shrinkage in gold exports, which were mainly responsible for buttressing the exchange rate during the worst phase of the depression. The Bank was able to obtain its requirements of sterling by weekly tenders from scheduled banks at the rate of 1S.6 $\frac{1}{8}$ d. and occasionally through purchases of intermediates on tap at .6 5/32d. The sterling purchases of the Bank during the years 1935-37 amounted to £ 36.9 million †, £ 42.7 million and £ 33.9 million, respectively. Besides meeting the requirements of Government for normal remittances, the acquisition of sterling during this period was adequate to enable the Bank to put the Government in a position to repay the 5½ per cent India Bonds, 1936-38 for £ 16.9 million. In July 1935, the Government floated a sterling loan (3 per cent 1949-52, a £ 98) for £ 10 million to enable them to repay the 6 per cent 1935-37 sterling bonds for £11.9 million. The Bank's holdings of sterling recorded a net increase from Rs. 61 crores in April 1935 to a peak of Rs.108 crores in April 1937; the ratio of gold and sterling securities in the Issue Department to note issue rose from 50 per cent at the inception to 60 per cent in April 1937, which level seems to have been the goal.

The tide, however, turned in 1938 with the emergence of recessionary trends abroad and the apprehensions generated in the wake of the Central European crisis. The consequent decline in exports affected the course of the rupee-sterling exchange during the greater part of the subsequent period. The foreign exchange market turned weak from the beginning of April 1938 and there was an appreciable decline in the amount of sterling tendered to the Bank. The Bank at first tried to stop the rot in the exchange by effecting a drastic reduction in its acceptance of the mid-month tender to the nominal amount of £10,000 at a rate of 1S.6 3/32d. and by rejecting in the following week tenders made at 1S.6d. As these measures did not have the desired effect, the Bank suspended purchases by tender altogether from the beginning of May. The exchange rate, however, continued to fall and touched the statutory lower point of IS. 5 49/64d. in the first week of June.

The Bank also levered up money rates to give support to the exchange. Thus, from a low of 7 annas per cent in August 1937 the Treasury bill rate was gradually raised to Rs.1-9-8 by March 1938. With the improvement of exchange, the rate was allowed to go down to a little under 10 annas by August 1938. Later, towards the close of 1938 and early part of 1939, when exchange became weak, the Treasury bill rate was taken up again to a high of Rs. 2-9-8 in January-February 1939. In December 1938, the Imperial Bank also put up its advances rate, in stages from 2 to 3 per cent, to induce banks to bring funds from

† Including purchases effected by Government during January-March 1935.

abroad rather than borrow from it (the Imperial). In sympathy with the above movements, call rates also moved up.

From July 1938, however, the improvement in the business outlook and the balance of trade led to an improvement in the exchange market, the rupee staging a slight recovery; the rate remained steady until the close of the year between 1S. 5 13/16d. and 1S.5 15/16d. The total amount of sterling purchased by the Bank during the year was only £ 19.1 million as against £ 33.9 million in 1937; as this was insufficient to meet Government's sterling requirements amounting to £ 36 million, the Bank had to transfer sterling securities to the tune of £ 15.6 million from reserves (i.e., by transfer from Issue to Banking Department). In December 1938, forward exchange rates weakened as a result of speculative forces, and to curb these Government issued a communique, repeating their decision to maintain the statutory ratio. From the peak of Rs.108 crores on April 30, 1937, the sterling assets of the Bank reached a low of Rs. 58 crores on January 6, 1939, the ratio of gold and sterling securities in the Issue Department to total note issue reaching a nadir of 49.78 per cent. The sterling holdings in the Banking Department were less than Rs. 1 crore on some occasions in 1938.

The exchange remained more or less steady between 1S. 5 29/32d. and 1S. 5 15/16d. during 1939 up to the outbreak of war, except for a sagging tendency in May. The Bank resumed tender purchases of sterling on February 22, 1939, after an interval of about 10 months. However, on account of the weakness of the exchange, the Bank discontinued sterling tenders in May, until further notice. From August, exchange improved and large offers of sterling were made to the Bank. On the eve of the war in September, sterling assets had risen to about Rs. 70 crores from the January low of Rs. 58 crores. After the outbreak of the war, following the raising of the Bank's tap rate in October, the market rate rose further to 1S. 5 31/32d. at which level it remained almost unchanged till the end of the year. Apart from direct purchases from banks, the Bank's sterling holdings were augmented principally by transfers from the Secretary of State for Government purchases of war commodities and the proceeds of silver sales. The total amount of sterling purchases by the Bank during 1939 amounted to £ 63 million at the average rate of 1S. 5 31/32d. This enabled the Bank not only to meet the Government's requirements of sterling amounting to £ 21.6 million but also to augment the external assets during the year by over Rs. 50 crores, to Rs.113 crores.

Exchange Ratio Controversy

The exchange rate question was in a sense always active. In October 1936, for instance, the matter had figured in the Legislative Assembly

and a motion to censure the Government on this issue was only lost by the casting vote of the President of the Assembly. The weakening of the exchange rate of the rupee in 1938 brought to the fore the ratio controversy associated with the demand for a lowering of the exchange rate. The Working Committee of the Indian National Congress took up the question and sought to bring pressure on the Government of India by directing the Congress Ministries in the Provinces to send representations urging on them the need for an immediate lowering of the rate. In May 1938, the Conference of the Prime Ministers of the Congress-governed Provinces at Bombay was reported to have considered the question and resolved to secure the co-operation of all Provinces in representing to the Central Government the case for a lower rupee-sterling ratio. The Government rightly sensed that the fall in the exchange to the lower point early in June would provide an edge to the agitation for a lower rupee and, to scotch any such move, promptly issued the following communique on June 6, 1938, affirming their determination to maintain the existing ratio:

In view of the suggestions that have been given publicity in various quarters that the exchange value of the rupee should be altered, the Government of India wish to make it clear that they are satisfied that maintenance of the present value of the rupee is required in the interests of India, and that the resources available for this purpose are more than ample.

In this connection, it may be pointed out that the gold and sterling assets actually in the hands of the Reserve Bank and the Government of India are at the present time worth more than Rs. 160 crores. The Government of India have no intention of permitting any alteration in the present statutory ratio.

The Bank's Governor, Sir James Taylor, apparently concurred in the views of the Government regarding the adequacy of the Bank's external resources for carrying out its statutory exchange obligation and the probable injurious effects of a change in the ratio. However, the elected members of the Board took the attitude that for coping with the deterioration in the exchange rate they should recommend to Government an immediate alteration in the statutory ratio. Sir Purshotamdas Thakurdas, at the meeting of the Central Board of the Bank held in Madras in July 1938, made the following statement on the question and desired the substance of the discussion to be communicated to Government:

On a review of the Bank's affairs since the last Board meeting I should like to record the deterioration in the sterling assets of the Issue Department from Rs. 78.81 crores on the 3rd June to Rs. 72.15 crores on the 8th July. This has been unavoidable owing to the difficulty of purchasing

sterling since May and therefore the requirements of the Government of India had to be met by sale of necessary sterling assets against cancellation of rupee currency notes in the Banking Department. I apprehend that such contraction of currency without affecting the Bank rate or money market cannot be feasible for a long period, and therefore, unless exports improve materially and soon, contraction of currency actually in circulation will be inevitable in efforts to maintain the rupee at the lower point of 1s.6d. I consider this, unless restricted to a few crores, to be highly detrimental to the interests of the country as a whole, and desire to draw the attention of the Government of India and the Legislature to the serious position facing the country.

I have noted the Press Communique issued by the Government of India on 6 June last. I desire to record that I do not agree that the gold and sterling resources of the Bank were Rs. 160 crores as stated in that communique; if such calculation is based on valuation of the gold in the Issue Department at current market rate (140s.), the Government of India appear to have presumed that the Legislature would agree to an amendment of section 33(4) of the Reserve Bank Act which lays down the price at which gold is to be valued (84s.). This point may be made clear to the public by Government.

I consider any effort to change the existing basis of valuation of gold as inequitable and consider it to be the duty of the Government of India to bring the existing situation to the notice of the Legislature without delay to enable them to decide, after review of the existing economic conditions in India, on such policy regarding devaluation as would prevent depletion of India's currency assets entailing contraction of her currency.

The Governor, in reply, stated his personal opinion that, in view of the extent of external resources of the Bank and the international policy of cheap money, there was no cause for apprehension that the maintenance by the Bank of the exchange obligation imposed on it would be detrimental to the credit of the country while, on the other hand, a change would certainly be injurious and probably disastrous. After some discussion, three of the elected Directors expressed their agreement with the views of Sir Purshotamdas, while a nominated Director said that he had no objection to the views of the members being sent to Government, though he was personally not convinced that a stage had been reached where apprehension was called for. The other Directors expressed no opinion. The Governor, as Chairman of the Board, in deference to the wishes of the elected Directors, communicated their reactions to the Finance Department. The Government were not in a mood to listen and informed the Bank that they regarded a discussion of the question as most inopportune to embark on at that time, when it could only add to the prevailing uncertainty and uneasiness about world credit conditions. The Government's reply also referred to a statement by a leading representative of the Indian Merchants' Chamber that the Reserve Bank had expressed an opinion on the subject of the ratio and

implied an oblique thrust at the Bank for its failure to maintain secrecy in respect of matters discussed by the Board.

The cavalier treatment meted out to their representation made the members of the Board press on with a formal resolution on the subject at their meeting in Calcutta in November 1938. Sir Purshotamdas Thakurdas moved the following resolution, which was seconded by Mr. Kasturbhai Lalbhai:

In view of the heavy fall in the export trade of India, the continually unremunerative and virtually ruinous prices obtainable to the grower of raw produce and the resulting steady deterioration in the economic condition of the masses as a whole, all of which have led to the steady depletion of the currency resources of the country in the efforts of the Governor of the Reserve Bank to maintain the ratio of 1S. 6d. to the rupee as required by the Statute, the Board of the Reserve Bank consider it their duty to recommend to the Governor General in Council to take effective steps to obtain the consent of the Legislative Assembly to a lowering of the ratio of the rupee to sterling.

The Governor opposed this resolution stating that, in the then unsettled conditions of the world's currencies, it would be impossible to say that any other ratio would be more to India's interests or more easily maintainable than the then existing one, and, in the circumstances, it would be premature and dangerous to contemplate any change. The Governor was also of the view that voting at the Board would be on a basis of complete unreality if it proceeded on the assumption that that was an open question on which the Government were awaiting the views of the Board. There was general discussion on the resolution during which the Government representative made it clear that the Governor General was determined to maintain the statutory ratio by every means in his power. Sir P. T. objected to the categorical nature of the Government pronouncement and desired his reaction to the message to be conveyed to Government. Sir Homi Mehta, a nominated Director, also criticised the official attitude and remarked that their arriving at a conclusion before the Board's decision was reached constituted a grave reflection on the utility of the Board. The resolution was put to vote and carried by a majority of eight to four and was conveyed to Government. In reply, the Government merely reiterated the statement made by their representative on the Board.

The serious attention which the members of the Central Board gave to the ratio question was part of the wider agitation in the country at large on the subject; very likely, there was co-ordination in this matter. Following the lead given by the Congress Ministry of Bombay, most of the Provincial Governments made representations to the Government of India regarding their views on the ratio question. It appears that nearly all of them sought to present the case for a reduction of the

rupee ratio with a reiteration of the familiar arguments in support of it. The memorandum submitted by the Government of the Central Provinces and Berar, however, struck a different path by examining the basic issues from a wider angle rather than the narrower question of the exchange ratio and by advocating a mildly reflationary policy to assist economic recovery and growth. It is of interest to record that this document owed its inspiration to Mr. C. D. Deshmukh, who was then the Finance Secretary of the Government.

The issue of the exchange rate revision was also raised on the floor of the Legislative Assembly in August 1938 and several Members pressed the Government, with dogged persistence, to vouchsafe information on the reported representations made by Provincial Governments. Again, in September 1938, some-non-official Members of the Assembly made an unsuccessful attempt to secure the appointment of a committee to report on the whole question of the rupee ratio and to determine a permanent basis for the Indian monetary system. The intransigence of the Government on the ratio question made the Indian National Congress take it up as a political issue. On December 14, 1938 the Congress Working Committee passed a resolution urging immediate steps to lower the ratio to 1S. 4d., in the course of which it observed:

The Committee are of opinion that the rate of 1S.6d. to the rupee has hit hard the agriculturist of this country by lowering the prices of agricultural commodities and given an undue and unfair advantage to imports into this country. The Working Committee is satisfied that the rate of 1S. 6d. cannot any longer be maintained by large exports of gold which have been very injurious to the country. Matters have now reached a stage when the rate can only be maintained by a policy of contraction of currency and credit and by further depletion of the gold and sterling resources of India and particularly the Paper Currency Reserve. Those sterling resources have already been used up to an alarming extent and there is a danger of further serious depletion taking place if efforts continue to be made by the Government of India to maintain the present ratio.

The Government of India issued a long communique on December 16, 1938, disputing the facts set forth in the Working Committee's statement. It also reaffirmed Government's determination to defend the existing exchange value of the rupee and confidence in their ability to maintain it.

To consider the Government's press communique, the matter was again brought before the Central Board by Sir Purshotamdas at the meeting held in January 1939. The Board, by a majority of eight to five, passed a resolution deploring the attitude of the Government and trusting that they would be pleased to reconsider their decision. The

resolution also stated that 'if the opinion of the elected members of the Board is set aside in this manner by the Government of India, the very purpose and motive of starting the Reserve Bank is, to a considerable extent, discounted'. The Government representative, of course, disowned any intention on the part of the Government 'to discount in any way the importance of the Board of the Bank or to refuse to give due consideration to its views on any matter', but at the same time reaffirmed Government's inflexible stand. It appears that the Government even considered the question of superseding the Central Board 'to prevent an increasing element of futility creeping into their relations with the Board, should this difference of opinion in regard to this vital matter of the ratio persist'. * The Board did not press the matter any further 'possibly on recognising the fact that the ratio agitation did not apparently command more than a formal support from the major political party in the country'. * The agitation for a lower rupee rate lost most of its force as the exchange steadied and withered away with the outbreak of war and a change in the entire outlook.

Conclusion: Impact on the Money Market

The efficacy of monetary management, in the circumstances prevailing at that time, has to be judged among other things by the narrowing of the seasonal and regional variations of money rates. Despite the limited extent of the Bank's intervention, this object appears to have been achieved to a modest extent in the formative years of the Bank. It may perhaps be argued that it would be difficult to say whether the Reserve Bank's policies could take credit for this state of affairs or whether it was inherently due to a generally languishing economy and the very plentiful supplies of short-term money. While, obviously, the general abundance of short-term funds assisted the stability of rates, the Reserve Bank's presence and its policies would also appear to have helped this. The Bank made it a conscious policy not to vary the Bank rate frequently, as was the practice of the Imperial Bank prior to 1933, which used to put up the rate during the busy season. Stability of its lending rate induced stability in the rates of the Imperial Bank, which continued to play to some extent, the role of a bankers' bank.

Secondly, the Bank was able to co-ordinate fairly effectively the various elements that influenced the state of the money market. Its management of the foreign exchange as well as public debt, including in particular the management of the Treasury bill market, and its centralisation of the reserves helped the Bank maintain the money market on an even keel. Unlike the Imperial Bank or the Government, which had to pursue only limited objectives, the Reserve Bank had to

* Sir C. D. Deshmukh, op. cit.

take a harmonious view of the various considerations. It did not allow, for instance, the Treasury bill rate to go too low, lest it should have an adverse impact on the exchange; for this purpose, among other things, the Bank raised the bill offerings. On the other hand, on occasions it restrained the uptrend, by reducing the Treasury bill offers, by requesting the Imperial Bank not to put up the rate and giving facilities to the bank for the rediscounting of Treasury bills, and finally by increasing the tenders for the purchase of sterling. Likewise, the Bank varied its sterling tenders also having regard to the state of the money market, rather than the requirements of exchange only.

Thirdly, the Reserve Bank's operations in Government securities were primarily designed for maintaining orderly conditions in the money market, whereas earlier in the case of the Imperial Bank, purchases and sales of securities were guided by its resources position. Although the Imperial Bank largely met its busy season requirements for funds by reducing its cash holdings, it also used to resort to sales of Government securities to some extent, thereby adding to selling pressure on the market. On the other hand, the Reserve Bank's operations, even if modest on the whole (at times they were substantial), had a compensatory effect; the Bank purchased during periods of stringency and sold during periods of ease.

It should also be noted that remittance facilities provided by the Reserve Bank were much more liberal than those obtaining prior to its establishment. The easier movement of funds no doubt helped to equilibrate regional imbalances in the demand for and supply of funds.

It is undeniable that the benefits of cheap money did not percolate widely into the interior. Nor did the Bank give any special assistance to the growth of banking facilities, although the importance of this was obvious to the Bank. The Bank was optimistic that cheap money conditions would stimulate banks to extend their operations up country; to some extent this happened, but not on an adequate scale, and in some areas like the South, the growth had elements of instability. However, although statistical evidence cannot be adduced much in this behalf, it is unrealistic to hold the view that the unorganised and organised sectors were so watertight that the easy conditions in the one did not get transmitted even mildly to the other. In any case, it is a fact that the bazar bill rates too declined in the cheap money era and the spread of these rates during the year was much narrower than in the pre-Reserve Bank days, though how far this was due to the existence of the Reserve Bank will always remain an open question.

Emerging Role as a Bankers' Bank

The basic purpose of the establishment of the Reserve Bank of India was the unification of the authority for the regulation of currency and of credit. In regard to the banking system of the country, the primary role of the Reserve Bank was conceived as that of the lender of last resort for the purpose of ensuring the liquidity of the short-term assets of banks. Hence, the provision of credit facilities to banks through discounts and advances was to constitute the centre of relationship between the central banking authority and the scheduled banks. The custody of the cash reserves of banks vested in the Bank was primarily meant to serve as a central pool to be available for use in times of emergency for supporting scheduled banks, rather than constitute an instrument of credit control.

The Bank's Statute did not provide for any detailed regulation by it of commercial banking operations towards ensuring sound banking practices. The submission of weekly returns by scheduled banks under Section 42(2) of the Act was mainly intended to keep a watch over their compliance with the requirements regarding maintenance of cash reserves with the Bank. Inspection of banks by the Reserve Bank was also visualised for the limited purpose of determining the eligibility of banks for inclusion or retention in the Second Schedule to the Act. Thus, apart from the limited scope of the Bank's powers of supervision and control over scheduled banks, the large number of small banking institutions, which came to be known as non-scheduled banks, lay entirely outside the purview of its control. Besides, but for the few relatively minor provisions in the Indian Companies Act, 1913 governing companies engaged in the business of banking, there was a virtual absence of specific laws or regulations for controlling the operations of commercial banks. Soon after the Bank commenced operations, it became clear enough that the lacuna in regard to banking legislation

was bound to prove a serious handicap in the sphere of its regulatory functions over the banking system. The urgency of such a measure was also highlighted by the South Indian banking crisis of 1938 which brought to the fore several of the undesirable features in the working of banking institutions. Accordingly, the Bank's attention, as bankers' bank, was mainly occupied during this period with the problems of banking regulation, rather than with discounts and advances for which, as mentioned in Chapter 5, there was also not much demand on account of the prevalence, of easy money conditions.

First Move Towards Banking Legislation

The first attempt at banking legislation in India was the passing of the Indian Companies (Amendment) Act, 1936, incorporating a separate chapter on provisions relating to banking companies. Prior to its enactment, banks were governed in all important matters such as incorporation, organisation, management, etc., by the Indian Companies Act, 1913, which applied commonly to banking as well as non-banking companies. There were only certain relatively innocuous provisions in the Companies Act which made a distinction between banks and other companies. These were: Section 4, which prohibited a partnership exceeding ten from carrying on the business of banking unless it was registered as a company; Section 136, which required every limited company doing banking business to display a statement regarding its assets and liabilities in the prescribed form (Form G in the Third Schedule to the Act) every half year; Section 138, which empowered the local Government to appoint inspectors to investigate the affairs of a banking company on the application of members holding not less than 1/5th of the shares issued (as against 1/10th of the shares in the case of other companies) ; and, Section 145, which provided that if a banking company had branches beyond the limits of India, it was sufficient if the auditor was allowed access to such copies and extracts from the accounts of the branches as had been transmitted to the head office of the company.

These provisions touched only the fringe of the problem of banking regulation. The Report of the Central Banking Enquiry Committee, as mentioned in Chapter 2, emphasised the need for enacting a special Bank Act, covering the organisation, management, audit and liquidation of banks. The Committee cited the instances of the United States of America, Canada and other countries, where there were special banking laws, the objects and scope of which varied. according to individual circumstances and requirements. In a number of European countries too, after the economic depression of 1930-33, legislative restrictions on banking were introduced with the object of preventing

malpractices in the working of banks. In the U.K., however, apart from the Companies Act, there was no special enactment for the regulation of commercial banks.

There were two important features of the new legislation which embodied some of the recommendations of the Central Banking Enquiry Committee. For the first time, a determined effort was made to evolve a working definition of 'banking' and to segregate banking from other commercial operations. Secondly, the special status of scheduled banks was recognised inasmuch as certain provisions of the amended Act, such as building up reserves, were made applicable only to non-scheduled banks, on the ground that the scheduled banks could be left to the general supervision and control of the Reserve Bank. The principal banking provisions of the amended Companies Act, which came into force on January 15, 1937, were:

- (i) the definition of a banking company as 'a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order', notwithstanding that it engaged in any one or more of the forms of business specified in the Section (Section 277F);
- (ii) prohibition of banking companies from engaging in business other than that specified in Section 277F [Section 277G(2)];
- (ii;) restriction on the managing agency system in respect of a banking company by providing that it should not employ or be managed by a managing agent other than a banking company (Section, 277H);
- (iv) prescription of minimum paid-up capital of Rs. 50,000 for banking companies incorporated after the commencement of the Act (Section 277I);
- (v) prohibition of creation of charge on unpaid capital (Section 277J);
- (vi) transfer by non-scheduled banking companies, before any dividend was declared, of not less than 20 per cent of the annual profits to the reserve fund until such fund equalled the paid-up capital, and for the investment of the reserve fund in Government or trustee securities or in a special account with a scheduled bank (Section 277K) ;
- (vii) maintenance by non-scheduled banking companies of, a cash reserve of at least 1½ per cent against their time liabilities and 5 per cent against demand liabilities (Section 277L) ;
- (viii) restriction on formation of a subsidiary company or holding of shares in any subsidiary company except a subsidiary company formed for the purpose of undertaking the administration of estates as executor trustee or otherwise and for other purposes set forth in Section 277F as were incidental to the business of accepting deposits on current account or otherwise (Section 277M); and

(ix) the grant of a moratorium by the court to a banking company in temporary difficulties (Section 277N).

Reserve Bank and Banking Legislation

While the initiative for the amendment of the Indian Companies Act came from the Central Government, the Reserve Bank was actively consulted on the portions of the measure pertaining to banking companies. The vexed question of definition of 'banking' appears to have given rise to a cleavage of views at the highest executive level inside the Bank. The definition, incorporated in the Amendment Bill, was welcomed by the Governor, Sir Osborne Smith, whose personal view, recorded in November 1935, was that the activities constituting banking had never been defined in this country and it was high time that the permissible duties and limitations were defined by Statute. However, Sir James Taylor, the 'senior' Deputy Governor, was more concerned with the difficulty of framing such a definition; a difficulty which, he said, had been emphasised by every authority which had examined the subject both in this and other countries, e.g., in England the Macmillan Committee, and in India the Hilton Young Commission and the Central Banking Enquiry Committee. In his opinion, the enumeration of the various lines of business which a banking company could undertake would involve Government in expensive litigation on difficult border-line cases, hamper legitimate current activities and impede future development. There could also be evasion by some banks, claiming that banking was not their 'principal' business, which would 'drive a coach and four' through the Bill's whole object, namely, to effect a clear separation between banking and other companies. In July 1936, the Reserve Bank conveyed to the Government its opinion that the attempt to frame a comprehensive definition should be abandoned and a banking company should be merely described as a company which carried on the business of banking. The Bank, however, suggested that, if it was thought desirable, there could be a statutory 'objects' clause in the memorandum of association for banking companies, to prevent the growth of mushroom institutions. The views of the Bank did not have much practical effect and the Select Committee appointed to consider the amendments (under the chairmanship of Sir N. N. Sircar, the Law Member of the Viceroy's Executive Council) adopted a definition of 'banking company' almost in the same form as was originally proposed and incorporated a more detailed list of activities in which a banking company might engage. The stand taken by Sir James was, however, vindicated later, when the difficulties envisaged by him in determining whether a company was a banking company or not posed knotty problems for the Registrars of Companies.

Apart from the question of definition, the Bank was also averse to the clauses regarding (a) maintenance of a cash reserve by non-scheduled banks, in the absence of a provision for statutory returns necessary for its enforcement and (b) grant of moratorium to an individual institution, since, in any case, a sound bank in difficulties could count on the Reserve Bank for assistance and the sooner that an unsound bank closed its doors the better, so as to make the winding-up process fair to all concerned. About the other clauses, the Bank was of the view that the minimum paid-up capital for a banking company suggested in the Amendment Bill was too low at Rs. 50,000 and should be raised to Rs.1 lakh and that the annual transfer by non-scheduled banks to the reserve fund before any dividend was declared, should be not less than 2½ per cent of the paid-up capital till the former equalled the latter. The other suggestions made by the Bank related to (i) the examination of the question of extending the clause regarding prohibition of loans to directors of companies (Section 86D, which was inapplicable to banking companies) to the directors of a banking company and (ii) the prohibition of loans to auditors.

None of these suggestions found a place in the Amendment Act of 1936 in the manner the Bank wanted. Perhaps, the Central Government was in a hurry to see the Amendment Act through, recognising that some legislation for banks was better than no legislation.* In his minute of dissent to the Select Committee's Report, a member, Mr. Mathuradas Vissanji, emphasised the desirability of a separate comprehensive legislation to regulate and govern banking business in the country and asked for a public undertaking from Government, as had already been given with regard to insurance companies, to bring forward the necessary legislation for banking business also.

Reserve Bank and Non-Scheduled Banks

The amended Indian Companies Act, no doubt, placed some restrictions on the business of non-scheduled banks, but they were still outside the purview of the central banking authority, which practically had no information on their working. In view of the fact that over 200 out of 1,421 banking and loan companies had paid-up capital and reserves of over Rs. 50,000 and several of them could be regarded as potential scheduled banks, the Bank considered that it should establish closer

* Sir N. N. Sircar was so worked up with the number of amendments suggested that he wrote in August 1936 to Sir James Taylor thus: 'I said casually that the bill will take 10 full days in the House, upon which Pandit Pant observed "It will take more than 12 days"! If I do not last till the end, I hope you will find time to attend my funeral. I shall leave instructions for a copy of the Company Law to be burnt at my cremation'. Sir James replied: 'I do not think that the alterations you have made will lead to any difficulty and hope that you will be able to maintain them in the discussions with the Legislature, so that all the trouble which you have taken will not end on a combined burning ghat '!

contacts with them. Accordingly, at the instance of the Bank, the Central Government passed, in February 1938, an amendment to the Indian Companies -Act, under which non-scheduled banks were required to submit an additional copy of their returns (such as cash reserve returns, balance sheets, etc.) to the Registrars of Joint-Stock Companies for being transmitted to the Reserve Bank for information. The Reserve Bank, however, had no statutory power to call for any further information even though it might feel the need for it for enabling it to assess the soundness of individual banks. In November 1938, a circular letter was, therefore, addressed to non-scheduled banks with paid-up capital and reserves of Rs. 50,000 and over, enquiring whether they would be willing to place the Reserve Bank in possession of information regarding their operations so that the Bank could, if necessary, help them with advice and guidance. The response from non-scheduled banks to this informal approach was quite encouraging. The Bank also recommended to the Government of India a standard form for submission of the cash reserve return under Section 277L of the Indian Companies (Amendment) Act, 1936.

The information on non-scheduled banks which the Bank obtained in pursuance of its efforts merely served to substantiate the general impression about deficiencies of small banks. The following extract from the Governor's speech at the annual general meeting of shareholders of the Bank in February 1939 portrays the Bank's concern for them:

Small banks have doubtless a useful place in society provided that they circumscribe their activities to a small area and serve the needs of small scale industries and agriculturists. When, however, they extend their ramifications too far, they must inevitably labour under the difficulties attendant on small scale institutions, such as the competition of the larger banks, their inability to employ an equally well-qualified staff conversant with modern methods of banking, or to spread their risks. They are the most vulnerable points in our banking system which become exposed when there is the slightest shock to our credit structure. . . . It remains to be seen whether the provisions in the Indian Companies Amendment Act will be sufficient to ensure the orderly development of banking in this country or whether it will be necessary for the Central Legislature to consider a more comprehensive and detailed measure dealing with banks alone.

Later in the year, proposals for such a measure were submitted by the Bank to the Central Government; these proposals are set out in some detail later in this chapter.

Growth of Joint-Stock Banking: 1935-38

A brief survey of the growth of joint-stock banking in the years immediately following the Bank's inception may be introduced at this stage

so that subsequent banking developments may be viewed in proper perspective. The first three years of the Bank's functioning synchronised with a fairly steady growth of commercial banking. The scheduled banks (inclusive of four banks incorporated in the Burma region*): 48 in number at the time of the establishment of the Bank, rose to 57 by the end of 1938. Their demand and time liabilities increased from Rs. 208 crores in July 1935 to Rs. 239 crores in December 1938. The Central Government, at that time, had no option under Section 42(6) of the Reserve Bank Act but to direct the Bank to include in the Second Schedule to the Act any bank which had paid-up capital and reserves of an aggregate value of Rs. 5 lakhs or more irrespective of its financial position and methods of operation. This made it convenient for some of the non-scheduled banks on the border line to acquire the status and privileges of scheduled banks by making relatively small increases in their paid-up capital and reserves. A scrutiny of the balance-sheets and other returns of some of the banks seeking inclusion in the Second Schedule to the Act revealed resort to certain undesirable practices in raising the paid-up capital and reserves.

There was also a substantial increase in the number of offices of scheduled banks from 723 to 1,125 during the period, though this was in part due to the inclusion of new banks in the Second Schedule. The branch expansion, both among the scheduled and non-scheduled banks, was particularly noticeable in South India. This growth in branch banking did not fail to attract the attention of the Bank, which attributed the trend to the desire of banks to develop the potentialities of the up-country markets on account of cheap money conditions. The Bank also welcomed the expansion of branches by the larger banks as one of the main solutions to the problem of building up rural credit and spreading the banking habit. However, the Bank was soon to be made aware of the lurking dangers of unhealthy expansion and the urgent need on its part for exercising greater vigilance over the operations of banking institutions, by the rude shock administered by the failure of a leading bank in the Southern region.

South Indian Banking Crisis

Since the banking crisis of 1913-14 which brought disaster to many a joint-stock bank, bank failures in the decades following constituted, by and large, individual failures resulting from endemic weakness and deficiencies to which several banking companies were prone in the days

* Consequent on the separation of Burma from India in April 1937, these four banks were, under the India and Burma (Burma Monetary Arrangements) Order, excluded from the Second Schedule to the Reserve Bank Act and redesignated as 'Burma scheduled banks'. They were, however, obliged, till February 1942, to maintain minimum cash balances with the Reserve Bank and submit weekly (or in difficult circumstances, monthly) statements of position.

of unregulated banking. The failure of the Travancore National and Quilon Bank (TNQ Bank) in the middle of 1938 created a public scare of which the Government and the Bank had to take notice. It drew attention to the urgent need for comprehensive banking reform and legislation to avert the dangers of policies of unbridled expansion of branches, frittering away of profits by distributing high dividends, speculation in investments, granting of advances without security or on inadequate security, incompetence or dishonesty of management and so on. The size and standing of the TNQ Bank were such that its failure sparked off a banking crisis in Southern India in the form of heavy withdrawals of deposits. Luckily, the crisis in a severe form lasted only for a short period; but an underlying feeling of nervousness persisted in the region until the close of the year. The Reserve Bank, on receiving news of the crisis, sanctioned increased borrowing limits to banks in that region up to their statutory deposits; the limits were doubled subsequently. Additional assistance was extended by the Bank to some of the banks which approached it for help during the closing months of the year. Yet, there was much adverse criticism of the Reserve Bank's policy in relation to the banking crisis in general and the TNQ Bank in particular. To appreciate the grounds of criticism and the Bank's stand, it is necessary to narrate in some detail the proximate events surrounding the closing of doors by the TNQ Bank.

The TNQ Bank was constituted in September 1937 by the amalgamation of two separate banks, the Travancore National Bank and the Quilon Bank, which were established in the then Travancore State in 1912 and 1919, respectively. The merger was acclaimed in the local press as the 'greatest banking amalgamation in South Indian history'. The Reserve Bank also felt that an amalgamation, if soundly conducted, might be of material assistance in improving the banking situation. The Governor, while welcoming the step, advised the bank to devote its profits towards building up reserves rather than paying higher dividends. To facilitate the amalgamation, the Reserve Bank also sanctioned a line of credit to cover the actual period of the change-over extending up to the end of December 1937. As on December 31, 1937, the amalgamated bank had paid-up capital and reserves of Rs. 28 lakhs, deposits of Rs. 3½ crores, investments of Rs. 56 lakhs and advances of Rs. 2⅔ crores. It had 75 branches spread over the country with the Central Office at Madras and the Registered Office in Travancore State. In April 1938, barely six months after the amalgamation came into effect, there was an unprecedented run on the bank and it withdrew the bulk of its statutory deposit with the Reserve Bank. It was subsequently rumoured'-and this was given publicity by a section of the South Indian press-that the initial panic was artificially created

and sustained by the highest authorities in the Travancore State, on political and communal grounds. As the run continued to grow in intensity, the TNQ Bank was constrained to suspend payment on June 21, 1938.

A fortnight before this event, the Managing Director of the bank (Mr. Mathen) had approached the Reserve Bank for financial help. The Deputy Governor (Mr. Nanavati) informed Mr. Mathen that 'he would always be glad to help the bank if there was possibility of doing so on business consideration' and asked him to submit as soon as possible a statement of loans, advances and investments and, in particular, setting out clearly the secured and unsecured loans to employees, directors and their families as well as loans that were overdue or under litigation. The Deputy Governor also indicated that if the statement showed *prima facie* a solvent position, a thorough investigation into the position of the bank would be conducted so that the Reserve Bank might make advances against specifically segregated assets of the bank. The bank agreed to the investigation, whereupon the Reserve Bank issued instructions to the TNQ Bank's auditors on the lines the investigation had to be carried out by them. The investigation was commenced on June 20, 1938, but on the same day the TNQ Bank instructed the auditors not to continue the investigation as the Reserve Bank was not giving any immediate help. The next day, June 21, the bank suspended payment. Proceedings for winding up commenced in Quilon where the Registered Office of the bank was situated and also in Bombay on June 22. Another petition for winding up was presented at the Madras High Court on June 23.

The bank, meanwhile, had requested the Reserve Bank to take charge of its property and assets and conserve them, pending further investigation. The Governor replied that under the Reserve Bank Act such functions could not be undertaken. At the same time, the Governor deputed Mr. Nanavati, the Deputy Governor, to Madras on June 27 because of the continued uneasiness of the situation. Discussions took place between the Deputy Governor and the Madras Government on June 27 and 29 regarding the affairs of the TNQ Bank. On June 30, the Government of Madras issued a press communique stating that the Government had anxiously considered all possible steps that could be taken to meet the situation, and that in consultation with the Reserve Bank they had to suggest the following course of action. The TNQ Bank should apply to the Reserve Bank to take up an immediate and thorough investigation of its affairs through competent auditors and agree to act according to the advice tendered by the Reserve Bank as a result of the investigation, for the continuation, reorganisation or liquidation of the bank, whichever course was finally suggested. The TNQ Bank informed the Reserve Bank of its acceptance

of the proposal for investigation and requested the latter to make suitable arrangements for carrying it out.

The Reserve Bank provisionally estimated that the expenses of the investigation would amount to Rs. 10,000 and intimated its willingness to undertake the investigation on payment of this sum. The TNQ Bank moved the Madras High Court, on July 2, 1938, to appoint provisional liquidators and to sanction the payment of Rs.10,000 out of the assets of the bank. The Court appointed the provisional liquidators and adjourned the hearing of the winding up proceedings to July 28 pending investigation by the Reserve Bank; the provisional liquidators were directed to give every assistance in their power for making the investigation possible. The Court, however, refused to sanction the costs of investigation on the ground that it had no power for authorising the expenditure. The Madras Government and the TNQ Bank thereupon requested the Reserve Bank to take up the investigation, assuring that the costs would be borne by a third party. On July 8, the Reserve Bank expressed its willingness to depute a Special Officer at its expense to keep it in touch with the liquidators, assist them generally and apprise it of further developments. In the beginning, the Special Officer could not secure the necessary co-operation from the bank officials, but he examined some books and statements with the help of the provisional liquidators and submitted a preliminary report to the Bank during the third week of July 1938. The findings of the report were: nearly all the easily realisable securities had been realised during the run in April and May 1938; the balance-sheet as on December 31, 1937 was an incorrect one; the bank was buying its own shares presumably with a view to keeping up their market value; it was indulging in speculation in stocks and shares; the directors and other interested parties had borrowed to the tune of Rs. 26 ½ lakhs on inadequate security or on a clean basis, etc.

In order to have a first hand knowledge of the situation, the Governor visited Madras between July 18 and 20. He had an interview with the Prime Minister of Madras and received a deputation from the Committee of Creditors of the TNQ Bank. After perusing the Special Officer's report and getting all the information from the local sources, the Governor wrote to the Prime Minister on July 28, 1938, that the only conclusion to be drawn from the material available was that the interests of the depositors would best be served by allowing the liquidation proceedings to take their course without further postponement. The letter was published in the local press on August 9, 1938. In the meantime, a scheme for reconstruction of the bank had been presented before the Madras High Court and the Quilon District Court by certain depositors. The Madras High Court was inclined to consider the merits of the scheme; but difficulties were encountered due to the

Official Liquidator of Travancore not being prepared to recognise the claims of 'foreign' creditors in the distribution of the Travancore assets. The District Court of Quilon, relying on the report of the Official Liquidator of Travancore, considered the scheme to be unworkable and ordered the winding up of the bank in August 1938. An appeal was made by the bank against this order in the High Court of Travancore, but the High Court confirmed the order of winding up passed by the lower court stating that the bank was commercially insolvent and that it was satisfied that the bank would not be able to pay the claims of the creditors as they accrued. The Agent of the Imperial Bank at Travandrum was appointed as Official Liquidator. As it was unable to pursue with the consideration of the scheme on account of the decision taken by the courts in Travancore, the Madras High Court also ordered, on September 5, the winding up of the British Indian offices of the bank and appointed the provisional liquidators as Official Liquidators. Thus, there was a jurisdictional tangle, which later affected the smooth progress of liquidation proceedings of the bank as the bulk of the money was borrowed in British India while the greater part of the assets were in Indian States. The liquidation proceedings went on for about seventeen years, till the bank's dissolution on March 21, 1955, during which time a total dividend of 12 annas 3½ pies in the rupee was paid to creditors.

The Reserve Bank's role in this episode came in for vehement criticism in the press as also by the Chambers of Commerce in the Southern region and by some of the South Indian scheduled banks. The Bank was attacked, in the first place, for what was considered to be the negative attitude it took while the TNQ Bank was sinking, and secondly, for not offering adequate aid to the other South Indian banks which were affected during the crisis. It was contended that the Bank had pointlessly insisted on an examination of affairs at a time when the TNQ Bank was gasping for breath and that such investigation, if at all, should, have been carried out at the time of amalgamation or in the course of the preceding three years. It was also argued that the Reserve Bank could have provided assistance subject to payment of a penalty. Wrote the Indian Finance:*

A few days after the Travancore National and Quilon Bank suspended business, Mr. Nanavati visited the South Indian capital, where every bank of local domicile was, in the panic that followed, being subjected to severe raids. He went; he saw; and he conquered. The Reserve Bank was willing, he proclaimed, to help every sound bank. And a new definition of a sound bank was discovered. Any bank expressing its willingness to Mr. Manilal Nanavati to have its accounts examined by the Reserve Bank was the new description of a sound bank. Not

*July 23, 1938.

to be left behind, even the half-dead, half-living Travancore National and Quilon Bank sought to buy the goodwill of Mr. Nanavati by offering to throw open all their books and by a promise to find Rs. 10,000 for the gracious look-over by the Reserve Bank. One wonders if this ransom of Rs.10, 000 was laid on each of the banks which applied for the Reserve Bank's inspection.

It may be mentioned in this context that all the further inspections of banks have been conducted by the Bank at its expense. Even in this case, although initially the Bank claimed reimbursement of the expenses of inspection, later it deputed, as stated earlier, its own Special Officer for a scrutiny.

The criticism that the Bank should have lent a helping hand to the TNQ Bank in the emergency failed to take note of the fact that such help would have meant investing good money after bad, even assuming that the fetters imposed by the Reserve Bank Act could have been relaxed. The position of the bank was, even from the preliminary and cursory evidence at the disposal of the Special Officer and the official liquidators, quite bad. The judgment of the courts in Travancore and Madras brought to light several disquieting features in the bank's operations. The position is well summed up in Governor Deshmukh's words*:

In the light of the repayment made to the depositors by the liquidators it has been argued in some quarters that the intrinsic position of the bank was sound and that the failure could have been avoided had the Reserve Bank given timely assistance to the bank. The Board could be expected to take into account only the existing conditions and the information available to them. Although the depositors were paid 12 to 14 annas in a rupee, it may be mentioned that this was possible only by calling in from the shareholders their liability in respect of the unpaid amount of the shares; and another fortuitous circumstance was that, as a result of war, the liquidators were able to realise much larger prices for the estates and lands on which advances had been made by the bank.

The Southern India Chamber of Commerce, voicing the opinion of the joint-stock banks and indigenous bankers of Southern India, in a memorandum to the Governor, mentioned that the banks and the public had been disillusioned by the attitude adopted by the Bank towards the scheduled banks in the crisis. The Chamber wanted a definite pronouncement from the authorities of the Bank in regard to the attitude which the Bank would assume when similar crises arose in future. It suggested that if a scheduled bank was in liquidation, the Reserve Bank could give some relief to the commercial and other interests by making to the liquidator some advances against the sound

* Central Banking in India -A Retrospect.

assets of the bank to meet partially the demands of the creditors, the extent of the advances depending on the valuation of those assets. The Chamber deprecated the over technical and strained interpretation placed on the provisions of Section 17 of the Act by not accepting demand promissory notes of the constituents of banks and the latter's promissory notes supported by documents of title to goods in their possession, which were offered as security for advances. The ceiling on accommodation set by the Bank for rediscounting bills (i.e., twice the statutory deposit made under Section 42 of the Act) was, the Chamber said, too low to be of much practical help to the banks. To avoid the complications of independent jurisdictions, it also suggested that banks incorporated in Indian States or foreign settlements in India should not be allowed to open branches in British Indian Provinces, except under certain safeguards, such as fresh registration under the Indian Companies Act or obtaining a licence from the Reserve Bank.

The Governor's view, as conveyed to the Chamber, was that, if the Reserve Bank was to render effective help, the scheduled banks should also play their part and make proper provision for emergencies. He said that the Bank could not possibly help a bank experiencing a run by taking over its entire management, as this would mean that the Bank would be guaranteeing the solvency of each and every bank. There was also the problem of finding a new directorate for a bank, after its reconstruction, since the public would have come to the conclusion that the previous directorate was incompetent to handle its affairs. The Governor felt that making advances to liquidators also went beyond the Bank's statutory functions and would require legislation. He explained that there was no statutory limit setting out the extent to which the Bank could advance, but if advances were made by the Bank without proper investigation, there would be more harm than good to the unfortunate depositor in the event of liquidation becoming eventually necessary. In his general remarks, the Governor assured that the constructive suggestions made by the Chamber would be carefully considered, but he did not think it advisable to rush into hasty legislation as all such provisions are double-edged. He objected to too much control of the banking system on the ground that 'no control in the world will prevent recklessness or dishonesty while on the other hand it gives a false sense of security', but recognised that 'conditions in India are different from those prevailing in England' and that 'there must be occasions here in which control is desirable even though it is proved unnecessary elsewhere'.

The failure of the TNQ Bank and the banking crisis in South India led to the view that, in the interests of the depositors, adequate powers of obtaining information and exercising control and supervision over the affairs of banks should be assumed by the Reserve Bank, so that it

could come to the rescue of sound banks in times of such emergency, prevent the gross abuses prevalent in the banking system and help build a sound banking tradition. The banking crisis of 1938 was thus the immediate cause of the proposals for a Bank Act made by the Reserve Bank in 1939, the whole of the draft of which was initially prepared by Sir James Taylor himself.

Bank's Policy Regarding Discounts and Advances

One of the results of the banking crisis was the elucidation of the Bank's policy regarding discounts and advances to scheduled banks. With a view to removing any misunderstanding about the nature and extent of the financial assistance which scheduled banks could expect from the Reserve Bank, a circular letter was issued by the Reserve Bank to all scheduled banks on September 1, 1938. The main purport of the letter was to explain that a central bank was, in essence, the lender of last resort and it could use the resources at its command only at times when the resources of the member banks had been exhausted. It would also assist individual member banks when in difficulty, so long as it was satisfied that they were strong. There was also 'the obvious difficulty that the Reserve Bank is being asked to help a bank in circumstances in which the credit bills of the country have not been exhausted, when other banks have funds but are not prepared to lend to it, in short, when the problem is as to the solvency of the member bank or group of banks, and not dearth of money in the credit system as a whole'.

The circular went on to say that the Reserve Bank did not have in its possession adequate data to enable it to judge the true financial position of the scheduled banks and that full information would be necessary if the Bank was to be in a position to extend assistance to deserving institutions without delay. There was, therefore, imperative need for scheduled banks to submit to the Bank periodical returns of their investments, bills and advances portfolios. The Bank also offered to depute an officer to establish informal contacts with banks. Later, speaking at the annual general meeting of the shareholders of the Bank, in February 1939, the Governor stated that the Bank had succeeded in establishing closer contacts with some of the South Indian banks in pursuance of the policy set out above. Such contacts, which were entirely voluntary on both sides, had afforded, he mentioned, an opportunity for frank and confidential discussions, enabling the Bank to give advice and guidance in suitable cases.

In December 1938, the Bank also circulated an Explanatory Memorandum to the scheduled banks, indicating the circumstances under which accommodation from the Bank might be sought by scheduled banks, the lending policy of the Bank and the 'eligible securities'

under the Reserve Bank Act which could be offered as collateral. It was mentioned that the Reserve Bank might be called upon to assist the scheduled banks (a) to meet some unexpected and temporary demands for which the scheduled banks concerned might not have been able to make provision in advance ; (b) to meet seasonal needs when there was stringency in the money market; and (c) in special circumstances affecting one bank or group of banks (e.g., a slump affecting the trade or industry with which certain banks were more particularly concerned or a scare imperiling banking habit in one particular part of the country). The very nature of the functions permitted under Sections 17 and 18 of the Reserve Bank Act required that business which the Reserve Bank undertook should be liquid, short-term and generally self-liquidating the securities eligible under Section 17 would consist of bills of exchange and time promissory notes, Government and trustee securities, bullion and documents of title to goods.

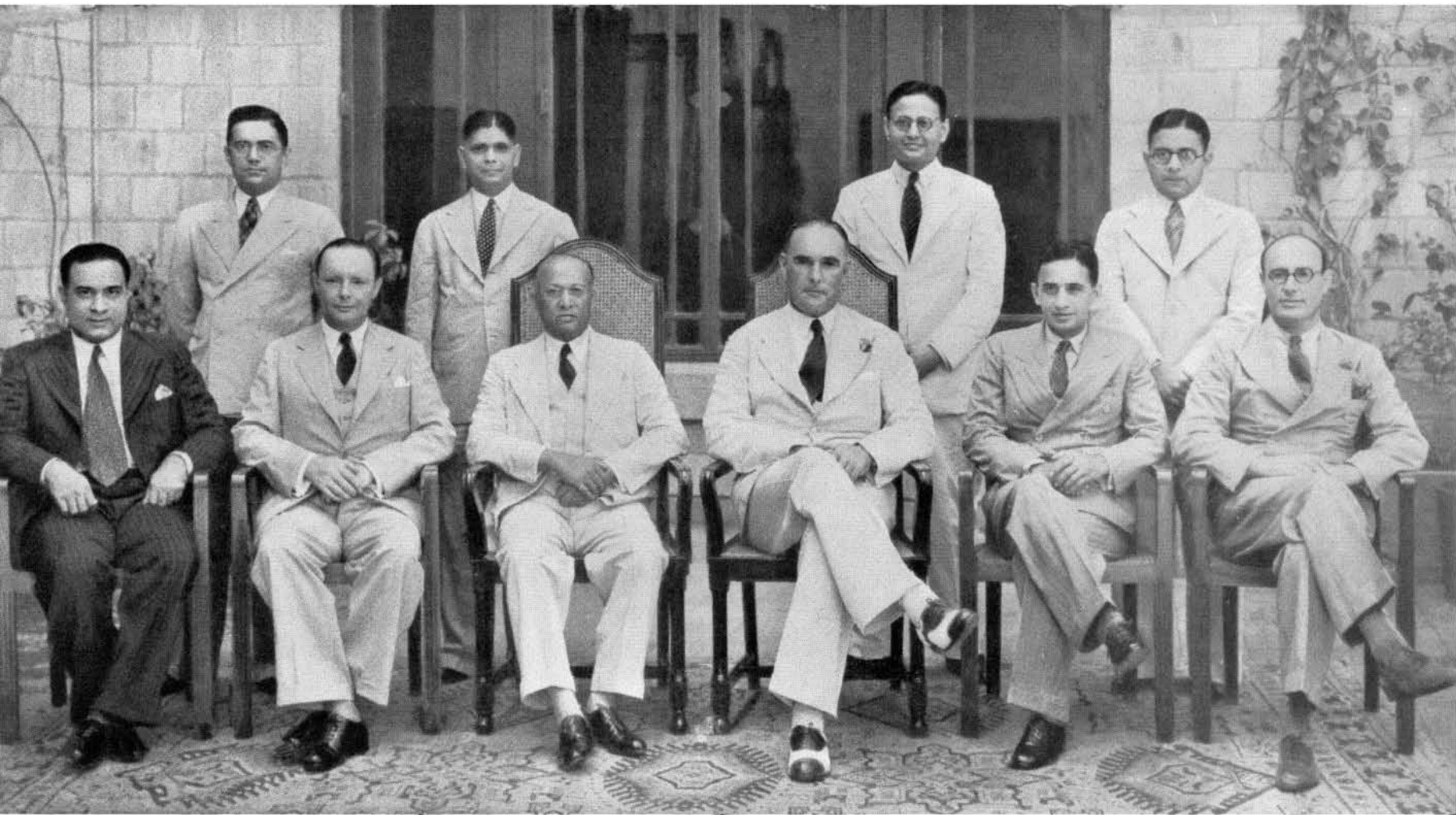
The adherence of the Bank to a strict interpretation of 'eligible securities' for granting advances to scheduled banks under Section 17 of the Act had given rise to considerable criticism during the banking crisis. Consequently, the Explanatory Memorandum took pains to elucidate that the Reserve Bank was precluded from accepting, for purposes of purchase, discount or granting advances, demand promissory notes of constituents of banks which were not eligible paper under Sections 17(2) and 17(4) (c) of the Act, as these instruments had no fixed maturity. It also clarified that Sections 17(4) (b) and 17(4)(d) did not envisage advances against the security of gold or goods pledged to scheduled banks. This was because the scheduled bank could not transfer better title to the gold than it had itself, and had to release the gold on repayment of the original debt. On the other hand, delivery of gold was required which would need the development of an organisation for physical possession of gold by the Reserve Bank throughout the country. Likewise, Section 17(4) (d) referred to 'documents of title to goods' and not to 'goods' because if the goods were transferred to a scheduled bank by its customer, the document of title would have to be created by the scheduled bank which had made the advance; it was not possible for the bank to create such a document in respect of the goods pledged to it since, despite possession of the goods of its customer, it was not his mercantile agent as defined in the Indian Sale of Goods Act. Further, the Reserve Bank Act did not contemplate the Bank's taking possession of the goods and looking after their warehousing. It followed, therefore, that the documents of title given by the customer to the scheduled bank and passed on to the Reserve Bank should be fully negotiable instruments, such as, warehousing receipts issued by an independent warehousing authority. The Bank's solicitors concurred with

the Bank's views-mentioned above. About Section 17(4) (d), they were also of the view that the security required could only be a transfer, assignment or pledge of the document already pledged, transferred or assigned to the scheduled bank by its customer and that such a document could be created only if the goods were not in the possession of either the scheduled bank or its constituent but in the possession of a mercantile agent or a warehouseman.

It must be mentioned that the draft of the Explanatory Memorandum had come in for criticism by some Directors of the Central Board at its November meeting. Sir Purshotamdas Thakurdas was of the view that unless the Reserve Bank could, on a scheduled bank approaching it, advance against pledged goods, assistance from the Bank, for practical purposes, would be very small. While he did not wish to contest the legal opinion, he felt that a practical solution to the difficulty might be found by way of taking off the stamp duty on time bills or hundies, which was the main handicap to the popularity of bills. Mr. C. R. Srinivasan was highly critical of the Bank's rigid posture. He said:

Service with safety is the normal measure of value, of a Central Bank. All for safety and none for service cannot be the motto of a Central Bank alive to its larger responsibilities. In the literature that has so far issued from the Reserve Bank, it seems to me, there is far too much of doctrinaire assertion and far-too little of practical grasp of the realities of the situation. The method of approach strikes me as wrong. Organised credit in this country is yet of small dimensions and if the slender contact maintained with the scheduled banks is allowed to suffer by ultra cautious and conservative methods of dealing with their needs and requirements, the Reserve Bank can play no vital or vitalising part in the direction or diversion of credit in the country. That is a position few of us can view with equanimity.

Mr. Srinivasan felt that until the bill market developed and the warehouses came into existence, promissory notes endorsed/executed by the banks covering goods pledged could be treated as eligible paper. This suggestion regarding the acceptance of demand promissory notes was not found practicable by the Governor. His view was that such promissory notes were usually not drawn for any business transaction and accommodation was granted for an indefinite period according to the convenience of the bank or the drawer. The insistence on time bills was therefore based on genuine trade practice in India and foreign countries. Hence, the only immediate course open to the Reserve Bank was to try to work the Act as it stood. In the circumstances, the Board approved the issue to scheduled banks of the circular as proposed in the draft, also resolving that 'in accordance with the memorandum submitted by Sir Purshotamdas



The Governor and the Deputy Governor with some officers of the Bank (1941).
SITTING (LEFT TO RIGHT): B. L. Punjabi, C. R. Trevor, Manilal B. Nanavati, James B. Taylor,
C. D. Deshmukh, H. D. Cayley.
STANDING: N. D. Nangia, C. S. Divekar, B. K. Madan, D. N. Maluste.

On becoming a Director of the Central Board of the Reserve Bank of India I do solemnly and sincerely declare that I will faithfully perform the duties of Director and that I will to the best of my ability uphold the interests of the Reserve Bank of India and that I will observe strict secrecy respecting all transactions of the Bank and all matters relating thereto and that I will not directly or indirectly communicate or divulge any of the matters or any information which may come to my knowledge in the discharge of my duties as such Director except when required or authorised to do so by the Central Board of the Bank or by law.

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Bank's scroll of oath of secrecy.

Thakurdas the Board repeat * their recommendation to Government that the stamp duty on usance bills be reduced as early as possible, and point out that failing such reduction other methods of affording assistance will have to be considered which may involve amendments of the Act '.

It may be mentioned, incidentally, that Section 17(4) (d) was amended in 1951 by substituting after 'documents of title to goods' the words 'such documents having been transferred' instead of the words ' which have been transferred', thus making it clear beyond doubt, that only documents of title to goods were acceptable to the Bank for advances.

Banking Development in the Post-Crisis Period

The banking crisis of 1938 was largely a localised affair confined to South India; It had no serious repercussions on the banking system in the country as a whole. On the other hand, the number 'of scheduled banks increased from 57 in December 1938 to 61 in December 1939, despite the exclusion, from the Second Schedule, of the TNQ Bank on account of its liquidation, and of two other banks following a change in constitution and amalgamation with another bank, respectively. The increase was partly explained by the entry into scheduled status of some non-scheduled banks to secure the exemptions given to the scheduled banks from the operation of debt relief legislation and to acquire the status and publicity that scheduled banks enjoyed in the public mind. The demand and time liabilities of scheduled banks increased from Rs. 239 crores at the end of 1938 to Rs. 251 crores at the end of 1939. The number of their offices rose from 1,125 to 1,277 during 1939; the major part of the increase in offices was accounted for by the seven new banks scheduled during the year.

The character of the territorial distribution of banking offices in the period 1935-39 may also be commented upon briefly. According to a study made by the Bank, despite the rapid development of branch banking during the period 1935-39, there were 956 towns (about 57 per cent of the total number of towns) with a population between 20,000 and 50,000 which had not been served by an office of a joint-stock bank; towns with a population of 50,000 and more were, however, well catered for. The Bank's finding was that the small towns did not afford lucrative avenues to new banks. Besides, most of such towns were already being served by co-operative banks and societies. The distribution of banking offices was very uneven, some towns having a very large number of banks, while others, though important, had only a few.

* A similar recommendation had been made earlier in the Statutory Report made under Section 55 (1) of the RBI Act.

There was also concentration of banking offices in certain Provinces like Madras, Bengal, the Punjab and Bombay.

As regards the state of banking confidence, the suspension of payment and application for moratorium in May 1939 by one of the scheduled banks-in the Calcutta Circle, had practically no adverse effect in that region, although one bank in the Delhi Circle was temporarily affected and the Reserve Bank had to grant it a limit for rediscounting of bills to help tide over the crisis. The decline in silver prices in the middle of 1939 gave rise to unfounded rumours of impending trouble in the case of a scheduled bank .based on its association with silver interests, but confidence soon returned. Again, in September 1939, on the outbreak of hostilities in Europe, certain scheduled banks experienced hurried withdrawals induced by fears of widespread escalation of the war, but the deposits soon began to return as the initial panic subsided and was followed by the emergence of boom conditions due to war.

Meanwhile, the Bank continued its efforts to get into closer touch with non-scheduled banks. A second circular was issued to them in August 1939 indicating that, if any of them required the Bank's advice or guidance, they should forward to it copies of their Memoranda and Articles of Association, balance-sheets for the previous three years, etc.; further, if they sought detailed advice, they would have to furnish detailed information about their operations. The Bank, however, found that, out of about, 42 concerns which could be considered to be non-scheduled banks, only 682 banks were submitting cash reserve returns. Most of the remaining banks contended that they were not banks inasmuch as they did not accept deposits withdrawable by cheque, draft or order. The Registrars of Companies instituted test cases against some of these concerns, but the proceedings resulted in their acquittal. There was also the anomalous position that companies which were registered before the coming into force of the Companies Amendment Act were allowed under that Act to call themselves as banks even if they were not carrying on banking business as defined in the Act; such companies could, despite having the words 'bank', 'banker' or 'banking' as part of their names, refuse to comply with the provisions of the Act relating to banking companies.

The Bank prepared and submitted to the Central Board, in October 1939, a report on the non-scheduled banks, with special reference to the distribution of their assets and liabilities. The report mentioned that several of these banks had poor cash reserves, a low investment ratio, overextension of the advances portfolio and a large proportion of bad and doubtful debts; especially in Bengal and Assam, there had been a mushroom growth of banks whose financial position was suspect; and all this information was given only on the basis of dressed-up

balance-sheets, which did not disclose many of the more unsatisfactory features.

Proposals for an Indian Bank Act

In June 1939, the Governor circulated to the Local Boards of the Bank a memorandum prepared by him containing proposals for an Indian Bank Act which was designed to bring within the orbit of the Bank's control the entire joint-stock banking sector. These proposals were formulated after a study of the banking laws of several foreign countries such as Canada, Australia, Denmark, U.S.A., Norway, Sweden, South Africa and Switzerland. The objective was limited to what was immediately necessary and practical, but at the same time the framework of the new measure possessed sufficient flexibility to provide room for further additions as experience accumulated.

The proposals, in the first instance, envisaged a clear-cut definition* of 'banking' as the accepting of deposits on current account or otherwise subject to withdrawal by cheque and of a 'banking company' as a company defined in the Indian Companies Act including a foreign company which did the business of banking in British India; co-operative banks were therefore excluded from the purview of the Act. It was also provided that a company which did banking business should include as part of its name the word 'bank', 'banker' or 'banking' and no company which did not do banking business should use any of these words as part of its name. A list of the forms of business in which a banking company could engage, as enumerated in Section 277F of the Indian Companies Act, 1936, was also incorporated in the new proposals along with the provision that it should engage in no other business except such as the Government might notify in the Gazette of India.

A major objective of the measure was to safeguard the interests of the depositor. The case for affording adequate protection to the depositor was admirably and forthrightly set out by the Governor as follows:

It never has been, and never will be, possible by legislation to prevent the rogue gulling the greedy fool, that is, the person who is open to be deceived by specious promises of high profit. A depositor, however, stands on a different footing when he places his money with a bank on current account at a very low rate of interest or without interest at all, because he thinks that it will be safe. If the Legislature wishes to protect him, and it is obviously in the interests of the development of the country that he should be protected, so as to encourage him to save and to deposit his money with banks as a preferable alternative to hoarding and as a preliminary to investing his money in Government securities or otherwise, we must take such measures as will ensure that any institution

* Apparently, Sir James Taylor had come round to the view that it was necessary and possible to give a clear definition of 'banking'.

calling itself a bank which receives money on current account should firstly have sufficient resources to make it humanly possible that it can operate on a scale large enough to give it a working profit even if it has to confine itself to proper banking business; secondly, that certain minimum restrictions should be imposed on its investments to ensure that there are limits to the loss which the depositor can incur if it fails; thirdly, provision must be made to expedite liquidation proceedings so that if a bank does fail the depositor will get what is left with the minimum of delay and litigation expenses.

To achieve the desired objective, the proposals included, inter alia, (a) minimum capital standards, the amount of capital depending up on the area of a bank's operation and the population of the towns in which it operated, (b) a minimum proportion of assets to be held in British India and in liquid form and (c) certain provisions for expediting liquidation proceedings, besides incorporating some of the provisions of the Indian Companies Act relating to banking companies. The Governor was not inclined to provide for elaborate periodical inspections by the Bank or any separate Government Inspection Department which would 'merely tend to create a false sense of security in the minds of the public and throw all the onus of responsibility on those responsible for inspection in the event of a bank failing'. His view was that 'if the work is to be done properly, it must involve legal power to summon books for inspection which it would be somewhat invidious to give to the Reserve Bank, as this would tend to give the latter the role rather of a policeman than of a colleague and helper of other banks which is the obvious ideal'. He was also not in favour of extending the Act to private and indigenous bankers. The reasons given were that (a) these bankers rarely took deposits on current account and as such, no case had been made for protecting their depositors, (b) the regulation of usurious money lending practices was an item of Provincial legislation and would almost certainly be considered ultra vires of a Central Act, and (c) any assistance that such bankers might require from the Bank would be difficult to give, in the absence of their keeping proper accounts segregating their banking from other businesses.

The Local Boards of the Bank evinced a great deal of interest in the proposals. With the exception of the Madras Local Board, they welcomed the proposed Bill, but they were of the opinion that it was capable of expansion and modification and suggested certain amendments to individual clauses of the Bill. The Madras Local Board felt that the Bill per se concentrated on safety to the prejudice or neglect of service and some of the regulations imposed might lead to unforeseen results and unexpected developments. It gave vent to its concern for the protection of the borrowers and asked for sufficient safeguards to assist well conducted banks in panic. The Governor's reply was that

the general comments of the Madras Local Board seemed to put the matter in wrong focus. He did not wish, for the purpose of the proposals, to cover the whole range of lending and borrowing money which would be manifestly impossible; what he wanted to do was to ensure that, as far as possible, a person who wished to deposit his money in a bank, so that he could have the use of it at any time, did not find that the bank was using the money in such a way that it was not available when wanted. The proposals were, therefore, based on the general principle that the primary objective should be to safeguard the interests of the depositor, not the borrower or shareholder. It was not that the Local Boards merely indulged in criticism of the proposals; they did make several suggestions which were found useful and incorporated in banking legislation in subsequent years, such as, the quantum of liquid assets to be maintained, preferential treatment of smaller depositors in the event of liquidation, licensing and audit of banks, restrictions on directors' borrowing and prohibition of the chief executive of a bank being engaged in any other business or vocation.

The Governor submitted the proposals, along with the suggestions made by some of the Local Boards, to the Central Board in July 1939; the Board suggested further consultation with Local Boards. Meanwhile, the proposals had leaked out in the press. Some of the newspapers commented that insistence on investment of 30 per cent of liabilities in Government securities was unwarranted; the provisions were calculated to make liquidation peremptory, simpler and speedier and reconstruction possibilities more difficult; the proposals were inadequate and objectionable; and so on. It must, however, be mentioned that the press also gave useful suggestions in regard to such matters as inspection of banks by Reserve Bank officials, possession of knowledge of banking by bank directors and insurance of bank deposits - suggestions which found their way into banking legislation much later.

In October 1939, the Central Board approved the proposals. A list of the final proposals submitted to the Government of India, in November 1939, is given below:

- (i) Definition of 'banking' and 'banking company', as stated earlier;
- (ii) Stipulation as to minimum capital and reserves for each banking company as follows:
 - (a) Rs.1 lakh for any banking company not covered by clauses (b) to (d) below;
 - (b) Rs.5 lakhs for a banking company having its office at Bombay or Calcutta;
 - (c) Rs. 2 lakhs for a banking company having offices at other places with a population of over one lakh; and
 - (d) Rs.20 lakhs if a banking company operated outside the State or Province in which it had its principal office of business. (It was

also stipulated that the subscribed capital of a banking company should not be less than half of its authorised capital and its paid-up capital not less than half of its subscribed capital);

(iii) Maintenance by a banking company of at least 30 per cent of its demand and time liabilities in cash or in unencumbered approved securities ('approved securities' being defined as securities in which a trustee could invest under Section 20 of the Indian Trusts Act, 1882);

(iv) Holding of assets in British India by a banking company to the extent of at least 75 per cent of its liabilities;

(v) Prohibition of a banking company holding shares in any company whether as pledge, mortgagee or absolute owner of an amount exceeding 40 per cent of the issued capital of that company;

(vi) Provisions regarding compulsory winding up of a banking company if it was unable to pay its debts and preliminary distribution to depositors on winding up without the necessity of calling for a meeting of creditors or contributories and restriction on voluntary winding up unless approved by the Registrar;

(vii) Penalties for defaults in complying with the provisions of the Act; and

(viii) Central Government's powers to suspend a portion or any of the Sections of the Act for not exceeding two months at a time and to make regulations for enforcing the Act.

Besides the above provisions, the provisions in the Indian Companies Act, 1936, pertaining to banking companies were also incorporated in the proposals.

The Banking Companies Act took even longer time to be born than the Reserve Bank of India Act; it was only in 1949 that the measure was placed on the Statute-book, though there were odd bits of interim legislation.

First Steps in Agricultural Finance

Few aspects of the working of the Reserve Bank have been so striking, in comparison with other central banks generally, as its evolving role in the sphere of rural finance. The Bank's responsibility in this field has its origin in the predominantly agricultural basis of the Indian economy and in the urgent need to expand and co-ordinate the credit facilities available to the agricultural sector. For the fulfillment of this important role, as mentioned in Chapter 3, the Reserve Bank of India Act itself laid down, in Section 54, that the Bank should set up a special Agricultural Credit Department, to study the problems of agricultural credit, to be available for consultation by Central and Provincial Governments, provincial co-operative banks and other banking organisations and to co-ordinate the operations of the Bank with those of the agencies engaged in purveying such, credit. In terms of Section 55(1)(b), the Bank was required to submit to Government a report, with proposals, if it considered fit, for legislation on 'the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the Bank'. While, for various reasons, the activities of the Bank in this sphere did not blossom till about the 'fifties, modest beginnings were made in the early years of the Bank.

The Reserve Bank Act also imposed an obligation [in Section 55(1)(a)] on the Bank to submit a report on 'the extension of the provisions of this Act relating to scheduled banks to persons and firms, not being scheduled banks, engaged in British India in the business of banking'. This concerned what is commonly referred to as the problem of linking the unorganized sector of the money market with the organised sector, in particular with the Reserve Bank. Government's view,

which was also fully explained in the Legislature in the course of the debate on the Reserve Bank Bill, was that the services of the indigenous bankers and moneylenders should, after suitable adaptation of their methods, be utilised in any scheme for provision of credit to the economy. Very little progress was made in this area in the manner envisaged by the Legislature. Over the years, there have of course been sporadic references to this subject, but nothing concrete has emerged. Indeed, even to this day, the progress made has been negligible and it is doubtful if there was at all any scope for progress. An account of the history of the early efforts at integration is given in this chapter.

The Agricultural Credit Department was set up on the inauguration of the Bank in April 1935. Mr. K. G. Ambegaokar, I.C.S., who had had experience in the field of co-operation as Senior Deputy Registrar of Co-operative Societies in the C.P. and Berar, was appointed as the Officer-in-Charge of the Department, which started functioning with a skeleton staff. One of the earliest tasks of the Department was to study the Darling Report.

It was only after the coming in of Mr. (later Sir) Manilal B. Nanavati, as Deputy Governor, 'in December 1936, that the Agricultural Credit Department got into stride. Mr. Nanavati put considerable life into the Department by bringing to bear on his new responsibilities in the Bank the rich experience he had gained in the field of co-operation and rural development. He took the initiative to organise several studies on the working of the co-operative movement as a whole as well as individual institutions. Mr. Nanavati also paid considerable attention to the task of devising suitable operational principles and procedures for the extension of financial assistance, by way of loans and discounts, from the Reserve Bank to the co-operative institutions.

Darling Report

The Government of India took special steps to ensure that the Agricultural Credit Department was organised in the best possible way. Since it was recognised on all sides that the co-operative institutions, despite their shortcomings and deficiencies (which have been briefly indicated in Chapter 2), constituted the most suitable agency for dispensing rural credit, Government were keen to have the position of the co-operative movement in the various Provinces investigated, to enable the Bank to take appropriate organisational and policy measures. Accordingly, in May 1934, Mr. (later Sir) Malcolm Darling, I.C.S., an officer who had long practical experience of co-operation and agricultural credit problems in the Punjab and had also studied the cooperative movement in other countries, was appointed by the Central Government to examine and report on the most suitable organisation

for the Bank's Agricultural Credit Department and the manner in which it might most effectively work with the co-operative banks and other agencies for providing credit to the agriculturists and landowners. He was later informed by the Finance Department that his primary duty would be to study the co-operative movement in various parts of India, to indicate how and to what extent it could suitably be financed by the Bank, and only incidentally to examine the question of how agricultural finance -could be afforded through channels such as scheduled banks or indigenous bankers. Subsequently, Mr. Darling was also asked by the Member, Department of Education, Health and Lands, to examine the position of the co-operative movement in different Provinces to see how it could be strengthened. His report on the constitution of the Agricultural Credit Department, together with his note on the co-operative movement in the major Provinces, was received by the Bank in June 1935.

Pursuant to the instructions of the Finance Department, Mr. Darling devoted the larger part of his report and recommendations to the assistance to be afforded through co-operative banks (including land mortgage banks) and dealt somewhat sketchily with the other possible channels of assistance.

As regards the Agricultural Credit Department, Mr. Darling's views, as summed up by him, were as follows:

Firstly, it must be in a position to advise the Bank in regard to its financing of the co-operative movement, especially in the field of land mortgage banking; and for this purpose it must be expert in co-operative finance and familiar with the working of the movement throughout India. And since co-operation is a world movement, it will be well advised to gain some knowledge of the movement in countries whose conditions at all resemble those in India. Secondly, it must get into touch with all commercial banks in any way financing agriculture and examine whether their operations can be co-ordinated to the advantage of the agriculturist. Thirdly, it must explore the whole field of indigenous banking and obtain the information that the Bank will require for its report under section 55 (1) (a) Finally, it must make a systematic study of the whole field of agricultural credit in India in order to be able to advise the Bank as to what action it should take in regard to section 55(1) (b).

In Mr. Darling's opinion, the Head of the Department had to be an officer of not less than fifteen years' service with at least three years' experience of co-operation. Concerning the Reserve Bank's relations with the co-operative institutions, Mr. Darling was of the view that:

- (1) In provinces where there is a provincial (co-operative) bank, the Reserve Bank should deal with it alone; and where there is no Provincial

Bank, it should deal, if necessary, with one central (co-operative) bank in each province,

2) It should deal only with the provincial or central banks that are thoroughly sound, and the movement behind them must also be sound,

(3) Assistance to the co-operative movement should be given in the following ways:

(a) subject to what is said above, provincial banks, or central banks if necessary, should be supported in any emergency for which they are not responsible;

(b) all central banks should be classified as A, B, C or D, and for this purpose co-operative paper of A and B banks should be rediscounted under section 17(2) (b) of the Act;

(c) the amount to be advanced in this way should not exceed 50 percent of the average amount recovered by the central banks concerned during the three years prior to the advance: in insecure tracts, a 5-year average should probably be taken;

(d) advances might also be made under section 17(4) (d) against promissory notes supported by documents of title to agricultural produce.

(4) Advice should be given, as required, on land mortgage banking, and it will be useful if the Reserve Bank could invest a limited amount of its capital in debentures issued by a Central Land Mortgage Bank which is working to its satisfaction, provided that the debentures were guaranteed by the local Government as to both principal and interest.

(5) The financial activities of the provincial banks might possibly be co-ordinated.

(6) The Reserve Bank should use its influence to secure a proper level of financial efficiency and soundness in the co-operative credit movement.

(7)

8) The assistance should be conditional on:

(a) the necessary statements being regularly supplied, and

(b) the banks concerned allowing themselves to be inspected.

The conclusion of Mr. Darling was that the Bank could, under the prevailing circumstances, make advances to only three provincial banks, namely, those of Bombay, Madras and the Punjab, but since these three banks had ample surplus funds, assistance was not likely to be required by them in the near future. He expressed the view that, for some years, the help that the Bank would be able to give to the agriculturist was likely to be of the most modest description, and if there were no co-operative movement, it would probably be unable to help him at all. This, according to him, called for strengthening the movement, 'for it is no use attempting to fit an old bullock cart with a powerful engine'.

Follow up and Preliminary Report

The Bank's Central Board considered the Darling Report in November 1935. The Bank's management took the view that:

Without further investigation and information it would be inadvisable for the Bank to commit itself to the acceptance of these proposals, nor is it necessary for it, at the present stage, to do so, because, he (Mr. Darling) considers that there are at present only three provincial banks to whom it would be prudent for the Reserve Bank to make advances, and they have so much surplus funds that they do not require any.

The first task of the Bank was to have a clear picture of the working of co-operative banks, by obtaining more detailed and up to date information on important aspects of their working, viz., the manner in which their share capital had been built up, i.e., whether by voluntary subscriptions or by compulsory deposits or deductions from loans, the extent of overdues and the manner in which the overdues under principal and interest were treated. The Bank had also to examine how and to what extent credit agencies other than the co-operative banks could be developed and fitted into the general system. The Central Board endorsed this approach and it was decided to call for detailed information from the Provincial Governments, through the intermediary of the Central Government, regarding co-operative societies, indigenous bankers, moneylenders, etc., engaged in the business of agricultural finance.

The replies received from the Provincial Governments indicated that they preferred to wait and see how the newly enacted legislation relating to rural indebtedness functioned in practice before committing themselves to any expression of opinion on matters referred to them. The Governor, however, felt that action on this question should not be delayed on this account and, in a memorandum submitted to the Central Board, in May 1936, he set out the broad features of the problem to serve as a basis for the preparation of the report under Section, 55(1) of the Act. The memorandum, which was also circulated to the Local Boards of the Bank for eliciting their comments, viewed the problem of agricultural credit both from its long-term and short-term aspects. It pointed out that long-term credit should not be dealt with by a bank and still less by the Reserve Bank, which must keep its resources liquid ; the proper agency for meeting such credit needs would be land mortgage corporations. On the other hand, short-term advances for marketing of produce should be regarded, in a primarily agricultural country like India, as one of the most important items of banking business, for which assistance might be provided by the Bank, when necessary, under the existing provisions of the Act. The memorandum discounted the possibility of the Bank's investing in land mortgage debentures on grounds of lack of liquidity. The Local Boards, by and large, endorsed the policy set out in the memorandum, but the Calcutta Local Board advocated a bold and progressive policy on the

part of the Bank, instead of too rigid an adherence to orthodox central banking principles.

Incidentally, on orders of the Government of India, the Darling Report was not made available to Local Board members, since some Provincial Governments had objected to certain portions of the Report. Some of the Local Boards were sore about this. Protracted correspondence by the Governor with Government for circulation did not meet with success.

Owing to the difficulty of framing constructive proposals, which would at the same time be practical, the Board considered that the Bank should issue a Preliminary Report, well in advance of the time limit given under Section 55(1) of the Act, setting out 'the main features of the problem and its difficulties and their (the Bank's) preliminary reaction to them with a view to clarifying the issues and ascertaining public opinion on them'. In August 1936, the Central Board approved the Preliminary Report for submission to Government. The Report was released for general information by the Government of India in December 1936.

The Preliminary Report contained a restatement of the peculiarities of peasant farming, its special features in India and the difficulties of financing agriculture under such conditions on a commercial basis. It drew attention to the urgent need for reducing the enormous burden of rural indebtedness, through the setting up of debt conciliation boards for reducing accumulated debt, and simplification of the procedure for recovery. The suggestions for the reorganisation of the cooperative movement, with particular reference to the problem of over-dues and the broad guidelines for the future operations of co-operative agencies, formed the core of the Report. For meeting the long-term credit needs of agriculture, it recommended the establishment of land mortgage corporations, run preferably on commercial lines. As regards indigenous bankers, the Report did not favour direct discounting of their paper by the Bank, but envisaged the possibility of registering those carrying business on proper lines so that the Bank could accept the names of such parties as one of the names on two-name paper coming through scheduled banks. The advantage of this arrangement, according to the Report, was that such recognised parties would be able to obtain better terms from the scheduled banks than before. The Report also recommended a reduction in stamp duty on usance bills. As regards moneylenders, the Report was of the view that even with the revitalisation of the co-operative movement, they would 'continue to be an important and indispensable factor in the rural economy of the country'; however, a radical reform in their methods was called for and the Report suggested legislation regulating money lending, especially compulsory licensing of all and registration of approved

moneylenders by Provincial Governments. The Bank would then be prepared to help by extending to approved moneylenders, registered by Provincial Governments, facilities analogous to those proposed to be given to indigenous bankers, namely, accepting them as one of the names on two-name paper.

Generally speaking, the Preliminary Report evoked more criticism than appreciation. Not many reactions were similar to that of the Times of India †, which considered that the Bank's proposals formed 'a healthy relief to the sentimental and unreal atmosphere in which too often co-operation and rural credit are discussed'. The Hindustan Times† remarked: 'a more fatuous document than the Report of the Reserve Bank, it has scarcely been our misfortune to read '. The Madras Journal of Co-operation †† regarded the Report as 'a very disappointing document'. Even Mr. Darling, while calling the Report 'valuable and suggestive', remarked : 'some of us may think that the report makes no great attempt to discriminate between the areas where the movement is sound and those where it is unsound, and that it does not make sufficient allowance for the features that distinguish cooperative from ordinary commercial banking '. *

Statutory Report

The Bank, of course, studied carefully the comments and criticisms on the Preliminary Report, in its preparation of the Statutory Report. In this task, the Bank had the guidance of Mr. Manilal Nanavati, who, as already mentioned, joined the Bank as Deputy Governor in December 1936. The Bank submitted the Statutory Report to Government by the end of 1937.

The Statutory Report, which was complementary to the Preliminary Report, described the features of agricultural finance with special reference to the role of various agencies such as Government, commercial banks, moneylenders and the co-operative movement. Of these, the moneylenders supplied the bulk of agricultural finance. However, as the various enactments relating to agricultural debts had impaired their activities in many parts of the country, the Report suggested 'reasonable' legislation for regulation of moneylending.

The Report was categorical that the co-operative movement was the most suitable agency for the supply of agricultural finance, and that, although the movement in this country had not come up to the standard required to meet adequately the credit needs of farmers, it was capable of playing its proper role in this sphere if it was suitably reconstructed

† December 31, 1936.

†† April 1937.

* Presidential address at the U.P. Co-operative Conference, Madras Journal of Co-operation, March 1937.

and revitalised. Such reorganisation should be directed mainly towards tackling the problem of overdues, building up strong reserves and effecting prompt recoveries of loan instalments out of the harvest. The foundations of the movement ought to be sound and the primary societies should build up their own funds with share capital and reserves and attract deposits from members by teaching them the lesson of thrift and prudence. Further, they should not be merely agencies for supplying finance, but an influence for the all-sided development of agriculture and the betterment of the life of villagers. Co-operative marketing had also to be developed from the bottom, right from the level of primary societies. There was also large scope for reform of the central and provincial co-operative banks on sound banking lines through contacts with commercial banks of standing and proper training of the staff.

About the role which the Reserve Bank could play in the sphere of agricultural credit, the Report stated that it would not be possible for the Bank to advance large sums to co-operative banks or indigenous bankers, for being lent out to cultivators, as a matter of course. Its resources, which largely consisted of the cash reserves of scheduled banks, were in the nature of a reserve against their deposit liabilities, to be drawn upon in times of emergency, and had, therefore, to be maintained in a liquid form. Hence, co-operative banks, like commercial banks, would have to stand on their own legs and obtain their normal finance from deposits, and could not expect the Reserve Bank to supply such finance or act as the apex bank of the movement. The Reserve Bank could come to their aid only when the ordinary pool of commercial credit appeared inadequate to meet the reasonable business requirements of the country. In such conditions also, the Reserve Bank would have to follow the same basic principles in making advances to co-operative banks as those for other forms of credit. The types of paper and security against which the Reserve Bank was authorised to lend to provincial co-operative banks and central land mortgage banks were already laid down in Section 17 of the Reserve Bank Act.

The up shot of the Report was that, while the advice and guidance of the Bank for the improvement of the co-operative movement and other matters relating to agricultural finance would be available, it would not be able to come to the aid of co-operative banks, save as the lender of last resort against securities eligible under the Act. The Bank's attitude to the co-operative institutions was more or less identical with its attitude to commercial banks, although the importance of the rural sector was repeatedly stressed by everybody. The Bank's thinking, in this matter was similar to that of the Government expressed by Sir George Schuster in the Legislative Assembly, in December 1933, that the Bank was there to provide proper co-ordination, control and

support by means of reserves, for the general banking system of the country and it was not intended to go out itself and 'usurp' the functions of the banks or other organisations which were dealing direct with individuals. The Report recognised that one of the charges against the Bank levelled by the public was that it had failed not only to assist agricultural credit by direct monetary help but also to give an indication of the lines on which it would be prepared to grant such help. This charge, said the Report, was clearly due to a misapprehension of the legitimate functions of a central bank in the sphere of agricultural and other credit. The Report discounted as premature or undesirable the various demands made by the co-operative associations from time to time for the extension of the provisions of the Act so as to include supply of normal agricultural credit to co-operative banks, application of the provisions of Sections 17(2) (a) and 17(2) (c) to provincial co-operative banks and investment in debentures of land mortgage banks.

The Statutory Report aroused little enthusiasm and the comments were generally to the effect that the Bank did not envisage for itself an active role in the sphere of agricultural credit beyond studies and offer of advice, though the importance attached to the co-operative organisation was noted with satisfaction. The Bombay Co-operative Quarterly* remarked:

The sum and substance of the lengthy memorandum is that while the Reserve Bank is willing to offer advice and even to direct and control co-operative finance it is not willing at present, for various reasons, to deal with provincial co-operative banks -in the case of some because they are not creditworthy, in the case of others because they have established their credit and possess resources themselves.

The comment of the Indian Finance † was:

The Reserve Bank has through the medium of this exquisite report told an expectant world where they stand in regard to agricultural credit -that they stand miles away and cannot afford to get mixed up in such things just yet.

The approach of the Statutory Report, which might look excessively orthodox when considered in the light of the policies adopted or proposed by the Government and the Bank today, has to be viewed in the context of their generally conservative attitude thirty years back. The Central Board of the Bank was of the view that it was not to be expected to put forward a final scheme within the short initial period of three years and that it did 'not consider its labours ended with this report'. The Board also stated in its annual reports that it was giving its continuous attention to these important problems and hoped to be able to make useful contributions towards their solution as it acquired

* March 1938.

† January 22, 1938.

experience by experiment. However, the Governor's own approach was that credit was the, least important aspect of agricultural development. Outlining his views in his speech to the shareholders in February 1938, the Governor stated that the problem of agriculture was obviously far more deep and difficult than that of indebtedness and expansion of credit and could only be met if the wider problem was tackled, of improving the whole position of the agriculturist, both social and economic, and raising his own standard of living. A 'comprehensive attack from all sides' was required and 'when it has been done it will be seen that the problem of credit will fall into a comparatively minor place and will present fewer difficulties'.

Accommodation from the Reserve Bank -Circular of May 1938

As a corollary to the Statutory Report and with a view to explaining the procedure to be followed and the conditions to be fulfilled by cooperative banks desirous of obtaining financial accommodation from the Reserve Bank, a circular letter was issued on May 14, 1938, to all provincial co-operative banks and central land mortgage banks. The principal contents of the circular were as under:

1. The Reserve Bank will deal with approved provincial cooperative banks and through them with eligible co-operative central banks placed in A and B classes in audit.
2. Provincial co-operative banks which desire to be classed as approved should make an application to this effect to the Bank through the Registrar of Co-operative Societies. The application should be accompanied by copies of their audited balance-sheets, profit and loss accounts and annual reports for the last three years as well as a copy of their bye-laws *. If it is desired to rediscount, or obtain advances against the promissory notes or bills of A and B class central co-operative banks, similar statements for such banks should also be enclosed. After scrutinising the financial statements and making such further enquiries as may be necessary the Reserve Bank will prepare a list of approved and eligible banks, which will be revised from time to time.
3. In deciding the question of admission to the list, the Reserve Bank will not be guided merely by the classification of a bank according to the audit but will consider whether its business is carried on generally on sound banking lines and will in particular pay attention to the following matters :

(i) maintenance of adequate reserves and fluid resources ; (ii) strict separation of short-term loans repayable within a year and long-term loans, which should not constitute an unduly high proportion ;

* To ensure uniformity, the Bank also circulated a form of balance-sheet for consideration and adoption by the provincial banks.

- (iii) proportion of overdues and bad debts to total loans and provision for them;
- (iv) distribution of assets in cash, investments, short-term loans and long-term advances;
- (v) rate of interest paid on deposits; and (vi) dividends distributed.

4. Provincial co-operative banks admitted as approved banks will have to agree to the following:

- (i) Maintenance of a cash balance with the Bank, the amount of which shall not, at the close of business on any day, be less than 2 ½ per cent of the demand liabilities and 1 per cent of the time liabilities in India of each such bank;
- (ii) Preparation and submission of the balance-sheets and annual reports on the lines laid down by the Reserve Bank, and such other periodical statements as may be prescribed by the Reserve Bank, and
- (iii) Inspection of the banks by officers of the Reserve Bank from time to time.

5. After a provincial co-operative bank is informed of its inclusion in the approved list, if it desires any financial accommodation for the forthcoming season it should make an application to the Bank, through the Registrar, specifying its requirements under the various clauses of Section 17 of the Act. The Reserve Bank will fix the credit lines for each bank at its discretion; alter considering the bank's position as a whole. Fresh credit lines will be fixed every year and for this purpose the provincial bank should send its application at the beginning of every financial year through the Registrar.

6. Financial accommodation will be available under the following heads:

Section 17(4) (a) - Loans and advances for periods not exceeding ninety days to provincial co-operative banks and through them to co-operative central banks against Government securities and approved debentures of land mortgage banks.

Section 17(4) (c) -Loans and advances for periods not exceeding ninety days to provincial co-operative banks against promissory notes of approved co-operative marketing or warehouse societies endorsed by the provincial banks and drawn for the marketing of crops or against promissory notes of central co-operative banks endorsed by provincial co-operative banks and drawn for financing seasonal agricultural operations or the marketing of crops.

Section 17(2) (b) -Rediscount of promissory notes mentioned above maturing within nine months.

Section 17(4) (d) -Loans and advances for periods not exceeding ninety days against promissory notes of provincial co-operative banks secured by warehouse warrants issued by corporations independent of the borrower or on the security of promissory notes supported by

documents of title to goods which have been assigned or pledged as security for cash credits or overdrafts granted by the provincial cooperative bank to approved marketing or warehouse societies.

7. In all cases of loans, advances or rediscounting, the provincial bank will be responsible for payment to the Reserve Bank on the due date and the amount will be recovered by the Reserve Bank by debiting the account of the provincial bank.

8. As regards land mortgage banks, the Reserve Bank will deal with approved central institutions which are declared to be provincial cooperative banks under the Act. The Bank will, when necessary, advise them regarding the terms and the timing of the floatation of debentures. In emergency, the Bank will grant loans and advances up to ninety days, against approved debentures, to central land mortgage banks and to primary land mortgage banks coming through them. The Bank will also grant them loans and advances up to ninety days against Government paper.

The response of the co-operative sector to this circular was -poor. Only the Bombay Provincial Co-operative Bank took interest in the matter and held discussions with the Reserve Bank to have certain points clarified and to convey its views. The main points raised were whether the bills and promissory notes of primary societies, with whom the Bombay Provincial Co-operative Bank dealt with directly, would be eligible for advances or discounts and whether the inspection by the Reserve Bank would be 'a vexatious inquisition into details by subordinate staff'. The bank also protested against the need to maintain minimum balances with the Reserve Bank, though at half the rates fixed for scheduled banks. As regards the first point, it was clarified by the Bank that though legally it would be possible to accept bills of primary societies also, it was considered inadvisable to do so in the case of the Bombay Provincial Bank as its dues from societies under liquidation were of the order of Rs. 17 lakhs against which it had reserves of Rs. 3.50 lakhs only. It was suggested that it would be preferable for the bank to take advances against Government securities, of which it had enough holdings, than seek advances against promissory notes of societies. In regard to the maintenance of minimum balances with it in cases of banks which wanted to borrow from it, the Reserve Bank insisted on this requirement in order to bring the co-operative banks also fully under banking discipline. The subject of maintenance of minimum deposits was raised by the co-operative banks again and again in subsequent years also, but the Bank stuck to its decision. As regards inspection by the Reserve Bank, an assurance was given that it would be undertaken by a responsible officer of the Bank. As a matter of fact, the Bank did not take up the inspection of co-operative banks for more than a decade after the issue of the circular.

In January 1939, the Bombay Provincial Co-operative Bank approached the Reserve Bank for 'permanent' arrangements for financial accommodation against Government securities. A credit line was sanctioned in February 1939; while no specific figure was indicated to the bank, the Bank intended to limit it to Rs.10 lakhs. The provincial bank did not draw upon the limit during the period covered by this chapter.

Reorganisation of the Co-operative Movement: Circular of June 1939

Pursuant to the view that the co-operative agency was best suited for purveying rural credit but that it needed to be reorganised on banking lines, the Bank addressed to all provincial and central co-operative banks a comprehensive circular on June 12, 1939, indicating the lines of reorganisation of the co-operative movement. The circular outlined the Bank's basic philosophy as under:

In all essential respects the nature of the business of co-operative banks is the same as that of commercial banks. Both types of institutions accept deposits and are therefore responsible for investing their funds in such a way as to safeguard the interest of their depositors. The same considerations of safety and liquidity in the employment of funds are essential for the stability of both. The principal difference is that whereas commercial banks lend to trade and industry, co-operative societies make advances mainly to agriculturists. The fact that the agricultural cycle is longer than the commercial and that the co-operative banks are not primarily concerned with making profits for their shareholders does not make any essential difference in the fundamental principles which both types of institutions have to observe as banking concerns. As a matter of fact, the type of business the co-operative banks are called upon to undertake makes it all the more necessary for them to observe strict business principles.

The circular also suggested operating norms to co-operative institutions, generally on the pattern of norms adopted by commercial banks in the U. K. and India, but with some modifications to suit their special type of business, viz., provision of agricultural credit. These related, in particular, to the maintenance of a sound pattern of assets distribution, restriction of loans generally to short-term periods (up to nine months) and limiting the amount of intermediate-term credit to the share capital and reserves of the banks, proper calculation of over-dues, avoidance of fictitious repayments, strengthening of reserve funds by regular allocation from profits and linking of interest rates on deposits and advances to the Bank rate.

The reaction of the Bombay Provincial Co-operative Bank, which was again the first to come out with its comments, was typical of the reaction of the co-operative sector to this circular. The Chairman of

the bank, Mr. R. G. Saraiya and the Managing Director, Mr. V. L. Mehta, had discussions with the authorities of the Bank. It appeared that the provincial bank felt a sense of disappointment and irritation that the Reserve Bank should come forward with a lot of advice, while it did nothing by way of actual financing of co-operative banks. The question of maintenance of minimum balances was again raised and it was stated that in the absence of any quid pro quo from the Reserve Bank, the balances could as well be maintained in the shape of current accounts with other banks. About the suggestion for the restriction of advances by co-operative banks to periods within nine months, it was pointed out by them that agricultural advances for six or nine months were often extended owing to the poor paying capacity of the farmers and the vagaries of the seasons, with the result that agricultural banking became long-term banking. The generalisations regarding fictitious repayments were also objected to. The other suggestions made in the circular were considered as 'mere words which have no value unless concrete suggestions are made'.

Co-operative journals too made adverse comments on the circular. The Bombay Co-operative Quarterly editorially commented, in its issue of September 1939, that some of the recommendations were 'impracticable and hardly conducive to the development and progress' of co-operative credit institutions and there was 'every justification for the feeling that the Reserve Bank is not in intimate touch with the position and working of co-operative credit institutions'

The Madras Journal of Co-operation also came out with an article* on the circular, in its issue of February 1940. The general reaction in this case too, was that the Reserve Bank lacked intimate touch with co-operative institutions and that many of its suggestions were impracticable and not suited to conditions in India. The article stated:

There is not the slightest attempt on the part of the Bank to accommodate its business, even to a very small extent, to suit the special requirements of agriculture. Its suggestions smack something like chopping the head to suit the cap, as the Tax nil proverb goes.

The article was critical of the Reserve Bank for drawing comparison with joint-stock banks in Britain rather than with co-operative banks; Britain was a 'backward country' in co-operative banking. It felt that it would have been better if the Bank had given the experience of German co-operative banks instead, for guidance, as 'Germany is more advanced in co-operative credit and we have to learn a great deal from their co-operative banking'. The article pointed out that no reference had been made to debentures of land mortgage banks as a mode of investment of liquid resources of co-operative banks and interpreted

* The Reserve Bank's Circular to Central and Provincial Banks, by V. S. Ramaswamy Iyer.

it as the Reserve Bank's lack of sympathy for such debentures - 'they have betrayed their unsympathetic attitude, by their hesitation to accept them as security for advances'. As regards limiting intermediate-term loans to the share capital and reserves of the banks, the article observed:

They want to restrict intermediate credit (loans) to the owned capital of banks, and they stop there. They have not bestowed an iota of thought on the question whether the total requirements of agriculturists in this direction can be met. This limit will be far too small and may not meet even a small fraction of their requirements. Nor have they given any suggestion as to where to go for the balance. Should the co-operators go again to money-lenders for this? . . . The Reserve Bank is shirking its legal responsibility in not going further into the matter of intermediate credit and finding a way out.

These and other criticisms made in later years were studied carefully by the Bank and modifications were made from time to time, while generally adhering to the principles enunciated in the circular.

Direct Linking of Indigenous Bankers

The other part of Section 55, namely, the extension of the provisions of the Reserve Bank of India Act relating to scheduled banks to persons and firms other than scheduled banks, that is, the problem of direct linking of the indigenous bankers with the central banking institution, may now be dealt with.

The indigenous bankers, as mentioned earlier, played in the 'thirties a fairly substantial role in financing the inland trade and indirectly in supplying agricultural credit through assisting the movement of crops. The question of linking the indigenous bankers with the modern banking system and bringing them under the fold of the Reserve Bank, when established, engaged the attention of the Central Banking Enquiry Committee and figured prominently during the various stages of consideration of the Reserve Bank Bill. The Central Banking Enquiry Committee made definite proposals for the linking with the Reserve Bank, after its establishment, of such of the indigenous bankers as (a) were engaged in banking proper or were prepared to shed their business other than banking ; (b) had a minimum of capital and reserve (the Committee did not suggest what the standard should be) ; (c) kept accounts in the usual recognised manner, got them audited by recognised auditors and made them available for inspection; and (d) did not charge unduly high rates of interest. In the Committee's view, the bankers satisfying the above conditions could be placed in the approved list of the Reserve Bank on the same footing as joint-stock banks and be entitled to the benefits of rediscount facilities against bank

endorsed paper and to remittance facilities. The Reserve Bank and the commercial banks could use such indigenous bankers as agents for collection of cheques and bills in the same manner as they might use a joint-stock bank or a co-operative bank. It was also proposed that such of the indigenous bankers whose deposits did not exceed five times their capital should, during the first five years of the working of the Reserve Bank, be exempt from the maintenance of compulsory deposits with the Bank. Recognising that a large number of indigenous bankers whose principal business was not banking would remain outside the scope of its proposals, the Committee recommended the adoption of a more liberal policy by the Imperial Bank of India in granting facilities to them.

Although the Central Banking Enquiry Committee had thus called for action regarding indigenous bankers with a view to integrating their operations into the modern banking system, Sir George Schuster, the Finance Member, was of the view that 'unfortunately, the problem was one which we could not possibly tackle in connection with the Reserve Bank Bill'. He took what appeared to be the line of least resistance by enjoining the Reserve Bank, under Section 55(1) (a) of the Act, to examine the question and submit a report within three years from the date on which the Section came into force, i.e., January 1, 1935. The question of indigenous bankers also figured in the terms of reference to Mr. M. L. Darling. However, Mr. Darling confessed in his Report that he had no time to make a full inquiry on the channels, other than the co-operative movement, through which agriculture could be financed. All that he was able to do was to interview certain prominent indigenous bankers and ascertain their views in regard to possible dealings with the Reserve Bank. His findings were that, outside Bombay, Madras and Burma, the large mass of indigenous bankers neither required nor desired to have access to the Reserve Bank.

The Bank, however, dealt with the matter, as thoroughly as was possible in the circumstances. As part of the enquiry on agricultural credit, the Bank solicited detailed information from the Provincial Governments whether the indigenous bankers were prepared to register themselves and maintain separate and standardised accounts of their banking and other business. As already mentioned, most of the Provincial Governments were not prepared to commit themselves to any expression of opinion on the matter. In view of this position, the Preliminary Report to Government under Section 55 did not go beyond suggesting the possibility of registering indigenous bankers and accepting the names of such parties as one of the two names on the paper routed through scheduled banks. After considering the comments and criticisms on the Report, in May 1937, the Reserve Bank sent a circular letter to scheduled banks and shroff associations, stating that

in view of the large number of indigenous bankers and the highly personal and fluctuating character of their business, the Reserve Bank could only deal with them through some intermediate agencies which would share the financial responsibilities and undertake detailed examination of their transactions. The Bank was, however, prepared to consider most carefully any practical scheme, emanating either from the indigenous bankers themselves or from any other source, for organising their members to enable credit to be accorded to them direct. Such organisations were to be self-contained legal entities with a minimum of owned resources and were to maintain deposits with the Reserve Bank on the same basis as was applicable to scheduled banks; besides, they were to maintain separate and properly audited accounts of their banking and other business, the latter being confined to bona fide trading and not speculation. If indigenous bankers were prepared to accept these conditions, the Reserve Bank would be willing to implement a scheme which had been provisionally drawn up by it, under which it would provide accommodation against a bona fide trade bill originating with a merchant or an agriculturist and endorsed by the indigenous banker and rediscounted with a scheduled bank, or against a promissory note originating with an indigenous banker with a possible second signature and discounted by a scheduled bank. Scheduled banks were to maintain lists of the shroffs with whom they were prepared to do business, as also a record showing the credit limits which they could be safely accorded and the type of business which the shroffs carried on. Until the scheme developed and the Reserve Bank had acquired experience of the amount and character of credit which was likely to be involved, it would not discount such bills but only make advances against them under Section 17(4) (c) of the Act.

The circular was criticised by the Madras Local Board that it ran contrary to the declared intentions of the Government of India. It suggested that the indigenous bankers should be brought into direct relations with the Reserve Bank subject to equitable provisions with regard to conduct and control. The Bombay Shroffs Association regarded direct relationship between the indigenous bankers and the Reserve Bank as a 'cardinal and fundamental principle'. According to it, to ask the indigenous bankers to come to the Reserve Bank through scheduled banks was unjust to the former who were rivals of the latter. The Association wanted the Bank to maintain a register of private bankers, to which a banker having a capital of Rs. 2 lakhs would be eligible for admission, and to extend to such registered bankers all privileges enjoyed by scheduled banks. The Indian Merchants' Chamber also expressed almost identical views.

In the light of the replies to the circular letter, the Bank forwarded in August 1937 to the representatives of indigenous bankers and others

a draft scheme for the direct linking of the indigenous bankers with itself, on the basis of the recommendations of the Central Banking Enquiry Committee and the regulations relating to banking companies contained in the Indian Companies Act, 1936. The scheme-intended to be an experimental measure for the first five years -was to be applicable to indigenous bankers confining their business to banking proper as defined by the Indian Companies Act and having minimum working capital of Rs. 2 lakhs (to be increased to Rs. 5 lakhs within a reasonable period). Their names would be registered in an approved list maintained by the Reserve Bank and they would be entitled to the privilege of rediscount facilities against eligible paper, the right of advances against Government paper and remittance facilities similar to those for scheduled banks. However, unlike the scheduled banks, they would be free from the obligation of keeping deposits with the Bank during the experimental stage unless it was seen from the weekly statements that their time and demand liabilities exceeded five times the amount of their capital in the business.

The indigenous bankers, who were already receiving as much assistance as they needed from the Imperial Bank and the other banks, reacted to the proposals quite unfavourably, as they were unwilling to curtail their activities and adopt forms of business which were inconvenient to them. Generally speaking, they disagreed with the Bank's suggestions regarding taking of deposits and giving publicity to their accounts. Many of them were not agreeable to the maintenance of accounts in the approved form. Though there was general agreement that speculative business should be ruled out, they were not prepared to confine themselves to banking business. In short, they wanted the scheme to be so modified as to be incompatible with the main proposals. The following extract from the letter dated September 27, 1937 of Seth Fatichand Gokaldas of Madura is typical of their reactions:

Our business is based on strict privacy and it will greatly hamper our business if we make up our minds to show our account books. Besides, like the Reserve Bank, every other blessed bank having dealings with us will call upon us to produce our accounts at any time and the result will be, we will be at the mercy of the scheduled banks If the Reserve Bank wishes to do business with the indigenous bankers on the lines of the Imperial Bank and other banks, this step will be most welcome . . . but on the terms and conditions mentioned by you we may assure you no banker with self respect would come to your door to have the facility of discounting bills with you.

The Bank authorities were not surprised at these reactions. The Governor was aware that there was a 'good deal of unreality' about the question of direct link with the Reserve Bank, which it would seem was not strictly necessary for either the indigenous bankers or the

Reserve Bank's monetary management. The Bank informed the Government, in its Statutory Report, that it could not recommend any immediate legislation to amend the Reserve Bank Act for extending its provisions relating to scheduled banks to the private bankers. The offer made in the Bank's letter of August 1937 was still open and the Bank would be prepared to take up the matter with the Government with a view to amending the Act, if the indigenous bankers were prepared to conform to the conditions stipulated by it or suggested any other practical alternative. In the opinion of the Bank, the ultimate solution to the problem lay in the development of an open bill market in which first class bills were freely negotiated. It would then be possible for the Bank to extend its open market operations to trade bills thereby giving first class indigenous bankers the closer and, possibly, the direct relationship which they desired without compelling them to make any radical changes in the essential character of their business. The Bank recognised the onerous rates of stamp duty as one of the impediments in the way and pressed the Central Government and through them the Provincial Governments to reduce the stamp duty to a uniform level of two annas per thousand rupees, as recommended by the Central Banking Enquiry Committee.*

At the meeting of the Bombay Local Board of the Bank held in November 1937 to consider the Statutory Report, Sir Purshotamdas Thakurdas, one of the staunch advocates of the direct link, summed up the position in these words:

the Bank had done all it could and since the indigenous shroffs were not prepared to accept the suggestions and no further constructive proposals had been made, that part of the Report could hardly be improved upon.

Simultaneously, the Bank made efforts to bring within the banking system the village moneylender, so as to make credit more extensively available to the agriculturists at reasonable rates of interest. It was felt that finance for marketing of crops might be made available to a much larger extent through the agency of the moneylender, if his advances to cultivators on the security of produce were to be drawn up as bills so that they could be discounted by scheduled banks and rediscounted by the Reserve Bank. Accordingly, a circular letter was addressed to scheduled banks on January 3, 1938, outlining a tentative scheme, to enable them to rediscount with the Bank bills of exchange or promissory notes of approved moneylenders drawn for the purpose of financing the marketing of crops and maturing within nine months. As a special inducement, the Bank offered to rediscount, at a concessional rate of 1 per cent below Bank rate, agricultural paper in respect of areas

* The duty was reduced only in January 1940.

where interest rates were unduly high. The concession was to be available only if a scheduled bank agreed to charge the moneylender not more than 2 per cent over the Bank's rediscount rate and the moneylender, in turn, passed on the credit to the agriculturist with a further margin not exceeding 2 per cent. The scheduled bank discounting such paper was also responsible, under the scheme, for satisfying itself that the moneylender was creditworthy, his business was conducted on sound lines and he kept simple books of account in proper form.

In reply, the scheduled banks referred to various difficulties in working the scheme. The main difficulty was that the smaller agriculturist did not usually borrow against security of produce. He needed money for crop production than for its marketing. He generally obtained finance by keeping a running account with the moneylender and would not favour loans payable on a fixed date. Further, the banks would not be in a position to gauge the moneylenders' credit or to force the latter to reorganise their business; nor could the banks dictate the interest charged to the cultivators. Moreover, even first-class Multani bills were discounted by banks at very fine rates due to competition and there would thus be little scope for rediscount of the bills with the Reserve Bank even if the Multanis had borrowed for the purpose of advancing money to agriculturists. Lastly, agricultural debt relief legislation had created an atmosphere in which the moneylender was shy of utilising his own capital fully in business and this reduced the prospect of his borrowing from scheduled banks. Under these circumstances, the Bank felt that there was little likelihood of the scheme making a wide appeal and that until more experience was gained of the actual working of such legislation it would be hardly worthwhile to proceed with it. While communicating its views in the matter to Government, the Bank stated that the realisation of the objective of cheapening credit to agriculturists had to come about mainly through the regulation of moneylending, the development of branch banking and the strengthening of the co-operative movement.

Other Activities of the Agricultural Credit Department

While the Agricultural Credit Department gave increasing attention to the study of agricultural credit problems, its role in tendering advice to the Central and Provincial Governments on various matters pertaining to agricultural credit also steadily expanded. Under the able stewardship of Mr. Nanavati, the Department undertook intensive studies of the co-operative movement in India and Burma. The results of such studies were embodied in bulletins, four of which were published during the period, namely:

- (1) Report on the Banking Union at Kodinar.

- (2) Co-operative Village Banks.
- (3) Recent Developments in the Co-operative Movement in Burma with suggestions for their applicability to India.
- (4) Co-operation in Panjavar.

While the first three were based on studies conducted by the Department, the last one was written by an officer of the Punjab Co-operative Department.

Three of these Bulletins (Nos. 1, 2 & 4) were devoted to developing the idea that co-operative credit institutions should not confine themselves to the provision of credit but should expand their activities to cover all aspects of the life of agriculturists. Bulletin No.2, dealing with societies at the primary level, suggested that the activities of the village societies should be expanded so that in addition to supplying credit they could assist the members in obtaining their various requirements such as better quality seeds, manures, etc., at less cost and be instrumental for teaching their members the lessons of 'better living, better farming, and better business'. Bulletin Nos. 1 and 4 presented an objective study of the working of two successful banking unions, one at Kodinar in Baroda State and the other at Panjavar in the Punjab. The main theme of these Bulletins was briefly this: central co-operative banks as they were constituted in India had till then confined their activities to the supply of funds to their affiliated societies, while other functions such as supervision over the societies and the education of their members were left to other agencies. As such a division of functions was not found conducive to the healthy growth of the movement at the primary level, it was suggested that the societies should be federated into banking unions which would take up all these functions. The banking union, with its area restricted to a taluka or tahsil and its membership confined to primary credit societies, would, apart from financing the societies, take interest in all the activities undertaken by them and in addition take up supervision over them and education of their members. It may be of interest to mention that the banking union at Kodinar was organised and fostered by Mr. Nanavati himself.

Bulletin No. 3 described the steps taken for the rehabilitation of the co-operative movement in Burma, which was badly affected by the economic depression of the 'thirties, and discussed their relevance for the reconstruction of the movement in India.

One of the statutory functions of the Department was to be available for consultation by Governments and banks on all matters pertaining to agricultural credit. The Department, at the request of the Central and Provincial Governments, examined and expressed its opinion on several Bills relating to debt conciliation, land mortgage banks, moneylenders, regulation of interest rates, relief of agricultural indebtedness,

etc. Among the more important of such Bills on which the Bank's opinion was invited, may be mentioned the Moneylenders' Bills of the Central Provinces and Berar, Bengal and Bombay, the Debt Conciliation Bills of Bombay, Madras and Assam and the Land Mortgage Bill of the Central Provinces and Berar. Besides, the Department was frequently consulted by the Registrars of Co-operative Societies and co-operative banks on matters concerning agricultural credit, as for instance, the manner in which land mortgage banks could extend their business, model bye-laws for land mortgage banks, comparative merits of sinking funds versus debt redemption funds, floatation of new debentures, accounting procedures in respect of overdue interest in co-operative societies and so on. At the request of some scheduled banks in Madras, a suggestion was made by the Bank to the Government of Madras that those banks might be exempted from the operations of the Agriculturists' Relief Act. The Department thus acted as a clearing house of information on agricultural credit.

The Deputy Governor and the Officer-in-Charge kept close and continuous touch with the co-operative movement, consulting with the Governments and co-operative agencies and attending conferences. The major conferences attended included the Twelfth Conference of Registrars of Co-operative Societies at Delhi in 1936, the Co-operative Conferences at Bangalore in 1937 and Gwalior in 1938, and the Thirteenth Conference of Registrars of Co-operative Societies held at Delhi in December 1939. In 1938, the Officer-in-Charge, during his tour of Europe and America on furlough, visited the central banks of several countries. Among the subjects studied by him were the working of agricultural as well as consumers' co-operative societies; operations of co-operative and other agricultural credit agencies both for short and long-term finance ; measures taken by various Governments to improve agriculture and to enable the agriculturists to obtain a better price for their produce ; the manner in which studies relating to agricultural economics were carried out; the organisation of the statistical and research departments of central banks and the regulation and supervision of banks. He also made a special study of the Credit Agricole D'Egypt.

Apart from its principal sphere of activity relating to agricultural credit, the responsibility for giving continuous attention to the study of monetary and banking developments and problems also devolved upon the Agricultural Credit Department. In February 1937, a Statistical Section was started, the main duties of which were to collect and interpret the existing data on scheduled banks as well as to prepare periodical reports on the money and financial markets of India. The Section took over, in April 1937, the publication of the Reserve Bank's Monthly Statistical Summary, which was till then being handled by the Central

Accounts Office, Calcutta. The Bank also started issuing annually a publication entitled Report on Currency and Finance, with the first issue covering the years 1935-36 and 1936-37; this took the place of the annual report of the Controller of the Currency, which office was abolished from October 1937. In January 1938, a separate Banking Section was created within the Department and the duties performed by the Central Office of the Bank in regard to scheduled banks were transferred to it. These functions mainly related to the maintenance of records of scheduled banks' daily balances, the recovery of penal interest on shortfalls in statutory balances and dealing with loan applications of scheduled banks. Besides, the Section was also entrusted with the preparation of a weekly report on the main features of the money market to be submitted to the Committee of the Central Board. The Section also devoted attention to the problems of banking legislation and undertook in this connection the collection of information about foreign central and commercial banking legislation.

Thus, during these initial years, the Bank was mainly engaged in building up the necessary expertise for handling problems relating to agricultural credit and the co-operative movement. In its Statutory Report the Bank endeavoured to state, in broad terms, the salient features of agricultural finance in India and the scope of action which the Bank could undertake to begin with. The Bank made efforts towards an enlarged flow of agricultural credit through the agency of the moneylender and to bring the indigenous banker within the ambit of organised banking, though these efforts met with little success. Modest as these activities of the Bank were in the sphere of agricultural credit, they prepared the ground for a more active role in later years. To sum up, in the words of Sir Chintaman Deshmukh: *

The activities of the Department have expanded and proliferated to an extent not realised by either the Governments in India or the public concerned with its operations. The foundations of the Department were laid under the experienced and solicitous eye of Sir Manilal Nanavati, Deputy Governor from 1936-41, who brought to bear on the task all his rich administrative experience and his constructive talents.

* op. cit.

Governors, Government, Board and Shareholders

Quite early in its career the Bank witnessed important changes in its top management. The change of Governor raised fundamental issues concerning relations between the central bank and the Government. These and several other matters mentioned below are of sufficient interest to merit a separate chapter. The elected members of the Central Board as a whole endeavoured to play an active role in the shaping of the Bank's policies, in maintaining its independence and generally in safeguarding the interests of the country. Some of the Local Boards were dissatisfied with the passive role assigned to them and made unsuccessful efforts to be entrusted with important responsibilities. Yet another aspect of some interest is the proceedings of the annual general meetings of the shareholders of the Bank.

Sir Osborne Smith's Resignation

Sir Osborne Smith, Governor, tendered his resignation towards the end of October 1936. The resignation was accepted by the Governor General, though it became effective July 1, 1937, consequent on Sir Osborne's being sanctioned eight months' leave from November 1, 1936. The duties of the Governor were carried on by the 'senior'* Deputy Governor, Sir James Taylor, who was appointed Governor, with effect from July 1, 1937. A few days earlier to Sir Osborne's resignation, that is to say, with effect from October 20, 1936, Sir Sikander Hyat-Khan had also resigned from the Deputy Governorship.

* In the Bank's documents and publications, capital S has been used for the word senior; in the Reserve Bank of India Act, however, there is no provision for a Senior Deputy Governor, similar to that in some of the central bank Statutes elsewhere.

Sir Sikander's place was taken by Mr. Manilal B. Nanavati, who assumed office on December 21.

Sir Osborne's resignation aroused widespread interest in the press and in the Legislature, although newspapers and journals do not give the full story, apart from the fact that in such matters the complete story can seldom be known. This matter needs to be dealt with at some length. The brief reference to Sir Osborne's resignation in Sir Chintaman Deshmukh's Gokhale Institute address seems to put the matter in a nutshell:

While it would be obviously inappropriate for me to state the details of his conflicts with Sir James Grigg, the then Finance Member, and my predecessor the late Sir James Taylor, who was one of his deputies, I think I must permit my self to record that the main causes of Sir Osborne Smith's resignation were, apart from his temperamental incompatibility with the other two, the serious difference of opinion which arose between him and the Finance Member over the lowering of the Bank rate, with all its implications, and the management of the Bank's investments.

It would appear that besides the above two matters (that is, Bank rate and management of investments), there were also differences of opinion concerning the exchange rate of the rupee. Sir Osborne had for long, that is to say, even from his Imperial Bank days, been critical of the 1S. 6d. ratio and its deflationary consequences. Press reports also mentioned that Sir Osborne had proposed an export duty on gold to discourage the outflow of the yellow metal and that Government opposed it. Some reports even hinted at there being certain wild allegations against the Governor.

Apparently, the differences between the Governor and the Finance Member were not a matter of later development; they seem to have been brewing even before the Bank was inaugurated on April 1, 1935. For, in his letter of April 2, 1935, to Sir Osborne, Sir Purshotamdas Thakurdas expressed his perturbation at hearing from a common friend that there were differences between the Governor and the Finance Member. Sir Osborne was, it appears, a person who was keen on maintaining the independence of the institution he headed. Even in his Imperial Bank days, Sir Osborne used to complain of pressures from Government and the Secretary of State. Referring to one cablegram from the Secretary of State, he had remarked in 1930: 'anyone would assume that the Imperial was a department and a very inconspicuous department of Government' and he had told the Government people: 'so long as I run the Imperial Bank I will not be run by London or anywhere else, and further, that I would not tolerate interference with my business' Again, writing to Sir Purshotamdas in June 1936,

Sir Osborne complained that he was 'sick to death of Government's always attempted domination of the Bank'.

That there was temperamental incompatibility between the Governor and the Finance Member was widely known. The Indian Finance* commented that it was 'an open secret' that:

there has been a lack of that perfect understanding and instinctive cordiality that should prevail between the Treasury and the Central Bank At the head of the Treasury and of the Central Banking Institution, we have two men, each with a strong and pugnacious personality.

It would also appear that the relations between the Governor and his 'senior' Deputy Governor were not quite cordial. The Governor suspected that on a number of matters the Deputy Governor was dealing directly with Government without his knowledge. It is very probable that the difficulties which arose between the Governor on the one hand and his Deputy and the Finance Member on the other represented to a certain extent the traditional conflict between professional bankers and civil service personnel!

These conflicts perhaps explain why Sir Osborne was out of India for a good many months, even during his very short tenure of office. In 1935, proceeding to the U.K. in connection with arrangements for the opening of the London office of the Bank, he stayed for almost five months, though a part of this stay was in connection with his taking a 'cure'. When he returned, his 'senior' Deputy went on six months' leave for 'convalescence'. Shortly after the Deputy's return, Sir Osborne again went to the U.K. and returned after five months. During this period, apparently, decisions were taken regarding his resignation, which was announced by Sir Osborne at the meeting of the Central Board held on October 28, 1936. The Board recommended to the Governor General that Sir Osborne be granted eight months' leave from November 1, 1936 and 'the most liberal gratuity possible in appreciation of his successful organisation and initiation of the Reserve Bank '. The Board eulogized Sir Osborne's services in the following terms:

Resolved that the Board note with the deepest regret Sir Osborne Smith's resignation as intimated in the above letter. They place on record their high sense of appreciation of Sir Osborne Smith's single-minded devotion to the Bank's interest in organizing the affairs of the Bank from its commencement. The Board regret they must lose Sir Osborne Smith's assistance and experienced guidance in the affairs of the Bank hereafter and they cannot speak too highly of the services

*June 20, 1936.



Sir James B. Taylor
Gouvernor, 1937-43

which he has rendered to the Reserve Bank and to India during the period of his connection with this country. The Board tender Sir Osborne Smith their best wishes for his prosperity and happiness in his future career.

The Government of India issued the following statement on October 30, 1936:

The Governor General in Council has received Sir Osborne Smith's application to resign from the Governorship of the Reserve Bank of India. He has accepted it with regret at the loss of an officer who has rendered invaluable service to India, both generally and in the establishment and conduct of the affairs of the Bank. It is with real regret that the Government of India, in deference to his own wish, part with Sir Osborne Smith's great experience and high capacity.

Sir Osborne was sanctioned a gratuity of Rs.50, 000, or the same sum as was mentioned in the terms of his appointment as Governor.

There were comments in the press and in the Legislature, too, on Sir Osborne's resignation. The Indian Finance feared that the resignation was calculated 'to cause grave doubts' about the independence of the Reserve Bank. The comment of the Commerce was that 'Sir Osborne Smith would never have taken such a decisive step unless the position had become impossible, which is a matter for deep regret, as his loss to the Reserve Bank at the present period is serious for the country'. The Secretary of the Indian Merchants' Chamber, Bombay, in a communication to the Finance Department, stated:

the Indian business community were becoming accustomed to believe that they could look with increasing confidence to Sir Osborne Smith for the protection of their interests. His outstanding ability, exceptional calibre and sympathetic understanding of Indian conditions engendered high hopes for the success of the Reserve Bank The commercial community are, therefore, seriously perturbed by rumours that serious differences of opinion with Government have driven Sir Osborne Smith to resign his position as Governor of the Bank. My Committee are very anxious that nothing should happen to impair in the slightest degree the position, prestige and independence of the Reserve Bank.

The demand was also voiced in several quarters including the Legislature, that Government must make a full statement explaining all the circumstances leading to the resignation of the Governor. The authorities, however, remained tight lipped over this episode.

It was necessary to dwell on the Governor's resignation at some length because of the importance of generally harmonious relations between persons at the helm of the Treasury and of the central bank, It is also important that relations between the Governor and the

Deputy Governors are characterised by cordiality, mutual confidence and loyalty. Perhaps the absence of this sort of relationship at different levels provide part of the explanation why the Bank did not make greater progress in its role as central bank in the pre-war years.

Sir James Taylor succeeded to the Governorship of the Bank from July 1, 1937, on the unanimous recommendation of the Central Board, made at its meeting in New Delhi on April 3, 1937. His term of office was five years; as regards salary, on the same principle on which the Deputy Governor's salary was reduced earlier, it was fixed at Rs. 7,500 per month as against Rs. 10,000 paid to the first incumbent. Sir James's background and eminent qualifications for entry into the Reserve Bank as a senior executive have already been mentioned in Chapter 4. The only point that was raised in some quarters was whether the appointment of one who was so closely associated with the Government was conducive to the healthy independence of the central bank. But it would seem that Sir James strove hard, and reasonably succeeded, to harmonise the interests of the Bank and the wishes of the Government as also to safeguard India's national interests without ignoring those of the ruling power. While his work as Governor will be referred to in later chapters, it was considered to be outstanding enough to be rewarded by the extension of his office for another term of five years, with effect from July 1, 1942, on the unanimous recommendation of the Central Board, though he was not destined to complete it.

Sir James appears to have had very cordial relations with the Board as well as with the Government. His advice was sought and highly respected by Government. This cordiality with the Government was not only on account of his having been a senior civilian in the Finance Department but also owing to the circumstance that he and the Finance Member, Sir James Grigg, were known to each other very well. It appears that in the British Civil Service Examination of 1913, Grigg stood first and Taylor second. In his autobiography, *Prejudice and Judgment*, Sir James Grigg has the following to say about the Central Board of the Reserve Bank and the skill and tact of Sir James Taylor as Governor:

Incidentally also I had inherited from my predecessor an obligation to set up an Indian Reserve Bank to take over the management of the currency and debt independently of the Government. This I did, but the results were quite other than its promoters intended, for the Central Board was, under the bank's charter, to be mainly elected by the shareholders, and within four years it came to be dominated by those Hindu big business men who were more than sensitive to suggestions from the Congress caucus, and some of whom had contributed largely to its funds. This might have had serious consequences. That it did not was due very largely to the skill and tact of Sir James Taylor, who was Governor for most of the time I was in India. In addition to his

admirably efficient management of the internal affairs of the bank, he showed the utmost loyalty to me, both officially and personally, and we became the firmest of friends. His death during the war was a great grief to me and a severe loss to the bank, though he had trained a gifted Indian deputy who was able to succeed him.

Change of Deputy Governor

Sir Sikander Hyat-Khan resigned his post as Deputy Governor, effective October 20, 1936, to return to politics in the Punjab. His successor was appointed fairly expeditiously. Apparently, in those years the Deputy Governorship of the Reserve Bank was regarded as a prize post. Apart from the salary (which was Rs. 5,500 per month in the case of Taylor and Khan but reduced in respect of later appointments), there was also a lot of prestige and halo attached to the top posts in the Bank. It would seem that about twenty-five people were in the run for the post vacated by Sir Sikander. These included some of the most eminent people who later became Members of the Viceroy's Executive Council, Dewans, Ministers, Ambassadors and Members of the Planning Commission. The person finally recommended by the Central Board of the Bank and approved by the Governor General in Council was Mr. Manilal B. Nanavati, a Naib Dewan of Baroda State. Mr. Nanavati had a rich background of administrative experience in the Baroda State in several important capacities, such as, Registrar of Co-operative Societies, Director of Commerce and Industries, Collector, Accountant-General, Revenue Commissioner and lastly Naib Dewan (Minister). Agricultural economics was his forte.

The appointment was for a term of five years. As regards Mr. Nanavati's salary, Sir James Taylor, in his memorandum to the Board, referred to the Joint Select Committee's view that though a higher salary might have to be paid initially, it should be possible to effect a certain reduction in the case of later appointments. Pursuant to this, the Board recommended a salary of Rs.4,500, the Government concurring in this recommendation.

Search for a European Deputy Governor

The vacancy of the post of Deputy Governor caused by the elevation of Sir James Taylor to Governorship was not filled. The Government of India and the Home Government 'felt that the interests of the Empire demanded also a European Deputy . . who should primarily be a banker and who would have more or less to be chosen by the Bank of England, so that the Reserve Bank retained the goodwill and confidence of the Bank of England' *. While Sir James Taylor did

* Sir C. D. Deshmukh, op. cit.

make some effort to secure a European Deputy, apparently his heart was not in it and he managed to carry on without a second Deputy.

In 1937, the Viceroy sought the assistance of the Chairman of the Bank of Scotland for a suitable person. The Viceroy wrote as follows:

The main qualification required is good practical banking experience. In addition to ordinary banking experience and skill the position requires that its holder should be a man of calibre above the average and of high educational qualifications. . . . Experience in the London office and in the Bill Market would be of real value. . . . We are thinking of a comparatively young man, say, between 35 and 40 years of age. . . . Naturally, I am thinking of the Bank of Scotland first. . . . My own opinion is that this opening constitutes a great opportunity for the right man.

The Chairman of the Bank of Scotland could not suggest a suitable person. Sir James Taylor remarked that the search seemed likely to be difficult and that he was always doubtful whether he should be able to find anyone immediately available.

In a memorandum to the Committee of the Central Board, dated June 24, 1937, Sir James mentioned that during his last visit to London actually five persons had been suggested but the results were negative, as the persons considered *prima facie* suitable could not be spared by their principals.

While the search for a European Deputy was to go on, Sir James decided to obtain immediately the services of someone, 'whether immediately suitable for the post of Deputy or not', having a real knowledge of central banking. For this purpose, as already mentioned in Chapter 4, Mr. P. S. Beale of the Bank of England was brought in, in the middle of 1937, as Secretary of the Bank, after he had been interviewed by some Directors of the Central Board who happened to be in England.

In July 1937, the Governor again wrote to the Governor of the Bank of England, confirming that they needed a European Deputy Governor. The requirements were described as follows:

We are looking for a man of about 37 to 40, that is to say, a man who will have already established his position as a banker of ability and promise and yet who will be sufficiently young to adapt himself to new conditions and, what is possibly as important, to the very different climatic conditions in the centres in which he will have to work, that is to say, Bombay and Calcutta. His main task, as I see it, will be to organize the building up and co-ordination of the immense Indian banking system on modern and scientific lines and if he is to be successful in this he will obviously require both experience and the ability to apply it well beyond the ordinary.

The Governor also indicated that the prospective candidate would be interviewed by one or more Directors of the Bank who happened to be in the U.K. at the time, if this could be done before October. A name was suggested in November 1937 and the candidate was just over forty and 'spare, active and wide-awake. He seems to be able to keep his head and sense of proportion, and to be tenacious and not easily abashed'. Sir James replied that none of the Directors was in the U.K. then and that on the other hand a visit to India of the candidate, which could not be kept secret, might provoke unfavourable reaction in the country. The idea was also mooted of bringing him in a temporary post in the following year. Sir James consulted Sir Purshotamdas Thakurdas about the candidate, suggesting that he (Sir P.T.) might also have a word with the Finance Member. Sir P.T. expressed the view that the candidate might not be suitable, which, he stated, was the view of the Finance Member too and so the proposal was not pursued. However, the idea of getting a European Deputy was revived towards the end of 1938, when, in the words of Sir Chintaman Deshmukh (in his Gokhale Institute Lecture),

India Office raised the question of management of the Bank should Taylor fall ill or take leave. The reaction from India was evasive, adducing the difficulty of finding the right type of European to import. As a short-term solution it was thought best to maintain a liaison officer to keep the Government of India closely in touch with developments by being Government's representative on the Board and also attending committee meetings. Against the contingency of Taylor becoming suddenly and permanently incapacitated, the Government of India thought a senior officer of the Imperial Bank would be most suitable.

The Liaison Officer selected was Mr. (later Sir) C. D. Deshmukh. He was nominated as Government Director on the Central Board in July 1939 and later, i.e., in October 1939, he was appointed as Secretary of the Bank. The story of Mr. Deshmukh's career in the Bank as Deputy Governor and Governor will be told in later chapters. Suffice it to say here that Sir James Taylor made conscious efforts to pave the way for early Indianisation of the Bank's Governorship.

Role of the Governor and the Central Board

The central banking institution of a country occupies a position of vantage in providing informed, well-considered and disinterested advice and guidance to Government not only on financial matters but also on various economic issues. Even from its early years the Reserve Bank played a significant role in this sphere of its work.

Over the years, on account of the increase in the number and complexity of the economic problems facing the country, many channels

of communication, at different levels, have developed between the Bank and the Government. But the principal responsibility for keeping the Government informed of important developments and of tendering advice has always devolved upon the Governor; this was particularly so in the first decade of the Bank's life. There were close personal contacts between the Governor and the Finance Member and his senior officials by his visits to New Delhi/Simla and their visits to Bombay/Calcutta. Although, naturally, the Bank's contacts were largely confined to the Central Government, with the inauguration of provincial autonomy under the 1935 Act, its advice was available to the Provincial Governments too.

Besides detailed correspondence on specific matters, the Governor initiated, in September 1937, the practice of writing, on Saturdays generally, a weekly demi-official letter to the Finance Secretary, containing a brief review of the money, exchange, bullion and commodity markets in India and abroad. In the pre-war and war years, happenings in the stock, bullion and share markets were of considerable significance to the monetary authorities. In these letters, the Governor also outlined the strategy regarding Treasury bill sales, sterling tenders, etc., etc. Till September 1937, the responsibility for keeping the Government informed on the state of the money and other markets was that of the Controller of the Currency; in fact, till that date, the Bank's official channel of communication with Government was the Controller. But, with the abolition of the Office of the Controller of the Currency from October 1937, this responsibility was taken over by the Bank.

In his letter of September 18, 1937 to the Finance Secretary, Sir James Taylor outlined the scope of the weekly D.O. letters as under:

In addition, I propose to write you weekly a confidential D.O. setting out informally any particular features of the week which I think would be of interest to you but without following any particular programme. It seems to me that the more and informal such letters are the better, and for this reason I should be glad if you 'would treat them as both confidential and ephemeral, that is to say, that they should be regarded as for the personal information of yourself and the Hon'ble Member so that they will not be circulated or recorded. This will enable me to write more freely and informally.

The Bank of England kept the Reserve Bank informed regularly, by letters and cables, of important developments in the London, European and American money, exchange and bullion markets. The Governor passed on the gist of these developments to Government, in the weekly letters.

Till about 1947, it was the practice for the Governor himself to write the weekly letter, except when he was out of India or indisposed. Subsequently, it came to be written by a Deputy Governor or an Executive Director, the change reflecting on the one hand the diminished importance of the stock and bullion market developments and on the other the substantial expansion in the range of the Bank's interests and responsibilities, many of which came to engage the Governor's personal attention.

The records reveal that in the formative years of the Bank the Central Board as a whole endeavoured to play an active role in the working of the Bank. The Directors endeavoured to safeguard the interests of the Bank and maintain the tradition of the independence of a central bank. The active Directors were mostly the Presidents of the local Boards of the Bank. The most distinguished and outstanding of these was Sir Purshotamdas Thakurdas. He was held in the highest esteem and confidence by both Sir Osborne Smith and Sir James Taylor as also the Deputy Governors, who consulted him on all matters of interest, major or minor. Likewise, the Finance Member and the Viceroy took him into their confidence on important matters relating to the Bank, including in particular the selection of Governors and Deputy Governors. His colleagues on the Central Board, too, looked to him for leadership. His policy as that of his colleagues on the Board was to co-operate on a constructive basis with the foreign Government in India, while trying the utmost to safeguard the Bank's and the country's interests. Sir P. T. was both a driving force and a restraining influence.

On various matters relating to the Bank's policies in the field of agricultural credit, indigenous banking, loans and 'discounts and recruitment of personnel, the Directors were active and alert, making suggestions to the Governor and the Deputy Governors, and discussing matters actively amongst themselves. Correspondence between individual Directors was not infrequent, canvassing support for this or that policy.

From the beginning some of the Directors showed themselves to be zealous guardians of the Bank's independence. At the very first meeting of the Central Board held on January 14, 1935, the Board adopted the following resolution moved by Sir P. T. and seconded by Dewan Bahadur (later Sir) M. Ramachandra Rao:

That in view of the statutory responsibilities of the Reserve Bank in the matter of credit generally and particularly of agricultural credit the Governor be authorised to express to the Governor General in Council the hope that Government will take the Bank into consultation on any legislative proposals relating to these matters.

On another occasion, the reply given in the Legislature in October 1937 by the Finance Member, Sir James Grigg, concerning the transfer of public debt functions to the Bank, prompted Sir P. T; to write to the Governor:

There was some question put regarding Government having adequate control over the Reserve Bank in view of the post of Controller of Currency being done away with. The reply of Sir James Grigg as I saw it in the papers was not only not clear but appeared to me to be somewhat unsatisfactory from the Bank's point of view. Surely, it cannot be Sir James's intention to exercise any control over the Reserve Bank which is not intended under the relative legislation. I wonder if you can throw some further light on this, because I do not think that the Bank should allow any wrong impression to exist in the minds of the public in connection with control of the Bank

The Governor's reply sought to put the matter in its proper context. He stated:

The Bill related to the final transfer of administrative duties in connection with the public debt. In the past we had to refer all matters to the Controller of the Currency for final orders. In future we can pass orders on any matter at our discretion but naturally Government reserve the right to give instructions on matters which may involve them in expense or loss, for example, law suits.

In the debate some speakers tried to raise the general question of the control of the Bank but Sir James Grigg made it clear that that had been settled and that all he was referring to was the subsidiary and routine matter of the administration of debt.

Changes in the Central Board

The Central Board also underwent changes during the period. A reference has already been made to the replacement of nominated Directors representing the Western Area (Bombay) by two Directors elected by the Local Board, which, however, did not involve any change in individuals constituting the Board. Consequent on the death of an elected Director, Mr. F. E. Dinshaw, there was a bye-election in the Western Area during 1936, and Mr. (later Sir) R. P. Masani was elected in the vacancy. The first election of Directors of the Central Board from the Eastern Area (Calcutta) took place in 1936. Rai Bahadur Sir Badridas Goenka retained his seat while Sir Edward Benthall, the other nominated Director, was replaced by Mr. B. M. Birla, who assumed office in January 1937. In May 1937, the Governor General nominated Mr. Satya Paul Virmani and Mr. C. R. Srinivasan to the Central Board from the Delhi and Madras registers, respectively, in the vacancies caused by the resignation of Sir Sundar Singh Majithia and the death of Dewan Bahadur Sir M. Ramachandra Rao. In the

same month, Mr. R. P. Masani resigned and Mr. Kasturbhai Lalbhai was elected by the Bombay Local Board in the vacancy.

The first elections of Directors from the Madras and Rangoon registers [which comprised one register for the purpose of Section 15(4)] were held in 1937 and Mr. C. R. Srinivasan and U Po Byaw, who were the nominated Directors, retained their seats. The election of Directors from the Delhi register was held in November 1938 and Lala (later Sir) Shri Ram and Mr. Satya Paul Virmani, who were nominated Directors under Section 8(1) (b) and Section 15(3), respectively, were elected. The former replaced Khan Bahadur Syed Maratib Ali, who was one of the nominated Directors representing the Delhi register and who did not stand for election. Subsequently, Khan Bahadur Syed Maratib Ali was nominated in place of Lala Shri Ram under Section 8(1) (b). Mr. J. W. Kelly, the Controller of the Currency, who was the Director representing Government of India, was replaced by Mr. (later Sir) A. J. Raisman, I.C.S., on October 1, 1937; the latter was replaced by Mr. K. Sanjiva Row during June-November 1938. In March 1939, Mr. (later Sir) C. E. Jones, I.C.S., was nominated in place of Mr. Raisman and in July 1939 Mr. C. D. Deshmukh, I.C.S., was nominated in place of Mr. Jones. Mr. Jones was renominated as Director in November 1939.

Local Boards

The general interest shown by the Local Boards on certain questions of policy has already been referred to at appropriate places in the earlier chapters. Under the Act, besides the election of Directors to the Central Board, the Local Boards were to advise the Central Board on such matters as might be generally or specifically referred to them and were to perform such duties as were assigned to them by the Central Board. However, broadly speaking, the primary duty entrusted to the Local Boards related merely to the registration of transfer of the Reserve Bank's shares. Some of the Local Boards were dissatisfied with this narrow role and expressed desire for greater responsibility in the consideration of policy issues before the Bank.

The Calcutta Local Board, at its meeting held on January 2, 1936, resolved to request the Central Board to reconsider its direction that Local Boards meet only once a quarter. The Local Board desired to have monthly meetings and to be furnished with a copy of the proceedings of the Central Board. Further, it wanted the Central Board to draw up a comprehensive list of powers which it proposed to delegate to the Local Boards and furnish such a list to them for their consideration and suggestions. Later, in April 1936, it made the suggestion that Local Boards should have the power to examine and frame recommendations

in respect of all applications for rediscount. The management or the Central Board said 'no' to all these requests, stating, 'the functions and powers delegated to the Local Boards are already set out in the General Regulations and the Central Board does not consider 'it necessary to make any further delegation at present'. Obviously, disposal of applications for discounts was too important a matter to be left to the Local Boards.

Likewise, in April 1936, in its report to the Central Board on its working for the first three months, the Madras Local Board complained that no question of policy or procedure had been referred to it till then. 'Important questions have arisen of which no knowledge has been vouchsafed to the Local Board'; this was obviously a reference to the Darling Report on agricultural credit. The Local Board, the report went on, had also no knowledge as to what was intended to be done in the matter of grant of accommodation to scheduled banks. Citing these two instances, which were intended to be merely illustrative and not exhaustive, the report urged that the time had arrived for entrusting to the Local Boards work of a responsible character. The Madras Local Board also desired that proceedings of the Central Board be made available to members of the Local Board.

The reply of the Bank was to justify the status quo. The letter began by saying that 'the work of the Central Board and its Committee is itself largely of a routine character' and so no useful purpose would be served by devolution of authority. The hope was expressed, however, that 'there is no reason, however, to anticipate that this state of affairs will be permanent, as the activities of the Bank develop'. The Bank also said 'no' to the request for circulation of proceedings of the Central Board as they were 'confidential'. However, shortly thereafter, the Governor relented and recommended the circulation of the proceedings of the Central Board and of its Committee to members of Local Boards for their perusal and return, to which the Central Board gave its concurrence.

Again, the Madras Local Board in its quarterly report for April-June 1936 referred to the proposals for the revision of election regulations and complained that the Local Boards should have been consulted about the matter. Its request in January 1937 that in suitable cases the Local Boards be permitted to take legal opinion in the matter of transfer of Reserve Bank shares was turned down; the Bank management was of the view that, in the interests of uniformity, this matter had to be dealt with in the Central Office of the Bank which, as already mentioned, used to move between Bombay and Calcutta, in the pre-war years.

There was also some correspondence among Directors on the subject of increased responsibility for the Local Boards. Thus, Mr. C. R.

Srinivasan, President of the Madras Local Board, sought to mobilise the support of Sir Purshotamdas Thakurdas for the fuller utilisation of the Local Boards. Sir P. T. replied that his opinion from the very start had been that the Local Boards would be in the nature of a fifth wheel to the coach of the Reserve Bank but he agreed that something should be done to make greater use of these Boards. Writing again to Sir P. T., Mr. Srinivasan remarked that even fifth wheels were no longer being treated as clogs but as controls. Sir P. T. thought that perhaps after some years, when the Bank had settled down to its functions, this feeling of disappointment would disappear; in his opinion, Local Boards should have been brought into existence at this later stage.

Since 1943, applications for opening of new banks and for increase of capital by existing banks came to be referred to the Local Boards for their recommendations, while since 1946, in view of their knowledge of local conditions, their advice was sought on the reports of inspections of banks and on applications from banks for opening of new branches.

In subsequent years too, the question of the place of Local Boards was raised and at one stage, in the year 1956, an unsuccessful attempt was made to abolish them.

Annual Meetings of Shareholders

Annual meetings of shareholders are, generally speaking, a tame affair all over the world. The meetings of central bank shareholders are not very different. Under the Reserve Bank of India Act, the main function of the shareholders was to elect members of the respective Local Boards. So far as annual meetings were concerned, the two items of business were (i) consideration of the balance-sheet, the profit and loss account and the auditors' report and (ii) the selection of auditors and the fixing of their remuneration. The dividend to be paid was fixed by the Governor General in Council. The main item of interest in the annual meetings of the Bank was the address of the Governor, supplementing the information contained in the Report of the Directors and discussions on some of the important matters engaging the Bank's attention.

The first annual general meeting was held on February 3, 1936 in Calcutta. 2,677 shareholders were present, 66 in person and the rest by proxy. (In this connection, it is interesting to mention that at the shareholders' meetings of the Bank of England, prior to nationalisation, the attendance of shareholders did not exceed about a dozen.) The Governor's address was devoted mostly to explaining the various items on the assets and liabilities sides of the statements relating to the Banking and Issue Departments and little else. The first meeting appeared to have been rather lively, with some points of order raised by shareholders, by way of complaints regarding late circulation of accounts

and balance-sheets. There were also requests for various items of information. However, general satisfaction was expressed at the 'successful working of the Bank' and 'for the large profits made'. The profits for the nine-month period covered by the report amounted to Rs. 56 lakhs, out of which dividend was paid at the rate of 3½ per cent, the surplus of Rs. 43 lakhs being transferred to Government. The figures of income and expenditure for the first four years are given in the table below*:

(Rs. lakhs)

| | 1935 (9 months) | 1936 | 1937 | 1938 |
|---|--------------------|--------|--------|--------|
| Income | 125.92 | 155.49 | 127.11 | 136.70 |
| Expenditure | 69.86 | 102.07 | 99.20 | 98.25 |
| Of which | | | | |
| (a) Establishment | 22.50 | 33.17 | 34.86 | 34.34 |
| (b) Agency charges | 17.26 | 24.13 | 24.96 | 25.13 |
| Net Balance. | 56.06 | 53.42 | 27.91 | 38.45 |
| Of which | | | | |
| (a) Dividend at 3 l/s per cent. . | 13.13 | 17.50 | 17.50 | 17.50 |
| (b) Surplus paid to the Central Government | 42.93 | 35.92 | 10.41 | 20.95 |

In the next three years the net balance was not as much as in the nine-month period of 1935. Cheap money conditions affected the Bank's earnings. However, during these three years the establishment expenditure remained fairly constant, around Rs. 34 lakhs. The dividend remained unaltered at 3½ per cent, which meant that the surpluses paid to Government were smaller.

The second annual general meeting was held on February 8, 1937 in Bombay. 424 shareholders were present either in person or by proxy. This was presided over by the 'senior' Deputy Governor, Sir James Taylor. The Chairman's address contained a review of economic and financial trends and a discussion of the problems before the Bank. It would appear that only three shareholders spoke. One of them enquired about the reason for Sir Osborne Smith's 'retirement' from the Bank. The other made a request that copies of the report and accounts might be supplied to every shareholder of the Bank by post. The third criticised the form of the balance-sheet of the Bank and enquired 'why the Bank had maintained the same rate of 3 per cent for so long and why they could not reduce it to a lower figure'. The shareholders also passed unanimously a resolution, expressing their 'deepest regret' on Sir Osborne's retirement and placing on record 'their deep sense of appreciation of Sir Osborne Smith's single-minded devotion to the

* Till 1939 the Bank's accounting year was the calendar year.

Bank's interest in organising the affairs of the Bank from its commencement '.

The third annual general meeting was held in Delhi on February 7, 1938, attended by 512 shareholders, present in person or by proxy; there were neither questions nor comments by the shareholders. The same was true of the fourth annual general meeting held in Madras on February 6, 1939, the attendance being 514 shareholders either in person or by proxy.

THE WAR TEARS: 1939-45

Organisation, Management and Allied Matters

For the Reserve Bank of India, as for the Indian economy and indeed generally for central banks everywhere, the years of World War II constituted a distinct and important phase of history. To an extent the war interrupted the normal evolution of the new central bank. Yet the Bank had developed sufficiently to be able to face with reasonable success the numerous and complex problems created by the war. Not only did the war bring challenges but it also offered some opportunities. A landmark of the war years was the appointment of the first Indian Governor, though the opportunity for this came in a sad way, through the premature demise of the British Governor who, it must be added, had consciously worked for Indianisation; the predominantly Indian Central Board of the Bank played an important role in this matter, as in many others involving the national interest.

Although India was not an actual theatre of war except for a brief period on its eastern borders, the economic and financial problems it had to tackle were not dissimilar in character to those of the countries which were the scene of warfare. As a member of the British Empire, India was called upon to support the Allied war effort with men and resources. The country's contribution to the war effort, in fact, proved to be considerable.

The purchases of war materials and services in India by the Allied Governments resulted in a large accretion of sterling balances, posing problems of utilisation in a manner most beneficial to the country. The immediate problem was one of restraining currency expansion, which became automatic on account of the sterling-rupee link, and the upsurge of inflation, accentuated by acute shortages of domestic consumption goods and severe contraction of imports. These were the

principal matters engaging the attention of the Reserve Bank during the war years, thus reversing the nature of the anxieties of the pre-war years. In the earlier period, the acquisition of sufficient sterling to meet the Home Charges of Government and the maintenance of the ratio of 1S. 6d. were not always easy matters; also, while reflation was very much needed, the Bank could not pursue a basically expansionary policy during those years because of the rigidity of the sterling-rupee link.

Its teething troubles by then over, the Bank was in a position to play its role as banker to Government in financing the war. But the efforts to combat inflation met with limited success; the additions to its sterling balances and currency in circulation were largely due to political and constitutional factors beyond the Bank's control. In these circumstances not much could have been achieved by an active monetary policy, especially through enhancement of interest rates; indeed, as in most countries the pursuit of cheap money policy during the war period became a well accepted objective. However, the Bank did employ open market operations fairly successfully; and in certain other spheres, such as the repatriation of India's sterling debt, the Bank played an important role and much initiative came from the Bank itself.

The war saw the introduction of exchange control in India. The Reserve Bank not only administered the control, but was also Government's adviser in this matter, as in all financial matters. Exchange control helped the Bank to familiarise itself with the practical operations of the world of international finance. In the realm of external finance, a significant development was the Conference at Bretton Woods in July 1944 for the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development. The Reserve Bank played an active role in the consultations and deliberations leading to India's membership of these institutions.

In the sphere of banking regulation, although in a sense the enactment of comprehensive legislation was more urgent, its consideration was delayed and only ad hoc enactment of some urgent measures of regulation was resorted to. However, towards the close of the war, active steps were taken in hand for the enactment of the Banking Companies Bill.

As regards rural credit, the Bank's major contribution lay mainly in the field of study of and advice on such matters as the organisation of the co-operative movement, legislation to regulate moneylending, establishment and financing of land mortgage banks and setting up of licensed warehouses. But a beginning was made in respect of the grant of credit facilities to the co-operative sector, the credit being made available at a concessional rate. The Bank was also actively

associated with the drawing up of post-war plans in the sphere of rural credit.

The Bank also played an active role in the formulation of proposals, as part of post-war planning, for the establishment of special institutions for the financing of industry.

A landmark in the Bank's organisational development was the establishment, in August 1945, of a full-fledged Department of Research and Statistics and a Department of Banking Operations, as a preparation for the expanded and more active role the Bank was to play in the post-war years in the fields of formulation of monetary and public debt policy, regulation of banking and promotion of financial institutions and functioning as Government's economic and financial counsellor.

The war years were thus eventful for the Bank. Though there was not much scope for monetary experimentation, the Bank had to be very active in the performance of what may be regarded as the routine central banking functions of banker to Government, manager of the nation's currency and custodian of the country's international reserves; there was room for initiative on the part of the Bank in these matters. The war witnessed a substantial growth of banking and monetisation of the economy. The Bank's contacts with the money market and banking system also became more intimate.

All in all, it could be said that at the end of the war the Bank was organisationally ready to face the problems of transition to a peace economy, to weather the storms of partition of the country and to participate in the efforts to speed up economic growth through a series of economic plans.

It is convenient to cover briefly the developments concerning the Bank's organisation, management and allied subjects before dealing with those relating to the financing of the war effort and its consequences, and other important matters. Not all the developments are inter-connected but they are being mentioned together in one chapter for the sake of convenience. There are also some matters which are not of much current interest but which ought to find mention in a history. On the other hand, a development like the appointment of Mr. C. D. Deshmukh as Governor had undoubtedly a significant impact on the direction of the Bank's policies, not only in the matter of safeguarding India's interests but also in anticipating the expansion of the Bank's role in the task of development of the economy in the post-war period.

Exchange Control Department

To cope with the growing load and variety of work consequent on the war, the Reserve Bank had to expand its staff, open new offices and

also create new Departments and Sections. The war, and especially its extension to the eastern hemisphere, called for special arrangements to safeguard the Bank's records, securities and cash.

The immediate organisational problem posed by the war was the establishment of an exchange control wing in the Bank. Although the exercise of control over transactions in foreign exchange was a function of the Central Government -they had assumed powers for such control under Part XIV of the Defence of India Rules -it was decided for reasons of administrative convenience that control in India and Burma should be exercised by the Reserve Bank, as their agent. Preliminary arrangements for the introduction of exchange control had been made well before the outbreak of the war but were kept secret. The necessary notices and circulars were prepared by the Secretary's Department of the Bank under the immediate supervision of the Governor. It was realised, however, that the work of control over all the foreign exchange transactions would necessitate the creation of a special department and a few days after the war started the Exchange Control Department was formally established. The Governor looked to the Secretary (Mr. Beale) for assisting in the organisation of the new Department. With the Bank of England's request for the return of Mr. Beale coming close on the heels of the Department's establishment and delay in Mr. Ram Nath, who was coming back from England, being available to relieve him, the question of finding someone to assume charge of this work became urgent. Mr. H. D. Cayley, who was working with the National Bank of India at Calcutta, was selected for this job. The deputation arrangement was continued by the Reserve Bank till the end of February 1948,* so that his experience of exchange problems during the war might be available to the Bank in sorting out complicated post-war problems. Some of these arose out of the arrangements made with the British Government for the utilisation of the sterling balances; and others concerned the implementation of the policies of the International Monetary Fund and the International Bank for Reconstruction and Development, for which some measure of exchange control would be necessary for a number of years.

The headquarters of the Exchange Control Department were located in the Central Office of the Bank in Bombay under the immediate charge of Mr. Cayley who was designated Deputy Controller, the Governor being ex-officio Controller. (It was a generation later, that is, in February 1962, that the Officer in charge of the Department came to be designated as the Controller). In Calcutta, on account of the volume of work, a separate branch of the Department was formed under the charge of an Assistant Controller; at Bombay, all the regional

* Mr. Cayley later became the Chief General Manager of the National and Grindlays Bank Ltd., London.

exchange control work was handled by a section of the Exchange Control Department there placed under a separate Assistant Controller. At the other centres, the Managers were appointed ex-officio Assistant Controllers and looked after all exchange control matters 'in their respective areas. At Lahore, exchange control work was taken up in 1940 with the establishment of a branch of the Banking Department, but at Cawnpore a beginning was made only on July 18, 1942. The system worked smoothly and ensured that applications for foreign exchange by the authorised dealers were dealt with expeditiously.

With the intensification of warfare in the Far East and growth in the volume of transactions, it was thought desirable that an officer with exchange control experience should be sent to the Rangoon Office of the Bank. For a short while the services of Mr. Claude E. Loombe of the Chartered Bank of India, Australia and China were available. Later, Mr. G. O. W. Stewart of the Hongkong and Shanghai Banking Corporation took his place. Mr. Stewart proved to be of invaluable assistance in the arrangements for closure of the Rangoon Office in 1942 and during all the stages of its reopening after the war was over.

Expansion of the Banking Department

With the institution of exchange control, it was considered desirable to make available fuller banking facilities at Karachi and so a branch of the Banking Department was established there on February 1, 1940. For the same purpose, a branch of the Department was opened at Lahore later that year, with effect from October 18. Besides organising exchange control work with respect to the surrounding districts, these branches maintained principal accounts of the scheduled banks and managed the Clearing House. The branches did not, however, take over Government business from the Imperial Bank as the existing agency arrangements at those centres were working smoothly and any change would have involved the question of the terms of remuneration of the Imperial. The Managers were, nevertheless, available to the Provincial Governments for consultations and were to serve as a link between the Central Office and those Governments in matters such as the floatation of loans, issue of Treasury bills and grant of ways and means advances.

The Bank's policy to extend its banking activities found further expression in the opening of a branch of the Banking Department at Cawnpore on August 1, 1942, with restricted functions* as at Karachi and Lahore.

* The Department came to be entrusted with the conduct of limited Government business only as late as April 1966.

Administrative Problems caused by War

The outbreak of war with Japan in December 1941 rendered the eastern borders of India and Burma vulnerable and special steps had to be taken to protect the records, securities, cash balances, etc., of the Bank's Offices at Rangoon, Calcutta and Madras, and even of Bombay as a precautionary measure.

At Rangoon, at the first signs of danger, arrangements were made for the duplication of records of balances and daily transactions and for the preservation of the duplicates at the Imperial Bank of India at Mandalay. Later, the surplus balances and securities which could be safely shipped to Calcutta were despatched there, while the records were sent to Mandalay. Simultaneously, all further consignments of notes and coins to Rangoon were stopped and steps were taken to reduce the balances of the outlying currency chests; soon afterwards, some of the chests were closed.

The situation worsened steadily and it was considered advisable to shift the Issue Department balances still at Rangoon to Shwebo, in northern Burma. The banks in Rangoon closed on February 20, 1942 and reopened at Mandalay five days later. Between these two dates, the Reserve Bank's Office shifted to Shwebo, leaving a small staff to meet military and other Government disbursements. Two months later, that is, on April 21, the Government of Burma decided that the Bank's Rangoon Office should close. On account of transportation difficulties not all the employees could reach India.

The war developments in Burma created problems also with respect to the maintenance of the Rangoon register of shareholders and the functioning of the Rangoon Local Board. Elections to the Local Board were due to be held towards the end of 1942 according to the roster. A majority of the shareholders on the Rangoon register were Indians who had transferred their domicile to India with the onset of the emergency and there was some prospect of arrangements being made for the Government of Burma to function at a centre in India in an attenuated form and possibly for a limited purpose. The question therefore arose whether an effort should not be made to comply with the requirements of the law by holding a shadow election in India but such a course was ruled out. Considering all the circumstances, it was decided to keep elections to the Local Board in abeyance; the members who were due to vacate office on the election of their successors were thus to remain in office only nominally. The Director elected to the Central Board was to continue in office in the same way, after the expiry of his five-year term. As, in the nature of things, it had become impossible for the Local Board to carry out its functions, it was also necessary to suspend its activities and to empower specifically another body to perform them.

With the closure of the Rangoon Office, the Rangoon shareholders' register had also to be maintained at a suitable place in India. To give effect to these proposals, the Government of India issued an Ordinance at the Bank's request on August 21, 1942, authorising the Central Board to take the necessary action. The Ordinance also validated all action taken in respect of any matter pertaining to the Rangoon share register including the exercise of the functions of the Burma Area Local Board on or after February 1, 1942. In modification of the provisions of the Reserve Bank of India Act [Section 9(4)], the Central Government were to fix a date by notification in the Gazette of India for the election of the Director to represent this register. In terms of this Ordinance, the functions of the Rangoon Local Board were first entrusted to the Manager of the Rangoon Section in Bombay and later (in December 1942) to the Chief Accountant, Central Office, at Bombay, after the Rangoon Section had been almost completely disbanded and it was considered unnecessary to retain a separate Manager in charge of it.

As the war clouds spread further westwards, steps had to be taken to evacuate partially the Calcutta, Madras and Bombay Offices also. From Calcutta, the Public Debt Office and most of the Securities Section (dealing with the security deposits of insurance companies) were transferred to Cawnpore during March and April 1942, leaving a skeleton section to deal with such work as could not be conveniently transferred to a centre outside Calcutta. The Central Accounts Section, which maintained the main accounts of the Central and Provincial Governments, Railways and the Imperial Bank, was likewise shifted to Allahabad in April. In order to reduce the balances of the Issue Department at Calcutta as much as possible, a number of currency chests of the Calcutta circle were transferred to the jurisdiction of the Currency Officer, Cawnpore. Further, the supply of fresh currency notes and coins to the Calcutta Office as well as to the chests linked to it was drastically reduced and the quantities surplus to their immediate requirements were arranged to be held at Cawnpore.

Similar schemes were drawn up for removing the non-essential sections and departments at Bombay and Madras to safer places in the interior. The Central Debt (Accounts) and the Fund (Accounts) Sections of the Central Office at Bombay were shifted to Allahabad, where they commenced functioning from June 1, 1942, under the Manager in charge of the Central Accounts Section there. The Securities and Share Transfer Departments, Public Debt Office and Issue Department Registration branch of the Madras and Bombay Offices were arranged to be shifted to Akola in Berar between May and July 1942. Some of the Madras sections including the Public Debt Office had been moved to Bombay a little earlier and were reshifted to Akola

along with the corresponding Bombay sections; the other sections/ departments were shifted from Madras to Akola direct. Under instructions from the Madras Government, the remaining sections of the Issue Department housed in the Fort St. George, which it was essential to retain at Madras, were removed to leased premises inside the city; so was the Banking Department functioning at the First Line Beach. As at Calcutta, arrangements were made with the Nasik Press and the Imperial Bank branches in the interior for dispersal of the Issue Department balances as widely as possible.

Instructions were issued to all the offices for duplication of all the vital records and their preservation at places far removed from vulnerable areas, as well as for the safety of the Bank's secret codes. The Issue Department's holdings of gold were also shifted to an inland centre.

Various kinds of special allowances, benefits and compensation were sanctioned to the Rangoon Office staff in view of the extraordinary difficulties they had to face. The Bank also proposed to absorb, in one or the other of its offices in the country, nearly all those who were able to return to India eventually. The Bank came forward equally readily to give financial assistance to the staff at the other centres also, particularly those who found themselves obliged to leave their homes at short notice and go to other places of work. In Calcutta, where there was near panic as a result of the air raids, a special compensatory allowance was introduced, in order to encourage the staff to stand by their posts. On the other hand, the employees who deserted their posts in Burma during crucial stages of the functioning of the Office were dealt with sternly. Happily, such cases were very few.

Early in 1945, it became apparent that the Bank would shortly have to reopen its Rangoon Office. In March of that year, it was notified that the Rangoon register of shareholders and the Rangoon Office functioning at Bombay would be transferred to Calcutta in the first instance. The duties and functions of the Rangoon Local Board were also simultaneously entrusted to the Manager at Calcutta. Arrangements were thereafter put in train to reconstruct the different sections and build up the staff necessary to man the Office. As a first step, the Rangoon Section was closed at Bombay on the forenoon of March 22 and reopened at Calcutta on April 2. The re-establishment of the office was carried out in stages so as not to burden it with more work than it could cope with.

The Bank's building at Rangoon was not damaged seriously by the ravages of war but practically no furniture was left and all the vaults had been broken into. Mr. Brian Reynolds, War Correspondent of the Times of India reported* on the situation thus:

* May 9, 1945.

In the large white-pillared Reserve Bank of India, where I was taken by a British officer now guarding it against further looters, the underground safes and strong rooms had been broken open. Millions and millions of rupee notes have been stolen. And one walks about the building knee-deep in them. Some of the vaults were not easily opened, but the looters, who appear to have been expert safe breakers, had bored holes in the thick concrete walls. Inside many of the safes were dead bodies of. Burmans slashed to pieces. They had apparently fought among themselves.

The building was quickly made serviceable and the Bank commenced functioning at Rangoon with effect from August 20, 1945. Conditions in Burma were not, however, considered sufficiently stable to permit retransfer of the Rangoon register and the Securities Department to that office; the repatriation was, therefore, to be held over until the return of the civil Government. However, the Rangoon register remained at Calcutta throughout.

The conditions under which the Rangoon Office had to function when it was reopened were extremely trying. There was no water supply, no electricity, no sanitation and no telephone in the office premises. The exceedingly difficult living conditions in Burma prompted scheduled banks to put off their re-entry into that country till long after the Reserve Bank had established itself.

With the brightening of the prospect of Allied victory and the early cessation of the war, the emergency receded and the functioning of the various offices gradually returned to normal. The departments of the Madras and Bombay Offices which were functioning at Akola were repatriated to the respective home centres by the end of February 1945. Retransfer of the Calcutta sections at Cawnpore was completed by November 1945 and the sections of the Central Office located at Allahabad returned to Bombay in May 1946. The Central Accounts Section of the Bank at Allahabad, which was the last to close, reopened at Calcutta on January 29, 1947.

Economic Intelligence and Reorganisation of A. C. D.

The increase in the complexity and diversity of the problems handled by the Bank during the war time necessitated the collection and study of monetary, financial, banking and other data on an ever-increasing scale. The importance of this work for the Bank's normal functioning in the post-war period came to be such as to merit the establishment of a full-fledged department, with effect from August 1945. However, even prior to this, steps were taken to strengthen the section in the Agricultural Credit Department dealing with these matters.

Among the periodical compilations and reports prepared by the Bank, mention may be made of the monthly Statistical Summary, the annual Report of the Central Board to the shareholders, the annual Report on Currency and Finance, the Weekly Report to the Committee of the Central Board on financial conditions, the weekly Demi-official Letter to Government on the position of the money market, the Weekly Letter (it was issued monthly from December 1939) to the Empire central banks and the Review of the Co-operative Movement in India, commencing with the review for the year 1939-40. Many special studies were made on national and international finance. The important ones were the census of industrial share values in India since the beginning of the war, conducted late in 1941 and revised and brought up to date from time to time; and studies of sterling investments in India, repatriation of India's sterling debt, and issues relating to compilation of India's international balance of payments. There were studies on the budgets of the Central and Provincial Governments in India and Indian war finance, the post-war monetary plans, the effects of war on Indian banking, the war-time absorption of currency, wartime controls on commodities, the British Government budgets, the role and significance of the Bank rate in the U. K., the U.S.A. and India, distribution of world gold stocks, post-war planning, and the general relationship between central banks and Treasuries. Mention may also be made of statistical studies of the developments in public debt, revenue and expenditure of the Empire countries and the U.S.A.; a comparative study of war finance in the Empire countries; and comprehensive bibliographies of the literature on inflation and the principles and practices of price control.

The work of compilation and publication of the Statistical Tables relating to Banks in India and of the Statistical Statements relating to the Co-operative Movement in India was taken over from the Director General of Commercial Intelligence and Statistics; the first issue of the former, covering the years 1939 and 1940, was published by the Bank in July 1941 and the first issue of the latter, for the year 1940-41, came out a year later.

With the object of enabling the business sections of the country as well as the general public to obtain a clearer conception of the nature and range of the Bank's activities a comprehensive brochure entitled Functions and Working of the Reserve Bank of India was brought out in July 1941.

A natural corollary to the enormous increase in the work devolving on the various sections of the Agricultural Credit Department was its substantial reorganisation in August 1945. From small beginnings, the Department had branched out into multifarious activities. In February 1937, a Statistical Section was started in the Department.

The Department was sub-divided a little later into three distinct sections, viz., (1) the Agricultural Credit Section, to deal solely with the problems arising out of agricultural credit and the co-operative movement and legislation in connection therewith, (2) the Banking Section, to deal with scheduled banks' statutory returns, balance-sheets, etc., bank inspections, the Bank's relations with the non-scheduled banks and indigenous bankers and matters relating to banking legislation, and (3) the Statistical and Research Section, to collate and record statistical information, prepare the Bank's Report on Currency and Finance and the Board's annual report to the shareholders and undertake special studies of various monetary and fiscal problems.

With an increasing part of the time of the Officer-in-Charge of the Department taken up in maintaining personal contacts with the Provincial Governments, and the growing specialisation in the work of the Statistical and Research Section, it became clear that there was need for a competent economist to be entrusted with the duty of collecting and maintaining all the varied statistical and economic material so essential for the shaping of central banking policy. A post of Director of Research to be in charge of this Section was therefore created early in 1941 and Dr. B. K. Madan who, since 1940, had been the Economic Adviser to the Government of Punjab became its first incumbent in the middle of that year. After holding higher positions like Economic Adviser and Executive Director, Dr. Madan became a Deputy Governor of the Bank in July 1964.

In the middle of 1943, the Research Section was expanded for undertaking a fuller study of problems of central banking and wartime fiscal and monetary developments as a background to the proper consideration of questions like controls, planning for reconstruction and development and international currency and exchange arrangements that were likely to arise in the post-war period. Towards the end of that year, the Bank arranged to obtain the services of Mr. J. V. Joshi, the Deputy Economic Adviser to the Government of India, on loan as Senior Economist for the purpose not only of advising the Bank on economic matters including currency and central banking, but also for reviewing and suggesting improvements to the existing machinery for collection and co-ordination of economic intelligence; Mr. Joshi was later to become the Bank's first Economic Adviser. Mr. Joshi served the Bank for over a decade. After a four-month spell as Deputy Governor, in a leave vacancy in the latter half of 1952, Mr. Joshi worked as an Executive Director for two years, retiring in January 1955.

In the closing stages of the war, there was further increase in the work of this Section, associated with the collection and interpretation of a wide variety of economic data. Besides the examination of domestic

financial problems which were bound to increase during the transition to a peace-time economy, the proposed international organisations, the International Monetary Fund and the World Bank, were expected to ask for a large mass of information from each member country, a considerable part of which would have to be compiled by the central banks of these countries. The advanced countries, e.g., the U.S.A., Canada and the U.K., had already expanded and geared up their research organisations, both official and non-official, to cope with the tasks ahead. In India, apart from the research work done by the Reserve Bank and one or two universities, the position was highly unsatisfactory; the financial and economic data available were both meagre and of poor quality. It was therefore imperative that the Bank expanded its own research organisation to be able to undertake the work on a scale that would be adequate for coping with the growing responsibilities devolving on it.

Over the years, the work which the Banking Section of the Department had to undertake also grew enormously. There was a marked expansion in the work of supervision over banks, centralised in this Section. The work consisted of statutory duties under the Reserve Bank Act and the Scheduled Banks' Regulations, duties of an advisory nature such as advising the Government regarding the financial position of banks on their applications for inclusion in the Second Schedule and for the issue of capital under the Defence of India Rule 94A, banking intelligence covering maintenance of statistics regarding scheduled and non-scheduled banks, branch banking, publication of statistics relating to banks, and the study of banking conditions in India and abroad. Under the proposed legislation to consolidate and amend the law relating to banking companies, introduced in the Legislative Assembly on November 16, 1944, the Bank was being called upon to undertake several additional duties and responsibilities, especially in the matter of receiving returns from banks, inspection and liquidation. For the satisfactory discharge of these additional functions, it was felt necessary to expand this Section substantially and also to establish regional offices at important centres under the local Managers.

With a view to achieving these objects, the Agricultural Credit Department, which had by then practically become a loosely knit organisation of three separate units, was reorganised with effect from August 1, 1945, and two new departments, viz., the Department of Research and Statistics and the Department of Banking Operations, were set up. The first was to function under the general supervision of the Economic Adviser to the Bank, the first incumbent of the post being Mr. J. V. Joshi. The establishment of the Department owed much to the initiative of the Governor, Sir Chintaman Deshmukh; the detailed planning of this Department was the work of Mr. Joshi, ably assisted by Dr. B. K.

Madan who, for this purpose, visited important economic, financial and central banking research institutions in the U.S.A. and Canada in 1944, at the conclusion of his assignment as Secretary of the Indian Delegation to the Bretton Woods Conference. Even in many of the developed countries it is only in the last 10 to 15 years that the establishment of a full-fledged research department in the central bank has received impetus. The foresight of the senior executives and that of the Directors of the Central Board who enthusiastically supported the Governor's proposals, is indeed praiseworthy. The Department was conceived on very broad lines, to undertake research work and provide guidance to the authorities not only in the narrow sphere of money and banking but over a broad spectrum of economic problems. The Department was organised into three major Divisions, the Division of Monetary Research, the Division of Rural Economics and the Division of Statistics, the first Directors of the Divisions being Dr. B. K. Madan, Mr. B. R. Shenoy and Dr. N. S. R. Sastry, respectively. The Officer staff of this Department were recruited mostly from outside the Bank, through advertisement and selection by interview. Over the years this Department, like most others, has recorded a marked expansion reflecting the growth of the Bank's responsibilities in range and depth.

Till about 1951, that is to say, prior to the inauguration of the Five Year Plans, the Central Government's economic staff were on the whole small, and during those years in particular it was customary for Government to draw upon the Bank's expertise and personnel in the handling of various economic issues and in filling the Indian delegations to various international economic conferences. .

The new Department of Banking Operations dealt with all problems relating to the scheduled and non-scheduled banks, such as fixing credit limits for the scheduled banks, carrying out on behalf of the Central Government inspections of banks applying for inclusion in the Second Schedule and of those which *prima facie* appeared to be unsuitable for retention in the Schedule, studying the balance-sheets and other returns submitted by banking companies, rendering advice on banking and financial matters to banks and Governments, banking legislation, etc. In order that the Bank became fully conversant with the procedure for bank inspections adopted by central banks in other countries, Mr. T. V. Datar, who was the Officer-in-Charge of the Banking Section of the Agricultural Credit Department and became the head of the new department, was deputed to the U.S.A. in 1945 for a few months to study the system of bank examinations and bank supervision obtaining in that country.

The residual Agricultural Credit Department, which consisted of only the Agricultural Credit Section, was then left exclusively with the discharge of the functions arising under Section 54 of the Reserve Bank

Act and was thus organisationally better geared to play an active role in the sphere of agricultural finance.

Bank's Functioning in Burma

The Burma Monetary Arrangements Order, 1937, contemplated that at least for a period of three years from the separation of Burma from India the currency and exchange of both countries should be closely linked and managed by a common central bank. During the currency of the Order, the Reserve Bank was also to act as banker to the Government of Burma. The Reserve Bank continued, however, to be the currency authority for Burma until June 1942 when it was divested of the liability for the note issue in that country. Its function as banker to the Government of Burma continued, though in an attenuated form, even after the Government moved their headquarters temporarily to India in the spring of 1942 under the stress of the Japanese war and the Bank's office in Rangoon was evacuated to this country. At the close of the war, the Bank undertook limited functions for a short while for the British Military Administration in Burma prior to the return of the civil Government. The Bank ceased to function as banker to the Burma Government with effect from April 1, 1947 only, on expiry of the notice of termination of the Burma Monetary Arrangements Order served by that Government.

By exchange of correspondence between the Bank and the Burma Government, it was agreed that the Government of Burma would maintain a minimum balance with the Bank of Rs. 85 lakhs on Fridays and Rs. 75 lakhs on other week days and that ways and means advances would be made whenever, required by them on lines similar to those adopted for the Provincial Governments in India.

Till 1942, the Burma Government did not, as a matter of fact find it necessary to take any ways and means advance. With the Japanese invasion, however, the finances of the Government were seriously upset and pending completion of long-term arrangements, the Bank agreed, in March 1942, to give ways and means advances, repayable within three months, in multiples of Rs. 25 lakhs so as to maintain the minimum balance of the Burma Government at Rs. 85 lakhs, and also offered to purchase their holdings of Government of India securities at the minimum prices fixed by Government. By early April, the total amount advanced had risen to about Rs. 2.25 crores. At the same time, however, in view of the indefinite and special nature of the responsibility to finance the Government of Burma who had hardly any income of their own, the Bank considered it necessary to get the British Treasury to guarantee the advances made by it. The British Government agreed to guarantee the Bank's advances. The minimum balance which the

Burma Government had to maintain with the Bank was reduced to Rs. 25 lakhs towards the end of May 1942. The maintenance of even this minimum balance was waived in March 1946, i.e., some time after the Government of Burma returned to their headquarters in Rangoon, and a different arrangement was devised to compensate the Bank for its services.

In terms of the Burma Monetary Arrangements Order, the Bank issued for some time after separation overprinted Government of India notes for circulation in Burma and in May 1938 the Bank began to issue distinctive Burma notes, which were not legal tender in India. Indian currency notes other than Government of India one rupee notes were deprived of their legal tender character in Burma after March 31, 1942, by a Government of Burma notification issued on October 29, 1941.

With the occupation of Burma by the Japanese, the Bank's continuance as the currency authority for Burma was beset with many difficulties. The overrunning of the country by the Japanese placed them in possession of huge quantities of Reserve Bank Burma notes and the problem was how to prevent effectively their unauthorised infiltration into India and their being used by the enemy for fifth column activities in India. Of course, with the country under total enemy occupation and with no agency of the Bank or the Government of Burma functioning in that country, Part II of the Burma Order, which laid down the Bank's obligations in Burma in regard to payment of legal tender currency in exchange for its notes and doing various other things, could be considered as having ceased to have any legal effect. However, the Bank felt that this was not sufficient justification in itself for its refusing to honour in India the liabilities it had incurred in Burma. In the case of the commercial banks, although they could not statutorily be compelled to pay in India their deposit liabilities in Burma, they were anxious to do so for the sake of their prestige and good name. The Bank was itself following the same policy in respect of the banks' accounts with it, not to speak of the accounts of the Government of Burma. The Bank regarded that there was a moral obligation on it to honour the Burma notes if legitimately presented to it. In fact, since January 1942 the Bank's offices, and subsequently the Imperial Bank branches and certain Government Treasuries were authorised to encash Burma notes at a small discount. As such encashment was obviously undesirable on political grounds, it was essential that the import of Burma notes should be rigidly controlled.

The total of the Burma notes which the Bank had duly issued amounted to about Rs. 30 crores and the Bank had full cover against them. It was clear that not much of this would be presented for payment in India, even allowing for the currency percolating to India

through enemy agents. There was, on the other hand, the liability on account of the note forms lost in the currency chests -estimated at approximately Rs.10 crores -which had to be deemed to have gone into circulation and had, therefore, to be fully covered by assets (cf. Section 33 of the Act) even though not all of these notes, too, would be exchanged in India. Such cover could only be provided out of the Bank's reserves and profits, i.e., at the cost of the Government and the Bank's shareholders. In March 1942, the Bank came to the conclusion that the best solution in regard to the Bank's note issue in Burma would be for the liabilities together with corresponding assets to be taken over by the Government of India and for the Bank to reduce the figure of note circulation to that extent; against this reduction of its liability, the Bank considered that in the existing emergency the simplest mode of payment by it was by cancellation of ad hoc Treasury bills for an equivalent amount. Thereafter, the Bank would pay Burma notes under Government's specific authorisation only. The notes lost in the chests would be Government's uncovered liability.

The Government of India fully agreed with the Bank's-views and pro.-posed to give effect to them by amending the Reserve Bank Act, but met with opposition from the India Office. The Secretary of State was sceptical about the need for any kind of action. The best method, he felt, was to leave everything unchanged save that the Government of India would give a. guarantee indemnifying the Bank against any loss that it might be faced with by encashing notes 'not duly emitted' (i.e., those lost in the chests) under the Government's authorisation, to comply with Section 33 of the Act. If this was impracticable for any reason, the suspension of the Burma note liability was to be done in 'some more patently temporary form' than that suggested by Government, perhaps in the form of a Defence Regulation providing that notwithstanding the Reserve Bank Act, the liability was pro tanto suspended until further notice or alternatively, in the form of an Ordinance suspending the operation of Section 34(3) * until such time as notified by the Governor General, assets for a like amount being transferred from the Bank on such suspension.

The Governor objected strongly to the Secretary of State's 'extraordinary dictum' that the Bank could be indemnified by Government in respect of claims on notes not issued properly. He felt that the suggestion to transfer the liability from the Bank to the Government offered by far the best solution.

The Government of India proceeded to issue the Ordinance and the necessary notifications on June 6, 1942, merely advising India Office

* Section 34 defined the liabilities of the Issue Department as being the total of the currency notes of the Government of India and bank notes for the time being in circulation. Section 34 (3) read: 'In this section, references to bank notes include references to Burma notes.'



Informal opening ceremony of the new premises of the Bank at Lahow on February 21, 1940. Sir James B. Taylor, Governor of the Bank, with Sir Henry Craik (wearing the garland), the Governor of the Punjab.

The front view of the Bank's Lahore premises.





Rangoon building of the Bank

Rs. 5 (Burma) 5" \boxtimes 2 1/2" in size and with peacock design and K&G George VI's portrait, first issued in May ~8v9 under Governor Taylor's Signature. On the reverse, there is a forest scene with an elephant.

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that they were doing so with the concurrence of the Government of Burma and in consultation with the Reserve Bank. The Ordinance, called the Burma Notes Ordinance, 1942, prohibited the Bank from paying the value of any Burma note except to such persons and in such circumstances as might be authorised or decided by the Central Government, from such date as might be specified in this behalf by the Central Government; this date was, by separate notification, fixed as June 8. The Ordinance provided also that as from the notified date and until such date as the Central Government might direct, reference to Burma notes in Section 34 of the Act was to be deleted.

The actual amount of Burma notes in circulation for which the liability was transferred to Government in pursuance of the Ordinance was Rs. 28.69 crores; rupee Treasury bills for a corresponding amount (less the value of rupee coin lost in the chests in Burma) were cancelled in reduction of the assets. The actual uncovered liability of Government for Burma notes lost in chests amounted to Rs. 6.44 crores. Burma notes purchased by the Bank's offices from then onwards were paid by debit to Government account.

With effect from July 15, 1942, the facilities which had been earlier granted to evacuees from Burma to encash Burma notes at all offices and branches of the Reserve Bank and the Imperial Bank of India as well as at Government Treasuries in the Provinces of Bengal, Assam, the U.P., Orissa and Madras at a small discount were withdrawn. From that date, the exchange facilities were restricted for genuine refugees to a few branches of the Imperial Bank and certain specified Treasuries in Assam and Bengal, besides the Calcutta, Cawnpore and Madras Offices of the Reserve Bank. The restrictions, which were varied from time to time by Government on the Bank's advice depending on the pace of exchange of the notes, were relaxed substantially with effect from May 1, 1945, following the reoccupation of Burma early in 1945. The total amount of Burma notes encashed in India between January 5, 1942 (when the offices of the Bank were first authorised to encash these notes) and March 31, 1946 was Rs. 16.78 crores.

The question of what currency should be used in Burma on its reoccupation engaged the serious attention of authorities in the U.K. (e.g., War Office and India Office), the Government of India and the Bank as early as August 1942. On an enquiry from India Office whether the Bank had even 'provisional' plans in view, Sir James Taylor indicated, after discussion with the Burma Government who agreed with him, that the best course would be to use ordinary Indian currency (which, other than the one rupee notes of the Government of India, had ceased to be legal tender in Burma) for the requirements of the Army in the first instance. The Governor was firmly of the view that the introduction of a new separate Burma currency should not be

considered until the political situation was perfectly clear. The Governor's suggestions found broad acceptance amongst Government and the Army authorities, as also India Office. It was decided that while the Indian notes would be used in the initial stages, the advancing forces would put into circulation, after some progress had been made and conditions stabilised, a special military currency of their own, with special military notes of annas eight and annas four.

The stage for the issue of distinctive military currency by the British Military Administration of Burma (B.M.A.) was set early in 1945 and a Proclamation declaring it legal tender in Burma was issued on May 1, 1945. These notes (other than the notes of annas eight and annas four) were ordinary 'India' notes of the Reserve Bank and the Government of India one rupee notes super scribed with the legend 'Military Administration of Burma -Legal Tender in Burma only'. Besides these, the Reserve Bank 'India' notes of all denominations, the Government of India one rupee notes and the Reserve Bank 'Burma' notes of Rs. 100 and below were to continue to be legal tender in Burma. The Proclamation also suspended all the provisions of the Burma Monetary Arrangements Order, 1937, relating to the rights as well as the obligations of the Bank in respect of the currency of Burma. The responsibility for the management of the B.M.A. currency which was initially with the Civil Affairs Staff (Burma) was taken over by the Bank on its return to Burma, in terms of an Ordinance issued in June 1945 empowering it to act as agent of the B.M.A. as indicated below; the liability for these notes continued, however, to be that of the B.M.A.

The Reserve Bank of India (Temporary Amendment) Ordinance, 1945, promulgated on June 9, 1945, temporarily amended the Reserve Bank Act by inserting a new Section 20A which authorised the Bank to (a) maintain the accounts of the B.M.A., undertake their exchange, remittance and other banking operations and generally afford to them facilities similar to those which the Bank afforded to the Government of India and (b) perform such functions in relation to the currency and coinage of Burma and in relation to other business of the B.M.A. as might be entrusted to it by the B.M.A. The Ordinance also amended Section 17(5) of the Act to enable the Bank to grant ways and means advances to the B.M.A.

In August 1945, the Bank reopened its Rangoon Office, which took over the functions of the B.M.A. Treasury at Rangoon immediately. On September 1, 1945, remittance facilities between India and Burma were reintroduced. On November 7, 1945, the Bank entered into an agreement with the Civil Affairs Staff (Burma) representing the B.M.A., laying down its functions in Burma as agent of the B.M.A., the agreement was deemed to have come into force on August 7, 1945. In view of the non-availability of banking facilities due to the reluctance

of banks to reopen in Burma along with itself, the Bank undertook to accept deposits temporarily from the public, interest on which was debitable to the account of the B.M.A. In terms of the agreement, the Bank received from the B.M.A. by way of remuneration for its services during the period it functioned as its banker, viz., from August 1945 till the end of January 1946, the actual cost of maintaining its office in Burma plus 12½ per cent on its establishment charges to compensate it for any items of expenditure which did not enter the books of the Rangoon Office.

A detailed account of the termination of the Bank's activities in Burma, on the expiry of the Burma Monetary Arrangements Order on April 1, 1947, is given in a later chapter.

Banker to Ceylon Currency Board

There was also some widening in 1940 of the scope of the Bank's function as banker to a foreign currency authority. The Ceylon Government had for some time been considering a change in the currency arrangements in the island which, they felt, were unsuited to modern conditions. Although the Indian rupee was legal tender there, it was not actually in circulation, the currency in use consisting of Ceylon notes and small coin based on the rupee. This system entailed the maintenance of a substantial reserve of Indian silver rupees by the Board of Commissioners of Currency and occasioned large physical transfers of silver coin, making it unnecessarily cumbrous and expensive. The revised proposals announced late in 1939 envisaged the establishment of a Currency Board which would operate an exchange standard linking the Ceylon currency with the Indian rupee at par and also with sterling; the Ceylon Government's intention was that the link with sterling should not normally be operative.

The Ceylon Government approached the Bank with the suggestion that it should act as agent of the proposed Currency Board for the purpose of receiving and paying out Indian rupees against the corresponding transactions in Ceylon currency in Colombo. In view of the governmental character of the business and the fact that it was clearly in the interests of India that the Ceylon currency system should remain as closely linked with Indian currency as possible, the Bank readily agreed. Since, however, the Bank was empowered under the Act to undertake agency functions only on behalf of a bank which was the principal currency authority of any country and the proposed currency authority in Ceylon was to be a Board and not a bank, the Act [Section 17 (13)] was amended* in March 1940 to enlarge the

* The Reserve Bank of India (Amendment) Act, 1940, effective March 11, 1940.

scope of its operation. Simultaneously, the Bank was also empowered [by amendment to Section 17(4)] to grant temporary advances to the Currency Board against suitable security. The actual agreement between the Bank and the new Board of Commissioners of Currency, Ceylon, was executed nearly 1½ years later after an Ordinance had been promulgated in Ceylon on September 1, 1941 for the regulation of currency. Under the Ordinance the Ceylon rupee was linked only to the Indian rupee and had no direct relation with sterling. Under the agreement the Bank was appointed as the Currency Board's agent for the purpose of receipt and payment of monies on behalf of the Board in Bombay; the Board was to maintain an agreed minimum interest-free deposit with the Bank to remunerate it for the agency functions undertaken by it. The Board's funds were to be invested in Treasury bills and short-term rupee securities of the Government of India. The Bank was to make advances to the Currency Board against its rupee or sterling assets and discount the Treasury bills held on its behalf whenever required. The advances against the Board's sterling assets were to be liquidated by the transfer of sterling to the Bank's account with the Bank of, England. For the services rendered, the Reserve Bank was entitled to recover from the Board all out-of-pocket expenses incurred on its account and to charge commission at 1/16 of 1 per cent on all purchases and sales of securities made on its behalf.

The link between the Ceylon rupee and the Indian rupee continued till September 1948 when, following the devaluation of sterling, the Ceylonese Government decided to devalue the Ceylon rupee to the same extent and express its value in terms of gold. On the establishment of the Central Bank of Ceylon as the currency authority of Ceylon on August 28, 1950, the agreement with the Board of Commissioners of Currency was terminated and the Bank undertook to provide more or less similar services to the new central bank by virtue of the general authority the Bank had to provide these services to central banks.

Agreement between the Bank and the Imperial Bank

The terms of remuneration payable to the Imperial Bank of India for the conduct of Government business, under the agreement concluded between it and the Reserve Bank, fell due for revision on April 1, 1945, a decade after they came into effect. The Third Schedule to the Reserve Bank Act stipulated that the terms for the ensuing five years and thereafter for each succeeding five-year period until the agreement was terminated should be determined 'on the basis of the actual cost to the Imperial Bank of India, as ascertained by expert accounting investigation, of performing the said functions'. The Auditor General of India, who had been entrusted by the Joint Select Committee of the

Legislature with the scrutiny of the original proposals as embodied in the Reserve Bank Bill, was naturally the most appropriate authority to undertake the expert investigation. On the basis of the results of the scrutiny made by him of the data furnished by the Imperial Bank in an approved form for a period of several years, the rates of commission payable to the bank on the turnover of Government account for the quinquennium April 1, 1945, to March 31, 1950, were revised downwards with its concurrence as follows :

| | |
|--|------------------------|
| On the first Rs. 150 crores (in the place of the first Rs. 250 crores) | at 1/16 of 1 per cent |
| On the next Rs. 150 crores (in the place of the remainder) | at 1/32 of 1 per cent |
| On the next Rs. 300 crores | at 1/64 of 1 per cent |
| On the remainder of the total receipts and disbursements on Government account | at 1/128 of 1 per cent |

As the date for revision of the terms drew near there was public demand for replacing the Imperial Bank by another agency. There were also comments -mostly ill-founded -in various financial journals regarding the manner in which the Reserve Bank would comply with the requirements of the Third Schedule. To dispel all mistrust, the Reserve Bank issued in June 1945, after consulting the Imperial Bank, a press note publicising the revised rates.

As the Bank's agreement with the Imperial Bank was to remain in force initially for a period of fifteen years only [Section 45(1) of the Act], the question arose in 1950 whether it should be terminated after giving the bank the prescribed notice of five years, running from April 1, 1950. However, in December 1950 the Central Board agreed with the recommendations of the Rural Banking Enquiry Committee that the existing system for the management of cash work at Treasuries and Sub-Treasuries in Part 'A' and Part 'C' States should remain undisturbed for the time being. So there was no point in discontinuing the agency arrangements with the Imperial Bank at that stage. Consequently, the rates of commission to be paid to the bank for the next quinquennium, i.e., from April 1, 1950 to March 31, 1955, were required to be determined afresh. On the basis of the expected annual turnover of Government business during these years and in the light of the data of actual commission paid vis-a-vis the cost incurred by that bank during the years 1945 to 1950, the rates of remuneration were revised upwards as indicated below:

| | |
|------------------------------|------------------------|
| On the first Rs. 150 crores | at 1/16 of 1 per cent |
| On the next Rs. 300 crores | at 1/32 of 1 per cent |
| On the remainder of turnover | at 1/64 of 1 per cent. |

This was subject to the proviso that if the total turnover exceeded Rs. 1,200 crores during any year, the rate applicable to the turnover in excess of this figure would be 1/128 of 1 per cent.

Change in the Bank's Accounting Year

The accounting years of central banks and Governments show diversity. The appropriate accounting year for Government has also been a matter of some discussion in India in recent years. The change in the Bank's accounting year from January-December to July-June, which occurred in 1940, should be of some interest. The calendar year had been adopted earlier presumably on the analogy of the practice of many of the commercial banks, although the Imperial Bank preferred to hold its shareholders' meeting in August. This arrangement suffered, however, from several drawbacks. The end of December coincided with a heavy outgo of currency and at the same time, there were the Christmas and New Year holidays so that there was considerable difficulty in getting the accounts compiled and audited in time for the annual general meeting which had, under the Act, to be held within six weeks from the date on which the accounts were closed. Besides, it was inadvisable to prepare the Board's annual report right in the middle of the most active part of the busy season. A July-June accounting year would also make it possible to incorporate in the report Government's figures which were based on the financial year ending March 31, a matter which was specially important from the point of view of maintaining the statistical continuity of the Controller of the Currency's reports. Furthermore, the majority of the commercial banks closed their accounts on December 31 and if the Bank wrote its report in July it would have ample opportunity to study their annual balance-sheets.

Convinced of the desirability of the change-over, Sir James Taylor took the initiative in 1937 to secure the concurrence of the Board and thereafter of the Governments of India and Burma (who would be affected from the point of view of the Bank's surplus profits) and to sponsor the necessary legislation to facilitate its implementation. The Reserve Bank of India (Closing of Annual Accounts) Act, 1940, permitting the Bank to close its accounts on June 30, 1940, i.e., six months after the previous closing and to hold an 'annual' general meeting within six weeks thereafter for consideration of those accounts became law on March 11, 1940. Thus, the year 1940 saw the convening of two 'annual' general meetings -one in February in the usual course for considering the accounts for the whole of the year 1939 and the other in August for considering the accounts for the half-year ended June 1940. The Bank has been closing its annual accounts on June 30 ever since.

Limitation of Dividend

Another measure which is now of purely historical interest but which then received much attention both from the Board and, fittingly, from the shareholders, was the promulgation of the Reserve Bank of India (Limitation of Dividend) Ordinance of June 30, 1943. Under Section 47 of the Reserve Bank of India Act read with the Fourth Schedule thereto, the Bank's shareholders were entitled to an additional dividend on a graduated scale out of the surplus profits remaining after payment of the fixed dividend of 3 ½ per cent, when the surplus exceeded Rs. 4 crores. The provision became operative for the first time with respect to distribution of the profits for the year ended June 30, 1943, when the surplus rose steeply to Rs. 7.52 crores from Rs. 3.24 crores for the previous year (see table below). The Ordinance superseded, for so long as it remained in force, the provisions of Section 47 of and the Fourth Schedule to the Reserve Bank Act, to the extent that it limited the aggregate of the rates of the fixed (cumulative) dividend and the additional dividend payable to the shareholders in terms of these provisions to 4 per cent per annum. The balance of the profits was to go to the Central Government. The Ordinance stated that an emergency had arisen making it necessary temporarily to limit the dividend receivable by the Bank's shareholders.

(Rs. lakhs)

| | Year ended December | Year ended June | | | | |
|--------------------|------------------------|-----------------|---------------|---------------|----------------|----------------|
| | 1939 | 1941 | 1942 | 1943 | 1944 | 1945 |
| Income | 122.95 | 381.76 | 456.45 | 919.19 | 1200.43 | 1667.52 |
| Expenditure | 100.45 | 102.53 | 114.91 | 149.38 | 173.85 | 178.25 |
| Of which | | | | | | |
| Establishment | 35.92 | 36.39 | 39.08 | 43.41 | 51.70 | 61.14 |
| <i>Net Balance</i> | <i>22.50</i> | <i>279.26</i> | <i>341.54</i> | <i>769.81</i> | <i>1026.58</i> | <i>1489.27</i> |
| Of which | | | | | | |
| (a) Dividend | 17.50 | 17.50 | 17.50 | 20.00 | 20.00 | 20.00 |
| (Rate) | (3 ½ %) | (3 ½ %) | (3 ½ %) | (4%) | (4%) | (4%) |
| (b) Surplus paid | 5.00 | 261.76 | 324.04 | 749.81 | 1006.58 | 1469.27 |

In a press communique issued simultaneously, Government set out in greater detail the considerations that weighed with them in taking this action. It was explained that the profits of the Bank had swollen very abruptly as a result of the increase in the income-earning securities held as backing against note circulation which had expanded enormously due to the large Allied war expenditure in India, and that the normal operation of the provisions of the Act would result in a sudden increase in the rate of dividend payable to the shareholders. Government believed, the press note added, that a stabilization of

dividend was in the Bank's own interest and would be welcome to the shareholders as it would discourage undesirable speculation in the Bank's shares. The measure was also 'eminently reasonable in the light of their anti-inflationary policy'. Further to appease the shareholders, they explained that 'the incidental gain to Government is likely to be only a few lakhs and in no way influenced Government in coming to this decision'! While there is no doubt that Sir James was consulted about this -it is not improbable that the initiative in this matter came from him -the Bank was not formally consulted on the issue of the Ordinance. However, when the Bank's accounts for the year ended June 30, 1943 were placed before the Board at its meeting on July 20, no protest was recorded. Instead, it resolved that 'Government be moved to give an undertaking that, in the event of the Bank's profits in any future year falling below such level as would suffice for maintaining stability of the dividend rate at the present or any higher level, they would be prepared to make up the deficit to the extent of the additional amount they have received as a result of the Ordinance, and would promote such amendment of the law as would ensure that the sum so restored to the Bank is wholly available for distribution as additional dividend'! Government's reply was that while they could not give any long-term commitment to the Bank in this behalf, a good case in equity would exist for their making up any deficiency in the Bank's profits to the extent to which they had benefited as a result of the operation of the Ordinance, should the profits fall 'in the not too distant future' below the level required to maintain a dividend of 4 per cent or such higher rate as they might consider to be reasonable and appropriate in the circumstances.

While public opinion was not averse to the measure which ensured that 'no unduly large benefit is passed on to the shareholders who have done precious little to cause the increased profits of the bank', the Bank had to answer a volley of letters from its shareholders protesting against it. One of them accused the Government of violation of the terms upon which subscriptions to the Bank's capital were invited. The shareholder reasoned that since Government did not come to the rescue of the shareholders when the shares declined below their paid-up value, they had no right to deprive the shareholders of higher dividends within the limits of the Statute. If they could not immediately raise the rate to 5 per cent as visualised by the framers of the Act, the extra dividend, he demanded, should be kept in deposit and refunded by Government at the end of the first year after the conclusion of hostilities. The matter was repeatedly raised at the annual general meetings also and the Governor took pains to explain to the questioners the rationale of the decision and the Board's efforts to secure from Government an assurance to maintain the stability of the rate of dividend.

The Ordinance was not revoked by Government even after the end of the war and the rate of dividend stayed at 4 per cent till the Bank was nationalised on January 1, 1949.

Concentration of Shareholding

Even before the Bank had completed two years of its existence, a matter which had been debated at great length by the Legislature during the passage of the Reserve Bank Bill was to engage the attention of the Central Board. Sir Purshotamdas was concerned about the increasing tendency for big blocks of shares to get into the hands of certain individuals and the consequent sterilisation of votes and felt that the Board should 'come to a definite decision regarding the policy they wish to adopt before it gets too late'. In November 1936, he brought up the issue before the management of the Bank and insisted on its being placed on the agenda for discussion at a Board meeting. Sir James Taylor was, however, of the opinion that it was premature to suggest any limitation on the size of the individual shareholding which required an amendment to the Act. He pointed out that the amendment that no person should be allowed to hold more than 200 shares had been rejected by the Legislative Assembly by a majority of 49 to 48 after a two-day debate, the argument against the amendment being that any such restriction would militate most seriously against the marketability of the shares and that in any case the danger was not serious, inasmuch as the limitation of the maximum voting rights to ten would increase the actual voting power of the shares held by small holders, if a large number of the others were sterilised. In his reply to the debate, Sir George Schuster had also expressed a strong belief that the very wide distribution of shares, which the provisions for their initial allotment were designed to ensure, would continue to prevail in the future. The time, Sir James Taylor felt, was also not ripe for any remedial legislation to arrest the other phenomenon of gradual accumulation of shares on the Bombay register at the expense of the other registers. The position did, however, require careful watching and the Central Board, at its meeting held on December 1, 1936, decided that the Local Boards should submit annual returns showing the total number of shareholders on their registers when the registers were closed for the issue of dividend, along with the number and names of shareholders holding more than 50 shares. Monthly statements were also to be submitted to the Committee showing the distribution of shares amongst the various registers.

On receipt of the Local Boards' reports, the Central Board examined the question again in January 1937 and concluded that it was not necessary yet to report the position to Government. The Committee

was asked to keep a close watch and the Governor was requested to submit an annual report to the Board for its consideration.

Within a couple of months, however, on perusal of further reports from the Local Boards, the Board thought that the matter had become sufficiently serious to warrant a report to Government. A recommendation was therefore made to Government in April 1937 for initiating early action for amendment of the Act to lay down a ceiling of 200 shares on individual holdings. It was pointed out that the number of shareholders had fallen to 66,273 in January that year from 92,047 when the Bank was established and that out of a voting strength of 100,000, approximately 13 per cent had already been sterilised. Government's attention was specifically drawn to the debates in the Assembly and to the Board's view that the existing Section 56* of the Act did not provide any remedy against undue concentration and the resulting sterilisation of the shares. If the process was allowed to go on, it was quite conceivable that a situation might be reached where the voting power would be so restricted that it would become liable to undue manipulation. The experience of the Bank of France in this regard was then cited. The Board's opinion that 'considerations of marketability' should not be allowed 'to prevail against the paramount desirability of having a widely distributed electorate for the Bank' was also conveyed to Government.

Government acted on the suggestion immediately and tabled an amending Bill in the Simla (summer) session of the Assembly but the Bill was unfortunately crowded out. The Finance Member (Sir James Grigg) appears to have anticipated opposition from 'some important groups (besides the Europeans!)' so that 'it was no good expecting to get the Bill through in a few hours'. Sir Purshotamdas Thakurdas was constantly in touch with the Finance Member in connection with enactment of the amendment. His anxiety would be obvious from what he wrote in May 1937 to the Indian Chamber of Commerce, Calcutta, which requested him to express his opinion on the proposed amendment Bill:

I am convinced that it was never the intention of the Legislature to offer in the form of Reserve Bank shares merely good investment for the public but it was their intention to give the public an instrument by which they may have their say in the Reserve Bank of India, and, in addition, get a small but reasonable return on their investment. The premium at which these shares are being quoted is, to my mind, deplorable. If it goes down, I do not think that anyone can feel that avoidable harm is being done to the investor The only power left to the shareholders is to express their opinion at annual meetings, . . . wherever circumstances justify to pass a vote

* It empowered the Local Boards to call upon any shareholder to furnish to them particulars of all shares registered in his name.

of censure against the Central Board or the Governor, as the case may be, in case of something anti-Indian being done by either the Governor or the Central Board If this opportunity of preventing Reserve Bank shares from passing into unknown hands in this manner is lost, I am afraid the control of the Indian public opinion on the Reserve Bank will be permanently lost.

It was, however, almost three years before the Bill was actually passed: the Reserve Bank of India (Second Amendment) Act 1940 (Act XIII of 1940) restricting the number of shares to be held by a shareholder to 200 by the addition of a new sub-section to Section 4 came into effect on March 26, 1940. Despite the amendment, the decline in the number of shareholders continued. It came down to 57,192 on December 31, 1939; as on June 30, 1945, the number of shareholders was 46,640 and as on June 30, 1948, 44,400. There was also a continuous gravitation of the shares towards the Bombay register, which could only partly be explained by the extension of the war to Burma and the transitory arrangements made for the maintenance of the Rangoon register in India.

Fresh Elections of Local Board Members and Directors

On the expiry of the five-year terms of the Directors representing the various Local Boards, fresh elections were held to the Local Boards, commencing with the Western (Bombay) Area Local Board in 1940. These were followed by fresh nominations to those Boards by the Central Board and the election of fresh Directors of the Central Board by the newly elected members of the Local Boards. The Local Board elections were keenly contested in view of the prestige attached to a seat on the top management of the central bank. Apart from the standing of the candidates, success in the Local Board elections appears to have depended to a substantial extent on the candidate's organisational ability for collecting proxies which were solicited actively. There were instances where specific areas or groups of shareholders were also earmarked among the candidates for the canvassing of proxies, though it would appear that these understandings were not, always observed. As for elections to the Central Board, when competition was keen and there were prospects of a close fight, not infrequently understandings were reached between the contestants for serving on the Board by turns and these were generally honoured. In some instances, candidates were induced to stand down by offers of appointments on Boards of large companies!

In regard to the elections to the Bombay Local Board, it would appear from correspondence between the Directors that Sir P. T., Mr. R. P. Masani, Mr. (later Sir) Chunilal B. Mehta, Mr. Kasturbhai

Lalbhai and Sir Sultan M. Chinoy issued a statement, stating that proxies given to any of them would be treated as proxies given to all of them, as they desired to work together. They requested the shareholders to give their proxies to the representatives of any one of them. The proxies were to be collected together and the votes were thereafter to be recorded according to an agreed arrangement. Eventually, no election was held as there were only five candidates for the five seats.

Sir Purshotamdas Thakurdas, Mr. B. M. Birla, Sir Shri Ram, Mr. Satya Paul Virmani and Mr. C. R. Srinivasan were re-elected as Directors and remained to shape the Bank's policies throughout the war. Mr. Chunilal B. Mehta who was elected to the Central Board from the Bombay Local Board in January 1941 resigned in January 1942, when Mr. Kasturbhai Lalbhai took his place. The latter resigned in July the same year and Sir Sultan M. Chinoy was elected in his place. Sir Sultan did not however stay long; he made way for Mr. Kasturbhai Lalbhai again in February 1943, shortly after Sir James Taylor died. It appears to have been a result of mutual understanding that Mr. Kasturbhai Lalbhai should stand for election to the Board in his place in order to strengthen the Board's hands for sponsoring Mr. Deshmukh's candidature for the Governorship. Mr. Lalbhai then stayed on until expiry of the term of office of the Directors representing the Bombay Local Board in December 1945. Dr. Narendra Nath Law, the other elected Director from the Calcutta Local Board, resigned in February 1944 and Mr. A. K. Ghose was elected in his place in November 1944. There was no election by the Burma Local Board in December 1942 when it became due and U Po Byaw continued as an elected Director representing the Rangoon register until his resignation in September 1946 consequent on his nomination as a member of the Burma Legislative Council.

All the nominated Directors, namely, Sir Homi Mehta, Mr. (later Sir) Arthur A. Bruce, Khan Bahadur (later Sir) Syed Maratib Ali and Khan Bahadur Adam Hajee Mohammad Sait, were renominated by Government for a further period of five years on the expiry of their term of office at the end of 1939. They were again renominated for another five-year term with effect from January 1, 1945.

As for the Government Director on the Central Board, the post was successively held by Mr. (later Sir) Cyril E. Jones, Sir P. Raghavendra Rau (who died in January 1942), Mr. A. C. Turner and Mr. K. G. Ambegaokar. For a very short while, in 1939, Mr. C. D. Deshmukh was also Government Director.

A reference may also be made in this section to some modifications concerning meetings of the Committee of the Central Board. The constitution of the Committee of the Central Board was modified in July 1942 so as to include not only the Directors of the area in which the

meeting of the Committee was held but also Directors of other areas who might happen to be present there at the relevant time. The Governor felt not only that it was discourteous to exclude the other Directors who might be available at the venue of the Committee meeting, but also that it ought to be within the discretion of the Governor and the Committee to invite one or more Directors of another area to attend a meeting where a matter of importance to that area was coming under review. While not detracting from the powers of the full Board in any way, this would, he felt, 'provide a more elastic and informal, and yet effective, method of dealing with matters of more than current administrative importance'.

Another amendment to the General Regulations related to the election of a substitute Director by a Local Board to attend a meeting of the Committee of the Central Board in the absence of the elected Director: the amendment brought the procedure in line with Section 12 (2) of the Act by providing that the election was to be by the elected members of the Local Board and not by the entire Local Board.

Indianisation of the Governorship

Perhaps in no other sphere of the Bank's activities during the war years was there greater drama and excitement than in the matter of appointing a successor to Sir James Taylor which came up with his sudden and premature demise after a short illness on the night of February 17, 1943.

Sir James had been reappointed as Governor for a second term of five years, on the expiry of the first, at the end of June 1942. Notwithstanding his outstanding abilities, this had to be carefully planned; the good offices of a Director like Sir Purshotamdas Thakurdas had to be secured by the Finance Member for the purpose. Clearly, the Board had established itself as a body to be reckoned with; even greater proof of its influence and authority was to be had very soon in connection with the selection of Sir James's successor.

Sir Purshotamdas Thakurdas found, of course, that the reaction of the other elected Directors was entirely favourable to the reappointment of Sir James; in the words of one of them (Mr. C. R. Srinivasan) :

There can be no two opinions on the extension of Sir James Taylor's term. He has acted to the best of his lights in office and the knowledge and experience that he has picked up in the service of the Bank should not be lost to it at a critical occasion like the present.

The Board's recommendation for the reappointment was unanimous. Government's announcement of the reappointment on February 16, 1942, nailed the wild speculation that the post had been earmarked for Sir Jeremy Raisman, when he vacated the office of Finance Member.

Commenting on the subject, 'the Ditcher' said in his 'Diary' in the Capital (of February 26, 1942):

And in any case the Bank possesses a most excellent Governor in Sir James Taylor who has rendered it yeoman service from the time when it was nothing more than a scheme on paper. . . . Like Sir James Grigg, the new Minister of War, Sir James Taylor is also 51 years of age, and his appointment for a further term of five years is not only testimony to his personal qualities but to the smooth and continuing influence the Bank exercises upon India's economy Sir James' reappointment as Governor of the Reserve Bank is an earnest that the monetary problems which will inevitably arise (in the post-war era) will be resolved realistically, and on the basis of past experience. Quite properly, the office will ultimately pass to an Indian banker. Till then Sir James Taylor can be relied upon to put India's interests first in all the Bank's transactions.

Little could anyone have then imagined that the passage of the high office to an Indian would be as difficult as it actually turned out to be.

Sir James Taylor's untimely death, and that too at a time when the country was beginning to feel more than ever before the impact of the large war expenditures both by the Indian and Allied Governments, was widely mourned. While the Government of India were 'understandably unnerved', Indian sentiment acknowledged Sir James's identification with the country's interests and expressed profound regret at his passing away. The Committee of the Central Board met in a special session on February 18 to pass a condolence resolution. The full Board expressed its grief at its meeting on April 5, in the following resolution:

That the Board record with the profoundest sorrow the premature death of Sir James B. Taylor, the Governor of the Bank, and desire to express their deepest sympathies to Lady Taylor.

The Board also wish to pay a tribute of admiration and gratitude to Sir James B. Taylor for the invaluable assistance which he rendered in organising the affairs of the Bank as Deputy Governor and for his masterly handling of them as Governor. They cannot speak too highly of his single-minded devotion to the Bank's interests and the fairness and understanding which invariably characterised his relations with the Board. They mourn the loss of an admirable colleague and consider that by his death the Bank has lost an administrator of the highest calibre and India a very good friend.

Illustrative of the esteem in which Sir James was universally held, it should suffice to give extracts from the eulogy of his trusted deputy Mr. C. D. Deshmukh:

Sir James Taylor was among the most remarkable men that it has been my good fortune to know. His intelligence was like a lambent

flame which illumined everything that it touched and purged it of dross, and he had a catholicity of interest, a breadth of outlook and a warm humanity which I have seldom seen equalled. His political views were most liberal and fair-minded It was his firm conviction that the indispensable condition for the achievement and maintenance of self-government for India was a strong, efficient and honest administration through Indian personnel He was, therefore, an ardent champion of a rapidly progressive Indianisation of the administration with the final goal of complete Indianisation being kept steadily in view. Communalism he regarded as a canker in the body politic, and it was his opinion that communal electorates must go if there was to be any practical political advance at all in India In financial matters he was, even in his Controller of the Currency days, a vigilant watch-dog of India's interests

His relations with the Board of Directors were generally cordial and he commanded their respect and willing co-operation, except where, in their opinion, the interests of the country called for disagreement. "I must carry my Board with me", he often used to say

It was well understood by the Directors that the Governor was very often consulted by Government in his personal capacity in matters which were outside the sphere of the Reserve Bank, but which, nevertheless, impinged very closely on it. They relied on him to take them into confidence at the proper time, whenever necessary, and, generally speaking, I know of hardly any instance where this mutual confidence was abused on either side.*

In the ordinary course, the Government of India should have had no difficulty in the choice of a successor to Sir James Taylor, as they had on hand a Deputy Governor, Mr. C. D. Deshmukh, who had been in office for 14 months and had had an impressive record of service, but this matter took a tortuous course. First Mr. Deshmukh's career, his entry into the Bank and his appointment as Deputy Governor in succession to Sir Manilal Nanavati, may be referred to briefly.

Born in January 1896, Mr. Chintaman Dwarkanath Deshmukh had a brilliant academic career, topping it with a first rank in the open competitive examination of the Indian Civil Service held in London in 1918. He signed his covenant in November 1919 and was posted for service in the Government of the Central Provinces and Berar, where he held several important posts; in the year 1932 he became Revenue Secretary and in 1934 Finance Secretary to the Provincial Government. Prior to his joining the Reserve Bank in July 1939, for a very short while he was the Joint Secretary in the Department of Education, Health and Lands of the Government of India.

As early as in 1936, Sir James Taylor had written to Mr. Gordon, the Chief Secretary of the C.P. and Berar, that he was looking for 'an Indian who might in due course be found suitable for promotion to one of the two Deputy Governorships-a man of good general

* Central Banking in India-A Retrospect.

financial knowledge and experience -and from this point of view Government finance was nearly as useful as banking or commercial experience -but primarily of energy and administrative capacity and presence’* and had asked for his opinion whether Mr. Deshmukh would adequately fill the bill. Mr. Gordon considered Mr. Deshmukh suitable for the purpose but added that the Provincial Government would not agree to relieve him as his services were needed for tackling the multifarious problems that were likely to arise under the new, Constitution. Sir James Taylor renewed the enquiry two years later but Mr. Deshmukh was not available.

Mention has already been made of the efforts to bring a European Deputy Governor to succeed Sir James Taylor when he was appointed Governor in 1937. The question of having an able Englishman close at hand to take the reins of the Bank’s management in the event of the Governor’s sudden illness or during his absence on leave never ceased to worry India Office and the Bank of England. The Government of India who were not very confident of being able to find the right kind of man thought of resolving the problem temporarily by arranging to maintain a Liaison Officer with the Bank. Sir James suggested Mr. Deshmukh’s name for the post of Liaison Officer early in 1939. This suggestion was not acceptable initially to the Finance Member (Grigg), for he feared that ‘ (1) the Board might not be prepared to recommend him in due course for Deputy Governor as they were predominantly businessmen and he a Mahratta, and (2) even if they did there was the danger that they would later want to make him Governor, and as there was no European Deputy Governor the Bank would be completely Indianised ‘*. However, with the good offices of Sir Jeremy Raisman, the next Finance Member, the Governor was able to get Mr. Deshmukh over as Liaison Officer in July 1939, the attempts of the Bank of England a little earlier to secure the appointment of a European Deputy Governor not having materialised.

On the outbreak of the war, Mr. Beale, Secretary to the Central Board of the Bank, was recalled by the Bank of England. Mr. Ram Nath had just relinquished his appointment as Manager of the Bank’s London Office and was expected to take Mr. Beale’s place, but the arrangement did not materialise as the former had to be sent to Calcutta to look after exchange control work. This left the post of Secretary vacant. The Governor could think of none other than Mr. Deshmukh to fill it up, as the incumbent had to be a ‘senior officer of administrative and organising experience ‘. Mr. Deshmukh had, in addition to his assignment as Liaison Officer, been appointed Custodian of Enemy Property for the whole of India since the middle of September 1939 but Government released his services to the Reserve Bank on the usual

* Sir C. D. Deshmukh, op. cit.

deputation terms. It should also be mentioned that during a visit to the U.K. on leave in 1940, Mr. Deshmukh spent some time at the Bank of England to get acquainted, in what was then the world's most important financial centre, with problems of central banking, monetary management and international finance.

Mr. Deshmukh appears to have been considered a natural successor to Sir Manilal Nanavati whose term of office as Deputy Governor was ending in December 1941. Indeed, it would seem that even as Secretary Mr. Deshmukh was to an extent functioning *de facto* as an additional Deputy Governor. While in a section of the press the candidature of a Muslim was canvassed, the Central Board of the Bank unanimously recommended Mr. Deshmukh for the post at its meeting held in Madras in October 1941. This was accepted by Government, who fixed the term of office at five years, effective December 22, 1941. However, the India Office now wanted that a European should be sent over to hold the second post of Deputy Governor which had been lying vacant for over four years, but Sir James Taylor was able to parry the move. Sir James and Mr. Deshmukh would appear to have made an excellent pair, and as narrated by Mr. Deshmukh, Sir James 'himself deliberately worked towards making me fit to carry the responsibility in succession to himself. He taught me all he knew of Central Banking and the currency and exchange and bullion problems of the country, withheld no confidences and pressed on purposefully with my training'

Sir James Taylor's death occurred so suddenly that Government were caught unprepared. Even the Ordinance [entitled the Reserve Bank of India (Governor's Powers and Functions) Ordinance, 1943] to empower Mr. Deshmukh to exercise the powers and functions of the Governor until the appointment of a new Governor was issued only on February 22, though this was made effective from the time of Sir James's death. Apparently the Government were not sure of wanting to entrust to Mr. Deshmukh even the temporary exercise of the Governor's functions. It would appear that Government were also not in a hurry to have a meeting of the Central Board convened for selecting a new Governor. At the meeting of the Central Board held on February 8, 1943, it had been decided to hold the next meeting on April 5 and neither the Government nor any of the Directors asked for an earlier meeting. This interval naturally gave time to the Government as well as the Directors to consider the matter and mobilise support for the candidates favoured by them. The elected Directors of the Central Board, in particular Mr. B. M. Birla, started working actively for the candidature of Mr. Deshmukh forthwith, under the leadership of Sir Purshotamdas Thakurdas. Among these Directors only one seemed to favour a non-Indian banker being appointed as Governor. But later, he also decided to join the others in supporting Mr. Deshmukh.

Sir P. T. apparently waited for some lead to come from Government before the Central Board meeting of April 5. However, no initiative seems to have come from Government, though the Directors got from reliable sources the report that Government were thinking of a candidate other than Mr. Deshmukh. At first, the name of an eminent London financial expert (who had also handled an important assignment in India) was mentioned as the Government's choice. Later, the name of the Managing Director of the Imperial Bank was mentioned, and when this too seemed unacceptable to the Board, Government 'sought to make terms with them by pledging themselves in advance to appoint Deshmukh as Governor after three years, during which period the banker they had selected was to be the Governor. They also attempted to induce Deshmukh to stand down in the public interest, which, in all humility, Deshmukh declined to do as it would have amounted to spiking the guns of the Central Board'.* By the time the Board met on April 5, the elected Directors had reached a unanimous decision among themselves to support the candidature of Mr. Deshmukh.

At the meeting of April 5, Sir P. T. moved a resolution, which was seconded by Mr. C. R. Srinivasan and supported by Mr. B. M. Birla and Sir Shri Ram, that Mr. Deshmukh be appointed Governor and that he be paid a salary of Rs. 7,500 per mensem. An amendment to the resolution was moved by Sir Homi Mehta and seconded by Sir Syed Maratib Ali and Sir Arthur Bruce that, in terms of the suggestion of the Central Government communicated to the Board through the Government Director, Mr. A. C. Turner (who was present at the meeting), Sir William Lamond (then Managing Director of the Imperial Bank of India) be appointed Governor for a period of three years on a salary of Rs. 10,000 per month and that Mr. Deshmukh 'continue to hold the post of Deputy Governor with a view to his being appointed as Governor on that office being vacated by Sir William Lamond'. The amendment was rejected by a majority of seven against three and the original motion of Sir P. T. was carried by the same majority.

The Government of India were obviously nonplussed and kept the matter pending; however, it would appear from the correspondence among the elected Directors that fairly soon after the Board made its recommendation the Government were more or less reconciled to Mr. Deshmukh's being the Governor. It was clear to Government that the elected members of the Board were absolutely firm and united in their desire to secure Mr. Deshmukh's Governorship. The quid pro quo which Government desired to have for Mr. Deshmukh's appointment was that the Board should agree to have a Muslim and a European

* Sir C. D. Deshmukh, op. cit.

as Deputy Governors. This was 'a novel suggestion'. The elected Directors tried unsuccessfully to persuade the Government not to bring in the question of a European; however, it appeared that a compromise in this matter would be to agree to the appointment of a senior European Officer of the Reserve Bank as Deputy Governor. The general reaction of the Directors to the Government's 'counter proposals' was best summed up in the observations of Mr. Srinivasan, President of the Madras Local Board:

On the question of personnel, it is a pity that Government think of it in terms of communal preference, but so long as the appointments actually made can be justified on grounds of merit, I shall not quarrel about the genesis of the proposals. I agree that if we win the first round, we should not put our strength to the test again so soon on a matter of secondary importance.

Mr. Srinivasan was however keen that the new Governor should be in full control of the affairs of the Bank. So he advised his colleagues as under:

There is only one position to be safeguarded and that is to make sure that the powers of the Governor are not sought to be short-circuited by the appointment of a Deputy Governor, who possesses more contact, and perhaps more confidence, with the Government of India.

Something of this kind, he apparently believed, had happened before and this possibility would be stronger with the Governor an Indian and one of the Deputy Governors a European.

Some delay occurred in locating a suitable Muslim candidate who was agreeable to take up the job. A few declined, but finally a person was selected. Now that the matter was more or less settled, the Government wrote to the Bank on June 28, 1943, that they were unable to pass orders on the Board's resolution of April 5 until they were in possession of the Board's views regarding the filling of the existing vacancy of Deputy Governor and also of the other vacancy that would be caused in the event of acceptance by Government of the Board's recommendation for the office of Governor. Promptly, at the meeting of the Central Board held on July 20, the Board recommended Mr. Wajahat Hussain and Mr. C. R. Trevor for the two posts of Deputy Governors on a salary of Rs. 4,500 per month each. On July 24 the Governor General cabled the Secretary of State to say that they proposed to accept all the recommendations of the Central Board and sought his approval. The Secretary of State's approval was received on August 9 and Government's order, approving the appointment of Mr. Deshmukh as Governor and of Mr. Wajahat Hussain and Mr. Trevor as Deputy Governors, was issued on August 10.

There is a mistaken impression in some quarters that the proceedings of the annual meeting of shareholders held on August 9 had a crucial influence on Government's decision to appoint Mr. Deshmukh as Governor. At that meeting, two shareholders (Messrs Bhagwati Prasad Khaitan and G. L. Mehta) referred to the Governorship, inquiring the reasons for the delay in the appointment and expressing the hope that the appointment would be made at the earliest possible date. From the sequence of events narrated above, it is clear that the decision had been taken much earlier. What happened was that the cable of approval from the Secretary of State was delayed; to use the Secretary of State's words:

I regret owing to circumstances that have still to be investigated this telegram which ought to have issued several days ago has been delayed.

Mr. Deshmukh assumed office as Governor on August 11, Government having fixed his term at five years. A similar term was fixed for the two Deputy Governors, both of whom assumed office on August 16.

It would seem that the earlier opposition to Mr. Deshmukh's appointment was more pronounced in the case of the Government of India who were 'more royalists than the King himself' and that Mr. Deshmukh's eventual selection was due to 'the rare sense of fair play and statesmanship' displayed by the Secretary of State. While reviewing these events some years later, Mr. Deshmukh, or Sir Chintaman Deshmukh as he had then become,* stated that the Finance Member was the first 'to bow with grace to the inevitable', whereas the Finance Secretary and the Economic Adviser 'were a little less forthcoming and more censorious'.† For some weeks the Finance Department went so far as to suggest that in every important case the Governor should also ascertain the opinion of the Managing Director of the Imperial Bank. This practice was, however, abandoned soon 'when they found that in no case was the second opinion different from mine'. Having said all this it must be said in favour of the Government's stand that, to use Sir Chintaman's own words, 'it is notoriously dangerous to change horses in mid-stream, and the anxiety of the Finance Department to ensure that the new mount would not sink with them in the stream was understandable'.

word about the new Deputy Governors. Mr. Wajahat Hussain, who was 49, entered the Indian Civil Service in 1919 after a brilliant academic career ending with study at Cambridge where he was a contemporary of Mr. Deshmukh. Besides his experience in various capacities with the Government of the United Provinces, he had been a Minister in the Jammu and Kashmir State and a delegate to

* Mr. Deshmukh was knighted in January 1944.

† op. cit.

the Third Session of the Indian Round Table Conference in London in November 1932. At the time of his appointment as Deputy Governor, he was Commissioner of Gorakhpur Division in the U. P. Mr. Cecil Russell Trevor, 44, was an Englishman and before his elevation the Chief Accountant of the Reserve Bank for many years. After seeing active service with the British Army during World War I, he came over to India and joined the Imperial Bank in 1921. He worked for over a decade in the different departments of the bank at Calcutta and other centres and was also the Agent of several of its branches before his services were lent to the Reserve Bank on its inauguration in 1935. With his knowledge and experience of accounts in both the banks, he was placed in charge of the general administration, while Mr. Wajahat Hussain attended to the matters pertaining to agricultural credit, banking regulation, and allied problems. Mr. Wajahat Hussain did not however finish even half the term; he died in December 1945.

The appointment of an Indian as Governor was productive of many initiatives, as described in the different chapters of the History. Indianisation also meant the safeguarding of India's interests more than was possible in the regime of a British Governor though, as already mentioned, Sir James Taylor was throughout sympathetic to India's interests and aspirations. The new Governor also endeavoured to maintain the tradition of independence of the Bank. A few incidents illustrative of this spirit are worth recording. In July 1945, the Joint Finance Secretary to Government wrote to the Governor a cryptic letter that Government would like to be consulted confidentially in regard to the proposed allocation of the Bank's net profit each year as soon as it could be reasonably estimated. The Governor took strong objection to Government's writing in this 'summary fashion'. Strictly speaking, the Governor wrote, the Government could not claim to be 'consulted'. Section 47 of the Act vested in the Bank the authority to make the necessary allocations for depreciation, bad and doubtful debts, etc., and the transfer of the balance of profit to Government after payment of dividend to the shareholders was merely a mechanical affair. He went on to add:

As a matter of courtesy and unwritten convention, my predecessor and I have been agreeing in advance with Government over the matter of appropriation for reserves, but I cannot engage to do so in subservience to what amounts to a claim to be consulted from the Finance Department. I regard it as important from the point of view of national interests, no less than in conformity with the intentions of the Legislature, that the independence of the Reserve Bank be preserved in the business aspects of its operations, and I feel constrained to enter a caveat against any semblance of an encroachment on its discretion.

Yet another instance where the Governor had to protest indignantly arose with reference to some comment of the Finance Secretary on the draft of the Governor's speech to the shareholders at the annual general meeting to be held in August 1945. A copy had been sent to him principally in his capacity as Government Director on the Bank's Central Board. Referring to some statement of the Governor, the telegram from the Finance Secretary employed the words 'somewhat disingenuous'. The Governor reacted angrily to the use of the words, remarking that it 'sounds oddly discourteous in the context in a communication from the Central Government's Financial Secretary to the Governor of the Reserve Bank' and demanded that 'a suitable correction' be made in the record. The protest produced an apology from the Finance Secretary who took responsibility for the 'bit of loose drafting' and added that from Government's point of view the correspondence regarding the speech was of purely ephemeral interest and would be destroyed once the speech was finalised and delivered.

Term of Service of Governors and Allied Matters

While on the subject of Governors, some developments concerning their terms of service may be mentioned briefly. Under the Act, the terms of appointment of the Governor and the Deputy Governors were a matter for determination by the Central Board with the approval of the Central Government. For more than a decade after the Bank was inaugurated, these chief executives of the Bank enjoyed no formal benefits of leave and leave fare concessions, except for short local leave up to a total period of one month in any one year availed of by informal arrangement with the Committee of the Central Board. During the early years of the Bank's life prior to the outbreak of the war, the Governor and the Deputy Governor had to proceed to the U.K. frequently on the Bank's business and this incidentally gave them some of the usual advantages of leave. Of course, leave for medical reasons was sanctioned on an ad hoc basis; thus, in May 1935 Sir Sikander Hyat-Khan was sanctioned two months' leave on full pay, on account of his illness, and in September Sir James Taylor, who was then Deputy Governor, was sanctioned six months' convalescent leave out of India on full pay.

Since the commencement of war, while on the one hand no such relief was possible, on the other, the strain of additional responsibilities increased enormously. On the recommendation of the Governor, the Central Board, at its meeting held on July 21, 1945, endorsed the proposal that the Deputy Governors be granted during the period of their appointment 'ordinary' leave up to a total of four months on one occasion, during which they would be paid a reduced salary of Rs. 3,500

per mensem. While no rail fares were admissible, the Deputy Governors and their families were made eligible for free passages to the U.K. and back and these were to be enjoyed equally by those of Asiatic domicile. Government accorded approval to these proposals. Sir Chintaman made no recommendation regarding the Governor: he felt that the matter could be considered by the Board at the time of the next appointment of a Governor. It was, however, not until 1966 that provision was made for leave for the Governor as part of the terms of his appointment.

Another interesting matter relating to the top executives was whether it was necessary to make officiating arrangements in the Governor's place during his absences abroad on duty. The provocation for the exchange of views between the Governor and Government was Sir Chintaman's decision to authorise one of the Deputy Governors to attend to his duties during his absence abroad in the autumn of 1944 as a member of the Indian Delegation to the Bretton Woods Conference. The Government desired, however, that officiating arrangements should be made for the period. The Governor held the view that Section 12(1)* of the Act contemplated arrangements for vacancies ejusdem generis (i.e., generally of the same kind or comparable) with leave and infirmity which did not exist in this case. When the Governor of 'the Bank had been abroad in comparable' circumstances on three previous occasions, the provisions of this Section had not been invoked at all. It could hardly be expected that 'an officiating Finance Member would be appointed if the Finance Member attended an international conference in which his presence is required qua Finance Member'! Besides, the initiative for making a recommendation for the officiating appointment rested with the Central Board and not the Government. He proposed therefore that Government consult their Legislative Department, particularly since there had been no discussions on the Reserve Bank Bill at any stage to indicate the precise scope of this Section. The Legislative Department confirmed the Government's view that the ejusdem generis rule did not apply here. However, since the Section was permissive, Government did not wish to press their point further on that occasion. The Governor was not satisfied with the legal ruling and felt it his duty to tell Government again that the implication of the decision would be that the Governor should raise the issue before the Board every time he had to be away from the country and that this was not 'a consummation entirely to be wished'.

* The Section read : ' If the Governor or a Deputy Governor by infirmity or otherwise is rendered incapable of executing his duties or is absent on leave or otherwise in circumstances not involving the vacation of his appointment, the Governor General in Council may, after consideration of the recommendations made by the Central Board in this behalf, appoint another person to officiate for him, and such person may, notwithstanding anything contained in clause (d) of sub-section (1) of Section 10, be an officer of the Bank'.

The question came up again in 1945 when the Governor desired to visit the U.K. for three months to study important banking and central banking trends, but it would appear that Government chose not to insist on any officiating arrangement being made.

In this context, it would be appropriate to mention the care that Sir C. D. Deshmukh took to maintain the equality of the Deputy Governors. This was, incidentally, in keeping with the views of the India Office Committee which, while commenting on the provisions of the Reserve Bank Bill of 1928 relating to casual vacancies in the office of the Governor, had also remarked that the two Deputy Governors 'should be of equal status and that there should be no question of seniority as between them'.

In practice, no doubt, the Governor of the Bank would normally decide which of them was to act in his place for brief incidental periods of absence; but in the case of longer periods we think that the decision should rest unmistakably with the Governor-General at his discretion, whose choice, of course, may rest on either of the Deputy Governors, or on any other suitable person. The maintenance of sub-clause (1) as it stands will secure the objects to which we attach importance.*

Having appointed one Deputy Governor to look after his work during his absence abroad in 1944, the Governor proposed to entrust the other Deputy Governor with his functions and duties the next year as he 'did not wish to create the impression that of the two Deputy Governors, one was senior and the other junior'. While Government agreed with the principle underlying the Governor's proposal, they suggested what they considered to be a better solution -that the two Deputy Governors be placed in joint charge. This was, of course, physically impossible, as explained by Sir Chintaman to Government, for 'placing in charge' really meant presiding over the Committee and Board meetings and voting for the Governor. It is interesting that Sir James Taylor, who should have known the recommendations of the India Office Committee better than anyone else, had allowed himself to be called the Senior Deputy Governor!

Another development of interest was the change in the practice relating to the location of the Governor's headquarters that occurred during this period. Although not explicitly laid down in the Statute, it had been the intention of its framers that the Governor should spend some of his time at each of the different centres where the Bank's offices were to be located, so that he would have 'the great advantage of personal intercourse with a wide business circle' and that with this

* The relevant clause in the Reserve Bank of India Act, 1934, was substantially the same as that of the 1928 Bill; the only change introduced at the Select Committee stage was to provide that the Governor General in Council would make the officiating appointment after consideration of the recommendations made by the Central Board in this behalf.

end in view the Central Board should hold its meetings at these centres by turns. Even during the general debate in the Assembly on the Reserve Bank Bill, there had been suggestions that the Bank's Head Office should peregrinate; Sir Leslie Hudson had proposed a stay of five months in Bombay, six months in Calcutta, a fortnight in Madras and a fortnight in Delhi. The Select Committee had also not favoured a fixed location for the Head Office. Speaking in the debate on the amendment to provide for one Deputy Governor only instead of two, Sir George Schuster made the point that two Deputies were necessary so that there were 'responsible officers' both in Bombay and in Calcutta.

Calcutta and Bombay being the most important commercial and financial centres in the country, it became the practice of the Governors to divide their time approximately equally between these two places (apart from brief visits to other centres) in conformity with the spirit of these recommendations. The Bank also acquired residential accommodation for the Governor in the two cities. A departure from this practice became necessary in the winter of 1942. Owing to the virtual closure of the Calcutta port as a result of war developments in the Far East and its proximity to one of the possible theatres of war, business in Calcutta had declined considerably and the pulse of its money and other markets was well below the norm. From the point of view of contacts with important banks and other commercial interests, therefore, a prolonged sojourn in Calcutta did not appear to have any commensurate public advantage. The Governor's house in Calcutta had also been requisitioned by the Army authorities in May 1942, but this was not an important reason for the Governor's keeping off Calcutta. It should be added that even after the practical necessity for spending most of the time in Bombay disappeared after the war, the subsequent Governors made Bombay their permanent headquarters and paid only periodical visits to the other centres.

Soon after Sir B. Rama Rau became Governor, he considered that it was no longer necessary or economical for the Bank to retain the Governor's house in Calcutta; he, therefore, obtained the Board's approval for its sale in December 1949. Lamenting the decision, the editor of Indian Finance (January 14, 1950) felt that the Bank's eagerness to dispose of the property was 'misconceived austerity'! He went on to say:

The Calcutta residence of the Governor of the Reserve Bank was a symbol of Calcutta's importance in our central banking and our central banking institution. And it is not far-fetched to suggest that its disposal indicates likewise the growing insignificance of this city in the direction of the affairs of the Reserve Bank If the Governor should be glued to any one spot, then that spot would inevitably gain an ascendancy in the counsels of the Bank. It was laid down, therefore,

that the Governor's stay should be distributed over the principal commercial and Provincial centres according to their relative importanceAn official residence in Calcutta for the Governor, owned by the Bank and maintained throughout the year for that purpose, was according to this plan, and no mere whim of any individual.

Though the decline has reached its nadir, I still hope the fall is not yet. In the rivalry between Calcutta and Bombay for the upper hand in the affairs of the Reserve Bank, Calcutta has lost steadily and all along the line. The decision to sell the house is the climax of it. For, it is impossible that the conversion of this property into hard cash is an urgent necessity for the Reserve Bank, which is the source of all fiduciary currency.

The Pattern and Consequences of War Financing

Of the several functions of a central bank, perhaps the most significant one during a period of war is that of banker to Government. Apart from handling the vastly expanded volume of Government transactions, the central bank has a special role to play in assisting Government to raise resources in the form of borrowings, to supplement those raised through taxation. The fundamental principle of war financing is to divert such portion of the Gross National Product to Government as might be necessary for the defence effort; the community has to make the requisite sacrifice. Some responsibility is also cast on the central bank to advise the Government in the sphere of fiscal policy, so that resources are maximised without generating severe inflationary pressures and equity ensured as between the various sections of the community as regards sacrifice of current consumption and investment.

The problems of war finance which India had to face were not materially different from those of other countries, although the country was not, by and large, an actual theatre of war. As a dependency, it was called upon to make a substantial contribution to the war effort of the U.K. and her Allies. This very circumstance, however, also imposed limitations on the ability of the British rulers in India to maximise the mobilisation of resources in a non-inflationary way. For, apart from the factor of low per capita income, the lack of enthusiasm for the war on the part of the country as a whole and non-cooperation from the leading political party set a serious limit to Government's efforts in raising resources in the form of taxation and non-inflationary borrowing from the public. Perhaps it is these factors rather than complacency or lack of understanding of problems of war finance that explain why the financial mobilization fell short of the needs of the situation. Considering

all the circumstances, perhaps the fiscal effort actually made was not altogether disappointing. While inflation did occur in a substantial way, it was of far less serious magnitude than it looked likely at one stage.

Budgetary Position of Government: General View

As already mentioned, it was the responsibility of the Government of India to find the resources not merely for the Government of India's own defence expenditure but also for the requirements of the Allied Governments, in particular the U.K. It turned out that the requirements of the Allies were in the aggregate almost as large as those of the Government of India. Of course, the Government of India were entitled to recover from the U.K. (and other Allies) the expenditure incurred on behalf of the latter. The basis of reimbursement of defence expenditure on behalf of the U.K. was set out in an agreement, called the Financial Settlement, which was concluded in November 1939 between the British Government and the Government of India and given retrospective effect from April 1, 1939. According to the Agreement, the whole of the defence expenditure incurred by India was to be apportioned between the two Governments on the following basis: India was to bear (1) a fixed annual sum representing the normal net effective costs of the Army in India under peace conditions, (2) an addition to allow for rises in prices, (3) the cost of such war measures as could be regarded as purely Indian liabilities by reason of their having been undertaken by India in her own interests, and (4) a lump sum payment of Rs. 1 crore towards the extra cost of maintaining India's external defence troops overseas. The total amount by which the net annual defence expenditure incurred in India during the war years exceeded the aggregate of items (1) to (3) was to be recovered from the British Government.

The budgetary position of the Government of India, including expenditure incurred on behalf of the Allied Governments, is set out in the following table. Considering first the Government of India's own outlay, it will be seen that the increase in expenditure was rather modest in the first two full financial years of the war, namely, 1940-41 and 1941-42. But in the next two years there were sharp increases; total outlay rose from Rs. 148 crores in 1941-42 to Rs. 367 crores in 1942-43 and further to Rs. 504 crores in 1943-44. However, in 1944-45 the rate of increase in expenditure was rather modest and in 1945-46 there was a slight decrease in expenditure, reflecting the cessation of war in August 1945. The aggregate outlay on India's account in the six-year period 1940-46 was Rs. 2,261 crores, of which expenditure on revenue account was Rs. 1,971 crores. The Recoverable War Expenditure began to rise sharply from 1941-42, in which year it amounted to

BUDGETARY POSITION OF THE GOVERNMENT OF INDIA

| | | (Rs. crores) | | | | | | | | | |
|---|-----|--------------|---------|---------|---------|---------|---------|---------|---------|---------------------------------|--|
| Fiscal years (April-March) | | 1938-39 | 1939-40 | 1940-41 | 1941-42 | 1942-43 | 1943-44 | 1944-45 | 1945-46 | Total for 6 years 1940-46 | |
| 1. Revenue Account | | | | | | | | | | | |
| (i) Revenue | 84 | 95 | 108 | 135 | 177 | 250 | 336 | 361 | 1,366 | | |
| Of which Tax Revenue | 74 | 81 | 77 | 98 | 125 | 171 | 254 | 282 | 1,007 | | |
| (ii) Expenditure | 85 | 95 | 114 | 147 | 289 | 440 | 496 | 485 | 1,971 | | |
| (iii) Balance* | - 1 | - | - 7 | - 13 | - 112 | - 190 | - 161 | - 123 | - 605 | | |
| 2. Aggregate Outlay on India's Account (Revenue and Capital Accounts) | 94 | 99 | 121 | 148 | 367 | 504 | 578 | 542 | 2,261 | | |
| 3. Overall Position (including Capital Transactions)* | + 2 | + 3 | - 2 | + 1 | + 2 | + 65 | + 183 | + 263 | + 513 | | |
| 4. Recoverable War Expendi- ture | - | 4 | 53 | 194 | 325 | 378 | 411 | 375 | 1,736 | | |
| 5. Total of items 2 and 4 | 94 | 103 | 174 | 342 | 693 | 882 | 989 | 917 | 3,997 | | |
| 6. Budgetary balance* on Indian and Allied Accounts com- bined (3-4) | + 2 | - 1 | - 55 | - 193 | - 323 | - 312 | - 228 | - 111 | - 1,223 | | |

* + Surplus; - Deficit.

Sources: Reserve Bank of India, *Banking and Monetary Statistics of India, 1954*, and Government of India, *The Indian War Economy (Supply, Industry and Finance)*, 1962.

Rs. 194 crores. It reached a peak of Rs. 411 crores in 1944-45; in that year the expenditure on Government of India's own account was also at the peak of Rs. 578 crores. The total of Recoverable War Expenditure in the six-year period was Rs. 1,736 crores. In other words, the aggregate outlay which the Government of India were called upon to finance was of the order of Rs. 4,000 crores. The peak of the combined expenditure at Rs. 989 crores in 1944-45 was almost ten times that of 1939-40, which included seven months of the war period.

It should be explained at the very outset that the reimbursable part of the war expenditure was received by the Government of India in the form of sterling, which could not be spent for the time being on buying goods either in the U.K. or elsewhere. Thus, in the six fiscal years 1940-46, the payments of sterling by the British Government totalled the equivalent of Rs. 1,633 crores, against the Recoverable War Expenditure of Rs. 1,736 crores. India also acquired sterling as a result of a surplus payments position on private account; the Reserve Bank's net purchases of sterling, relating primarily to non-Government transactions, were of the order of Rs. 650 crores in the period 1940-46.

While the Government of India received an asset in the form of sterling not immediately usable, they had to find the rupee resources for meeting that expenditure. It was not possible for the Government of India to raise the entire resources in a non-inflationary way through taxation and genuine borrowing. What the Government did was to finance a substantial part of the expenditure through the simple device of currency issue. The fact that India obtained sterling from the British Government in respect of their expenditure in India did not alter the fact that there was a substantial draft on India's real resources, the community having to make a cut in current consumption and investment. The Government transferred the sterling to the Reserve Bank and got rupee currency against these assets. In terms of Section 41 of the Reserve Bank of India Act, the Bank was bound to buy sterling in exchange for rupees at around the rate of 1S. 6d. a rupee. While undoubtedly there were factors at work to absorb the currency expansion, such as increase in national output and increase in the holding of cash, about which precise data are not available, their impact was modest; in the result there was an inflationary upsurge. How the thinking of the Government and of the public proceeded on the matter of the sterling-induced inflation and what the Government did to intensify the mobilisation of resources is discussed in subsequent sections of the chapter.

The Government of India endeavoured to raise additional tax resources both through levy of new taxes and enhancement of the rates of existing taxes. Even so, tax revenue did not keep pace with the Government of India's own requirements. In the result, there were

substantial deficits on revenue account, from the year 1942-43 onwards, the largest, namely, Rs. 190 crores, being in the year 1943-44. In the six-year period 1940-46, the tax revenue of the Central Government totalled a little over Rs. 1,000 crores or about 45 per cent of the outlay on Government of India's account. Tax revenue in 1945-46, at Rs. 282 crores, was about $3\frac{1}{2}$ times that in 1939-40. There was a significant increase in non-tax revenue (net earnings of Railways, Posts and Telegraphs, profits of the Reserve Bank, etc.), which increased from Rs. 14 crores in 1939-40 to Rs. 79 crores in 1945-46 and totalled in the six-year period 1940-46 Rs. 359 crores or a little over one-third of tax revenue.

As regards tax measures, briefly, there was a substantial stepping up of income and corporation taxes, including the introduction of excess profits tax in the budget for 1940-41. In respect of income-tax, a Central surcharge of 25 per cent was levied in November 1940, on all taxes on income. In the year 1941-42, the surcharge was raised to $33\frac{1}{3}$ per cent. In 1942-43, the burden of surcharge was raised through a change in the basis of the levy. In subsequent years, the surcharge was raised in respect of higher slabs of income. The super tax on companies was raised steadily from one anna in the rupee to three annas. In the budget for 1942-43, the exemption limit for income-tax was lowered from Rs. 2,000 to Rs. 1,500, though the higher limit was restored in 1944-45. Towards the close of the war, a differentiation was also introduced between earned and unearned income. As regards the excess profits tax, the rate was 50 per cent in 1940-41 and was raised to $66\frac{2}{3}$ per cent in 1941-42; the total yield was Rs. 265 crores in the six-year period 1940-46. In 1944-45, the 'Pay-as-you-earn' system of income-tax collection, that is to say advance payment, was introduced. In the field of indirect taxation, additional receipts came mostly from excise duties. The duties were raised on sugar, motor spirit, matches and kerosene, and fresh duties were imposed on several commodities, namely, tobacco, pneumatic tyres and tubes, vanuspati, betelnuts, tea and coffee. Revenue from Central excise duties rose from Rs. 6.5 crores in 1939-40 to Rs. 46 crores in 1945-46. The revenue from customs declined over the first three years, but from 1943-44 onwards there was a rise, the yield of Rs. 74 crores in 1945-46 being about 60 per cent higher than that in 1939-40.

Despite these efforts, it should be noted that the tax and non-tax revenue together met not much over two-thirds of the expenditure on revenue account, leaving a large deficit on revenue account, aggregating Rs. 605 crores in the period 1940-46.

In the three years 1940-43, the deficits on revenue account were met by surpluses on capital account, with the result the overall budget on Government's own account was in balance. Nevertheless, from 1943-44

onwards, on account of the inflationary pressures an effort was made to raise much larger sums through borrowings than were required to meet the revenue deficit and the capital expenditure of the Indian Government; the surpluses were utilised to finance a part of the Recoverable War Expenditure. Thus, the overall surpluses in the three years 1943-44 through 1945-46 were Rs. 65 crores, Rs. 183 crores and Rs. 263 crores, respectively. In the six years 1940-46, the overall surpluses on Government of India's own account totalled Rs. 513 crores. However, the surpluses were inadequate to meet the Recoverable War Expenditure which totalled Rs. 1,736 crores. In the result, the budgetary gap, on the combined account of India and the Allies, was as much as Rs. 1,223 crores, which was met by issue of currency. The largest deficit of Rs. 323 crores occurred in 1942-43, after which there was a steady decline, tapering off to Rs. 111 crores in 1945-46.

To complete the budgetary record, a brief reference may be made to the financial position of the Provincial Governments as a whole during the war period. The consolidated position of these Governments showed a surplus on revenue account in all the war years (1940-46), totalling Rs. 57 crores. There was also overall (i.e., in respect of combined revenue and capital accounts) surplus in all the years except in 1944-45, aggregating Rs. 23 crores. The total outlay of the Provincial Governments in the period 1940-46 was a little under Rs. 1,000 crores (or about two-fifths of that of the Central Government). About two-thirds of the Provincial outlay was covered by tax revenues, including the Provincial share of income-tax to the extent of about Rs. 100 crores.

Evolution of Fiscal Policy

The question naturally arises whether the Government of India could not have raised even larger resources on their own account, especially through additional taxation, so as to meet Recoverable War Expenditure to a greater extent. It is not easy to answer this question in a categorical way; what one can do is to place before the readers the relevant circumstances of the case. The capacity of a poor nation to contribute resources to the national cause in times of an emergency like war is elastic only to a limited extent. Moreover, it depends to some extent upon the kind of leadership that is provided by the political parties to arouse the patriotic spirit of the people. In India, as already mentioned, on account of the fact that there was a foreign Government and the major political party boycotted the war effort, this favourable circumstance was singularly absent. In the circumstances, the Government preferred to follow to an extent the line of least resistance by financing the deficit through monetary expansion. The authorities in India and the U.K. were alive to the need for an all out effort to mobilise resources



Sir Chintaman D. Deshmukh

Governor, 1943-49

but their ability was not equal to the task. The very low per capita income of the country and the inadequacy of the administrative machinery for collecting taxes also limited Government's ability to achieve any spectacular results in tax raising. Nevertheless, in retrospect it would seem that in absolute terms the performance of the Government in raising resources, both through taxation and borrowing, was not altogether unimpressive. Total tax revenue (including the Provincial share of income-tax) in 1945-46 was almost four times the level in the year 1939-40. Taxes on income recorded a sharp rise; the 1945-46 yield was over nine times that of 1939-40. In a period when there does not appear to have been a marked expansion of industries there was only limited scope for the levy of excise duties. While fairly large amounts were raised in the period 1943-46 through borrowing, they were not adequate to cover the entire budgetary gap. In other words, the main point of criticism against Government policy would appear to be not so much that they could not raise all the resources in a non-inflationary way but that the contribution to the Allied war effort that was demanded from India was of a magnitude that was beyond the country's capacity to finance in the conventional manner.

In his first war budget speech made in February 1940, the Finance Member outlined the budget strategy for war time. After referring to the growing view that budget should be planned not for a single year but for a longer period corresponding to a trade cycle, the Finance Member observed as under:

Now whatever the view which one may hold on the subject of budgeting for a year at a time or budgeting for a longer period more nearly corresponding to a trade cycle, there can, I hold, be no question that in the circumstances of India today the additional requirements of Government should clearly be met by drawing on the additional taxable capacity which the war has produced. It would in my opinion be indefensible in circumstances such as these to postpone for the future any part of the burden which can more easily be shouldered today.

As already mentioned, the main tax measure in the above budget was the levy of the excess profits tax.

The British Government also gave serious thought to the financing of the war effort in India. As early as May 1940, the India Office wrote to the Government of India that they had been 'giving some consideration to the effect on India's economy of the monetary expansion arising from war conditions, and the necessity of looking ahead so that we are ready to take timely action to prevent the situation getting out of hand'. The communication referred to the danger of inflation and the need to take effective measures. Apart from taxation, the need for the 'inauguration of a substantial rupee borrowing programme' was emphasised.

The anxiety of the British authorities was understandable in view of the rising trend of prices. In the first few months after the outbreak of war, commodity prices had recorded a sharp increase of a little under 40 per cent. While this appears to have been mainly due to exaggerated fears of acute shortages consequent on the outbreak of war, there was also general buying pressure financed by bank credit. After a decline in the first eight months of 1940, mostly reversing the rise in the first few months after August 1939, the trend of commodity prices was upward; even so, for the year 1940-41 as a whole, the general index recorded a decline of about 7 per cent, to 118.8 (Base: week ended August 19, 1939 = 100).

In the budget speech for the year 1941-42, the Finance Member did not seem to be much concerned with inflationary possibilities; he laid emphasis on the borrowing programme for augmenting the resources. On the other hand, the Reserve Bank authorities appeared to be rather worried. Writing in the middle of 1941 to the Finance Department, the Governor referred to the need for careful watch for signs of inflation. The only suggestion he had at that stage was that increases in wages and salaries of employees of business concerns drawing more than a certain maximum amount (say Rs. 75 per month) should not be allowed as expense in assessing income-tax or excess profits tax. In his address to the Bank's shareholders at the seventh annual general meeting held in August 1941, the Governor again struck a mild note of warning with regard to inflationary possibilities. He did not consider the rise in commodity prices that had taken place as being due to unhealthy speculative forces. He warned, however, that they could not afford to neglect the risk of such a possibility.

In his communication to the Finance Secretary in October 1941, however, the Governor was more forthright in his analysis of the inflationary potential, arising from allied expenditure in India. He seemed to favour a measure of Governmental compulsion to make people place a larger proportion of their income at the disposal of Government on the lines indicated by John Maynard Keynes for the U.K. In the context of conditions in India, his suggestion was that income and excess profits taxes should be increased, but that the increase should be compulsorily loaned to Government to be repaid after the war. The loan was to carry a relatively low rate of interest or no interest at all so that it might not compete with the normal borrowing operations of Government. He also suggested for consideration the taxation of profits from speculation.

With the entry of Japan into the war in December 1941, it was clear that the war would be more intense and widespread. In this context, the India Office again addressed the Finance Department in January 1942, about the likelihood of inflation reaching serious proportions in

India. Since an increase in supplies of goods was possible only to a limited extent during war time, it was suggested that attention ought to be given to drawing off purchasing power by additional taxation and/or borrowing and in this connection the India Office made several suggestions such as issue of six months Treasury bills at higher rates of discount, larger borrowing by Provincial Governments for repayment of debt to the Centre, introduction of a separate category of savings bank deposits, with restricted withdrawal facilities but carrying a higher rate of interest, levy of additional income-tax to be credited to the savings accounts of assesseees not withdrawable during the war, and introduction of a security on the lines of the tax reserve certificates of the U.K. The Finance Department consulted the Governor, who regarded most of the proposals unacceptable and Government would appear to have concurred. Governor, however, favoured borrowing by the Provincial Governments.

The Finance Member's budget speech of February 1942, presenting the estimates for the year 1942-43, recognised the need for intensification of the effort to mobilise resources. While some enhancement of taxation was effected, the main emphasis came to be placed on savings schemes. The measures took the form of option being given to new assesseees for income-tax (consequent on the lowering of the exemption limit from Rs. 2,000 to Rs. 1,500), to escape the liability by depositing in the Post Office Defence Savings Bank an amount approximately $1\frac{1}{4}$ times the amount of tax assessed, such deposits not being ordinarily withdrawable till one year after the end of the war. In practical terms these measures did not add to much.

The Central Board and Sterling Accumulation

By about the middle of 1942, the Central Board of the Bank became quite concerned with the large increase in currency circulation and the sterling assets of the Bank. The Recoverable War Expenditure had begun to show a substantial increase from the year 1941-42; the total for that year was Rs. 194 crores as against Rs. 53 crores and Rs. 4 crores, respectively, in the preceding two years. The increase in Recoverable War Expenditure was reflected in about an equal measure in the receipt of sterling from the British Government. In the result there was acceleration in the rate of growth of money supply, from Rs. 90 crores in 1940-41 to Rs. 168 crores in 1941-42, or from 21 per cent to 33 per cent. Both as a result of the monetary expansion and the psychological impact of Japan's entry into the war, the uptrend in commodity prices became much more pronounced, the aggregate rise for the year 1941-42 being 23 per cent; hence the anxiety of the Directors for a discussion of these matters. They must have felt that the

consideration of the Bank's annual report for the year 1941-42 would provide a convenient opportunity for this. So they enquired of the Governor:

Whether it would be possible to circulate some portion of the draft relating to these matters in advance so that the Directors could give them more lengthy consideration and would also have time to ask for further information or elucidation of points not clear to them.

The Governor did not see any objection to the course proposed and circulated on June 25, 1942, a brief letter outlining his views on these issues and also the preliminary draft of the relevant portion of the Bank's annual report for the year 1941-42. The Governor's view on the price rise was as under:

my view is that though there has been a considerable rise in internal prices, I do not consider that this is the result of the increase in the note currency, but rather that the two phenomena together are the unavoidable result of the large purchases of goods and services which are being made by the British Government in India. Unless this increase in purchases can be met by an equal increase in the supply not only of the articles being directly purchased by the British Government but of the foodstuffs and other necessities of life which those who are producing these supplies require to keep them going and which they are now in a position to purchase owing to the money accruing to them, there is bound to be an increase in commodity prices in this country. The remedy could only lie in advising Government to do all it can to encourage the production of foodstuffs and other necessities of life, and, on the other hand, by encouraging investment so that as much as possible of the increased purchasing power may not be spent unnecessarily now but may be kept as a reserve for the future.

The Governor welcomed the accumulation of sterling as being useful for India's post-war reconstruction. He did not think that there was 'any practical danger that these assets will not be convertible into such producer goods as and when they are required'. He also recommended continuance of the policy of repatriation of sterling debt (see Chapter 13). It is apparent that the Governor wished to put the matter of inflation in as subtle a way as possible, so that his Board and the public might be reasonably satisfied with the state of affairs and that the war effort should go on with undiminished vigour.

The Board had a comprehensive discussion on this item at its meeting of July 20, 1942, judging from an office note recorded by Deputy Governor Deshmukh. A suggestion was made that insofar as there was a payments surplus with the U.S.A., 'irrespective of the Lease and Lend arrangements', the possibility of acquiring gold or dollars should be explored and that arrangements should be made to sell the gold to the Indian public at a suitable price. It was also suggested that an

embargo should be placed on the export of gold; it was pointed out that 'such a course would depress the price of gold and inflict a loss on large number of people' ! The question of acquiring British investments in India was also mentioned as one which should be examined; in fact, Directors Mr. Kasturbhai Lalbhai and Mr. B. M. Birla had mentioned this to the Governor earlier. Some of the objections to this suggestion were stated to be that there would be problems of making satisfactory arrangements about the direction and control of the foreign owned enterprises and that repatriation would pose many administrative problems. All that the Board's resolution said on the annual report was that, while transmitting it to Government, the Governor be authorised to convey to them the Board's suggestion that the remaining sterling liabilities of the Government, including Railway debentures and annuities, be repatriated, with a view to using up the surplus sterling assets.

The annual report itself (for the year 1941-42) had the following to say on currency expansion and inflation:

The remedy for any inflationary tendency that the expansion of currency might have must take into consideration the causes which are producing the increased demand for currency, and these in present circumstances are not amenable to any action which the Reserve Bank can itself take. It may be stated, however, on a review of the facts and figures bearing on inflation, e.g., the course of prices, the extent of currency expansion, the increase in bank deposits and the volume of bank clearings, that although most of the recognised elements of inflation are present, there is no evidence that inflation is present in the country in any serious form.

It may be mentioned that the first sentence in the above quotation was as redrafted by the Finance Secretary. The Bank's draft had stated that 'the remedy for any inflationary tendency that the expansion of currency might have lies outside its proper sphere of action'. The Finance Secretary feared that the above statement 'might be attacked by financial critics as unsound and by political critics as an admission of what they are continually harping on, namely, that the Reserve Bank is not an independent currency authority but is entirely subservient to the Government'. In his speech to the Bank's shareholders in August 1942, the Governor gave his analysis of the problem of inflation (which term, he said, he 'disliked') on the lines of his earlier letter to the Directors. He said, in short, that there was nothing that the Bank could do about it and referred to the activities of hoarders and, speculators!

From about the middle of 1942 onwards the inflationary situation started assuming serious dimensions, with a substantial stepping up of the Government of India's own outlay as well as the expenditure on account of the Allies. Thus, the combined outlay more than doubled

from Rs. 342 crores in 1941-42 to Rs. 693 crores in 1942-43. There was a sharp increase in the rate of expansion of money supply, from Rs. 168 crores to Rs. 464 crores, or percentage wise, from 33 to 68. The general index of wholesale prices also recorded a marked increase, from 145.6 in March 1942 to 186.2 in December 1942 and further to 219.8 in March 1943, making a total of 51 per cent for the year 1942-43. The country's top economists, under the lead of Professor C. N. Vakil of the Bombay School of Economics and Sociology, realised the seriousness of the situation and wrote persistently giving an analysis of the inflationary situation and the directions in which fiscal action was called for to stem the inflation. The pride of place to the literature on the subject should go to Professor Vakil's booklet, *The Falling Rupee*, which was first issued in January 1943. This was the first systematic effort to focus public attention on the financial problems posed by the war. According to Professor Vakil, the correct methods of financing the allied expenditure in India were: (1) payment in durable assets, (2) payment to India in gold, (3) raising of rupee loans in India by the U.K. and (4) liquidation of British assets in India.

On account of the seriousness of the situation, a number of economists* issued a joint statement on April 12, 1943 analysing the causes of inflation and suggesting a comprehensive programme of action. Important portions of the statement are reproduced below. †

The Government seems to act as if it is enough for it to take care of its own budget deficit while meeting the needs of the British Government by printing more notes. This is a grave misreading of the whole situation and has resulted in an ever increasing expansion of currency unrelated to the needs of internal production and trade. As a result, the inflationary spiral is already at work in India. The inflation in India is, therefore, a deficit-induced, fiat-money inflation. It is the most disastrous type of inflation.

Inflation is the most inequitable way of distributing the war burden and usually large transfers of wealth from the poorer and the middle classes to the richer classes. It is also undesirable because it increases the cost of war and impairs the war effort by hindering production and distribution. Its consequences to economic society are immediately felt; it, however, also holds the threat of bringing about later, political consequences of an even graver nature.

We earnestly feel that immediate and drastic measures to check inflation are called for. In this connection we urge on the Government of India the primary necessity of closing the 'gap' by increased taxation and borrowing. Taxation, in our opinion, should be raised to the highest practicable pitch, adjusted to shoulders that can best bear it. We suggest a much steeper progression in income-tax rates, the laying of

* V. G. Kale, P. A. Wadia, K. T. Shah, C. N. Vakil, D. R. Gadgil, J. P. Niyogi, G. B. Jathar, B. V. Narayanaswamy, A. I. Qureshi, S. K. Iyengar, J. C. Kellock, M. K. Ghosh, D. Ghosh, H. C. Malkani, H. C. Sinha, B. R. Shenoy, J. J. Anjaria, L. N. Wellingkar, V. Y. Kolatkar and D. G. Karve.

† Source: *Financial Burden of the War on India* by Professor C. N. Vakil.

a maximum limit to individual consumption income and absorption of all profits above a limit, either in tax revenue or to be impounded into special loan contributions. To increase the volume of borrowings to the required level, it is necessary to institute a comprehensive scheme of compulsory savings as well as a rigid control of all investment outlets. This programme should be brought into effect with great rapidity. However, it will take some time before the inflationary gap is completely closed and the total currency in circulation is today already greatly redundant, even at the existing high prices. To tie up this vagrant purchasing power we propose the immediate initial steps of a blanket control of all prices followed by a strict examination of all later allowable increases. A rationing of the essential necessities of life should be undertaken to as large an extent as possible. An effective control of prices will involve a wage stop but this will mean no hardship as long as the price rise is stayed. An equally strict profits stop is indicated as a corollary of this policy as well as independently on account of financial considerations.

The leading Directors of the Central Board showed renewed concern regarding these developments, their anxiety being, it would appear, more about the accumulation of sterling with the Bank in a very visible manner than the emergence of inflation. In January 1943, Sir Purshotamdas Thakurdas, after discussions with the Governor, made two suggestions, one of which was that sterling that might accumulate thereafter in London should not be taken over by the Reserve Bank but should be kept by the Government of India for a temporary period, that is, until they negotiated a rupee loan to the U.K., sterling being converted on the basis of 1S. 6d. This was to 'remove the apprehension of people that large amounts of sterling continue to accumulate in London, and the apprehension of some at least that this sterling may not be worth in the future what it is today in rupees'. Sir Purshotamdas's other suggestion was that Government should revise their loan policy and offer attractive terms for short periods, if necessary free of income-tax. In making this suggestion, Sir Purshotamdas had in mind the substantial withdrawal of postal savings deposits and post office cash certificates that had taken place. Replying to Sir Purshotamdas, the Governor referred to the real difficulty of Government's being committed to cheap money policy. As regards the rupee loan to the U.K. Government, he was not clear what precise object that would achieve. Answering this in another communication, on January 9, Sir Purshotamdas explained that a Government-to-Government loan would 'serve the purpose of taking away from the public eye the enormous sterling balance, which, I am afraid, tends to make people nervous. However, I have an open mind on this and put this suggestion to you in order to benefit by your expert knowledge'. He was also critical of the argument of cheap money. Concluding, he remarked:

It strikes me on the whole that the Reserve Bank is being used at present to finance the Government of India under circumstances unforeseen at the time that the Reserve Bank Act was passed, and I wonder whether it is not putting too much strain on the very credit which the Reserve Bank does enjoy with the people, and thus tend to shake the of the people in the Reserve Bank of the country, i.e., in the currency of the country.

Two weeks later, that is, on January 22, 1943, Sir Purshotamdas Thakurdas requested the Governor to put on the agenda of the Board meeting to be held on February 8, 1943, in Delhi, 'the question of the increasing sterling balances in London and the general dissatisfaction regarding what has been termed "inflation in India" including the steadily rising prices of all commodities and manufactured articles in India '. As a matter of fact, the Governor and the Deputy Governor had also considered the need for a discussion of these matters at the next Board meeting and a memorandum was under preparation. This was circulated to the Directors on January 25. Sir Purshotamdas also suggested to the Governor that it might be useful for him (the Governor) to wire to the Governor of the Bank of England ('it may not be unprofitable to invest even a few hundreds in sending him a full and elaborate telegram') his frank opinion on the current inflationary situation in India and the sterling accumulation and 'invite his guidance and suggestions for an early solution of this'. Sir James replied that he had kept the Governor of the Bank of England informed of general developments in India and he did not see 'what advice he could give beyond the obvious in a matter which is essentially for domestic and administrative solution'.

Governor's Memorandum on Sterling Balances and Inflation

The memorandum, which the Governor circulated to the Board on January 25, 1943, entitled Sterling Balances and Inflation in India, was only a more forthright restatement of his earlier views on inflation in India and its causation. The memorandum also commented on the suggestion that Britain and the U.S.A. should float rupee loans in India for financing their own purchases. Surprisingly, there was no reference at all in the memorandum to Sir Purshotamdas Thakurdas's suggestion regarding a rupee loan from the Government of India to the British Government. This was later taken up by Mr. Deshmukh, after he became Governor.

In connection with the consideration of the inflationary impact of the currency expansion in India, the Governor drew the attention of the Directors to the increase in the hoarding of currency and consequent reduction in the velocity of circulation; a part of the currency had also

been transformed into bank deposits. He also observed that in assessing the rise in prices it should be remembered that the prices of many of India's staple agricultural commodities had been markedly below the normal in relation to those of manufactured articles for the period immediately preceding the outbreak of the war.

Regarding the role of accumulation of sterling as a direct cause of inflation, the Governor had the following to say:

It is hardly necessary for me to draw attention to the underlying fallacy. It is obviously not the form in which we receive credit from Britain that releases purchasing power in India but the rupee disbursements that have to be made for war supplies, etc. Unless therefore we make the ridiculous assumption that the war effort should be arbitrarily curtailed, it clearly follows that even if we received no sterling, our currency would have to be expanded just the same, unless either the Government taxed more, or the public were prepared to lend more. The only difference would be that the expansion would be against rupee securities, that is against the credit of the Indian Government instead of sterling, that is the credit of the British Government. I would go further and say that the problem of inflation that would arise in the former case would be of a more difficult order than at present since, when any reverse currency trends make their appearance in the post-war period, in the former case the return of currency would have to be purely deflationary while in the latter case it will occur against sterling expended on the purchase of a variety of useful imports.

The Governor considered that India was not doing so badly in regard to raising of public loans and that it would be difficult to do much better in this sphere. In his view, the scope for increasing public interest in Government securities or other forms of public debt was not so large as to make by itself a vital difference to the problem of inflation. He considered it would be fatal to try to increase the rates of interest paid on Government loans, as it might set in motion speculation regarding a continuous increase in the rates and that 'the cheap money policy on which the present war is being financed is therefore of vital importance'. In view of this analysis regarding the scope for public borrowing, the Governor did not 'think it necessary to make more than a passing mention' of the suggestion that Britain and the U.S.A. should float rupee loans in India. The Governor's comments on this were as under:

To my mind in view of the extent to which our war effort is being financed from outside, now running to twenty or so million pounds a month, this idea is chimerical and could only appeal to theorists in experienced in the practical scope and limitations of the Indian securities market. Put briefly if the general structural of interest rates is not to be disturbed by these foreign floatations, there seems no likelihood of their attracting investment would not go in any case into the

Government of India's own loans, and if the rates of interest offered were to mark an appreciable increase over the prevailing Indian rates in the hope of tapping fresh sources of investment, the entire structure of the securities market, which has been built up as a result of such careful control, would be disrupted and economic consequences set in train which would be far more serious than the evil, partly imaginary or at least exaggerated, which the floatations would be intended to serve. Further, if distrust of the future of sterling is at the back of this suggestion, it is difficult to see what difference would be made by an alteration of the currency in which credit is granted to Britain.

The Governor concluded his analysis of the problem of 'rising prices' in the following terms:

Thus on a comprehensive survey of the position from the purely financial side, one arrives at the conclusion that there can be no complete solution to the problem of rising prices in war time, if the war effort is to be maintained at its fullest pitch and pace and that such remedial action as is possible in the circumstances prevailing in India does not lie on monetary lines, but on those of practical administration. There is also no means open to the Reserve Bank of putting any artificial restraint on the rate at which sterling is accumulating with it. If therefore the Reserve Bank desire to communicate any opinion to Government it can only be in the nature of an advice to intensify governmental effort on the production of food and other necessities of life and to draw up and pursue vigorously plans for promoting the rural development of the country not only so as to draw off surplus purchasing power and counterbalance the economic maladjustments created by the war but, what is more important from the long range point of view, also to improve the capacity of the country to deal with the problems of the post-war period.

Sir James's account of the discussions at the meetings of the Central Board and the Committee, held on February 8 and 10, 1943, respectively, is very interesting. (This is contained in the draft of a letter he dictated for issue to the Finance Secretary but which he never vetted and signed, as he became ill and passed away on the 17th night. It was, however, forwarded to Government by Mr. Deshmukh). Sir James's view of the Board's general reaction to his memorandum was as under:

I was somewhat surprised to find that the memorandum met with general approval from the Directors, particularly . . . , and after thinking over the matter it seems to me that what was really pleasing him was the line we were taking about inflation. They have always been inflationists themselves and naturally inflation suits the big businessmen and, whatever are its attendant evils, would be far better to them than any curtailing of war expenditure as a deflationary measure.

The meeting also discussed the terms of a draft resolution which Sir Purshotamdas Thakurdas had submitted. This draft made no mention of repatriation or acquisition of British business interests in

India. It referred mainly to the need to secure an assurance from the British Government that any future depreciation of the value of sterling would not affect the value of sterling possessed by India and that to ensure this the accumulation was to be related to the U.K. price index at the average rate prevailing when the sterling was acquired. An assurance was also sought from the British Government that the sterling would be freely convertible after the termination of the war, to finance India's purchases abroad. Sir James remarked that 'obviously the brain wave behind the resolution was that it would enable India both to eat its inflationary cake and have it, that however much prices might be pushed up by inflation it would not matter because the assets would be going up *pari passu*'. After the discussion had 'rambled on' for an hour, the Governor pointed out that any constructive suggestions which the Board wished to make might be on the lines of his memorandum, 'namely, that Government should start at once to examine and correlate schemes for post-war reconstruction, particularly those requiring foreign assets, as there would undoubtedly be a tremendous scramble for productive machinery after the war, and no country whether it happened to be a creditor or not in its own petty way would be able to get priority unless it could establish a case based on the common good'. The terms of the final resolution were to be finalised at a meeting of the Committee of the Central Board on February 10. The resolution as adopted by the Committee (which was in fact a Committee of the whole Board, since as many as eleven Directors were present) was as under:

The Central Board of the Reserve Bank are concerned at the rapidly growing volume of the Bank's external assets exclusively in the form of sterling (apart from the small holding of gold), the bulk of which represents a curtailment in current consumption by the country in the interests of the common war effort, notwithstanding India's backward industrial development and its low standard of living, and with a view to safeguarding the value of these assets and arranging for their utilization after the war to India's best advantage, the Board would recommend to Government -

- (i) That they draw up in consultation with business and commercial opinion in the country a considered programme of development and reconstruction for India for the post-war period and frame in connection therewith as approximate an estimate as is possible of her requirements of capital and other goods and the sources from which they can be most speedily and suitably secured, and
- (ii) that they concert with H.M.G. equitable safeguards for ensuring that these assets, or their equivalent in foreign currency, will be available to India on a basis which will not involve a loss to India in the value of the accumulated sterling.

Curiously, a report on the Central Board's deliberations on the above subject was sent to the India Office by the Finance Department only

as late as May 10, 1943, apparently after receipt of a telegram that day from the India Office, referring to the indications that inflation was developing in India and asking for a brief statement of what steps had been taken or were in contemplation, 'for drawing off purchasing power or providing outlets for it or regulating supplies and prices', including important measures considered but rejected.

In its reply to the above telegram, the Finance Department sent a telegram and also a longish note, discussing the question whether and at what rate potential inflation develops into actual inflation apparently, in the opinion of the Government actual inflation had not yet occurred! The note referred to the factor of the psychology of the population and in this connection drew attention to 'widespread underground propaganda' by the Congress party to 'destroy' confidence in the currency. It was mentioned that this campaign had been actively supported by big business and financial interests. The note also referred to the 'huge press campaign' initiated by the publication of Professor Vakil's pamphlet *The Falling Rupee*, 'which on political grounds developed into an out and out scare publicity aimed at compelling Government to curtail India's war effort'. The note said that the cumulative result of the above was the emergence of a hoarding mania. Reference was also made to the difficulty of imposing direct controls on distribution and prices of essential commodities. Finally, the note referred to an Ordinance that had been issued on May 17 to speed up the process of collection of excess profits tax in order to draw off a part of the surplus purchasing power seeking avenues, largely speculative, of short-term investment. In reply, India Office sent another long telegram on June 10, 1943, suggesting further measures for consideration of the Government for intensifying the resources mobilisation. The telegram concluded as follows:

While I am conscious that there probably are objections to all above expedients, there are also such grave objections, political as well as economic, to allowing inflation to take charge, that I feel we must face question as one of a choice of evils and not necessarily rule out measures which are per se unpalatable or even potentially dangerous if they offer prospects of escape from something on balance even more disagreeable or dangerous.

One such measure which it was decided to adopt was the sale of gold and silver in India, and sales of gold actually began on August 16. The borrowing programme was also intensified. These matters are dealt with in some detail in Chapter 11.

The Directors' annual report for the year 1942-43, issued in July 1943, also recognized the presence of inflation in the economy, in less ambiguous terms than the earlier report; of course, by this time

inflation had become much more pronounced. In his speech to the shareholders, the Deputy Governor (Mr. Deshmukh), then in charge of duties of the Governor, referred to the far-reaching shifts in economic position of the different classes of the population, and especially the deterioration in the position of people with fixed incomes, as a result of the steep rise in commodity prices and the need for corrective action, in the following terms:

The public has received directly or indirectly assurances from the highest Governmental quarters that energetic measures are being planned and put into operation to remedy the situation. These assurances are received none too soon; for with the social sense of the population imperfectly developed, as is unfortunately yet the case in the country because of its size and diversity, inequalities in the real sacrifices imposed by war conditions on the community can only be corrected by vigorous Governmental action, both constructive and regulative; and, in the alarms and excursions of war, 'everyone for himself and the devil take the hindmost' becomes a perilously attractive philosophy of life. Anti-social tendencies flourish in an inflationary atmosphere Speculative tendencies can, therefore, be effectively regulated only if efficacious measures are adopted to ensure an enlarged supply of essential goods to meet the minimum needs of a large population and are combined with measures to encourage genuine and voluntary savings, as well as direct measures to regulate the distribution and prices of essential commodities. This is particularly important having regard to the real difficulties of direct control in our country with its size and diversity of local conditions, the small scale and unorganised character of her productive and distributive systems, the extremely low standard of literacy and account-keeping as well as the lack of proper economic statistics and indices.

Rupee Loan to His Majesty's Government?

Earlier, a reference was made to a proposal by Sir Purshotamdas Thakurdas that a rupee loan be made to the British Government by the Government of India and Sir James Taylor's opposition to it. In the light of the possibility of substantial cash balance accumulation as the combined result of large scale market borrowing, large refunds of Recoverable War Expenditure, provisional collection of the E.P.T., and transfer to Government account of a part of the proceeds of official gold sales, Governor Deshmukh revived in November 1943 the suggestion in the form that Government should lend their surplus funds to the British Government as a ways and means advance. Such an advance would not affect the figure of Government's cash balances with the Bank, since the British Government did not have any separate account with the Bank; it could be shown merely as a book entry in Government's accounts. The advance might carry interest at a rate which might be the average for all borrowings of Government, say

2 ½ per cent and might be made repayable after twelve years. The arrangement, if implemented, would have had the same effect as if the British Government had borrowed in India themselves and slowed down the pace of sterling accumulation.

The Government of India, however, did not consider certain features of the proposed arrangement attractive from political and accounting aspects. The merger of the two balances, they feared, would lead to 'a lot of misinformed criticism'. They therefore suggested opening of a separate account for the British Government by the Reserve Bank. They also considered it essential that any loan or advance granted by the Government of India to the British Government should be included in the demand dealing with 'loans and advances by the Central Government' and put to the vote of the Legislative Assembly. The Bank gave its consent to have a separate account in the British Government's name in its books. The proposal was cabled to the Secretary of State on November 16, 1943. While forwarding the proposal, Government tried to impress on the Secretary of State that the Government were faced with the problem of preventing their cash balance rising beyond a certain limit and that the object of Government's surplus market borrowing was to counter inflation, which had resulted from the procedure adopted for financing the British Government's expenditure in India. If they had borrowed direct in India, it would not have been necessary for the Government to raise loans on such an extensive scale.

The Secretary of State replied to say that he did not understand what particular embarrassment Government had from an abnormal rise in cash balance and why Government could not repurchase from the Bank a substantial block of other rupee securities held in the Issue Department and cancel them since only Rs. 2 crores of ad hocs were left. As regards the proposal regarding a loan to be taken by the British Government from the Indian Government, the Secretary of State commented:

Seeing that safeguarding of India's economic position dictates maximum borrowing on part of Government of India, suggestion that Treasury here should take a ways and means advance from you at say two and a half per cent seems to us tantamount to a suggestion that they should finance to that extent the cost of your anti-inflation campaign.

The cable was forwarded to the Governor by the Finance Department with a request to suggest an effective reply. The reply suggested by the Governor was:

(I) High balances embarrassing because of the attention they must focus on our apparent indifference to the just incidence of the cost of raising rupees for H.M.G's war expenditure.

(2a) Apart from the inadvisability, which we should have thought was obvious, of holding the backing to Indian currency almost wholly in sterling, we expect the Reserve Bank to object strongly to parting with their rupee securities which they use for the purpose of regulating the money market.

(b) Taking over the Bank's sterling will imply currency expansion against ad hoc treasury bills, i.e., undisguised Central Bank credit inflation. In essence, problem remains the same, viz., that the cost of countering the inflation caused by the method of financing H.M.G.'s war expenditure falls on India.

(3) Since current requirements of H.M.G. are met by recourse to the inflationary currency printing press, the argument that cost of fighting inflation should be borne by India appears almost cynical. In view of uncertainty about liquidating heavy accumulations India could fairly refuse to accept any more sterling and ask H.M.G. to raise the rupee finance required by direct rupee loans in India. Would the Treasury be prepared to consider this alternative?

The Secretary of State cabled back on January 4, 1944, stating that 'matter under reference to Treasury but it may be little time before decision is reached '. No decision was reached and Government balance with the Reserve Bank went up to Rs. 481 crores by the end of 1945, which was several times larger than Government's indebtedness to the Bank, in the form of the latter's holdings of Government securities of Rs. 83 crores.

Attempts to fix a Ceiling to Currency Circulation

In the Central Board, some Director or the other kept on taking an active interest in the matter of sterling accumulation and inflation. At the April 1944 meeting of the Board, Mr. Kasturbhai Lalbhai wished to move a resolution as under:

The Board of Directors of the Reserve Bank of India consider it essential to fix the maximum limit to currency expansion. Before taking the decision, however, they require the Governor to find out if the Government of India have any suggestions to make.

Apparently, the Board did not wish to pass a resolution not likely to be acceptable to Government! As no previous notice had been given and as there was inadequate time, the matter was postponed for discussion at the next meeting of the Board. The Governor (Sir C. D. Deshmukh) conveyed this to the Finance Department. The Finance Department sent a long letter to the Governor in May 1944 expressing Government's serious concern at the continued currency expansion, but pointing to the objections to setting an arbitrary limit to the expansion of currency or sterling accumulation, which would in effect set a limit to India's contribution to the war effort. It was clearly in India's

interest to bring about a speedy termination of hostilities. The Government desired that the Governor discuss the whole matter informally with the Board in the hope that Mr. Kasturbhai Lalbhai might be persuaded not to move the resolution but rather the Board might 'pass a resolution urging the maximum possible support for Government borrowings of all kinds, including small savings'. The Finance Department also wanted the Board to examine possibilities of further efforts to draw off extra spending power from the public.

The Finance Department also dealt with the difficulty in the British Government's giving at that stage any hard and fast guarantee with regard to the value of sterling balances, as proposed in the Central Board's resolution of February 1943. Such arrangements, it was stated, would probably have to provide for reduction in the balances should sterling appreciate after the war. The communication concluded with the words 'every effort would, however, continue to be made to keep the accumulations of sterling as low as possible whilst maintaining India's effort at the minimum pitch which the desirability of the speedy termination of the war demands'. Meanwhile, the subject of sterling balances got merged to an extent with the discussions on the currency plans and arrangements for international monetary co-operation in the post-war period, for which proposals had begun to be made as early as from 1943 (see Chapter 14).

Mr. Kasturbhai Lalbhai's resolution actually came up before the Board only at the December 1944 meeting. First, Mr. Lalbhai himself preferred some postponement as the Governor was out of India. The Board was also busy with the important matter of post-war monetary plans. Of course, the Government themselves wanted the matter to be delayed if they could not succeed in persuading Mr. Lalbhai not to move it! Mr. Lalbhai's resolution recommended to Government that they take such steps as would limit the total note liability of the Reserve Bank to Rs. 1,200 crores (the note issue at that time was Rs. 981 crores), and that in particular the British Government be requested to find the rupees for their disbursements 'either by raising local loans, or by the transfer of gold or silver or other assets, readily saleable in India, at world parity prices'. The resolution that was finally adopted, after considering an amendment moved by Mr. B. M. Birla, was as under:

That the Board is of the opinion that the expansion of currency that has been continuously taking place in India as a result of the method which has had to be adopted for the financing of Allied war expenditure has approached a level beyond which it may prove disastrous to the larger interests of the country, by reason of the inflationary trends it creates. In the opinion of the Board it is imperative to check these trends forthwith. To this end the Board recommends to the Government

of India that in order to enable the Reserve Bank to limit their further note liability to the barest minimum possible as well as to arrest effectively further accumulation of sterling they take the following steps:-

- (a) make renewed efforts to stop the export of essential manufactured articles and raw materials of which there is shortage in this country; and
- (b) to request His Majesty's Government to find, as far as possible, the rupees for their disbursements in India by
 - (i) the sale of gold and silver in India and
 - (ii) the facilitating of the supply of capital goods to India at fair prices.

It will be seen that the resolution deleted the reference to the limit of Rs. 1,200 crores for currency expansion; likewise, the suggestion that the British Government raise loans in India was also dropped.

The Finance Secretary desired that the word 'disastrous' in the above resolution should be toned down, though he did not press the point. The Governor replied that as it was, he had had difficulty in getting the Board accept amendments to the original draft and he felt himself unable to suggest to the Board further amendments. The Governor consoled the Secretary by saying that:

After all, the meat of the resolution lies in the concluding portion, and the verbiage of the introductory portion does not seem to me to matter very much from the point of view of either Government or the Reserve Bank.

The subject of inflation or sterling balances did not again come before the Board formally till about the early months of 1946.

Accent on Government Borrowing and Economic Controls

From 1943 onwards, Government's principal measures to deal with the inflationary situation were (i) intensification of the borrowing programme, including small savings and (ii) substantial reliance on controls over prices and distribution of essential commodities. In his speech introducing the budget for the year 1943-44, while the Finance Member echoed the Governor's views on the nature of the inflationary situation in India, Government embarked on a substantially larger borrowing programme. Whereas in the years 1940-43 net market borrowing amounted to Rs. 260 crores, in the next three years, that is, 1943-46, the figure was as much as Rs. 809 crores. In the case of the small savings schemes, the improvement was even more marked. In the three years 1940-43, there was a net withdrawal of funds by investors to the extent of Rs. 43 crores but in the following three years (1943-46) Government collected a net sum of Rs. 129 crores. In the six years 1940-46, net market borrowing amounted to Rs. 1,068 crores and small savings receipts to Rs. 86 crores. The two together were about Rs. 150 crores larger than the aggregate receipts on tax revenue account.

The performance of India in respect of borrowings compared not unfavourably with that of the U.K. or of the U.S.A. In respect of tax effort, however, India's performance was much less impressive than that of the other two countries. Consequently the percentage of funds raised in the form of money creation was much higher in India. The result was a substantial rise in commodity prices.

In India, as in many other countries, Government resorted to various physical controls during war time to ensure proper distribution of essential commodities at reasonable prices, curb speculative tendencies and prevent diversion of scarce resources for inessential purposes. The scope of the controls was widened from 1943 onwards. The Governors of the Bank backed the use of physical controls, to supplement fiscal and monetary measures in combating inflation. Control measures had also the support of the academic economists; in fact, their general view was that Government were not going far enough in this matter.

Soon after the outbreak of war, the Government of India armed themselves with powers to regulate prices under the Defence of India Rules, and by a notification dated September 8, 1939 they empowered Provincial Governments to fix prices of essential articles, such as, foodstuffs, kerosene, cheaper varieties of cloth and medical supplies. These regulations were generally allowed to be inoperative as the rise in prices during the early stages of the war was quite moderate. However, from 1942 onwards close attention came to be paid to the institution and administration of controls, especially in respect of essential items like foodgrains and cloth. Controls were also imposed during the war on transactions in shares and bullion and on capital issues.

It is beyond the scope of this volume to go into the details of the control measures. Perhaps it would suffice to say that the administration of the various controls was far from satisfactory and that they were evaded in many ways in letter and spirit, although the extent to which this happened varied from commodity to commodity. However, in their totality it would seem that they did help curb the rise in prices; and this was particularly so in the case of cloth. Over a period of about two years from the middle of 1943 the general index of wholesale prices recorded hardly any net variation, the fluctuations during this period being very narrow. The index for August 1945 was 241.5 as compared to 243.4 for June 1943. It should be mentioned that in these two years the expansion of money supply also slowed down in absolute terms as well as percentagewise. In the financial years 1943-44 and 1944-45 the expansion was Rs. 428 crores and Rs. 300 crores or 37 per cent and 19 per cent, respectively. Further, from 1944 onwards, imports were substantially stepped up. Thus, in the years 1944-45 and 1945-46 imports amounted to Rs. 201 crores and Rs. 245 crores,

respectively, as compared with Rs.119 crores and Rs. 110 crores in the earlier two years 1943-44 and 1942-43.

Overall Inflationary Impact

Taking the period of six years 1940-46, approximately 55 per cent of the combined outlay of the order of Rs. 4,000 crores, on account of the Government of India and the Allies, was financed in a non-inflationary way, that is, through current revenues and borrowing from the public. * Because of the high proportion of deficit financing, there was substantial monetary expansion of the order of 400 per cent. Data on India's Gross National Product for the war years are not available. However, the growth of GNP must have been of a modest order, for agricultural output did not record any major change during the war years as a whole, and the increase in industrial output was less than 20 per cent. The situation thus was inherently one leading to a substantial rise in commodity prices. The general index of wholesale prices at the end of March 1946, at 254, represented a rise of 100 per cent over March 1940 and about 150 per cent from about the time the war began in September 1939 (see table below). The official index no doubt underestimated the extent of the rise; for, on account of the partial success in administering price controls, the prices used for the compilation of the index did not fully reflect the true level of prices which had to be paid. It would also appear that to an extent there was a decline in the velocity of circulation of money- both deposits and currency. Besides increased cash holdings by banks, hoarding of currency by the public must have occurred on a significant scale, not only for purposes of tax evasion but also for owning an asset which had been scarce for the rural population in particular during the long years of depression.

International economic comparisons are difficult even with the advances in data availability and analysis in the last twenty-five years; it would be hazardous to make such comparisons for the war period. Even so, a few remarks on the pattern and consequences of war financing in the U.K. and the U.S.A. could be hazarded. Broadly, in both the countries, as compared with India a much larger share of Government expenditure was met by taxation and genuine borrowing (90 and 75 per cent); the monetary expansion was considerably smaller (180 and 150 per cent); there was also significant growth of GNP in real terms, especially in the case of the U.S.A., of the order of 75 per cent, the rise in the U.K. being 23 per cent. In the result the extent of rise in the general price index was smaller in those two countries than in India. Using the statistics published in the Annual Report of the Bank

* Investment of banks in Government securities to the extent of the increase in their time deposits is treated as non-inflationary financing.

SELECTED ECONOMIC INDICATORS

(Rs. crores)

| Last Week | Bank Credit to Government* | | | Sterling Securities | | Money Supply† | | Wholesale Prices | |
|-------------|----------------------------|-------------------------------|-------------|-------------------------------|-------|-------------------------------|-----|--|-------|
| | Outstanding | Variation over previous March | Outstanding | Variation over previous March | | Variation over previous March | | Variation over previous March | |
| | | | | Absolute | % | Absolute | % | Absolute | % |
| | | | | | | | | | |
| | | | | | | | | Index (Week ended Aug. 19, 1939 = 100) | |
| March 1939 | 6 | | 74 | | | 339 | | 100.3 | |
| August 1939 | 39 | | 67 | | | 327 | | 127.5 | |
| March 1940 | — 4 | — 10 | 142 | 68 | 92.1 | 425 | 86 | 25.3 | — 8.7 |
| " 1941 | 105 | 109 | 144 | 2 | 1.8 | 515 | 90 | 21.2 | — 6.8 |
| " 1942 | 216 | 111 | 248 | 104 | 71.7 | 683 | 168 | 32.6 | 26.8 |
| " 1943 | 332 | 116 | 509 | 261 | 105.1 | 1,148 | 464 | 68.0 | 74.2 |
| " 1944 | 193 | — 139 | 946 | 437 | 85.9 | 1,576 | 428 | 37.3 | 13.7 |
| " 1945 | — 11 | — 204 | 1,363 | 417 | 44.1 | 1,876 | 300 | 19.0 | 14.6 |
| August 1945 | — 61 | | 1,507 | | | 1,955 | | 241.5 | |
| March 1946 | — 241 | — 230 | 1,724 | 361 | 26.5 | 2,120 | 244 | 13.0 | 6.1 |

Variation of

(i) Aug. 1945

over Aug. 1939

(ii) March 1946

over March 1940

| | | | | | |
|-------|---------|-------|-------|-------|-------|
| 1,440 | 2,151.4 | 1,628 | 498.4 | 141.2 | 140.8 |
| 1,582 | 1,114.4 | 1,695 | 398.8 | 126.7 | 99.4 |

* Bank credit to Government is the total of (i) holdings of Government Securities of the Reserve Bank and the scheduled banks and (ii) Reserve Bank's loans and advances to Central and Provincial Governments, less (i) deposits of Central and Provincial Governments with the Reserve Bank and (ii) time deposits of scheduled banks.

† Data relating to rupee coin in circulation are not available prior to October 1943. Monthly figures of absorption or return of rupee coin are, however, available, and on the basis of these, figures of rupee coin in circulation have been worked backwards from October 1943; these have been used for arriving at figures of money supply with the public. However, it would appear that pre-October 1943 rupee circulation figures are understimates; hence the percentage variations of money supply given in the chapter calculated on the underestimated base figures are somewhat overstated.

for International Settlements, whereas the increase from January-June 1939 to December 1945 was 186 per cent in India (Calcutta), in the U.K. and the U.S.A. the rise was only 74 per cent and 40 per cent, respectively.

Everything considered, that is to say, the low standard of living of the masses, the magnitude of the effort that was demanded of the country, the troubled political situation and the difficulty of administering an effective system of price and distribution controls, it would appear that India did not fare too badly in its fiscal effort. The economic and social distress caused by inflation had the alleviating feature that at the end of the war the country was in possession of a substantial volume of sterling assets, offering great scope for economic development in the post-war years.

War-Time Central Banking Operations

The nature of the inflationary process during the war was such that there was not much that monetary policy could do to counter it. In fact, it has been the experience of the world in the post-war years too that when there is a serious fiscal imbalance, the scope for and the efficacy of monetary policy is comparatively limited. During the war years, nearly all over the world the monetary instruments remained passive, this being especially true of the instrument of interest rate. The general tendency was for the pursuit of a policy of relatively low and on the whole stable interest rates. This was so in India too, although Governor Taylor was not an apostle of the cheap money doctrine; by and large, the war was financed on a 3 per cent basis, the Bank rate also remaining unchanged at this level throughout the war period (in fact, till November 1951). The instrument of open market operations was used extensively by the Bank, primarily to facilitate the Government's bond-selling operations, which it was the Bank's responsibility to conduct efficiently. Naturally the Bank was quite active in tendering advice to Government regarding the quantum, terms and timing of the borrowing operations. In those years the Reserve Bank did not possess the instrument of variable reserve ratio; nor was this quite necessary in view of the relatively low credit-deposit ratio of commercial banks, which invested the major portion of their deposit accretion in Government securities. To some extent, the Bank employed the selective credit controls (under the powers conferred by the Defence of India Rules) and also moral suasion to restrain banks from extending credit for speculative purposes in the commodities, shares and bullion markets.

In the field of exchange management, the war-time situation was on the whole a contrast to the position in the pre-war years. In the earlier

period, owing to precarious sterling reserves there was considerable difficulty in meeting the Government of India's Home Charges and in maintaining the 1S. 6d. rupee-sterling ratio. During the war years, the problem was the other way round, namely, effortless and abundant accumulation of sterling, and in consequence no semblance of any problem in maintaining the ratio at 1S.6d. Indeed, for a time speculation was rife that the exchange rate of the rupee might go up significantly. The efforts of the authorities were directed to using up as much of the sterling as possible by repatriating India's sterling liabilities, through voluntary as well as compulsory schemes (see Chapter 13).

Though there was not much to be done in the field of monetary policy proper, the Bank was kept busy during the war in discharging its responsibility in the field of currency management and as banker to Government. Currency management posed numerous problems. Metallic currency, especially small coins, had to be issued in considerable quantity; at the same time, economies in the consumption of the metals were achieved through such devices as issuing one rupee and two rupee notes and lowering substantially the silver content of the rupee. The Bank seems to have also handled with competence the many details relating to anti-inflationary sales of gold and silver in the years 1943-45. Further, the Bank took considerable interest in the healthy functioning of organised markets in commodities like cotton and jute, shares and bullion. Many initiatives in the matter of regulating these markets came from the Bank.

Bank's Monetary Policy Defined

In the first public utterance after the outbreak of the war, namely, at the annual general meeting of the Bank's shareholders held in February 1940, the Governor, Sir James Taylor, set out in clear terms the Bank's views with regard to monetary control during the war. After warning against oversimplification of problems, the Governor referred to the fact that the machinery of monetary control was more highly organised than in the last war and he made a case for a policy of stable interest rates. That is to say, he was for neither high rates nor artificial cheapening of money. It is worthwhile quoting the Governor's observations at some length:

In this war we are fortunate in that the machinery of monetary control is more highly organized than in the last war but even this improvement in organisation carries with it dangers which must not be overlooked. People are too prone to oversimplify problems. To many monetary control means cheap money, and it is often argued both in this country and elsewhere that the better the control the cheaper it should make

money. This of course is essentially fallacious. The business of the controlling authority, as I see it, is to do as far as possible what freely operating markets would have done for themselves if they were not being subjected to abnormal stresses beyond their control or their ability to foresee. In the absence of control these would be reflected in violent fluctuations upwards and downwards. To take money as an instance, if we left the markets to themselves there would be large rises and falls in the exchange value of the rupee and correspondingly violent fluctuations in interest rates, the banks' lending rates rising quite possibly to 7 or 8 per cent during the busy season followed by equally violent drops later. It is obviously advantageous to have machinery to control and iron out these fluctuations, and thereby give traders greater stability for their legitimate transactions. On the other hand, if one goes further and tries to use such machinery to carry out theoretical policies and do what the market if left to itself in normal circumstances would not do one is liable sooner or later to find oneself in a mess Too great a reduction in the effective rate of interest must lead to drying up the investing habit in which case the only alternative is inflation, because Government must be efficiently carried on, particularly in war time, and must get its money somewhere. . . . the controlling authority has to take all these factors into consideration. It has to keep money on an even keel so as to encourage investment and to see that speculation, though a necessary element in the market, does not go too far. It cannot proceed on the easy assumption that the better the control the cheaper it should make money. After all, no high degree of technique is required if the whole of monetary theory simply boils down to turning on the printing press.

This broad philosophy of stable interest rates was more or less adhered to both by Sir James Taylor and Sir Chintaman Deshmukh. This policy was also duly reflected in the fixation of the terms of Government borrowing.

Earlier, when the British Bank rate was temporarily put up, in August 1939, from 2 to 4 per cent, India did not follow suit, the rate remaining unchanged at 3 per cent. According to Sir Chintaman Deshmukh, Governor Taylor had some idea of raising the Bank rate 'in imitation of the action taken by the Bank of England' but he abandoned it on the advice of the then Deputy Governor, Mr. Manilal Nanavati. Sir James was out of India when the U.K. Bank rate was put up on August 24; it appears that Sir James telegraphically advised Mr. Nanavati to put up the Bank rate but that the latter did not concur. It may be added that the U.K. Bank rate was brought back to 2 per cent in October 1939, after reduction to 3 per cent in September.

Management of Government Borrowing

The Bank's role in managing Government's borrowing may first be described. The Central Government's market borrowing operations in the war period are summarised in the following table.

| (Rs.crores) | | | |
|------------------------------|--------------------|-------------------|------------------|
| Year ended March | Gross Borrowing | Loans Redeemed | Net Borrowing |
| 1939-40 | 16 | 20 | --4 |
| 1940-41 | 112 | 19 | 94 |
| 1941-42 | 74 | 11 | 64 |
| 1942-43 | 104 | Negligible | 103 |
| 1943-44 | 316 | 15 | 301 |
| 1944-45 | 222 | Negligible | 222 |
| 1945-46 | 329 | 43 | 286 |
| Total for 6 years 1940-46 | 1,157 | 89 | 1,068 |

The strategy of Government bond sales was varied from time to time with regard to such matters as choice between the issue of a new security and a reissue of an existing loan, maturity, issue price, timing, and decision whether the loan should be kept open for a fixed period or be on tap. Only in respect of a few loans was the amount of issue specified and subscriptions called for before a prescribed date. Many loans were tap issues which continued to be available for sale for quite some time. The nomenclature of the various loans, such as, Defence bonds, Victory loan and Development loan was also done carefully so as to have the most effective appeal to subscribers.

Broadly speaking, the war was financed with a coupon rate of 3 per cent, the issue price, in the case of longer dated loans, being gradually raised so as to come closer to an effective yield basis of 3 per cent. For instance, the yield worked out to 3.3 per cent in respect of the special issue of the 3 per cent 1963-65 (21-23 years) made in October 1942, 3.12 per cent in respect of the Funding Loan, 1966-68 (23-25 years) issued in October 1943 and 3.2 per cent in respect of the First Development Loan, 1970-75 (25-30 years) issued in April 1945; the issue prices in respect of these loans were Rs. 95, Rs. 98 and Rs. 97, respectively (see table on page 314). In the last two years, 1944-45 and 1945-46, the coupon rates were fixed below 3 per cent in respect of short and medium issues; these were two issues of the $2\frac{3}{4}$ per cent Loan, 1948-52, made in June 1944 and April 1945, two issues of the $2\frac{1}{2}$ per cent Bonds, 1950, made in July and October 1945, and an issue of the $2\frac{3}{4}$ per cent Loan, 1960, made in January 1946. The loans issued comprised all the three types of maturities, namely, long, medium and short; steadily, the length of the long-dateds was increased. In the early years the Bank's preference seems to have been for medium issues, whereas Government desired to have issues of short and long maturities; the Governor felt that the market was not ripe for a long-term issue whereas a short-term issue would mean making to the banks a present of higher rates. However, in the latter part of the

**MARKET BORROWING OF THE GOVERNMENT OF INDIA,
1948-41 TO 1945-46**

(Rs. crores)

| | <i>Original Issue Price (Rs.)</i> | <i>Year of First Issue</i> | <i>Total Receipts</i> | <i>Of which Cash</i> |
|--|---------------------------------------|--------------------------------|---------------------------|--------------------------|
| 1. 3% Six-Year Defence Bonds:- | | | | |
| (a) First Series . . | 100-0-0 | 1940-41 | 65 | 52 |
| (b) Second Series | 100-0-0 | 1940-41 | | |
| 2. 3% Loan, 1949-52 (Second Defence Loan) | 100-0-0 | 1940-41 | 56 | 50 |
| 3. Three-Year Interest-Free Bonds | 50-0-0 | 1940-41 | 2* | 2* |
| | and above | | | |
| 4. Rupee Counterparts (Net Investments) | | | 219 | 219 |
| 5. 3% Loan, 1951-54 (Third Defence Loan) | 100-0-0** | 1942-43 | 55 | 55 |
| 6. 3% Loan, 1963-65 | 95-0-0 | 1942-43 | 55 | 55 |
| 7. 3% Funding Loan, 1966-68 | 98-0-0 | 1943-44 | 110 | 110 |
| 8. 3% Loan, 1953-55 (Fourth Defence Loan) | 100-0-0 | 1943-44 | 115 | 109 |
| 9. Five-Year Interest-Free Prize Bonds, 1949 | 10 and 100 | 1943-44 | 5 | 5 |
| 10. 3% Victory Loan, 1957 | 100-0-0** | 1944-45 | 111 | 111 |
| 11. 3% Second Victory Loan, 1959-61 | 100-0-0** | 1944-45 | 113 | 113 |
| 12. 2¾% Loan, 1948-52 | 99-14-0 | 1944-45 | 75 | 75 |
| 13. 2½% Bonds, 1950 | 100-0-0 | 1945-46 | 35 | 35 |
| 14. 3% First Development Loan, 1970-75 | 97-0-0 | 1945-46 | 115 | 96 |
| 15. 2¾% Loan, 1960 | 100-0-0 | 1945-46 | 26 | 26 |
| TOTAL | | | 1,157 | 1,106 |

Note: Figures are inclusive of subscriptions from the Reserve Bank and amounts taken up by the Government of India in their Cash Balance Investment Account in respect of some loans.

* Net

** Plus accrued interest.

war period there was a distinct demand for relatively long-dated issues, largely due to speculative demand on anticipations of a substantial cheapening of money, and so these maturities were offered.

A reasonable stability in the interest rate on Government borrowing was strongly favoured by the Bank. Earlier, it was Government's desire to lower the yield basis to below 3 per cent, Thus in November 1941, while considering the loan programme for the year 1942-43, Governor Taylor suggested a reissue of the 3 per cent 1951-54 at par and a longer term loan of 3 per cent 1967-69 around Rs. 95, giving an effective yield of over 3 ⅓ per cent. However, Government were thinking in terms of a 12 year 2 ½ per cent loan at Rs. 98 and a 25 year 3 per cent loan also at Rs. 98, giving effective yields roughly of 2¾ per cent and 3⅓ per cent, respectively. The Governor doubted the advisability of such a substantial reduction in yield and he was particularly concerned

about the inflationary impact of such a reduction; he preferred to go very slow in the matter of reduction of the yield even when reduction was indicated. Meanwhile, consequent on the entry of Japan into the war, there was a sharp break in Government security prices; in fact, in March 1942 Government had to fix minimum prices in terms of the authority under the Defence of India Rules. The Secretary of State was, however, impatient that Government must come out with new issues, notwithstanding the prevalent uncertainty; this annoyed the Governor a great deal. By June 1942 market conditions improved but Government did not press for a yield below 3 per cent.

In 1943, on the other hand, suggestions were made in various quarters, in view of the growing danger of inflation, that the interest rate should be raised to stimulate investment in Government bonds. But Deputy Governor Deshmukh opposed this, in the following terms, in a letter to the Finance Department, in April 1943:

The results of attempting any enhancement of interest rates at this stage are likely to be embarrassing for those who have so far subscribed to Government loans, especially the institutional investors Apart from the fact that high interest rates increase the burden on succeeding generations, there is always the possibility of any such increase failing in its immediate effect and defeating its own purpose. As each increase in rates lowers the market price of existing Government loans by making them correspondingly less attractive, there is a risk of the market anticipating that this process will continue as the war goes on.

Nor was Mr. Deshmukh in favour of further cheapening of money. In the same letter, he remarked:

The cogency of the arguments for a rise in the rate of interest may, however, be recognised to this extent that in present conditions it does not seem possible to proceed further in the direction of cheapening money and that Government may content themselves with aiming at the maintenance of the present level of long-term interest rates.

It is of interest to note in this context that of the issues made during the war, two did not bear any interest. One was the Three-Year Interest-Free Bonds, first issued in June 1940, obtainable in any amount above Rs. 50, which remained on tap throughout the war period, the total subscription being a paltry Rs. 3.7 crores. The other was the Five-Year Interest-Free Prize Bonds, issued from January 15, 1944. This issue should also be regarded as a failure, as it brought in only Rs. 5.30 crores. The Bank had opposed this issue, as described below.

The question of organising State lotteries for encouraging subscriptions to war loans or for other war purposes was reviewed at length in 1940 and Government came to the conclusion that on both ethical

and financial grounds Government should not organise any form of State lotteries; the Secretary of State also advanced a few reasons against the proposal. He feared that lotteries would not account for more than a small portion of Government's requirements and that they might injure India's credit within and abroad. However, in 1943, suggestions were renewed for organising some kind of a State lottery; several Provincial Governments also supported this. After considering various types of lotteries, such as a straight lottery wherein the unsuccessful holders of tickets lose their whole capital, a lottery where a fraction, say, half of the cost of tickets is returned to the unsuccessful holders and finally a lottery loan or premium bonds, in which the unsuccessful holders lose only the whole or part of the interest to which his investment would normally be entitled, the last one was favoured by the officials of the Finance Department. The Finance Member supported the proposal as an experiment, on the ground that:

We have now reached a stage at which we cannot afford to decline the use of methods, not ideally acceptable in normal times, which bid fair to make a real contribution to the problem of mopping up surplus purchasing power and save the country from the horrors of uncontrolled inflation.

The Government invited the Bank's comments; Mr. Deshmukh opposed the proposal for the following reasons:

In the first place there is the ethical aspect of it that certain principles should not be abandoned by the State, no matter how severe the crisis calling for such abandonment, e.g., that the State should not appeal to the baser passions of the populace . . . But apart from this, if the State countenanced even a mild form of gambling, would it not be weakening its hands for dealing severely with the various forms of speculation it is endeavouring to check?

There is, in my opinion, a real danger of lottery loans merely attracting money which would either be already invested in a Government security or would be intended for such investment. Now that much greater interest is being taken in Government securities, it would be impolitic to show lack of confidence in this straight investment . . .

From the practical point of view, expenses will be considerable on account of printing, advertising, distribution, commission on sales, remittance of funds, etc. On account of the unfamiliarity of the rural population with bearer instruments, there will be legal claims to face as well as claims for lost and stolen bonds, and these claims will not be easy to settle.

Government, however, decided to go ahead and asked for approval of the Secretary of State, who cabled back as follows:

My predecessors and I have also in the past been opposed to any arrangement of this character but in present circumstances welcome your proposals.

You might also consider whether path of scheme might be smoothed by using some such title as prize loan or premium bond issue rather than word 'Lottery'.

The outcome was the issue of the Five-Year Interest-Free Prize Bonds, 1949, from January 15, 1944, in denominations of Rs. 10 and Rs. 100; the amount of prize money involved a cost of 2 per cent per annum. As already mentioned, all that was raised was Rs. 5.3 crores during the period January 1944 to March 1946.

An innovation during the war period was to give names to loans, indicating the purpose for which the loan was floated. The first war issue was called 'Defence Bonds' and the loans issued subsequently till July 1943 were called 'Defence Loans'. In July 1943 Mr. Deshmukh suggested floatation of a 3 per cent 1943-46 'Funding' loan, as the next issue. Later, in March 1944, in respect of a new loan to be floated, Governor Deshmukh recommended the nomenclature of 'Victory', in accordance with the then stage of the war. Later, in December 1944, in connection with the issue of a new 3 per cent Loan 1945-46, the Governor suggested that it be called a 'Development' loan. These suggestions were accepted by Government.

Provincial Borrowing Operations

The Provincial Governments also raised modest sums in all the years except in 1941-42, the aggregate gross borrowings in the six-year period 1940-46 being Rs. 41 crores. The annual sums raised by the Provinces as a whole varied from about Rs. 4 crores to Rs. 13 crores. As in the case of the Central Government, the borrowing was much larger in the three years 1943-46 as compared to 1940-43. Although the Provincial Governments were not, by and large, in need of loan funds, and Provincial borrowing would have affected to some extent Central borrowing, the Governor, Sir James Taylor, was keen that the Provinces must make some issues, for two reasons. In the first place, it was desirable to restrain the excessive rise in the prices of the existing loans, so that Provincial Governments might have no illusion about their being able to raise money in the post-war years on the basis of the low yields that would otherwise prevail. It was also considered desirable that the Provinces pay in advance their debt to the Centre, consolidated in terms of the Niemeyer Award,* rather than wait till 1945-46 when they were given the option to make interim payments,

* Under the Government of India Act, 1935, the inauguration of Provincial Autonomy was to be preceded by an expert inquiry into the financial position of Provinces, the special assistance required by each, and the time and mode of distributing the Provincial share of income-tax. Sir Otto Niemeyer was appointed by the Secretary of State in January 1936 to conduct this enquiry and he submitted his report in April 1936.

necessitating large issues in a single year. The Central Government and the Provincial Governments accepted the Governor's advice.

There were in all 21 issues, five each by the Punjab (Rs. 12.45 crores) and Madras (Rs. 7.30 crores), three each by Bombay (Rs. 10.44 crores), U.P. (Rs. 7 crores) and C.P. and Berar (Rs. 1.54 crores), and one each by Sind (Rs. 2 crores) and Assam (Rs. 0.5 crore). On Governor's advice, from 1940-41 onwards, unlike in the previous years, a simultaneous issue was made by the borrowing Provinces, with the same maturity and coupon rate (which remained unchanged at 3 per cent), the issue price, however, varying slightly from Province to Province. But, broadly speaking, the price of successive issues was stepped up, reaching par for one Province in 1943-44 and three Provinces in 1944-45. The loans were all medium-dated ones, the maturity varying from 12 to 15 years.

For the Provincial loan issues, the underwriting system, introduced for the first time in 1938, was followed throughout the war period. Some issues had to be underwritten by the Reserve Bank. Of the 21 issues, 17 were not fully subscribed, and the underwriters including the Reserve Bank, had to take up about a third of the amount of the issues in the aggregate.

The underwriting system and the Bank's role therein came in for a great deal of criticism, particularly in 1944, following very poor response to the loan issues, necessitating substantial contribution by the underwriters. The Indian Finance, for example, commented as follows, in its issue of August 19, 1944:

It is obvious that the Reserve Bank authorities have not been taking any special steps to prepare the ground for Provincial loans In the first place, the Reserve Bank might have argued that, as the total amount involved in all the Provincial loans was only a few crores, it would not be in accordance with a sense of proportion if elaborate steps by way of preparing the market were undertaken. In the second place, the Reserve Bank might feel that, having arranged for the underwriting of the loans, its responsibility was finished. If the loans were not fully subscribed, it was the funeral of the underwriters; why should the Reserve Bank be unduly concerned about it ? the responsibility of the Reserve Bank cannot be said to end with the conclusion of the underwriting agreement. As bankers to the Provincial Governments, it is the duty of the Reserve Bank to maintain the status of the Provincial Governments in the esteem of the underwriters.

The Bank's view was that the underwriters had made the mistake of quoting higher rates than were justified; if only the Bank had persuaded them to quote lower issue prices (that is, the yields made higher), the loans would have been described as a 'success'. However, the Bank reviewed the system and put forward some proposals in January 1945

for eliminating the defects of the system. The essence of the Bank's proposals was to reduce drastically the list of underwriters to three large banks and six well-established firms of brokers. The terms of issue were to be fixed by a conference of underwriters convened by the Governor every year. The Bank recognised that this entailed on its part a certain amount of responsibility by way of direction in the determination of the rates for underwriting tenders, but the Bank was confident of doing this to the best advantage of the Provincial Governments, though all the Provinces would not be able to secure the same rate. As there was strong opposition from a few Provincial Governments to the proposal for drastic reduction in the number of underwriters, the Bank submitted a modified proposal in March 1945, limiting the list to those banks and brokers who had supported the Provincial loans in the past, with say a maximum of 20 names. This meant that banks and brokers already in the list, who had not shown any interest in the Provincial loans till then, were to be removed from the list. This was agreed to by the Provincial Governments, and accordingly, eight banks were removed from the list in June 1945.

Bank's Open Market Operations

During the war years, the Bank's open market operations became an integral part of the Bank's debt management operations, to maintain stability of Government security prices and help obtain maximum contribution to the various loan issues. The Bank provided substantial facilities to investors for switch operations. During periods of loss of confidence, on account of unfavourable war news in the early years, the Bank provided substantial support, besides arranging for the fixation of minimum prices.

The Bank's open market operations were on a modest scale in the first three years or so after the outbreak of the war, but from 1942-43 (July-June) onwards, they assumed substantial dimensions. In 1940-41, the purchases and sales amounted to Rs. 5.64 crores and Rs. 7.34 crores, respectively; in 1944-45, these went up to Rs. 66.08 crores and Rs. 61.06 crores, respectively. The Bank was on the whole a net buyer to the extent of over Rs. 20 crores during the 5½ year period January 1940 to June 1945. It operated in all the maturities, while concentrating on issues that were either due to mature or were close to the maturity of loans that were in the process of being issued. The Bank's operations were integrated with those of transactions in the Government's Cash Balance Investment Account. Including securities acquired otherwise than through the market, the Reserve Bank's holdings of Government securities increased by about Rs. 62 crores in the six-year period 1940-46; this should be regarded as modest in relation to the

net increase in the Central Government funded debt of about Rs. 1,050 crores. The net increase in the holdings of other categories of investors like commercial banks was as under:

| (Rs. Crores) | | | | | | | |
|-------------------------|-------------|--------------|------------|--------------|--------------------------------|----------------------------|--------|
| | Holdings of | | | | | | |
| | Total Debt | Central Govt | State Govt | Reserve Bank | Commerical & Co-operation Bank | Indian Insurance Companies | Others |
| As on 31-3-1946 | 1,499 | 55 | 54 | 92 | 447 | 88 | 764 |
| As on 31-3-1940 | 451 | 26 | 2 | 30 | 74 | 37 | 282 |
| Increase during 1940-46 | 1,048 | 29 | 52 | 62 | 373 | 51 | 482 |

In other words, the contribution from sources other than banks, the Reserve Bank and Governments themselves, to the Government's borrowing programme, was Rs. 533 crores, or a little over 50 per cent of the net loan receipts. This was not unsatisfactory, considering that commercial bank subscription to Government loans could be inflationary and that such subscription by the central bank is invariably so.

Substantial support to the borrowing programme came from the princely States. Although the marked increase in the liquidity of the economy was a major factor in attracting subscriptions from non-banking sources, the results were in part due to employing Government machinery to put pressure on people to subscribe to Government loans. Many of these subscribers turned out to be weak holders, who gave instructions to their bankers (who had often obliged with a loan for the purpose) to sell the securities at an agreed loss shortly after floatation, a phenomenon in evidence in the 1950s and 1960s too, especially in respect of State Government issues. A few big industrialists and businessmen made large subscriptions of some crores, with a lot of publicity, and subsequently disposed them of at a modest loss, which was regarded as well incurred, since the large initial subscriptions were trusted to bring their own reward in prestige or Government favour in some shape or the other!

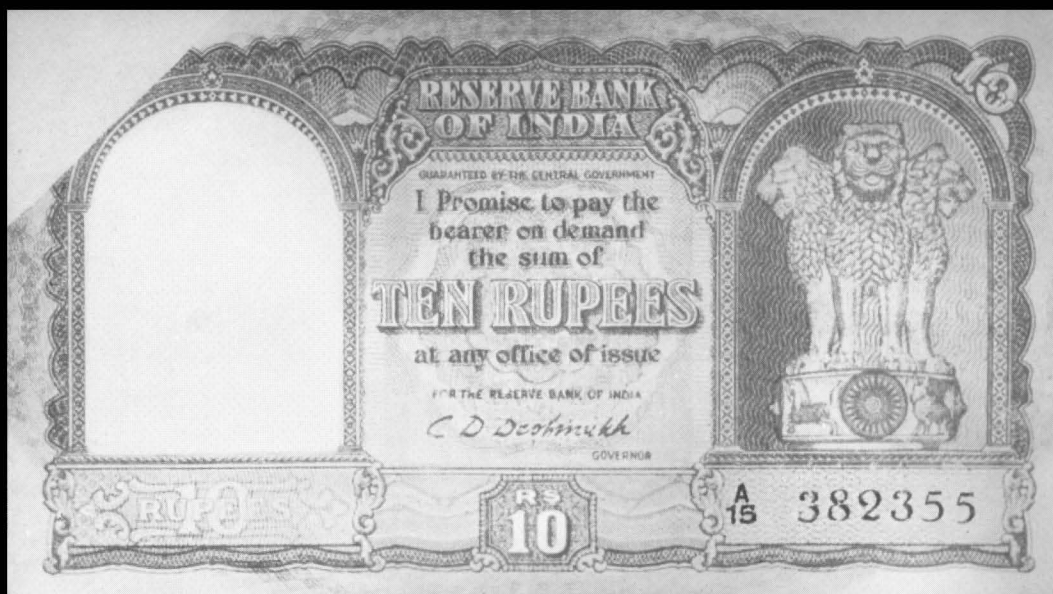
Before leaving the subject of Government borrowing, a reference may be made to the Bank's efforts to ensure the safety of Government securities held by the public, this no doubt being regarded as of indirect assistance in popularizing Government loans as a form of investment. In February 1942, the Bank issued a notice drawing the attention of the public to the advantages of holding Government securities in the form of stock certificates rather than promissory notes. The Bank



RS. 10,000 First issued under Governor Taylor's signature in June 1938. Actual size of note 8" x 5". On the reverse, three oval framer, the middle one showing the value in eight Indian languages.

RS. 2 First issued in February 1943; Deshmukh series first issued in March 1944. Size, $4\frac{1}{2}$ " x $2\frac{1}{2}$ ". On the reverse appears an oval frame containing a guilloche overprinted with the value.





Rs. 10 Series with Asoka Pillar, emblem of independent India, issued under Governor Deshmukh's signature in 1949. $5\frac{3}{4}" \times 3\frac{1}{4}"$ in size, on the reverse is a picture of a sailing boat.

Rs. 100 First Deshmukh series issued in May 1944. Three panels on both sides. The picture in the middle is of a tiger's head. Actual size, $6\frac{3}{4}" \times 4\frac{1}{4}"$.



continued to offer to convert promissory notes into stock certificates free of charge. An additional inducement which the Bank offered was to reconvert stock certificates into promissory notes, without levying the usual fee. Further, the facility of holding Government securities in Public Debt Offices of the Bank in the form of a special ledger account, known as the Subsidiary General Ledger Account, was extended to institutional holders such as the scheduled banks, provincial co-operative banks and insurance companies.

Treasury Bill Operations and Policies

Unlike in the pre-war days, the Treasury bill issues were not governed by any consideration of inducing inflow of foreign funds. The offer of these bills was governed largely by the requirements of the Government in earlier years and later by the need to provide the banking system with a short-term liquid asset. Partly for the latter reason, the Bank did not favour any substantial issue of short-dated Government bonds.

Till about the middle of 1942 there was no marked resort to borrowing on Treasury bills, by the Government of India. The weekly offer of the bills for tender generally did not exceed Rs. 2 crores and the amount of outstanding bills with the public (that is, holders other than the Reserve Bank and Government) was in the range of Rs. 20 to 40 crores. Subsequently there was a substantial increase, the weekly tender going up to Rs. 10 crores in November-December 1942. In 1943-44 also, in the majority of weeks, the weekly tender remained at Rs. 8 crores. The outstanding amount with the public rose to almost Rs. 140 crores by the middle of 1943. Apparently, the surplus funds of banks were invested in these bills, pending subscription to market loans. By March 1946, outstandings with the public came down to about Rs. 30 crores. The Provincial Governments steadily increased their investments in these bills; their holdings, which stood at about Rs. 12 crores at the end of 1939-40, rose to about Rs. 46 crores by the end of 1945-46. Ad hoc bills were issued to the Reserve Bank from time to time, mainly in connection with the temporary financing of the repatriation of sterling debt. Since the Government's receipts through rupee loans did not always coincide with the repatriation of sterling loans, temporary resort to ad hoc bills became necessary to replace sterling securities held in the Issue Department of the Reserve Bank. There were sharp fluctuations in the volume of Treasury bills held in the Issue Department; for instance, in 1941-42, the weekly holdings ranged from Rs. 7 crores to Rs. 103 crores, in 1942-43 from Rs. 53 crores to Rs. 142 crores, and in the first nine months of 1943-44 from Rs. 2 crores to Rs. 102 crores. From January 1944 till the end of 1945-46, they remained unchanged at Rs. 5.7 crores.

Provincial Governments also had resort to Treasury bills; the borrowing under this head was stepped up substantially from 1943-44 onwards. From Rs. 1 crore or below at the end of the first three fiscal years (1940-43), outstanding Provincial bills rose to Rs. 17 crores at the end of 1943-44; there was later a decline, the figure at the end of 1945-46 being Rs. 11 crores.

As in the pre-war years, the Imperial Bank was the largest tenderer at the Treasury bill auctions, this being done in close consultation with the Reserve Bank, both as regards the quantum of tender and the price. The Reserve Bank was, of course, keen that interest in the Treasury bills should be more widespread. For this purpose, the terms on which the Bank was prepared to discount Treasury bills were liberalised. It will be recalled that in early February 1938, the Bank had agreed to discount Central Government Treasury bills for the Imperial Bank at the average rate of the last preceding auction. A few days later, the discounting facility was extended to other scheduled banks, but the rates were to be ascertained by them from the Bank. In April 1938, the discount rate was fixed at the average rate of allotment at the previous week's tender plus 2 annas per cent and rounded off to the next anna above; in addition, a minimum interest of one anna per cent actual was to apply, i.e., the price paid for any bill was not to exceed Rs. 99-15-0 per cent. Except for about two months or so from the close of August 1939 (when the discount rate was the same as the Bank rate), this rate was generally operative till about the middle of 1940; later, for a period of about 2½ years, the discount rate was kept lower, at the previous week's allotment rate rounded off to the next anna above, subject to the proviso that the minimum interest received was 1 anna per cent actual. Thereafter, that is to say, from 1943 onwards, the rate was 1 anna above the previous week's allotment rate, rounded off to the next anna above; the minimum interest received was to be 1 anna per cent actual.

It was mentioned in Chapter 5 that the Bank's rate of discount for Provincial Treasury bills was higher than the rate at which Central bills were discounted. These rates were halved in November 1939 to 2 annas and 4 annas over the rates of discount on Treasury bills of the Central Government, respectively for bills maturing within 28 days and those maturing within three months. The Provincial Governments, however, were not satisfied and insisted that the Bank should discount their Treasury bills on the same basis as the bills of the Central Government in order that the Treasury bill rate for Provinces might come down. There was also pressure from the Provincial Governments that the Reserve Bank must so arrange things that the tender rate for their Treasury bills should not be materially different from the rate on the Central bills.

In April 1940, the Bank addressed a long communication to the Provincial Governments, explaining the reasons for the higher rates of discount on Provincial bills and making some general observations on the subject of Provincial ways and means advances from the Bank. The Bank stated that the primary cause for the disparity in the rates was not the misconception about the credit of the borrowing Province. The whole question was one of liquidity; there was very little interest in these bills in the money market. Analysing the tenders accepted for the Provincial bills for about two years from April 1938, the Bank noted that only 12 per cent of the Provincial bills had been taken up by parties other than the Imperial Bank and the Reserve Bank, whereas in the case of Central bills this percentage was 44.5. If the discount rates for Central and Provincial bills were identical, even this measure of outside support would disappear, the Bank observed. It might not always be possible for the Imperial Bank to carry the burden and at times the Reserve Bank might have to be almost the sole lender. The Bank was not prepared to accept this position 'not only because it would virtually abolish the distinction between ways and means advances by the Bank and lending on Treasury bills but also because it would be unsound central banking'.

The Bank went on to explain that the distaste for Provincial bills was based on genuine banking considerations. In the busy season there would be difficulty of obtaining renewals of Treasury bills, with the result that bills might have to be taken up almost entirely by the Reserve Bank or discounted by it. Even if the market was prepared to put up the money, it would only do so at rates which were competitive with the rates obtainable from other short-term investment. While this fact of the market being unable to carry its bills during the busy season made the bills a useful means of control as it forced the market into the hands of the central banking authority, clearly this advantage could only be secured by the best form of security of this type, namely, the Central Government bills. 'Similar issues by other authorities are not so suitable as a regulator for short-term money rates unless the Reserve Bank was prepared to treat them all on the same footing, which would run directly counter to its policy of making the market the judge of the financial standing of each Province'.

With a view to widening the interest of the investing public in Provincial Treasury bills, the Bank advised Provincial Governments to restrict their Treasury bill issues to the minimum, and to take such steps as would convince the public that their finances were managed correctly and on sound lines. Provincial Governments were also urged to build up adequate working balances by either funding loans or accumulating revenue surpluses. According to the Bank, such action on the part of Provincial Governments would result in an improvement in rates for

their limited Treasury bill issues and such an improvement would be 'far more desirable and durable than any arbitrary lowering of rates attempted by the Reserve Bank'.

One of the Provincial Governments urged that in order to reduce the disparity in the tender rate for Treasury bills and to improve the liquidity of Provincial bills, the Reserve Bank should (a) tender at a rate not more than half an anna per cent over the rate at which it would be prepared to tender for Central Government Treasury bills in the same week, and (b) rediscount Provincial Treasury bills on the same basis as Central Government bills. The Bank, in its letter dated August 9, 1940 to Provincial Governments, consented to give the two suggestions a trial subject to two conditions, viz., (i) if Provinces fell short in their ways and means and had to borrow over the year end, they should be prepared to pay the rates imposed by the market, and should not look to the Bank for assistance and (ii) if, within a reasonable time, the market failed to react to the lower rates and the discount facilities, the Bank would have the right to modify the rates upwards. As regards the rate for discounting Provincial bills, the Bank offered a slightly modified formula, namely, the average rate for the last Provincial Treasury bills issue, rounded off to the next anna above or at 2 annas above the average rate of discount on Central bills, rounded off to the next anna above, whichever was more favourable to the party. Some years later, that is to say, in March 1944, in response to further criticisms, the Bank went a step further and reduced the discount spread over the rate on Central bills to 1 anna. In other words, the rate for discounting Provincial bills was made identical with that for Central bills.

Over the years, there was a lowering of the spread in the tender rates between the Central and Provincial bills, in absolute terms, of annas and pies. However, since the tender rates themselves declined substantially from 1940-41 onwards, it would seem that there was no substantial narrowing of the spread, percentagewise. Thus, in the year 1988, the spread was around 4 annas, with the Central rates around Rs. 1-8-0 per cent. In 1945, the spread was mostly in the range of 1 to 2 annas, with the Central tender rates in the range of 4 to 9 annas per cent.

Policy Regarding Ways and Means Advances

From the outset, the Reserve Bank was keen that its ways and means advances to Government, in terms of Section 17(5) of the Act, should be strictly short-term and that nothing should be done to violate the spirit of this provision by automatic renewals of any advance, after three months. Sir James Taylor had put this to the Central Finance

Department in strong terms, as early as October 1938. This matter formed the subject of a dispute between the India Office on the one hand and the Finance Department and the Reserve Bank on the other in 1942 and is worth alluding to.

The Section empowered the Bank to make ways and means advances to Governments 'repayable in each case not later than three months from the date of the making of the advance'. The Bank interpreted it as 'requiring the liquidation of the ways and means position within a period of three months'. It happened that the three months' limit in respect of over Rs. 1 crore of Burma Government's ways and means outstanding was due to expire on September 30, 1942, and the Government of India drew the Secretary of State's attention to it on September 25, 1942. As there was not enough time on hand, the India Office wanted the advance to be renewed to get over 'technical obstacles of three months limit', but in the Bank's view, 'technical obstacles' would not be overcome by renewal of amounts overdue. India Office was not convinced. According to India Office, while Section 17(5) prohibited the making of an advance repayable at a date more than three months ahead, it did not debar the Bank from making subsequent advances, from the proceeds of which the borrowing authority could discharge the earlier advance, 'so that the Reserve Bank would be in a position in appropriate cases, in effect, to renew advances from time to time.' The Bank, however, remained firm. In his letter dated November 16, 1942, to the Finance Department, Deputy Governor Deshtnukh said:

We have always construed the provision in question as requiring the liquidation of the ways and means position within a period of three months. In effect, in our view, the accommodation is not intended to be so much a series of ways and means advances as an overdraft, which must be cleared within three months, as is the practice of the Imperial Bank in regard to overdrafts. The contrary interpretation would render the provision entirely futile, since once the principle of renewal is conceded, there could be no end to the process so far as the legal position is concerned, and this must defeat the object of the provision. Our view is supported by the history of this clause and the observations relating to it contained in the Report of the Joint Committee on the Reserve Bank Bill, and the substitution of the present provision for the one in the draft bill, requiring liquidation 'not later than 3 months after the close of the financial year in respect of which the advance has been made' would have been pointless had the new clause not been intended in the sense which we attach to it. We have always acted on this interpretation. . . .

The Finance Department consulted the Legislative Department, which, however, took the view that from strictly legal point of view India Office's interpretation was correct and that the sole relevant effect of

Section 17(5) was, in Mr. Baxter's (of India Office) words 'to prohibit the making of advances which at the time when they are made are repayable on a date more than three months ahead'. The Department, however, remarked that 'the observations of the Select Committee doubtless merit consideration by the Bank in determining its policy in regard to the grant or refusal of in effect renewals; but they have no bearing on the interpretation of the clause'.

The Legislative Department's view was brought to the notice of the Bank. Sir James Taylor in a noting to the Finance Department reiterated the Bank's policy:

The matter is, however, as they point out, entirely within our discretion, and we have taken the views of the Joint Select Committee* as a clear directive to us as the policy which we should follow There can, however, be no doubt as to the policy, and it is one which we would not be prepared to infringe as we consider that one of the essential duties laid upon us by the Legislature is to ensure that when Government is in debt, that debt unless of a purely temporary nature, is put upon the market to be assessed by it.

Sir James also mentioned that in the Agreement the Bank had made with Provincial Governments, it was clearly stated that 'these are to be regarded as overdrafts which must be fully paid off at intervals not exceeding three months'.

A procedural matter in regard to ways and means might also be mentioned. To meet the problem of delays in telegraphic communications, the Bank suggested to the Central Government in January 1942 to give it authority to make ways and means advances to them to prevent their balances from falling below the required minimum. The advances were to be repaid, as and when possible, subject to confirmation by Government. The Bank already had a similar arrangement with a Provincial Government and it had worked well. The Government of India gave their concurrence to the proposal. Similar facility was later extended by the Bank to all Provincial Governments.

Pattern of Money Rates

At this stage it would be useful to indicate the trend of interest rates in the war period. The objective of the authorities to have a fairly stable pattern of rates was largely achieved in the case of gilt-edged securities. The monthly average yield of the 3½ per cent Rupee Paper, the most active security, moved within very narrow limits, except during short periods in the early years of the war, when the news was

* The Joint Select Committee considered that normally such advances should be converted into Treasury bills, as soon as possible, which should be offered on the open market even though the Reserve Bank might take them up.

adverse to the Allies. As compared to the yield of 3.6 per cent in June 1939, the yield went up above 4 per cent for a short while in the first few months after the declaration of war; thereafter there was a gentle decline to 3.4 per cent about the time the war ended.

The money market remained easy practically throughout the war period with substantial expansion of money supply and modest demand for bank credit. The most sensitive of the money market rates, namely, the inter-bank call rate, which moved in the range of $\frac{1}{4}$ to $2\frac{3}{4}$ per cent in the year prior to the outbreak of the war, spurted for a while and then recorded a declining trend. From about the middle of 1942 onwards the rate remained practically unchanged at $\frac{1}{4}$ per cent during the rest of the war period. Likewise, the Central Government Treasury bill rate, which was around 1 per cent prior to the war, initially spurted to 1.9 to 2.8 per cent but later recorded a more or less continuous decline to $\frac{1}{4}$ to $\frac{1}{2}$ per cent at the close of the war.

Currency and Coinage Problems

The phenomenal expansion of currency during the war and the very marked increase in demand for silver rupees and small coin posed several problems for the Bank and the Government. Steps had to be taken to procure supplies of paper and the required metals for the issue of currency notes and coinage, while discouraging at the same time hoarding, especially of small coin. Naturally, available currency notes had to be put to the maximum use, relaxing the usual standards with regard to their retirement from circulation. Besides the issue of one rupee notes, a new denomination of currency notes, namely Rs. 2, was introduced to relieve the growing demand for rupee coin, including the Government of India one rupee notes. Special problems were also posed in regard to the circulation of Burma notes. In these matters, as in many others, the main initiative came from the Governor of the Bank and there was general support to his proposals from the Government of India and the India Office.

The pace and pattern of war-time expansion of currency is given in the table on page 328. On the outbreak of the war, Currency Officers were directed to resort to reissue of serviceable notes on an extensive scale and to ensure that the Imperial Bank and the Treasuries did not return notes which were fit for reissue. Later, with a view to effecting utmost economy in the consumption of note forms, the usual standards of worthiness for circulation of currency notes were further relaxed by laying down that they were to be withheld from circulation only in the event of being too dirty or torn as to be unfit for reissue. Besides, practices such as stamping of notes, particularly by Railways and Government Departments, and recording of names by note examiners,

(Rs.crores)

| Period (September to August) | Notes | Rupee Coin* | Small Coin* | Total |
|---------------------------------|------------|-------------|-------------|--------------|
| 1939-40 | 53 | 53 | 5 | 110 |
| 1940-41 | 45 | -4 | 4 | 45 |
| 1941-42 | 226 | 12 | 7 | 245 |
| 1942-43 | 280 | 55 | 15 | 350 |
| 1943-44 | 172 | 16 | 21 | 210 |
| 1944-45 | 212 | 10 | 17 | 239 |
| TOTAL | 989 | 142 | 68 | 1,199 |

* Rupee coin includes one rupee notes. The data in respect of notes and rupee coin up to March 1942 and of small coin up to January 1942 are inclusive of Burma.

** Coins below the denomination of a rupee. Prior to the introduction of decimal currency in April 1957, the rupee was divided into sixteen annas; an anna was further divided into four pice or twelve pies. Besides these denominations, two anna coins were also in circulation.

were sought to be eliminated to prevent avoidable spoliation of currency. Simultaneously, arrangements were made through India Office to procure necessary supplies of note paper for building up enhanced reserves. The possibility of an interruption in the supply line from the U.K. also made the Bank explore for some time the question of manufacturing note paper in India-the Deputy Governor, Mr. Nanavati, took much interest in this matter -although eventually it was given up as the situation never turned out to be so pressing.

While every precaution was taken for ensuring adequacy of note paper, in 1942-43 the situation was critical. During this acute phase, with a view to further economising the use of note paper, the Bank gave consideration to the issue of notes in the denomination of Rs. 20 which had earlier been made in 1862, but it was dropped on account of the practical difficulties of the Security Press in handling too many denominations. From the end of 1943 the paper position began to show gradual improvement. The only new denomination of currency issued was that of Rs. 2. The authorities first considered a revival of the Rs. 2½ note issued during the First World War but decided against it, since the denomination had proved unpopular. Instead, a new denomination of Rs. 2 note was decided upon and the initial issue was made on February 1, 1943, Ten rupee note of a new design was also issued from October 1944 to prevent forgery, on account of the appearance of forged notes on a large scale.

The position in regard to rupee coin was that minting of standard silver rupees had been suspended since 1923 and there had been a substantial return of rupee coins from circulation in the pre-war years. On the eve of the war, the Issue Department had stocks of about Rs. 76 crores and Government of over Rs. 40 crores in coin and bullion. This cushion of reserves appeared to be comfortable. However, the

absorption of rupee coin was quite rapid, amounting to as much as Rs. 53 crores in the first year of the war. The main objectives of official policy in regard to rupee coinage, on the eve of the war, were to conserve supplies of silver and to prevent the tendency for the disappearance of coin from circulation whenever silver prices rose to the point where melting became profitable. Immediately on the outbreak of war Sir James Taylor wrote to Government: 'we ought to see whether we cannot take the opportunity of the war to liberate the Indian currency system as far as possible from the incubus of silver, a metal which does not seem to have any future before it'! Accordingly, the proposal was on the anvil to replace the existing silver coinage by one of lower silver content and, in fact, experiments were being conducted by the mints for production of rupee coin in quaternary* alloy with the security edge to prevent counterfeiting, which was widespread.

Meanwhile, the Government took some interim steps such as promulgation, on June 25, 1940, of a rule under the Defence of India Act, making it an offence to acquire coins in excess of personal or business requirements, under which the Reserve Bank set limits up to which rupee coin could ordinarily be issued. The limits varied from Rs. 50 for an individual to Rs. 300 to Rs. 500 for a business firm. It is hard to say if this was at all effective. To tide over the immediate crisis, about one crore of standard silver coins of the 1938 George VI pattern were also minted since there was delay in the arrival from London of the one rupee notes for Rs. 25 crores, which had been printed as far back as 1935!† This consignment reached Bombay on July 22, 1940 and on July 24 a Currency Ordinance was issued providing for the issue and putting into circulation with immediate effect of Government of India one rupee notes which were to be deemed to be included in the expression ' rupee coin ' for all the purposes of the Reserve Bank Act. The introduction of one rupee notes, which proved popular, helped ease the situation to a considerable extent. Meanwhile, the mint was able to overcome the technical difficulties of issuing quaternary coins with the security device. By the end of November 1940, a sufficient quantity of these coins had been minted and consequently on December 23, 1940, the Indian Coinage (Third Amendment) Ordinance was promulgated, reducing, with immediate effect, the fineness of the whole rupee coin from eleven-twelfths of fine silver to one half of fine silver.

* So called because the coin was to consist of four alloys, namely, silver, copper, nickel and zinc. The proportions in which these metals came to be used in the new rupee coin were 50, 40, 5 and 5, respectively.

† These notes were printed as part of the measures designed to deal with the situation arising from the aggressive purchases of silver by the U.S. Government, in pursuance of the Silver Purchase Act of 1934, threatening to disrupt the Indian currency system by raising silver prices to the point of melting and export of silver rupees.

These coins were issued in December 1940 and simultaneously infractions were given that save in exceptional circumstances, no standard silver rupee should be issued to the public.

Incidentally, in some parts of the country there was some unwillingness to accept the new coins on account of the nomenclature quaternary rupees. So, the Governor gave instructions that the new coins should be described merely as the new rupee coin. Some of the Directors of the Central Board were unhappy that the Board had not been consulted in the matter of the new rupee coin, even informally.

New issues of one rupee notes, with the effigy of King George VI, were also put into circulation from July 1941. Gradually the various issues of standard silver rupees and other subsidiary coins were demonetised. This process began on April 1, 1941 and was completed by November 1943. It may be mentioned here that Government also considered and rejected during the period of stress in 1940 the alternatives of producing a nickel rupee, a cupro-nickel rupee and an Indian dollar of the value of two and a half rupees.

The difficulties were most acute in respect of small coinage, for the demand for small change was unprecedented. In March 1940, the fineness of the four anna coin was reduced from eleven-twelfths of fine silver to one half of fine silver; in July 1940; this was extended to the eight anna pieces also. In due course, the protective device of the milled edge with a shallow groove was incorporated in these coins also, to prevent counterfeiting.

On account of the urgent need to conserve nickel for war purposes, the nickel content of subsidiary coins was reduced by the use of a nickel-brass alloy with a nominal nickel content in respect of the two anna, one anna and half anna coins; the last one was introduced in January 1942, mainly in the hope of minimising the use of the pice (that is, one quarter anna). But this expectation was belied, for the price of copper kept going up and with it the demand for pice, which went into the melting pot. To meet this situation, a new pice with a circular hole in the centre and with considerably reduced metallic content began to be issued from February 1943. Some attempts were made to discredit this coin by putting it to non-currency uses, in particular, as a washer and one of the Directors also drew the Bank's attention to this fact. Deputy Governor Deshmukh in his reply said:

I have seen the new pice fitted to a cycle as a washer for a nut, but I do not think that need disturb us unduly not many people would be foolish enough to pay seven to twelve annas a dozen for coins which they should have no difficulty in obtaining from us at their face value. In view of our intention to go on issuing the coin it does not seem worth while making any statement to the press. I expect people will soon realise that the issue of the coin has not been stopped.

The supplies of small coin were considerably enhanced by the introduction of night shifts in the mints at Bombay and Calcutta and the setting up of a third mint at Lahore, which started production in October 1943. To meet the demand for the pice coin, the surplus capacity of the South African mint was availed of for obtaining a supply of 60 million pieces. On the whole, these measures led to a very substantial improvement in the small coin situation by 1944. Besides augmenting the supplies of small coins, some measures were taken to discourage unreasonable demand for these coins. Rules were issued, under the Defence of India Act, penalising acquisition of small coins in excess of genuine requirements, though here again it is hard to say how effective the regulations were. Mention may also be made of the introduction by certain institutions like the B. E. S. T. in Bombay and the Calcutta Tramways, of the practice of issuing their own coupons in lieu of the various denominations of small coins, thereby helping ease the position to some extent.

Exchange Management

Exchange management during the war was relatively simple as the Bank was faced with a surfeit of sterling. In fact, there was, at one time in the middle of 1941, speculation that there would be a rise in the rupee-sterling ratio. Besides the sterling receipts from the British Government on account of the war expenditure, the Bank made large purchases of sterling from the scheduled banks throughout the war period, reflecting the substantial favourable balance of trade that the country enjoyed.

As mentioned earlier, the Bank had discontinued the system of purchase by tender in May 1939 owing to the weakening of the exchange. The position improved in August but subsequent purchases came to be made at rates declared by the Bank, rather than by tender, on account of the availability of sterling freely. The spot buying rate for sterling remained almost unchanged at 1S. 6d. from November 1939 onwards.

As regards sales of sterling, which were small and intermittent, the Bank came to the assistance of the exchange market whenever it was temporarily in difficulties owing to a large remittance demand or a shortage of export bills on account of lack of shipping. For instance, in March 1941, the Bank undertook to sell ready sterling at 1S.5 31/32d. to ease the stringency in the market. Again, in October 1944, when an imbalance developed in the market due to a paucity of ready sterling required by importers on the one hand and a large supply of forward sterling from exporters on the other, the Bank came forward to sell limited amounts of sterling for ready delivery at 1S.5 63/64d. The

imbalance was further aggravated by the higher interest rates obtainable on Treasury bills in London which led banks with large rupee funds to transfer them to London and to cover forward with the Reserve Bank. Since the imbalance was expected to continue for some time owing to the increasing imports, the Bank began to sell ready sterling without limit at 1S. 5 63/64d. with effect from April 25, 1945.

To assist exporters, the Bank commenced purchasing forward sterling from the scheduled banks in October 1939. Initially, the forward rate varied according to the length of delivery; in February 1940, the rate was fixed at 1S. 6d. for delivery up to six months forward. This rate (as also the spot buying rate) and the ready selling rate of 1S. 5 63/64d. remained unchanged until the rupee was devalued in June 1966. The Bank commenced forward sales of sterling only in October 1946; this is dealt with in a later chapter.

When banks occasionally found it difficult to take up their forward contracts with the Reserve Bank on due dates on account of the non delivery of or delays in the realisation of shipping bills, as in March 1941, the Bank agreed to the extension of their contracts without penalty. Similar extensions were granted in late 1944 also, but at a penalty of 1/64d. The Bank did not consider it necessary to agree to purchase sterling for periods longer than six months; it was, however, agreeable to have the contracts extended if the non-delivery was due to bona fide reasons.

Policies Regarding Gold

During the war years the Reserve Bank and the Government had to pay special attention to the bullion market in view of the important place that gold and silver have held in the Indian economy, constituting important sources of saving and sensitive indicators of the economic and political trends. Bullion prices recorded a more or less continuous rise during the war years, reflecting primarily the fast rising money incomes and the growing preference for bullion not only as a hedge against inflation but also as a commodity that could be freely used in any possible emergency during war. In dealing with the bullion market, the authorities had the same dilemma as that with regard to war financing as a whole. On the one hand, the requirements of the British Government for the U.S. dollars and other hard currencies made it difficult to arrange for any large scale imports of these metals into India; in fact, in the early years of the war the opposite was done, namely, export of these metals from India. On the other hand, with the worsening of inflation, somehow gold and silver had to be found for sale in India. It should be said that the authorities were under no illusion that the necessarily limited sales of gold and silver

would curb effectively the inflationary pressure arising from substantial budget deficits. However, the idea was to use gold and silver sales to fight inflation mainly on the psychological front. Perhaps this limited objective was achieved, though so far as gold was concerned, this was at the cost of making available substantial profits (almost matching the rise in commodity prices) to the U.K. and the U.S. Governments. While in the three years 1939-42, India exported (net) 4.435 million ounces of gold at the average rate of Rs.111 per ounce (or fractionally below the Bank of England's price of 168 shillings), she had to pay during 1943-46 an average of Rs. 192 for the 7.5 million ounces of gold sold on behalf of the Allies, that is to say, at a premium of something like 75 per cent.

The movement of bullion prices in India during the war years was as under:

| Year | Gold (Spot) per tola* | | | Silver(Spot) per 100 tol | | |
|---------|-----------------------|---------------------|----------------------|--------------------------|---------------------|----------------------|
| | Highest Rs. a. p. | Lowest Rs. a. p. | Average Rs. a. p. | Highest Rs. a. p. | Lowest Rs. a. p. | Average Rs. a. p. |
| 1938-39 | 37 10 6 | 34 12 3 | 35 10 3 | 53 1 6 | 48 2 0 | 51 11 3 |
| 1939-40 | 43 8 0 | 36 9 0 | 39 13 11 | 66 4 0 | 44 7 6 | 55 4 9 |
| 1940-41 | 48 8 0 | 40 2 6 | 42 6 0 | 64 13 0 | 54 10 0 | 62 8 0 |
| 1941-42 | 57 12 0 | 41 9 6 | 44 7 11 | 97 6 0 | 61 12 6 | 66 11 4 |
| 1942-43 | 72 0 0 | 44 12 0 | 57 10 10 | 116 8 0 | 75 4 0 | 94 2 6 |
| 1943-44 | 96 4 0 | 65 4 0 | 76 11 6 | 141 8 0 | 101 8 6 | 120 7 11 |
| 1944-45 | 76 12 0 | 61 2 0 | 71 7 4 | 143 4 0 | 113 10 0 | 128 10 9 |
| 1945-46 | 97 12 0 | 63 6 0 | 80 3 0 | 159 6 0 | 118 0 0 | 135 1 11 |

*8 tolas = 3 ounces.

It will be seen that except for the year 1944-45, the average price of gold registered a continuous increase from Rs. 35-10-3 per tola in 1938-39 to Rs. 80-3-0 in 1945-46. The average price of silver recorded a steady rise, from Rs. 51-11-3 (per 100 tolas) to Rs.135-1-11; the extent of the rise in silver was thus larger than in gold.

This section will be devoted mainly to a discussion of policies with regard to aspects such as conservation of the stocks of monetary gold already in the possession of the Bank, exports of bullion from India in the early years and imports for sale on Government account later, as an anti-inflationary device. Other aspects of bullion such as banning of futures trading, regulation of the delivery period and restrictions concerning extension of credit against bullion are not covered here. A general observation that can be made on these various measures of control is that they were, by and large, ineffective, much more so than in the case of the controls over other commodities.

At a very early stage, the Directors of the Central Board recognised the importance of gold as backing for currency and endeavoured to get

the Bank's stocks of gold augmented. They were not successful in this, but at least this had the effect of preventing the drawing down of the existing stocks. In 1939, on the eve of the war, the Bank of England began quietly buying gold in India through the Reserve Bank. Consequently, net exports of gold from India, which had declined from 3.01 million ounces in 1936-37 to 1.36 million in 1938-39, recorded a marked increase to 3.16 million in 1939-40. However, with the rise in Indian prices, above the British parity of 168 s. an ounce or Rs. 42 per tola, net exports declined to 1.09 million ounces in 1940-41 and practically ceased in the next year. Indian opinion had always been critical of the exports of gold. With continuous accumulation of sterling by the Reserve Bank, these exports made little sense, so far as India was concerned. Naturally in the Board there were suggestions for placing an embargo on the exports of gold, but this was opposed by the Governor on the ground that such a step would depress the price of gold in India! This point was ably met by the Board by the suggestion that the Reserve Bank should acquire gold with the surplus sterling resources, at least in the Banking Department where its valuation was not subject to any statutory provision. For, in terms of the Reserve Bank Act, gold was valued at approximately Rs. 21 as. 4 per tola, whereas the prevalent market price was about double. Of course, an amendment of the Act would have been no problem in war time if the authorities had so wished. Naturally the British authorities and the Viceroy were unhappy at the proposal for the Reserve Bank to acquire gold. The Viceroy sent a personal message to Sir Purshotamdas Thakurdas that in his opinion any action by the Bank to impede the outflow of gold would be detrimental to India's war effort. The British Government and the Bank of England also sent an appeal to the Bank not to acquire any gold at that time. This matter came up before the Central Board on August 5, 1940. The Board was persuaded to defer consideration of the question of acquiring gold only after an assurance was given by the Governor, on behalf of Government, that gold then held by the Bank in the Issue Department was not to be touched by executive action. The Board insisted on getting this assurance in writing from Government. This was complied with. In fact, clarification was obtained that the term 'executive action' also covered ordinance making power of the Governor General! The Board also expressed the hope that the dollar requirements of India would receive special consideration.

It appears that the Governor suspected, and it so turned out, that the Directors had put forth the suggestion to acquire gold in order to forestall any attempt to whisk away the existing stocks of the Bank's gold. To quote Sir Chintaman Deshmukh:*

* op. cit.

As it happened, in this the Directors were shrewder than they knew. For, a few months later, the Secretary of State for India did sound the Government of India about utilising the Reserve Bank's gold in order to assist Great Britain. The Government of India opposed the proposal and His Majesty's Government abstained from pressing it.

With the gathering of inflationary forces in India and the increase in the price of gold, not only did exports of gold vanish, but sales of gold in India as an anti-inflationary measure came to be considered, culminating in the commencement of official sales on August 16, 1943. In February 1943, the Secretary of State for India cautiously sounded the Government of India for their views regarding the expediency of certain suggestions that the sale of gold to the public in India might be resorted to as a counter inflationary measure. The feeler from India Office also sought Government's reaction to the proposal that the Reserve Bank's own gold or some part of it ought to be first employed for the purpose in question. The Government of India, in the normal course, desired to have the views of the Governor on these proposals. Sir James Taylor happened to be seriously ill at that time and the Bank's views, opposing these proposals, were communicated to the Government by Deputy Governor Deshmukh after consultation with the Governor, in the following terms:

He (Taylor) thought it unwise for the India Office to have started on this question on the ground that once gold is supplied for any purpose it would be impossible to limit the demand for it to that purpose alone. From previous talks on the subject which I had with him I know that even from the domestic point of view he does not consider it right for Government to encourage the public to speculate in gold, by making supplies available. I believe he does not also attach much importance to the psychological value of an additional gold backing to our currency, although I myself expect that should gold be made available for similar purposes to China or the Middle East countries a demand for similar treatment will arise in India and Government may be pressed to concede it at least to the extent of obtaining gold as an additional backing to the currency. In view of this it need hardly be said that any proposal to use some of the Reserve Bank's own gold for anti-inflationary sales will be violently resisted.

In the light of the Bank's opinion, the Government of India wrote back to India Office:

We consider it most dangerous to embark on gold sales unless the amount of gold available (is) very considerable. We should not therefore wish to embark on sales of gold except under the strongest pressure or in the sure knowledge that we had at our disposal ample stocks with which to satisfy all demands. On the other hand, if gold is likely to become available we feel that confidence in our and consequently general confidence could largely be restored

by increasing the gold backing and we should probably ask for amount of gold which revalued existing reserve would cover one-third of our note issue. Our probable requirement for this purpose would be £ 100 million in gold.

As regards the proposal for using the Reserve Bank's own gold, the Government replied in an emphatic negative as the 'inevitable and immediate result would be severe currency scare'.

The suggestion for gold sales by the British and American Governments as a means to siphon off surplus purchasing power which could be diverted for defence outlays again found favour at a Conference held in Cairo in April 1943 for considering measures necessary to arrest the growing inflationary pressures in the Middle East countries. The Government of India were represented at the Conference and their attitude was that if gold were to be made available for sale in the Middle East countries it would be politically embarrassing to them if the same facility were not made available to India, although Government would prefer to utilise it for strengthening the gold backing against note issue.

Meanwhile, a new proposal came from Sir Henry Strakosch of the India Office, that India should buy gold from the U.S.A. at 168 shillings per ounce (equivalent to Rs. 42 per tola) and resell to the U.S.A. at the same rate, in instalments, over a sufficiently long period, to enable India to acquire the necessary amount of gold from new production. The Government of India welcomed the suggestion. However, the British Government opposed the proposal, being unwilling to assume responsibility for repayment. But they agreed to try out a policy of gold sales in India and the Middle East to cover part of their military expenditure and that of the U.S.A. in these countries and the Government of India accepted the proposal. The first instalments to be made available to India was 0.75 million ounces to cover a period of three months, after which the question was to be further reviewed. It was at first proposed by the U.K. Government that, to start with, the Reserve Bank might sell its own gold against gold earmarked in its favour in London. This suggestion, however, was opposed by the Government of India as this 'would arouse most acute suspicion and baseless rumours that published gold reserve in fact no longer existed intact, which no amount of government denial could kill.' Finally, arrangements were made by the U.K. Government for shipment of gold to India from South Africa.

The Bank started selling gold on behalf of the U.K. Government on August 16, 1943 and sales were later made on account of the U.S. Government too. The sales went on, with some breaks, till mid-August 1945. No announcement was made regarding the sales as it was deemed undesirable for Government to incur any commitment and further

there was some advantage in keeping the market guessing. Naturally this itself introduced an element of speculation. It was not, however, difficult for the market to guess that the sales were being made on account of the Allied Governments, since from the Reserve Bank's weekly statements it was obvious that the Bank was not selling its own gold.

Gold and silver sales operations kept the executives of the Bank, especially the Governor, exceptionally busy, since most of the details had to be worked out by the Bank and cleared with the Government of India, the Bank of England, the British Government and the United States Government. In spite of its continuous pleading the Bank did not get that measure of freedom of operation which it desired to have. However, on most of the issues involved in the sales, the Bank's views were accepted by the Bank of England and the British Government. It must also be added that the Governor's views were invariably supported by the Government of India.

There were many practical issues to be settled in connection with the sales, such as, concentrating sales at one important centre, namely Bombay, versus sales all over the country, sales in the form of bullion versus sales in the form of sovereigns and small bars, fixation of limits below which the metal should not be sold and conditions on which gold other than that of the U.K. and the U.S.A. could be sold in India. As already mentioned, on these matters the Bank's views were generally accepted though with some modifications to accommodate the points of view of the other interested parties (that is, the Government of India, the Bank of England, etc.). The Bank itself was most vigilant and took the initiative to suggest changes in the strategy of sales to suit the changing situation.

A close study of the operations reveals that the authorities tried to reconcile several objectives. They wanted to sell as much of the metal as was possible but with reasonable price stability. In other words, the authorities did not want the price to go down significantly below the level on the eve of the commencement of the sale, which was around Rs. 76 per tola. That is why initially a minimum of Rs. 70 for the sale price came to be indicated at a fairly early stage of the sale; later this was raised to Rs. 75, but towards the close of the sales operations it was brought back to Rs. 70. The U. S. authorities, however, seemed to have been a little more flexible in their attitude with regard to the minimum price at which gold could be sold, though it must be added that their requirements of rupees were much smaller than those of the U. K. It was, however, clear that the Allied Governments wanted to make a profit on the sales in relation to the parity price on the basis of \$35 an ounce (or 168 shillings an ounce, later raised to 178s. 3d.). The idea was that the price of gold should not fall below the approximate parity

with prices of other commodities. It is interesting that the Finance Department of the Government of India came out as a supporter of profit-making by the Allied Governments. Its view was that the widespread criticism in India of profit-making by the Allies and the claim for a profit in the gold sales 'can be fairly rebutted since the price of gold has not risen to the same extent as prices of items and services which H.M.G. and U.S.A. are purchasing here'.

The Bank was able to maintain reasonable stability in price by varying the quantum of its sales to the point of suspending sales altogether for several weeks at a time. Thus, for instance, sales were suspended between May 23 and July 11, 1944 and again between November 3, 1944 and April 2, 1945. The highest price at which gold was sold was Rs. 86-10-0 and the lowest Rs. 61 per tola. The total realisation on the sales of 7 ½ million ounces was Rs. 144 crores or an average of Rs. 72 per tola; the parity price on the basis of \$35 an ounce was Rs. 42 per tola. The sales amounted to 3.4 million ounces in 1943-44, 3.2 million in 1944-45 and 0.9 million in 1945-46.

For operational convenience, the bulk of the sales were made in Bombay, originally through recognised bullion dealers and later, from March 30, 1944, through tenders submitted at Bombay. The Bank opposed the sale of the metal in the form of sovereigns since they commanded a high premium and the Bank did not want the Allies to make a further profit. However, in order to make gold available on a country-wide basis, small bars of gold, of and 5 tolas, were sold in upcountry centres through the Imperial Bank from the middle of February 1944. In Bombay such sales were made across the counter from March 29, 1944.

There were enquiries from other countries such as Ethiopia and Australia for sale of gold in India and the Bank was prepared to issue licences on the basis of the levy of a licence fee, corresponding to approximately 50 per cent of the likely profit on the sales, but no such sale materialised.

The Governor successfully resisted attempts for some kind of supervision of the Bank's operations in regard to the sales. The American Government were keen to send an observer to supervise and report on gold (and silver) sales in Bombay; the British authorities found it difficult to resist the request. However, the Governor threatened that in that event the U.S. Government would have to make their own arrangements to sell without the Reserve Bank's intervention. The Bank of England was, of course, keen that the Reserve Bank should handle the U.S. sales too and later the proposal was modified, in that a U.S. Treasury official stationed in Chungking was to spend a week in India to study the working of the gold sales, on his way back to the U.S.A. The Governor had no objection to this arrangement. It is also

learnt authoritatively that once when the price of gold threatened to pass the ceiling they seemed to have in mind, the Government of India offered to send their Economic Adviser to advise the Bank on how to handle the situation, which was summarily rejected by the Governor. It was not long before the authorities in India and the U.K. recognised the able manner in which the Reserve Bank had handled the gold sales, requiring to a high degree faculties of secrecy, toughness, capacity to elude the proverbially smartest speculative elements of the Indian bullion market, winning the confidence of the bullion trade that the Bank's procedures were equitable and satisfying the principals in the transaction, namely, the British Government and the U.S. Government. The Bank of England's telegram of February 16, 1944, addressed to the Governor, had this to say:

The successful manner in which you have handled this extremely difficult matter is highly appreciated here and in Whitehall. You may rest assured that any advice and guidance you may wish to offer will always be most welcome.

For quite some time, even the Central Board Directors were not taken into confidence in the matter of gold sales. There was an unofficial move during the meeting of the Central Board held at Cawnpore on December 11, 1943 to ascertain on whose behalf the sales of gold were being effected, but the Governor would not vouchsafe any information. The Directors, however, wanted to make sure that the Bank's own gold holdings were intact and nine of them paid a visit to the Allahabad Fort, to which place gold had been removed in 1942 with utmost secrecy, for inspecting the gold stocks. It would appear that the Board meeting was specially arranged to take place at Cawnpore, to enable the Directors to pay a visit to Allahabad for this specific purpose. The first official announcement about gold sales was made by the Finance Member in February 1944 while replying to a question in the Central Legislative Assembly. Subsequently, a memorandum giving details of the sales was placed before the Central Board at the meeting held on April 17, 1944.

Exchange of Sovereigns for Gold

Before concluding the section on gold, a brief reference may be made to the exchange of the Bank's holdings of sovereigns for gold bullion, at a premium. The Bank's gold reserve comprised a substantial amount of sovereigns; there were practical disadvantages to the Bank in holding the coins. There was wear and tear; verification for audit purposes was time-consuming and expensive; transportation was difficult; finally, there was scope for petty thefts. On the other hand, there was

substantial demand for these sovereigns on account of the seal of purity, easy identification ('its weight, size and fineness have been elaborated by thousands of years' experience', as Sir James Taylor remarked) and convenience to hold, hoard and smuggle in and out. The sovereign therefore commanded a premium over its bullion value.

Thus, it was both convenient and profitable for the Bank to exchange the sovereigns for gold bullion. So, in August 1936, the Governor consulted the Finance Member whether the Bank might start the exchange operation. Government conveyed their concurrence promptly, after getting the matter cleared with India Office, saying that the exchange might be made 'as and when an opportunity of profit arises, say, whenever the premium is 6 annas or above'. The Bank began the operations in September 1936 and except for short breaks, the exchange went on till January 1947. The demand for the sovereigns and consequently the premium, varied a great deal, depending upon the economic and political developments. Thus, during the war, on account of inflation and international political uncertainties of various sorts, the demand increased considerably. In the pre-war years, the premium had varied between 3½ annas and one rupee. In the war years, it ranged from 7 annas to Rs. 6 and annas 10; on occasions the premium constituted over 15 per cent of the bullion value. Sales in the period 1936-47 amounted to almost 12 million pieces, resulting in a profit of over Rs. 2.5 crores.

Early in 1942, because of the tendency to smuggle sovereigns abroad, especially to the Middle East, the Government desired that the exchange of sovereigns be stopped. The Bank reluctantly agreed but within two months the exchange had to be resumed. For, on account of the war developments, the Bank wished to move its gold holdings out of the coastal centres to an interior place. By offering sovereigns at these places, it was possible for the Bank to arrange for delivery of refined gold at Bombay, thus saving the Bank the trouble and expense of transporting the gold stocks.

There were requests more than once that the Bank might make available to foreign Governments sovereigns against credit to its gold account with the Bank of England but the Bank persistently declined these, since in terms of the Reserve Bank Act gold held abroad had to be shown separately in the Bank's Weekly Statement of Affairs and it was feared that this might lead to uninformed suspicions regarding the disposition of India's gold reserves.

Silver

The developments with regard to silver were also many and full of interest. In the case of this metal, official sales were made from the very

commencement of the war. In Indian conditions, and in the early years of the war in particular, the authorities had to pay greater attention to silver, not only because of its being the precious metal of the masses but also because of its importance for coinage. Originally, the main objective of official silver policy during the war was to prevent a sharp rise in the price with its adverse repercussions on the currency system of the country, namely, hoarding and melting of silver coins if the bullion value went above the nominal value; in later years, disinflation was the primary objective. It was considered that the appropriate policy for the Government was to utilise the large reserves of silver available with them for meeting the prospective demand both in India and the U.K. at prevailing prices. These reserves consisted partly of bullion acquired in the past for currency purposes and the stocks of silver rupees steadily returned from circulation with the growing use of paper currency. It may be recalled that on the recommendation of the Hilton Young Commission the Government of India had been pursuing since 1927 a policy of reducing the large reserves of silver; the sales of silver on Government account were being conducted in London by the India Office. Even before the war, Sir James Taylor made efforts to have the locale of selling transferred to India, but the India Office was reluctant to give up its prerogative. It had, therefore, been arranged that in the event of a large demand developing from India, especially following a change in the U.S. Government's silver policy and the outbreak of war, the India Office would start selling silver in the London market for delivery at Bombay.

On the eve of the outbreak of war, when silver prices rose sharply owing to the depreciation of sterling and therefore of the rupee vis-a-vis the U.S. dollar and speculative buying, the India Office started sales of silver on August 25, 1939 against deliveries from the Bombay Mint on the basis of London prices including cost of transportation and import duty. After repeated representation from the Bank about the operational advantages of conducting sales in India, India Office concurred. But this was on the eve of the practical exhaustion of the stocks of fine silver! It was announced that, effective December 14, 1939, sales of silver for delivery at Bombay would be conducted by the Bombay Office of the Reserve Bank. After a few days' sales of fine silver, the Bank started selling standard silver, (that is, of eleven-twelfths fineness), which was declared to be tenderable at the Bombay Bullion Exchange at a discount.

Meanwhile, the trend of prices of silver in India and abroad led to growing domestic demand for the import of the white metal from the U.S.A. Since the Reserve Bank could not indefinitely refuse exchange for the import of silver under the exchange control regulations, the import of silver bullion and sheets and plates without a licence from

the Reserve Bank was prohibited under the Sea Customs Act in October 1939. Government had large stocks of standard silver in the form of rupees, but the demand in India was for refined silver and the rising trend of prices was resumed following the ban on imports. The Reserve Bank, therefore, introduced on December 18, 1939, a scheme of licensing imports of silver from the U.S.A. and sterling area countries on a profit-sharing basis and fixed the minimum and the maximum prices for the sale of imported fine silver covered by licences at Rs. 62 and Rs. 64 per 100 tolas, respectively. The Secretary of State and the Bank of England were of course unhappy about imports from the U.S.A. and indeed the Bank of England later refused to allot any appreciable dollars for these imports. Imports under the scheme, which remained in operation till January 31, 1942, amounted to about 11 million ounces, by no means a large quantity.

In the early war years, the Secretary of State seemed to be mainly concerned about using India's silver for meeting the U.K.'s coinage and essential war requirements, for the sake of conserving dollar exchange! In the three years 1940-43, India was a net 'exporter' of silver, to the tune of 68 million ounces; the exports to the U.K. were in the nature of forced supplies to the U.K. Government. Governor Taylor more than once protested against exports to the U.K., which he said, ought to import from sterling area countries like Australia, rather than recommend such action to India. Governor was not also happy at the price paid by the U.K. Government for Indian silver, which was Rs. 50 per 100 tolas, whereas the market price went on rising steadily from an average of Rs. 55-4-9 in 1939-40 to Rs. 94-2-6 in 1942-43. These exports, however, declined sharply from 1943-44 onwards, India becoming a net importer.

On account of the large sales of Government silver by the Bank, there was reasonable price stability till about the close of 1941; the problem of monetary silver was successfully met through the issue of one rupee notes and quaternary rupees. The outbreak of war with Japan intensified the demand for the metal leading to a renewed spell of rising prices. The Bank continued the policy of meeting the demand through the sale of standard silver as its stocks of fine silver were practically exhausted. The uptrend in prices however continued, and the Bank found it very difficult to meet the demand; in one day alone, that is on December 8, 1941, the market absorbed about 6 million ounces. There was temporary suspension of official sales from February 20, 1942. Thereafter, the Bank made only a feeble attempt to exercise restraint through occasional sales, and the speculative orgy continued unabated. The Bank thought it best to let the price rise, in the hope that, to use Sir James's words, 'after all, when people have time to reflect they will realise what the world price of silver is'! Meanwhile,

the requirements of silver for coinage increased and sales were finally discontinued from October 14, 1942. The price rising above the melting point of Rs. 109 (per 100 tolas) for standard silver coin no longer bothered the authorities.

As the rise in the price of silver continued, the question of resumption of imports from the U.S.A. was considered, from the anti-inflationary point of view. The Bank made it clear that controls on bullion trading would not be effective. The Bank, as Mr. Deshmukh explained to Government in June 1943, was also of the view that Government were not equal to the task of controlling the price. The crux of the problem was the intensification of anti-inflationary action. However, Government were keen on arranging for some imports from the U.S.A. It was noted that the bulk of the silver coming to the market was allocated for industrial requirements. The only prospect of getting silver was from the U.S. Government. Through the passage, in July 1943, of what is known as the Green Bill, the U.S. Treasury was in a position to make available supplies as a result of the freeing of about one billion ounces from monetary reserves. So, negotiations were set in motion and in the first instance, in August 1943, the U.S. Government agreed to make available 20 million ounces to the Government of India for coinage purposes, to be returned within a period of five years from the termination of the war emergency. Negotiations were also begun for the supply of about 100 million ounces for supplementing currency reserves and for anti-inflationary sales in the Indian market. There was considerable delay in the finalisation of the arrangements, especially over the question whether the agreement should be between the U.S. Government and the Government of India, as in the case of the 20 million ounces supplied for coinage purposes, or whether the British Government should be a party to the agreement. The U.S. Administration was keen on the latter, in view of the uncertainty about the future Indian constitution and the attitude of the Government of India to foreign obligations. The agreement was finally concluded in June 1944, on the basis that the British Government would stand guarantee for the return of the metal after the war. In all 226 million ounces were supplied to India under the Lend-Lease Arrangement. The actual sale of Lend-Lease silver in the Indian market was only 50 million ounces, about 37 million in 1944-45 and about 13 million in 1945-46. It may be mentioned that the Reserve Bank had maintained from the beginning that the direct anti-inflationary value of silver sales would not be considerable, and that the sales could only have indirect psychological effect. Finally, Government came round to this view and the sales of silver were suspended from July 4, 1945, six weeks prior to the suspension of the sales of gold. A good portion of the lend-lease stocks remained in bullion form, enabling the Government to return the metal

partly in bullion and partly in the form of quaternary coin, in 1957. During the seven-year period 1939-46, Government sold in all 181 million ounces of silver in the Indian market, as under.

| | (April-March) | | (Million ounces) |
|---------|---------------|----|------------------|
| 1939-40 | .. | .. | 3.0 |
| 1940-41 | .. | .. | 18.0 |
| 1941-42 | .. | .. | 94.0 |
| 1942-43 | .. | .. | 16.0 |
| 1943-44 | .. | .. | - |
| 1944-45 | .. | .. | 37.1 |
| 1945-46 | .. | .. | 12.9 |
| | | | ----- |
| TOTAL | .. | .. | 181 .0 |

Exchange Control

One of the areas of economic policy wherein advance preparation had been made by most countries prior to the outbreak of World War II was exchange control; consequently, it was possible to introduce the control immediately on the outbreak of war. This was so in India too, though control was considered necessary not on grounds of shortage of foreign exchange in general -it was the other way about -but for conserving non-sterling area currencies, especially the U.S. dollar. The scheme formulated for India was intended to be a part of a much larger and integrated plan of control devised for what came to be known as the 'Sterling Area', co-ordination being exercised by the British Treasury and the Bank of England. The control was to be administered by the Reserve Bank as agents of the Government of India. The relevant notifications were issued by the Government under the Defence of India Rules and the Sea Customs Act, 1878, from time to time; a separate Foreign Exchange Regulation Act was passed only in 1947, The Bank exercised control through instructions issued to the public and the authorised dealers in foreign exchange and bullion in the form of circulars, public notices, etc. The directions in which control was required were a matter for decision by Government, but the Reserve Bank's advisory role was an important one; a great deal of initiative in this matter lay with the Bank.

Throughout the war, exchange control was confined to transactions with non-sterling area countries, the currencies of which, particularly U.S. dollars, had to be conserved for purchases of essential war materials. Thanks to the elaborate advance preparations, the system of control was quite comprehensive even at its inception, although there was considerable evolution and widening of its scope in the light of experience and the special circumstances created by the different turns in the war. By the time the war neared its end, the control had become

fairly well established, in the sense that many loopholes had been located and plugged and there had been an effective contribution to the Allied war effort by way of the substantial dollar surpluses made over to the sterling area's dollar pool.

Mention should also be made here of the Bank's efforts for the segregation of India's contribution to the Empire Dollar Pool with a view to ensuring its ready availability for post-war reconstruction and development. While this objective was not achieved, the Government of India succeeded in getting the U.K. Government to agree to earmark some sterling which would be convertible into dollars for meeting post-war requirements. These developments are covered in a separate section at the end of this chapter.

After the war, there were gradual relaxations in the control system in the developed countries, particularly as regards current transactions. But in the developing countries like India, generally, exchange control was not only retained but was made more and more stringent; indeed, it has become a part of the permanent apparatus of planned economic development. Although the scope of the control in India has undergone several changes, its basic structure has remained what it was during the war time.

The First Steps

The first move towards devising a system of exchange control for the sterling area was made in April 1939. With growing tension in Europe, the Governor of the Bank of England, in consultation with the British Treasury, felt it necessary to address confidentially his counterparts in the central banks of all the Dominions and India, detailing the regulations that the British Government proposed to put into force in the financial sphere in the event of outbreak of a war involving the U.K. The object of the regulations was to conserve the country's resources in gold and foreign exchange and apply them to meet national needs. The proposal made by the Bank of England was that all the countries of the British Empire (with the exception of Canada, Newfoundland and Hong Kong, which had closer financial and trading relations with other countries than with the U.K.) should adopt similar measures of exchange control in respect of their dealings in currencies other than those of the Empire and that all their earnings and disbursements of these currencies should be centralised in London. That is to say, all the foreign exchange accruing to these countries known collectively as the sterling area would go into a general pool under the control of the Bank of England, and out of that pool the Bank of England would provide foreign currencies to meet the requirements of any part of the sterling area. The first enquiry of

the Bank of England was whether India would be in a position to establish a system of exchange control, enabling her to be admitted to the sterling area in which financial transactions between member countries were as far as possible to be free.

Sir James Taylor's first reaction to the proposals was typical of the concern he always had for India's interests. Judging by the experience of World War I, India herself, he felt, would have no difficulty in maintaining her rate of exchange as war conditions would lead to an intensified demand for her exports and a slackening of imports owing to a reduction in the supply of goods for civilian consumption from belligerent countries, shipping difficulties, etc. 'If history is any guide at all', he wrote in May 1939 to the Governor of the Bank of England, 'everything points to our ultimate difficulties being not to maintain exchange at its existing level but to prevent it from rising above the present statutory limit'. The Bank of England was informed that while India would be prepared to come into the sterling area arrangements, a rigid system of exchange control from the outset would be difficult to enforce as well as undesirable, as that would create the feeling that the central bank was doubtful of its ability to maintain the rupee on an even keel, and this in turn would lead to an increased demand for remittance and probably also gold for hoarding. Besides, India had large overseas commitments in respect of debt servicing, repayment and also private remittances. In order to ensure the necessary exchange to meet these commitments, there had to be the least possible interference with legitimate trade. Again, since the bulk of India's financial operations, private as well as official, were being conducted through London, there were adequate safeguards in the proposed U.K. regulations against irregular transfer of the funds to third countries. Furthermore, as there was every likelihood of her maintaining a favourable balance of payments throughout the war, the non-introduction of exchange control in India on the scale contemplated in Great Britain could not be a material objection to her admission to the sterling area.

The Governor, therefore, considered that the control in India would be adequate if it guarded against loopholes through which transactions which were unauthorised under the U.K. regulations could pass unchecked. This objective was to be secured thus: in respect of sales of sterling, which would not be subject to any restriction, banks which would be authorised to deal in foreign exchange would be instructed to maintain complete records of all transactions, and as regards other foreign currencies banks would provide exchange only for legitimate trade purposes, so that the banks would be put on enquiry if it was found that they were acting contrary to the prescribed arrangements. It was also suggested by the Governor that a War Trade Department

should be set up which, in the light of events, might consider it necessary to introduce a system of rationing of imports; in that case, licences would be issued by them and the Reserve Bank could regulate the corresponding releases of foreign exchange.

On the side of exports, the Governor considered it sufficient for the Control to purchase the proceeds of exports to the extent to which they were offered for sale in the open market. The foreign currency proceeds of exports from India to the non-sterling area countries would accrue in any case to the sterling area as a whole, strengthening the area's external reserves. At the same time, the Governor saw some justification for the Bank of England's fear that if the Indian regulations were less exacting than those imposed in London, the tendency might be for exchange transactions with the rupee to be effected outside the sterling area on an increasing scale. The Governor, however, considered that the existing organisation of India's foreign trade made it impossible to institute a system of export licences coupled with a regulation making it necessary for everyone acquiring foreign exchange as a result of export (or other transactions) to offer the exchange to the Reserve Bank. The object had, therefore, to be to 'make India as a whole a source of strength to the sterling area rather than weakness, without endeavouring to tighten control to such an extent that it might defeat its own object'.

As regards other financial transactions, e.g., personal remittances on current account, foreign travel and capital transfers, the same procedure as was adopted with regard to trade would generally be followed so that, while not imposing the same measure of control as was proposed in London, the regulations would provide an adequate check on undesirable movements of funds. If the measures introduced initially proved to be inadequate, there would be no insurmountable difficulty in stiffening up the control later to any extent necessary. As for transactions in bullion, the Governor did not consider it necessary to go beyond licensing of imports and exports thereof at the outset, any further restrictions being left to be decided as the situation developed. Calling for declaration of holdings beyond a limit to be specified and requiring banks to report all advances against bullion would put the Bank in a position to take effective action immediately on its being required.

The Bank of England, despite the Governor's assurances of the fullest co-operation consistent with Indian conditions, did not agree. The Bank made it clear that admittance to the sterling area without the establishment of a complete system of exchange control was not possible. In the words of Mr. Montagu Norman, the Governor:

Our own ideas incline towards stringency. In principle, we think it will be best, this time, to get the whole position under control at the outset, and then see in which directions it may be possible to relax.

We cannot look forward, as you can, to a strengthening of exchange in an emergency; but we expect to have ample resources if they can be reserved for national needs. Our main preoccupation is therefore to prevent their being dissipated, and this can only be done by a control which extends to all possible methods of evasion. As you clearly realise, one of our stable doors -to which you have the key -is in Bombay.

The Bank of England also stated that as long as there were no restrictions on transfers between London and India, it would be possible for residents in the United Kingdom who had been refused foreign exchange to transfer sterling to India and buy their foreign exchange there. As a consequence, India would provide a loophole for the escape of sterling funds outside the sterling area. The fact that India herself had a favourable balance of payments was immaterial as the balance might be reversed owing to the weight of remittances through her by other countries in the sterling area. In addition, the Bank of England considered that a strict control on dealings in bullion would be necessary.

The matter was, of course, one of policy and for the Government of India to decide; Government, whom the Governor kept apprised of the exchange of correspondence with the Bank of England, supported his views, especially in view of the likely adverse political repercussions in India of introducing a stringent system of controls right at the outset. The Finance Member (Sir Jeremy Raisman) made these views known to the India Office. In view of the importance and urgency of the matter, the Governor paid a visit to London in July 1939 to work out an agreement. After detailed discussions with the Bank of England officials and India Office and in consultation with the Government of India, it was ultimately agreed to adopt a stringent system of control on the lines proposed for the U.K.

The Control System in Outline

The system of exchange control to be established was as follows:

Powers were to be taken by the Government of India under the Defence of India Rules (these Rules were set out in Part XIV Financial Provisions):

- (a) to prohibit the acquisition of foreign exchange either directly or indirectly or the dealing in foreign exchange by residents in British India except under their authority (Defence of India Rule 91);
- (b) to require residents in British India to declare their belongings of foreign currencies and foreign securities and on the issue of special orders to surrender them (Defence of India Rules 92 and 94);
- (c) to prohibit the acquisition by residents of securities from persons

resident outside India or the export of securities from India except with their permission (Defence of India Rule 93) ; and
(d) to prohibit dealings in bullion except under their authority (Defence of India Rule 91).

The Government we're also to prohibit the export and import of gold except under licence from the Reserve Bank (this was to be done by a notification to be issued by Government under Section 19 of the Sea Customs Act, 1878).

Action on these lines was taken immediately after the outbreak of the war, that is to say, on September 3, 1939, when the Defence of India Ordinance and the Rules framed there under were issued. The authority to deal in foreign exchange, to empower other firms to deal in foreign exchange and to license the acquisition of foreign securities, the export of securities and dealings in bullion was transferred to the Reserve Bank by a notification* issued on September 4. The licensing of imports and exports of gold coin and bullion was also delegated to the Reserve Bank.

The administrative action taken by the Bank under these powers is indicated in the following paragraphs. 'Foreign exchange' as defined in Rule 91 (1) of the Defence of India Rules meant any currency other than currency which was legal tender in India or Burma†. Rules 91 to 95 therefore applied to all currencies other than the rupee. General permission was granted by the Bank for purchases and sales of sterling‡ by the public from and to the authorised banks and for the acquisition of sterling securities. Rules 92 and 94, which provided for compulsory acquisition by the Government of foreign exchange and foreign securities, respectively, were not intended to be enforced immediately. The system contemplated was similar in form and scope to that introduced in the U.K., except that in the latter country all private holdings of specified foreign currencies and gold had to be surrendered to the Treasury and private dealings in gold were prohibited.

Sir James arranged to get the drafts of the preliminary instructions to banks on exchange control, in the event of an outbreak of war, and the various specimen forms of applications, returns, certificates, etc., approved by the India Office and the Bank of England before he left the U.K. The Bank's offices were to issue them immediately on receipt of intimation from Government regarding receipt of war telegram from India Office and promulgation of the Defence of India Ordinance. As

* Finance Department Notification No. 123-SRB.

† The words 'or Burma' were deleted on June 6, 1942.

‡ In addition to sterling, currencies of all the Dominions (except Canada, Newfoundland and Hong Kong), Colonies and Protectorates were to be treated on the same basis as sterling. Currencies of all other countries as also the three excepted Empire currencies mentioned above were to be treated as 'foreign currencies'. Thus, the terms 'Empire currencies' and 'non-Empire currencies' (or 'foreign currencies') were used synonymously with the terms 'sterling area currencies' and 'non-sterling area currencies', respectively.

identical measures were to be introduced in Burma also, it was arranged with the Government of Burma for simultaneous issue of instructions to the Manager of the Rangoon Office of the Bank.

From the records it would appear that the Central Board was not formally consulted at any stage during the preliminary discussions; the Governor informed the Committee of the Central Board at its weekly meeting held on September 8, 1939, that 'following the outbreak of war the Central Government had taken powers to control transactions in foreign exchange and had by notification appointed the Reserve Bank as their agents to exercise these powers'. He also mentioned that as the work developed special staff arrangements might become necessary, for which he would approach the Committee in due course, and that the question of payment of any extra charges incurred by the Bank in this connection was left open for settlement with the Government of India later. Subsequently also, the practice was -and this continues to the present day -for the management to apprise the Central Board (or the Committee) of important developments from time to time, rather than to obtain its formal concurrence to each major change in policy, as the Board was not responsible for the framing of exchange control policy. Of course, as in other cases, energetic Directors sometimes had their own points to make on one or the other aspect of the control, which helped in a fuller study of the relevant problems being made with a view to making the control more effective while at the same time minimising inconvenience to the public.

The notice to banks, which was addressed to all scheduled banks, was very elaborate. The covering letter drew their attention to the Financial Provisions of the new Defence of India Rules and explained that transactions in foreign exchange could only be made in accordance with the special notice attached. The notice embodied the following instructions and information.

First, it stated that the Reserve Bank had been authorised by Government. to deal in foreign exchange, to license other banks or persons to deal in foreign exchange and to issue directions to these ' authorised dealers ' regarding such transactions from time to time. In exercise of these powers, the Bank was prepared, on application made to it, to grant licences to deal in foreign exchange to banks which had offices in British India, were included in the Second Schedule to the Reserve Bank of India Act and had exchange dealings with the Reserve Bank in the past. This stipulation limited the granting of licences to banks with some experience of foreign exchange transactions and which were therefore unlikely to break the regulations through ignorance of exchange matters.

Secondly, general limits for the foreign exchange operations of licensed banks were laid down. These were briefly as follows:

- (a) Purchases and sales of sterling were allowed without restriction subject only to the general prohibition of trading with the enemy and with enemy firms;
- (b) Purchases of foreign currencies (i.e., currencies other than sterling) were allowed freely;
- (c) Sales of foreign currencies (i.e., other than sterling) could only be made to persons who had made applications to an authorised bank on prescribed forms. These forms had later to be submitted to the Reserve Bank. Sales could be made for the purposes of meeting reasonable trade or business requirements, performing contracts made before the outbreak of the war and defraying reasonable travel or other petty personal expenses;
- (d) In the case of purchases of sterling for ultimate transfer into other currencies, authorised dealers could sell sterling freely but they had to certify to their London offices or correspondents, the correctness of the statement made by the applicant regarding the purpose for which the exchange was required, to enable the U.K. authorities to consider providing the necessary exchange (the supply of foreign exchange against sterling was entirely a matter for the U.K. authorities, the certificate conferring no right on the purchaser in this behalf) ;
- (e) Forward transactions in exchange were allowed provided they were limited to bona fide commercial purposes;
- (f) Rupee transfers to the credit of the accounts of foreign banks were permitted provided the transactions were reported to the Reserve Bank on the appropriate form; and
- (g) The opening of foreign currency accounts (i.e., other than sterling accounts) for private persons in India was prohibited.

To begin with, no restriction was imposed on imports; foreign exchange was provided freely for all goods arriving into India. The Bank had also made it clear to Government that any such restriction, if found necessary later, should be introduced through the medium of a prohibition under the Sea Customs or other Act accompanied by a system of licensing to be administered by a Government department. The Bank would then dovetail this into its scheme of exchange control.

The notice to banks and leading bullion dealers advised them that while domestic dealings in gold were being allowed to be continued freely, the Central Government had prohibited the import and export of gold coin, gold bullion and ingots except under a licence from the Reserve Bank and that such licences would only be issued to approved banks and dealers who had been duly registered as authorised dealers by the Reserve Bank. Registration as authorized dealers in gold would be done on application being made to the Reserve Bank subject to the

condition that returns of the amounts of gold held and purchases and sales effected during each week were submitted regularly. The reason for the establishment of this system of registering dealers in gold was to comply with the wishes of the Bank of England which was afraid that an uncontrolled bullion market operating in India might lead to the evasion of exchange control. The system of registration was, however, discontinued after a brief trial as it was found to serve no useful purpose. It was also announced that (i) licences would be issued freely to authorised dealers for imports or exports of gold from or to the U.K., (ii) in order to comply with the U.K. regulations, the exports should be consigned to the Bank of England or to a dealer authorised by that Bank and (iii) the Reserve Bank was prepared to make arrangements to facilitate such exports. As for exports to or imports from other non-hostile countries, licences were to be granted subject to such conditions as the Reserve Bank might consider necessary in each case, e.g., in the case of exports, the exporters might be required to offer the foreign exchange proceeds thereof to the Reserve Bank against payment in rupees at rates to be intimated by it.

An explanatory memorandum was also issued for the information of the public, indicating the salient features of the control over transactions in foreign currencies and the import and export of gold. The public were also advised that while they should continue to deal direct with their usual bankers, all dealings in foreign currencies, including sterling, must be made through authorised dealers in foreign exchange.

All the notices were issued by the Bank on September 4, 1939, immediately after the Government's notification of the same date empowering the Bank to discharge on their behalf the various responsibilities in regard to control of dealings in foreign exchange and bullion was issued.

It was mentioned in Chapter 9 that the intricacies of the administration of exchange control required that a separate department be set up to tackle it with expedition and competence. The Managers (who were ex-officio Assistant Controllers) were told that until a comprehensive set of instructions could be framed, they should interfere as little as possible with the customary methods of doing business, so long as they had no reason to suspect that these were likely to lead to evasion of the objects of the control. An important function of the Exchange Control Department was to keep in close touch with the Censorship of the Posts and Telegraphs, and the Enemy Trading and Enemy Property Departments, so as to get wind of possible loopholes and evasions.

The initial instructions issued by the Bank in respect of exchange control as well as those issued from time to time modifying, deleting or adding to them were codified and published in the form of an

Exchange Control Manual in June 1940; revised editions of the Manual were issued from time to time.

It should be of interest to note briefly the major points of difference between the Indian and the U.K. controls. In the U.K., licences to deal in foreign exchange were limited to a few leading British joint-stock banks, whether or not they had transacted foreign exchange business before. The authorised dealers operated as direct agents of the Bank of England, and all their transactions had to be conducted at the actual buying and selling rates for each currency as fixed by it. The exchange difference was retained by the Bank of England but the authorised dealers were permitted to charge commission on each transaction to their customers. On the outbreak of war, all the banks had to surrender their foreign currency balances to the Bank of England, which thereafter released reasonable amounts to them as working balances.* The system established in India was a more loosely-knit one; this to some extent was due to the vast size of the country and the less developed banking organisation but, more importantly, because the Reserve Bank, as mentioned earlier, did not have enough staff of its own experienced in foreign exchange matters to deal with the detailed technical operations of the authorised banks from day to day. This was also just as well, for a highly centralised control was not really called for, from the point of view of the country's foreign exchange position. Authorised dealers in India were allowed to continue their normal methods of operation provided all their foreign exchange transactions were conducted on the basis of the London Control rates and the ruling rupee-sterling rate. Subject to this, the operative rates were fixed by the Exchange Banks' Association and when granting licences to deal in foreign exchange, the Reserve Bank stipulated that banks must follow these rates. Alterations in these rates were made only after consultation with the Reserve Bank. The Reserve Bank did not buy and sell U.S. dollars (except the proceeds of gold shipments to the U.S.A.) or other foreign currencies on its own account. If it undertook to purchase some currencies in 1940, it was with a view to facilitating the operation of the new export control regulations; the arrangements made in this connection are detailed in a separate paragraph.

Essential uniformity of control and collaboration between the territories comprising the sterling area was secured by the Bank of England by advising the exchange control authorities in the different countries of any new measures instituted to enable these countries to issue corresponding orders with such variations as might be necessary to suit local conditions. Member countries were required to deliver all their earn

* The system was discontinued in January 1947 and arrangements similar to those in vogue in India were introduced.

ings of foreign currencies to the Bank of England which held them in a common pool (this came to be known as the Empire Dollar Pool as the U.S. dollar was the most important component); in return, they could draw on this pool for their essential requirements, the drawals bearing no relation to the size of their individual contributions. In India, the returns of foreign currency purchases and sales made by banks enabled the Reserve Bank to watch their exchange positions; if any bank became overbought to an extent that was considered excessive it was requested to reduce its position by a sale to the London Control. In addition, banks were permitted to deal in foreign currencies with each other without restriction, and as the rates at which they did this inter-bank business were within those quoted by the London Control, authorised dealers always tried to cover their requirements locally. As a consequence, it was only the final balance of foreign exchange that was sold to or bought from the London Control. In effect, therefore, the functioning of the Indian system differed little from that in the U.K., except in regard to the retention of the exchange profit by the Indian authorised dealers themselves.

On the whole, the Indian system worked smoothly, and many problems were settled by the Bank through direct discussion with the Chairman of the Exchange Banks' Association. The interference with normal trade transactions resulting from the introduction of exchange control in India appeared to be considerably less than in many other countries.

It would be appropriate to discuss, in separate sub-sections hereafter, the manner in which the various facets of exchange control actually developed during the war time.

Licensing of Authorised Dealers

All the exchange banks, whether British or foreign, were eligible for licences to transact foreign exchange business as all such banks were included in the Second Schedule. At the beginning, these and a few Indian scheduled banks, numbering 28 in all, which had carried on exchange dealings with the Reserve Bank before the war, were licensed as authorised dealers; some of these banks, whose operations so warranted, were granted limited licences, i.e., licences to deal in sterling only. Although the Bank of Cochin was a non-scheduled bank and had no offices in British India, it was permitted to continue to transact foreign exchange business, on the condition that it abided by all the rules of the Indian exchange control. The Bank's policy was not to license a large number of banks, which was in keeping with the policy of the Bank of England except that in the U.K. the list was limited to British joint-stock banks. There were no enemy banks operating in India in

1939 although later (i.e., on July 31, 1941)) of course, the three Japanese banks had their licences cancelled on the suspension of trade relations with Japan. As mentioned earlier, the licensed banks could transact business only at the rates laid down by the Exchange Banks' Association.

The list of authorised dealers remained practically unaltered until 1943; a few banks had been licensed to deal only in sterling during this period. However, as newly established Indian banks with sizeable capital wished to take up foreign exchange business, the Bank was obliged to reconsider its policy. With the expansion and development of Indian banks-which could not have been foreseen in 1939-it became apparent that strict adherence to the original rules would mean that no newly formed Indian bank or an Indian bank which had not dealt in foreign exchange in the past would be able to take part in financing the foreign trade of the country as long as the control lasted. It was largely due to the initiative of Governor Deshmukh that the policy was liberalised so as to enable the discriminating admission to the list of authorised dealers of Indian banks with reasonable capital, which wished to take up foreign exchange business. It was then decided that licences would be granted if the following conditions were fulfilled: (a) the bank was of good standing, (b) it showed reasonable chances of attracting exchange business and had made arrangements for the appointment of overseas agents and (c) it had appointed managers experienced in exchange dealings. In cases where the third condition was not fulfilled but where the Reserve Bank considered that there was a reasonable prospect of its being complied with at not too distant a date, a restricted licence to deal only in sterling area currencies was issued, with the object of ensuring that the bank concerned obtained some experience before it could be given a general licence. The following remarks of the Governor made in August 1943 on the application of a bank which held a restricted licence, for a full-fledged one, indicates the reorientation of policy:

I think we must look beyond the immediate War conditions and give a fair chance to any scheduled bank which gives evidence of having the necessary technical equipment. Even if the operations are not large they may yield experience both to the bank concerned and our selves. These questions are bound to arise as soon as the preoccupations of the War are over and no charge should be laid at our door that we have thwarted Indian banks' efforts to enlarge their experience, unless we have very good reasons of public interest. These do not appear to exist and I would grant the licence applied for.

The stipulation that the banks should adhere to the exchange rates fixed by the Exchange Banks' Association (within the limits set by the London rates and the rupee-sterling rate) was continued to be imposed

while granting new licences so that the Reserve Bank's control over rates could still be exercised through this Association as in the past. On the other hand, with a view to assisting the new banks to establish satisfactory agency arrangements with foreign banks, particularly in the U.S.A., without locking up large funds abroad, the Reserve Bank introduced the following procedure. These banks would deposit rupee securities with the foreign banks' agents in India to cover roughly the average value of outstanding letters of credit opened by them against imports and confirmed by the foreign banks; the Reserve Bank agreed to guarantee the convertibility of the sale proceeds of these deposits into foreign currencies in the event of the banks' failure to honour their commitments. The facility of deposit of rupee securities as collateral was granted also to banks desirous of availing themselves of overdraft facilities from their foreign correspondents.

As with all forward-looking innovations in policy, this one too encountered opposition from vested interests. Even the Finance Department, which had until then not thought it necessary to interfere with the Bank's discretion in the matter of issue of licences, wanted to ascertain the considerations that led to the grant of a licence to a new Indian bank, marking a departure from the Bank's expressed policy as laid down in 1939. 'Apart from the undesirability of granting licences to new and untried institutions when the dollar exchange is under such close control', the Finance Department wrote in January 1944, 'there is the further danger that trouble may arise when the difficulties of the post-war period emerge should such a bank become committed on a large scale'. Government's doubts were set at rest by the Governor who explained at great length the considerations which had prompted a revision of the earlier policy. He pointed out that it had clearly not been the intention of the initial statement of policy to exclude for ever new and promising Indian banks from the field of financing of the country's foreign trade. The development of banking in India during the preceding few years had been rapid and this had no parallel to conditions in the U.K. or the Dominions where the appearance of new banks was unlikely. The Governor also drew the Government's attention to the irony of the previous situation where, on political grounds, licences had to be granted to foreign banks of which the country knew nothing, while at the same time they were being refused to respectable Indian banks. 'A private word by me in the ear of the Finance Member', Sir C. D. Deshmukh recalled in retrospect years afterwards, 'that India was the only country in which Government could bring itself to question why a trading privilege had been granted to a national . . . proved to be the last word on the subject'.*

* op.cit.

As the war drew to a close, the licensing policy was again reviewed. An examination of the operations of the banks licensed till then -these numbered 38* at the beginning of 1945, of which 11 held licences to deal in sterling area currencies only-revealed that practically the whole of the exchange business, i.e., over 99 per cent, was being handled by 15 banks, the other 12 authorised dealers doing only about one half of 1 per cent. The banks which transacted the bulk of the business were the leading exchange banks established before the war and three or four of the Indian banks. The other Indian banks did little more than the business of a few of their small merchant customers, since the big traders preferred to deal with the established exchange banks having large resources and experience and also because the banks experienced difficulties in establishing satisfactory agency arrangements abroad. The commercial community at the important centres was served adequately by the existing authorised dealers and there was no public need for more dealers. Further, an expansion in the number of authorised dealers meant more administrative work for the Reserve Bank by way of increased supervision and scrutiny of a larger number of returns. Also, with the limited business available, any large increase in the number of dealers posed the danger of a lowering of the quality of the staff employed, including defections from the existing dealers, as also a scramble for business.

On the other hand, it was important that the financing of the foreign trade of the country did not remain a virtual monopoly of the old exchange banks; successive Presidents of the Indian Merchants' Chamber had reiterated the necessity for establishing Indian exchange banks. Taking all factors into account, the Governor felt that while it was necessary and desirable to continue to encourage Indian banks to take up an increasing share of the financing of the foreign trade of the country, the Bank must proceed cautiously in this matter. It was considered that the issue of new licences should be restricted to banks which commanded sizeable resources and could demonstrate their ability to develop their foreign exchange business substantially within a reasonable time. To this end, it was decided in the middle of 1945, with the approval of Government -which was specifically sought on this occasion to strengthen the Bank's hands while refusing fresh licences-that licences to deal in sterling area currencies alone should be given initially to applicant banks satisfying the criteria laid down earlier. The extension of the licence to cover operations in all foreign currencies was not to be granted unless the bank's sterling operations during a year revealed that it was developing its business to a level comparable

* One authorised dealer ceased to do banking business and was consequently excluded from the Second Schedule, but its licence to transact foreign exchange business was not withdrawn.

to that of one of the smaller exchange banks and its paid-up capital and reserves amounted to Rs. 50 lakhs and its deposits to Rs. 4 crores. Although some of the banks already licensed were liable to have their licences withdrawn under the revised formula, no action in this direction was taken; a general advice was, however, issued to all the authorised dealers that the list would be reviewed periodically and that it might be curtailed, if necessary, by the exclusion of banks the volume of whose exchange business did not warrant their continuance on it. The banks were, at the same time, called upon to give an undertaking to the Reserve Bank that they would abide by the rates, terms and conditions laid down by the Exchange Banks' Association, whether or not they were members of that Association; the object was to prevent unhealthy and uneconomic competition among them. Such an under-taking was obtained thereafter from the newly licensed banks.

It should be added that around the same time, i.e., May 1945, the Bank of England also decided to expand its list of authorised dealers in foreign currencies to meet the requirements of the post-war period. The criteria for inclusion in its list were, however, laid down with reference to categories of banks (such as members of the British Bankers' Association), avoiding altogether any scope for individual selection. In pursuance of this policy, the U.K. offices of central banks or banks of issue in other parts of the sterling area were also to be licensed as dealers. The Reserve Bank's London Office, which fell in this group, was thus granted a full licence; this conferred on it the power to deal in all foreign currencies and the power to approve sterling transfers to non-resident accounts. However, the London Office did not deal in foreign currencies.

The Reserve Bank's policy in regard to licensing of dealers in foreign exchange underwent little change in the next few years. Periodical reviews revealed that only a few large Indian banks were able to expand their foreign exchange business considerably, the share of other Indian authorised dealers remaining negligible. From the point of administration of the control, it was considered desirable that the exchange business was handled by a few banks with good resources and technically competent personnel and so there was no liberalisation of the policy adopted in 1945. In fact, it called for cancellation of some of the licences already issued, although this was not done having regard to the adverse repercussions this action would have had on the general reputation of the banks concerned and consequently on their internal business.

Early in 1947, there was a slight tightening up of the policy of licensing of authorised dealers. With the possibility of sterling becoming multilaterally convertible, necessitating extension of exchange control to the sterling area currencies also, it was considered probable

that banks holding licences to deal only in sterling would automatically have their licences extended to cover transactions in all foreign currencies. Hence the issue of new licences to deal in sterling area currencies was itself made subject to fulfilment of all the prescribed conditions including that with regard to the bank's paid-up capital and reserves as well as deposits. Owing to this, hardly any new licences came to be issued from early 1947 onwards. An exception was made in the case of the Australasia Bank Ltd., Lahore, which was granted a licence in December 1947 in compliance with a special request from the Pakistan Government to license it, in view of the prevailing banking difficulties in the Punjab, where many of the offices of the other authorised dealers were not functioning.

After the Foreign Exchange Regulation Act was passed in March 1947, fresh licences were issued by the Bank to all the authorised dealers in exercise of the powers conferred on it under Section 3 of the Act, the licences issued earlier under the Financial Provisions of the Defence of India Rules being no longer valid. There was, however, no change in the Bank's licensing policy. In the middle of 1948, the number of authorised dealers stood at 45, of which 11 held restricted licences; the increase of 7 over the 1945 figure which occurred almost entirely before the end of 1946 was due to the issue of a few new limited licences and the conversion of some such licences issued earlier into full-fledged ones. Of the 34 full licensees, 15 were exchange banks. Co-operative banks were not considered suitable for issue of licences to deal in foreign exchange.

The total volume of foreign exchange business handled by the Indian authorised dealers at the end of the war was relatively small; even in 1948, it amounted only to about 16 per cent of the total business transacted by all the authorised dealers. The Bank felt, however, that there was little that it could do to assist the Indian banks to secure an increasing share of the financing of the foreign trade of the country, besides such indirect encouragement as its licensing policy gave to these banks for increasing their foreign exchange business and beyond seeing that rules were not framed or market practices established that impeded their progress or operated to their disadvantage. Mention has already been made of the facilities provided by the Bank to resolve the difficulties experienced by some banks in meeting the demands of their foreign correspondents for deposit of security. The Bank also allowed reasonable remittance facilities to the Indian banks to meet the requirements of their foreign branches in the initial period of their operations. In the Bank's view, the steady increase in the volume of exchange business of some of the Indian banks, both during the war years and afterwards, clearly showed that there were no major obstacles in the way of the others developing their business similarly.

Several suggestions for assistance from the Reserve Bank were put forward by the banking or business community from time to time, e.g., provision of direct financial assistance through the rediscounting of sterling bills under Section 17 (3) of the Reserve Bank of India Act or that the Reserve Bank's London Office should act as agent for Indian authorised dealers who did not have branches in London. As regards the first suggestion, the London Office of the Reserve Bank had actually received no requests for discount facilities, and this was apparently due to the fact that there were ample facilities in the London market for the discount of bills. If the banks did come to the Bank's London Office for the purpose, the latter could easily offer assistance provided the bills satisfied the requirements of Section 17(3) of the Act. As for discount of import bills, for various reasons it was felt that it would be more advantageous for banks to obtain assistance from the Reserve Bank in the form of advances under Section 17(4) (c) rather than by discounting them under Section 17 (2) or (3). The suggestion that the Bank's London Office might act as agent for the authorised dealers was not a feasible proposition nor was it likely to be to the advantage of the banks concerned. While Section 17 of the Act did not authorise it to act as agent for commercial banks in the handling of shipping documents and dealing in all types of bills, such a step would also be contrary to the Bank's policy of not taking an active part in commercial banking. Besides, in view of the Bank's lack of experience of this type of business and the general absence of the competitive motive, it was hardly likely that the commercial banks would get as good service from it as from their own foreign correspondents.

The Governor (Sir C. D. Deshmukh) was strongly of the opinion, when a review was made in January 1947, that the fault of those banks whose foreign exchange business showed little increase lay mainly in the fact that they were not prepared to establish active foreign exchange departments and carry on a vigorous campaign to obtain business, rather than in the lack of financial resources, absence of branches abroad or inability to obtain satisfactory service from banks in foreign countries. The fact was that in most cases it was the exporter and the importer who determined the bank through which they wanted to conduct their exchange business. A proposal made that the Indian banks combine to float a separate exchange bank which would open branches in various places overseas and handle the foreign exchange business of all its share-holding banks was found to be beset with considerable practical difficulties. The Central Board concurred with the Governor's view that the Reserve Bank could be of little assistance to banks which regarded their exchange business merely as a side-line and the licence to deal in foreign exchange as a symbol of prestige.

Some specific Aspects of the Control

Broadly, the extent of the control in the war years depended on the dollar position of the sterling area as a whole. Incidentally, in India, the sterling area was not legally defined until the Defence of India Rules were amended on July 12, 1941, by introduction of Rule 92A; the new Rule described it as being His Majesty's Dominions (excluding Canada, Newfoundland and Hong Kong), the British Protectorates and Protected States, and such other territories as might be declared by the Reserve Bank to be included for the time being in the sterling area. The inclusion or exclusion of any country in or from this group by the Reserve Bank was done entirely in the wake of the decisions taken by the Bank of England. In the Reserve Bank's own notices and instructions, however, the term was being used even earlier. The dollar position of the sterling area in turn closely depended on the vicissitudes of the war, e.g., the occupation of the major part of Europe by Germany, the entry of Japan into the war and the overrunning of many of the Far Eastern territories by Japan, as these resulted in shipping difficulties, and loss of overseas sources of supply of raw materials or manufactured goods or of overseas markets. These turns in the war also necessitated special measures to safeguard the exchange value of the sterling area currencies, particularly sterling. Then there were the Lend-Lease arrangements* with which came a considerable easing of the dollar scarcity; these rendered a relaxation in the control possible. Thus, there were continuous modifications in the original system;

* Lend-Lease was an arrangement under which the U.S. Government, instead of granting direct dollar loans, made available to various Allied Governments during the war a widely defined range of 'defence articles' not excluding essential civilian needs, for which the receiving country had to make no cash payments: It may be mentioned that the Johnson Debt Default Act (1934) had prohibited grant by the U.S.A. of dollar loans to foreign Governments in default of the World War I obligations, while the Neutrality Act (1925 and amended in 1937) prohibited shipments from the U.S.A. to countries involved in war. The Neutrality legislation was amended again in November 1939, repealing in effect the embargo provision of the earlier Act, but insisting that exports to belligerent countries were not to involve the extension of credit or the use of U.S. vessels. Under this 'cash and carry' rule, as it was called, the U.K. financed its purchases in the U.S.A. initially out of its gold and dollar resources resulting in their substantial depletion. With a view to assisting the U.K., the Lend-Lease legislation was enacted on March 11, 1941, empowering the U.S. President to provide aid on terms which he considered satisfactory including 'payment or repayment in kind or property, or any other direct or indirect benefit'. Under the Mutual Aid Agreement entered into between the U.S.A. and the U.K. in February 1942 for the provision of such assistance, the latter was under the obligation to extend Reciprocal Aid (or Reverse Lend-Lease) to the U.S.A. and to promote the objective of freer international trade, with reduction of tariffs and other tariff barriers, in the post-war period.

India was also an indirect recipient of Lend-Lease aid through the U.K.; she accepted the benefits subject to the important reservation that she was free to pursue her own tariff policy. She also undertook to provide Reciprocal Aid, up to the value of Lend-Lease goods received by her, in the form of goods and services to the U.S. forces stationed in India. Approximately equal benefits, of the order of Rs. 206 crores in each direction, were received by the two countries under the arrangement. Lend-Lease assistance from the U.S.A. to India ceased on VJ Day (September 2, 1945), but Reverse Lend-Lease by India continued till May 31, 1946. Final settlement of all transactions was effected in terms of an agreement entered into by the two countries in May 1946.

correspondingly, the latitude given to authorised dealers in making sales of foreign exchange varied.

In the administration of the control, there was considerable delegation of authority to the Reserve Bank from the Central Government. The application of the broad principles of the control involved scores of day-to-day decisions at the top executives' level, for there were innumerable marginal cases to which the provisions, whether of import control or export control or the freezing orders, could not be applied without some modification.

There was also some delegation of authority to the authorised dealers. Besides co-operation from the authorised dealers, the successful administration of the control was also facilitated by the fact that there was seldom any criticism of the regulations by the press or the public. What Professor Sayers had to say of the British control in his book *Financial Policy, 1939-45* could be said to be largely true of India also:

Administration of the Regulations was greatly helped by the full support they enjoyed throughout the war from public opinion, and by the willingness of the banks to undertake all the routine work. There were inevitably some awkward problems, but public acceptance of the control eased the task of the authorities in overcoming the difficulties.

Import Control: The main object of exchange control, as mentioned earlier, was to conserve the foreign currency resources of the sterling area as a whole. This was achieved, first, through import control, established in May 1940, whereby exchange could only be sold to importers holding import licences issued by the Import Controllers situated at each of the major ports. The issue of import licences was determined to a considerable extent by the availability of shipping space, although in many cases, licences were refused on the ground that the currency of the supplying country was 'difficult'. In the concluding stages of the war, the licensing system was relaxed considerably, to permit larger imports as a means of combating inflation and of meeting extreme shortages.

Regulation Of Other Remittances: Along with the introduction of control on imports, regular procedures were also laid down for making other trade remittances, e.g., those on account of insurance premia, freight, royalties, and earnings from steamers and films. The facility whereby authorised dealers were allowed to approve remittances without reference to the Reserve Bank was withdrawn in April 1940.

Control over remittances of profits, however, came much later, i.e., on October 21, 1941. Other parts of the sterling area had already taken steps to restrict them; in India, the delayed action was due to the fact that the bulk of the foreign interests were engaged in the manufacture of essential articles and there was fear that any curbs placed on remittances might result in curtailment of output. The basis for allowing

remittances was to be decided by the Commerce Department of the Government of India; the Reserve Bank was called upon to assist Government in dealing with the applications for remittances made by the various concerns. There was a gradual lifting of the restrictions from December 1942, due to improvement of the dollar position consequent on the Lend-Lease arrangements, and by April 1944 all the restrictions were removed.

Release of exchange for foreign travel and remittances for miscellaneous private purposes also came to be regulated from the middle of 1940. Subsequently, to check the evasion of the regulations through travel 'without any foreign exchange' resulting in deferred exchange liabilities to the hosts abroad, a system of issue of Exit (Finance) Permits by the Reserve Bank (the forerunner of 'P' form I) was introduced effective August 2, 1943. The initial regulations in regard to remittances for other private purposes, such as maintenance of families abroad, transfer of capital and of interest, dividend and insurance premia were also gradually made more stringent, in line with the policy of the U.K. Control.

Vesting Orders Concerning Dollar Holdings: A measure to consolidate the existing private holdings of U.S. dollars in the official coffers was the requisitioning, by vesting orders issued by the Government of India, of all privately owned U.S. dollar balances and certain specified U.S. dollar securities against payment of value thereof in rupees. Unlike in the U.K., action was not taken in India immediately on the outbreak of the war nor was it considered necessary to take over holdings in currencies other than dollars. The entire administrative work relating to the taking over of the vested securities and balances devolved on the Reserve Bank. After the relevant data were collected by the Bank, a Government notification was issued on November 23, 1940 requiring the surrender of all private holdings of U.S. dollar balances. The vesting order requisitioning private holdings of twenty-four of the principal U.S. dollar securities followed soon afterwards, on March 10, 1941. The amounts of U.S. dollar balances and securities surrendered till the end of March 1945 were \$4.8 million and \$2.95 million, respectively.

Control Over Export Proceeds: Control over exports also became necessary to ensure that the foreign exchange proceeds of exports to non-Empire countries accrued to the sterling area. The Reserve Bank had, as early as in October 1939, taken steps to prevent goods which were shipped to the U.S.A. and other countries outside the sterling area being paid for in cheap sterling obtainable in the free markets of New York and other centres. It prohibited banks from negotiating or collecting sterling bills drawn on countries outside the sterling area, the bills covering shipments to non-Empire countries were required

to be drawn in the currency of the country concerned or, if in sterling, had to be drawn on London under credits registered with the Bank of England, (The London Control would exercise the necessary check over the sterling provided by the foreign importers to meet these bills). The Bank also prohibited authorised dealers from purchasing sterling from non-Empire banks for the purpose of laying down rupee funds in India unless the sterling had been bought in London at the Control rates. In framing these regulations it turned out that the Reserve Bank was ahead of London policy as it was only eight or nine months later that the Bank of England took effective steps to control the free sterling markets.

Steps were also taken simultaneously to ensure that rupee transactions with the United States were conducted on the basis of the rates fixed by the London Control. Transfers from the rupee accounts of foreign bank branches or correspondents held with banks in India were not permitted unless the holding bank certified that the rupees had been sold on the basis of the London Control rates. In January 1940, at the request of the Reserve Bank, the Bank of England issued an order to London banks that rupees could not be sold to foreign banks or parties against sterling unless the sterling had been provided by the sale of the currency of their country of residence to the London Control. However, as the transactions in 'free' sterling were not yet within the control of the Bank of England, these measures only resulted in Indian exporters and American importers financing their business in sterling in order to take advantage of the lower rates quoted for sterling in the New York free market. The regulations therefore proved effective only when measures were eventually taken by the London authorities to control outside (i.e., non-resident) sterling.

Export control proper was introduced in India and throughout the sterling area in March 1940. The system at first covered a limited number of commodities which were good dollar earners and applied to exports made to the American Continent (excluding Canada and the Argentine), Belgium, the Netherlands and Switzerland. In India, the commodities covered were jute and jute manufactures and rubber. The objects of the scheme were to ensure, first, that the foreign exchange proceeds of exports were returned to India and surrendered to the Control and, secondly, that the exports were financed in certain specified ways so that full export proceeds were received. The system was worked through the Customs, the Export Trade Control, the Reserve Bank and the authorised dealers. Considerable initiative and supervision were also called for from the Reserve Bank in devising special procedures to meet certain peculiar trade practices, and ensuring the timely submission of the forms completed by the exporters and the authorised dealers. In June 1940, the export control scheme was

extended to cover all commodities shipped to the U.S.A. and Switzerland. Other changes were also made from time to time.

Problem Of Cotton Exporter: In the early stages of the war, the East India Cotton Association raised the question of the inferior position in which the cotton exporter was placed by the Bank's control of the rupee-dollar exchange rate. Raw cotton was a commodity which was both imported by India from the U.S.A. and exported by her to that country. Owing to the existence of a free market for sterling in New York in the initial stages of the war, the sterling-dollar rate was ruling lower in the New York market than in London; in view of this and the requirement of the Indian exchange control that the exporters should deal only with the authorised dealers and that they should deal with them only at the Control rates, the Indian exporters to the U.S.A. were at a disadvantage compared to the American exporters, and their competitive position was thus adversely affected. In other words, the American exporter could quote less for the same quantity of cotton, as he could sell the dollar proceeds at the free market rate for sterling whereas the Indian exporter could only do so at the Control rate. Sir Purshotamdas Thakurdas, who was also Chairman of the East India Cotton Association, held that it was unjustifiable that the control should react to the disadvantage of the Indian cotton grower, either directly or indirectly, and was keen to secure for him the full benefit of the New York-London free sterling rate. In view of the importance of the subject, he wrote to the Governor early in November 1939 and requested that it be brought before the Board.

The Governor (Sir James Taylor) was already seized of the problem but thought that Sir P.T.'s fears were exaggerated. The Bank of England with which he was already in correspondence was not in a position to give any estimate of the actual extent to which foreign purchasers of Indian produce were enabled to purchase sterling at the free market rates (and through sterling, the rupees to pay for the goods) as such transactions were illegal under the British exchange control regulations and would therefore be clandestine. Owing to the large foreign holdings of sterling at the outbreak of the war, control in the U.K. was obviously a much more difficult matter than it was in India, but he had no reason to doubt that it was being steadily tightened.

The problem was discussed at two successive Central Board meetings held on December 4, 1939 and January 22, 1940. The Governor was then able to convey to the Board the results of his communication with the British Control. The latter was already trying its best to stop the leakage of sterling into unauthorized channels and hoped that the business which was evading the Control-probably not more than one-tenth of the total-would dwindle in course of time. The Bank of England was also contemplating tighter control over the foreign exchange

proceeds of shipments to non-Empire countries and was in correspondence with the other Empire Controls so that the scheme could be introduced simultaneously by all of them. Sir James hoped that with the introduction of this scheme it would be possible to block up the remaining loopholes within a comparatively short time. He also indicated broadly the steps that India herself was taking to prevent the American importer from providing cover through the non-official market. Besides, as a prelude to a more complete control over export finance, the Government of India had already issued a notification on December 27, 1939 requiring exporters to non-Empire countries to furnish information regarding the channels through which payment for the exports was being obtained.

The East India Cotton Association brought up the matter before the Governor formally in April 1940. The Governor took special trouble to clarify to it the various steps already taken and those in the offing to reduce the size of the free market for sterling. The Association's insistence that the free market channel of finance through sterling should be opened up to the cotton trade however annoyed the Governor greatly. Nor did he agree with its methods of controversy, including the 'confidential release' of the entire correspondence with the Bank to its members, which was tantamount to full publicity, against which the Governor had advised the Association. He thought that no useful purpose would be served by carrying on the discussions with it in these circumstances, but Government (to whom he had reported the matter in detail) desired that he should 'keep the ball rolling' until the British Government did something in the matter, as his proposal to close the correspondence with the Association would only lead to the subject being taken up again by the Board (at Sir P.T.'s instance, of course!) or by the Federation of Indian Chambers of Commerce and Industry or similar body. However, Sir James took no action and the East India Cotton Association also did not pursue the matter further, perhaps because of the subsequent war developments. The Central Board, which was kept apprised of the Association's views and the subsequent developments with regard to export control, also appears to have been satisfied that the Governor was doing all in his power to reduce the disadvantage to the Indian exporter.

Provision Of Forward Cover By The Reserve Bank: The Bank entered the forward market in foreign exchange in October 1939 to provide cover for exporters, as banks were reluctant to do forward business owing to the difficulty of obtaining cover in London for positions other than spot and the rise in discount rates there. It intimated its willingness to purchase sterling from banks up to three months forward at a rate $1/32d.$ higher per month than the spot rate. On February 12, 1940, the offer of three months forward purchase of

sterling was extended to six months at 1S. 6d. The Reserve Bank did not, until then, purchase other foreign currencies either ready or forward, barring US. dollars resulting from gold shipments (the dollar proceeds of gold exports were to be surrendered to the Bank either ready or on arrival of the gold in the U.S.A.). However, as it was apparent that under the new export control regulations there would be a large increase in foreign currency bills, the Bank announced simultaneously that in order to assist banks to cover immediately any large purchases they might make of foreign currencies, it would purchase from them, on behalf of the Bank of England, Belgian francs, Swiss francs, Dutch guilders, Norwegian kroners and Java guilders, delivery up to four months forward, and U.S. dollars up to six months forward, on the basis of the Bank of England buying rates for these currencies and its sterling buying rate of 1S.6d. less a commission of $\frac{1}{8}$ per cent. The occupation of the major part of Europe by Germany by the middle of 1940 led to the cancellation of these arrangements, excepting those for Swiss francs and U.S. dollars. The Bank discontinued the purchase of these two currencies also in August 1945; actually this facility had not been utilised by authorised dealers to any great extent for quite some time previously.

Export of Notes And Jewellery: With a view to plugging loopholes in exchange control, it became necessary to regulate the export of Indian and foreign currency notes, as well as the exports of jewellery. For these purposes, the Government of India promulgated a new Defence of India Rule (90B) on November 2, 1940, requiring the Reserve Bank's permission for export of money in any form to any place outside British India (except Burma); Government also issued a notification on January 11, 1941, imposing a similar requirement with respect to the export of diamonds, precious stones and jewellery. **Import Of Currency Notes:** Regulation of the import of foreign currency notes also became necessary, but for different reasons either to preserve the exchange value of the Bank of England notes, or to restrict the import of notes from territories occupied by Japan. In the former case, the Reserve Bank co-operated closely with the Bank of England; so did the other Empire Controls.

There were no restrictions on the import of rupee notes except that with the extension of the war to Burma, limits were laid down by Government on the amounts that could be brought in by refugees from that country.

There are other aspects of exchange control which, on account of limitations of space, cannot be dealt with even briefly; these are also, of course, of very little current interest. These relate to such matters as releasing exchange for operations of Indians in foreign commodity markets and the administration of the various freezing orders issued by

the Government of India at different stages of the war in the Far East. With the entry of Japan into the war and its occupation of various territories in the Far East, the Government issued freezing orders applicable to transactions between India and those countries; the objects of the orders varied, however. The objects of the Japanese freezing order were to bring Japanese business with India to a standstill and to control Japanese assets in the country; in the case of the Chinese freezing order, the object was to help the Chinese Government to gain control over the foreign exchange earnings of exports from China. The control over exchange transactions with China proved most difficult to enforce on account of severe inflation in China, the marked increase in smuggling of goods from India and the black marketing in currency prevalent in both countries.

As already mentioned, the administration of exchange control imposed enormous strain on the Bank's senior executives, but on the whole it would seem that the control worked well. Judging from the almost complete lack of criticism in the press or from the commercial bodies, it may be said that the regulations were administered satisfactorily. Of course, in those years, there was no dearth of foreign exchange. But in later years, as the foreign exchange reserves began to decline, the control necessarily became more elaborate and stringent, rendering the task of administering the regulations more difficult, and inevitably led to a more critical attitude on the part of the public.

India and the Empire Dollar Pool

Before concluding this chapter a brief account may be given of the efforts of the Central Board and the Government of India towards the segregation of India's contribution to the Empire Dollar Pool so as to conserve dollar earnings for post-war reconstruction and development. During the period September 1939 to March 1945 India's net contribution to the Pool was of the magnitude of \$300 million.

As the war drew to a close, there was a growing opinion in India that steps should be taken to ensure the availability of the country's earnings of dollars in the post-war period for purchase of plant and machinery. A more drastic proposal was that the country should come out of the Empire Dollar Pool straightaway and hold its dollar earnings separately.

The Board's anxiety to acquire dollars or gold with the Bank's sterling balances dated back to the early months of 1940. The matter was also discussed actively at the Board's meeting on July 20, 1942. The Directors were keen to see that India should secure for herself the balance in her favour of her exchange operations with the U.S.A., irrespective of the Lend-Lease arrangements, in the form of either gold or dollars.

Another suggestion was that India should obtain an assurance from the U.K. that after the war she would be allowed to purchase dollars with the accumulated sterling at the existing rate of exchange for payment of imports from the U.S.A. Sir James Taylor himself did not share the Board's uneasiness; he was genuinely optimistic about the sterling balances being available for the purchase of producer goods, as and when they were required, after the termination of the war. He, therefore, saw no strong reason for commending these suggestions to the Government of India.

The question came up again informally at the October (1942) Board meeting. In view of the importance of the matter, the Governor sought the Government's approval for the stand he proposed to take before the Board, should the point be raised again; he was actually expecting it to come up at the very next meeting of the Board. In the Governor's view, the process of determining the actual balance of payments between the U.S.A. and India was a complicated one, and the figures that might be worked out could only be very approximate. He also felt that the problem could not be separated from the more general one of whether India should have a separate Lend-Lease arrangement with the U.S.A. or whether she should remain linked with the U.K. Even if she were to be separated, apart from the reciprocal Lend-Lease aid which would have to be provided by her immediately, it was extremely doubtful whether the American Government would agree to incur a dollar debt to India or make payment in gold while they were incurring Lend-Lease obligations of any sort to this country. The two principles seemed, in fact, to be fundamentally inconsistent. ' India could not be expected to be allowed to pick out the plum without taking the rest of the bun. ' Sir James wished not only to apprise the Board of these difficulties but also to tell them, should Government agree, that apart from the general arguments, the country's favourable balance with the U.S.A. would be drastically reduced, if not changed into an unfavourable one, if the amount of Lend-Lease assistance to India was taken into account, and that if that was not the case so far, it was likely to happen very soon.

The Government of India fully agreed with the line that Sir James Taylor desired to adopt. To quote from a communication they sent to him on November 24, 1942:

Lease-Lend must inevitably be brought into the argument because the very *raison d'être* of Lease-Lend was the Empire's inability to pay in dollars or gold for the further American supplies necessary to carry on the war. India has accepted and is accepting Lease-Lend goods and by that very fact she must be regarded as estopped from also claiming the dollars she has earned. It must also be obvious that as His Majesty's Government have already thrown their gold and the entire Empire

Pool of dollars into the common war effort, they are not in a position to release gold or dollars as and to the extent suggested. This argument will apply irrespective of the amount of Lease-Lend assistance received by India. It is however quite certain that the net receipts by India under "mutual aid" would greatly exceed in value her own earnings of dollars.

It seems, however, that the Government of India did have doubts about the free availability of the sterling accumulations for use after the war; they had, in the meantime, been considering seriously the question of requesting the U.K. Government to constitute a Development and Reconstruction Fund* to which an agreed portion of India's sterling balances would be credited, for being made available to India in regular amounts annually for purchase of capital equipment from the U.S.A. or other sources after the war. It would appear that the proposal emanated from the India Office early in 1942† and that in the correspondence with the Government of India which ensued, it was contemplated that the Fund might be of the size of £ 200 million, to be drawn on at a rate not exceeding £ 20 million per annum. By the end of the year, the scheme had reached the stage of being recommended to the British Treasury for acceptance as part of an Anglo-Indian settlement concerning the whole of the sterling balances. When the scheme of funding the sterling pensionary liabilities (which is discussed in the next chapter) came before the Governor General's Executive Council in January 1943, the Council made, in fact, a demand that there should be a simultaneous announcement by the British Government of their acceptance in principle of such a Fund, and an assurance from them that the goods ordered against this Fund under an agreed plan would be duly forthcoming. Another suggestion made by the Council was that India's net dollar earnings resulting from the sales of her goods in the U.S.A. should not henceforth accrue to the Empire Dollar Pool, but should be held separately and reserved for post-war use in connection with Indian reconstruction; the suggestion was based on the view, though erroneous, that with the introduction of Lend-Lease financial arrangements, the Empire Dollar Pool was not necessary for the conduct of the war.

The proposal for the Reconstruction Fund, like that for the funding of the sterling pensionary liabilities of the Government of India, was, however, dropped subsequently due to the opposition of the British Government, which was just as well; as Professor Sayers remarked, 'Had it materialised on the scale suggested in these 1942-43 discussions, the Reconstruction Fund might conceivably have operated to

* The Finance Member, Sir Jeremy Raisman, described the scheme broadly in his budget speech of 1943-44, paragraph 49.

† Prof. R. S. Sayers, *Financial Policy, 1939-45, History of the Second World War, United Kingdom Civil Series.*

restrict India's post-war demands, as compared with those the United Kingdom actually had to meet in the early post-war years'.*

In the meantime Mr. Deshmukh, who had on Sir James Taylor's sudden death been empowered to carry on the Governor's functions, was consulted by Government about the best manner in which the dollars could be held, should the British Treasury agree to India's secession from the Dollar Pool. Mr. Deshmukh believed strongly in the need for early arrangements satisfactory to India being arrived at. He felt that the dollars could be held initially as part of the Reserve Bank's Banking Department balances abroad; if it became necessary later, the surplus dollars could be held in the form of short-dated securities in the Issue Department by amending Section 33† of the Act. The matter would, he added, require a lot of consultation with the Bank of England regarding fundamental issues affecting trade finance, especially in view of the large part of the imports from the U.S.A. into India being financed through London. An elaborate procedure of maintaining dollar debits and credits would have to be worked out, with perhaps a periodical adjustment with the Bank of England. He pointed out also that if India contracted out of the Dollar Pool, the Bank of England would expect her to provide dollars against any adverse balance of payments with other countries outside the sterling area such as Switzerland, Canada and possibly also Iran.

The idea of a Reconstruction Fund was revived late in 1943 when the question of extending the scope of India's Reciprocal Aid to the U.S.A. to cover raw materials and foodstuffs also (she was already providing certain military supplies under Reciprocal Aid) came to be considered. The Government of India actually pressed the Secretary of State to agree to the segregation of India's dollar earnings (i.e., the proceeds of her exports to the U.S.A. and payments received for services rendered to the U.S. forces stationed in India otherwise than under Reciprocal Aid). In other words, the proposal now was for India to break away from the Empire Dollar Pool altogether rather than that some portion of India's sterling balances should be designated for special convertibility privileges after the war. It was explained that the favourable effect of such an arrangement on public opinion in India, which was highly critical of the existing methods of financing the Allied war expenditure in India, 'would go far towards reconciling them to the additional liability involved in the proposed extension of India's Reciprocal Aid', as such extension would result in increased rupee expenditure in India without a corresponding accrual of sterling.

The British Treasury and the Bank of England were understandably reluctant to agree to the proposal that India should hold her dollars

* op. cit.

† Only sterling securities could be held in the Issue Department, in 'terms of this Section.

herself as it involved 'a radical departure from the basic principle of the sterling area which has been tried and proved in all the strains of the war'. The Treasury felt, however, that a proposal under which any such dollars were segregated in a Reconstruction Fund to meet urgent post-war needs might be less difficult to accept than one of holding them in the currency reserve. Its agreement to the creation of such a Fund was eventually communicated to the Government of India by the Secretary of State in November 1943. The amount to be held in the Fund was to be related to the proceeds of sales by India to the U.S.A. of raw materials for civilian use, but the existing banking and exchange channels were to be left undisturbed. The Secretary of State, therefore, suggested that while the existing procedure, whereby banking arrangements were centralised in London and the surplus dollars accruing directly to India were sold to the U.K. Control, would continue, an annual amount not exceeding \$20 million would be paid over to India, this being held by the Reserve Bank in a dollar account with the Bank of England. (The arrangement subsequently made was for the amount to be held physically as part of the U.K. Exchange Equalisation Account under a specific earmark.) For the year 1944, the Secretary of State suggested the maximum figure of \$20 million as a 'lump sum settlement'; a similar allotment was proposed for 1945 'provided statistics of trade justified a figure of this order'. Whether any contribution was to be made for subsequent years was to be considered in 1945. The Fund was not to be drawn upon until after the conclusion of hostilities with Japan and then it was to be utilised for restocking and capital expenditure in the U.S.A. before any call on the U.K. dollar resources was made for these purposes. In the meantime, the U.K. would continue to provide India with dollars against sterling for her current needs as heretofore. The whole scheme was to come into operation only after an acceptable settlement of the Reciprocal Aid question was reached between India and the U.S.A.

The Governor welcomed the Treasury's response but was puzzled at the amount mentioned by the Secretary of State for the maximum annual contribution to the Fund. Even after making allowances for various factors, such as the U.S. gold sales in India, he felt that the real trade surplus with the U.S.A. should be around three times that figure annually.

Meanwhile, there was public criticism in the U.S. commercial circles to the effect that the surrender of India's surplus dollars to the U.K. was detrimental to their interests as it shut U.S. exporters out of the Indian market. In India too, trade and industry began to refer to the adverse effects on India of the whole scheme of the dollar pool and demanded that the country's favourable trade balance with the U.S.A. 'should be accounted for by accumulation of dollars'.

The Central Board had also not lost sight of the matter. When it considered the British and American plans for post-war monetary arrangements in October and November 1943, and again when it discussed the Joint Statement by Experts in May 1944 -these matters are discussed in a later chapter -it took the opportunity to press Government to pursue vigorously the question of obtaining and retaining India's balance of accounts with the U.S.A. in dollars.

In the course of his budget speech in February 1944, the Finance Member announced the British Government's acceptance of the principle of starting a nucleus dollar fund for meeting India's postwar reconstruction requirements; this was to be 'an integral part of the reciprocal aid arrangement'. The Fund, he added, would be apart from and in addition to India's current dollar requirements which were met from the Empire Dollar Pool under the existing arrangements. The actual size of the contribution was, however, not disclosed.

As mentioned earlier, Governor Deshmukh was keen to know the basis on which the U.K. Treasury had specified the ceiling of \$20 million for the annual contribution to the Fund. He was also eager that some part at least of India's pmt contributions to the Pool should be made available. At his instance, the Government of India pursued the matter with the Secretary of State and urged him to persuade the British Treasury to enhance the limit substantially. They met with no luck however. Nor did the Secretary of State's argument that the amount was 'a reasonable round sum in all the circumstances' carry any conviction. The Governor felt strongly that the British Government and the Secretary of State owed it to India to explain satisfactorily the reasons for fixing such a low figure as well as the refusal to reopen past transactions. In a letter to the Government of India in April 1944, he said:

Since, however, this arrangement of creating and maintaining an Empire Dollar Pool is based on the voluntary action of all the members of the Commonwealth, it seems only fair that H.M.G. should furnish all the contributors with a precise statement of all credits and debits to the Pool, and of the prospective demands on the Pool in order to convince the nations which contribute that the continuance of their contribution is still required in the interests of the common war effort and that if any exceptions are to be made, the scale of such exceptions is necessarily to be strictly limited. . . . Briefly, I think it is only fair that the Treasury should take the Government of India into their confidence and lay all their cards on the table, even if in the interests of security the Government are precluded from making public this information or any part of it. It would then be possible for the Government of India to say in justification of any proposed figure that although it is not open to them to state all the relevant considerations, they have satisfied themselves that the figure they propose to adopt is a reasonable one in all the circumstances.

The Government of India thereupon pressed India Office for an upward revision of the proposed annual allocation. The continued agitation by the public and the Reserve Bank Board, they said in a cable to India Office in September 1944, made it impossible for them to hold off announcing the amount of the contribution much longer. They added that in their view enhancement of the allotment to 20 per cent of the actual surplus or \$50 million would be reasonable. The Government did not, however, consult the Governor before these figures were suggested. When, therefore, India Office rejected these proposals again, Sir Chintaman was quick to deplore their action. There was a wide variation in the assessment of the actual surplus by India Office and the Government of India (who relied largely on data compiled by the Reserve Bank from the returns of the authorised dealers and periodical statements received from the Bank of England) due to various factors, and neither could be considered accurate. The proposed percentage of 20 had, according to the Governor, no logical relation to any important factor in the situation. What mattered was the extent to which India's surplus dollars were required for the common war effort; the excess available over this contribution rightly belonged to India. In his letter of December 5, 1944: to Government, that is, some months after his visit to the U.S.A. and the U.K. in connection with the Bretton Woods Conference, the Governor said:

The informal conversations which I had in London with Bank of England officials and which H. M.* and the Economic Adviser and I had with the Treasury officials indicated that the principal use to which our surplus dollars are now put is the strengthening of the backing of gold and dollars of the United Kingdom's sterling liabilities to the outside world. To a certain extent, this use of India's surplus dollars is in India's interests, as it strengthens the currency in which all her foreign assets are held. But it is conceivable that a stage has been reached when all reasonable requirements of this nature are being met, and if, that is the case, then India is entitled to the whole of her surplus, after every possible allowance has been made for contingent liabilities on India's behalf. There can be no question here of generosity, and if the India Office feel that they are accepting on India's behalf an arrangement which errs on the side of generosity to India and is correspondingly onerous to U.K., then Government would be justified in suggesting that India would be prepared to take over all the surplus, together with all the current and contingent dollar liabilities. I think Government owe it to the public to satisfy themselves that only that amount of dollars is retained by U.K. out of its surplus earnings which can reasonably be regarded as furthering the common war effort.

In the budget speech of 1945-46, the Finance Member announced the contribution of \$20 million by the British Government for each of the years 1944 and 1945; he described the arrangement as 'a fair and

* Honourable Member (for Finance).

valuable concession '. The actual allotment for 19 was however made only in July 1945; a similar sum was credited for the subsequent year on the same basis. A detailed procedure was drawn up for utilising the amounts released. The earmarking would appear to have been discontinued with the termination of Reciprocal Aid.*

The conclusion of the first interim sterling balances agreement between India and the U.K. on August 14, 1947, for the period up to the end of December 1947, did not affect the unexpended balances (of approximately \$25 million) in the Fund which came to be known as the Post-War Dollar Fund. These balances were at the disposal of India in addition to the releases, which were multilaterally convertible, agreed upon in terms of the above-mentioned settlement. However, when the agreement was extended in February 1948 to be in force till June 30, 1948, the remaining balance in the Fund was included in the limit fixed for India's drawings upon the central reserves during the half year. Thus, India was to have no further claim on the Post-War Dollar Fund after that date.

After the war, the problem was not so much to secure the country's dollar earnings as to ensure the availability of the accumulated sterling balances for expenditure in dollars to meet India's essential requirements. This matter formed an important part of the discussions between the Governments of India and the U.K., the Reserve Bank playing an active role in the negotiations.

* Prof. R. S. Sayers, *op. cit.*

Repatriation of Sterling Debt

The war posed, on the one hand, the problem of conservation and effective utilisation of scarce dollar resources of the sterling area, of which India was a member; this called for an elaborate system of control, described in Chapter 12. On the other hand, the vast acquisition of sterling by the country during the war provided an opportunity for the repatriation of its sterling debt, the story of which is told in this chapter. Much initiative in this matter came from the Reserve Bank, which also implemented the numerous details of repatriation. There was almost complete identity of views between the Bank and the Government of India, but differences were encountered with the India Office, the British Treasury and the Bank of England, both on the principle of repatriation and its many details. Nevertheless, with dogged perseverance from the Indian side, it was possible to put through the operations in a remarkably successful manner.

It would be useful to give some information on the genesis and growth of India's sterling debt. Till the Mutiny of 1857 the sterling debt of the Government of India was insignificant, of the order of Rs. 4 crores only out of a total debt of about Rs. 56 crores. On account of the expenditure in connection with the Mutiny, the sterling debt went up to about Rs. 24 crores in 1860. From 1867 onwards there was a regular programme of borrowing in London for productive purposes, particularly irrigation and railways. By 1913, the sterling debt rose to Rs. 269 crores. There was a further increase in the debt during the inter-war years, on account of Government's assuming responsibility for the control and management of company-managed railways, the railway annuities and the war gift of £100 million to the U.K. As on March 31, 1937, the funded sterling debt stood at £357.3 million or the equivalent of Rs. 476 crores, as under:

*Terminable Loans**(£ million)*

| | | |
|----------|---------------|-------|
| India 5% | Stock 1942-47 | 9.48 |
| “ 41/2 % | “ 1950-55 | 39.85 |
| “ 41/2% | “ 1958-68 | 17.50 |
| “ 4% | “ 1948-53 | 12.00 |
| “ 31/2% | “ 1954-59 | 10.00 |
| “ 3% | “ 1949-52 | 10.00 |
| | | ----- |
| | Total | 98.83 |
| | | ----- |

Non-terminable Loans

| | | |
|-------------|---------------------|--------|
| India 3 ½ % | Stock 1931 or after | 88.67 |
| “ 3% | “ 1948 or after | 77 .02 |
| “ 31/2% | “ 1926 | 11..54 |
| | | ----- |
| | Total | 177.23 |
| | | ----- |

| | |
|---|--------|
| Railway Debentures | 24.66 |
| Liability for British Government 5% War Loan 1929-47 taken over by India | 16.72* |
| Railway Annuities | 39.86 |
| | ----- |
| Grand Total | 357.30 |
| | ----- |

The repatriation of sterling debt began even before the war, that is to say, in the financial year 1937-38, on a very modest scale. However, it was only during the war years that repatriation was undertaken on a large scale; the major part of the debt was extinguished by the middle of 1943. Initially the repatriation was on a voluntary basis, but from early 1941 schemes of compulsory repatriation were brought into effect. Later, the Railway Annuities were also funded. Requisitioning of the Railway Debenture Stocks and liquidation of the Chatfield debt were other forms of sterling debt repatriation. By March 1946, sterling debt of the value of £ 323 million had been repatriated. The Bank and the Government of India were, however, unsuccessful, during the war years, in persuading the British authorities to acquiesce in the funding of the sterling pension liabilities.

Repatriation of sterling debt posed the problem of raising equivalent rupee funds. Since the sterling used for the repatriation of debt belonged

* Out of this, the liability for £ 1.25 million was assumed by the Government of Burma on separation. The actual total of outstanding sterling debt was therefore reduced to £ 356.05 million on April 1, 1937.

to the Reserve Bank, suitable arrangements had to be made to provide the Bank with alternative eligible rupee assets. The major part of the rupee finance for the first compulsory repatriation scheme was provided by the issue of rupee counterparts to the Bank and Government, roughly on a 50 -50 basis; Government paid for their share by drawing upon their cash balances, supplemented by temporary ways and means advances from the Reserve Bank. The counterparts held by the authorities were sold to the market gradually. Rupee finance for the second compulsory scheme was met by the issue of ad hoc Treasury bills to the Bank; with the intensification of the Government's loan programme and with the sale of counterparts later, these were mostly retired.

Initial Efforts: Open Market Purchases

The question of utilising the sterling balances of the Reserve Bank for repatriating the sterling debt had engaged the attention of Sir James Taylor right from March 1937. The level of sterling purchases of the Bank and the general economic and financial picture that was emerging in the early months of the year pointed to the accumulation of sterling assets in the Banking Department of the Bank to an extent that the Governor considered unnecessarily large. There were, in addition, the large hidden reserves in the form of gold, amounting approximately to Rs. 30 crores at the ruling market price, which would take the ratio of gold and sterling in the Issue Department to 75 per cent of the total notes issued. The Governor was averse to seeing this percentage rise above 60 in the following months; in March 1937, the ratio was 57 per cent. In his opinion, at least 10 per cent of the Issue Department's assets had to consist of internal securities, if the Bank were to have 'reasonable resources to control the internal market'. Assuming a continuation of India's export surplus on the existing scale, the Governor expected the Bank to be faced with surplus sterling of £5 to £10 million, after providing for any necessary expansion of the currency.

Writing to the Finance Member early in March 1937, the Governor stated that the situation was developing in a manner which required the serious consideration of Government. He pointed out that 'the nationalist school of thought' had its own suggestions to make for dealing with this problem. One suggestion (proposed to the Governor by Director Mr. B. M. Birla) was that the Bank should begin to buy gold. A second was to use the surplus for expansion, but the Governor did not favour it; he considered such a course inflationary! His solution was that Government should buy up their sterling debt, especially that maturing between 1948 and 1950. This he considered was 'the most effective way of building up the financial independence of the country'. The modus operandi envisaged first a reduction in the Government

balance by the equivalent of £5 million 'so as to necessitate Government obtaining it from the public by Treasury bills, with a view to the partial control of short money rates'; the Governor did not favour issue of ad hots to the Bank.

The Government of India were not enthusiastic about the proposals. They decided that the requirements of the situation would be met by the Bank selling to them its own holdings of the dated India sterling stock, for which the Bank had been in the market for some time. The Bank was to continue to pick up at its discretion any offers, however small, of these loans that came in the market -the loans were very tightly held -and to transfer them to the Government of India in convenient lots at periodical intervals. This was to be done in a manner suited to the Government's ways and means position, at the market price of the date of transfer with interest adjusted up to that date and at the rate of exchange for Government transactions of the day (later, the basis was changed to the price at which the Bank purchased the securities). While the Bank would effect the purchases through the Bank of England acting on its behalf, at the prevailing market prices in London, this was subject to the yield limits indicated by the Secretary of State which could be modified by the Government of India as circumstances dictated. It is interesting to know that Sir James Taylor opposed the criterion proposed by the Secretary of State requiring comparison of the yields on the India sterling stock with those of British securities; this, according to him, was of doubtful relevance, as the more important comparison would be with the yield on the Government of India's rupee securities of similar maturities. At that time, the average market prices of the sterling securities were appreciably below those of the corresponding rupee securities. The Government of India accepted Sir James's view. They also agreed to all the details of procedure drawn up by him to enable the Bank to operate in Indian Government securities in the London money market not merely as a buying agent but as a central bank, and having regard to the Government's ways and means position. The first sale of securities to the Government of India was effected on June 28, 1937. It was decided in September 1937 to cancel the securities already purchased by the Government and to have future instalments cancelled on purchase.

The Governor did not rest content with this procedure for repatriation since it was clear to him that with the small amounts of stocks that were available in the London market, there were no prospects of his being able to pick up more than about £ 1 million a year of securities for cancellation by the Government of India. He also anticipated that the Bank might be faced with 'embarrassing requests, not from India this time, but possibly from abroad, to build up gold reserves, which might not suit us'. He, therefore, proposed to Government

that the Bank should purchase the non-terminable 3 per cent and 3½ per cent sterling Stocks which had a free market and that the Government should cancel them in exchange for the same nominal value of the 3 per cent and the 3½ per cent Rupee Paper; the Bank would take these into its own portfolio in the first instance and sell as opportunity offered. This procedure would give the Bank a valuable weapon for controlling security prices in India because the 3½ per cent Paper was still the barometer of the gilt-edged market. Similar conversion terms for the fixed maturity loans were not then contemplated.

Neither the Secretary of State nor the Governor of the Bank of England lent the proposals his whole-hearted support. Both felt that the project should be limited to a sum of £ 5 million, further operations being left to be decided in the light of experience gained. Further, both the India Office and the Bank of England were again concerned lest the Reserve Bank should be saddled, 'contrary to sound central banking practice', with a large undisposable amount of irredeemable securities. As a safeguard, therefore, they suggested that the Bank's 'open position' should not at any time exceed £1 million. The U.K. authorities also felt that the correct formula would be to issue the rupee paper not for the face value of the sterling loan purchased but for the purchase price of the latter converted at the rate of exchange applicable to Government remittances on the date of cancellation, and taking into account the ruling market price of the corresponding rupee paper. The 'profit' arising from the difference between the sterling and the rupee prices would then be reflected in the Government of India's debt position and not in a revenue receipt through the Bank's surplus as would be the case under the Reserve Bank's proposals. The Bank of England felt it even more prudent for the Bank to undertake the transactions as Government's agent, when it could be compensated for its services by a reasonable remuneration.

Since the whole object of the scheme was to bring the prices of sterling and rupee securities closer, Sir James felt that the procedure proposed by the Secretary of State for issue of rupee paper to the Bank was almost certain to land the Bank in losses. The limitation of £ 1 million on the Bank's open position was equally unacceptable to the Governor. In his words:

I would certainly not be prepared on behalf of the Bank to make any promise restricting our freedom of action beyond the reasonable limits imposed by the second proviso to Section 17 (8) * of our Act which was arrived at after considerable discussion. Though naturally we do not contemplate working up to anything like these limits, we must reserve freedom of action.

* This proviso laid down the limits up to which Government securities of various maturities could be held in the Ranking Department.

The only solution Sir James could think of, short of dropping the scheme entirely, was for the Bank to do the business as Government's agent. As he confided to the Bank of England:

the important thing is to get an early decision because in addition to other factors the passing of the Insurance Bill has led to a speculative rise in rupee gilt-edged with a consequent increase in the outflow of capital for investment in London. I am indifferent who gets the profits, or whether they are devoted to debt redemption or revenue, so long as I can get machinery into being to regulate these capital movements. I do not anticipate that I shall be able to do much but it seems to me that even a little is better than nothing. In India, also, the circumstances are not the same as in other countries. Elsewhere it might be arguable that it was immaterial whether external debt was redeemed through the central bank or directly by the investing public but in India it must be remembered that in many quarters the dogma that Indian exchange is too high and ought to be reduced by two pence has acquired an almost religious sanctity. Their devotion to this creed is not likely to be lessened if they stand a chance of gaining an additional 12 per cent by sending their money abroad.

The Government of India accepted Sir James's proposal that the Bank undertake the work as their agent on payment of commission. They did not also consider it worthwhile to argue with India Office about crediting the profits to revenue instead of taking them in reduction of debt. The arrangements were put into effect immediately, i.e., on October 18, 1937, when the Bank commenced transferring to Government from its own holdings of the 3 per cent and the 3½ per cent sterling Stock acquired by sporadic purchases in the London market.

The scheme was, however, halted in February 1938, on account of the weakening of the exchange and the fall in the sterling purchases of the Reserve Bank. Apparently the Governor regarded this as a temporary phenomenon; in fact, he had taken some measures, especially the levering up of short-term money rates, to improve the exchange position. Therefore, he continued to press Government for acceptance, at least in principle, of his original proposal that the Bank do the whole business as a principal rather than as the Government's agent, while still adhering to the principle laid down by the India Office regarding the appropriation of the 'profit' arising out of the transactions. His proposals, Sir James argued further, would give the Bank the necessary freedom of action to conduct the operations (viz., the purchase of the sterling stocks in the London market, passing them on to Government for cancellation, and sale of the rupee securities in the Indian market) at its discretion; besides, with its general reserve and also provident and similar funds to invest, the Bank could, without any embarrassment, hold much more paper than Government could, whereas under the existing procedure Government could easily be

saddled with considerable quantities of rupee securities which was 'neither sound in theory nor convenient in practice'.

The Secretary of State was unconvinced by the Governor's arguments. He found it difficult to accept the view that it was 'sounder in theory or more convenient in practice' that the rupee securities should be held by the Bank rather than by Government. According to him, it was hardly an opportune time to resume the repatriation operations owing to the uncertain outlook as regards the trade balance and the lower level of gold exports, not to speak of the uncertainty of world political and economic conditions in general.

The Government of India agreed with the Governor in regard to the need for commencing the repatriation operations. However, in view of the falling off of the Bank's sterling purchases, the scheme was not revived during 1938. The total repatriation of debt in the financial year 1937-38 amounted to about £3 million or Rs. 4 crores, almost three-fourths comprising terminable loans. The cost of the terminable stock was met from the Government's resources. For the balance, rupee counterparts of the 3 per cent and 3 ½ per cent non-terminable Stocks were created for sale to the market. Besides, in the two years 1937-38 and 1938-39, payment of over £9 million was made towards the transfer of the Government's outstanding liability for the Family Pension Funds.

War-time Steps: Voluntary Repatriation

After the outbreak of war, sterling began to accumulate with the Reserve Bank in substantial amounts and it appeared desirable to resume the Bank's purchases in the London market for cancellation and issue of rupee securities there against. About the end of October 1939, India 3½ per cent sterling Stock 1931 or after was quoted at about £79 ½ against the quotation for the 3½ per cent Rupee Paper in India of about Rs. 86-8-0; thus the purchase of sterling stock in London and the creation of rupee paper for sale to the public in India was a profitable proposition for Government. Operations were, therefore, resumed about the end of October and the first cancellation was put through on November 15, 1939. As a result of the operations, the disparity between the price of the 3 ½ per cent India sterling Stock in London and the 3½ per cent Rupee Paper in India was reduced and it soon became apparent that if repatriation was to be effected on a substantial scale a more comprehensive scheme would have to be introduced. The Bank's external reserves had been built up to approximately 60 per cent of the note issue (excluding the hidden reserve in gold) and there was also a large sterling balance in the Banking Department; it was therefore felt safe to embark on repatriation on a larger scale.

The outline of the larger scheme was again the handiwork of Sir James. He considered that in any such scheme the basic principles to be followed should be that the scheme should be elastic and that the sterling loan cancelled should be replaced by a rupee loan of equal length as it would be inadvisable to pay off a long-term obligation and replace it by a short-term maturity, which might create an embarrassing position for Government later. His proposal contemplated the opening of rupee books by the Reserve Bank for each dated sterling loan and an offer to holders of the latter to have their holdings transferred to the rupee books on payment of a premium. This premium would be fixed from time to time by the Reserve Bank for each loan and it would be so graded as at times to give a reasonable profit to the transferor and at others to make the proposition less attractive. It was to be made quite clear that there would be no right of retransfer to sterling. He proposed further that the Bank might also purchase dated stocks direct for transfer to Government against creation of rupee securities which could be peddled out in the Indian market. While the Governor still preferred that the Bank should act as principal in these transactions, he did not press it for fear of delay in getting the scheme going. In any case, since the Bank held nearly £40 million sterling securities and Rs. 25 crores rupee securities as its working stock as at the end of 1939, the limitations of £1 million on the open position and £5 million on the total transactions prescribed earlier by the Secretary of State at the instance of the Bank of England had become pointless and needed to be scrapped straightaway.

In January 1940, the Government of India recommended to the India Office adoption of the proposals, which would result in extending the scheme of repatriation to all the India sterling stocks. The notification introducing the scheme was not issued until February 22, 1940 as there was a long three-way correspondence between the Secretary of State, the Government of India and the Reserve Bank. The delay was largely due to 'the attitude of rather negative criticism' of the India Office, as Sir James Taylor put it. Many of the India Office's suggestions were not acceptable to the Bank, but it succeeded in bringing round the Secretary of State to its point of view. One suggestion of the India Office was the avoidance of an 'undue multiplicity of issues' and the offer of exchange facilities 'wherever practicable into a generic rupee security of similar maturities and same interest rate', e.g., 'sterling Stocks of 4½ per cent 1958-68, 3½ per cent 1954-59 and 3 per cent 1949-52 might possibly be related to rupee loans repayable 1955-60, 1947-50 and 1951-54, respectively'.

Another suggestion made by the Secretary of State which did not find much favour with the Governor was that if the Bank's direct purchases in the market proved insufficient to cope with the sterling

accretions, the surplus sterling might be invested in United Kingdom securities of appropriate maturities with a view to utilising eventually their sale or maturity proceeds for repayment of India's sterling loans as they matured. This alternative could, the Secretary of State said, be considered in preference to compulsory acquisition or if the latter actually proved impracticable. While the Governor agreed that such a step would be preferable to one involving compulsory acquisition, he referred to a number of practical difficulties. Because of the five-year limit on the maturities of sterling securities held in the Issue Department which he 'would not like to see removed', and as the holding of sterling securities in the Banking Department would involve the payment of British income-tax which 'would take all the gilt off the ginger bread' the sterling investments would, Sir James reasoned, have- to be held by the Government of India and not the Bank.

The Secretary of State was also at long last agreeable to scrap the limits both on the open position and the total operations. Sir James had argued against the limits in severe terms, as 'an irritating reflection on our common-sense'.

The new scheme was announced in February 1940 and was made effective April 1, 1940. Under the scheme, which was also known as the Licence Scheme, since parties desirous of availing themselves of the scheme had to take out a licence from the Reserve Bank, rupee counterpart loans of identical maturity were created against the following sterling loans :

| | | | |
|-------|------|-------|---------|
| India | 3% | Stock | 1949-52 |
| " | 3½% | " | 1954-59 |
| " | 4% | " | 1948-53 |
| " | 4½ % | " | 1950-55 |
| " | 4½ % | " | 1958-68 |
| " | 5% | " | 1942-47 |

The scheme did not, however, prove to be much of a success, partly because the sterling and rupee prices were in close approximation to each other and there was little or no inducement to convert sterling holdings into rupee loans and partly because of the delay and interruption to which communications between India and the U.K. were subject during the summer of 1940.

In 1939-40, total repatriation amounted to £17 million; rupee counterparts for the equivalent amount, namely, Rs. 22.79 crores, were created.

First Compulsory Scheme: February 1941

The Licence Scheme, while effecting repatriation of the sterling debt, had not assisted the other important object of utilization of the sterling

resources of the Bank. By November 1940, the Bank's sterling balances had increased substantially and the initiative for further action came from the India Office, although both the Government of India and more so the Reserve Bank had been keeping the position under continuous watch and had been contemplating large scale repatriation on lines similar to those then proposed by India Office. The India Office was prepared to urge the U.K. Treasury to requisition the holdings of dated sterling loans and sell them to the Government of India for cancellation. The rupee finance was to be provided by the issue of an equivalent amount of rupee securities, created ad hoc, to the Reserve Bank which could hold them in the Issue Department. For this purpose, India Office also felt that it would be appropriate to have the proviso to Section 33(3) of the Reserve Bank of India Act, imposing a ceiling* on the holdings of rupee securities in the Issue Department, amended.

Sir James recognised that the offer to requisition the India sterling securities would be 'a very welcome gesture by the British Government'. He proposed that the repatriation of the terminable debt should be done in three instalments, the earliest maturities being taken up first. At the prevailing market prices the cost of requisitioning the three lots was estimated roughly at -£ 24 million, £ 40 million and £ 26 million, respectively, or about Ego million in all, the face value of the total outstandings being &84 million. As regards finding the rupee finance, according to Sir James the basic principle was to avoid replacing long-term liabilities by short-term obligations. On that basis, the Bank was prepared to take up the whole of the first lot as rupee counterparts either in the Issue or in the Banking Department as suited it and the Government's ways and means programme. The Bank could then sell them out to the market as opportunity offered.

While the Government of India accepted Sir James's suggestions in toto, a number of problems were posed by India Office before it was convinced that it could approach the British Treasury and the Bank of England. As Sir James remarked, 'when the India Office start to elaborate side issues it is generally because something else is worrying them'! One important point was whether the entire terminable debt should be repatriated in one operation or whether it should be in three lots but with simultaneous notice for all the three. Sir James felt that a single operation of the magnitude involved might be too large even by the standards of the City of London; he also preferred giving separate notices for the three lots.

Another question was whether the requisitioning should not apply to residents of the U.K. only. Sir James had proposed and the Government of India had agreed that compulsion should apply to everybody;

* The ceiling was one-fourth of the total assets or KS. 50 crores, whichever was greater.

the India Office's suggestion to restrict the operations to holders resident in the U.K. would create difficulties for Indian holders who would be unable to sell their holdings to U.K. residents later. The final decision was in accordance with the proposals of Sir James and the Government of India.

As regards the restrictive provision concerning rupee securities in terms of Section 33(3) of the Reserve Bank Act, the position was that the first stage of the operations could be carried through under the existing limitation, but its retention would make the subsequent stages impracticable. Although Government initially thought that the limit (for the holding of rupee securities in the Issue Department) might be raised from 25 to 40 per cent or even 50 per cent, they later agreed with Sir James Taylor who considered it preferable to omit the proviso altogether. In the Governor's view, public objection to the abolition was also unlikely to be strong 'as its primary object, the development of a bill market, is obviously quite impracticable on the scale contemplated'. The Bank of England had, however, to be assured that the contemplated amendment retained 'adequate safeguards against unlimited use of the Issue Department' and did not give the Reserve Bank inflationary powers. Its fear of the likely undesirable consequences of the amendment also made it suggest revaluation of the Bank's gold which would extinguish some Rs. 40 crores of the repatriated debt and so avoid pro tanto creation of new rupee counterparts. This step was obviously out of question, for political reasons.

The Governor also put it to Government that the Silver Redemption Reserve might be abolished and its sterling assets of roughly Rs. 10 crores be used in buying the repatriated debt. This Reserve had been set up to enable the Government to pay the Bank for the rupee coin returnable in the event of Section 36(1) * of the Bank's Act becoming operative. The return of rupee coin was unlikely and, in any case, on the discharge of Government's sterling liabilities on the contemplated large scale, there would be no occasion for the Bank to desire payment for the rupees in sterling. The matter was taken up with India Office which, however, thought differently.

* Section 36(1) read: '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 for that year prescribed under sub-section (1) of Section 53, is greater than fifty crores of rupees or one-sixth of the total amount of the assets as shown in that account, whichever may be the greater, the Bank may deliver to the Governor General in Council rupee coin up to the amount of such excess but not without his consent exceeding five crores of rupees, against payment of legal tender value in the form of bank notes, gold or securities:

Provided that if the Bank so desires and if the amount of gold coin, gold bullion and sterling securities in the assets does not at that time exceed one-half of the total assets, a proportion not exceeding two-fifths of such payment shall be in gold coin, gold bullion or such sterling securities as may be held as part of the assets under sub-section (6) of Section 33 '.

While discussions in respect of the various details of the scheme were going on, the Reserve Bank kept out of the market in London so as not to push prices up.

The Bank of England considered that from the technical point of view it could take up the entire terminable debt in one operation and the British Treasury agreed to the requisitioning of the dated India sterling stocks on the same understanding. The Governor was only too happy to accept this offer, as by this time the Bank had accumulated adequate sterling. Eventually the Bank of England was able to undertake the operation on the date originally contemplated, viz., February 7, 1941. Accordingly, on that day, a Securities (Restrictions and Returns) Order was issued by the U.K. Treasury under Regulation 1 (1) (a) and (b) of the Defence (Finance) Regulations, prohibiting market dealings in and calling for returns of holdings of the terminable India sterling stocks from residents of the U.K. Simultaneously, an Acquisition of Securities Order was issued, transferring these securities to the U.K. Treasury, at the prices (the day's quotations in London plus allowance for 2 ½ per cent interest) notified in the Order. On the following day, i.e., February 8, a vesting order was issued by the Government of India under the Defence of India Rules, transferring these securities held in India to themselves at the prices notified in the U.K. Order converted into rupees at 1S. 6d. Owners in India were given the option to receive payment in cash (in rupees only) or in rupee counterpart securities. Unlike in the case of the Licence Scheme of February 1940 for conversion of the sterling loans into rupee counterparts which was administered by the Bank's Bombay Office only, the facility was offered at both the Bombay and Calcutta Offices and no licence fee was charged; the object was to make the scheme as attractive as possible.

Residents and rulers of Indian States fell outside the purview of both the British and Indian Orders; it was decided that these persons should be given the option, as were other residents of the sterling area outside India and Burma, to surrender their holdings to the Bank of England against sterling, and if they so desired, to the Reserve Bank against rupees or rupee counterparts.

As agreed, the Government of India issued an Ordinance on February 8, 1941 deleting the proviso to Section 33(3) of the Reserve Bank of India Act. Two press communiques issued simultaneously explained the repatriation operation and the rationale of amendment of the Act.

Neither the Central Board nor its Committee was formally consulted during the discussions leading up to the decision to requisition compulsorily the outstanding terminable sterling debt. A last minute effort was made to keep the Board informed when, on February 5, 1941,

Sir James asked the Government if they could postpone the issue of the Ordinance amending Section 33(3) to the 13th so that he would have the opportunity of referring it to the Committee at its meeting on the 12th. However, Government issued the Ordinance on the 8th, as they wanted it to be out before the Assembly session began on the 11th. In these circumstances, the Governor had to meet the local Committee members at Calcutta to explain the scheme to them privately and convince them of its soundness, in advance of the meeting on the 12th, when he apprised the Committee officially of all the steps taken till then for the repatriation of the external debt. All the same, the Directors desired the Governor to bring it to the notice of Government that in their opinion the Committee ought to have been consulted before the Ordinance amending the Act was issued. They added that though this particular proviso was comparatively unimportant and that if they had been consulted they would have agreed, the principle was important as it might give rise to uneasiness that major alterations might be effected without reference to them. The matter was dropped on receipt of an apology from the Finance Member explaining that the situation was exceptional as 'the combined requirements of extreme urgency and the need for synchronisation with the action taken by His Majesty's Government made it impossible for Government to consult the Committee in this case' and that 'in the normal course of procedure Government would desire to consult the Committee or the Central Board before taking any action to amend the Reserve Bank of India Act'.

Rupee Finance for the Repatriation

As regards the local financing of the operation, rupee counterparts were to be issued for a nominal value equal to that of the sterling loans cancelled, in order to avoid any adjustments in respect of capital or interest in Government accounts. The manner in which the rupee counterparts were to be held involved a delicate balancing of principles and Sir James's knowledge and experience proved valuable in devising a flexible arrangement.

It was considered undesirable to replace a large block of funded debt by floating debt; it was, on the other hand, impracticable to raise the whole amount immediately by sale of counterparts to the public. It was thought best that out of about Rs. 120 crores estimated to be involved in the operation, some Rs. 50 to 60 crores of the counterparts be taken in the Bank's Issue Department to replace the sterling Treasury bills. The Government were to take on their own account as much as their ways and means position permitted, the Bank helping them by taking up intermediate Treasury bills in the Banking Department or

by giving them ways and means advances. Investment demand was to be met either out of Government's stocks or the Bank's, care being taken not to depress security prices. Government approved of the broad plan of distribution.

The total repatriation, till the end of March, under the scheme of February 8, was £ 60.05 million, including £ 6.03 million surrendered by residents in British India; the repatriation done through open market purchases and the Licence Scheme during the year 1940-41 amounted to £ 11 .24 million, making a total of £ 71 .29 million in all for that year. The total counterparts created amounted to Rs. 94.86 crores, of which Rs. 10.22 crores were issued to the public. The balance was taken up about equally by the Bank and the Government, the latter obtaining in March temporarily ways and means advances for Rs. 16 crores.

As the amounts of counterparts taken up by Government and the Reserve Bank aggregated over Rs. 80 crores and there was no possibility of the market being able to absorb this amount, steps were taken to cancel securities for Rs. 47.73 crores in the year 1941-42. Also, in order to reduce Government's liability for high interest bearing loans, an offer was made to the public in June 1941 to convert their holdings of 4 ½ per cent Loan 1950-55 and 4 ½ per cent Loan 1958-68 into 3 per cent Loan 1951-54 and 3 per cent Loan 1963-65, respectively, on terms corresponding to the prevailing market prices of these securities.

The repatriation operation formed the subject of a very heated debate in the November 1941 session of the Legislative Assembly on a resolution moved by Mr. Jamnadas Mehta, recommending that ' in any fresh scheme of the repatriation of India's sterling debt, care should be taken to see that the cost of such repatriation on India's revenues is not unduly heavy as was the case with the last scheme '. The sting of the resolution was obviously in its tail! The mover charged Government with having incurred a loss of Rs. 35 crores on the whole transaction-Rs.15 crores (£ 11 million) in the discount allowed when the debt was incurred, Rs. 12 crores lost because advantage was not taken of the lower rate in 1939 and Rs. 8 crores lost because Government deliberately allowed the prices of the vested securities to rise by their open market purchases in London! There were other criticisms also against the operation and the rapid rate of accretion of the sterling balances. It was urged that the operation was undertaken more to help the British Government. A demand was made that the British Government should pay for their defence expenditure in India in rupees. The resolution was passed only after Mr. Mehta agreed to the deletion of the last few words referring to the cost of this operation as having been unduly high.

Second Compulsory Scheme: December 1941

The operations relating to the first compulsory repatriation scheme were virtually completed in the middle of June 1941, while open market purchases continued. The question of repatriation of the non-terminable sterling debt by one or more similar large scale operations had, however, come up for consideration much earlier. As on the previous occasions, action was initiated mainly by Sir James Taylor. He figured that, after earmarking an appropriate sum for currency expansion, sterling of the order of Rs. 200 crores would be available at the end of 1941; he considered that the most obvious use to which this large sum could be put was the repatriation of the non-terminable portion of India's sterling debt.

The non-terminable debt consisted of the 2 ½ per cent Stock 1926, the 3 per cent Stock 1948 or after and the 3 ½ per cent Stock 1931 or after, the face value and the market value of the outstanding portions of these loans aggregating £161 million (Rs. 215 crores) and £148 million (Rs. 197 crores), respectively. There was, however, no information as to how much of this was held by residents in the U.K. and in India. The India Office estimated that the liability for repatriation of all these loans could be taken to be roughly Rs. 175 crores of which Rs. 85 crores could be held to consist of the 2 ½ per cent and 3 per cent Stocks. Although Sir James had put the total figure lower, at around Rs. 150 crores, he was not averse to accepting the India Office's estimate.

As the 3 ½ per cent Stock stood very nearly at par, the Governor felt that the British Treasury would be unwilling to acquire it compulsorily and would expect the Indian Government to redeem it after giving the requisite one year's notice. The loan could of course be called in during the notice period but Sir James was not very hopeful of such action being taken by the British Government. On the other hand, on notice of repayment being given for the 3 ½ per cent Stock, the prices of the 2 ½ per cent and 3 per cent Stocks would rise materially in view of a possible requisitioning or redemption sooner or later. If therefore any action was taken in regard to the 3 ½ per cent Loan, the Governor considered it desirable that the British Government should be asked to simultaneously exercise their requisitioning powers in respect of the other two loans. This meant a very large scale operation, as it would result in the clearing off of practically the whole of the external sterling debt. Balancing all the advantages and disadvantages of a combined operation, Sir James personally preferred that the 2 ½ per cent and 3 per cent Stocks should be requisitioned first and the 3 ½ per cent Stock left over till some time later. In this context, the Governor recommended also that the Bank's gold should be revalued so as to release equivalent sterling for the repatriation operation.

The Governor also considered other possible alternatives to repatriation of the sterling debt. In his opinion, one course was to lend sterling, free of interest, to the British Government up to £100 million, to be repaid within a year or so after the war. Another (which actually came from the Finance Member) was to request the British Government to take over the non-terminable liabilities and pay them off as and when it suited them, since compulsory acquisition of the non-terminable loans, which Government were free to redeem on a year's notice, might be the subject of still more unfavourable criticism in London business circles than in the case of the terminable stocks. Besides avoiding such criticism, the proposal had the theoretical justification that the liability in respect of India's sterling loans would be shared to a certain extent by the British Government, a position which was recognised by the India Office as early as January 1930.

While the first proposal appears to have been dropped at the Government of India's level, the second expedient, which was put to the Bank of England by Sir James Taylor himself (and later to India Office by Government), was found unacceptable 'partly because it would be most embarrassing to us as regards vesting by other Dominions and partly because of technical objections'.

The Government of India requested India Office early in April 1941 to sound the British Treasury as to whether it would be prepared to requisition the 2 ½ per cent and 3 per cent Stocks immediately as the prices of these loans were already rising. India Office did not consider the rate of accretion of sterling to the Reserve Bank such as to demand urgent action. The Treasury was consulted leisurely and a reply came only at the end of June 1941 that the proposals were unacceptable. It was considered dangerous to proceed on the assumption that the forecasts of sterling accruals would prove correct. The view was that there would not be any 'huge accumulations of surplus sterling'! The standard, the Secretary of State emphasised, should rather be a normal holding of at least 50 per cent in gold and sterling in the Issue Department, and in addition, 'a further appreciable margin of sterling in one Department or other' which would meet the requirements of large imports of essential raw materials, etc., when conditions permitted. The Secretary of State was also opposed to the use, for repatriation, of sterling released by the revaluation of gold; the position would be very different, he added, if the proposition was to release gold in excess of Rs. 44.4 crores at the new valuation and sell it for dollars, in which case, the resultant sterling accumulation would fully qualify for treatment as 'surplus sterling' in connection with repatriation proposals!

Sir James Taylor found the Secretary of State's reply not unencouraging. In the interests of facilitating a speedy decision, he was

agreeable to adopting the formula prescribed by the Secretary of State for calculating the 'surplus' sterling available. He thought, however, that Government should seize this opportunity to return to the attack in regard to the Silver Redemption Reserve. 'Even if it is not to be abolished -for reasons which are far from convincing -there is no reason why the 10 crores which are locked up in a purposeless investment should not be regarded as part of the margin to be maintained'. As for the sequence of the operations, he stuck to his earlier view that the Stocks to be dealt with first should be those carrying the coupon rates of 2 ½ per cent and 3 per cent.

By the end of September 1941, the sterling assets of the Bank (in both the Banking and the Issue Departments) had risen to Rs. 200 crores. Rumours both in the U.K. and in India that a big programme of repatriation was again likely to be under way shortly had set the prices of the India sterling stocks rising. The Government of India continued to press the India Office to take up the matter with the Treasury early, but as usual, the Secretary of State desired to have a large amount of data in regard to the financing of the first scheme of compulsory repatriation before proceeding further. Both the Governor and the Government of India had to take pains to convince him that the prevailing opportunity for repatriation of India's sterling debt was too good to be missed.

The British Treasury's views were conveyed to the Government of India late in November 1941. The Treasury was unwilling to apply its requisitioning powers to the 2 ½ per cent and 3 per cent Stocks while there was outstanding and quoting near par the 3 ½ per cent Stock, which could be called for redemption in the normal way. The alternatives were, therefore, either to give the year's notice of redemption of the 3 ½ per cent Stock or wait till all the three could be tackled simultaneously. The Secretary of State personally preferred the latter alternative.

The Reserve Bank as well as the Government of India agreed that a combined operation was the best arrangement and considered that the Bank's existing sterling assets together with the outstanding forward market purchases were adequate to cover the repatriation requirements. The Government of India therefore urged the Secretary of State in the strongest possible terms to persuade the Treasury to agree to implementing the combined operation immediately. They cabled as follows on November 26, 1941:

Opinion in India including Press is becoming increasingly critical of delay in effecting further stage of repatriation while prices continue to rise. In recent Assembly session resolution was passed that in any future scheme of repatriation care should be taken to see that cost was not unduly heavy. Debate was not without acrimony and charges were

levelled that we were acting more in interests of foreign investor than of Indian tax naver. With a view to minimising ill effects of debate Resolution was accepted by Government in modified form omitting insinuation that last repatriation was unnecessarily expensive. Any material delay in respect of undated loans will put us in extremely embarrassing position. There is distinct possibility of Congress attending Budget session when fresh and still more virulent debate on repatriation must be expected. We regard it as most important that this should be avoided by fait accompli before beginning of session

In next Budget we shall have again to emphasise necessity of raising large rupee loans, main popular argument for which is repatriation, as means of financing war supply. If repatriation incomplete or capable of being represented as not having been carried out in manner reasonably favourable to India loan propaganda will suffer.

The Secretary of State's reply intimating the Treasury's agreement in principle to a combined operation was received about three weeks later. On December 23, 1941, the Treasury issued a vesting order, asking residents to surrender to it their holdings of the 2 ½ per cent and 3 per cent Stocks at prices (market quotations of the day plus interest) notified in the order. On December 24, an order was issued by the Government of India transferring to themselves the holdings of these Stocks by residents in India at prices equivalent to those in the U.K. order converted into rupees at 1S. 6d. At the same time, notice was given by the Secretary of State for the repayment of the 3 ½ per cent Stock on January 5, 1943. In the case of these operations no option was given for taking out counterparts as on account of the war situation in the East, Indian security prices were depressed as compared to the prices in the U.K. and it was thought that the response to any offer to give counterparts would be poor. It was arranged that the rupee finance would be provided by the issue of ad hoc Treasury bills to the Reserve Bank.

The operations were welcomed by both financial and political circles in India. In regard to this combined operation also, the Bank's Central Board was not consulted formally.

In terms of the second compulsory scheme, debt of the face value of £73.85 million was repatriated by the end of March 1942; the purchase value was £65.78 million or Rs. 87.71 crores. Sterling debt repatriated through open market purchases and the first compulsory scheme aggregated £25.19 million during 1941-42; in this connection, rupee counterparts for Rs. 33.58 crores were created.

In 1942-43, the repatriation operations covered the 3 ½ per cent Stock 1931 or after, the Railway Debenture Stocks and the Railway Annuities. The 3 ½ per cent Stock fell due for repayment on January 5, 1943. During the period from that date up to March 31, 1943, the total amount redeemed was £56.21 million including £2.37

million held in India. To finance this repayment operation, the Government created ad hoc Treasury bills for Rs. 72.2 crores in favour of the Issue Department of the Reserve Bank; the remaining amount was met from Government balances. Rupee counterparts of the face value of Rs. 67.63 crores were created in the form of extensions of the existing undated 3 ½ per cent Rupee Paper and were taken to the Government's Cash Balance Investment Account for gradual issue to the market through the Reserve Bank, as usual.

Funding of Railway Annuities

With the near completion of the repatriation of the sterling loans, dated and undated, the stage was set for the funding of the Railway Annuities and the requisitioning of the Railway Debenture Stocks. Action in these directions was accelerated by the keenness with which the Central Board of the Reserve Bank pursued the problem.

The total payments to be made under the Railway Annuities until their termination were estimated at £34.1 million. In September 1942 an arrangement was entered into by the Government of India with the British Government whereby for a payment of about £30 million by the Government of India, the British Government undertook to provide the annual sums required for payment to the annuitants until the termination of the Annuities. The arrangement was calculated to give the Government of India a return of about 2 ¼ per cent on their investment. The procedure was for the Indian Government to continue to pay the annuitants until maturity but the British Government were to find the finance for each instalment as and when it fell due, thus relieving India of any further payments on this account. Finance for this operation was provided in the first instance by ad hoc Treasury bills for Rs. 30 crores taken up in the Issue Department, the balance of Rs. 10 crores being met by a ways and means advance. Rs. 15 crores of the ad hoc bills were subsequently cancelled from the proceeds of the 3 per cent Loan 1963-65, a special issue of which was made in October that year for the purpose.

Meanwhile, arrangements were in train for the requisitioning of Railway Debenture Stocks; as a matter of fact, from April 1942 onwards purchases of the Debenture Stocks were being made in the market as and when available. On January 15, 1943, the British Treasury issued a vesting order, requiring all residents of the U.K. to surrender to it their holdings of nine specified Railway Debenture Stocks, at prices fixed on the basis of the market quotations as on that date plus an allowance, by way of interest, for the delay in examining the documents surrendered for repayment. A similar order was issued by the Government of India the following day. The total nominal value

of the Debenture Stocks covered by these vesting orders was £20.2 million. At the same time, the requisite one year's notice was given for the redemption of the remaining three 3 ½ per cent Railway Debenture Stocks of which £11.2 million (nominal) was outstanding. The total face value of the Stocks acquired till the end of the financial year 1942-43 was £18.58 million, the rupee cost or purchase price being Rs. 24.51 crores. About half the rupee finance was found by the issue of ad hoc Treasury bills to the Reserve Bank, Rs. 5 crores by the issue of rupee coin to the Bank under Section 36 (2)* of the Reserve Bank of India Act, and the rest from Government balances.

Thus, in 1942-43, the repatriation was the largest, aggregating £119 million (purchase value Rs. 162 crores), inclusive of the open market purchases and the amounts surrendered under the earlier schemes.

During the year 1943-44, the various schemes of repatriation were nearly completed. The 3 ½ per cent Railway Debenture Stocks were redeemed on February 4, 1944 on the expiry of the notice period, the total amount paid being £8.9 million. Government also arranged to liquidate the Chatfield debt † of £8.5 million arising from the pre-war scheme of modernisation of the Indian Army.

With the virtual completion of the several schemes of repatriation by 1943-44, the debt repaid during the next two years related merely to repayment of repatriated stocks not surrendered earlier. Stray lots amounting to £0.41 million and £0.28 million (face value), respectively, were repatriated during the two years.

The stocks of railways owned and managed by private companies were also gradually acquired by the Government of India. The total cost of purchase of the various railways acquired during the war amounted to £30.7 million (Rs. 41 crores).

The amounts of sterling debt repatriated annually under the various schemes commencing from 1937-38 are given in the following table. It will be seen that out of a total debt of £323 million repatriated till the end of March 1946, about £53 million was accounted for by open market purchases. Against the repatriation cost totalling the equivalent of Rs.429 crores, Rs. 274 crores of rupee counterparts were initially created; of these, securities for about Rs. 50 crores were

* In terms of Section 36(2), the Government were to issue rupee coin to the Bank against payment if the Bank's holdings of such coin in the Issue Department fell below a prescribed figure.

† The Expert Committee on the Defence of India appointed in September 1938, with Lord Chatfield (Admiral of the Fleet) as Chairman, to make proposals for the reorganisation, expansion and modernisation of the Indian Army, submitted its report in January 1939. It postulated the acceptance by the Government of India of joint responsibility with the British Government for the external defence of India. The pre-war capital cost of implementation of the Chatfield Plan was estimated to be about £34 million, India's share being one-fourth of this amount.

REPATRIATION OF STERLING DEBT -FINANCIAL YEARS 1937-38
THROUGH 1945-46

| | <i>Face Value (£ million)</i> | <i>Purchase value</i> | | <i>Rupee Counter parts created (Rs. crores)</i> |
|--------------------------------------|---------------------------------------|-----------------------|-------------------|---|
| | | <i>£ million</i> | <i>Rs. crores</i> | |
| 1937-38 | | | | |
| Open Market Purchases | 2.99 | 3.04 | 4.05 | 1.12 |
| 1938-39 | — | — | — | — |
| 1939-40 | | | | |
| Open Market Purchases | 17.09 | 16.34 | 22.05 | 22.79 |
| 1940-41 | | | | |
| Open Market Purchases | 9.22 | 8.52 | 11.36 | 12.10 |
| Licence Scheme of February | | | | |
| 22, 1940 | 2.02 | 2.02 | 2.69 | 2.69 |
| 1 st Compulsory Scheme of | | | | |
| February 8, 1941 | 60.05 | 64.70 | 86.27 | 80.07 |
| Total for the year | 71.29 | 75.24 | 100.32 | 94.86 |
| 1941-42 | | | | |
| Open Market Purchases | 12.11 | 12.36 | 16.48 | 16.14 |
| 1 st Compulsory Scheme of | | | | |
| February 8, 1941 | 13.08 | 14.14 | 18.85 | 17.44 |
| 2nd Compulsory Scheme of | | | | |
| December 24, 1941 | 73.85 | 65.78 | 87.71 | — |
| Total for the year | 99.04 | 92.28 | 123.04 | 33.58 |
| 1942-43 | | | | |
| Open Market Purchases | 10.48 | 10.40 | 14.00 | 11.40 |
| 1 st Compulsory Scheme of | | | | |
| February 8, 1941 | 1.45 | 1.13 | 2.02 | 1.29 |
| 2nd Compulsory Scheme of | | | | |
| December 24, 1941 | 5.22 | 4.31 | 6.12 | 2.30 |
| Redemption of 3½ per cent | | | | |
| sterling Stock 1931 or after | 56.21 | 56.21 | 74.95 | 67.63* |
| Railway Debentures | 18.58 | 18.38 | 24.51 | — |
| Funding of Railway Annuities | 27.06 | 30.05 | 40.07 | — |
| Total for the year | 119.00 | 120.48 | 161.67 | 82.62 |
| 1943-44 | | | | |
| Open Market Purchases | 1.60 | 1.63 | 2.17 | — |
| 1 st Compulsory Scheme of | | | | |
| February 8, 1941 | 0.16 | 0.16 | 0.22 | 0.04 |
| 2nd Compulsory Scheme of | | | | |
| December 24, 1941 | 0.32 | 0.28 | 0.37 | 30.38† |
| Redemption of 3½ per cent | | | | |
| sterling Stock 1931 or after | 0.71 | 0.71 | 0.94 | 8.00 |
| Railway Debentures | 1.33 | 1.29 | 1.72 | — |
| Redemption of 3½ per cent Deben- | | | | |
| ture Stocks of E.I., G.I.P. and | | | | |
| B.B. & C.I. Railways | 8.90 | 8.90 | 11.87 | — |
| Total for the year | 13.02 | 12.97 | 17.29 | 38.42 |

(Continued)

| | <i>Face Value</i> <i>(£ million)</i> | <i>Purchase value</i> <hr/> <i>£ million Rs. crores</i> | | <i>Rupee Counter parts created</i> <i>(Rs. crores)</i> |
|--|---|---|---------------|---|
| 1944-45 | | | | |
| 1 st Compulsory Scheme of February 8, 1941 | 0.09 | 0.09 | 0.12 | 0.02 |
| 2nd Compulsory Scheme of December 24, 1941 | 0.25 | 0.21 | 0.28 | 0.15 |
| Redemption of 3½ per cent sterling Stock 1931 or after | 0.03 | 0.03 | 0.04 | — |
| Railway Debentures | 0.04 | 0.04 | 0.05 | — |
| Total for the year | 0.41 | 0.37 | 0.49 | 0.17 |
| 1945-46 | | | | |
| 1 st Compulsory Scheme of February 8, 1941 | 0.15 | 0.16 | 0.21 | 0.01 |
| 2nd Compulsory Scheme of December 24, 1941 | 0.06 | 0.06 | 0.07 | — |
| Redemption of 3½ per cent sterling Stock 1931 or after | 0.06 | 0.06 | 0.08 | — |
| Railway Debentures | 0.01 | 0.01 | 0.01 | — |
| Total for the year | 0.28 | 0.29 | 0.37 | 0.01 |
| <hr/> | | | | |
| Grand Total | 323.12 | 321.21 | 429.28 | 273.57 |
| Of which open Market Purchases | 53.49 | 52.49 | 70.11 | 63.55 |

* Created against cancellation of £56.72 million of 3 ½ per cent sterling Stock 1931 or after.

† Includes counterparts for Rs. 30 crores created against cancellation of £26.25 million of 3 per cent sterling Stock 1948 or after during the period March 2 to June 16, 1942.

cancelled later, mostly in the year 1941-42. As at the end of March 1946, the total sterling debt of the Government of India was the equivalent of Rs. 38 crores only, as compared with Rs. 469 crores at the end of March 1939.

Funding of Pensionary Liabilities

One other direction in which the sterling balances could have been fruitfully employed but were not, owing partly to the inordinate administrative delays caused by the attitude of the India Office to view every suggestion that came from India with suspicion, was the funding of the pensionary, provident fund and other similar liabilities of the Government of India, expressed in sterling. Realising that this was a means of utilising a substantial sum of sterling, the Finance Member—this time the initiative came from him—raised the subject with the Governor in April 1942, by which time arrangements for repatriation of both the dated and undated India sterling stock had

been made. In the nature of things, the aggregate liability in respect of these items could not be quantified with any degree of accuracy, there being a number of imponderables. However, even if the liability was ascertainable on the most general terms, Sir James Taylor felt that it was desirable to fund it as it would absorb some of the sterling and secure a higher rate of interest than what the Bank would otherwise earn.

Several alternative methods of providing for the liability suggested themselves. The Government of India or the Reserve Bank could invest the required amount of sterling in suitable long-dated British Government securities (such investment by the Reserve Bank needed an amendment to the Act) or a once-and-for-all payment could be made to the British Government, who would make the necessary sterling available to the Government of India as and when required to meet the pension claims falling due. Sir James Taylor preferred the latter method, the arrangement taking the form of a loan by the Government of India to the Government of the U.K. He envisaged that the U.K. Government would constitute a fund with the amount and credit interest to it at an agreed rate. That fund would be calculated actuarially so as to give as accurate an estimate as possible of the amount which would be required at this rate of interest to amortise both the sterling pensions and repayment of the sterling portions of the provident funds. If at any time the relations between the two countries were politically determined, the fund would be made over to the British Government in exchange for a guarantee by them that they would take over the corresponding liabilities. The amount of the fund was to be revised actuarially every five years and the necessary adjustments made by payments by or refunds to the Government of India according as the valuation revealed that the fund was in deficit or had a surplus. In case the British Government were unwilling to finance the scheme directly in this manner, the Governor also thought that the Government of India would have to set aside a certain amount of sterling to be invested in longer dated British Government securities so as to form a nest-egg for such a fund. Assuming on a rough and ready basis of calculation that £75 million would be required for the operation, Sir James told Government in July 1942 that he would be prepared to provide them with the amount immediately.

The Finance Member discussed the proposals with India Office during his visit to the U.K. in August 1942. It was, however, not until the end of October that the Secretary of State sent a reply to say that the broad outlines of the scheme had to 'go the rounds of about five other Departments here' and that in the light of their comments, a revised scheme was prepared and was then 'undergoing

what I hope will be a final and expeditious circulation to the interested Departments’!

India Office was, however, in no hurry to discuss the matter with the Treasury. The proposals got bogged down in a lengthy triangular correspondence between New Delhi, London and Bombay, over various objections raised by India Office. The latter got Sir Sidney Turner, its Accountant General, to make a rough evaluation of the financial aspects of the scheme and arrived at a capital payment estimate of £150 million. Although this was considered by the Government of India to be a somewhat generous estimate, they had no mind to dispute it, particularly as the Reserve Bank saw no difficulty in releasing this amount by about the end of March 1943. The scheme contemplated an annual payment by the British Government of £6 million for 25 years tapering off gradually over the next 50 years, in return for a single capital payment by the Indian Government; the legal liability for the pensions was to continue to be that of the Indian Government.

The matter was mentioned in the Reserve Bank Board meeting of October 24, 1942. As Sir C. D. Deshmukh reported later, it ‘ failed to receive enthusiastic support, possibly as a result of a lack of a clear understanding of its implication’.* It would appear that the Government of India were keen to ensure that India Office recognised that the proposal was essentially theirs and not the Reserve Bank’s ; for they made it clear to India Office that the suggestion for funding was discussed by the Bank Board ‘purely informally and unofficially ’ and that ‘ although general sense of meeting was clear, Board cannot be regarded as officially committed to recommendation since no resolution was passed or record of discussion entered in proceedings’.

The Government of India, relying on the Bank’s expectations of the accruals of sterling, were keen to make the capital payment on April 1, 1943 and to have the Treasury’s annuity payments commence on October 1 of the same year. One of the points raised by India Office was whether the Reserve Bank would be able to provide by the end of March 1943 the entire sterling required for the operation in one lump sum and still maintain its external reserves against note issue at 50 per cent plus a ‘safe’ margin of Rs. 12 crores. In fact, the Secretary of State propounded a new principle, viz., that as the note issue grew larger and larger in the war conditions then prevailing, each new increase should, in effect, have an increasingly higher proportional backing in the shape of external assets. The 40 per cent minimum fixed under the Act, he went on, had not at any time been thought of as the normal proportion to work to; the 50 per cent figure which had been generally accepted since the foundation of the Bank as a more appropriate ratio had been further modified in 1941 by

* Central Banking in India -A Retrospect.

the addition of a 'further appreciable margin' of sterling in one Department or the other.

Sir James Taylor had not been very enthusiastic even about the maintenance of the '50 per cent ratio plus a safe margin'. Hence he had based his calculations for the pensions funding scheme on the 40 per cent cover; in any case, he felt that the position would be speedily rectified by the continuing sterling accretions. He had, however, no objection to playing it safe, if the Secretary of State so wished, and accepting his proposal that two-thirds of the capital payment might be made immediately and the balance later, after three months or so.

In a letter which Deputy Governor Deshmukh wrote to the Finance Department on January 14, 1943, the Bank's objections to the Secretary of State's views on the need for a high sterling cover were stated elaborately, and as it appears in retrospect so validly, thus:

It is necessary to remind ourselves that whereas in 1934 when the rupee was statutorily linked to the sterling the latter was a dominating currency in international money markets and India was a debtor to Britain to a very large extent, today sterling is not in its old pre-eminent position and a reversal has already occurred of the debtor-creditor relationship between Britain and India, with the prospect of the process continuing at least as long as the war lasts.

We believe that at the back of the public criticism of India's growing sterling accretions and the concern expressed at their steady increase is the realization, whether it is expressed or implicit, that the international status of sterling is no longer what it used to be. It is this feeling that has obviously inspired the many non-official suggestions that in order to safeguard the solvency of its external assets India should endeavour to hold a larger proportion in either gold or dollars. Even from the historical point of view it is not so certain that theoretical opinion was unanimous that the principle of a percentage backing was suitable in all circumstances. There was the alternative theory that any such percentage should be subject to an overriding quantum limit in order that the size of the assets held in external currency should have some relation to the possible requirements of the country of that currency for correcting any temporary maladjustments. It could be argued, in other words, that some maximum limit, say, of £250 million, should be fixed for that proportion of external assets which is to be held in the form of sterling.

Looking at the matter from another point of view, it will be easy to establish that the main demand on our sterling in the past has been for meeting the Home Charges on debt, pensionary and other establishment costs, and that neither the Currency Department nor its successor, Reserve Bank, has been called upon to sell exchange to anything like the same extent to make up shortages on private account. If that is so, then obviously with the almost spectacular diminution in the Home Charges that has taken place and is in progress the country need hold proportionately very much less sterling as part of its external assets against its foreign liabilities.

As regards the nature of India's future foreign trade, it is not so certain either that in the post-war years it will run through channels requiring a large draught on its resources either in sterling or any other external assets. Very likely its internal trade will expand in the direction of making the country more and more self-contained, with the result that its requirements of external assets for the purposes of financing its foreign trade might not be on the scale which we were accustomed to see in the past. Thus from the point of view of the country's probable future trade needs it could be argued that there was no case for increasing our present statutory requirements, but rather for lowering them.

In spite of the virtual extinction of Home Charges that has already occurred or is imminent, we have, however, no intention of raising the question of the reduction of the statutory percentage under present circumstances. With the way sterling is accruing as part of the war effort, it does not appear to be a practical issue. If, however, the theoretical question is raised of the desirability of our holding a larger percentage, we feel that we should set out the arguments to the contrary, particularly if our acquiescence was likely to be an impediment in finding sterling for any further funding operations that are regarded as otherwise fair and practicable.

The Bank's views were conveyed by the Government of India to the Secretary of State.

Another point raised by India Office was the question of the rate of interest to be applied for calculation of the capital payment. Since the Railway Annuities transaction had been effected at 2 ¼ per cent, it considered that it should be possible to arrange for 'something better' in this case, and sought the Government of India's agreement to negotiate with the Treasury (whose rigid attitude on the issue was well-known) for a rate not less than 2 ½ per cent. Both the Bank and the Government of India felt that there was a 'very good' case for 3 per cent, but not wishing to haggle, Government agreed to an 'absolute minimum of 2%'.

However, the U.K. Treasury made it known to the Secretary of State in February that while it was by no means unsympathetic, it would be averse to bringing the scheme into actual operation till several months later, possibly not before the next autumn, as it would otherwise come too closely on the heels of the disbursements for the 3 ½ per cent undated Stock and the vesting of the Railway Debentures. The Secretary of State tried to mollify the Government of India by suggesting that the delay would enable them 'to take credit twice over for scheme first by announcement in budget speech that it has been recommended to H.M.G. and later by announcing its inception'!

Further time was lost in the Finance Member's getting the Executive Council to agree to the scheme, as the Council linked the proposal with the one to set up a Development and Reconstruction Fund for post-war developmental purposes. Hopeful of getting the British Treasury's

agreement in principle to the scheme -the Secretary of State was already in informal consultation with the Treasury and its response was not unencouraging -the Finance Member mentioned it in his budget speech of February 1943; the idea met, however, with 'a somewhat cold reception'. In June 1943, after the approval of the Executive Council had been obtained to the broad outline of the scheme, the Secretary of State was authorised to put the proposals officially to the Treasury and to urge it to submit the scheme as early as possible to the Chancellor of the Exchequer for approval. The Secretary of State accordingly made a firm offer to the Treasury on the basis of interest at 3 per cent, the capital sum being payable on October 1, 1943 and the instalments commencing on April 1, 1944.

The postponement proposed in the date of capital payment disturbed Mr. Deshmukh (who had then assumed the Governor's powers) considerably. For one thing, there was already a lot of uninformed criticism in the country. The Indian commercial community opposed the scheme on the ground that it was less urgent than the acquisition of British investments. Even the amount of payment involved was being incorrectly reported in the press as being of the order of £240 million. For another, early implementation of the scheme would have helped the loan propaganda and also justified raising larger amounts by way of Treasury bills. It would also have been a great advantage to the Reserve Bank itself as it would have made possible an announcement at the annual general meeting that a further large lot of sterling had been put to good use. The Directors were beginning to express serious concern over the apparent inactivity of Government in the matter of considering their February 1943 resolution for valorisation of the sterling balances. There was, however, little that either Mr. Deshmukh or the Government of India could do.

The delay that had ensued between the Treasury's first unofficial acceptance of the scheme in principle in February and the time when the India Office could put the proposals to it officially after the Viceroy's Executive Council had given its approval had, in fact, hardened the attitude of the Treasury. The scheme was shelved indefinitely in February 1944 on the consideration that the proposals raised 'fundamental problems affecting not only India's balances but also the sterling obligations of the U.K. to other countries arising from the war'. It was only in July 1948, as part of the comprehensive agreement with the U.K. on the utilisation of the sterling balances, that the matter was finally solved through payment of £168 million for the purchase of annuities in respect of pensions payable to British nationals by the Government of India and the Provincial Governments,

Although what had been accomplished so far in the matter of debt repatriation made an impressive showing, the sterling used for

repatriation represented only about one-fourth of the sterling receipts of Rs. 1,649 crores from His Majesty's Government from September 1939 to March 1946. There were, besides, substantial sterling purchases by the Bank in excess of the other commitments. Thus, the sterling balances of the Reserve Bank, which stood at the equivalent of Rs. 70 crores on the eve of the war, had risen to Rs. 1,724 crores at the end of March 1946. So, the problem of sterling utilisation was still there!

The repatriation operations were summed up by the Finance Member in his speech on the budget for the year 1943-44, as follows:

And thus India has completed the transition from a debtor to a creditor country and extinguished within the brief space of about three years accumulations over decades of its public indebtedness to the United Kingdom. Apart from the immediate exchange gain of a substantial relief from the necessity of finding sterling annually for the payment of interest charges, a great deal could be said on the implications of this remarkable change in India's status. To deal adequately with that theme and to attempt to prognosticate the role which India is destined to play in the post-war world, would carry me far beyond the limits of a budget speech.

Participation in Post-War Currency Plans

A feature of World War II was that even as advance arrangements had been made for financial and economic control on the outbreak of war, preparations were made during the war period itself for the drawing up of comprehensive plans for international monetary co-operation in the post-war years. These efforts resulted in the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development, of both of which India has been an important member from the beginning. In the shaping of India's attitude in regard to these plans and arrangements and in safeguarding India's interests, the Bank's executives, especially the Governor, played an important role. India of course shared the world's interest in the drawing up of the post-war currency plans. But she had a special concern in the plans in view of the 'embarrassing plenitude' of the sterling balances built up by sacrifice of current consumption during war time. India was keen to secure the establishment of an order which would not only safeguard the value of these balances after the war but also enable her to draw on them in a manner best suited to her post-war requirements for the development of the economy. While in the matter of the repatriation of the sterling debt Governor Taylor had played the key role, in regard to India's participation in the post-war currency plans Governor Deshmukh took a leading part. He was a member of the Indian Delegation to the Bretton Woods Conference, and was accompanied by Dr. B. K. Madan (Director of Research), as Secretary of the Delegation. The Central Board took an active interest in the post-war currency plans; its views were also formally sought by Government.

*Conferences on Post- War Currency Arrangements -----
the Central Board's Interest*

Early in March 1943, a conference of Finance Ministers of the Allied Governments was held in London to discuss post-war currency arrangements in Europe. A British Treasury communique issued on the occasion stated that the Conference was held under the chairmanship of the Financial Secretary to the Treasury, Mr. Ralph Asheton, and that Finance Ministers of all Allied countries having their headquarters in London as well as representatives of the French National Committee took part; representatives from the United States, Chinese, Soviet and British Dominion Governments were also present.

On seeing a short news item about the Conference in the Times of India of March 5, 1943, which stated that besides currency matters other post-war financial questions of common interest were discussed and that further meetings would soon be held, the ever-vigilant Sir Purshotamdas Thakurdas wrote to Mr. Deshmukh, who was then exercising the powers and functions of Governor, saying that he presumed that either the Government of India or the Bank of England would let him (Mr. Deshmukh) know what transpired at the Conference, especially in view of the fact that representatives of the British Dominion Governments attended it. Apart from the newspaper reports, Mr. Deshmukh did not have any authentic information relating to the Conference. 'Since the British Treasury has issued a communique on the matter', Mr. Deshmukh observed in his letter to Mr. Cyril Jones, the Finance Secretary, Government of India, 'there would appear to be no objection to keeping the Reserve Bank informed of the developments in which they have an interest, as sufficient details become available'. Mr. Deshmukh also enquired as to who represented India at the Conference.

The Finance Secretary merely forwarded to Mr. Deshmukh an extract from the Finance Member's speech in the Legislative Assembly on March 17, 1943 on the subject. The Finance Member had referred, in the course of his speech, to the British and the American proposals for monetary arrangements and had stated that so far as the Government of India were aware, official conversations had not till then taken place between the two Governments and no agreement had been reached, or even approached, but there were indications that the two Governments aimed at creating a monetary system permitting multilateral clearings and thus affording holders of one currency the opportunity of free exchange into other currencies. However, the Finance Member had not made any reference in his speech to the Allied Finance Ministers' Conference of March 1943 to which the news item of March 5 related, but had referred to another meeting of expert representatives of the Dominions and India held in London earlier, viz., in late 1942,

which was, he observed, ' of a purely preliminary and exploratory nature ' , and for that reason, strict secrecy had been enjoined on all the participants; India was represented at the Conference by Sir Rama-swami Mudaliar (Member of the Viceroy's Executive Council) and Sir Theodore Gregory (Economic Adviser to the Government of India). The Finance Member added that no Government commitments of any kind had been entered into, by either the representatives of India or those of the Dominions, and that the Government of India did not stand committed in any way to any of the schemes under discussion.

At the Board meeting of April 5, 1943, the correspondence exchanged by Sir Purshotamdas Thakurdas, Mr. Deshmukh and the Finance Secretary (Mr. Cyril Jones) was placed before the Directors. Informally, during the course of discussion, Sir P. T. suggested that Government should be requested to furnish to the Governor a copy of the preliminary discussions at the London meeting of the experts of the Dominions and India (attended by Mudaliar and Gregory), to enable the Governor to pass on to the Board such information as he considered appropriate. Sir P. T. added that he had, in fact, already mentioned this to the Finance Member. Sir P.T.'s suggestion was supported by the other Directors and was taken note of by the Government Director, Mr. Turner.

A few days later, the U.K. and the U.S. Governments were forced to publish the plans prepared by their experts, owing to premature leakage of their contents. The U.K. Plan, associated with the name of Lord Keynes, was known as Proposals for an International Clearing Union; the U.S. Plan, associated with the name of Dr. Harry Dexter White, was known as Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated Nations. The Government of India issued, on April 8, 'for the unofficial guidance of the Press ' , a telegraphic summary received by them of the Keynes Plan for an International Clearing Union; the plan in its 'final' form, i.e., as it ' emerged from the technical examination of experts of the Government of the United Kingdom, India and the Dominions', was to be released as soon as it was received in India. The Government's Press Note issued in this connection stated that His Majesty's Government, 'while being themselves in no way committed to the principles or the details of the scheme, hope that it will afford a basis for discussion, criticism and constructive amendments'.

In his letter of April 8 forwarding a copy of Government's Press Note and the telegraphic summary of the plan to Mr. Deshmukh, the Finance Secretary expressed surprise as to how the Bank's Directors expected the trend or scope of the discussions held in London in October 1942 to be communicated to them 'without a violation of the pledge

of secrecy which Gregory took upon himself as a condition precedent to his participation in the discussions’.

In the circumstances, while forwarding to Sir P.T. on April 14, 1943 some papers regarding the Keynes Plan, Mr. Deshmukh mentioned that since the participation of India’s representatives in the preliminary discussions was under a seal of secrecy and the discussions were in the nature of a technical examination by experts, it seemed hardly worthwhile pressing the Board’s request for being furnished with records of the contribution of India’s representatives to the discussions. But Sir P.T. was adamant. In his letter of April 19, 1943 to Mr. Deshmukh, Sir P. T. remarked:

I feel that while the participation of India’s representatives in the preliminary discussions is under a seal of secrecy, there can be no secret from the Reserve Bank, and therefore I would suggest that you press for being furnished with records of contributions made by India’s representatives at these discussions.

There are many points in the telegram which now make me more determined than ever that it is necessary for the Reserve Bank to have an Indian at its head with this sort of thing being in the purview of the Reserve Bank only, and particularly of the Governor of the Reserve Bank, as there may be secret things passed on to him which the Governor may not disclose to anybody. In view of this, I feel more strongly than ever that I should request you to ask the Government of India to let you have the papers which the Central Board said they should have. Really we must not reconcile ourselves to anything being kept secret from the Reserve Bank, and in fact I feel that the Reserve Bank owe it to themselves to keep complete record of these facts.

Mr. Deshmukh, it seems, did not pursue the matter further, as in the meantime, he received another very strongly worded letter from the Finance Secretary flatly refusing to comply with the Board’s request. The Finance Secretary observed:

I cannot wait further to point out to you the impossibility of the Board expecting Gregory to tell them what he said at the preliminary discussionsno decent person could possibly be expected to break an obligation of secrecy which he had solemnly undertaken and I have no doubt that Sir Ramaswami Mudaliar would take the same line were he in India. . . .Moreover, since the preliminary discussions were concerned solely with a technical formulation of the plan and were held without commitments of any sort, it seems entirely unnecessary for the Board to know what part India’s representatives contributed to that formulation. Neither India’s representatives themselves, nor India, nor the Reserve Bank, nor even His Majesty’s Government stand committed in any way to either the principles or the details of the scheme as it has emerged from the various preliminary expert discussions, and both the Reserve Bank of India and the Government of India are perfectly free to consider the scheme on its merits as and when we receive it. This should be all that the Board could possibly ask for or wish.

An Outline of the Keynes and White Plans

At this stage, it should be useful to give a brief outline of the Keynes and White schemes, both of which purported to be tentative.* They provided the outlines of an international monetary system, with a fundamental similarity in general principles and objectives, but important differences in the practical framework and technique of operation. In general, the White Plan was less explicit about the fundamental than the Keynes Plan, but went more meticulously into details in regard to the constitution, management and working of the Fund.

The main object of both the plans was the promotion of international trade through the establishment of a multilateral system of clearing, provision of credit up to prescribed limits to member countries in balance of payments difficulties, arrangements for orderly changes in exchange rates, prescription of guidelines for action to restore balance of payments equilibrium within a reasonable time and the creation of a permanent machinery for consultation and cooperation in running the international monetary system.

The main feature of the Keynes Plan (of April 1943) was the establishment of an International Clearing Union based on an international currency (for book-keeping purposes only) called *bancor* with value fixed (but not unalterably) in terms of gold. The initial par values of currencies of member countries were to be fixed in terms of *bancor*, which was to be accepted by them as equivalent of gold for settling their international balances.

Member countries were to be assigned a quota fixed on the basis of the value of their foreign trade in the three pre-war years. No payment was to be made by member countries by way of subscription in gold/foreign exchange towards the quota; the size of the individual quotas was intended to measure the member's responsibility in the management of the Union and set a limit to the maximum credit facility available to each member. That is to say, the Union was to have no capital of its own.

Members were to keep accounts with the Union. The essence of the system was that member countries were to accept, in respect of currency balances due to them from other members, a transfer of *bancor* to their credit in the books of the Clearing Union. Member countries were also entitled to transfer *bancor* to other members overdrawing their own accounts with the Union, till the debit balances thereby created reached the size of their respective quotas. The plan was thus based on the 'overdraft' principle. The plan did not encourage excessive debit or credit balances, both being made subject to payment

* Later, proposals were also submitted by French and Canadian experts.

of charges. Non-members were also to be allowed to keep credit clearing accounts with the Union, but they had no right to overdrafts and no voice in the management.

While the quota set the outermost limit of borrowing allowed, corrective measures were to come into operation long before the maximum limit was reached. Countries with excessive credit balances, that is to say, with persistent balance of payments surplus, were also required to take appropriate measures.

The plan did not interfere with countries desiring to maintain a 'special intimacy' within a particular group associated by geographical or political ties.

The plan suggested inclusion of some provision for the transitional period, by which the war-time balances could remain liquid and convertible into *bancor* by the creditor country, while there would be no corresponding strain on the *bancor* resources of the debtor country, or the resulting strain would be spread over a period.

The White Plan (of April 1943) proposed the setting up of a Stabilization Fund and member countries were to have three distinct relationships with it, viz., as stockholders, as customers and as depositors. The monetary unit of the Fund was to be *unitas*, equivalent to $137 \frac{1}{7}$ grains of fine gold or U.S. \$10; the value of the currency of each member country was to be established in terms of gold or *unitas* and might not be modified without the approval of the Fund.

Each member was to be allotted a quota determined on the basis of its holdings of gold and foreign exchange, the magnitude of fluctuations in its balance of international payments, and its national income; quotas were payable in gold, securities and local currency in stipulated proportions, to constitute sources of funds for the exchange operations of the Fund. The right of a member to purchase foreign exchange from the Fund with its local currency was recognised only to the extent of its quota, subject to certain limitations. However, the Fund might sell foreign exchange till its holdings of the member's currency reached 200 per cent of the quota, or even beyond this limit, if the country agreed to take appropriate corrective measures or the balance of payments of the country whose currency was acquired was such as to warrant the expectation that the excess currency holdings could be disposed of within a reasonable time. When the Fund's net holdings of a member's currency exceeded the quota for that country, the member was to maintain a special reserve with the Fund and also pay charges on excess holdings of its currency by the Fund. Countries having continued surplus would also be required to take corrective measures.

To promote the most effective use of the available and accumulating supply of gold and foreign exchange, member countries were

required to offer to sell to the Fund all gold and foreign exchange they acquired in excess of the amount held by them immediately after joining the Fund.

Member countries could tender gold to the Fund and create deposits in unitas, which were transferable and were redeemable in gold or foreign exchange.

The Fund was to assist in liquidation of war debts by buying from member countries a proportion of their abnormal war balances held in other countries in exchange for local currency, or for foreign exchange when such exchange was needed to meet adverse balance of payments not arising from acquisition of gold or accumulation of foreign balances or other capital transactions, subject to certain conditions. The Fund was free to dispose of its holdings of such balances after a 23-year period, or earlier either with the consent of the country in which the balances were held, or if the Fund's holdings of that particular currency had fallen below 15 per cent of that country's quota.

A general point of difference between the two schemes was that the British Plan provided for decisions by a simple majority, whereas in the American Plan, for most of the important decisions, a four-fifths majority was required.

During June-July 1943, discussions on the White Plan took place in the U.S.A. between the U.S. Treasury experts and the representatives of nearly 30 Allied nations. The Government of India were unable to send any representative for the deliberations as they had not received any authentic copy of the U.S. Plan, and had not considered the proposals. Following the discussions, the U.S. Plan was revised and issued on July 10, 1943; a copy of this was sent to the Finance Member by the U.S. Secretary of the Treasury.

The main changes made in the revised White Plan were: (i) the proportion of gold in quota subscription was raised substantially; (ii) when the gold and exchange holdings of a member exceeded 50 per cent of the quota, the member was required to make one half of the payment in respect of foreign exchange bought from the Fund, in gold or foreign exchange acceptable to the Fund; (iii) only one half of the gold and foreign exchange acquired in excess of a member's official holdings at the time of joining the Fund was to be offered by the member for sale to the Fund and that too only if the member's official holdings were in excess of 25 per cent of its quota, and (iv) blocked balances purchased by the Fund were not to exceed in the aggregate 10 per cent of the quotas of all members, in the first two years.

The revised plan deleted an important provision, viz., the Fund's power to accept deposits in gold from members.

Board's Views on the Schemes

Copies of the two plans received by the Bank from the Government of India towards the close of June 1943 were forwarded to the Central Board Directors and Local Board members. The formal request from Government that they would 'welcome the views of the Bank on these two proposals or any modifications thereof as soon as the Bank have had full opportunity of considering the matter', came later, viz., in early August 1943.

In the meantime, on July 5, just a few days after forwarding the copies of the two plans to the Bank, the Finance Secretary suggested to Mr. Deshmukh that 'it would perhaps be advantageous if he (Sir Theodore Gregory) were to attend the meeting of the Directors of the Central Board for a general talk on the subject of the post-war currency plans...'. The Finance Secretary wanted some sort of suggestion or invitation to come from the Board to justify Sir Theodore's making the journey. The suggestion regarding his attending the Board meeting had been discussed by the Finance Secretary with Sir Purshotamdas Thakurdas too, when the latter was in New Delhi and Sir P. T. approved of it, but considered it desirable to obtain first the reactions of the Local Board. On being shown by Mr. Deshmukh the Finance Secretary's letter of July 5, Sir P. T. expressed doubt whether the other Directors would be willing to send an invitation or 'even initiate the proposal that Gregory should address them'. In the circumstances, Sir P. T. suggested that the matter should be brought up informally at the next Board meeting, which was on July 20, probably to find out the Board's reaction. 'I presume', Mr. Deshmukh observed in his letter to Mr. Cyril Jones, 'this will give time enough for Gregory to arrange to come to Calcutta should the outcome of the discussion at that Meeting indicate that Gregory should address the Directors either on Government's initiative or on our own on the 9th August'.

The Finance Secretary took strong exception to the words 'Government's initiative'. To quote him:

The one thing I wish to make clear is that there can be no question of Government taking any initiative in this matter at all. The question does not in any way arise of our wishing to send Gregory for this purpose. It is true that the suggestion came from me in the first instance but that was merely born of a desire to be helpful to you and to the Directors. Government naturally wish to have the considered views of the Reserve Bank on the two schemes which have now been published and will doubtless receive them. For our purpose that is all that matters... If the Directors would like him to come to talk to them I can see no reason why either they or you should not ask Gregory to do so. If they do not want such a discussion, the matter naturally ends there and the whole thing is off.

A letter stating that the Directors 'would be glad of an opportunity' of informally discussing with Sir Theodore Gregory the post-war monetary plans on August 9, 1943, was sent by Mr. Deshmukh to the Finance Secretary; in his forwarding letter, Mr. Deshmukh remarked :

Now that the suggestion has been made, the Directors would be glad to discuss although I cannot honestly say that the idea of seeking any such opportunity had occurred to them on the ground of their finding themselves unable to follow the implications of the two schemes. I do not think that there is any advantage in following up this comparatively unimportant issue of whether the Board are gladly falling in with a suggestion in fact made by you or whether they wish to make it appear that they are on their own initiative requesting Government to ask Gregory to discuss the matter with them. I hope the matter will be allowed to rest there

Sir Theodore was unable to attend the August 9 meeting owing to 'more urgent official preoccupation'. It was decided that the Directors would discuss the plans informally amongst themselves at the next Board meeting to be held on October 16 but would formulate their views only at another meeting on October 18 after hearing Sir Theodore Gregory on that day.

A memorandum entitled Post- War Monetary Plans by Mr. Deshmukh, who had been appointed the Governor by that time, together with elaborate notes on the subject prepared by Dr. B. K. Madan, Director of Research, and Mr. H. D. Cayley, Deputy Controller, Exchange Control Department, was circulated to Board members. Another note by Professor D. R. Gadgil, giving his comments on the Keynes and the White Plans, was also circulated to Board members.

The Governor, in his memorandum, observed that it was difficult at that stage to express any precise opinion on the merits of the different plans drawn up, owing to the diversity of the methods proposed to accomplish the same objects, the fluidity of the plans themselves and the fact that a conference of the financial experts of the United Nations was reported to be engaged in examining the various schemes in detail. Of these deliberations, the Bank knew little; a good deal of mystery surrounded the conference of experts, at which India appeared to be unrepresented. The Canadian plan being essentially similar to the U.S. plan, the Governor confined himself to broad comments on the principles underlying the British and American plans.

The Governor's general reaction to the two schemes is summed up in the following paragraph:

The Keynes' scheme is the more idealistic of the two plans, is definitely expansionist in character and seems likely to lead to a continued and genuine expansion of world trade, provided all countries play the game.

The American plan, on the other hand, while it would appear to work admirably provided no country's surplus exceeded a fixed figure, once this surplus is reached, proposes as a remedy the re-adoption of trade and currency restrictions, or in other words, the old deflationary methods which can only result in severe contraction of trade throughout the world. In spite of this disadvantage, the U.S. plan does seem the more practical. Under the Keynes' plan the penalties for a defaulter appear to be confined to the general disadvantages of being outside an exchange system within which the other major countries of the world are trading. On the other hand, under the U.S. plan each country must deposit a proportion of its quota in gold (in the latest version 50 per cent) and a default by a country would mean the loss of this deposit. Advances of foreign exchange under the U.S. plan would therefore in effect be given against security. This system under present conditions would seem to be wiser and less liable to disruption than the unsecured nature of the Keynes plan, though the obvious advantages of the latter may lead to its ultimate adoption when the nations of the world have had more experience of international financial co-operation.

Considering the plans in relation to India's position and interests, the Governor felt that since the British plan was expressed in more general terms than the U.S. plan, it was impossible to say whether some of the provisions explicitly made in the latter would not be included in the detailed draft of the former at a later stage. The American plan did however lay down detailed provisions for the liquidation of blocked war balances and was, therefore, of considerable interest to India. The maximum amount up to which the Fund would purchase such balances within the first two years was put at 10 per cent of its general resources. The balances would be liquidated only to the extent to which the creditor country bought foreign goods and ran a deficit on current account. India could not, under this scheme, convert her blocked sterling into dollar holdings, but could use her sterling up to the limits laid down in the plan to purchase goods in any part of the world. One estimate of India's limit for the sale of blocked sterling to the Fund was put at £100 million within the first two years. This was, of course, based on quotas which were not then fixed, but the Governor felt this was not far off India's requirements.

The Governor considered that on a short-term view the U.S. plan suited India's requirements admirably. The country's immediate object was industrialisation and, in addition, she would be required to sell large amounts of her agricultural and primary products abroad. By assisting world trade, the U.S. plan would enable overseas buyers to purchase India's exports, while its scheme for the liquidation of war debts would enable India to utilise her blocked sterling balances for the purchase of the plant and machinery required for her industrial programme. The Governor was also very optimistic regarding the Indian balance of payments in the post-war period. He predicted a cessation

of imports of capital equipment and the building up of a large export surplus, probably augmented by increased exports of manufactured goods, in 10 or 15 years; a situation might then arise, he observed, where the country's surplus, represented in the books of the Fund by a fall in its holding of rupees, reached a figure where the Fund felt called upon to submit recommendations to her (India) for rectification of the position. If the surplus was not reduced, the Fund might have to ration rupees as a scarce currency, which would result in a forcible reduction in the country's exports. Obviously, such a situation could arise whether or not India became a member of the Fund; however, membership might assist India to overcome these problems with a minimum of trouble, as the Fund, in order to survive, would have to operate for the general benefit of all its members.

As arranged earlier, the Central Board had a preliminary discussion on the subject on October 16, 1943. At this meeting, the Board expressed, according to a cable sent by the Governor General to the Secretary of State, 'dissatisfaction at our lack of knowledge of what is going on in America and of present position of discussions there.' Another meeting of the Board held on October 18 was addressed by Sir Theodore Gregory, who answered questions on the various technical aspects of the two schemes put to him by the Directors. The Board thereafter resolved that the Governor should prepare a draft letter to Government in the light of the discussions at the meeting, submit it for consideration to the Committee of the Central Board and circulate to the Directors the draft together with the modifications the Committee might wish to make. The formal letter to Government was to be issued after the draft was amended in the light of comments and suggestions made by the Directors.

The Committee considered the Governor's very comprehensive draft letter on November 3, 1943, which was then circulated to the other Directors. The communication as amended in the light of the comments received was forwarded to Government on November 18.

Recognising the importance of international financial co-operation and hoping for a synthesis of the Keynes and White plans, the Board's observations were confined in the main to the broad principles involved, with particular reference to the safeguards that India's vital economic interests required. Any international scheme to be acceptable to India, the Board observed, had to be 'capable of promoting India's special interests in a way in which they would not be promoted if India stood aloof'. In the opinion of the Board:

India's attitude towards any international scheme, involving a certain of limitation on monetary freedom or restriction on the direction of commercial policy, is bound to be conditioned by special factors such as its economic backwardness, its appalling poverty, its dismally

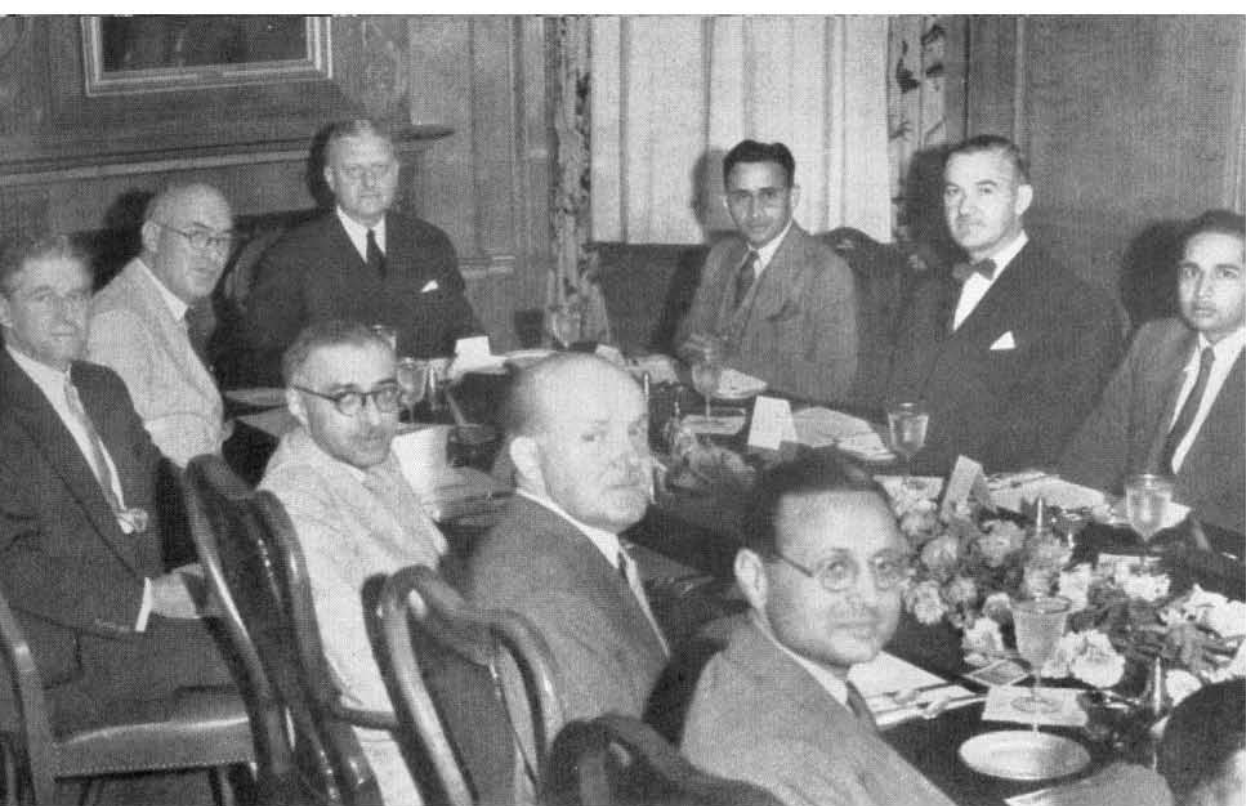
low standard of living and its just aspirations to make up the long leeway in industrial and agricultural development. It can legitimately claim special treatment not only because of the inherent justice of its claims, but also because it has, by virtue of its constitutional position, not in any degree been responsible for contributing to the economic and political chaos which has culminated in the present war.

The Board suggested that any plan to be acceptable to the economically backward countries like India should include among its major aims 'the making of conscious efforts to raise the standard of living in these countries, although such efforts might temporarily mean a standing-still in the more advanced countries'. The specific inclusion of such an aim would call for 'a mental discipline of a high order' on the part of the more important Allied nations after the war was over; in the absence of it, the Board felt, the plan would hold no special attraction for India, and if she participated at all, it would 'only be to avoid the penalty of being left out in the cold in the economic sense'.

While the Board appreciated the need for international co-operation, it was not optimistic that a full-fledged plan could be operative in the immediate post-war period, owing to, among other things, uncertainty regarding the treatment to be meted out to aggressor nations and the special problems of reconstruction. (Later, however, the proposal for a World Bank was mooted and approved, to meet the needs of reconstruction and development. Things actually turned out to be better than anticipated).

The Board also assumed that India's participation in the proposed arrangements would be as an entirely free agent, and that the fiscal autonomy she was 'said to enjoy will be genuine and unqualified'. In this context, the Board referred to the view prevailing in certain quarters that the freedom allowed by the Keynes Plan to maintain a special intimacy within a particular group of countries associated by geographical or political ties, such as the existing sterling area, indicated a desire to keep India tied for ever to the apron-strings of Britain. The Board believed that this view was based on a misconception and that any such special intimacy would be contracted by any country purely on a voluntary basis and could be terminated at its own free will. Special groupings, it added, were also inconsistent in principle with a completely international order.

In the Board's view, India's actual participation in any scheme would not be worthwhile, unless the raising of the low standard of living was included as one of the objectives, and unless satisfactory provision was made for (i) the orderly liquidation of her sterling balances, (ii) voting rights in accordance with India's importance, by virtue of her population, in the general over-riding aim of improving human standards of life, (iii) a reasonable flexibility of exchange rates, and (iv) liberty to

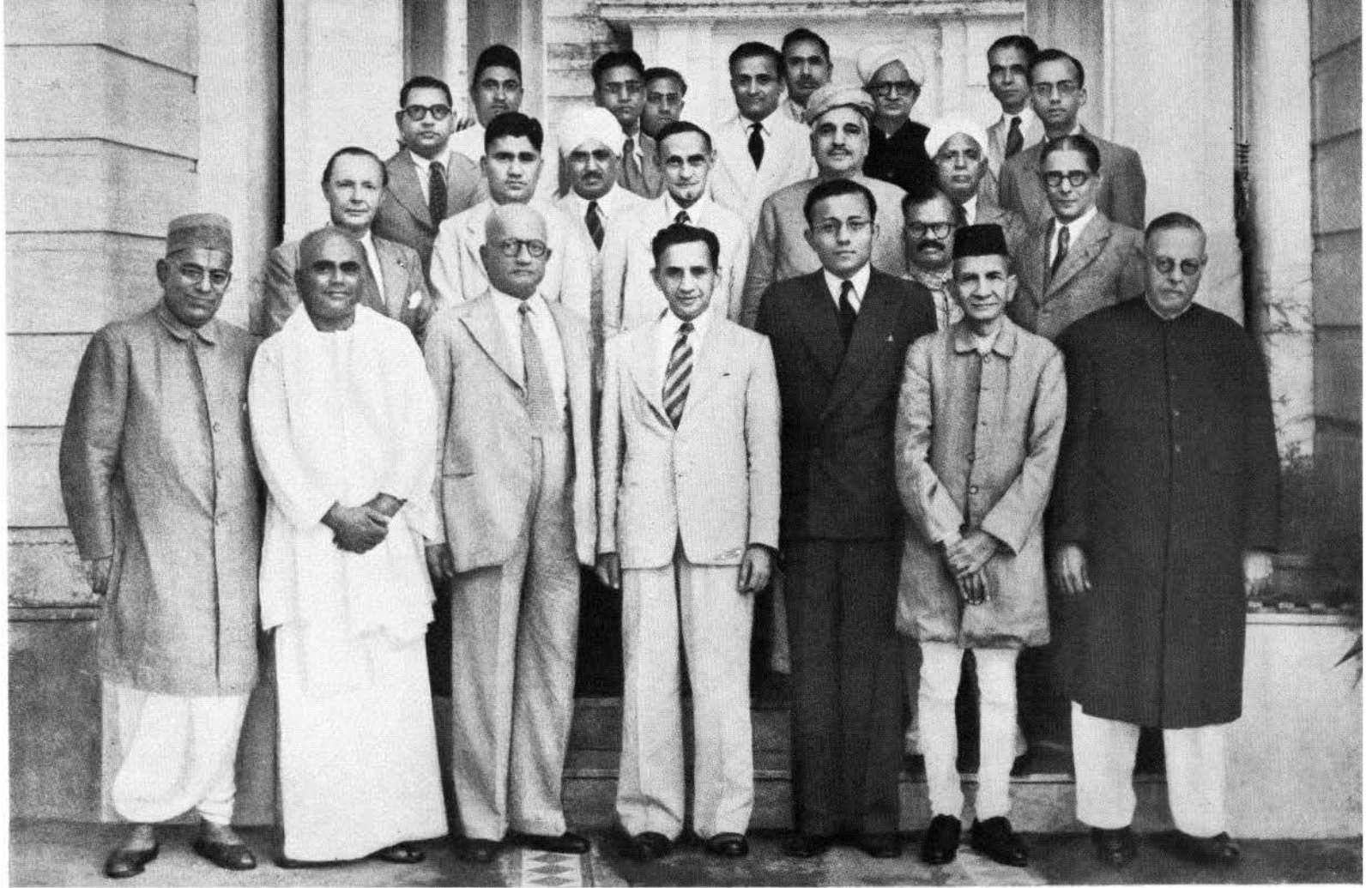


Indian Delegation to the Bretton Woods Conference

The delegates from India in the photograph above are (clockwise) Dr. B. R. Madan, Mr. A. D. Shroff in the third chair, Sir Jeremy Raisman and Sir C. H. Deshmukh (seventh).

In the photograph below Sir R. K. Shukla Chetty is seen third from left.





Group photo taken at a luncheon given by Director Mr. R. Ramanathan Chettiar to the Directors of the Central Board of the Bank on December 29, 1948 at Madras.

participants to secede from the international body without undue loss of time and without penalty.

As regards (i), the Board recognised that it was premature to prescribe any concrete scheme immediately but it saw the need for any future arrangement to provide for two things -the liquidation of the balances within a reasonable period and their conversion into universal purchasing power so as to assist in India's industrial and agricultural development to the maximum extent possible. Taking note of the 'tendentious writings in the British financial press' that India's sterling balances represented a mistaken generosity on the part of Britain and other statements that Britain would not have the capacity to supply the capital goods that India would require after the war, the Board trusted that:

the essential justice of India's claims to the maximum utilisation in her own interests of her sterling balances will not be denied and that the special efforts of all concerned will be directed towards maximizing Britain's capacity to export, e.g., by means of technological advances, rationalisation, increase of productive efficiency and, if necessary, by submitting, for the time being, to continuous economic discipline so that India may be assisted to make up at least a part of her economic leeway for the ultimate furtherance of international welfare.

At the same time, there was the need on the part of India to expedite the preparation of careful surveys of immediate industrial possibilities and of co-ordinating these with the demands of road development programmes, the needs of irrigational schemes, hydro-electric projects, etc., without which the effective utilisation of the balances could not be achieved.

In regard to exchange rates, the Board held the view that for backward countries like China and India a larger flexibility of exchange rates was necessary than for the more advanced countries, the economic impulses generated in which often determined the trend of economic development elsewhere. From this point of view, the Board regarded the provisions in both the plans as unsatisfactory.

The Board was also dissatisfied with the provisions of the two plans relating to the governance of the Fund or Union. Since the voting rights were in some way related to the quotas established in the two schemes and since the quotas were to be fixed on the basis of criteria like the volume of international trade, national income, etc., which were 'manifestly unfair to India', the Board felt 'the voice of India will only be faintly heard in the Councils of the Fund or Union'. However, in the Board's view, much importance should not be given to the regulatory powers of the governing body, since 'the strength of any international body would lie not in the formal powers which international agreements vest in them, but in the reasonableness and the equitableness

of the action taken and the advice given by the governing body'. Where a participating country considered that the requisition or advice of the governing body was unfair and prejudicial to its interest, it should be in a position to withdraw 'without undue loss of time or without incurring any penalties'.

In the matter of gold, India had only a minor interest, being neither a large producer nor a large (official) holder of gold. The Board took the opportunity, however, of recommending to Government that 'the connected problem of India retaining her credits in dollars, so far contributed to the Empire Dollar Pool, should receive their constant and vigilant attention'; this should be an offset to any possible liability that may devolve on India as a result of lend-lease arrangements. But for the possibility of the emergence of some kind of international scheme for converting the sterling balances into universally acceptable foreign exchange, the Board said, it would have urged upon Government the importance of taking steps on the lines of its recommendations made in February 1943 for safeguarding their value (see page 299).

Although the Board stated in conclusion that in view of the possibility of a synthesis of the two schemes it did not consider it necessary to express a preference for either scheme, it gave greater support to the American scheme, in the following terms:

the full introduction of an 'idealistic' scheme like the Keynes scheme should be deferred to a later stage of international co-operation, and that it would be desirable in the meanwhile to proceed on the basis of well-understood monetary principles, such as that of deposit banking, of the mutual type, underlying the Stabilization Fund Scheme. In their view, the security principle, implicit in this scheme, is likely to be more convenient from the point of view of monetary practice than the overdraft principle on which the Keynes scheme is based, although the essential difference between the two in its application to the international sphere is only one of degree rather than of kind. They also believe that the principles for international monetary expansion which the Keynes scheme provides might be too risky for adoption in the immediate post-war world, where the most pressing problem threatens to be that of inflation, until it has been possible for a war-weary world to re-establish in their fullness the means of production of consumable goods.

In the course of the Board's deliberations, one of the Directors expressed the hope that 'the delegation to be sent from India to participate in the discussion on these plans will include men (non-officials) who would be likely to command the confidence of the business world and the public in general'. The Committee wanted the Governor to convey this suggestion informally to Government, and this was done.

Earlier, the Finance Member had desired to elicit the general opinion of the country on these plans and considered that a high level

Reconstruction Committee would serve the purpose. The committee was to be thoroughly representative, both geographically and of all interests having a stake in international trade. The Finance Secretary suggested the inclusion on the committee of a representative of the Reserve Bank and of chambers of commerce and outstanding persons like Sir Purshotamdas Thakurdas and Mr. G. D. Birla. Mr. Deshmukh was requested to give his suggestions after discussing the matter with Sir P.T.

Sir P. T. and Mr. Deshmukh were not enthusiastic about the suggestions. In his letter of August 6, 1943, to the Finance Secretary, Mr. Deshmukh stated:

Sir Purshotamdas, whom I sounded the other day on your tentative idea, said that, while that was sound enough as far as it went, he doubted if you would elicit any opinion free from mental reservations as long as the extent to which India would in reality be free to act in the spheres of finance and commerce. His point seemed to be that it was only on the basis of real and unqualified fiscal autonomy that India could participate in discussions relating to the post-war international monetary arrangements. I imagine what is at the back of his mind is that the various nonofficial Indian interests would not wish it to be understood that they stood with the Government of India in preferring either plan or a new plan, i.e., mechanism, if when actual decisions were taken, e.g., in fixing the initial exchange ratio or varying it, or imposing or modifying tariffs, Government were to be in a position to override the Legislature and get measures certified in the supposed interests of the country. This is political ground-not necessarily irrelevant -on which I cannot very well tread.

Political consideration apart, in my opinion the inherent difficulty in the matter is the existence of two schemes differing in important particulars, and before setting up any advisory committee I suggest that Government frame the issues on which advice is to be sought at this stage. Do they, for instance, wish to know which of the schemes should be supported by India as it stands or with modifications consistent with the basic principles of either? Do they wish to know what importance should be attached to the early liquidation of post-war balances, aiding thereby the speedy industrialization of the country? Is opinion to be invited on each separate aspect of the schemes, e.g., (i) clearing or initial gold and other assets; (ii) character and composition of governing body; (iii) powers of the body and mode of exercising them; (iv) duties and liabilities of member countries, etc. Unless the issues are clearly framed there is a risk of the schemes being considered as if they immediately involved the fixing of the exchange ratio!

There are no records to show whether the Governor's advice was followed or not. However, it appears that the subject of post-war international monetary co-operation was discussed in January and May 1944 by both the General Policy Committee and the Consultative Committee of Economists of the Reconstruction Committee of Council.

Board's Views on the Joint Statement by Experts

As a result of close study, spread over many months, by technical experts of more than 30 nations, a tentative agreement grew out of the American and British proposals, regarding a broad outline of the basic principles that should govern an International Monetary Fund. This agreement, called the Joint Statement by Experts, was announced by the Secretary of the U.S. Treasury, Mr. Henry Morgenthau, on April 21, 1944. An international conference to discuss the proposals was in the offing; the Finance Department of the Government of India therefore sought the Bank's views on the proposals urgently. The matter was to be considered by the General Policy Committee of the Reconstruction Committee too, at its meetings on May 4 and 5, 1944, and the Finance Department extended invitation to the Governor and through him to the Bank's Directors to be present at those meetings.

A few remarks may be made on the Joint Statement. The Experts used the cautious White Plan as their framework, though the scheme which emerged from them did reveal the influence of the Keynes Plan to an appreciable extent.

The Joint Statement proposed the establishment of a Fund -the International Monetary Fund -and member countries were to subscribe in gold and local currency amounts (quotas) to be agreed upon, amounting in all to about \$8 billion, as compared to the sum of 'at least \$5 billion' proposed in the White Plan, for the aggregate subscription of members. Unlike the White Plan, the Joint Statement did not lay down any basis for determination of quotas. The compulsory gold contribution by individual members was fixed by the Experts at 25 per cent of the quota or 10 per cent of the member's holdings of gold and gold-convertible exchange, whichever was smaller; this was substantially lower than that fixed under the revised White Plan.

While the purposes of the proposed Fund were broadly similar to those mentioned in the two plans, an important objective specifically mentioned by the Experts was 'to facilitate the expansion and balanced growth of international trade and to contribute in this way to the maintenance of a high level of employment and of real income, which must be a primary objective of economic policy'. On the other hand, as compared to the White Plan, a significant omission in the Joint Statement was any reference to facilitating effective utilisation of blocked foreign balances as one of the objectives of the establishment of the Fund.

The Experts provided for the fixation of the par value of currencies of member countries in terms of gold and not units, as proposed under the revised White Plan (July 1943). Another important change made by them was giving power to the Fund to require members to

use up to one half of the increase over the year in their gold and foreign exchange reserves to repurchase Fund's holdings of their currency, till such holdings fell to 75 per cent of the country's quota or the member's gold and exchange reserves fell below its quota; under the revised White Plan, on the other hand, all countries with gold and exchange holdings in excess of 25 per cent of the quota were required to offer to the Fund for sale one half of the gold and foreign exchange acquired in excess of their holding at the time of joining the Fund. A new important provision included by the Joint Statement was to permit member countries to maintain, if necessary, certain exchange restrictions during the 'transition' period of three years.

The Central Board considered the Joint Statement at a special meeting in Bombay on May 11, 1944. Earlier, a very detailed note explaining the provisions of the scheme, prepared by the Bank's Senior Economist, Mr. J. V. Joshi, had been circulated to the Directors. The Board decided, after discussion, that the draft letter to Government embodying its views should be submitted to the Committee of the Central Board for approval, at its meeting on May 17. The Board's views 'as settled after discussion' at the Committee meeting were communicated to Government on May 18.

The Governor's letter to the Finance Secretary stated that the Board, was disappointed as the Joint Statement neither included among its avowed objectives the facilitating of the development of the less advanced countries as an integral part of the common aim of full employment and rising standards of living, nor made any provision for the multilateral clearance of blocked balances through the machinery of the proposed Stabilization Fund. 'Thus judged in the light of India's *sine qua non*, the scheme is inadequate and unsatisfactory'. Dealing with the first of these objectives, the Board was convinced that:

no international economic co-operation worth the name will succeed and lay the foundation for enduring international peace and prosperity unless the retarded development of important units like India and China receive special recognition and treatment. In the absence of any such recognition and treatment, international machinery, with the inevitable preponderance of the representation of the more advanced countries, is apt only to serve as a stalking horse for selfish national policies on behalf of such countries at the behest of powerful vested interests and under the guise of plausible economic theories about the division of international labour. In concrete terms, and as an illustration, countries like India are apt to be relegated to the production of primary commodities in the interests of maintaining full employment in advanced manufacturing countries.

The inclusion of such an objective would, in the opinion of the Board, automatically imply the conferral on the countries in question, e.g., India and China, of special weight age both in the matter of the quotas and in the management of the Fund. It would also exhibit the

importance of utilising accumulated war balances in proper perspective and reinforce the need of making some sort of provision in the machinery of the Fund for the clearance of such balances.

In regard to the second omission, judging from the comments in the British financial press, it appeared that the liquidation of the sterling balances had been left to bilateral agreement in order to avoid overstraining the machinery of the Fund. The Board felt there was no reason to fear that the multilateral clearing of the large and continuously increasing sterling balances of India might exhaust very rapidly the Fund's holding of the currency of a country like the U.S.A. whose goods might be exported to Britain's creditors; provision could very well have been made for the Fund to take over these balances at its discretion. The Board went on to remark:

From Britain's point of view, especially vis-a-vis India, a bilateral settlement would have the advantage of limiting India's choice in receiving the goods which Britain might offer in repayment, but it is difficult to conceive what advantage the U.S.A. could have by excluding from the scheme the multilateral clearing of what were called abnormal war balances. Such a method of clearing might have furnished her with markets where she had no markets before. It is possible that an isolationist view, alarmed at the prospect of the U.S.A. being left with the war-balance baby, has prevailed. . . . It is also a point that needs stressing that the very size of the war balances is an argument for not relegating them entirely to bilateral clearing, since the resultant transactions would occupy such a large proportion of the total volume of trade of the countries concerned in the mutual arrangements that the facilities offered by an International Monetary Fund would be reduced to insignificance, with the consequent danger of the Fund becoming moribund. The Board urge that on behalf of India the inclusion of a provision for at least a partial multilateral clearance of war balances should be strongly pressed in the interests of the Fund itself and for the furtherance of its fundamental objective of expanding international trade.

Drawing Government's attention again to its resolution of February 8, 1943, the Board pointed out that with the deliberate exclusion of this provision from the scope of the Fund's activities, it had become extremely urgent for the Government to apprise themselves of the steps which the British Government themselves proposed to take at their end for the liquidation of the sterling balances. Before expressing her wishes in regard to joining the Fund, it was necessary that India should know definitely what the intentions of the U.K. Government were. The urgency was all the greater for 'British financial journals seem to have started a deliberate campaign of misrepresentation to the effect that these balances represented over generosity, a donation, a gift and what not, on the part of Great Britain towards India, foreshadowing some sort of whittling down of India's claim'.

In this context, the Board also pointed out that the related question of India's keeping her surplus of dollars assumed importance, since if there were to be no multilateral clearing of India's sterling balances apart from the question of past accumulations, steps should at least be taken to ensure that she received and retained all the dollars arising out of her transactions with the U.S.A. and not utilised for any vital war purpose. The Board also reiterated its original view about the incompatibility of the sterling area arrangements, including the maintenance of the Empire Dollar Pool, with the existence of an International Monetary Fund. The matter was, in fact, one that admitted of little doubt; it was, therefore, puzzling that the British Chancellor of the Exchequer should have been reported to have made a statement that the British Government would not favour any plans likely to interfere with relations between States who had been associated with one another in the sterling area arrangements. With the continuance of these arrangements and with bilateral agreements in regard to sterling balances, India's participation in any international monetary scheme, the Board felt, would become little more than a formality.

Another point to which the Board attached great importance was the manner of fixation of the quotas of the member countries, since on this depended the distribution of voting rights and seats on the management of the Fund. The Joint Statement made no mention of how quotas were to be determined. Apart from the criteria indicated in the earlier plans such as the volume of the external trade of a country, its internal trade and its national income, the Board urged that population was one of the most important in the case of countries which had yet to make up a long leeway; in their case, it seemed all the more necessary to ensure that development was not hampered by an unduly restricted quota. Also, in the case of countries like India, figures of past trade furnished no reliable guidance for determining the needs of the future; what was more relevant was the anticipated size of their post-war trade. In the opinion of the Board, on the basis of these criteria, India was entitled to the fourth place among the United Nations and, therefore, to a seat on the executive committee of the Fund in her own right. In its words:

This is a point to which the Board attach the greatest importance, viz., that whatever the selected provisions might be for the strength of the Board of management or the executive committee, India must have representation in her individual right without being put to the hazards of an election. Having regard to the criteria indicated above, the Board feel that if the managing committee is to be restricted to five, China and India are entitled specifically to be included both on grounds of regional distribution, and, what is more important, as representing the two large nations whose store of resources and capacity are yet far from being developed to their maximum extent.

Among the other suggestions of the Board, mention may be made of the need for India to be consulted before the par value of sterling was fixed in view of the long and close link between the rupee and sterling, the need for retaining complete tariff freedom for member countries, and the desirability of ensuring that in the apportionment of the scarce currencies, the determination of India's share was not influenced by any imports from the U.K. which she might receive under any separate agreement for the liquidation of her sterling balances. The Board also pointed out that if India's representative on the Fund was to be constitutionally bound to accept guidance from authorities not politically responsible to Indian public opinion, her participation would fail to inspire confidence among the people.

Finally, noting that the House of Commons had agreed to the motion that 'the statement of principles recently announced provide a suitable foundation for further international consultation with a view to improved monetary co-operation after the war', the Board suggested that 'India's participation in the impending discussions be restricted on the same basis and without any commitments whatsoever on the part of the Indian peoples, especially in view of India's peculiar and unfortunate constitutional position'.

Plan for Reconstruction and Development Bank

As mentioned earlier, the Reserve Bank attached much importance to the arrangements for adequate flow of capital to the less developed countries in the post-war years, as an integral part of international monetary co-operation. This aspect was not neglected by the Allied Powers; the U.S. authorities gave careful attention to the problem of international reconstruction and development finance. It was feared that, in the immediate post-war period, the devastated as well as the underdeveloped nations of the world would be faced with the stupendous task of acquiring foreign capital needed for reconversion and reconstruction and also for purchase of machinery and other capital goods. Private capital was unlikely to come forward in the required volume, and it was felt that only an international agency could tackle the problem by encouraging the flow of private capital abroad and itself providing a part of the capital not otherwise available.

The technical staff of the U.S. Treasury and other Government Departments prepared a draft scheme for setting up an international agency for encouraging and facilitating international investment in the post-war period. Although this scheme did not receive much attention prior to the Bretton Woods Conference and it did not formally come up before the Central Board, a brief outline of the U.S. scheme may be given, since the scheme, with some modifications, came to be

approved at Bretton Woods. The proposal, the details of which were announced on November 24, 1943, was for the establishment of a Bank for Reconstruction and Development of the United and Associated Nations, as a companion agency to the proposed International Stabilization Fund. In the words of Mr. Henry Morgenthau, Secretary of the U.S. Treasury:

Each agency could stand and function effectively without the other; but the establishment of such a Bank would make easier the task of an International Stabilization Fund, and the successful operation of such a Fund would enhance the effectiveness of the Bank.

The proposed Bank was to have a share capital of \$10 billion, to be subscribed by members in agreed proportions, determined on the basis of the members' national income and foreign trade. Payments were to be made in gold and local currency. The monetary unit of the Bank was to be the same as that of the Stabilization Fund, viz., unitas.

The Bank was to have powers to guarantee, participate in or make loans to any member country, or through the Government of such country to any business or industrial enterprise in that country, subject to certain conditions. The Bank might also guarantee, in whole or in part, loans made by private investors, provided certain conditions were fulfilled, or might participate in loans placed through the usual investment channels.

The Bank might engage in other operations with the approval of its members like (i) buying, selling, pledging or discounting any of its securities, (ii) borrowing from member governments, fiscal agencies, central banks, etc., and (iii) buying or selling of foreign exchange after consultation with the International Stabilization Fund.

BRETTON WOODS CONFERENCE

Towards the end of May 1944 President Roosevelt issued invitations to 'United and Associated Nations' to send their delegates to a conference to be held at Bretton Woods, New Hampshire, U.S.A., for 'formulating proposals of a definite character for an international monetary fund and possibly a bank for reconstruction and development'. The invitations explicitly stated that the delegates were not required to hold 'plenipotentiary powers'; and that the proposals formulated at the conference would be referred to the Governments of the participating countries for their acceptance or rejection. Forty-four nations, including India, participated in the conference, which came to be known as the United Nations Monetary and Financial Conference, lasting from July 1 to July 22, 1944.

The Governor of the Bank, along with the other members of the Indian Delegation, played a leading role, in pressing forward the case of the less developed countries generally and of India in particular. Incidentally, the participation of the Governor in the Delegation, as he stated later, led to a greater understanding and friendship between him and the Finance Member, Sir Jeremy Raisman, leader of the Delegation*. The size of the Indian Delegation (six in all) was small in comparison with those of countries like China, the U.S.A., Russia and the U.K., but it was ‘ a hand-picked and a high-powered one ‘. The Governor felt subsequently that there was a case for a larger delegation from India, considering its size and importance, and particularly since as many as four committees often sat at the same time.

Purposes of the Fund

Before the full-scale Conference at Bretton Woods, a preparatory meeting of technical experts from a limited group of countries was held at Atlantic City, New Jersey, for preparing a draft agenda to be submitted at the Conference. Sir Theodore Gregory was designated to attend this meeting on behalf of India; later, however, it was decided that the Finance Member and the Governor should also go to Atlantic City with a view to ensuring that the questions in which India was particularly interested were included in the draft agenda. The Indian Delegates secured the inclusion of two amendments to the purposes of the Fund, so as to provide for the following:

(i) ‘ to assist in the fuller utilisation of the resources of economically underdeveloped countries and (ii) to promote and facilitate the settlement of abnormal indebtedness arising out of the war ‘.

At the opening session of the Conference at Bretton Woods on July I, 1944, Mr. Morgenthau, the Secretary of the U.S. Treasury was elected President of the Conference. The Conference set up three Commissions, numbered respectively: I. International Monetary Fund, II. Bank for Reconstruction and Development and III. Other Means of International Financial Co-operation. Sir C. D. Deshmukh was nominated Chairman of Committee 4 of Commission II which went into the Form and Status of the Bank for Reconstruction and Development. As the meetings progressed, a large degree of specialised representation developed and Sir Chintaman and Sir Theodore attended meetings of Committees 3 and 4 of Commission I, which were concerned with organisation and management, and form and status, respectively, of the Fund. Later, the Committees of Commission II functioned at the

* The other members of the Delegation were: Sir Theodore Gregory, Sir R. K. Shanmukham Chetty and Mr. A. D. Shroff; the last two were non-officials. Dr. B. K. Madan, as already mentioned, was Secretary of the Delegation. Sir David Meek, Indian Trade Commissioner in London, was associated with the Delegation as Adviser.

same time as those of Commission I, and the Governor generally represented the Indian Delegation on the Committees of Commission II constituted to study the setting up of the Reconstruction and Development Bank, while the rest of the Delegation attended meetings of Commission I.

The Indian Delegation succeeded in securing an extension of the purposes of the Fund to cover economic development though not in terms of its first amendment tabled at the Atlantic City meeting. According to the Joint Statement by Experts, one of the purposes of the Fund was 'to facilitate the expansion and balanced growth of international trade and to contribute in this way to the maintenance of a high level of employment and real income, which must be a primary objective of economic policy'. The main change proposed by the Indian Delegation was insertion of the words 'to assist in the fuller utilisation of the resources of economically underdeveloped countries' after 'to facilitate the expansion and balanced growth of international trade'. The amendment received fairly widespread support; there was also some opposition to it on the ground that it went beyond the scope of the Fund. The para in the article as adopted read as under:

To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

As the Governor put it later,*

Our case rested on the proposition that poverty and plenty are infectious and that if the operation of an international body like that projected was not to grow lopsided, it was necessary to pay special attention to the development of countries like India with resources awaiting development. Our appeal was to enlightened self-interest.

The Indian Delegation was, however, unsuccessful in its efforts to get the Conference agree to the inclusion of the settlement of the abnormal indebtedness arising out of the war among the purposes of the Fund. In the meetings of Committee I, dealing with the purposes, policies and quotas of the Fund, the leader of the Indian Delegation drew the attention of the other delegations to the fact that the necessity of assisting the liquidation of abnormal war balances had been recognised in the earlier versions of international monetary proposals. Although the Indian Delegation recognised the difficulties in dealing with this matter, it was essential that the Fund should provide some assistance towards the solution of the problem.

* Talk to the Bombay Rotary Club, October 3, 1944.

The Indian proposal was supported wholeheartedly by the Egyptian Delegation but was opposed by the Delegations of the U.S.A., the U.K. and France. An alternative amendment, namely: 'The Purposes of the International Monetary Fund shall be: To assist a multilateral clearing of accumulated war balances', moved by the Egyptian Delegation was supported by India, but was likewise opposed by the U.S.A., the U.K. and France. Committee I decided to refer the matter to Commission I. The Indian Delegation circulated, before the meeting of the Commission, a revised amendment, toning down its earlier version and reading as under:

To facilitate the multilateral settlement of a reasonable portion of the foreign credit accumulated amongst the member countries during the war so as to promote the purposes referred to in subdivision 2, without placing undue strain on the resources of the Fund.

The Indian proposal was not seconded and therefore lost.

The main opposition to the Indian proposal was on the ground that the resources of the Fund would not be adequate to tackle the problem of the war balances of members; the British Delegation did recognise, however, that there was no essential conflict of interests between themselves and the Indians. Discussing the outcome of the Conference in his Rotary Club talk, Governor Deshmukh said:

Had we been allowed to develop our case, it would have been for a gold and dollar overdraft against only a small portion of the sterling balances which would enable us to get on with our development plans in the transitional period in the event of Great Britain finding her self unable to supply the kind of goods that we require. We should have asked for a temporary doubling of the quota. The U.K. objection to this was that it meant their asking a joint guarantee in respect of the repayment of such overdrafts over a period of years, a commitment which at present they could not undertake on account of the uncertainty in regard to their future balance of payments. The American objection, on the other hand, was that any such arrangement would mean an increase in the resources of the Fund, an increase which they dare not agree to in view of the already existing opposition to the scheme. It may be mentioned here that on political grounds, viz., to meet China and Russia, they did later on agree to an increase in the size of the Fund.

Although the Indian request was rejected, the Delegation was able to obtain a valuable assurance from Lord Keynes, the Leader of the British Delegation, to the effect that his country would 'settle honourably what was honourably and generously given'.

The work of the Indian Delegation was rendered difficult by the general misconception that existed in regard to sterling balances; every opportunity was taken by members of the Delegation to remove this and to clarify what an enormous amount of sacrifice the accretion of

these balances meant to the country's population. For the same purpose, a press conference was also held. The American press was generally apathetic to Indian utterances, but some sections of it recognised that the matter was not solely a bilateral affair, and it was just as much a concern of the U.S.A. and other countries to see that as much of the blocked purchasing power as possible was released for purchase of goods in the most advantageous markets.

The rejection of the Indian Delegation's proposal that settlement of war-time balances should be brought within the scope of the Fund caused much disappointment in India. According to the New Delhi correspondent of *Indian Finance* *, there was 'an almost general demand here for the recall of the Indian Delegation' from the Conference. The Governor was not, however, unduly worried over the decision at Bretton Woods in regard to sterling balances. In his address to the Bombay Rotary Club, cited earlier, the Governor observed:

The rejection of our request, especially in connection with sterling balances, need not, however, depress us unduly. It should be borne in mind that both the U.S.A. and the U.K. have their own special difficulties in regard to the carrying through of the scheme So far as we are concerned, there seems to be no hurry for making up our mind. We can afford to let the dust of controversy settle in order to be able to see things more clearly while the U.S.A. and the U.K. are making up their minds.

On our own part, instead of devoting too much attention to our possible attitude to the prospective Fund and the Bank, it would be more helpful if we devoted serious thought to considering what measures would be necessary to enable us to receive the payment that Britain might be in a position to make from time to time in the form of goods. In other words, we ought to get busy with our development planning and to consider what sort of controls and exchange rate would be appropriate in the circumstances of the case, the objective being the establishment of a suitable surplus of imports from the U.K. over exports representing the repayment of our sterling balances.

Quotas

Securing a satisfactory quota for India and also a permanent seat on the board of management of the Fund (and the Bank) was perhaps the most arduous of the Indian Delegation's tasks. The efforts of the Delegation met with limited success; not all that was desired was obtained. In view of the importance of quotas for membership it should be of interest to deal with this matter in some detail.

The Keynes Plan had suggested fixation of initial quotas based on volume of international trade of each member country, while the White

* July 15, 1944.

Plan provided for computation of quotas by an agreed upon formula giving due weight to the important relevant factors like a country's holdings of gold and free foreign exchange, the magnitude and fluctuations of its balance of international payments, its national income, etc. But the Joint Statement by Experts did not stipulate the basis for determining the quotas of individual members, the intention being to consult prospective participants before laying down any basis, since the matter was a complex one. It was, however, recognised that a satisfactory quota formula should give consideration to the multiple functions of the quota viz., (i) to determine a country's contribution to the Fund's resources, (ii) to define a country's normal degree of access to the Fund's resources and (iii) to indicate the economic significance of a country and its relative voice in the management of the Fund. Factors which ought to be taken into account for fixation of quotas were therefore: (i) national income -a good index of a country's ability to subscribe to the Fund's resources, (ii) a country's gold and exchange holdings, i.e., its international purchasing power (and therefore desirable assets for the Fund) and (iii) magnitude of fluctuations in a country's balance of payments, as indicated by imports and exports. Once the factors were decided upon, the points deserving due consideration were the weight age to be given to each of these factors and the period to be taken. In this context, it must be mentioned that the formula regarding quotas had to fit into a pattern of which the U.S. quota would be around \$2,750 million. Eventually, a crude formula suggested by the Division of Monetary Research of the U.S. Treasury Department was used during the discussions at Bretton Woods. This was:*

- (a) 2 per cent of national income, 1940;
- (b) 5 per cent of gold and dollar balances, July 1, 1943;
- (c) 10 per cent of average imports, 1934-38;
- (d) 10 per cent of maximum variation in exports, 1934-38; and
- (e) the sum of (a), (b), (c) and (d) increased by the percentage ratio of average exports to national income, 1934-38.

This is not to say that the quotas finally fixed strictly conformed to the above formula. In the words of the Indian Delegation:

In the actual statistical treatment of the elements in the formula, however, this last stage (refers to (e) above) has been combined with adjustments in consequence of the intangible factor of ' economic significance ' referred to above, and the precise determination of the Final result is not directly traceable to the terms of a definite formula.

* The Financial Structure of the Fund, by Rudolf Kroc, published by the International Monetary Fund, 1965.

It appears from records that some months before the Bretton Woods meeting, that is, in March 1944, the Government of India were advised by the India Office that provisional quotas had been suggested by 'the American', as under:

| | (\$ million) |
|--------------|--------------|
| U.S.A. | 2,900 |
| U.K. | 1,300 |
| Russia | 900 |
| China | 600 |
| France | 500 |
| Canada | 300 |
| India | 300 |
| Netherlands | 250 |
| Belgium. | 235 |
| Australia | 150 |
| South Africa | 150 |

The India Office and the Government of India were both unhappy that India's quota should be so low, viz., only \$300 million, as against \$600 million for China. To quote the India Office cable:

We pointed out objection to putting India so far below China and suggested parity. It was pointed out in reply that the case of China as one of four major United Nations is affected by special political considerations. Keynes then produced tentative revised quotas which would reduce China to 500 and raised India to 400 leaving U.S., U.K., Russia, France as before.

The Government of India's reply was:

It should be obvious that India's international liabilities both actual and potential are likely to be considerably more important than those of China and that moreover India is at present a very considerable creditor of the United Kingdom, a point to which Indian public opinion attaches the greatest importance. In these circumstances it is clear from the technical point of view that India requires and should receive a quota at least as large as that assigned to China. If there are special political considerations which weigh with His Majesty's Treasury as regards China, we would reply that special political considerations are equally relevant in the case of India.

We must emphasise that Indian public opinion is likely to be extremely sensitive on size of the quota and that any attempt to put India below China would gravely imperil acceptability of scheme.

According to the Indian Delegation, the increase proposed by Russia at the Bretton Woods Conference in her quota from \$900 to \$ 1,200 million, necessitated adjustments in the quotas of other countries. All discussions towards influencing the decision on quotas took place behind the scenes

of the Conference sessions, as it was felt inadvisable to allow adjustments and changes to be proposed and made in open Conference in this matter, after any fundamental accord arrived at outside the Conference.

The Indian Delegation, in a special meeting which it had with the U.S. Secretary of the Treasury on July 14, was informed that India's quota had been fixed at \$400 million, out of aggregate quotas of \$8,800 million for all the 44 countries represented at the Conference. It was explained by Dr. White that 'they had, to start with, applied an economic formula but had made necessary adjustments in the determination of final quotas to allow for the general (economic and political) significance of a country, which could not be quantitatively represented by the exact terms of a formula, apart from the fact that essential data were not available for certain countries'. In the American Delegation's view, India's quota was based 'on due recognition of India's economic significance'. With a quota of \$400 million India came sixth on the list, after the U.S.A., the U.K., the U.S.S.R., China and France (see table below).

(In millions of U.S. dollars)

| Country | Quota | Country | Quota |
|--------------------|-------|--------------------------|-------|
| Australia | 200 | Iraq | 8 |
| Belgium | 225 | Liberia | .5 |
| Bolivia | 10 | Luxembourg | 10 |
| Brazil | 150 | Mexico | 90 |
| Canada | 300 | Netherlands | 275 |
| Chile | 50 | New Zealand | 50 |
| China | 550 | Nicaragua | 2 |
| Colombia | 50 | Norway | 50 |
| Costa Rica | 5 | Panama | .5 |
| Cuba | 50 | Paraguay | 2 |
| Czechoslovakia | 125 | Peru | 25 |
| Dominican Republic | 5 | Philippine Commonwealth | 15 |
| Ecuador | 5 | Poland | 125 |
| Egypt | 45 | Union of South Africa | 100 |
| El Salvador | 2.5 | Union of South Socialist | |
| Ethiopia | 6 | Re-publics | 1,200 |
| France | 450 | United Kingdom | 1,300 |
| Greece | 40 | United States | 2,750 |
| Guatemala | 5 | Uruguay | 15 |
| Haiti | 5 | Venezuela | 15 |
| Honduras | 2.5 | Yugoslavia | 60 |
| Iceland | 1 | | |
| India | 400 | Total | 8,800 |
| Iran | 25 | | |

The Indian Delegation was not quite satisfied with the quota and along with the delegates of some other countries, Sir Jeremy Raisman, who was on the Committee on Quotas, entered a reservation. On behalf of India, Sir Jeremy observed:

they (the Indian Delegation) are aware of the strong feeling that prevails in their country that her economic importance should be duly recognized in any international economic institution of this character. It is not only a question of India's size, nor alone of her population, but that on purely economic criteria India is an important part of the world and will be an even more important part in the years to come. India is not disposed to argue about the absolute size of the quota in the manner in which some other countries might wish to do. She is more concerned about her relative position among the countries that form the general set-up of the Fund. India feels that if due regard is given to her economic importance, there should be no danger of her failing to acquire a due share in the councils of the institution. She recognises that other considerations may have been applied in the determination of the final quotas in the case of certain countries but feels that this procedure should not result in such a distortion of the economic merits of the case. In conclusion, I have to express my agreement with the representative of the Netherlands that it is not only a question of the quota but it is the arrangements relating to the management of the Fund that are our concern.

On his return to India, talking of the U.S. reluctance to support India's request, the Governor said:*

Here it was clear from the beginning that we were up against a foregone conclusion, a conclusion foregone not on any valid economic ground, but for political reasons. I should not like to attribute any specific statement to any member of the U.S.A. Delegation, but we gathered the impression that they were unwilling to support our request because of the fear that the inclusion of two permanent members from the British Empire might be misunderstood by the American public. It was no use our making it clear to them that we did not mind who else was included and that all we pressed for was that having regard to the size, significance, and any other economic criteria that might be chosen, India was entitled to take a continuous and active part in the deliberations of the Managing Committee. In an indirect way, the validity of our claim was recognised in that we were given a quota sufficiently large to ensure a seat for us in every election without any outside support. Thus, the conclusion might be regarded as meeting all our legitimate aspirations but not satisfying our national dignity.

It is interesting to know that at one stage, when it seemed that there was a danger of India's quota being fixed too low so as to endanger her chances of securing a seat on the management of the Fund even by election, the Governor advocated the withdrawal of the Indian Delegation. In this, he had the whole-hearted support of the two nonofficial members, Sir R. K. Shanmukham Chetty and Mr. A. D. Shroff. The Finance Member disagreed initially, thinking 'that this was another manifestation of the unfortunate Indian tendency to non-co-operate'. Half an hour later, he told Sir Chintaman that he had

* Talk to the Bombay Rotary Club.

thought over the matter and he was convinced that 'withdrawal was the only honourable course to take should there be no improvement in the proposed quota for India'. His determination was doubtless largely responsible for securing a favourable result. It would appear that the British Delegation had also had a hand in persuading the U.S. delegates to agree to the increased quota of \$400 million for India.

Executive Directors

Turning to the allied matter of the Executive Directorate of the Fund, the Joint Statement by Experts had stated that 'the executive committee shall consist of at least nine members including the representatives of the five countries with the largest quotas '. The Indian Delegation made an unsuccessful effort for increasing the number of appointed directors from five to six. (Eventually, when the U.S.S.R. decided not to join, India automatically became one of the five countries entitled to appoint an Executive Director on the Fund and the Bank, that is to say, without having to go through the process of election.) The provisions finally agreed upon were:

- (1) increase in the number of executive directors to not less than twelve, of whom five shall be appointed by the five members having the largest quotas;
- (2) reservation of two executive directorships for election by the American Republics; and
- (3) provision for the representation on the Fund's Directorate after two years of the Fund's functioning, of the two largest creditor countries on current account, if not already represented thereon.

One of the provisions included in the Final Act which was actively supported by the Indian Delegation was that the Executive Directors should reside at and function in continuous session at the principal office of the Fund. Another provision relating to the staff which was adopted at the instance of the Indian Delegation, supported by the United Kingdom Delegation, was that in appointing the staff the Managing Director should pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible.

It would be appropriate to conclude the brief account of the deliberations of the Bretton Woods Conference by quoting from Lord Keynes's closing address to the delegates, on the night of July 22, moving the acceptance of the final Statutes of the Fund and the Bank.

We . . . have been trying to accomplish something very difficult to accomplish. It has been our task to find a common measure, a common standard, common rule applicable to each and not irksome to any. We have been operating, moreover, in a field of great intellectual

and technical difficulty. We have had to perform at one and the same time the tasks appropriate to the economist, to the financier, to the politician, to the journalist, to the propagandist, to the lawyer, to the statesman -even, I think, to the prophet and to the soothsayer. Nor has the magic of the microphone been able, silently and swiftly perambulant at the hands of our attendant sprites, the faithful Scouts, Puck coming to the aid of Bottom, to undo all the mischief first wrought in the Tower of Babel.. . . .we have perhaps accomplished here in Bretton Woods something more significant than what is embodied in this Final Act. We have shown that a concourse of 44 nations are actually able to work together at a constructive task in amity and unbroken concord. Few believed it possible. If we can continue in a larger task as we have begun in this limited task, there is hope for the world.

According to the Articles of Agreement of the International Monetary Fund adopted at the Conference, original membership of the Fund was confined to countries represented at the Conference whose governments accepted membership before December 31, 1945. A similar condition was operative for original membership of the Bank; in addition, membership of the Fund was a prior condition for membership of the Bank, for original as well as subsequent members. On behalf of the Government of India, the Articles of Agreement relating to the Fund and the Bank were signed by the Agent-General for India in Washington on December 27, 1945 along with representatives from several other countries participating in the Bretton Woods Conference. The approval of the Legislative Assembly for the Fund and Bank agreements was obtained in October 1946. The Reserve Bank played an important part in explaining to the Legislature the Bretton Woods arrangements and securing its approval. These and the subsequent developments in regard to India's membership of the I.M.F. and the I.B.R.D. and her use of their resources are dealt with in a later chapter.

Commercial Banking Developments

The Second World War had a tremendous impact on the Indian banking system. There was a phenomenal growth of banking, in terms of resources as well as number of offices, under the stimulus of monetary expansion and the large-scale war effort. The Indian banking system as a whole withstood the strains of the war period very well and displayed remarkable resilience and vigour in several directions. There is no doubt that there was also growth of the banking habit in the country. However, the war-time banking structure presented several disquieting features too, which were particularly marked in the case of the newly established units. While the needs of the economy during the war warranted a rapid expansion of banking and there was certainly room for some new institutions, there was a pronounced tendency for opening banks with little intrinsic strength in the form of a sound capital structure and liquidity of assets; more serious was the rather indiscriminate opening of branches and the employment of unsound methods to attract deposits. The motives behind several of the new banking ventures were not altogether legitimate or worthy. There was evidently a desire to get control over public funds for speculative investments and trading activities and also for pecuniary gains in many ways through excessive salaries, bonus, commission, etc. There was again, in some cases, a desire on the part of industrial houses to have under their control sizeable banking and insurance establishments; this interlocking of interests between banks, insurance companies and industrial concerns was generally detrimental to the interests of bank depositors. There was moreover, in some cases, the dressing up of accounts to give a misleading impression of the financial position of the bank. A number of banks also engaged in dubious devices to become eligible for inclusion in the Second Schedule.

These developments lent urgency to the passing of comprehensive banking legislation. Unfortunately, this did not materialise during the war period. In the early years of the war, the Bank itself desired postponement of such legislation; in the later war years, the new Governor made every possible effort to get the measure enacted but this did not prove possible owing to circumstances beyond the Bank's control. However, some ad hoc enactments were made to deal with some specific abuses and shortcomings of the banking system. The Reserve Bank spared no pains to have an adequate statutory base for the regulation of the banks on sound yet progressive lines. The Bank's contacts with the commercial banks, both scheduled and non-scheduled, became much closer during the war; these would in any case have taken place, but the war developments made it all the more imperative on the part of the Bank to be in a position to keep a close watch on the banking system.

During the war years banks did not have to seek much accommodation from the Reserve Bank, since there was a very marked expansion of deposits and there were no corresponding avenues for lending; in the result, the bulk of the funds came to be invested in Government securities. The Bank's assistance was sought mainly on occasions when, because of war developments, there was a temporary run on some banks. Nevertheless, the Bank tried to enlarge to some extent the availability of funds to the banks through loans and discounts. While the principal forms of assistance were by way of purchase of and loans against Government securities, arrangements were also made to provide accommodation under Section 17(2)(a) or 17(4)(c) of the Reserve Bank Act against usance promissory notes supported by bills in respect of Government supply contracts. But, as already mentioned, the Bank's actual lending to the scheduled banks was negligible, the largest outstanding accommodation being in the neighbourhood of just Rs. 1 crore. Another direction in which the Reserve Bank tried to assist the banks and indirectly the balanced development of the national money market was the liberalisation of remittance facilities. These facilities were also extended to approved non-scheduled banks and indigenous bankers. A further promotional measure, which was largely the result of the Bank's efforts, was the reduction, in 1940, in the stamp duty on commercial bills and promissory notes, to a nominal level of two annas per Rs. 1,000 or part thereof.

Towards the close of the war, the Bank started taking interest in the subject of industrial finance. In a statement which the Government of India issued on April 21, 1945, outlining among other things, their plan for the future industrial development of the country, it was stated that the question of the promotion of an Industrial Investment Corporation or a similar institution, for providing long-term funds for industry, was

being examined by Government. In the General Purposes Sub-Committee appointed by the Department of Planning and Development, it was generally agreed that the question was one of urgency and should be examined by the Finance Department in consultation with the Reserve Bank. In implementation of this decision the Bank prepared a comprehensive study on the subject in the middle of 1945; its conclusion was that the most suitable financial institution would be one owned jointly by Government, Reserve Bank and institutional and other investors, with the power not only to lend but also to underwrite issues of share and debenture capital. The Bank's proposals were generally accepted by Government and the Bank was entrusted with the task of the formulation of a detailed plan, including a draft bill. These efforts culminated in the establishment of the Industrial Finance Corporation of India in 1948. The developments in this regard will be discussed in detail in the section relating to the period 1945-51

War- time Banking Growth

The growth of commercial banking, which was most marked in the latter part of the war period, is indicated in the table below, relating to the scheduled banks.

(Rs. crores)

| Last Friday of | | No of Reporting Schedules Banks* | Liabilities | | | Cash and Balances with in Reserve Bank | Advances and Bills Discounted |
|----------------|------|---|-------------|------|-------|--|-------------------------------------|
| | | | Demand | Time | Total | | |
| August | 1939 | 55 | 135 | 103 | 238 | 34 | 105 |
| December | 1939 | 56 | 139 | 101 | 240 | 26 | 143 |
| " | 1940 | 57 | 166 | 97 | 263 | 57 | 100 |
| " | 1941 | 58 | 213 | 108 | 321 | 42 | 125 |
| " | 1942 | 62 | 334 | 111 | 445 | 60 | 99 |
| " | 1943 | 74 | 501 | 158 | 659 | 117 | 168 |
| " | 1944 | 84 | 617 | 203 | 820 | 109 | 250 |
| " | 1945 | 91 | 673 | 280 | 953 | 122 | 327 |

* Excluding Burma scheduled banks; figures in other columns exclude those in respect of the Burma branches of Indian scheduled banks.

† Figures include those relating to Burma banks up to the end of 1941; the amounts in respect of Burma banks are, however, negligible.

With the extension of the war to Burma in December 1941, scheduled banks in India with branches in Burma found it increasingly difficult to submit returns prescribed by Section 42 of the Reserve Bank Act in

respect of their business in that country. To relieve their difficulties, the Reserve Bank of India (Temporary Amendment) Ordinance was issued in February 1942, amending temporarily Sections 42(1) and (2) and 43 of the Act, so as to omit all references to Burma. The effect of the Ordinance was that scheduled banks in India were not required to include their liabilities in Burma for the purpose of computing the statutory cash reserves with the Bank; their returns would reflect their position in India only. The provisions in the Burma Monetary Arrangements Order stipulating compliance by Burma scheduled banks with the conditions regarding maintenance of minimum cash balances with the Reserve Bank or submission of the weekly (or monthly) returns remained in abeyance, for all practical purposes, until June 1946 when they were deleted. Thus, after 1942, there was practically no statutory relationship between the Reserve Bank and banks in Burma.

The increase of thirty-five in the number of scheduled banks in the six years between 1939 and 1945, as against the increase of under ten in the pre-war years, was about equally divided between newly established units and existing units which acquired the scheduled status. The liabilities (mostly deposits) of scheduled banks rose by almost 300 per cent, demand liabilities recording a much larger rise than time liabilities. On the assets side, the principal changes were a decline in the share of advances and bills and an increase in investments mostly in Government securities. The advances-deposits ratio, which on the eve of the war was about 44 per cent rose sharply to 60 per cent by the end of 1939; over the subsequent three years, there was a significant contraction of credit and so the ratio declined. From 1943, scheduled bank credit rose rather sharply; even so, the ratio at the end of 1945 was only around 35 per cent owing to the steeper rise in deposits. Investments of Indian scheduled banks, mostly in Government securities, showed a nearly 500 per cent increase during the period from Rs. 75 crores to Rs. 433 crores, representing roughly three-fifths of the increase in deposits *. Apart from the war-time necessity to have a large portfolio of Government securities, banks found it quite profitable to do so, since these securities carried a yield of 3 per cent or more, whereas banks paid either no interest or negligible interest on demand deposits, which constituted the major portion of their total deposits, and the rates prevailing on time deposits too were comparatively low at $\frac{1}{2}$ to $1\frac{3}{4}$ per cent. The above phenomenon also, to some extent, contributed to the spurt in the starting of new banks and the tendency to open a large number of branches.

* Figures relating to investments of scheduled banks have not been shown in the table on p. 438 as they were not available from the returns under Section 42(2) of the Reserve Bank Act, on which it is based. The data are available in respect of Indian scheduled banks from their balance sheets. However, as the balance sheets of exchange banks relate to their global position, consolidated figures for all scheduled banks cannot be given.

Non-scheduled banks also shared in the deposit growth during the period although there was a decline in their number, as may be seen from the following table.

(Rs. crores)

| <i>Last Friday of</i> | <i>No. of Banks Submitting Returns</i> | <i>Demand and Time Liabilities</i> | <i>Cash Balances</i> |
|-----------------------|--|--|--------------------------|
| 1939 | 609 | 16 | 1 |
| 1940 | 604 | 17 | 1 |
| 1941 | 601 | 20 | 2 |
| 1942 | 534 | 25 | 3 |
| 1943 | 530 | 35 | 5 |
| 1944 | 613 | 53 | 6 |
| 1945 | 632 | 74 | 9 |

The substantial rise in the number of branches, especially in the latter half of the war period, may be seen from the table below.

| Year | Imperial Banks of India | Exchange Banks | Other Schedules Banks | Total Scheduled Banks | Non Scheduled Banks with Paid-up Capital and Reserves of Rs. 5 lakhs and over | Non Scheduled Banks with Paid-up Capital and Reserves of Rs.50,000 to Rs.5 lakhs | All Banks |
|------|-------------------------------|-------------------|-----------------------------|-----------------------------|---|--|--------------|
| | | | | | | | |
| 1940 | 383 | 87 | 844 | 1,314 | 105 | 545 | 1,964 |
| 1941 | 393 | 84 | 937 | 1,414 | 204 | 678 | 2,296 |
| 1942 | 392 | 84 | 971 | 1,447 | 263 | 869 | 2,579 |
| 1943 | 399 | 84 | 1,395 | 1,878 | 400 | 996 | 3,274 |
| 1944 | 421 | 79 | 1,944 | 2,444 | @ | @ | @ |
| 1945 | 428 | 77 | 2,451 | 2,956 | 811 | 1,434 | 5,201 |

@ Not available.

It will be seen that the tendency for expansion was particularly noticeable among the smaller banks. New offices were opened without careful preliminary prospecting. This resulted in the opening of too many branches in places which already had banking facilities. For instance, between 1942 and 1945, of the increase of over 1,500 in the number of offices of scheduled banks, only 217 offices were opened at places which were not previously served by either a scheduled bank or a non-scheduled bank having capital and reserves above Rs. 50,000.

EXTENSION OF FACILITIES TO BANKS AND INDIGENOUS BANKERS

The establishment of a sound banking system called for close surveillance by the Reserve Bank and legislation was necessary to clothe the Bank with the requisite powers in this behalf. Simultaneously, action was necessary to integrate the money market further and narrow the

variations in interest rates arising from regional as well as seasonal imbalances in the supply of and demand for funds. A brief account may first be given of the action taken in this area, namely, arrangements for an adequate system of remittances and the promotion, to an extent, of the bill market habit through reduction of the stamp duty on usance bills and promissory notes. The Bank also extended to non-scheduled banks the facility of opening of accounts with it (i.e., the Reserve Bank).

Scheme for Remittance Facilities, 1940

Provision of adequate remittance facilities constitutes one of the important means of narrowing seasonal and regional stringency in the money market and of unifying the national monetary and credit system. From 1935 onwards, the scheduled banks were enjoying certain facilities for effecting remittances (free of charge or at lower rates than those charged to other banks and the general public) between the accounts kept by them with the Reserve Bank and its agency, viz., the Imperial Bank*. The available facilities suffered from certain shortcomings. For instance, even the scheduled banks had no special facilities for transfers to and from places at which there were no offices of the Bank or branches of the Imperial Bank. For transfers to and from such places, they had to pay the same rates as the general public, viz., 1/16 per cent for Rs. 10,000 and over; 1/8 per cent for Rs. 1,000 up to Rs. 10,000; and 1/4 per cent for less than Rs. 1,000. Secondly, the existing facilities were not available to even the relatively larger and well managed non-scheduled banks or indigenous bankers; nor did the co-operative banks and societies enjoy these facilities except for certain limited types of remittances. Further, the remittances were effected in obsolete forms such as Currency Telegraphic Transfers, Supply Bills, Remittance Transfer Receipts, etc.

With the object of liberalising the facilities and altering the forms of remittance in a manner more consonant with ordinary banking practice, the Bank introduced in October 1940 a new scheme of remittance facilities. The principal features of the scheme were as follows:

* The facilities covered the remittances of money as follows:

- (a) an amount of Rs. 10,000 or a multiple thereof, between the scheduled bank's accounts at the offices and branches of the Reserve Bank, free of charge;
- (b) once a week an amount of Rs. 5,000 or a multiple thereof, to the account which the scheduled bank maintained with the principal office of the Reserve Bank from any place at which it had an office, branch, sub-office, or pay-office, and at which there was an agency of the Reserve Bank, free of charge;
- (c) other remittances to its account at the principal office of the Reserve Bank, subject to a charge of 1/64 per cent, and
- (d) other remittances through the Reserve Bank or its agency, subject to a charge of 1/16 per cent for amounts less than Rs. 5,000 and 1/32 per cent for amounts of Rs. 5,000 and above.

(i) The old forms of remittance were discontinued and were substituted by telegraphic transfers, mail transfers and Government and bank drafts.

(ii) For scheduled banks, the existing facilities were continued and, in addition, telegraphic transfers, mail transfers and drafts in favour of third parties were allowed, subject to certain limits on drawings on Treasury agencies, at the following rates; $1/16$ per cent for amounts up to Rs. 5,000 and $1/32$ per cent over Rs. 5,000. These rates were considerably lower (generally 50 per cent) than the earlier rates, already referred to. All the Treasuries and sub-Treasuries with currency chest facilities were designated as Treasury Agencies of the Reserve Bank for the issue and payment of telegraphic transfers and drafts.

(iii) The scheme was, for the first time, made applicable to such non-scheduled banks and indigenous bankers as were included in an approved list to be compiled by the Bank. These were to be charged the same rates as those charged to the scheduled banks for remittances in favour of third parties, viz., $1/16$ per cent up to Rs. 5,000 and $1/32$ per cent over Rs. 5,000.

For inclusion in the approved list, non-scheduled banks and indigenous bankers were to have a minimum owned capital of Rs. 50,000. Only those indigenous bankers who accepted deposits and/or discounted hundies with joint-stock or other banks primarily with a view to making loans were eligible to apply for inclusion. Besides, an approved non-scheduled bank or indigenous banker had to conform to any banking or moneylending regulation that might be in force in the respective Province. At the end of December 1945, there were seventy-nine non-scheduled banks and four indigenous bankers on the approved list for remittance facilities.

(iv) The scheme was also extended to co-operative banks and societies (see Chapter 16). These institutions were to be charged the same rates as those charged to scheduled banks for remittances in favour of third parties, i.e., $1/16$ per cent up to Rs. 5,000 and $1/32$ per cent over Rs. 5,000, except that the minimum commission per remittance was fixed at four annas for co-operative banks and societies as against Re. 1 for eligible commercial banks and indigenous bankers.

Thus, the remittance facilities were simplified and extended to cover the entire banking system in a uniform measure, except that the scheduled banks were allowed certain additional facilities for effecting remittances between the accounts maintained by them with the offices of the Reserve Bank or the Imperial Bank.

Reduction of Stamp Duty on Promissory Notes

Mention has been made in Chapter 6 of the keen interest shown by the Bank's Board to get the stamp duty on bills reduced by the Government with a view to popularising the use of bills for commercial transactions. The duty payable up to 1940 was on an ad valorem basis according to the schedule of rates prescribed by the Indian Stamp Act as far back as 1912. For instance, the duty payable on a bill of exchange or time promissory note of Rs.1,000 was fifteen annas. In January 1940, the Central Government reduced the stamp duty on inland bills of exchange of not more than one year's usance to two annas per Rs.1,000 or part thereof. The relative modification, however, omitted promissory notes from its scope; inasmuch as the vast majority of inland bills in India were drawn in the form of promissory notes, the higher rates of duty on them caused considerable inconvenience to the business community who were forced to draw their usance bills in the form of bills of exchange in order to obtain the benefit of reduction of the duty. This anomalous position was pointed out to the Central Government by the Bank in April and October 1940, with the request that the reduction be made applicable to promissory notes as well. The Central Government agreed to the Bank's suggestion and by a notification issued in November 1940 reduced the stamp duty on inland promissory notes payable otherwise than on demand and of not more than a year's usance to two annas per Rs. 1,000 or part thereof, with retrospective effect from the date of the original modification.

Opening of Accounts by Non-Scheduled Banks

On a representation received from certain non-scheduled banks, the Bank agreed to allow non-scheduled banks to open accounts with it with effect from February 1945. The opening of accounts was to be at the absolute discretion of the Bank and be subject to the following terms and conditions:

- (i) the bank should maintain a minimum balance commensurate with the volume of business transacted and in no case less than Rs. 10,000;
- (ii) the account should not be treated as an ordinary current account by issuing cheques in favour of third parties, but could be used for remittance purposes and inter-bank transactions;
- (iii) no interest would be allowed on balances maintained in the account;
- (iv) a bank would be allowed to open an account only at the office of the Reserve Bank within the Province in which the bank's principal office was situated; and

(v) the Reserve Bank could refuse to open an account or could close an account without assigning any reason.

At the end of 1945, eleven non-scheduled banks had been approved for opening accounts with the Bank.

BANKING REGULATION

As already explained, even in the pre-war years, the Bank gave considerable attention to the problem of regulating the banking system so as to eliminate the prevailing unhealthy features and unsound practices. These features assumed rather serious dimensions in the war period necessitating immediate action, albeit on an ad hoc basis. The various developments in the sphere of banking regulation may now be discussed.

Regulation of 'Scheduled' Status

The position at the commencement of the war period was that banks having paid-up capital and reserves of Rs. 5 lakhs and over were included or retained in the Second Schedule, more or less as a routine, irrespective of their financial position, as the returns submitted by them were not adequate for such an assessment and the Bank had no statutory power of inspection of their affairs. The Bank felt the necessity of knowing more of the methods of operation of such banks as approached it for assistance. This contingency arose when, with the intensification of the hostilities in May 1940, some scheduled banks experienced withdrawal of deposits due to a certain degree of nervousness among depositors. The scheduled banks, on the whole, had no difficulty in meeting the withdrawals; nevertheless, the Reserve Bank issued a circular letter in June 1940, advising scheduled banks that if they needed assistance from the Bank by way of rediscounting of bills, they would have to provide continuous information about their position and working. The circular also mentioned that it might be necessary for an officer of the Bank to pay a visit to the scheduled bank desiring accommodation in order to have a clearer idea of its financial position. It was made clear that the Bank would be prepared to give assistance to scheduled banks only if it was satisfied that their business was run on sound lines and on condition that any advances granted by the Bank would be utilised by them solely for the purpose of tiding over their difficulties and not for increasing their lending or investments.

Some important modifications were also made in the manner of implementing the statutory requirement that a bank must have paid-up capital and reserves of an aggregate value of not less than Rs.5

lakhs to qualify for the scheduled status. Hitherto, the general practice was for the Bank to be satisfied about this condition on the basis of the book value shown in the balance-sheet. Since this was found to lend itself easily to abuses on the part of non-scheduled banks aspiring for inclusion in the Second Schedule, the Central Government, in consultation with the Bank, decided that the words 'aggregate value of paid-up capital and reserves' occurring in Section 42 (6) of the Reserve Bank Act should be interpreted to mean the real or exchangeable value of paid-up capital and reserves and not merely the book value as shown in the balance-sheet. In pursuance of this decision, a new procedure for inclusion of banks in the Schedule was drawn up under which the Bank agreed to co-operate with the Government in evaluating the value of capital and reserves. Under this procedure, on receipt of an application from a bank, the Reserve Bank would, in the first instance, scrutinise the balance-sheets of the applying bank and if, as a result of the scrutiny, the Bank found the affairs of the bank were above board, it would recommend the bank for inclusion in the Second Schedule forthwith. If, however, the Bank considered that further details were required before an opinion could be expressed on the applicant bank's position, the Bank would request the Government to require the bank concerned to fill in the usual 'inspection' forms, which could give a fairly accurate picture of the bank's position. In cases where the balance-sheets revealed an unsound position, the Reserve Bank would inform the Government that an inspection of the applicant bank's books was necessary before it could be recommended for inclusion. Such inspection would take a week or less and be carried out by an officer of the Bank on behalf of the Government and with the consent of the applying bank. The report of the inspection, with the Bank's recommendations, would then be submitted to the Government for decision on the question of admission to the Schedule.

In terms of the new procedure, several banks were inspected by the Bank and many among them were considered ineligible for inclusion in the Schedule on the score of the real or exchangeable value of the paid-up capital and reserves being less than Rs. 5 lakhs. In 1941, as desired by the Government, the Bank submitted a list of banks already included in the Schedule but whose capital and reserves were suspected to have fallen below the prescribed minimum. Government thereupon issued notices to some of the banks stating that they desired to be satisfied whether the banks continued to fulfil the conditions requisite for retention in the Schedule and seeking their willingness to permit the Bank to inspect their books and accounts for the purpose. Most of the banks signified their assent for inspection; but before the programme of inspection could be completed, war developments and the consequent disturbance of rice made it temporarily difficult to evaluate the banks'

assets accurately and necessitated partial postponement of the programme. With the return of relatively stable conditions in 1942, the work was resumed. On the basis of the inspection, one bank was excluded from the Schedule in June 1943.

Although the inspections were undertaken by the Bank for a limited purpose and, that too, with the consent of the banks concerned, they did give the Bank an insight into the general financial position and working of the banks and afforded the basis for many of the clauses to be incorporated in subsequent banking legislation. From 1939 through February 1944, the Bank inspected about thirty banks.

Statutory Reserves -Reserve Bank (Amendment) Act, 1940

Ever since the closing of the doors of the Travancore National and Quilon Bank in 1938, the Bank's management was greatly concerned over the difficulty in the administration of Section 42 (1) of the Reserve Bank Act, which stipulated the maintenance with the Bank of a daily balance of not less than five per cent of demand liabilities and two per cent of time liabilities by each scheduled bank. The TNQ Bank had been in persistent default for over two months before it suspended payment. The Reserve Bank had asked it to rectify the position; and on its expressing its inability to do so, the matter had been referred to the Central Government whose sanction was necessary under Section 42(5) for any legal action under the Section. The Government had replied after taking legal opinion that the Bank had no statutory power to compel a scheduled bank to raise its deposits to the required minimum inasmuch as sub-section (4) of the Section provided a penalty for non-compliance and that the ordinary legal principle was that where a Section in an Act laid down that something should be done and in the same Section provided a penalty for not doing it, no other remedy was legally enforceable.

The Bank then enquired from Government whether it could refuse to allow a scheduled bank to draw on its account when the balance was below the minimum. Government again replied after taking legal advice that for the same reason the Bank had no power to do so. A third possibility, viz., the issue of a communique to the public, drawing attention to the non-compliance regarding maintenance of the prescribed minimum balance, was also explored, but the Bank was advised by its solicitors that such publication would be ultra vires, since the necessary power could be conferred upon the Bank only by an amendment of the Act and not by a mere amendment of the regulations made there under. Further, it was pointed out that publication of such information would immediately cause a run on the concerned bank and almost certainly force it to close its doors.

The position was thus unsatisfactory, especially because it left the public in ignorance of the fact that a bank had been persistently in default. Of course, the original intention in prescribing a minimum deposit was primarily to provide a credit pool which would be at the disposal of the Bank and not to give security to the depositors of the scheduled banks. Even so, the Bank felt that steps should be taken to rectify the anomalous position of defaults by banks. However, in view of the prevailing scare in Southern India after the TNQ Bank crash, the Bank contented itself with writing to each bank, which seemed to it to require correction after examination of its balance-sheet, pointing out the tendency among scheduled banks to overtrade and impressing on the bank concerned the necessity to restrict its advances to a maximum of 60 per cent of its total deposits and keep the balance in liquid form, that is, cash, Government securities, etc. Scheduled banks were also advised that they should, as a measure of prudence, augment their reserve fund until it equalled the paid-up capital, notwithstanding the fact that the provisions of Section 277K of the Indian Companies Act, 1936, compelling banks to build up their reserve fund, had not been made applicable to scheduled banks. The Legislature had felt that in the case of scheduled banks less rigidity was necessary and that the matter could be left to the general supervision and advice of the Reserve Bank.

The Central Board of the Bank had decided in July 1938 that consideration of the action to be taken in case of defaults by banks should be deferred until the liquidation proceedings pending with the courts were over. The matter, however, came up again for consideration in connection with the defaults committed by a bank in the Calcutta area. Thereupon a reference was again made to the Central Government in May 1939 requesting them to bring forthwith to the notice of the public that it was a misapprehension to think that Section 42 was meant to afford real protection to the depositors and that there was no legal impediment in the Act to the withdrawal of those deposits on payments of penal interest by the defaulting bank. The letter was subsequently published by the Government.

In view of further persistent defaults by some of the scheduled banks, the Central Board desired in August 1940 that early action should be taken to tighten up the effectiveness of Section 42 of the Reserve Bank Act in advance of the consideration of general banking legislation. The Board desired, in particular, that the Governor should consider whether the penal provisions of Section 277L of the Companies Act (i.e., imposition of fine on every director or other officer of the bank knowingly and willfully a party to the default) could not be made applicable to recalcitrant cases.

The Governor accordingly examined the question in all its ramifications and considered certain alternatives, such as: (i) vesting of

authority in the Bank to examine the affairs of the bank committing default persistently and to ascertain whether it was due to temporary difficulties or mismanagement, (ii) prohibition of the bank from taking fresh deposits or granting advances or declaring dividend, (iii) removal of the bank from the Second Schedule, and (iv) publication of the name of the defaulting bank. On careful study, all the above alternatives were found unsuitable.

Suggestion (i) was considered undesirable as it would have involved a fundamental change in the scope of Section 42. The criterion for inclusion in the Schedule was the size of the bank and not its soundness. Secondly, the solvency or otherwise of a bank could not possibly be judged by the small percentage of cash reserve held, without regard to its other assets. Suggestions (ii) and (iii) were also likewise considered by the Bank as too far-reaching. The last suggestion had already been discounted as causing unnecessary publicity and possibly scare. Ultimately, the Governor recommended to the Board the imposition of a penalty (i.e., fine) analogous to that provided in Section 277L of the Indian Companies Act, for non-scheduled banks. The Board approved the above proposal in October 1940 and suggested that an additional clause be provided for in the proposed amendment of Section 42 of the Reserve Bank Act to the effect that the Bank might at its discretion cause a notice to be served on the defaulting bank prohibiting it from receiving any fresh deposits and imposing a suitable punishment for any breach committed against such prohibition.

Legislation was introduced by the Central Government on the lines suggested by the Bank's Board and the Reserve Bank of India (Third Amendment) Act, 1940, became effective November 1940. Under this Act, every Director and officer of a scheduled bank who was knowingly and willfully a party to the default -the period being specified in the Section -was punishable with fine which could extend up to Rs. 500 per day; besides, the Bank could prohibit a scheduled bank from receiving fresh deposits. Similar penalty was to be levied if the bank accepted fresh deposits in contravention of the embargo laid by the Reserve Bank.

Control of Capital Issues

Alarmed at the rate of growth of mushroom companies, generally as well as in banking and insurance sectors, and with the object of preventing undesirable capital reconstruction practices as well as the diversion of funds from the defence effort, the Central Government published in May 1943 an amendment to the Defence of India Rules, inserting a new Rule, 94-A, to control capital issues. This Rule prohibited the floatation of new companies or raising of any fresh capital by the sale



Fifth Annual Meeting of the Boards of Governors of the I.M.F. and the I.B.R.D.

(Left to right) : Mr. Eugene R. Black, President, I.B.R.D., Sir Chintaman D. Deshmukh, Chairman of the Boards of Governors, Mr. Vincent Auriol, President of French Republic and Mr. Maurice Petsche, French Finance Minister.



Sir Chintaman Deshmukh (centre) with Mr. S. Sundaresan (to his left) and Mr. B. V. Joshi (to his right), at annual meeting of Board of Governors of the I.M.F. and the I.B.R.D.

of shares, stocks, bonds and debentures without the consent of the Central Government. Applications for capital issues by banks (and insurance companies) were referred to the Reserve Bank for its comments. The Bank had to keep in view, while judging the applications on their individual merits, the overriding consideration of promotion of healthy banking development in the country as also the need for strengthening the capital structure of the existing banks, which in the case of the vast majority of the Indian banks was weak. For instance, on December 31, 1943, in British India, there were 585 banking companies, of which only 82 (apart from the exchange banks) had paid-up capital and reserves of over Rs. 5 lakhs each, while 135 had between Rs. 1 lakh and Rs. 5 lakhs each and the remaining below Rs. 1 lakh each.

The disposal of applications from banks for capital issues by the Reserve Bank in the period between May 1943 and November 1944 is indicated in the table below.

| | Total No. of Banks applying | Total No. of Applications | Recommended | |
|-------------------------------------|--------------------------------|------------------------------|----------------|---------------|
| | | | For Acceptance | For Rejection |
| New floatations (proposed banks) | 60 | 67 | 34 | 33 |
| Existing | | | | |
| Scheduled banks | 46 | 72 | 49 | 23 |
| Non-scheduled banks | 206 | 265 | 117 | 148 |
| | 312 | 404 | 200 | 204 |

The largest number of applications came from Bengal (153)) followed by Madras (76), Bombay (45) and the Punjab (37).

At a Conference of joint-stock banks of South India held in Madras in November 1944, one of the complaints ventilated was to the effect that the Department of Examiner of Capital Issues in conjunction with the authorities of the Reserve Bank was standing in the way of the smaller banks strengthening their capital structure. This, on examination by the Bank, was found to be baseless. In fact, out of 76 applications from the Madras Province received up to November 1944, as many as 45 had been recommended for acceptance.

In a memorandum on the subject submitted to the Central Board in December 1944, the Governor explained that the applications were sanctioned on the basis of criteria such as the promotion of the company having reached an advanced stage, conversion of indigenous banking concerns into joint-stock companies, helping backward communities, serving places with inadequate banking facilities and good standing of the promoters. The rejection of applications in the case of new

floatations was mainly on the score of unsatisfactory reports on the standing of the promoters and the proposed areas of operation being already over banked. In the case of existing banks, unsound financial position and methods of operation formed the main reason for rejection; in a few cases, there was over-capitalisation. The Governor elucidated that 1:10 was usually regarded by the Bank as the normal ratio which should roughly exist between owned resources (paid-up capital and reserves) and deposits. This ratio, he added, was not, however, a rigid one nor was it the sole criterion adopted by the Bank. Each proposal was regarded on its merits, the underlying idea being whether the sanction would be in the best interests of the bank's shareholders and depositors and whether it would assist banking development.

The President of the Madras Local Board was rather critical of the Bank's policy with regard to capital issues control. An important point he made was that for its proper administration, control over the establishment of branches by banks was necessary. The Governor expressed the opinion that regulation and control over branch banking by the Bank was impracticable; any such regulation and control had to be based on a commercial survey, which was not there. Further, he said, the regulation to be effective had to be continuous. Later, however, the indiscriminate branch expansion during the years 1943-45 moved the Governor to sponsor legislation to regulate the opening of branches.

Proposals for a Bank Act

The Reserve Bank's proposals for a Bank Act, which were, as stated in Chapter 6, sent to the Government of India in November 1939, were circulated by the Government in January 1940 among banks, banking and commercial associations, prominent members of the public and the press, with the request that the replies be sent to the Reserve Bank (with a copy to Government) within a period of six months. The replies received indicated that, by and large, the draft Bill was welcomed by the business community and their associations. In fact, some of them, particularly the Federation of Indian Chambers of Commerce and Industry, felt that the proposed Bill was too limited in scope as it did not tackle questions such as regulation of foreign banking and the linking up of the indigenous bankers with the Bank. The exchange banks and non-scheduled banks, which were likely to be adversely affected by the Bill, opposed it. Among scheduled banks (other than the exchange banks), the proposal had a mixed reception and controversy generally centred on the clauses of the Bill relating to definition of 'banking', minimum capital and minimum liquid assets. There were also a number of suggestions which, on the whole, aimed at increasing the control of Government over banking institutions.

Those who opposed the proposals could be divided into two groups. The first consisted of some critics (including the Bengal Chamber of Commerce) who, while not opposed to banking legislation as such, felt that there was no need then for a separate Bank Bill in view of the fact that the Indian Companies Act, as amended in 1936, contained some provisions in respect of banking companies and that sufficient time had not elapsed to see how they worked. The other group of critics consisted of institutions such as the Imperial Bank of India and the Calcutta Exchange Banks' Association, to whom the whole idea of further restrictive legislation appeared anathema. Their views were based on the usual counts of opposition to any regulative measure, namely, that (i) inexperience, lack of business acumen and failure to appreciate the accepted canons of sound finance could never be remedied by legislation; (ii) State control might instil in certain sections of the public a false sense of security in banks; and (iii) it was unfair that sound banking institutions should be regulated in order to check the undesirable practices of a few small or dishonest banks.

Coming to the opinions expressed on the various clauses of the Bill, the draft definition of banking proposed by the Bank may first be dealt with. It may be recalled that the Indian Companies (Amendment) Act had defined a banking company as a company which carried on as its principal business the accepting of money on current account or otherwise subject to withdrawal by cheque, draft or order. The Bank's proposed definition in the draft Bill differed from the above definition in two essential respects, viz., it omitted the words 'principal business' and 'draft or order'. This definition was generally criticised as being too narrow and restricted and that it would leave out of account a good many institutions which were not issuing cheques, but which were carrying on the primary functions of banking, viz., the collection of savings of the community and placing them at the disposal of trade and industry. On a review of the opinions, the Bank's management felt that the expression ' withdrawal by cheque ' in the draft Bill was inappropriate and that it would be better to define banking as ' accepting of deposits repayable on demand ' which would emphasise the most essential function of banking, i.e., to receive the public's money on current account.

The proposal for minimum paid-up capital and reserves necessary for starting or running a banking company made by the Bank came in for severe criticism, especially from the smaller banks and their associations. They contended that the proposed provision would result in the virtual annihilation of the smaller units and that it would retard the development of branch banking. The Bank was clear in its mind that proposals that were in view such as compulsory reserves, Reserve Bank being the statutory liquidator and the inspection of banks were not

designed to work and would not work with petty institutions; the banks which might go under if its proposals were brought into force represented less than 5 per cent of the total bank deposits of the country. The Bank, nevertheless, was willing to reduce the minimum capital for all banks opening branches outside the Province or State of their origin, from Rs. 20 lakhs to Rs. 10 lakhs.

No clause came in for more severe or more uniform criticism than the one on liquidity requirement, laying down that every banking company should maintain at least 30 per cent of its demand and time liabilities in the form of cash or unencumbered approved securities. It was argued that the clause would make it difficult for banks to make reasonable profits; there was also risk of depreciation of Government securities as also difficulties of marketing the securities. The Bank's management was unable to accept the main objections to its proposal. It was, however, willing to consider the suggestion by some scheduled banks for enlarging the list of approved securities so as to include gold and balances held with scheduled banks on current account.

Quite a few Indian trade associations and Chambers of Commerce advocated measures to check the activities of the non-Indian banks in regard to their financing of internal trade and industry in India. A small scheduled bank suggested that certain business and banking experience should be among the minimum qualifications for directors of banks and that managers or managing directors should be persons holding some technical certificates or university degrees or persons who, from a statement of their qualifications, might be certified as fit and proper to be directors of a bank by either the Registrar of Companies or the Reserve Bank.

All points of view considered, it could be said that the draft Bill was received favourably. Indeed, there was some comment that the legislation could go much further. Thus, the Times of India* suggested that the Bill could be refashioned so as to extend its scope not merely to the protection of the depositors but to the improvement of banking conditions as a whole, for instance, by improved facilities in rural credit and for industry generally---a precursor of the later thinking on social control of banks !

There were certain proposals which were not provided for in the draft Bill, but which nevertheless were referred to in the explanatory memorandum on the Bill. One of these was that the Reserve Bank should be appointed as the statutory liquidator of banking companies. Opinion among the banks and the public was sharply divided on this issue. Some argued that no authority in the country was better fitted to be the statutory liquidator than the Reserve Bank. This opinion was not shared by many others who stated that the Bank might get involved in

*January 23, 1940

litigation on account of suits by disgruntled creditors and that the appointment should be left to the discretion of the court. Another matter dealt with was the question of link up of the indigenous bankers with the Reserve Bank by legislation. The position of these bankers remained, in the opinion of the Bank's management, as nebulous as before because of certain practical difficulties. These seemed 'insuperable', unless provision could be made for the bankers to organise their business on the lines prescribed for banking companies and to keep their accounts in such a manner that their banking assets were properly segregated from their other forms of business. The Governor was, therefore, of the opinion that they should be left outside the scope of the proposals. A third question dealt with in the explanatory memorandum was about periodic inspections of banks. In general, it seemed that the larger banks were against such a power while the smaller ones were in its favour. The Governor was still doubtful whether inspection would prove more than an illusory safeguard, unless the size of the member banks was very substantially increased. The utmost he was prepared to concede was that, if the Legislature considered that inspection was required, a separate authority such as a Superintendent of Banking could be created with such powers of inspection as the Legislature might deem it desirable to confer on him.

A synopsis of the replies received and the Governor's revised proposals were submitted to the Central Board in October 1940. The Board, however, resolved that the consideration of the Bill be postponed for a period of six months and that, in the meantime, the synopsis of the replies be sent to the Local Boards for their comments.

The reactions of the Local Boards revealed the same sort of mixed reception as was noticed among the banking and business community. The Rangoon Board supported the revised proposals in toto; the Calcutta and Delhi Boards, while endorsing, by and large, the Governor's proposals made some suggestions for incorporation in the Bill. The Calcutta Board suggested that the minimum capital and reserves for a bank having offices outside its Province or State could be lower at Rs. 15 lakhs instead of Rs. 20 lakhs. The Delhi Board was strongly of the opinion that provision should be made in the proposed Act for the annual or biannual inspection of banks' accounts by the Reserve Bank and for the issue of a certificate of the true state of affairs. The Delhi Board also suggested a reduction in minimum liquidity requirement from 30 to 20 per cent. The Bombay Board had no comments to offer, though one of its members, Sir R. P. Masani, was opposed to some of the important provisions. The Madras Board stuck to its former view that a Bill for a limited purpose would hardly be of any avail and might possibly prejudice fair consideration of the larger issues awaiting solution. It did not, in general, support the stand taken by the Bank on the

controversial clauses, except in backing the suggestion that a post of a Superintendent of Banking could be created.

Reviewing the mass of comments as a whole, the Governor wrote to the Central Government in March 1941 that opinion in the country was still not ripe for undertaking an elaborate new banking legislation. The field of controversy, he said, was so wide and the then existing conditions so abnormal that he doubted if in the distractions and preoccupations of the war it would be possible for the Government or the Legislature to devote the necessary attention to a technical matter of such complexity. Therefore, he was inclined to the view that the question of undertaking comprehensive new legislation should be held over for the duration of the war. However, he called for the passing of some interim legislation in order to reinforce the administration of the provisions of the Indian Companies Act relating to banking companies. The measure he had in view was designed mainly to remove the ambiguities in the definition of banking.

Interim Banking Legislation, 1941-42

The Governor suggested to the Central Government that Section 277G of the Indian Companies Act should be amended so as to restrict the use of the word 'bank' or its derivatives only to those companies which carried on banking and ancillary business as defined in Section 277F irrespective of when such companies were formed. He recognised that this would still leave a residuum of companies not calling themselves banks but, nevertheless, carrying on banking business and attracting deposits, and throw the onus on the depositors to deal with such a company at their own risk; it would be open to the Registrar to hold, in suitable cases, that any company of this type was a banking company, unless his decision was challenged successfully in a court of law. In June 1941, the Central Government conveyed their concurrence with the Governor's views regarding both the inadvisability of comprehensive banking legislation and the urgency of the interim measure, but made no formal announcement in the Legislature or in the press regarding this decision. It should be mentioned here that the Governor had not considered it necessary to obtain the prior approval of the Central Board on such an important matter as postponing sine die his own Bank Act proposals, before addressing the Government and obtaining their concurrence, although the Board had, as earlier stated, resolved in October 1940 to postpone the consideration of the proposals for six months and wished, in the interim period, to ascertain the comments of the Local Boards. The developments were subsequently (i.e., in July 1941) reported to the Board, which, however, only recorded them without any protest!

On the proposal made by the Governor for interim legislation regarding amendment of Section 277G of the Companies Act, the Government, after further examination, proposed in August 1941 that the object in view would be achieved by the insertion in Section 277F of an explanation to the effect that any company which used the term 'bank' or its derivatives in its name should be deemed to be a banking company irrespective of whether the business of accepting deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order was its principal business or not. The Governor had no serious objection to the alternative proposed by the Government. The Government had also meanwhile addressed a communication to the Provincial Governments and recognised Chambers of Commerce in October 1941 on the proposed amendment of Section 277F. The replies received by the Government showed that there was overwhelming support for the amendment. A Bill was consequently introduced in the Legislative Assembly in August 1942, adding a proviso to Section 277F, in substantially the same form as it originated from the Government and emerged as the Indian Companies (Second Amendment) Act, 1942, in October 1942. The Government, however, did not keep their promise made to the Bank in November 1941 that, in the Statement of Objects and Reasons of the Bill, mention would be made of the fact that the recommendation for the proposed amendment came from the Central Board of the Reserve Bank. The Bank had suggested this earlier not only to let the public know that it had not allowed the matter of banking legislation to drop out of sight, but also that such a reference to the Bank's role might carry weight with the Legislative Assembly and thus help passage of the Bill. The omission was probably due to the fact that the actual legislation was handled by the Commerce Department of the Government while the Reserve Bank's channel of communication was the Finance Department. In fact, the Commerce Department had earlier issued a letter to the Provincial Governments and Chambers of Commerce to elicit their views without the knowledge of the Finance Department!

Interim Banking Legislation and Control, 1943

In December 1942, the Bank undertook a review of floatations of banks in the country after the commencement of war and its findings were as follows. Since September 1939, 38 new banks had come into existence. The regional distribution showed that 12 of these banks had registered offices in Calcutta and 6 in Bombay; most of the others were also in other important commercial and industrial cities. The banks opened in Calcutta were small institutions, 6 out of the 12 banks having paid-up capital of less than Rs. 1 lakh. Three of the scheduled banks,

viz., the Bharat Bank, the Exchange Bank of India and Africa and the Associated Banking Corporation, had ambitious programmes of starting branches in the Indian States where banking facilities were inadequate; but it transpired that schemes of expansion of branches without ensuring proper supervision and control by the Head Office were themselves one of the main reasons for the undoing of these banks in later years. The review brought out several unhealthy features of expansion of banks as indicated below, and so further piecemeal measures of regulation followed in 1943, on the initiative of the Bank:

(a) While a few of the new banks started with large and even grandiose amounts of authorised capital, the majority of the new institutions commenced business with paid-up capital which could generally be regarded as inadequate.

(b) There was, in many cases, a distribution of the capital structure into preference, ordinary and deferred shares, to ensure, it would appear, a controlling voice in the management to an individual or a small group. The devices adopted in this regard were that (i) a portion of the capital was raised through preference shares without any voting rights; (ii) the nominal value of deferred shares, which could be easily distributed among the promoters and their adherents, was kept very low and the holder of one share was given the same voting right as was enjoyed by a person holding an ordinary share many times the value of the deferred; and (iii) only a small amount of the nominally large value of an ordinary share was called up.

(c) Some of the banks adopted devices to get round the principle underlying Section 277H of the Indian Companies Act, which prohibited a bank being managed by a managing agent other than another banking company. These banks owed their origin to the efforts of one or two enterprising individuals who had got themselves appointed as the managing directors; and it was not uncommon for a managing director to enter into an agreement with the Bank for a long term of office, varying from 15 to 20 years, entitling him to a fairly high salary and allowances and, in certain cases, a percentage of profits after the bank was able to declare a specified rate of dividend, which was generally fixed at a low figure. The managing director was thus in a position to employ the funds of the bank to promote the interests of industrial concerns owned by him or his friends and still might not be removable for such action if he had a long-term contract of service, either explicit or implicit, in the articles of association or agreement with the bank.

The Bank conveyed its findings to the Government in December 1942, adding that it was of the utmost importance that the capital structure and the system of management of banks should be such as

to minimise the temptation for an over-ambitious and get-rich-quick policy and to encourage, in its stead, cautious and steady banking on well-tried orthodox lines. It, therefore, suggested that Government might take action quickly, after consulting the Provincial Governments and commercial opinion, to add to Section 277I of the Indian Companies Act provisos to the effect that the subscribed capital should not be less than half of the authorised capital and the paid-up capital not less than half of the subscribed capital, and that no banking company should have other than ordinary shares. It may be recalled that the first of the provisos mentioned above had already been included in the proposals for an Indian Bank Act made by the Bank in November 1939. As regards management of banks, the Bank suggested to the Government in February 1943 legislation, in due course, for buttressing Section 277H with other provisions, namely, (i) prohibiting loans to a manager or a managing director or to a company in which he was avowedly interested otherwise than as a shareholder, (ii) setting, say, a ten-year time limit for his tenure of office and (iii) prohibiting participation in profits by a person entrusted with the management of a bank since such participation might provide a temptation for methods of management directed towards increasing profits in disregard of the ultimate safety and solvency of the bank.

In March 1943, the Government followed the usual procedure of circulation of the Bank's letter of December 1942 regarding the proposed amendments to the Companies Act, among Provincial Governments, scheduled banks and commercial associations. The Government also circulated an alternative proposal relating to the capital structure of banks, namely, allowing ordinary, preference or any other kind of shares provided the capital structure was such as to permit voting rights in proportion to the capital contributed by each class of shares. While the proposals were naturally opposed by many commercial organisations and banks, especially the Bharat Bank Ltd. (which initially had authorised and subscribed capital of Rs. 20 crores and Rs. 15 crores, respectively, and a paid-up capital of Rs. 15.60 lakhs only), there was general public support to the amending Bill. The Bombay Shareholders' Association, for instance, was wholly on the side of the Reserve Bank. It also counselled the Government to curb, at an early date, the undesirable tendencies in the managerial appointments of banks, pointing out that the arrangements or agreements entered into by many banks for the appointment of managing directors and managers were nothing but so many modified versions of managing agency agreements.

The executives of the Bank reviewed the various opinions and proposed to the Committee of the Central Board in September 1943 that legislation be recommended to amend the two sub-sections of the

Companies Act on the lines suggested by the Government, thus revising the Bank's own earlier opinion that amendment of Section 277H (management) was not of a relatively urgent nature. The Committee approved the proposals subject to the modifications that (i) neither preference nor deferred shares be allowed in the case of banks established after the coming into force of the proposed legislation and no unissued preference shares be allowed to be issued in the case of banks already incorporated and (ii) the permissible term of employment of a manager, etc., be reduced to five years, renewal being allowed. The necessary legislation was soon initiated; the Indian Companies (Amendment) Bill, 1944, received the assent of the Governor General in March 1944.

To recapitulate the provisions as were finally enacted: a bank was precluded from employing or being managed by a managing agent or any person whose remuneration or part of whose remuneration took the form of commission or share in the profits of the company or any person having a contract for its management for a period exceeding five years at a time (new Section 277HH). The following restrictions were also imposed on a bank incorporated after January 15, 1937: (a) the subscribed capital should not be less than half the authorized capital and the paid-up capital not less than half the subscribed capital; (b) the capital of the bank should consist of ordinary shares only or ordinary and such preference shares as were issued before the commencement of the Indian Companies (Amendment) Act, 1944; and (c) the voting rights of every shareholder should be strictly in proportion to the contribution made by him to the paid-up capital (Section 277I as amended).

The amending Act was generally well received by the press. Thus, the Indian Express* commented that the vices sought to be corrected were serious and it went to the credit of the authorities of the Reserve Bank that they were able to negotiate and direct legislation in such a short time.

Renewal of Efforts for a Bank Act

Some of the replies received in the middle of 1943 in connection with the amendments to the Indian Companies Act and some of the comments in the press revealed a renewed demand for comprehensive banking legislation at an early date as it was felt that piecemeal legislation would fail to achieve the desired object. As an illustration, the remarks of the Eastern Economist, in its issue of June 25, 1943, may be given:

* February 25, 1944.

We have still to evolve a banking system which really answers to the special needs and circumstances of our country and can stand up to the strenuous demands of our post-war economy. Some of the salient defects of our banking system as at present organised are under-capitalisation, over-trading and wasteful competitive branch banking. The proposals for interim banking reform by the Board of the Reserve Bank do not touch the basic maladies and needs of our banking system. The crying need is for a comprehensive legislation, and piecemeal efforts may do more harm than good. The war has, indeed, created many difficult situations which demand control, but in the peculiar circumstances and, at any rate, for the duration of the war, executive supervision, as for example, through a Superintendent of Banking, may prove more effective than over-all control through hasty controversial constitutional changes such as are proposed.

In view of this demand and the extent of support that the Bank's proposals had received, in June 1943 Mr. Deshmukh, who was in charge of the Governor's duties, considered that it was desirable to review the whole question of proceeding with separate banking legislation. According to him the arguments in favour of such action were the following:

- (i) the war appeared likely to continue for at least a couple of years more and it was undesirable to postpone action for so long a period;
- (ii) a large number of new banks had been started during the war period -a development not anticipated when Government decided to suspend action on banking legislation;
- (iii) there was a possibility of a severe post-war reaction to the war time monetary developments and inflationary growth factors -a reaction which had to be guarded against as early as possible; the introduction of banking legislation would be an important step in that direction inasmuch as it would ensure banking development on sound and healthy lines;
- (iv) there was a likelihood of the public favouring regulation to a greater extent through a realisation of the possible repercussions during the post-war period and the proposals consequently proving less controversial;
- (v) on account of the improved war situation Government themselves might find their pre-occupation with the war not so heavy as to preclude comprehensive banking legislation; and
- (vi) there was example of other countries, e.g., South Africa, which had introduced commercial banking legislation even in war time.

In September-October 1943, the Central Board and the Government concurred with the Governor's (Mr. Deshmukh had by then become Governor) views and set the pace for the renewal of the Bank's efforts for a more comprehensive Bank Act.

Banking Companies Bill, 1944

Early in 1944, the Bank proceeded to consider what modifications and additions were necessary to its original proposals in view of the criticisms and suggestions received from time to time and the experience gained during the war period. The Bank was still not convinced that in the conditions then prevailing in India it would be appropriate to attempt detailed legislation covering the various activities of banking as had been enacted in some countries abroad such as the United States of America. Further, even if such legislation were attempted, the Bank had no machinery to administer it and it would be some years before a suitably trained staff would become available. The Bank, consequently, felt that its original proposals were conceived on sound lines and that it should attempt to lay down only the foundation covering general principles, leaving the super-structure of detailed regulation to be built up later as might be necessary with growing experience. In the light of these general considerations and the criticisms and Suggestions received, the proposals were reviewed and a revised draft Bank Bill was submitted to the Committee of the Central Board in April 1944. The main changes and additions suggested to the original proposals made by the Bank, apart from those covered by the interim legislation, provided for the prohibition of a banking company engaging directly or indirectly in trading activities; disposal of non-banking assets acquired in satisfaction of claims within a period of seven years; inclusion of gold in the category of liquid assets; submission by banking companies of monthly returns of assets and liabilities to the Reserve Bank; restrictions on loans and advances on the security of own shares or to directors and firms or companies in which they were interested as partners or directors; inspection of a banking company by the Reserve Bank on being directed to do so by the Central Government; submission of a report by the Reserve Bank to Government in cases of temporary suspension of business or voluntary winding up; and appointment of the Reserve Bank as the Official Liquidator of a banking company on its being wound up by court.

Of the above provisions suggested by the Bank, the most significant was perhaps the one recommending inspection by the Bank, albeit for a limited purpose, in the background of the Bank's (in particular, Sir James Taylor's) earlier strong views against the vesting of such a power. In his memorandum on the subject submitted to the Central Board in April 1944, the Governor explained the shift in the Bank's position thus:

Although originally we were doubtful of the value of inspections, in the light of later developments and in view of possible post-war reactions, we have after careful consideration, altered our opinion, and I consider

that the power to inspect the books of a bank will be a valuable adjunct to the other statutory provisions. I do not, however, consider that it will be practicable to provide for a regular system of inspection of banks as has been suggested by the Local Board, Northern Area, for the requisite trained personnel is not available for the purpose. Nor do I think it will be conducive to the healthy growth of Indian banking if banks have to carry on their business under the atmosphere of continuous surveillance which such inspections will necessarily tend to create.

This question is closely linked with the question of the most appropriate authority for administering the Act and it has been suggested that this duty should be entrusted to the Reserve Bank. I consider that this function is primarily one for the Government to discharge but that with the experience we have gained of scheduled banks, the work of investigation or calling for information and returns should be carried out by the Reserve Bank who will report their findings to Government. This will not in any way militate against the establishment of harmonious relations with the commercial banks for we will be merely the reporting authority and the final decisions will be those of Government.

This statement, however, did not go far enough to meet the demand of one of the Directors, Mr. Kasturbhai Lalbhai, to institute a compulsory inspection of all banks irrespective of the size of their capital and reserves.

The proposals made by the Governor were approved in principle by the Central Board in April 1944, with the instruction that they should be finalised by the Committee of the Board after obtaining the urgent comments of the Local Boards. The Local Boards made some suggestions, the important ones being that a foreign bank opening a new branch in India should be required to obtain a licence from the Reserve Bank and that the percentage of approved liquid assets to be maintained could be reduced from 30 per cent to 25 per cent. These suggestions were incorporated in the draft Bill, with some modifications. There were also some suggestions by the Local Boards and their members which were not immediately acceptable to the Bank's management. Notable among these was a suggestion by the Calcutta Local Board that there ought to be a provision empowering inspection of banks by the Bank without the red-tape of prior consent of Central Government, consultation with the Government being restricted to cases of exclusion of banks from the Second Schedule. A very surprising suggestion was that put forward by the Madras Local Board (which had undertaken all along to plead for generous assistance by the Bank to the smaller scheduled banks), proposing that the minimum capital requirement for inclusion in the Schedule be raised from Rs. 5 lakhs to Rs. 20 lakhs. The acceptance of this suggestion would have meant exclusion of most of the South Indian banks from the Schedule!

The revised proposals of the Bank were forwarded to the Central Government in June 1944. The Bank also sent to the Government in October a separate pro forma balance-sheet for banks, which gave most of the details given in the prescribed form under the Indian Companies Act (Form F) as also certain additional ones which were of particular importance in the case of banks. A separate form of balance-sheet for banks was considered necessary because:

- (i) Form F under the Companies Act, being meant for companies in general, was not suited to meet the special requirements of banks and
- (ii) for better understanding of the affairs of banks, a standard form was necessary, since it was observed that many banks, especially the smaller ones, were publishing their balance-sheets in different forms, for window-dressing, among other reasons.

A Bill 'to consolidate and amend the law relating to banking companies' on the lines recommended by the Central Board was introduced in the Legislative Assembly on November 16, 1944 and a motion for circulation of the Bill for eliciting public opinion was adopted by the Legislative Assembly on November 20. Among the interesting points made in the brief debate were that the Imperial Bank Act should be repealed and that the bank be brought under the scope of the proposed Bill (Mr. T. T. Krishnamachari, who went to the length of referring to the bank as 'a tumour in the body politic of this country') and that banking should be nationalised or socialised (Mr. Sami Venkatachalam Chetty and Prof. N. G. Ranga). Prof. Ranga complained that no action had been taken on the suggestion of the Industrial Commission for the establishment of Investment Boards to offer credit to industrial concerns. This matter was, however, beginning to engage the attention of the authorities.

The Legislative Department of the Government forwarded the Bill to the Provincial Governments and the Chief Commissioners of centrally administered areas with a request to circulate it among the banks and the general public. Most of the opinions called for were received by the end of March 1945. The Bank's management considered these opinions exhaustively in a memorandum submitted to the Central Board for consideration at its meeting held on April 2, 1945; the Governor suggested certain modifications to the original Bill, for consideration and appropriate amendments at the Select Committee stage. The Board generally endorsed the Governor's recommendations, the principal ones being reduction in minimum capital requirement for banks having an office outside the Province or State of registration from Rs. 20 lakhs to Rs. 10 lakhs and lowering of the proportion of minimum liquid assets from 25 per cent to 20 per cent. The Bank's proposals were conveyed to Government in May.

The Problem of the Exchange Banks

At this stage, it is necessary to refer briefly to two matters which engaged the attention of the Legislature and the press, namely, the position of the exchange banks and of the Imperial Bank, in the scheme of banking regulation.

The exchange banks were not required to furnish the Bank any detailed information regarding their assets and liabilities. The only statements they were periodically submitting were (a) the weekly return under Section 42 of the Reserve Bank Act and (b) copies of consolidated balance-sheets (which did not give separate figures in respect of their Indian business) under Section 277(3) of the Indian Companies Act. These banks were not subject to the various provisions of the Indian Companies Act relating to Indian banking companies, except as regards proceedings in regard to the winding up of their affairs in this country.

The meagre information about them available with the Bank prompted the Central Board to ask the Governor (Taylor) in October 1941 to find out how the statistics regarding their business in India could be made as complete as those of Indian joint-stock banks. The Governor examined the question and intimated to the Board his view that it would seem somewhat futile to ask the Government to legislate calling for special returns from the foreign banks providing additional information without at the same time taking action on the proposals of the Bank Act. According to him, the exchange banks, being authorised dealers, were providing the Bank with detailed information under the provisions of the Defence of India Act regarding their daily exchange operations. He said that the collection of information about the assets and liabilities of such banks, in advance of general legislation, would only be of statistical interest.

The Governor's views did not satisfy the Board. It decided, in December 1941, that he should collate the information relating to the investments and foreign exchange business of these banks from the material available with the Bank. After studying the data, the Governor reported to the Board in February 1942 that the exchange banks were maintaining assets in India appreciably in excess of the limit of 75 per cent sought to be prescribed in the Bank's proposals for a Bank Act. About 33 per cent of their resources in India seemed to be employed in financing internal trade; around 16 per cent was maintained in cash and, perhaps, about 20 per cent in the form of Government securities. The bulk of the balance, about 23 per cent, appeared to have been utilised in the finance of foreign trade. In view of the Governor's findings, the Central Board decided to drop the matter for the time being.

The exchange banks which were thus in a privileged position in the matter of statutory provisions were naturally opposed to the proposed banking legislation. Public opinion was increasingly critical of the preferential treatment given to foreign banks and the Calcutta Local Board was also strongly advocating their being brought under stricter control by a system of licensing, but what the Bank's management suggested was the addition of a clause in the 1944-45 Bill, prescribing that banks incorporated outside British India or the United Kingdom should obtain licences from the Bank for carrying on business in British India! The British banks were thus placed on a footing superior to even banks incorporated in the Indian States or neighbouring countries like Ceylon and Burma. The Eastern Economist, in its issue of January 12, 1945, called this 'politically obnoxious and economically vicious' and added that 'this will not only foster uneconomic competition prejudicial to the growth of national banking institutions, but give rise to the presumption, wholly without justification, that U.K. banks do not need to be regulated in respect of their capital, liquidity and other standards of healthy banking'. The Select Committee, in its February 1947 Report, recognised the validity of the criticisms made against the clause as it stood and recommended extension of the provisions of licensing to all banks incorporated in or outside India.

The Position of the Imperial Bank

Like the exchange banks, the Imperial Bank was not governed by the provisions of the Indian Companies Act relating to banking business, being incorporated under a separate Act. Since the proposals for a Bank Act made in 1939 were applicable only to companies as defined by the Indian Companies Act, the Imperial was not covered. The criticisms made during the Legislative Assembly debates in November 1944 on the Banking Companies Bill made the Reserve Bank take up in right earnest the question of extension of the proposed banking legislation to the Imperial, which held nearly 30 per cent of the deposits of scheduled banks. The Bank recommended to the Government in the same month that the whole of the banking legislation excepting the clause relating to the business of banking companies should be made applicable to the Imperial also without affecting fundamentally any of the provisions of the Imperial Bank of India Act or the Regulations made under it. But, two months later, i.e., in January 1945, after consulting the Managing Director of the Imperial Bank, the Bank advised the Government differently, thus:

We have examined further the question of bringing the Imperial Bank of India within the purview of the Banking Companies Bill. The restrictions imposed on the business of the Imperial Bank by its own Act and

Bye-laws are in some respects considerably more onerous than those contemplated in the Bill, while under Regulation 59 (Schedule II) of the Imperial Bank of India Act, the Central Government have already power to appoint such auditors as they think fit to examine and report on their accounts. As regards the furnishing of returns and statistics, the bank has undertaken to co-operate with us in supplying the necessary information. In view of these considerations and the historical reason that the Imperial Bank formerly acted as bankers to Government and are now acting as our Agents for the transaction of Government business at centres where we are not represented, we do not consider it necessary to press for an amendment to bring that Bank within the purview of the Banking Companies Bill.

However, as in the case of the exchange banks, the Select Committee, in 1947, recommended that most of the important provisions of the Bill be made applicable to the Imperial Bank.

Select Committee on the Banking Companies Bill

On April 6, 1945, the Finance Member moved in the Legislative Assembly a motion for reference of the Bill to a Select Committee. After a four-day debate, the Assembly adopted the motion on April 11. Mr. Ram Nath, Secretary of the Bank, participated in the proceedings, as a nominated Member; it fell to his lot to reply to the debate, on behalf of the Government.

At this stage it is not necessary to go into the details of the interesting debate concerning the individual clauses of the Bill. More than the Bill, it would seem that the working of the Reserve Bank came in for considerable discussion, since the administration of the proposed Act was to be entrusted to the Reserve Bank. There was much criticism of the Bank's functioning, especially concerning what the members regarded as unsatisfactory progress in the sphere of rural credit. Mr. Manu Subedar went so far as to remark:

The Reserve Bank has failed entirely as an instrument of national policy. It is not a national institution as it stands. The Reserve Bank has failed to develop the mechanism for the advancement of agriculture, of exchange banking and of the financing of industries.

Mr. Akhil Chandra Dutta made the interesting suggestion that there should be a Bankers' Advisory Council, elected by the members of the Legislature or the banks themselves, for advising the Government with regard to the control of banks and particularly in regard to the exercise of powers conferred by Section 28 (Inspection) of the Bill and Section 42 of the Reserve Bank of India Act. The Council was to examine periodically the working of the whole banking system including the Reserve Bank and make reports, to be placed before the Legislature.

Prof. N. G. Ranga also made two proposals, one for the setting up of an Advisory Council, comprising representatives of the banking world, to study the inspection reports on banks and tender advice to the Reserve Bank. The other proposal was the replacement of the Reserve Bank's Board of Directors by an Advisory Board consisting of representatives of scheduled banks including exchange banks, the Legislative Assembly, Government and of agriculture, industry and commerce. The Governor and the Deputy Governors of the Bank were to supply information to the Board and initiate discussions. The Board was to make periodic reports to Government. The role of the Board was to be purely recommendatory. (In these suggestions we seem to have the germ of the idea of the National Credit Council, which was established on December 22, 1967.)

The meetings of the Select Committee were scheduled for October 1945 and the Bill was to be taken up for final consideration in the autumn session of the Legislature. Owing, however, to the decision of the Governor General to hold fresh elections and the consequent dissolution of the Assembly, effective October 1, 1945, the proposed meetings of the Select Committee were cancelled and the Bill lapsed. The Bill was reintroduced in March 1946 and again in March 1948, but the legislation was passed only in February 1949.

Meanwhile, as the Bank expected that there would be further delay in the passage of the Bill, it recommended the enactment of some urgent measures, which were brought into force in 1946. The interim legislation passed during the years 1946-48 and the developments eventually leading up to the enactment of the Banking Companies Act, 1949 are discussed in the section of the History relating to the period 1945-51.

Although a full-fledged Bank Act was not passed before 1949, there is no doubt that the interim measures of legislation, undertaken largely on the initiative of the Bank, had a salutary effect on the functioning of banks. The benefits of these measures were both direct and indirect. They helped achieve an improved standard in the working of banks and also restrained the overgrowth of banks. Bank failures recorded an almost continuous decline from 119 in 1939 to 27 in 1945. In the previous four years 1935 through 1938, the number of failures had ranged from 51 to 88. It could be argued that the war-time plethora of funds and rise in values of assets helped conceal trouble spots. However, the post-war performance of the Indian banking system bears some testimony to the useful contribution of the war-time regulatory measures.

Policies in the Sphere of Agricultural Credit

The main task for the Reserve Bank of India in the sphere of agricultural credit was one of promotion rather than regulation, especially to assist the consolidation and expansion of co-operative institutions and to enable them to obtain from the Bank some modest accommodation for seasonal agricultural operations and marketing of crops, with a view to bringing down the cost of agricultural credit. In Chapter 7, a detailed account has been given of the preliminary efforts of the Bank in this sphere in the pre-war years, and the submission of the Preliminary and the Statutory Reports in 1936 and 1937, respectively. The principles enunciated by the Bank in these Reports and the circulars issued thereafter, with regard to the lines on which the co-operative sector should develop and the Bank's role in providing credit to the co-operative institutions, remained practically unchanged for many years. It has also been explained how the Bank's scheme of May 1938 to provide financial accommodation to the provincial co-operative banks against agricultural paper met with poor response. Although the co-operatives appeared to be in no pressing need of accommodation, the Bank made another serious effort in early 1942 to provide accommodation to this sector, the main feature of this being the grant of a rebate in the interest rate charged by the Bank in respect of its rediscounts of and advances against agricultural paper. Although even this scheme had limited success, some kind of a break-through was accomplished in the field of Reserve Bank credit to the co-operative sector.

During this period, the Reserve Bank also brought co-operative banks under its scheme of remittance facilities. The original scheme of October 1940 did not appeal to the banks, but with modifications made by the Bank in 1941, the provincial co-operative banks agreed to join, though reluctantly.

The co-operative institutions recorded a noticeable increase in number, membership, deposits, owned capital and loan turnover during the war years; on the other hand, the outstanding amount of loans and overdues decreased. These phenomena perhaps reflect the improvement in the economic position of the farmers as a result of a rise in the prices of agricultural commodities. While the war did help strengthen the co-operative movement, it was not clear that the strengthening that had taken place during the war years was, by and large, of a permanent character.

Although in the sphere of loans and discounts to the co-operative sector the war years were on the whole quiet for the Reserve Bank, the Agricultural Credit Department of the Bank remained fairly active during this period. The Department continued to examine problems of agricultural credit, including the co-operative movement, debt legislation, schemes of rural reconstruction, land mortgage banking, impact of war on co-operative institutions, etc., etc., and prepared several studies on these subjects. The Department rendered advice to the Provincial Governments on various matters referred to it relating to rural credit and co-operative movement.

The Bank endeavoured to keep itself in close touch with the cooperative movement in different Provinces, by collecting information and attending meetings and conferences of co-operative organisations. The Bank actively participated in the formulation of the post-war plans concerning rural credit. Senior officials of the Bank were associated with two committees set up by the Central Government for this purpose, namely, the Agricultural Finance Sub-Committee and the Cooperative Planning Committee.

War-time Growth of Co-operative Institutions

World War II contributed to an overall improvement of the co-operative movement and also brought into prominence the non-credit side of the movement. The Reserve Bank's Review of the Co-operative Movement in India for the period 1939-46 welcomed the latter development enthusiastically, thus:

One would not, therefore, be far in the wrong if one suggested that the greatest contribution of the war to the Co-operative movement was the shifting of the emphasis from the credit aspect to its productive and distributive functions, or more generally, to its multi-purpose potentialities - a long-felt need for imparting that richness and balance which is necessary for the proper development of the Movement.

The growth of the co-operative institutions in the six years of the war as well as in the four-year period prior to the war is indicated in the

following three tables, relating, respectively, to primary societies, central banks and provincial banks.

PRIMARY SOCIETIES

| End of the year (July-June) | 1934-35 | | 1938-39 | | 1944-45 | |
|---|-------------|--------------------------|---------|--------------------------|---------|--------------------------|
| Particulars | Total | Of which agricultural | Total | Of which agricultural | Total | Of which agricultural |
| 1. No. of Societies (000s) . . . | 104 | 93 | 121 | 105 | 158 | 136 |
| 2. Membership . . (lakhs) | 43.96 | 30.08 | 52.67 | 35.60 | 81.44 | 50.13 |
| | (Rs.crores) | | | | | |
| 3. Owned Capital* | 21.55 | 13.48 | 22.75 | 12.78 | 31.97 | 15.29 |
| 4. Deposits. . . | 14.87 | 3.16 | 17.97 | 2.66 | 30.60 | 4.22 |
| 5. Borrowings. . | 19.43 | 17.58 | 18.14 | 16.18 | 15.86 | 11.02 |
| 6. Loans outstanding. . | 42.28 | 26.50 | 43.12 | 24.01 | 38.52 | 18.20 |
| 7. Loans made. . (during the year) | 19.02 | 5.18 | 21.66 | 6.75 | 30.62 | 11.82 |
| 8. Loans recovered (during the year) | 22.27 | 5.38 | 20.24 | 6.16 | 30.80 | 12.19 |
| 9. Overdues. . | 14.42 | 11.91 | 14.94 | 11.16 | 9.12 | 6.79 |

* Paid-up share capital and reserve and other funds.

CENTRAL CO-OPERATIVE BANKS

| End of the year (July-June) | 1934-35 | | 1938-39 | | 1944-45 | |
|--|-------------|-------|---------|-------|---------|-------|
| Particulars | Total | (A) | Total | (A) | Total | (A) |
| 1. No. of Banks | 615 | — | 594 | — | 602 | — |
| | (Rs.crores) | | | | | |
| 2. Owned Capital@ | 6.10 | — | 6.65 | — | 8.06 | — |
| 3. Deposits (P). . . | 19.94 | 17.13 | 18.34 | 15.53 | 27.82 | 21.05 |
| 4. Borrowings (Q). . | 3.36 | 2.99 | 4.43 | 4.02 | 3.94 | 3.31 |
| 5. Loans outstanding ing ® | 20.40 | 19.77 | 19.92 | 19.16 | 19.09 | 17.70 |
| 6. Loans made (S) (during the year) | 10.00 | 8.85 | 10.51 | 9.15 | 39.22 | 35.43 |
| 7. Loans recovered (T) (during the year) | 12.11 | 11.08 | 10.25 | 8.85 | 38.72 | 34.94 |

@ Paid-up share capital and reserve and other funds.

(P) Figures in column (A) refer to deposits from individuals and non-cooperative institutions.

(Q) Figures in column (A) refer to borrowings from provincial co-operative banks.

(R)(S) (T) Figures in column (A) refer to transactions with co-operative societies.

PROVINCIAL CO-OPERATIVE BANKS

| End of the year (July-June) | 1934-35 | | 1938-39 | | 1944-45 | |
|--|--------------|------|---------|------|---------|------|
| Particulars | Total | (A) | Total | (A) | Total | (A) |
| 1. No. of Banks | 11 | — | 10 | — | 11 | — |
| | (Rs. crores) | | | | | |
| 2. Owned Capital @ | 1.55 | — | 2.06 | — | 2.71 | — |
| 3. Deposits | 10.01 | 5.73 | 10.73 | 6.71 | 17.57 | 8.83 |
| 4. Borrowings from Govt. | 0.07 | — | 0.15 | — | 0.30 | — |
| 5. Loans outstanding (R) | 4.98 | 4.78 | 6.64 | 6.34 | 6.37 | 4.56 |
| 6. Loans made (S) (during the year) | 6.92 | 3.57 | 7.33 | 4.76 | 16.35 | 9.39 |
| 7. Loans recovered (T) (during the year) | 6.92 | 3.65 | 6.85 | 4.29 | 16.06 | 8.93 |

@ Paid-up share capital and reserve and other funds.

(P) Figures in column (A) refer to deposits from individuals and non-cooperative institutions.

(R) (S) (T) Figures in column (A) refer to transactions with central co-operative banks and societies.

The order of expansion in the resources of the co-operatives as a whole, significant as it was, was modest as compared with the expansion recorded by commercial banks. For instance, deposits of individuals and others (that is, excluding deposits of other co-operative institutions) recorded a rise from about Rs. 40 crores at the end of 1938-39 to about Rs. 60 crores at the end of 1944-45, or about 50 per cent, as compared to about 260 per cent rise in the case of deposits of scheduled banks. As regards the lending operations of the co-operatives, while the amounts loaned annually recorded some increase during the war period, there was hardly any *net* increase in the loans outstanding over the six-year period in the case of non-agricultural societies, while in respect of agricultural societies there was a marked decline from Rs. 24 crores to about Rs. 18 crores. It would seem that this was on account of the substantial increase in agricultural prices and the abundance of money. This appears to be corroborated by the decline in overdues of agricultural societies from Rs. 11.2 crores to Rs. 6.8 crores. These tables also bring out the fact that finance provided by the co-operative institutions as a whole constituted a small portion of that provided by the organised money market, that is to say, the commercial banks. On the non-credit side of the co-operative sector, large increases in the number and business were noticed in consumers' stores, weavers' societies, milk supply unions and societies, cane-growers' societies and several other societies for cottage industries.

Summing up the developments in the co-operative sector in the war period, the Reserve Bank's Review stated as follows:

Important as these developments are, they are very largely products of abnormal and artificial conditions engendered by the war. To what extent the progress achieved remains permanent when things revert to normality depends very much upon the innate strength which the institutions have gained during these years of favourable incubation and the earnest efforts made by co-operators to conserve it. It is encouraging to note that the Registrars are endeavouring to stabilise the gains and place the societies on a solid footing.

Resume of the Bank's General Approach

In the Statutory Report, it will be recalled, the Bank took the view that the co-operative movement was the most suitable agency for the supply of agricultural finance. However, the Bank was also keen that the services of other agencies, namely, indigenous bankers and moneylenders, should be used under a scheme of proper regulation. The Bank's initial efforts to bring in the indigenous bankers and moneylenders within the scope of the organised banking system were unsuccessful and during the period under review, that is to say, the war years, hardly any new initiative was taken in this matter. Even with regard to the co-operative sector, it is perhaps correct to say that the Bank was not very active. Its preoccupation with the various problems of the war and the abundance of monetary resources in the economy did not lend urgency to this matter. The Bank, of course, did not altogether remain quiet. Some effort was made to expand the Bank's assistance to the co-operative sector, against the security of agricultural paper, by offer of some incentive, though broadly within the four corners of the policy enunciated in the Statutory Report.

The first concrete step which the Reserve Bank took, pursuant to the Statutory Report, it will be recalled, was to issue a circular in May 1938, giving the detailed procedure to be followed by co-operative banks for obtaining accommodation. This circular met with very little response from the co-operative banks. The efforts made by the Chairman and the Managing Director of the Bombay Provincial Co-operative Bank to get the procedure altered in some respects were also not fruitful. It may also be recalled that later, in June 1939, the Bank issued a long circular to all provincial and central co-operative banks, clarifying some of the issues raised in the replies to the Bank's 1938 circular and indicating the manner in which co-operative banks must organise their business on banking lines and follow correct banking practices. The Bank's view was that as in the case of commercial banks, an obviously essential pre-requisite for the provision of credit was that the institutions through which it was provided should be soundly run.

Scheme of 1942 for Loans and Rediscounts

During the period under review, the Bank made another effort to encourage co-operative banks to obtain accommodation from it through rediscounts and advances, for financing marketing of crops or seasonal agricultural operations. For this purpose, the Bank drew up a modified scheme offering a concession in the rate of interest and circulated it to the provincial co-operative banks and Registrars of Co-operative Societies, on January 2, 1942.

The scheme was drawn up mainly on the initiative of Deputy Governor Nanavati, though it was issued a few days after his retirement on December 22, 1941. During his tenure of office as Deputy Governor from 1936 to 1941, he strove hard to build up close links between the Reserve Bank and the co-operative movement and this scheme was perhaps the culmination of the efforts.

Incidentally, even after retirement, Sir Manilal, as he had then become, took deep interest in matters relating to rural economics and co-operation and continued to have contacts with the Reserve Bank in this connection. He became the President of the Indian Society of Agricultural Economics in 1941 and continued as such for eighteen years up to 1959. He was the Chairman of the Agricultural Credit Organisation Committee appointed by the Government of Bombay in 1947, which made far-reaching recommendations for the reorganisation of the co-operative movement in Bombay Province, some of which were adopted in other Provinces also. It was appropriate that Sir Manilal, who initiated the Reserve Bank's active role in agricultural credit matters, should be a participant at the Informal Conference convened by the Reserve Bank in February 1951, which opened up a new era in the Bank's role in this sphere.

The circular of January 1942, while recounting the types of accommodation that could be made available to co-operative banks under the Reserve Bank of India Act, pointed out that Section 17(4) (d) (loans on the security of promissory notes supported by documents of title to goods) had remained inoperative on account of some practical difficulties. The reasons for Section 17(4) (d) being inoperative were explained by the Governor in his memorandum dated November 25, 1941 to the Central Board. He stated that the main aim of Section 17(4) (d) was to enable the small holder of agricultural produce to make it a marketable security for an advance so that the bank making such an advance could transfer its rights over it to the Reserve Bank. The principal legal as well as the practical difficulty here was that it would be impossible for the Reserve Bank to take physical possession of the goods offered as security especially on a scale sufficiently extended and detailed to help those for whom such assistance was primarily designed.

Further, such advances could not be made to the banks on their promissory notes, solely on the security of goods which they alleged were in their custody, as according to legal advice the bank which was a debtor to the Reserve Bank could not at the same time be its agent for guarding the security of such debt. Thus the object could not be achieved unless some third party could be constituted who would accept the goods for custody, exercise reasonable supervision that the goods so deposited were of the amount and quality set out, preserve them and ensure that they were not delivered except to the party entitled to them. The facilities for accommodation under Section 17(4) (d) could not be availed of until such an organisation, i.e., independent warehouses, were established. Under the circumstances only facilities under Section 17(2) (b) (rediscount of agricultural paper) and Section 17(4) (c) (advances against agricultural paper) could be made use of for the time being.

The Bank considered that in particular there was scope for extending financial accommodation for the marketing of crops under Sections 17(2) (b) and 17(4) (c), since in certain Provinces like Madras, cooperative sale societies, possessing go down facilities, had been established in recent years and their loans on the pledge of produce had shown a substantial increase during 1938-40. In order to offer some inducement to the provincial co-operative banks in the initial stages to borrow from the Reserve Bank against agricultural bills, the Bank stated that it would rediscount such bills or make advances against them at special rates by the grant of rebates to these banks in respect of such rediscounts and advances, somewhat on the lines of the rebates the Bank offered to the scheduled banks in January 1938.

The circular also dealt with certain technical difficulties that might arise in the provincial co-operative banks' making use of the facilities. The promissory notes of the primary societies which were to be endorsed by the central banks and subsequently by the provincial banks were generally in the nature of demand promissory notes; these were not eligible for rediscount by the Reserve Bank. As an alternative, the Bank had earlier suggested that the primary societies should draw clean usance promissory notes but this had not been found to be quite satisfactory from the point of view of the central co-operative banks. The circular therefore suggested that the central banks financing sale societies or primary societies should themselves draw time promissory notes so that these could be endorsed by the provincial banks and offered for rediscount to the Reserve Bank under Section 17(2) (b) or for advances under Section 17(4) (c) through the provincial co-operative banks concerned. In the alternative, it was suggested that the provincial banks themselves might draw bills on the affiliated central banks, which after acceptance by the latter could be offered to the Reserve Bank for rediscount or

advances. It was also stipulated that the central banks should submit along with these bills and promissory notes a list of loans made by them to the primary societies for the purposes of seasonal agricultural operations or marketing of crops, as the case may be. Further, the central banks were asked to be prepared to furnish through the provincial banks such information about their position as the Reserve Bank might require.

The Bank indicated that it would grant a rebate up to 1 per cent in the rate of interest, and that to begin with, it would be restricted to paper created for the purpose of the marketing of crops. The concession might be extended later to cover paper drawn for the purpose of financing seasonal agricultural operations as well. The circular also indicated that such a rebate would be available only if the Bank was satisfied that the benefit of the low rate was passed on to the agriculturist. This would be ensured if the primary societies or co-operative sale societies which would borrow from the central banks under the scheme would agree to charge reasonable rates of interest to agriculturists.

Many of the conditions laid down in the earlier scheme, such as, eligibility to A and B class banks only, maintenance of minimum cash balances with the Reserve Bank (at half the rates applicable to scheduled banks) and right of the Reserve Bank to inspect the provincial banks, were retained in the present scheme.

The circular solicited the opinion of Registrars of Co-operative Societies and provincial co-operative banks about the prospects of working such a scheme in the respective Provinces.

Response to the Scheme

The response of the various Provinces to the January 1942 circular varied. Replying promptly on January 8, the Sind Provincial Cooperative Bank stated that there were no central co-operative banks or sale societies in that Province and that advances were made to agriculturists for seasonal agricultural operations through the primary credit societies. The bank was also making advances directly against the pledge of agricultural produce, and, to individual zamindars against mortgage of standing crop. The bank wanted to know how that Province could make use of the Reserve Bank's facilities. The Registrar of Co-operative Societies, Sind, made the same points. The Reserve Bank replied that it was outside the scope of its business to make advances against the security of agricultural produce and/or mortgage of land or standing crop. The Bank would accept provincial bank-endorsed bills of primary societies, provided they belonged to A or B class and they granted finance for marketing of agricultural produce or were likely to do so.

The Bihar Provincial Co-operative Bank observed that the co-operative movement in that Province was not doing well for some years and that a five-year scheme of rehabilitation was being worked out. The provincial bank felt that during the rehabilitation period it would be practically impossible for it to satisfy the conditions stipulated by the Reserve Bank. The bank wanted to know if the Reserve Bank would be prepared to relax the conditions as a special case; the Cooperative Registrar of the Province agreed with these views. The C. P. and Berur Provincial Co-operative Bank stated that there were no prospects of working out the scheme in that Province, as there were no marketing societies; besides, the bank was in a position to meet the credit requirements of its members for seasonal agricultural operations from its own resources.

The response from the Bombay Provincial Co-operative Bank was more positive. After getting clarification on certain points, it stated in April 1942 that it had received applications from various central banks and requested that three central banks, namely, those of Karnatak, Broach and Belgaum, be placed in the Reserve Bank's approved list, for purposes of eligibility of their paper. Apparently, this was done to test the new procedure and establish contacts with the Reserve Bank. In the words of Mr. R.G.Saraiya, Chairman of the Bombay Provincial Co-operative Bank*:

Although I am fully conscious of the fact that almost all central banks in the Province are in a position to raise funds at reasonable rates of interest even in the present abnormal times and also of the further fact that the co-operative banks desire further simplification in the procedure and some modifications in the arrangement proposed by the Reserve Bank, I lay stress on the desirability of making a beginning and putting to practical test this offer of the Reserve Bank of India because I am anxious to build up contacts with that Bank such as, I am sure, will stand us in good stead in times of stress and strain. We have all been pleading, for the past several years, for forging links between the co-operative financial structure and the central banking authority of the country; and now that a suitable opportunity has presented itself, I trust we shall take full advantage of it.

The Punjab Provincial Co-operative Bank replied that it had only one sale society working there. Steps were being taken to organise more sale societies and it anticipated using the facilities offered by the Reserve Bank in due course. Madras came forward with a lengthy communication on the various aspects of the scheme in August 1942. The Registrar of Co-operative Societies stated that the matter was discussed at a conference of central co-operative banks held at Madras

*Presidential Address to the Bombay Co-operative Banks' Conference held at Poona, on May 23, 1942, published in The Bombay Co-operative Quart&, June 1942.

in July 1942 and that the conference favoured the alternative of the provincial bank drawing bills on the central banks with fixed dates of payment and getting accommodation against them from the Reserve Bank, provided the Registrar's classification of banks in audit was accepted by the Bank. The Reserve Bank agreed to accept the audit classification of the Registrar for the time being but added that while fixing the credit line for a central bank, it (Reserve Bank) would be guided not only by the audit classification, but also a number of other factors. The Registrar of Co-operative Societies, Orissa, indicated that there was no possibility of that Province availing of the facilities under the scheme as there was no provincial co-operative bank in the Province and the Provincial Government themselves proposed to finance the central banks and primary societies through the Registrar. The Assam Registrar said that neither the provincial bank nor any central bank was in a position to finance primary societies for seasonal agricultural operations. The U.P. Registrar replied that there was no provincial bank in his Province. No comments were received from Bengal.

Even as far back as April 1942, although only four Provinces had replied and only one, namely the Bombay Provincial Co-operative Bank, had indicated a desire to take advantage of the facilities, the Bank decided to go ahead with the scheme. In this connection the Deputy Governor (Mr. Deshmukh) remarked: 'We have raised hopes and expectations and must work the scheme as best as we can'. As regards the application from the Bombay Provincial Cooperative Bank, while the request was in respect of accommodation to three central banks, the Reserve Bank sanctioned limits in respect of two central banks, namely, those of Karnatak and Broach. For, in considering the application, the Bank desired to have detailed information on the position of these banks and there was delay in the Belgaum central bank's submitting the material. The scrutiny of the material of the two banks took some time and the Bank's sanction of the limits was communicated in January 1943. A credit line of Rs. 3 lakhs was sanctioned to the bank for advances to the Broach and the Karnatak central banks, not exceeding Rs. 1 lakh and Rs. 2 lakhs, respectively. The credit line was to be operative during the calendar year 1943. The ice was thus broken. The Reserve Bank agreed to give a rebate of 1 per cent; that is, its lending rate was 2 per cent, as the Bank rate then was 3 per cent.

The provincial bank drew a loan of Rs. 50,000 on March 25, 1943, in respect of its advance to the Karnatak Bank for financing the Hubli Co-operative Cotton Sale Society. It was repaid on June 18, 1943. Originally there was some confusion about the precise stage when the Reserve Bank's rebate would be given effect to and consequently the ultimate borrower did not get any concession in the rate at which

money was lent to him. Later, on a reference from the Reserve Bank, the institutions at the different levels undertook to pass the benefit of the concessional rate to the next in line. Thus, the lending rate of the provincial bank was fixed at $2\frac{1}{2}$ per cent, that of the central bank at $3\frac{1}{2}$ per cent and the rate charged by the primary society to the ultimate borrower was fixed at 5 per cent, as compared with the normal rate of $9\frac{3}{8}$ per cent. It should, however, be noted that this loan of Rs. 50,000 was only a single swallow, which did not make the summer of any impressive system.

The Officer of the Agricultural Credit Section visited the central bank and the society receiving the assistance and observed as under:

Some of the co-operative banks are at present faced with surpluses and the money market is easy. Moreover, under the present conditions of various controls and high prices of agricultural commodities, the markets are not functioning normally. I, therefore, doubt if there will be any demand for finance under the scheme so long as these conditions last.

He also stated that both the Karnatak Central Co-operative Bank and the Hubli Society felt that the rebate granted by the Reserve Bank was too small to make the scheme attractive as the co-operative institutions themselves were able to get deposits at about that rate. Another difficulty pointed out was that the amount the central bank might have to borrow from the Reserve Bank would be only a fraction of its total requirements of finance and in order to pass on the benefit of the low rate to the borrowers on the finance taken from the Reserve Bank, the bank would have to charge this low rate on the finance provided out of its own resources also. In the alternative, it had to pass on the benefit of the lower rate among the borrowing societies pro rata which would make the accounting procedure too complicated. If it passed on the benefit of the low rate to one or two societies financed with Reserve Bank funds, then it would be charged with partiality and discrimination.

A further and important point raised by the Bombay Provincial Cooperative Bank in December 1943 was whether the scheme would be available in regard to crop finance or marketing credit in areas where primary societies and co-operative purchase and sale unions were affiliated direct to the provincial bank. The Reserve Bank replied in the affirmative stating that it would be possible to extend the scheme to cover 'A' and 'B' class societies of good financial standing and approved by the Bank. It was also mentioned that the application should be sent through the Registrar of Co-operative Societies.

The last aspect, viz., routing the application through the Registrar, was objected to by the Bombay Provincial Co-operative Bank on the

ground that it was not so stated in the circular letter of January 2, 1942 and that the Reserve Bank had entertained its earlier application directly. It argued that the provincial co-operative banks should be treated on the same footing as scheduled banks, which sent their applications to the Bank direct. The bank also pointed out the need for simplifying the procedure for sanction of accommodation so that 'the grant of such accommodation can be put through expeditiously on occasions of emergency, when, principally, the provincial co-operative banks are expected to approach the Reserve Bank of India'.

The condition regarding the routing of the applications through the Registrar was in the Bank's circular of May 1938, and this was retained in the 1942 scheme. When the credit limit application from the Bombay Provincial Co-operative Bank was received in 1942, the omission to route the application through the Registrar was noticed at a late stage but the Bank did not want to delay the sanction of the limit further on this account. However, following the Bombay Provincial Bank's representation, the Bank decided in March 1944 that as long as the application for placing a co-operative bank on the approved list came through the Registrar, it was unnecessary to have the application for limits to be routed through him again. The Deputy Governor, Mr. Wajahat Hussain, noted:

So far as limits are concerned, these are matters to determine which he (the Registrar) has no special qualification which we have. We have a fair knowledge of the financial position of each central bank and the knowledge can be supplemented only to a small extent by the Registrar.

Accordingly, a direction was given to the effect that applications might be received direct by the Bank, though it reserved to itself the discretion to consult the Registrar in a particular case; the Bombay Provincial Co-operative Bank was advised accordingly.

A second set of limits under the scheme of rediscounts and advances was sanctioned to the Bombay Provincial Co-operative Bank in April 1944, Rs. 8 lakhs for the Karnatak Central Co-operative Bank and Rs. 0.45 lakh for the Garbada Vibhag Co-operative Purchase and Sale Union. These limits were sanctioned as advances under Section 17(4) (c) as on the earlier occasion. The limits were to be operative till the end of the relative calendar year, that is, 1944. They were not, however, utilised.

Extension of Concession to Seasonal Agricultural Operations

Apart from monetary ease, the low utilization of the Reserve Bank's assistance was due to the fact that co-operative marketing had not very much developed in India. The Bank, therefore, decided that the

concessional finance might be extended to cover 'seasonal agricultural operations' also. Incidentally, this decision, like the January 1942 circular, does not appear to have been placed before either the Committee or the Central Board, for approval, though the Board was informed of this in the Quarterly Reports on the activities of the Agricultural Credit Department. The extension was advised through a circular issued on November 18, 1944. The circular made it specific that the limits would be operative for a calendar year and that the applications should be sent through the Registrar, which appeared to be a reversal of the earlier decision. A copy of the application was however to be sent to the Reserve Bank in advance so that the Bank might process it pending the receipt of the formal application through the Registrar. It was stated clearly that the scheme would also cover bills and promissory notes of primary credit or sale societies financed directly by a provincial bank provided the societies fulfilled all the conditions laid down in the case of central banks. Finally, the rebate was not to be admissible in respect of loans made by provincial banks and central banks direct to individuals.

The U.P. Provincial Co-operative Bank was the first to take interest in the scheme shortly after its establishment in December 1944. In February 1945, the Registrar of Co-operative Societies of that Province wrote to the Bank, pleading for an enhancement of the rebate from 1 to 2 per cent, on the presumption that the object of the Bank in proposing the scheme was 'to enable the local and regional co-operative institutions to raise money at a cheap rate in their respective spheres with the assurance behind them that in case they fail to raise the money locally, they will be financed by the Reserve Bank itself'. It was stated by him that the cost of management of the central co-operative banks in his Province was as high as 2 per cent of their working capital, because of low level of their business and, as such, their rate to the ultimate borrower would have to be high.

In the circumstances, the Bank decided, in April 1945, to enhance the rebate to 1½ per cent in the case of U.P.; the position was to be reviewed after one year and the concession continued if the Bank was satisfied that the cost of management of the provincial and central banks was reduced. It could be argued that lowering the lending rate in circumstances where the costs in a particular Province were high would act as a disincentive to lowering of the costs. Apparently, the Bank wished to offer a special inducement to a new provincial co-operative bank to start using the Reserve Bank's facilities, especially since there had been so little resort to the Bank by the co-operative banks as a whole. It may be added that the enhanced rebate of 1½ per cent was made applicable to all the Provinces in July 1946.

Between May and November 1945 the Reserve Bank sanctioned credit limits for a total of Rs. 4.30 lakhs to the U.P. Provincial Cooperative Bank in respect of its accommodation to eight central banks and one marketing union, the individual limits varying from Rs. 25,000 to Rs. 75,000. The first sanction was on May 3, for the Ghazipur District Co-operative Bank, for a sum of Rs. 60,000. All these limits were sanctioned in terms of Section 17 (2) (b), that is, rediscount of agricultural paper. No sum was actually drawn till the end of 1945; in later years, small sums were drawn.

No other provincial bank sought assistance against agricultural paper. The C.P. and Berar Provincial Co-operative Bank sought some clarifications in the scheme, but no application for assistance materialised. The Punjab Registrar stated that the co-operative institutions in his Province had large surplus funds. The Madras Provincial Cooperative Bank said that the central banks of A or B class did not come to it for financing and that it was able to finance the requirements of other banks through monies raised as fixed deposits, on which the maximum rate of interest which the bank had to pay was 2 per cent.

Accommodation against Government Securities -Section 17(4) (a)

The provision of accommodation by the Bank even against Government and other trustee securities [Section 17(4) (a)] raised interesting issues, though the order of assistance disbursed was small, under Rs. 1 crore. The Bombay Provincial Co-operative Bank was the first to be sanctioned a credit line under this Section, in February 1939, though no amount was specified, and the bank did not actually draw on the limit; the limit was fixed at Rs. 20 lakhs from July 1940 and later enhanced to Rs. 30 lakhs in February 1942. During the period of the war, only two provincial co-operative banks actually used the facilities under this Section, namely, the Madras Provincial Co-operative Bank to the extent of Rs. 69 lakhs and the Punjab Provincial Co-operative Bank to the extent of Rs. 5 lakhs. The Madras bank drew Rs. 24 lakhs, Rs. 5 lakhs, Rs. 20 lakhs and Rs. 20 lakhs, respectively, in 1939-40, 1940-41, 1941-42 and 1943-44; the Punjab bank drew the amount in 1940-41. These advances were for periods not exceeding 90 days and were made at the Bank rate. It would appear that the Madras Provincial Co-operative Bank utilised the facilities more with a view to earning a profit than to meet a genuine need for funds. In March 1940, while examining the financial particulars of the bank at the time of sanctioning an additional limit of Rs. 20 lakhs, over and above the earlier limit of Rs. 10 lakhs, it was noticed that as on March 1, 1940, against demand and time liabilities totalling Rs. 209 lakhs, the bank had investments to the extent of Rs. 144 lakhs and advances for Rs. 96 lakhs. The action

of the bank in seeking accommodation from the Reserve Bank against the pledge of Government securities, in preference to selling a part of its holdings of such securities, was commented upon by the Governor in the following terms:

The trouble with these people is that they have not been able to resist the temptation to over-invest and then borrow to the hilt against their investments. This may enable them to scrape together a little extra business and profit but it obviously weakens their long range position.

These views were also conveyed to the provincial bank informally through the Madras Manager of the Bank.

Though in its circular of May 1938 the Bank had indicated that accommodation under Section 17(4) (a) would be available against both Government securities and approved debentures of recognised land mortgage banks, which were declared as trustee securities, if the bank considered that the debentures were readily marketable, in actual practice all accommodation under the Section was granted against Government securities only. On the other hand, the co-operative sector was demanding the Bank's support to these debentures by way of some subscription by the Bank, besides granting advances against these securities. The matter was revived in the Thirteenth Conference of Registrars held on December 12 and 13, 1939, and a resolution was passed in this regard, as follows:

This Conference recommends that the Reserve Bank should purchase a limited amount of the debentures of approved central land mortgage banks and such provincial banks as raise debentures the principal and interest of which is guaranteed by Government and should advance money against such debentures.

However, the Bank's attitude did not change, for reasons which are explained in the following account of the matter.

In January 1940, the Madras Provincial Co-operative Bank enquired whether the Bank would accept the debentures of the Madras Cooperative Central Land Mortgage Bank as security for advances under Section 17 (4) (a). The Agricultural Credit Department was inclined to agree to the proposal and made out a reply to the Madras Manager to this effect, in which a margin of 20 per cent on the market value of debentures was suggested. It was also proposed to stipulate that the purpose for which advances were to be sanctioned should be ascertained and the limit sanctioned only when there was a genuine need for it and that the object of the loan was to meet strictly the short-term requirements and that the proceeds were not to be utilised by the bank for purposes of financing the land mortgage bank or undertaking any other long-term commitment. These recommendations had the support of Deputy Governor Nanavati.

When the case was put up to the Governor in February 1940, he practically rejected the proposal, his remarks being as follows:

I am not satisfied with the position as regards these debentures and I think that we should write to the Madras Government pointing out our difficulties and ask them to face up to the position. The ideas these people have seem to me to be radically wrong. The debentures should be held by the investors and . . . it seems to me that an unduly large proportion of them is held by co-operative banks and other quasi-governmental institutions who are not in a position to make such large permanent investments and merely hold them as a basis for advances. To their minds it may seem a simple enough proposition so long as we are willing to lend against them at 3 per cent and they can get a higher rate. On the other hand, if anything should happen, and in war time we must be prepared for everything, we would simply find our security vanish, leaving both them and us in the lurch because there would be no genuine investor prepared to take them up The second feature which I do not like and which I think we should take the opportunity of bringing up is this Government guarantee. At first vague hopes were held out that sooner or later this guarantee would stop and that debentures could be floated with nothing behind them but the assets and the credit of the land mortgage bank. These hopes are rapidly failing and in view of the low rates of interest at which they are passing the money on to the agriculturist, I do not see any possibility of their being brought into effect as the jolt from the present low rates to the high rates which the market would probably insist on would prove insuperable politically. If that is so and if the Madras Government consider that for political reasons they should finance the agriculturist they ought to do so out of their own ways and means or by embodying such loans in their annual capital requirements, as the taxpayer and the investor would then know where they stood I feel that the stage has now been reached where we should substantiate these facts with such details as we possess regarding the distribution of these debentures and put the matter fairly and squarely before the Madras Government and ask what they propose to do about it

The office found that out of Rs. 160 lakhs worth of debentures, the Madras Provincial Co-operative Bank held Rs. 16 lakhs, other cooperative banks Rs. 50 lakhs, public bodies Rs. 55 lakhs, other joint-stock companies including insurance companies Rs. 25 lakhs and individual investors Rs. 13 lakhs.

In the Agricultural Credit Department's notings, several points in favour of acceding to the request of the Madras Provincial Co-operative Bank were mentioned, namely:

(a) Apart from co-operative banks and public bodies who held a major portion of the debentures, a substantial amount was held by joint-stock companies and individual investors. It was not correct to say that the co-operatives and public bodies were not in a position to make such large permanent investments and that they held them

merely as a basis for advances from the Bank. The local bodies presumably had large amounts on account of provident funds and security deposits of employees, which they had to invest in securities.

(b) As regards co-operative banks, they had large amounts representing their reserve funds which they had to invest outside their business. The investment of such funds in the debentures was to make the funds of co-operatives available to the co-operative movement itself.

(c) The Madras Legislature had fixed a limit of Rs.2½ crores for guarantee against which the amount of debentures outstanding was Rs.1.60 crores only. Thus, there was considerable margin left over.

(d) In any case, the question of guarantee need not be mixed up with the issue under discussion. Whether the Reserve Bank of India approved the Government's policy in regard to guarantee or not, the debentures thus guaranteed were already there and they were eligible security for advances.

(e) There had been considerable agitation in regard to Reserve Bank's attitude towards the debentures of land mortgage banks and there had been an insistent demand that the Bank purchase some of these debentures as a token of good-will and also in order to create greater interest in them. Even distinguished co-operators like Mr. V. L. Mehta, who was generally well disposed towards the Reserve Bank, were of the view that the Bank could at least purchase a few debentures of the Madras bank, which was doing so well. The same point had also been mentioned at the Registrars' Conference held at Madras.

(f) This was a test case and the security was good. Further, the additional security of the provincial co-operative bank was also there. The position of the bank was also sound.

(g) If the Reserve Bank did not agree to this request from Madras it would give further ammunition to a leading co-operator in that Province to carry on propaganda against the Bank.

Although the Deputy Governor endorsed these views of the Officer-in-Charge of the Agricultural Credit Department, Mr. Ambegaokar, apparently the Governor was not convinced by the above arguments, but before writing to the Madras Government to convey his views, he consulted the Government of India. In his letter of May 1, 1940 to the Finance Secretary, besides mentioning the points he made in his office note, the Governor stated as follows:

As these debentures are fully guaranteed both as to principal and interest, it would of course be open to us to say that we were prepared to regard them as on the same footing as Government loans without

more ado, and it is obvious that our reluctance to accept this view of them is being as mere obstruction. On the other hand, as a Central Bank I feel that it is incumbent on us to look on the matter not merely as a commercial proposition but also as advisers to Government in respect of their financial policy, and that in fact it is the latter consideration which ought to weigh with us and not the former.

From that point of view, the first thing to get clear is what the Government policy is. Their alleged ideals were to give this guarantee as a start, and thereafter, once the banks had established themselves, to abandon the guarantee so that future issues would stand on their own legs. There has, however, been a marked divergence from this in recent years. In the first place, in view of the somewhat curious view that interest rates should be reduced to the agriculturist simply because he was alleged not to be able to pay more, the rates have been cut down to such an extent that they compete unfavourably with those which the market can get by lending to first class commercial concerns. Secondly, Government went on increasing the emphasis of the Governmental nature of these loans .

...

The result has been that these debentures have made very little headway with the public. . . .

It is true that if we modified our attitude and let the public know that we regarded them as exactly on the same footing as other Government loans, the proportion held by them would increase, but by doing so I maintain that we would be widening the gulf between the guarantee and non-guarantee status, and in fact make it to my mind impossible for Government ever to discontinue its guarantees.

The only solution which occurs to me is that we should maintain our attitude of aloofness for the present and that Provincial Governments should be prepared in the case of future issues to agree to higher rates of interest so as to attract a larger proportion of genuine public money. I would be glad of your approval of our attitude that we should not be prepared to advance against these debentures in spite of the fact that legally they provide us with as good security as other Government loans, until the question of policy has been more clearly defined.

The above policy was approved by the Government of India and this was also conveyed to the Madras Government in August 1940, with a copy to other Provincial Governments. The Bank also suggested that debentures might be issued by tender in blocks of Rs. 10 to Rs. 20 lakhs, and it offered to take up the residuum of an issue if the public support was forthcoming to the bulk of it, so as to prevent the marginal rate making the total too high. The Bank felt that it might be possible later on, when conditions were more favourable, to put out a non-guaranteed issue, for the success of which it promised to render such assistance as it reasonably could. If this process meant an increase in the rate of interest charged to the agriculturists, it had to be faced. If the Provincial Government did not favour this plan, the only alternative, both from the point of view of the creditors as well as the borrowers, was to drop the conception of guarantee as a temporary necessity and for the Government to make a straight loan to the land

mortgage bank and to include its requirements in the ordinary loan programme of the Government.

In their reply, forwarded in March 1941, the Madras Government indicated that it had always been their intention eventually to end the guarantee system and that preparatory measures were being taken towards that end. This position was confirmed by the Registrar of Co-operative Societies, Madras, during the Deputy Governor's visit to that Province in October 1941. He stated that steps were being taken to strengthen the Central Land Mortgage Bank by building up its reserves and increasing its margin in the rate of interest so that it would be possible for the bank in the not too remote future to stand on its own legs and dispense with Government guarantee. The Reserve Bank took note of these developments and suggested in its letter dated October 9, 1941 that the Government might set a limit of say Rs. 5 crores up to which they would guarantee the debentures and in the meantime ensure through the Registrar's control that by the time that limit was reached, the bank was strong enough to inspire confidence among investors and to attract debentures without a guarantee. The fixation of such a limit would make it possible for the Reserve Bank 'to consider on its merits any application for the grant of accommodation under Section 17(4) of the Reserve Bank Act and even to purchase a small block of a new issue of guaranteed debentures as a token of our interest in the movement, if this is likely to improve their marketability'. It would appear that the Madras Government were not averse to the suggestion of the Bank for fixing a limit to the guarantee though they were not sure as to when the level of Rs. 5 crores would be reached, since as of the time of their reply to the Bank, in January 1942, the outstanding debenture amount guaranteed was only Rs. 2.64 crores and the prospects were for the outstanding amount to remain steady, with repayments and new issues being about equal. It does not appear that the Bank made any advances against land mortgage debentures, till the end of the war period. The provincial co-operative banks did not also appear to be in need of funds, by and large, The Bank had considered from the beginning that the request from Madras was only a token one, intending the Bank to commit to a principle regarding such advances.

Scheme for Remittance Facilities, 1940

Reference has been made in Chapter 15 to the introduction by the Bank of a new scheme for remittance facilities, in October 1940. The Bank's policies with regard to the application of the scheme to co-operative institutions are discussed below.

Till October 1940, co-operative banks were allowed free remittance facilities in respect of remittances of interest or investments realised for payment to the accounts of local boards and municipalities who used to invest their surplus funds in co-operative banks. Free remittance facilities were also allowed for bona fide transfer of funds between cooperative societies and co-operative central banks situated at places where there was no office of the Reserve Bank or its branch or agency, provided the amount remitted was not less than Rs.150. For all other purposes, the co-operative banks and societies were paying the same remittance charges as the general public.

Under the new scheme, the general rates for telegraphic transfers, drafts and mail transfers for both the scheduled and the co-operative banks were the same, viz., 1/16 per cent for amounts up to Rs. 5,000 and 1/32 per cent for amounts above Rs. 5,000, except that the minimum commission was fixed at four annas for the co-operative banks as against one rupee for the scheduled banks. However, the scheduled banks were given, in addition,

- (a) free remittance facilities between accounts maintained with the Reserve Bank;
- (b) free remittance facilities once a week to their principal account with the Reserve Bank; and
- (c) a concessive rate of 1/64 per cent for other remittances to their principal account.

The Bank explained that so far as (a) was concerned, the provincial co-operative banks rarely kept their accounts at more than one office of the Bank so that this facility could not be availed of by them to any considerable extent. Concessions (b) and (c) had been given to the scheduled banks primarily for the purpose of maintaining their statutory balances with the Bank; since the provincial co-operative banks did not as a rule maintain such minimum balances, the question of extending the facilities to them did not arise. The Bank, however, assured the provincial co-operative banks that when they did maintain balances with it, they would be entitled to the above additional facilities.

With the introduction of the new scheme in October 1940, the limited free facilities enjoyed by the co-operative banks and societies were withdrawn. The new scheme evoked immediate protests from the cooperative movement; there were charges of discrimination against the co-operative sector. Mainly at the instance of Director Sir Purshotamdas Thakurdas, who took a lot of interest in the co-operatives, the Bank addressed the Provincial Governments in October 1940, indicating to them that if the old free remittance facilities were to continue to be available to co-operative banks and societies either fully or partially, it

had no objection provided the Governments concerned met the cost of commission involved. The Bank's main argument was that it had to pay commission to the Imperial Bank on all its drawals effected through that bank and it was only equitable that charges thus incurred on behalf of the co-operative banks and societies should be reimbursed to the Bank. Otherwise, the burden would ultimately devolve on the Central Government by reducing the surplus profit of the Bank transferable to the Government. None of the Provincial Governments, with the exception of the C.P. and Berar, agreed to bear the remittance charges and revive the old free facilities.

The co-operative movement was dissatisfied with the scheme and pressed its demands for better remittance facilities on par with those enjoyed by scheduled banks. For instance, the Bombay Co-operative Quarterly in its issue of September 1940 wrote:

as the Indian Central Banking Inquiry Committee pointed out the free remittance of funds for co-operative purposes is of utmost importance to the co-operative movement -and one may add to the organization of agricultural credit in general -and no attempts should be made to curtail this privilege.

That is, however, exactly what the authorities of the Reserve Bank of India have now done according to the new schedule of rates they propose to bring into effect from 1st October. This decision runs counter to the considered views of all inquiry committees and the resolutions adopted at the Conferences of Registrars. It will impose a heavy burden on societies in rural areas at a time when their margins of profit, usually kept low, have contracted owing to the desire to reduce the burden of interest on the agricultural borrower and they can ill afford to bear additional charges

It is curious that while the Reserve Bank of India has established a full-fledged and costly Agricultural Credit Department, no attempt was made before the decision of the Bank was announced even to sound, much less to consult, co-operative banks and societies on a subject which so vitally affects their future finances and the orders, therefore, come to them as a bolt from the blue.

Some provincial co-operative banks and the Indian Co-operative Banks' Association also registered a similar protest. These protests moved the Bank to re-examine the issue and to extend within a year all the remittance facilities enjoyed by the scheduled banks to the provincial cooperative banks and their affiliated central banks (which were considered as their branches). However, it must be said that the Bank needed a great deal of goading from the co-operative movement to yield to its demands. To illustrate, in March 1941, after discussion with leading co-operative institutions, the Bank issued a revised scheme, which was designed to bring into line with scheduled banks such of the provincial co-operative banks (and their affiliates) as had their head offices in places where there were offices of the Reserve Bank and

agreed to maintain balances with the Bank to the extent of $2\frac{1}{2}$ per cent of their demand and 1 per cent of their time liabilities (these rates being half of those required of the scheduled banks). These banks were to be entitled to the same facilities as scheduled banks, with the exception of one benefit, viz., the free transfer of an amount of Rs. 10,000 or multiples thereof; this was not extended to the co-operative banks on the ground that such extra provincial remittances would be rare and not also necessary for bona fide co-operative business. In the light of criticisms of these proposals, the Bank agreed in July 1941 to extend the remaining benefit also to the co-operative banks and it also assured that a liberal interpretation would be given to 'bona fide co-operative purposes' so as to regard generally all business carried on in terms of the Co-operative Societies Act, rules and bye-laws as bona fide. The revised scheme came into effect in September 1941 and, one by one, most of the eligible co-operative banks started utilising the facilities.

A further liberalisation of the scheme was made in November 1941, under which a branch of a provincial co-operative bank or an affiliated central co-operative bank, at places where there was no branch of the Bank or its agencies, was granted the facility of making remittances of Rs. 5,000 or multiples thereof free of charge once a week to the principal account with the Bank, other remittances to the principal account being charged $1/64$ per cent. In respect of such remittances, the scheduled banks had to pay $1/16$ per cent up to Rs. 5,000 and $1/32$ per cent over Rs. 5,000, unless such transfers were between accounts maintained by them at the Bank's offices or agencies.

Thus, within a little more than a year, the co-operative banks succeeded in pressing the Bank to give them remittance benefits to an extent not only equal to those enjoyed by the scheduled banks, but perhaps even better.

Indigenous Bankers

During the period under review, there were hardly any fruitful developments in the matter of linking the indigenous bankers with the organised banking structure. While even Sir Purshotamdas Thakurdas had agreed that the Bank had done all it could and the ball was in their court, Sir Chunilal B. Mehta, another Director of the Bank, in the capacity of President of the Bombay Shroffs Association and in his personal capacity, time and again criticised the Bank for treating the subject as closed and not bringing it within the ambit of the proposals for a Bank Act. The main difference of opinion between him and the Bank's management lay in regarding the shedding of non-banking business by indigenous bankers as a pre-requisite for the 'link up'. Sir Chunilal brought up the question at a meeting of the Central Board

of the Bank in July 1941, suggesting that the Bank might review its proposals for the 'link up', but Sir James Taylor considered that there was no case for the Bank to change its view. Reluctantly agreeing to a suggestion made by Deputy Governor Nanavati that the Bank might write to Sir Chunilal to send definite proposals for modification of the Bank's scheme, the Governor remarked, in September 1941, as follows:

I doubt whether this will lead to anything. It is quite clear that unless we are to stultify not only our own legislative proposals but the wishes of the Legislature as expressed in the latest amendment of the Companies Act, development in this country must proceed in the direction of separating banking from non-banking functions.

Accordingly, a letter was addressed by the Bank to Sir Chunilal Mehta in October 1941, asking him to intimate how many members of the Bombay Shroffs Association would be prepared to join in the scheme if a modification was made permitting separation of their banking from their non-banking business, if not immediately, at least within a definite period of time. The response was, as anticipated, not encouraging. In its reply sent several months later, that is, in April 1942, the Association asked for a five-year period for legal separation of banking from non-banking business. It could not give any indication of the number of shroffs likely to join the scheme, but only gave a vague assurance that it would 'take all necessary steps to explain the scheme and bring in as many shroffs as possible within the scheme'.

The Bank was unable to understand why such a long period as five years would be needed for the purpose of a simple process of floating a separate company to do banking business. It also found the assurance of the Association that it would publicise the scheme among shroffs too meagre a basis for recommending to Government the necessary amendments to the Act. The Bank therefore confessed 'a misgiving on the utility of any attempt to evolve a workable scheme which would be capable of application on any appreciable scale in the present condition' and hoped that the trend towards legal segregation of banking among indigenous bankers would develop in course of time.

Other Activities

The other activities of the Bank in regard to agricultural credit during the period under review consisted mainly in advising Central and Provincial Governments and provincial co-operative banks on problems connected with agricultural finance and making suggestions for reorganisation of the co-operative credit structure in different parts of the country. One of the important problems on which advice was given related to the rehabilitation of the co-operative movement, which had

suffered on account of the depression of the 'thirties. Among the Provinces which received particular attention in this regard were C.P. and Berar and Bengal.

The Bank's Agricultural Credit Department continued its study of moneylending and debt relief legislation in the several Provinces and furnished its observations on these subjects to the Provincial Governments and commissions of enquiry set up by some of the Provincial Governments. The other topics taken up for study by the Department included land mortgage banking in India, cattle and crop insurance, multi-purpose co-operative societies in Bombay, establishment of licensed warehouses in Madras and Bengal, commercial banking activities of co-operative banks, especially in C.P. and Berar, constitution of sinking funds of land mortgage banks, investment of funds of co-operative banks, etc. Further, in an attempt to aid the creation of documents of title to goods acceptable to the Bank under Section 17 (4) (d), a draft Bill for the establishment of licensed warehouses was prepared and circulated in 1944 to all the Provincial Governments for adoption. During the period covered by this chapter, three Provincial Governments took steps to pass the legislation.

The Department also kept in close touch with the co-operative movement by taking part in conferences, participating in seminars and training courses for co-operative personnel etc. The most important of the conferences in which the Department participated were the Thirteenth and Fourteenth Conferences of the Registrars of Co-operative Societies. While the Officer-in-Charge of the Department took an active part in the Thirteenth Conference held at New Delhi in 1939, the Fourteenth Conference was organised and conducted by the Department itself in 1944. Various aspects of the co-operative movement were reviewed at these conferences, which furnished opportunities for exchange of views between the Reserve Bank and the co-operators both at the non-official and official levels. Apart from these conferences, the Officer-in-Charge and officers of the Department undertook tours of various Provinces to study specific problems or to attend provincial conferences and seminars, which served to strengthen the personal contacts established by them. The Bank also imparted training to officers of the co-operative departments of some of the Provinces, especially Madras and Bombay, which also served the purpose of the Reserve Bank's gaining better understanding of the problems of the Provinces concerned. Some officers of the Government of India and the Government of Burma also received training in the Department.

The period covered by this chapter saw the Department's taking over the publication of statistics and reviews of the co-operative movement in India. The compilation and publication of the Statistical Statements Relating to the Co-operative Movement in India was taken over from

the Government of India with effect from the issue for the year 1940-41 and two issues in the series, one relating to the year 1940-41 and the other to the years 1941-42 and 1942-43, were published. The Department also brought out the Review of the Co-operative Movement in India for 1939-40, which was the first of the series of reviews. The publication of further issues of this review had to be suspended during the war years; the second publication in this series was brought out only in 1948, covering the period 1939 to 1946.

The Officer-in-Charge of the Agricultural Credit Section also served as the Member-Secretary of two committees appointed by the Government of India during the period covered by this chapter. The first of the committees, viz., the Agricultural Finance Sub-Committee was appointed in September 1944, with Professor D. R. Gadgil as its Chairman, 'to report on the ways in which indebtedness could be reduced and finance both short-term and long-term provided under efficient control for agriculture and animal husbandry operations'. The second committee, named the Co-operative Planning Committee, was appointed in January 1945, under the chairmanship of Mr. R. G. Saraiya, in pursuance of a recommendation of the Fourteenth Conference of the Registrars of Co-operative Societies 'to draw up a plan for co-operative development'. The reports of both the Committees were submitted in 1945. Apart from attending to the secretarial work, the Department prepared a number of notes on various aspects of the terms of reference of the Committees and generally placed the material with it at the disposal of the Committees. The Co-operative Planning Committee, in particular, received valuable help and guidance at every stage of its work from Deputy Governor Mr. Wajahat Hussain, who had imparted dynamism to the work of the Bank's Agricultural Credit Department. In an In Memoriam attached to its report on his death in December 1945, the Co-operative Planning Committee expressed its appreciation of Mr. Wajahat Hussain's services in the following terms:

Since the Report of the Committee was signed we have learnt with profound grief of the premature and sudden demise of Mr. Wajahat Hussain, Deputy Governor of the Reserve Bank of India. It is our unanimous desire to place on record our deep sense of gratitude to the late Mr. Wajahat Hussain for the invaluable assistance we received from him. Although not a member, he was closely associated with the work of the Committee and brought to bear on it his long administrative experience, his mature judgment and above all, his deep sympathy for the welfare of the rural population of India. By his premature death, the Co-operative movement has been deprived of a true friend who had abiding faith in silent and unostentatious work. By his good humour, sweet courtesy and social charm, he had endeared himself to each one of us and we shall always cherish the memory of the days we spent with him.

Summing up, it may be said that however small and halting, some progress was made during the war years in the Bank's role in the sphere of agricultural credit, although the co-operative sector remained largely critical of the Bank's outlook and policies. The Legislature, as already referred to in the previous chapter, was even more critical of the Bank's performance in this matter. However, the fact is, that slowly, may be very slowly, the Bank's attitudes changed, with greater contacts with the co-operative institutions and awareness of the practical issues involved.

THE POST-WAR YEARS: 1945-51

Changes in the Bank's Organisation and Status

The five years or so from the end of the war in 1945 covered in this section constitute a distinct and eventful period in the Bank's history, as of the Indian economy in general. These were years of transition from a war to a peace economy, and the problems inherent in the process were aggravated by political uncertainties, culminating in partition of the Indian sub-continent. The country and the Bank went through much travail during the period. But it could be said broadly that by about 1950-51 the post-war transition was over and conditions were more or less propitious for embarking on developments effort on a planned basis; the Bank was also organisationally equipped to shoulder its responsibilities in the task of economic development.

The partition of the country altered the territorial jurisdiction of the Bank, which became the central banking authority for the Dominion of India (later Indian Union) only, after a brief interlude of serving both the new Dominions. The Bank endeavoured to handle the several administrative and organisational problems associated with this change, including the division of its assets and liabilities, firmly and fairly. Another important development concerned the change in the Bank's status from a shareholders' institution to a Government-owned one. The nationalisation of the Bank, effective January 1, 1949, was rendered smooth by, among other things, the continuance in office of Governor Deshmukh and Deputy Governor Trevor after the end of their normal term and the nomination of a majority of the members of the new Local Boards from the outgoing members and of the Presidents of the erstwhile Local Boards as Directors of the Central Board.

In the sphere of monetary policy, the period was characterized by a gradual retreat from cheap money; the Bank successfully resisted

Government's efforts early in the period to reduce the Bank rate, and later dexterously managed to bring about a modest but distinct reversal of cheap money, in accordance with the needs of the situation. There was, however, no change in the Bank rate; it was raised only in November 1951. The Bank's open market operations were designed to facilitate the restoration of the normal pattern of credit extension by banks, help finance the heavy balance of payments deficit on current and capital accounts and contribute to the maintenance of public confidence in the gilt-edged market during the years of political uncertainty and turmoil.

There were important developments in the fields of commercial and co-operative banking. Outstanding among these was the enactment, in May 1949, of comprehensive legislation to regulate the establishment and working of commercial banks, the major effort for this coming from the Bank. In the field of rural credit, the Bank made a distinct though modest progress in getting closer to the co-operative movement. The Bank's credit facilities to the co-operative institutions were liberalised. Steps were also initiated to enlarge substantially the Bank's role in the sphere of rural credit. The appointment (by Government, on the Bank's initiative) of the Rural Banking Enquiry Committee in 1949 and the setting up by the Bank, on the suggestion of Mr. Deshmukh who had become by then the Union Finance Minister, of the All-India Rural Credit Survey Committee in 1951, were important steps in this behalf. Besides strengthening the Agricultural Credit Department, a new Department of Banking Development was set up in 1950, mainly to implement the recommendations of the Rural Banking Enquiry Committee which submitted its report in May 1950,

The newly created Department of Research and Statistics got into stride early, and much progress was made in collecting data and organising research in a number of new directions. A new Balance of Payments Division was also created in the Department in 1949 to compile and analyse India's balance of payments, especially keeping in mind the obligation to supply information to the International Monetary Fund, the responsibility for which devolved largely on the Bank.

The period also saw change of stewardship of the Bank; Sir Benegal Rama Rau took over as Governor from July 1, 1949. There were also changes in the office of Deputy Governor, one of which came about as a result of the death of Mr. Wajahat Hussain.

In the sphere of external finance, the most important development was the satisfactory conclusion of a series of agreements on sterling balances, providing for orderly utilization of the balances for meeting India's needs of current consumption and capital development; the Bank played an active role in these matters, refuting vigorously all suggestions for a scaling down of the balances. The period also saw

India's joining the International Monetary Fund and the World Bank and the beginnings of utilisation of assistance provided by these institutions. The Governor of the Bank, in his capacity as Governor for India of the two institutions, took an active interest in their working and generally in guarding India's interests. Another important development in the sphere of external finance during the period was the devaluation of the Indian rupee in September 1949, simultaneously with the devaluation of the pound sterling and a number of other currencies.

The organisational developments, including in particular the nationalisation of the Bank, are covered in this chapter.

ORGANISATIONAL MATTERS

Changes in Governor and Deputy Governors

For the second time in its history, the Bank's top management suffered a tragic loss. Mr. Wajahat Hussain, who was on his way from Bombay to Calcutta to attend a Board meeting, passed away at Arrah, his home town, on December 4, 1945, after a very brief illness. During the short period of two years and four months for which Mr. Hussain had been Deputy Governor, he earned the love and respect of all those with whom he came in contact. In the Bank's annual report for 1945-46, an eloquent tribute was paid to his memory in the following terms:

By his death, the Bank has lost an administrator of great experience and capacity, and the Board a valuable and genial colleague and a distinguished public servant endowed with character, competence and courtesy far above the average.

At its meeting on February 25, 1946, held at Lahore, the Central Board made a unanimous recommendation for the appointment of a successor. In conformity with the prevailing convention, the choice was restricted to a Muslim. The candidate recommended was Mr. M. G. Mehkri, then Development Minister in the Jammu and Kashmir Government. The Board recommended that Mr. Mehkri be offered the same salary as Mr. Wajahat Hussain. Government accorded approval to the Central Board's proposals; Mr. Mehkri's appointment was for a term of five years with effect from July 8, 1946.

Born in 1889 and educated in Mysore and Bombay, Mr. Mehkri had a varied career in the Mysore Civil Service; the posts held by him included those of Registrar of Co-operative Societies and Chief Secretary to the State Government. In 1944, he was appointed Revenue Minister of the Government of Kashmir; later, he became its Development Minister.

The tenures of Governor Deshmukh and Deputy Governor Trevor were due to expire on August 10 and 15, 1948, respectively. The Government of India were keen to offer Sir Chintaman another full term of five years but for private reasons it was not convenient for him to accept it. However, having committed themselves to nationalising the Bank at the earliest opportunity, they desired that Sir Chintaman should continue for at least three or four months after the expiry of his term to see the arrangements through. It was also their desire that Mr. Trevor should stay on for one more year. The Directors were only too happy to recommend to Government, at the Board meeting held on July 19, 1948 the extension of Sir C. D. Deshmukh's term till the end of December 1948 and Mr. Trevor's term by another year, that is, till August 15, 1949; the terms and conditions of service were to remain unchanged in both cases.

With the enactment of the Reserve Bank (Transfer to Public Ownership) Act, 1948, the appointment of the Governor and the Deputy Governors became entirely the Central Government's responsibility but the Central Board was to determine the salaries and allowances of the chief executives as before, with the approval of the Government, as provided in Section 8(a) of the Reserve Bank Act. At Government's request, Sir Chintaman agreed to continue as Governor for a further period of six months with effect from January 1, 1949. Mr. Trevor's term was also extended by Government by a few months, up to the end of December 1949. The Central Board recommended, and Government agreed, that there should be no change in their pay and allowances.

In a resolution passed at its meeting held on June 13, 1949, the Central Board extolled Sir Chintaman's sterling services to the country 'and his 'high standard of efficiency, integrity and impartiality'; the Board also hoped that after taking sufficient rest, Sir Chintaman would put his 'great ability, administrative capacity and high sense of duty' at the disposal of the country for any responsible work he might be invited to undertake in future, and prayed that 'he may live long to distinguish himself further in the service of the motherland as one of the most noble and gifted sons of India'

Sir Benegal Rama Rau was appointed to succeed Sir Chintaman Deshmukh on July 1, 1949, his term of office being fixed at five years. (His term was extended twice, by one year and two years, respectively, though he did not serve for the full period of the second extension; he resigned in the middle of January 1957). Sir Benegal, like his two predecessors, belonged to the Indian Civil Service from which he had retired a few months earlier. Born on January 10, 1889, Sir Benegal was educated at the Universities of Madras and Cambridge and entered the Indian Civil Service in 1913. Among the several important

positions held by him, mention may be made of Secretary, Indian Taxation Committee; Financial Adviser, Simon Commission; Secretary of the Indian Delegation to the Round Table Conference and the Joint Parliamentary Committee (in this capacity he actively participated in the discussions on the question of establishing a Reserve Bank for India in the early 'thirties) ; Deputy High Commissioner for India in London; Chairman, Bombay Port Trust; and Ambassador for India in the U.S.A. To get acquainted with his new duties, Sir Benegal worked as Sir Chintaman's understudy for a few months. Early in May 1949, Government also nominated him as a Director of the Central Board of the Bank.

The new Governor's salary was fixed at Rs. 6,000 per mensem, or lower than that of the three former Governors. In advance of the meeting on June 13, 1949, the Central Board had been informed unofficially by Government that they wished that a lower salary should be fixed for the post in accordance with their general policy of scaling down the very high emoluments attached to some of the Government posts, and that the Governor-designate, who was sounded, had also expressed his willingness to accept a reduced salary. The Central Board was not inclined to agree with Government over the need to reduce the Governor's salary. Therefore, while recommending the lower salary of Rs. 6,000 p. m. for the new Governor, the Board recorded that 'in view of the importance and the status of the post of the Governor of the Reserve Bank of India, the Board do not consider that there is any justification for a change in the existing salary and other terms of service attached to the post'.

In this context, it would be appropriate to mention that some time later, that is in October 1949 when the question of amending the Reserve Bank Act comprehensively was under consideration, Government came to hold the view that the position regarding the determination of the salaries and allowances of the Governor and the Deputy Governors by the Central Board was somewhat anomalous and that it might be better to give the Government absolute power to fix these also in the same way as they were empowered to make these appointments. The matter was considered by the Central Board, which did not however agree with this view. In recommending the continuance of the status quo, the Board was guided by the analogy of other nationalised central banks, such as the Bank of England and the Bank of Canada, where the salaries of the chief executive officers were fixed by the Board. The Board further felt that:

The pay and allowances of these officers, who are non-officials, should be comparable with the scales of remuneration in the principal commercial banks. The Central Board is in a far better position than any department of the Government to suggest a scale that would attract

a man with the requisite experience and qualification. The statutory requirement in regard to the approval of the Government is an adequate safeguard against any extravagant recommendations.

In succession to Mr. C. R. Trevor, the Government of India appointed Mr. Nivarti Sundaresan as Deputy Governor for a term of five years. Mr. Sundaresan, who was born in June 1895, belonged to the Indian Audit and Accounts Service. He had a long and varied career in the Finance Department of the Government of India. He was for many years, especially during the war period, very closely associated with matters relating to currency, coinage, taxation and Government borrowing and had close contact with the Bank. He had also worked for some time in the Office of the Controller of the Currency. For about four years prior to his appointment as Deputy Governor, Mr. Sundaresan was Executive Director for India at the International Bank for Reconstruction and Development. Mr. Sundaresan was offered the same salary and leave benefits as were granted to his predecessor.

Subsequent to his relinquishment of office as Deputy Governor, Mr. Trevor was placed on special duty for a period of three months from January 1, 1950, on the same terms and conditions of service as he enjoyed as Deputy Governor, for organising the Inspection branch of the Department of Banking Operations.

Mention may also be made of the officiating arrangements during the absence on leave of Deputy Governor Trevor on two occasions, for four months and three months in 1946 and 1948, respectively. On both the occasions Mr. W. T. McCallum, Manager of the Bombay Office of the Bank, was appointed to officiate as Deputy Governor. Under Section 12(1) of the Reserve Bank Act, it was permissible to appoint an Officer of the Bank as Governor or Deputy Governor in vacancies caused by the absence on leave of the regular incumbents. No officiating appointments had, however, been made on earlier occasions in similar circumstances either because they were not considered necessary or perhaps because there was no formal provision for leave in the terms of service of the Deputy Governors until 1945.

The widening range of the Bank's activities led to the creation of the post of an Executive Director in the Bank. In August 1950, the Central Board approved the creation of the post on a temporary basis to hold charge of the new Department of Banking Development to be set up to deal with the development of banking and credit facilities in the country in pursuance of the recommendations of the Rural Banking Enquiry Committee. The post was higher in status than the Chief Accountant's but below that of the Deputy Governor; the incumbent was not to be a member of the Central Board. Mr. Burra Venkatappiah, Finance Secretary of the Bombay Government, was appointed to the post and he assumed charge on October 4, 1950. Exactly 43 years

of age on that date, Mr. Venkatappiah had had his education in the Madras and London Universities before he entered the Indian Civil Service in 1932. He was also a Member of the Rural Banking Enquiry Committee. Mr. Venkatappiah's initial term was for two years but it was extended till the end of June 1955, when he became a Deputy Governor of the Bank. He remained in that post till the close of February 1962 before taking up the office of Chairman of the State Bank of India.

Opening and Closing of Offices

During the period under review, a full-fledged office of the Issue Department was established in Delhi and a sub-office of that Department at Gauhati. Opened on December 1, 1947, and January 14, 1949, respectively, these offices were intended mainly to solve the administrative problems arising out of the servicing of the currency chests in East Punjab and Assam following the partition of the country. In pursuance of a decision taken in May 1946 to open new offices of the Bank at Nagpur and Patna mainly to relieve the pressure on the Bombay, Kanpur and Calcutta Offices, land for construction of the office premises at these centres was acquired in 1948 and 1949, respectively. However, it was not until many years afterwards that these offices were actually established: the one at Nagpur came up in 1956 and the other at Patna even later, i.e., in 1968.

Another proposal, which was on the anvil for many years but did not eventually fructify, was that to shift the Bank's office at Kanpur to Lucknow, the headquarters of the United Provinces (later Uttar Pradesh) Government. The decision to shift the Kanpur Office was taken in November 1947, mainly to meet the wishes of the Provincial Government. However, later it became clear that there were definite advantages in retaining the Bank's office at Kanpur, which was the most important commercial and industrial centre of the Province. After prolonged correspondence the Provincial (State) Government were persuaded in 1958 to agree to leave the final decision in this regard entirely to the Bank, which favoured the continuance of the office at Kanpur.

Note Cancellation Sections, which attended to the examination and disposal of soiled notes accumulated at the neighbouring currency chests, were also set up at several places in the country, viz., Lucknow, Allahabad, Agra, Ludhiana, Bangalore, Meerut, Nagpur, Patna and Ahmedabad, with a view partly to easing the increasing pressure of work at the offices of the Issue Department in handling soiled notes and partly to absorbing the staff in the Bank's offices at Karachi, Lahore and Dacca, who had opted for India. While many of these were subsequently

closed with the opening of new branches of the Issue Department or the expansion of existing branches, a few have continued to the present day. A Section at Amritsar functioned for a few months, between October 1947 and February 1948, having been opened mainly to provide immediate employment to the refugee staff from Lahore, and was closed down with the opening of the Section at Ludhiana.

Department of Banking Development

A new Department of Banking Development was set up in October 1950, mainly with the object of making arrangements for the early implementation of those proposals of the Rural Banking Enquiry Committee (see Chapter 23) on which action on the Bank's part was called for, and in particular, to give concentrated attention to the extension of banking facilities to semi-urban areas and to the problems of rural finance. The Department was intended to deal also with certain other closely allied matters such as the financing of medium and small scale industries and the establishment of State Industrial Finance Corporations. New or special problems were also expected to arise in the context of the mobilisation of rural savings or the extension of rural credit, and these were to be handled by the new Department. It was envisaged that the Department would primarily be 'a planning, initiating and co-ordinating department and only secondarily, an administrative or executive department, differing in this respect, from the Research Department of the Bank on the one hand, and from its Administrative Departments on the other, while at the same time partaking, to some extent, of the characteristics of both'. Mr. N. D. Nangia, a Senior Officer of the Bank, who had served as Member-Secretary of the Rural Banking Enquiry Committee, was the first Chief Officer of the Department.

Legal Division

In 1950 the Bank took a decision to constitute a full-fledged Legal Division in the Central Office to enable it to cope with the increasingly complex legal problems encountered by it in the discharge of its statutory functions. The work had earlier been handled by a small Legal Section formed in 1946 and put in charge of a Legal Assistant, of the rank of a Junior Officer. The coming into force of the Banking Companies Act particularly entailed considerable legal work. Further, under the new Constitution, all the acceding Indian States became States of the Republic (Part B States) and their financial integration meant the extension of the Reserve Bank of India Act to all those

territories; it was expected that the public debt of these States might also come to be managed by the Reserve Bank. All this involved a substantial increase in the volume of legal work.

In April 1950, the Committee of the Central Board approved the expansion of the Legal Section into a Legal Division with an Officer-in-Charge with sufficient experience recruited from outside. The Committee stressed at the same time that the creation of a legal department 'should not by any means result in the Bank not consulting its Solicitors or Counsel in all important cases where such opinion should be obtained'. The post of the Officer-in-Charge was filled in March 1951 by the appointment of Mr. B. N. Mehta, a Bombay Solicitor. As the Bank's activities became further diversified over the years, the Division played a useful role in tendering legal advice to the various departments and in assisting the Bank's Counsel in legal proceedings involving the Bank. Early in 1960, the Division was renamed as Legal Department and the Officer-in-Charge redesignated as Legal Adviser.

Research, Publications

With the establishment of a full-fledged Department of Research and Statistics at the close of the war, the comprehensive collection of a wide variety of data on a systematic basis and the organisation of financial and economic research gathered momentum. The Department kept itself up to date in methods of research work and statistical analysis by deputing some of its Officers to visit research organisations and departments abroad. Officers of the Department were also deputed to attend several national and international conferences on economic and financial subjects. Among the important items of work carried out by the Department may be mentioned the periodical surveys of the ownership of demand deposits of scheduled banks and of their investments in Government securities; studies on the working of stock exchanges abroad and in India, and matters relating to the statutory regulation of the stock exchanges; surveys of rural indebtedness and socio-economic conditions in selected villages or areas in association with other institutions engaged in similar research. The Department issued, starting with the first week of January 1950, weekly Index Numbers of Security Prices (General Purpose Series) with base 1938 = 100 which replaced the index numbers issued by the Economic Adviser, Government of India, with base 1927-28 = 100.

In January 1947, the Department also embarked on the publication of a monthly economic and financial journal called the Reserve Bank of India Bulletin. In this, the Bank was very much ahead of some of the older central banks and followed the pattern of the newer banks like the Federal Reserve. The contents of the Bulletin generally included

a monthly review of economic and financial conditions, articles based on the studies and surveys conducted by the Bank and a statistical section presenting monetary and economic data. Over the years, the range of the material published in the Bulletin has been enlarged and it has become an important source of reference on current monetary and economic problems.

In December 1948, a separate Balance of Payments Division was constituted for the purpose of compiling statistics of India's balance of payments along the lines adopted in advanced countries such as the U.S.A., the U.K. and Canada and the study of related problems. With a view to studying the latest techniques adopted in foreign countries in the compilation of the balance of payments statistics, two Officers of the Department, Mr. P. S. Narayan Prasad and Mr. V. G. Pendharkar, had earlier been deputed to the U.S.A. in the latter half of 1947. Mr. Prasad was appointed the first Director of the Balance of Payments Division.

An important function of the new Division was to furnish to the International Monetary Fund information relating to India's balance of payments, international investment position, etc., called for under Article VIII, Section 5, of its Articles of Agreement. To enable the Bank to comply with the requirements of the I.M.F., the Government of India had, by a notification dated October 23, 1947, conferred upon the Bank the powers to call for necessary information from all persons concerned. With the Government's concurrence, the new Division undertook a census of India's foreign assets and liabilities as of June 30, 1948, the findings of which were published in November 1950. The idea of conducting a census was actually sparked off by The Eastern Economist, which had suggested more than two years earlier (in its issue of January 11, 1946) that, since all the available estimates of the amount of foreign capital invested in India were at wide variance with one another, the Bank should embark immediately on a census of foreign investments in India in a scientific way. The Central Board of the Bank had also attached considerable importance to such a census being undertaken by the Bank, particularly in the context of the valuable material that it would make available for the sterling balances negotiations. The survey, which involved the analysis of 30,000 returns filed by individuals and institutions, yielded a large volume of useful information regarding the extent and form of foreign participation in Indian industry and trade. The study also enabled the Bank to furnish information to the I.M.F. on India's international investment position. The completion of the census was one of the early achievements of the Balance of Payments Division. It worked in close collaboration with the Customs Department of the Government of India and the Bank's Exchange Control Department, both having an important hand

in the preliminary collection of data from the importers, exporters and the authorised dealers in foreign exchange.

The services of Officers of the Department were on various occasions lent to the Government of India and other organisations; a few Officers were also appointed to represent the Bank on various financial/commercial bodies. To mention a few instances, the services of the Director of Monetary Research were placed on deputation with the Government of India as Deputy Secretary to the Tariff Board for some time in 1945 and 1946. The Director of Rural Economics was appointed a member, to represent the Bank, on the Marketing Sub-Committee of the Policy Committee on Agriculture, Forestry and Fisheries appointed by the Government of India, while the Director of Monetary Research served on its Agricultural Prices Sub-Committee to which he was appointed in 1944. The Director of Statistics was nominated as a member of the Standing Committee of Departmental Statisticians set up by Government for interim economic and statistical co-ordination. There was also participation in the Government's deliberations on the proposals for stock exchange legislation; an Officer of the Department (Mr. S. L. N. Simha) was appointed Member-Secretary of a Departmental Committee set up by the Government of India for the purpose, The same Officer was also appointed as one of the two Directors to represent the Bombay Government on the Board of the Bombay Bullion Association which had been formed in 1948. The Director of the Balance of Payments Division represented the Bank on the delegation of the Government of India which visited Karachi in 1949 for talks with representatives of the Government of Pakistan on the Trade and Payments Agreements between the two countries. He also acted as adviser to the Indian Delegation to the Commonwealth Conference held in Sydney in May 1950. In September 1950, he and another Officer of the Department (Mr. K. N. R. Ramanujam) were included in the Indian Delegation to the Meeting of Officials preparatory to the Commonwealth Finance Ministers' Conference held in London. Officers of the Department were also appointed on the Board and the staff of the International Monetary Fund.

NATIONALISATION OF THE BANK

On January 1, 1949, that is to say, 13 years and 9 months after its establishment, the Bank was transformed into a State-owned institution, in terms of the Reserve Bank (Transfer to Public Ownership) Act, 1948 -a landmark in the Bank's history.

The nationalisation of the Bank was in line with the general trend towards nationalisation of central banks abroad, which had set in three

to four years before the outbreak of the Second World War, and which gathered momentum after the war ended. In Denmark and New Zealand, the central banks were converted into wholly State-owned institutions in 1936; the same development occurred in Canada in 1938. After the end of the war, among the older central banks to be nationalised were the Bank of France (January 1946), the Bank of England (March 1946) and the Bank of the Netherlands (August 1948). Outside Europe, mention may be made of the nationalisation, in March 1946, of the central bank of the Argentine Republic set up in 1935.

In India, as already mentioned in Chapter 1, even as early as 1927 when the first Reserve Bank Bill was introduced in the Legislative Assembly, there was a strong demand for a wholly State-owned bank, and it was in fact the acute controversy over the matter of State versus private ownership which was mainly responsible for the long delay in the setting up of a central banking institution in the country. However, after the Bank had been set up in April 1935, the issue does not appear to have been widely debated in public till the announcement in 1945 of the proposal for the nationalisation of the Bank of England. The demand for nationalisation became stronger after the installation of the Interim Government at the Centre in September 1946; a nonofficial resolution urging the nationalisation of the Bank was moved in the Legislative Assembly in February 1947. Anticipating such a move, Government sought the Bank's views and advice in advance. The Governor's view was that it was premature even to refer the question to the full Board, and that Government should adopt a generally noncommittal attitude and undertake to have the matter carefully examined. However, Mr. Liaquat Ali Khan, the Finance Member of the Interim Government, announced Government's decision to nationalise the Bank in the course of his budget speech, on February 28, 1947. In January 1948, that is, after Independence, the Governor was again requested by the Finance Minister to set down his views on the proposed nationalisation of the Bank. Though the Governor made out a strong case against nationalisation at that stage, Government considered the assurance given in February 1947 binding upon themselves, and proceeded to nationalise the Bank. The Central Board of the Bank opposed nationalisation initially, but once it found that the Government's decision was irrevocable, it extended full co-operation in implementing it. These developments are narrated in detail in the following pages.

Demand for Nationalisation

The revival of the demand for a State-owned central bank followed the British Government's decision in August 1945 to nationalise the

Bank of England. In the course of the debate on the Indian Finance Bill on March 26, 1946 in the Legislative Assembly, Mr. Sarat Chandra Bose, Leader of the Opposition, asserted that nationalisation should be the keynote of all economic development in India. Mr. Bose commented that the Bank of England, 'a bank with a hoary past and great traditions,' might be nationalised, but so long as 'British imperialist domination' continued in India, the Reserve Bank of India could not possibly be nationalised.

The reply of the Finance Member, Sir Archibald Rowlands, was that he had no doubt that the Reserve Bank would be nationalised in the near future. He thought:

the real reason why it was not nationalised in the first instance was that the Legislature was not prepared to commit to the sole charge of an irresponsible Executive an institution which plays such an important part in the economic life of India.

Some months later, after the installation of the Interim Government at the Centre in September 1946, there was a strong demand from some Members of the Legislature and also a section of the press that Government should nationalise industries, public utilities, banks, civil aviation, etc.

The Finance Department, anticipating that during the consideration of the Banking Companies Bill Members would harp on the same theme, considered it was high time that Government decided upon their attitude to the question of nationalisation. The Bank was therefore requested towards the close of 1946 to convey its opinion regarding 'the possible advantages or disadvantages of nationalisation'.

Views of the Bank's Executives

Pending examination of the matter by the Bank's Research Department and before obtaining the informal views of the Committee of the Central Board on the subject, Deputy Governor Trevor (to whom the Finance Department's letter was addressed in the absence of the Governor from headquarters), discussed the issue with the Governor on his return and sent an interim reply to Government, which he observed, 'sets forth our own personal views'.

The Deputy Governor was of the view that the possible reasons for the agitation for nationalisation could be: (i) that the Bank had failed to fulfil the expectations to which its establishment had given rise, or (ii) that it was feared that in future the Bank would not prove 'sufficiently pliable and responsive to the wishes of the Government in power'. In respect of (i), he mentioned that there had not been any 'well-founded criticism' of the manner in which the Bank had carried

out its responsibilities; in fact, successive Finance Members had expressed satisfaction about the help the Bank had rendered to Government and had greatly appreciated the advice tendered by the elected Directors on the Board. As regards (ii) there was no reason to fear that the Bank would not endeavour to continue to carry out its duties and responsibilities 'as carefully and efficiently' as it had done in the past. The letter observed:

We feel that nationalisation would not lead to any increased efficiency in the running of the Bank, but rather that its processes would be slowed down and its efficiency impaired owing to the intrusion of extraneous factors.

The Deputy Governor suggested that if any 'oblique' reference to the nationalisation of the Bank was made by the Select Committee on the Banking Companies Bill *, Government's answer should be that it was premature to consider the matter until a permanent constitution for the country had been framed.

The note of the Research Department, prepared by Messrs Prasad and Simha, drew attention to the fact that the nationalisations of the Bank of England, which had prompted the call for a similar step in India, was mainly a 'de jure recognition of a de facto state of affairs'. There was practically no change otherwise in the working of the Bank. The main reason for nationalisation was the desire of the Government to ensure absolute loyalty of the Bank to the Government. In India, on the other hand, the Government already possessed adequate powers to ensure that their wishes would be carried out by the Reserve Bank. Also, the Bank had paid only conservative dividends, the surplus profits accruing to Government. An appraisal of the Bank's working during the short period of its existence, the note remarked, was rendered difficult because the floatation of numerous loans, the repatriation of sterling debt and the administration of exchange control engaged so much of the Bank's attention that it could not have given due consideration to other important problems. Also, the Bank had to function within the framework of its constitution, and it could not always pursue policies according to its own wishes. The note, however, listed a few important achievements of the Bank.

Referring to the criticism regarding the Bank's 'acquiescence' in the enormous currency expansion during the war years against sterling assets, and the resultant inflationary conditions in the country, the note remarked that the critics had not given due weight to the provision in the Act which imposed an obligation on the Bank to exchange rupees

* In a minute of dissent signed by five members appended to the Report of the Committee, it was stated:

Lastly, we wish to add that all banks should be nationalised at an early date and that as a first step, the Reserve Bank and the Imperial Bank may be made State Banks.

for sterling. 'It was open to the Legislature', the note argued, 'to have pressed for an amendment of the concerned clause'.

Summing up, the note observed that though there was a growing trend abroad towards nationalisation of central banks, and that in the long run it might be desirable to nationalise the Reserve Bank, the real question was 'whether the present is the time to do so'. The nationalisation of the Bank of England had been carried out because the British Government were ready with definite economic plans which they were keen to put into operation immediately. In India, any full-fledged large-scale economic planning was a remote possibility, and such planning as could be undertaken then was not likely to be hampered by the Bank's set-up. The note concluded that 'the case for nationalisation at the moment seems to be weak and inconclusive'. The note was discussed informally by the Committee of the Central Board on January 29, 1947.

Meanwhile, Government received notice of a resolution from a Member of the Legislature, Mr. Mohan Lal Saksena, recommending to the Governor General in Council 'to take necessary steps to nationalise the Reserve Bank of India and the Imperial Bank of India as a prelude to nationalisation of Banking and Insurance in India'. The Finance Department again wrote to the Bank on January 25, 1947, asking for (i) the Research Department's note mentioned above and (ii) the Bank's views on nationalisation of the Imperial Bank.

Forwarding a copy of the Research Department's note on nationalisation to Government, on January 31, the Governor mentioned that it had been discussed informally by the Committee of the Central Board. The Governor considered it premature to request the Committee to express any considered opinion on the question, or even to refer the matter to the full Central Board at its meeting on February 11. He feared that the Board would not be prepared to make any recommendations at that meeting in view of the short time and also in the absence of any indication regarding Government's policy with regard to the whole question of nationalisation; he added that, if Government insisted, he would put the question to the Board, and he expected the Government Director attending the meeting to be in a position to explain Government's ideas regarding nationalisation. Similar considerations applied in the case of the Imperial Bank. In conclusion, the Governor stated:

as I am not in a position to let Government have the Bank's views on the question of nationalisation of the Reserve and Imperial Banks, I am still less able to make recommendations regarding the general question of the nationalisation of all banks in India. The question is of such importance that it is not possible in the short time which has been allowed to formulate definite recommendations and I therefore suggest that Government adopt a generally non-committal attitude in response

to the issue and undertake to have it carefully examined; at the same time I venture to suggest that they should use their influence and advise the mover not to press the resolution to a vote in the Assembly.

It is not known whether the mover was advised not to press the resolution; anyway, the resolution did not come up before the Legislature for consideration.

Resolution on Nationalisation in the Legislature

The demand for nationalisation of the Reserve Bank, however, did not recede into the background; on February 18, 1947, Mr. Tamizuddin Khan moved a resolution in the Legislative Assembly recommending to the Governor General in Council that:

the Reserve Bank of India be taken over by Government, converted into a State Bank and run as such.

Nationalisation of the Bank was proposed by Mr. Tamizuddin Khan not because he was dissatisfied with its working, but because he considered that the monetary organisation of the country should be a national concern and should not be confined to a limited number of shareholders 'who are none but capitalists'.

It appears that the resolution had the strong support of both the major political parties in the Legislature, viz., the Congress and the Muslim League. Not many Members, however, participated in the debate-only six spoke, of whom four strongly supported the resolution and two opposed it. The most severe criticism of the working of the Bank came from Mr. Manu Subedar, who accused the Bank of having failed to carry out 'functions of a constructive character' which were entrusted to it. The Bank had failed, Mr. Subedar remarked, (i) to create a discount market and a bill market in the country [Section 17(2)], (ii) to abolish remittance charges and (iii) to make recommendations to Government for a permanent basis for the Indian monetary system and permanent measures for monetary standard [Section 55 (2)]. Mr. Subedar also referred to the 'lukewarm' efforts made by the Bank but given up later for linking up indigenous bankers and country banks with the central banking institution [Section 55(1)(a)] and the Bank's failure 'to improve all machinery for dealing with agricultural finance and closer connection between agricultural operations and the bank' [Section 55(1)(b)]. Referring to the principal argument of Sir George Schuster in justification of a shareholders' bank, viz., that Government, as the chief user of money, should not themselves be the authority controlling the creation of money, but that when they needed money, they should have to go to an independent authority and make

out their case just as any private individual had to do, Mr. Subedar remarked that that undertaking had not been kept. He censured the Directors of the Bank for not sending in their resignations, and for not protesting against Government's 'misusing' the provision of the Bank's Act 'in order to replenish themselves'.

The other Members who spoke in favour of the resolution criticised the Bank for not assisting small banks and for doing practically nothing in the field of agricultural credit. Reference was also made by Members to the tendency of the Bank's shares to concentrate in one part of the country and in the hands of 'a smaller and smaller public'.

Mr. K. G. Ambegaokar, Joint Secretary, Finance Department (a nominated Official), took part in the debate at the request of the Finance Member, Mr. Liaquat Ali Khan, who felt that when allegations were made against the Bank, it was only fair that somebody should place the Bank's point of view before the House.

Mr. Ambegaokar stated that a bill market had not developed in the country because that mode of accommodation had fallen into disuse everywhere, being costlier than the system of cash credits or overdrafts. He disputed the statement that the remittance charges had not come down, as expected. Referring to the criticism that the Bank had failed to report its views on a permanent basis for the Indian monetary system [Section 55(2)], he questioned when such a report could have been made, since conditions had not been stable at any time since the Bank's establishment. The Bank could not establish links with indigenous bankers, as was expected of it, because they were not prepared to shed their non-banking business. The Bank had given the greatest possible thought, Mr. Ambegaokar observed, to the question of improvement of the machinery for dealing with agricultural finance. He also defended the Bank for not assisting banks which did not listen to its advice and worked on unsound lines.

Mr. Ambegaokar also stressed the point that the Bank had been in existence for a very short time, and within five years of its establishment the war broke out; 'the surprise is not that it has done so little, but that it has done so much'.

Referring to the criticism that the Bank 'printed a lot of money' and helped inflation, Mr. Ambegaokar remarked that the Bank was not to be blamed, as its hands were tied under the Act. 'If it was the desire of this House that the Reserve Bank should not create more money against sterling credit, this House should have taken action to repeal those sections', he added.

Winding up the debate, the Finance Member observed that it was evident that there was a general desire for the nationalization of the Bank, and while Government were in favour of nationalizing any institution if such a step was of benefit to the country, they would study

carefully and sympathetically the proposition contained in Mr. Tamizuddin Khan's resolution. It is best to reproduce the text of the Finance Member's statement:

I have listened to the debate with great attention and interest. My Honourable friend who has just sat down said that the Government should be very careful because if they accepted the principle of nationalisation there would be a great demand from interested people made on them to the disadvantage of the tax-payer. I believe that any Government worth name must resist any unreasonable demand that may be made from any quarter which would be against the interests of the country as a whole. I can assure Honourable Members of this House that as far as the present Government is concerned, it will resist any demand from any quarter which would be to the detriment of the country. The Joint Secretary of the Department spoke not so much to put a case either in favour or against nationalisation of the Reserve Bank, but he took part in the debate at my request, because I felt that when certain allegations were being made against the Reserve Bank, who did not have a representative in this House, it was only fair that their point of view should be placed on the floor of this Honourable House. It is quite evident from the speeches that there is a general desire in this House that this institution, the Reserve Bank, should be nationalised. I also notice that this desire is not so much on account of any deficiencies that have been discovered in the present set-up of the bank, but it is due on the general grounds that an institution playing such a vital part in the economic life of the country should be nationalised to secure proper co-ordination and integration of currency, credit and monetary policy with the Government's financial and economic policy. That, I understand, is the reason behind this Resolution which has been moved on the floor of this Honourable House. As the House is aware, the present Government has taken office or has been in the saddle for a very short time and I think the House would not expect me at this moment to make a definite declaration with regard to this particular matter of nationalisation of the Reserve Bank. But, generally speaking, I might say that the Government are all in favour of nationalising any institution if it is found that it will be to the benefit of the country at large. That I may lay down as a general policy, and I can assure my Honourable friends that we will give our most careful and sympathetic consideration to this proposition which has been placed before this House. If we are convinced that the nationalisation of the Reserve Bank will be in the interests of the country, we shall not hesitate to take steps in that direction. But I must give a warning to the Honourable Members of this House on this occasion. I hope that no Honourable Member desires that the Central Bank of the country should become a handmaid of the Government of the time. When we talk of nationalisation and if we decide to nationalise the Reserve Bank, we must see that whatever constitution is framed for that bank, although it will be public ownership, it will not play the part of a subservient agent of the Government, whatever it may be at the time. I would like to acknowledge the willing co-operation which the Reserve Bank has given to the Government in the past. And as I have stated



Sir Benegal Rama Rau
Governor, 1949-57

just now, this is a matter which needs very careful consideration and I can assure Honourable Members of this House, because I notice that there is a general desire on all sides of the House that the Reserve Bank should be nationalised, that this desire which has been expressed will receive our very careful and sympathetic consideration and we will give our very careful thought to this problem. I hope that my Honourable friend the Mover of the Resolution will accept that assurance which I have given, because at this moment I cannot promise anything more than this that we will consider this proposition and will give it our most careful consideration and sympathetic thought. If we find that nationalisation of the Reserve Bank is in the larger interests of the country and if we find that a ripe opportunity has come for taking action in that direction, we shall not hesitate to do so.

In the light of the Finance Member's statement, Mr. Tamizuddin Khan withdrew his resolution.

Actually, within a few days thereafter, i.e., on February 28, 1947, in the course of his speech presenting the budget for the year 1947-48, the Finance Member announced that after careful consideration he had come to the conclusion that the advantages of nationalisation of the Reserve Bank outweighed any possible disadvantages, and that, therefore, the Bank should be nationalised, the time and the manner of nationalisation being considered separately.

The press comment on the Finance Member's announcement was mixed. Amongst financial weeklies, the Indian Finance was a staunch supporter of nationalisation. The Eastern Economist, on the other hand, strongly opposed the Bank's nationalisation. The journal argued (February 28, 1947 issue) that it did not matter much whether the central bank of a country was State-owned or privately owned. What was important was that it should work in harmony with Government, and that 'profit-making private interests do not employ the central bank as the instrument of their ends'. Neither of these charges could be made against the Reserve Bank, the journal observed. On the contrary, the journal remarked:

from the point of view of public interest, the complaint would be not that the Reserve Bank did not co-operate with Government, but that it co-operated so well and so completely with the bureaucratic administration until the recent past in its unsound monetary and economic policies, whereas it was an important part of the duty of an 'independent' central bank, in the prevailing dichotomy between the government and public opinion up to September 1946, to have emphasised its point of view in a more concrete manner than the Reserve Bank has perhaps done.

Referring to the various charges levelled against the Bank during the debate in the Legislature in February 1947, the journal remarked:

For several omissions and commissions, the Reserve Bank was not to blame; only the government or the statutory limitations imposed upon the Bank. But it is up to the Bank, in the altered political conditions now, to take a more positive and dynamic view of its functions and responsibilities in fields hitherto relatively neglected and make its recommendations to the new government.

The Commerce also viewed with disfavour the proposed nationalisation of the Bank. In the journal's (February 22, 1947 issue) view:

While, for all practical purposes, the Reserve Bank is as good as a nationalised institution, it has the added advantage of the benefit of private enterprise, the most important of which are the advice and guidance of seasoned business men of wide contacts, efficiency and freedom from departmental red-tapism. In its present form, the Bank will be able to keep cordial, informal and close contacts with joint-stock banks, the markets, and the public which are essential for the building up of an integrated banking structure.

Also, nationalising the Bank even before the country got a full-fledged national and independent Government, according to the journal, was like putting the cart before the horse.

Amongst the dailies, the Bombay Chronicle was a defender of Government's decision. According to the paper (March 19, 1948):

To say that the record of the Reserve Bank has been excellent is only partially true. While, on the one hand, it has been singularly ineffective in shaping the policy of the Government in essential matters, in its day to day working it has passed under the control of a Board which is for the most part elected by an ever-narrowing circle of shareholders The shareholders are the least important part of a Reserve Bank, and we do not feel that there is any justification for the view that the most vital part of the machinery of national economic policy should not be under the direct control of the State.

Governor on Proposed Nationalisation

The question of nationalisation did not appear to have been referred to the Bank by Government for some months, presumably owing to the sweeping political changes that took place, culminating in the partition of the country. In January 1948, however, when the Governor (Deshmukh) happened to visit Delhi, he was requested by Mr. R. K. Shanmukham Chetty, the first Finance Minister of independent India, to set down his personal views on the question of nationalisation of the Reserve Bank and the Imperial Bank; resolutions urging their nationalisation had obtained high priority in the agenda of the budget session of the Legislature. This the Governor did immediately, in a note he handed over to the Finance Minister before he left the capital.

Broadly, the Governor considered it very desirable that the Reserve Bank Board should be invited to express its opinion on the subject, before a final decision was taken by Government, adding, 'although it is recognised that in expressing views on the nationalisation of the Reserve Bank they (the Board) will not be entirely free of the suspicion of being biased in their own interests'. In the Governor's view:

The Board are, however, a body of very responsible business or public men and may be trusted to take a dispassionate view of the matter from the point of view of the interests of the country's economy.

As regards his own observations, the Governor stated that it was not possible to be dogmatic about the nationalisation issue one way or the other, and on a final analysis. it did not much matter whether the Bank was run as it was then constituted, or was nationalised. In the Governor's opinion, it was 'all a question of timing and fitting the character of the institution to the pattern of the country's economy'.

Admitting that the majority of the world's central banks were nationalised institutions, the Governor pointed out that in Great Britain, Australia and New Zealand, socialist Governments were in power, and in view of their declared intention to spread the field of socialism, it seemed only fitting that the central banks in those countries should be nationalised. In the U.K., nationalisation was undertaken only because it had for twenty years been on the political platform of the Labour Party and was the easiest to accomplish out of that programme.

In considering India's own problem, the Governor remarked, two things should be taken into account, viz., (i) whether a nationalised central bank was called for, for the implementation of or fitting into any well-defined plan of action in the economic sphere; and (ii) whether the administrative machine could be expected to respond to all the calls that could be made on it for the purpose of fulfilling any governmental programme. Applying these two criteria to the position in India, the Governor felt that as things stood nationalisation of the Bank was neither called for nor was it likely to be beneficial.

So far as the overall monetary and credit policy was concerned, the Governor remarked that whatever be its composition, the Reserve Bank was 'bound to be pliant to the will of the Government, as for purposes of war, so for any short-term purpose of peace', and therefore, it could not be said that the attainment of any important objective would be interfered with if the Bank was not nationalised. The Governor concluded as under:

The Reserve Bank, as it is constituted, secures the golden mean in that while it is generally responsive to broad government control, the Board, which is mainly elective, is free to take an independent view

of affairs and to tender advice to Government. In the complexities of present day economics this is of very great value, as no one can afford to be dogmatic about the correctness of his views, and two heads are better than one. The most striking result of nationalisation would be a change in the character of the Board, and there is bound to be nomination influenced, to a small or large extent, by political considerations. Even if by nomination the composition of the Board were to be comparable to its present composition and there were to be no change in the incumbency of the chief executive offices, even then, the psychological effect of being nominated is bound to make itself felt in the advice that is tendered. I have observed something of the working of the Bank of England after its nationalisation, and I feel convinced that they have lost a great deal of their independence. In that country, there is a strong and well-experienced Treasury assisting a mature democracy. In our own case, we are yet feeling our way and the Treasury requires strengthening even for its day to day existing business. In such circumstances, there is a danger of the wrong lead being given to a nationalised Reserve Bank by an inexperienced Treasury or by an inexperienced Ministry, although capable and experienced individuals in the Ministry or in the Treasury when they come will prevent such a state of affairs from arising. There is no reason, however, why such a risk should be run and why Government should be deprived of the fruits of the seasoned and matured experience of well-tried business men. In a year or two we shall see much more clearly what the pattern of our economy is going to be, how much stronger our administrative machinery is getting and where exactly the lack of nationalisation is impeding progress. In such a setting, one could proceed easily to nationalisation with greater confidence and greater clarity about the anticipated results.

As regards the proposal to nationalise the Imperial Bank, the Governor was of the view that it was not a necessity on purely logical grounds. Referring to the two charges levelled against that bank, viz., (i) that it was over-conservative and almost wooden in its banking service, and (ii) that it had not treated its Indian staff fairly and was generally backward in Indianisation, the Governor remarked that conservatism was only prudent banking, and that in that respect he did not think the Imperial Bank was 'much worse' than some of the other major scheduled banks. As regards the second charge, the Governor stated that the bank had stopped European recruitment some years ago, and that by 1954 only nine or ten European officers were expected to be left in the bank, which, he remarked, could not be regarded as excessive. The Governor's view was that Government should hasten slowly and 'not bite more than we can chew'. Nationalisation, the Governor observed, should be followed by the urge to extend business, where the institution was alleged to be not enterprising enough, and this would greatly increase the work of the Treasury. The Governor considered that instead of nationalization it should be ascertained 'more painstakingly and accurately where exactly the present institution is going wrong and calling it to account'. Also,

when business and commerce, to a large extent, were to remain within the private sector, it was not at all necessary, he remarked, that the main part of the banking system should be run as a nationalised institution. In the Governor's view:

If there is to be nationalisation of the banking system, it ought to apply to the system as a whole and not only to one unit, however, important that unit may be. I think, even a casual acquaintance with the Indian scene, would compel an observer to agree that the conditions in India did not call for such a kind of nationalisation at the present stage. There is no reason why we should at the beginning of our democratic existence, undertake an experiment which has not been undertaken else where, except in the U.S.S.R., where the entire economy is run on a communist basis. Even in Australia, where the nationalisation of commercial banks is being attempted, there has been a long history of experimentation and of socialist endeavours by the Government in power. My advice, in brief, is, therefore, that we should wait for a year or two before rushing into nationalisation of the banking institutions, and that, in the meanwhile, we should carefully observe how the present banking system is meeting the changing and developing economic needs of the country. A period of close observation will enable us to avoid the effects of any hasty action.

Nationalisation Issue again in the Legislature

The Governor did not, however, succeed in bringing Government round to his views. Despite his objections to nationalisation, Government decided to adhere to the view adumbrated by the Interim Government in February 1947 to nationalise the Reserve Bank. In reply to a question by Mr. Mohan Lal Saksena in the Legislative Assembly, on February 4, 1948, the Finance Minister stated that Government proposed to take steps to see that the nationalisation of the Reserve Bank was effected as soon as possible after September 30, 1948, when the Bank was to cease to be the common banker to India and Pakistan. Government's intention was to acquire the shares 'at the average of the monthly market value of the shares during the period March 1947 to February 1948 taking the opening quotations for each month'; 3 per cent long-dated stock of equivalent value of appropriate maturity was to be issued in exchange.

In respect of the Imperial Bank also, the Minister mentioned that the Government accepted the policy of nationalisation, but as that bank had branches outside India, Government first proposed to examine carefully the various technical questions involved before implementing nationalisation. For acquisition of the Imperial Bank share capital, a basis similar to the one in respect of the Reserve Bank shares was to be adopted. The Finance Minister further announced that Government did not have any intention to nationalise other

commercial banks; the Imperial Bank, incorporated by a special Act, stood on a separate footing. These replies had been framed after consultation with the Governor, when he visited Delhi.

Two days later, i.e., on February 6, 1948, the Finance Minister forwarded to the Governor a copy of the above replies with a letter stating:

Normally, Government would have consulted the Central Board before initiating the policy of nationalisation of the Reserve Bank. As you are aware, the decision to nationalise the Reserve Bank was taken last year and it was left to the present Government only to implement it. I hope that the Central Board of the Reserve Bank will appreciate the circumstances in which they could not be consulted beforehand. I am, however, keen that I should have the advice and co-operation of the Central Board in implementing the policy of the Government in nationalising the Reserve Bank and I have no doubt that it will be forthcoming.

Accordingly, the Governor was requested to place the matter before the Central Board and obtain its suggestions as early as possible. He was also desired to offer suggestions on the various details connected with the proposed nationalisation of the Imperial Bank.

Board's Views

The matter was considered by the Central Board at its meeting on February 23, 1948, and a resolution was unanimously passed to the effect that:

at the present stage of the country's political and economic development it will not be in the interests of the country to nationalise the Reserve Bank of India and such a step may be fraught with very great danger which cannot be fully foreseen at present,. . . .

The resolution was forwarded to the Finance Ministry; the Joint Secretary to the Ministry replied on April 13 that:

the Government of India, having given careful consideration to the views of the Central Board, do not see sufficient justification for revising their decision to nationalise the Bank.

The Bank's views on the proposed nationalisation of the Imperial Bank and subsequent developments in this matter are dealt with in a later section of the chapter. The story of the nationalisation of the Reserve Bank may first be completed.

Draft Bill for Nationalisation

Even before the Government's reply of April 13 was received, a memorandum was prepared in the Bank indicating the lines along which

nationalisation of the Bank should proceed; this was circulated to the Board for its consideration.

The major point of the memorandum was that the Bank, as it was organised then, was sufficiently responsive to broad Government control and had not hampered the pursuit of State policies. Hence, the measure nationalising the Bank 'need not have a wide scope, at least for the present ', and should be confined to making the minimum amendments necessary for symbolising the change of ownership, leaving the rest of the organisation undisturbed. In addition to indicating the changes necessary if the limited objective of change of ownership was accepted, the memorandum separately listed for the Board's consideration amendments which would be necessary if a comprehensive revision was undertaken. The memorandum was considered by the Board at its meeting on April 5 and it was resolved that only the minimum modifications necessary to give effect to the change of ownership should be embodied in the legislation to be drawn up, leaving the operational and other features of the existing organisation undisturbed. The resolution was communicated to Government.

A draft Bill embodying the necessary amendments to the Reserve Bank Act and a copy of the Bank's memorandum on the subject were considered by the Committee of the Central Board at its meeting on May 26. The more important provisions of the draft Bill submitted to the Committee were the following:

- (i) The capital of the Bank was to be acquired by the Central Government, paying compensation and also accrued dividends to the shareholders; the Bank was to continue thereafter as an autonomous corporation.
- ii) The management of the Bank was to be entrusted to a Central Board of Directors comprising
 - (a) a Governor and two Deputy Governors to be appointed by the Central Government,
 - (b) Chairmen of the four Local Boards,
 - (c) six Directors to be nominated by the Central Government from among non-officials, of whom one was to be a member of the Central Legislature, and
 - (d) one Government official to be nominated by the Central Government.The term of office of the six Directors to be nominated by the Central Government from among non-officials was fixed at four years, as against five years under the existing Act; two of the six Directors on the first Board were to retire at the end of two years, two at the end of three years and the last two at the end of four years; the Directors so to retire were to be determined by lots.

A retiring Director was to be eligible for renomination for not more than two full consecutive terms, after the retirement of Directors of the first Board had begun.

(iii) The Central Government were to constitute four Local Boards, each consisting of five members representing territorial and economic interests and interests of co-operative and indigenous banks (as against a maximum of eight members under the existing Act); the Local Board members were to elect, from amongst themselves, one person to be the Chairman of the Board for a period of one year, and the Chairman was to be the ex-officio member of the Central Board. (iv) The Governor, or in his absence a Deputy Governor duly nominated by him, was to be empowered to carry on all the usual business of the Bank pending the constitution of the Central Board and also subsequently, subject to the provisions of the Act and the regulations of the Bank, and also subject to such restrictions and conditions as may be imposed by the Central Board. The existing Act did not have a substantive provision for delegation of the Board's powers to the Governor although under Section 58 the Central Board was empowered to make regulations for all or any of the matters specified therein, which included 'the delegation of powers and functions of the Central Board to the Governor, or to Deputy Governors, Directors or officers of the Bank'. (v) An important new section was proposed, laying down the relationship between the Bank and the Government. Provision was made for the issue by the Central Government, from time to time, of such directions to the Bank as, after consultation with the Governor of the Bank, they thought necessary in the public interest. It was, moreover, provided that:

in the event of a difference of opinion between the Central Government and the Governor of the Bank as to whether any course of action is or is not in public interest, the Bank may be required to give effect to the direction only on the Central Government informing the Bank that they accept responsibility for the adoption by the Bank of a policy in accordance with the opinion of the Government and will take such action (if any) within its powers as the Government considers to be necessary by reason of the adoption of that policy.

(vi) Opportunity was also taken to propose amendments to Sections 17 and 33, enabling the Bank to hold, besides sterling securities, other foreign securities, as part of the Issue Department reserve and also in the Banking Department. This was a corollary to India's membership of the International Monetary Fund and the consequent replacement in 1947 of Sections 40 and 41 by a new section (Section 40) requiring the Bank to sell or buy foreign exchange (and not merely sterling).

(vii) The draft Bill also provided for the omission of a few sections, which were pertinent when the Reserve Bank legislation was enacted, but which had lost their significance with the lapse of time, or, which became unnecessary consequent on nationalisation. The more important omissions proposed related to powers of Central Government to supersede the Central Board (Section 30), provision for Reserve Fund (Section 46), allocation of profits (Section 47), and reporting on certain matters, like extension of the Act to persons and firms other than scheduled banks, improvement of the machinery of agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the Bank and a permanent basis for the Indian monetary system (Section 55).

The Committee of the Central Board approved, at its May 26, 1948 meeting, the draft Bill drawn up by the management for amending the Reserve Bank of India Act, with only one important modification concerning the clause relating to representation of Local Board members on the Central Board. The Bank's management had proposed that the Chairmen of the Local Boards should be ex-officio members of the Central Board; the object was to retain, to the extent possible, the elective principle in the constitution of the Central Board. The Committee's resolution stated:

That the draft Bill amending the Reserve Bank of India Act be approved as representing the recommendations of the Reserve Bank, with the modification that the representatives of the Local Boards be nominated by Government, like the rest of the Board (although it is hoped that ordinarily Government will nominate the elected Chairman); and that the Bill be now sent to the Government of India for their consideration.

The draft Bill as amended by the Committee was forwarded to the Finance Ministry on June 2, 1948. Government did not concur with the Bank on certain provisions; the more important related to the following matters.

(i) DIRECTIONS TO THE BANK

The clause relating to the giving of directions by the Central Government to the Bank was drafted by the Bank by combining the provisions of Section 4(1) of the Bank of England Act, 1946 and Section g of the Commonwealth Bank of Australia Act, 1945. The Governor considered it desirable to make it clear in the Act itself that when Government decided to act against the advice of the Governor, they took the responsibility for the action they wished to force on the Bank, although it was hoped that 'occasions for the exercise of such powers will be few'.

The Finance Minister considered that the proviso as drafted by the Bank was not necessary and that it would suffice if a provision was made on the lines of Section 4 of the Bank of England Act; the relevant sub-section read as:

4(1) The Treasury may from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest.

The clause thus provided for prior consultation with the Governor before issue of directives by the Treasury, but was silent as to the devolvement of responsibility, in the case of difference of opinion between the Treasury and the Bank. The prior consultation with the Governor would ensure that Government got the benefit of the Governor's views on matters of importance to the country. The clause was redrafted accordingly.

(ii) LOCAL BOARDS

The Finance Minister did not think it necessary to have Local Boards, but in the Governor's opinion they served a useful purpose in advising the Bank on matters relating to banking, in view of their local knowledge; their services were also useful in matters like acquisition of land and property by the Bank, building of bank premises, etc. Also, the Governor felt that there were very few people in the country who understood the Bank's operations and it would be useful to associate a few of the Local Board members with the work of the Bank. The draft Bill, as it finally emerged from the Ministry of Law and the Ministry of Finance, provided for Local Boards, each comprising three members; the Bill drafted by the Bank had provided for Local Boards of five members.

(iii) DISQUALIFICATION CONCERNING MEMBERS OF LEGISLATURE

In view of the demands made in the Legislature at the time the Reserve Bank Bill was discussed in 1927 and 1933, to the effect that a Member of the Legislature should not be debarred from being a Central Board Director or a member of the Local Board, the Bank had specifically provided in the draft Bill that one of the Central Board Directors to be nominated by the Central Government from among non-officials should be a Member of the Central Legislature; the clause [Section 11(5)] under which Members of the Legislature were disqualified from serving on the Central or Local Boards was to be deleted. The Bank had, however, indicated that it had no strong conviction in the matter. Government favoured the retention of the disqualification incorporated in the original Act. A similar disqualification existed in the Bank of England Act.

(iv) OTHER CHANGES MADE BY GOVERNMENT

(a) Government retained some sections, the deletion of which the Bank had suggested, the more important being (i) Section 30 providing for super session of the Central Board and (ii) Section 46 providing for constitution of the Reserve Fund. In the Bank's view, since Government were empowered to give directions to the Board under the nationalisation Bill, the possibility of the Bank failing to carry out the obligations imposed on it was very much narrowed down. As for the Reserve Fund, which was intended to safeguard the shareholders' interests, it was no longer necessary once the Bank became fully State-owned. Government, however, did not agree with the Bank's views. They considered that they should be able to take action if the Board failed to carry out the directions. Also, as a bank, the Reserve Bank should continue to have a Reserve Fund against losses. On reconsideration, the Governor concurred with Government and both the sections were retained.

(b) The clause relating to exercise by the Bank's executives of full powers vested in the Board was modified. While the Bill drafted by the Bank had sought to give full powers to the Governor, or in his absence a Deputy Governor duly nominated by him, to carry on all the usual business of the Bank pending the constitution of the Central Board and also subsequently, subject to such restrictions as might be imposed by the Central Board, the draft Bill gave such powers to both the Governor or in his absence the Deputy Governor duly nominated by him, for the interim period only, pending the constitution of the Central Board. Thereafter, however, the Governor & one was to have full powers to transact all the business of the Bank which might be transacted by the Central Board, subject to regulations made by the Board which were required to be approved by the Central Government. It was only in 1951 that the subsection was amended, the Deputy Governor nominated by the Governor in this behalf also being empowered to exercise, in the absence of the Governor, all powers vested in the Bank.

(c) The retirement of Directors on the first Board was to take place at the end of the first, second and third years, two at each time, as against at the end of the second, third and fourth years, provided in the Bill drafted by the Bank.

(d) Some drafting changes were also made. The substantive portion of the Bill dealt only with the acquisition of shares, payment of compensation and accrued dividends, vacation of office by existing office bearers and empowering the Governor or in his absence a Deputy Governor to exercise all powers pending the constitution of the Central Board. All other amendments, which were in the nature of amendments to the Reserve Bank of India Act, 1934, and which related to the constitution of Central and Local Boards, delegation of powers to the

Governor, allocation of surplus profits, etc., were included in the Schedule to the Act. The Act was to be called the Reserve Bank (Transfer to Public Ownership) Act, 1948; in the draft submitted by the Bank the title was the Reserve Bank of India (Amendment) Act, 1948.

(e) The draft Bill indicated the amount of compensation, viz., Rs.118-10 per share, which was left blank in the Bill drafted by the Bank; it also provided for the payment of dividend at the rate of Rs. 4 per annum per share for the period July 1, 1948 to the 'appointed day'.

The Bill in the Legislature

The Bill was moved for consideration in the Legislative Assembly on September 2, 1948 by Mr. K. C. Neogy (Minister for Finance and Commerce) and was passed the next day. The debate which followed the introduction of the Bill was rather brief. The Bank was accused of having been throughout 'the slave, -the maid of the old Lady of Thread needle Street -the Bank of England'. Another charge was that it had hardly done anything to help agricultural interests. One Member wanted some sort of assurance that the administration of the Bank would not deteriorate as a result of nationalisation, and that with every change in Government, the policy of the Bank would not change. Another Member suggested that Government should follow the practice that was followed in the case of the Bank of England though new Directors were appointed, those anxious to co-operate with Government were retained. There was also a suggestion that a comprehensive Bill on the nationalised Reserve Bank should be drawn up, circulated, and then referred to a Select Committee.

Winding up the debate, the Finance Minister assured the House thus:

although the framework of the administrative authority is being changed, we would to it that the Reserve Bank of India continues to function as a fully autonomous body and that the counsels of the different interests which find representation at the present moment through election on the management, would still be available to it, although the institution is being nationalised.

He also assured the House that Government would take up a complete revision of the Act at an early date.

The more important amendments to the Bill/existing Act proposed in the course of discussion and adopted were as follows:

(i) REMOVAL OF THE LIMITATION ON TENURE OF OFFICE OF DIRECTOR

The Bill had provided that a retiring Director should be eligible for renomination for not more than two full consecutive terms. Mr. T. T.

Krishnamachari moved an amendment for deletion of this clause, as in his view, considering the number of restrictions which had been already imposed on the type of people who could serve as Directors, there was no room for further restrictions. The motion for deletion met with the Finance Minister's approval, who remarked, 'it only enlarges the scope of Government's discretion'.

(ii) RAISING OF NUMBER OF MEMBERS ON THE LOCAL BOARD FROM THREE TO FIVE

The Bill had provided for Local Boards consisting of three members, as against a maximum of eight prior to nationalisation, and five recommended in the Bill drafted by the Bank. Two amendments were moved, one raising the number to seven and the other to five; the former was later withdrawn, while the latter was put to vote and adopted.

(iii) REMOVAL OF DIRECTORS FROM OFFICE

Under Section 11(1) of the Act, the Central Government could remove from office the Governor, or a Deputy Governor or any Director, provided that in the case of a Director, the power was to be exercised only on a resolution passed to that effect by the Central Board, by a majority consisting of not less than nine Directors. The Finance Minister moved an amendment empowering Government to remove from office any Director at their discretion without any resolution by the Central Board to that effect; this was adopted.

(iv) OTHER AMENDMENTS

Two amendments which were proposed by Members, but either rejected by the House or withdrawn, related to (i) amount of compensation, and (ii) composition of the Central Board.

In respect of compensation, an amendment was moved by Professor K. T. Shah, reducing the amount payable to shareholders from Rs. 118-10 as provided in the draft Bill to Rs. 114 per share; the figure of Rs. 114 was worked out by him by applying Section 57 of the Act relating to liquidation of the Bank, under which the total amount payable to any shareholder was not to exceed the paid-up value of the shares held by him by more than one per cent for each year after the commencement of the Act. The amendment did not find support and was negatived.

The other amendment, which was later withdrawn by the mover, was to the effect that the six Directors of the Central Board to be nominated by the Central Government, other than from the Local Boards, should represent, as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks. The Finance Minister explained that in respect of the composition of the Local Boards there was adequate provision for the representation of the various interests the Member had in mind.

Compensation to Shareholders

Before the draft Bill on nationalisation was taken up for consideration in the Legislative Assembly, the Bank made an effort to persuade Government to reconsider and alter the basis on which compensation to the shareholders was to be calculated, but it proved fruitless. The shareholders of the Bank, at an informal meeting held on July 28, 1948 under the auspices of the Bombay Shareholders' Association, passed a resolution urging Government to adopt for calculation of compensation 'the well recognised principle of maintaining the shareholders' revenue in respect of their investments in the Bank's shares'; it was pointed out that that principle had been adopted in respect of compensation for Bank of England shares. The resolution further stated that the period chosen by Government for calculating the average market value (March 1947 to February 1948) was 'most unfair and inequitable', as that period witnessed a heavy and continuous slump in share prices 'by reason of the new taxation proposals contained in the Budget for 1947-48'; a fair basis, according to the resolution, would be March 1946 to February 1947.

The shareholders' resolution and the Governor's own views on the subject of compensation were placed before the Committee of the Central Board at its meeting of August 4, 1948. The Committee resolved that the matter should be placed before the Central Board at its meeting on August 9.

Referring to the two methods for arriving at a fair compensation, viz., (i) ensuring shareholders a continuation of the average income enjoyed by them over a period of years and (ii) taking the average price of the shares of a concern over a given period, the Governor suggested that the Directors might like to decide and recommend to Government 'what they would consider a fair and equitable mode of compensation in this instance'. The Governor was of the view that the compensation, according to either the Government's formula (Rs.118-10) or the shareholders' resolution (Rs.159-11), might not be considered reasonable. Working on the basis of ensuring a 4 per cent taxable yield, the compensation would amount to Rs. 133-5-4 a for a coupon rate of 3 per cent, but if compensation was to be on the basis of the average price over a given period, the Governor considered it more reasonable to take the average quotation over a period during which the Bank paid a 4 per cent dividend, viz, July 1, 1943 to February 1948; this worked out to Rs.137-8, giving a yield of 4.13 per cent taxable.

The matter was considered by the Board at its meeting on August 9 and a resolution was passed stating that in the Board's opinion, the proposed compensation was 'both inadequate and inequitable'. The Board recommended that the compensation be fixed at the mean of a

4 per cent gross income (i.e., Rs.133) and the average quotation of the Bank's share between July 1943 and February 1947 when nationalisation was announced (Rs. 142); the average of the two bases was Rs. 137-8. The Government, however, adhered to the formula announced by them in February 1948 for acquisition of the shares.

The table below gives the annual average price of the Bank's shares for the years 1935 to 1948, based on the opening quotations for each month.

| Year | Average Price Rs. | Year | Average Price Rs. |
|------|-------------------|-----------------|-------------------|
| 1935 | 128-12-0* | 1942 | 101-10-0 |
| 1936 | 138-12-0 | 1943 | 115-12-0 |
| 1937 | 130- 1-8 | 1944 | 135 - 1-0 |
| 1938 | 117- 4-8 | 1945 | 139 - 8-8 |
| 1939 | 108-14-4 | 1946 | 162 - 0-0 |
| 1940 | 103 - 7-0 | 1947(Jan-Feb) † | 144 - 4-0 |
| 1941 | 106-11-4 | 1947(Mar-Dec) | 119 - 0-0 |
| | | 1948(Jan-Aug) | 112-14-0 |

* Relates to November-December 1935 only.

† Period to the Finance Minister's announcement regarding Government's decision to nationalise the Bank.

Notifications were issued by Government on October 19, 1948, fixing January 1, 1949, as the date on which the shares of the Bank would be deemed to have been transferred to the Central Government and listing rules framed under Section 6 of the Reserve Bank (Transfer to Public Ownership) Act, 1948, regarding the procedure for the payment of compensation.

Government first decided, in consultation with the Governor, to pay the compensation in the 3 per cent Loan 1986 or Later. If, on January 1, 1949, the loan was not quoted at par, the difference was to be deducted from or added to the cash payment, depending upon whether the loan was quoting at premium or discount. On reconsideration, the Governor felt that 'the nationalisation scheme would be better received by the public if a dated loan of a slightly shorter maturity were issued in exchange for the shares'; in his view, the 3 per cent Loan 1970-75, which was also quoting at par, was appropriate. This was accepted by the Government. The Bank was also informed that in the opinion of the Law Ministry no adjustment was necessary with reference to the market quotation of the loan; however, Government would have to see that the loan to be issued as compensation stood 'approximately at par'.

Out of a total of 5 lakh shares, compensation at the rate of Rs.118-10 was payable in respect of 4.98 lakh shares, i.e., excluding the 2,200 shares initially allotted to Government for disposal to Directors at par and which were to be acquired at par. Up to the end

of March 1951, compensation was paid in respect of 4.67 lakh shares, the amount involved being Rs. 5.54 crores.

Valedictory Observations

At the last meeting of the Central Board prior to the coming into force of the Reserve Bank (Transfer to Public Ownership) Act, 1948, held on December 20, 1948, the Board passed a resolution recording its appreciation of the valuable services rendered by the members of the Local Boards and 'the loyalty, competence and conscientiousness' with which the staff discharged their duties.

The Governor then made a few valedictory observations. He said:

As Governor of the Bank and your Chairman I have always been proud of the high-mindedness and realism with which you have deliberated upon the many important and complex issues that have been your concern in the Board during all these years of stress and strain. In our own sphere we have practised democracy with a sense of responsibility and a single minded devotion to the country's interests which, I trust, will receive due recognition at the hands of India's economic historians.

The Governor thanked the Directors for the splendid co-operation he obtained from them in the matter of frank expression of their views based on their wide business experience.

Mr. K. G. Ambegaokar, the Government Director, conveyed the Government of India's 'deep appreciation' of the services rendered by the Governor, Deputy Governors, and the Directors, and observed that Government always looked to Sir Chintaman 'for his opinion and valuable advice'.

The Finance Minister, Dr. John Matthai, also wrote to the Governor, on December 27, 1948, eulogising the services rendered by the Governor, the Deputy Governors, and the Central and Local Boards. The Finance Minister observed:

The majority of the Directors and members of the Local Boards have been with the Bank from the beginning, and they have not only helped in laying the foundations of the Bank and building up its organization on sound lines but also assisted in the stupendous tasks with which the Bank was faced during the difficult war years and the period succeeding it. Having to deal with these problems within a few years of coming into existence, the efficient manner in which the Bank has handled them is all the more creditable, and there can be no doubt that the achievement of the Bank in such fields as the establishment and working of foreign exchange control, the administration of the Public Debt and the management of the currency of the country, will compare favourably with those of Central Banks in countries like U.K. and U.S.A. with their vast resources, better organised banking structure, long established traditions and greater experience of Central Banking. The Reserve Bank has been of great assistance to Government throughout in shaping

the financial and monetary policy of the country. I shall be glad if you will convey to all the Directors and members of the Local Boards the Government's grateful appreciation of their services.

I should also like to express the thanks of the Government to the executive of the Bank to whom credit is due for the successful working of the Bank in difficult circumstances. The Government appreciate the assistance they have received from the two Deputy Governors, Messrs Trevor and Mehkri, in connection with the complicated arrangements arising out of the partition of the country and the banking situation. From your predecessor, Sir James Taylor, and yourself, the Government have received wise counsel and guidance. You have personally borne a heavy burden in guiding the deliberations of the Board and presiding over the administration of the Bank during this most difficult time, and in building up its organisation so as to enable it to cope with its very heavy responsibilities. I am most grateful to you for the readiness with which you have assisted the Government in all matters of financial and economic importance and for your advice, which always has been invaluable to us. It is a matter of great satisfaction to the Government that you have agreed to continue in your present position for some time longer. As you are aware, it was the hope and desire of the Government that you should continue to be at the head of the Bank for as long as possible, and we are indeed sorry you have not found it possible to accede to our request. We hope, however, that under your stewardship the change-over to the new set-up will be effected without any dislocation, and that it will have started to function smoothly before you lay down the reins of your office.

Nationalisation of Control over Imperial Bank

From the outset the demand for the nationalisation of the Reserve Bank in the press and the Legislature was associated with a similar demand in respect of the Imperial Bank of India also. Although the nationalisation of the Imperial Bank did not materialise during the period covered by this volume, the question engaged all along the attention of the Government and the Bank. It would therefore be appropriate to deal with these developments before concluding this chapter.

As already mentioned, in January 1948 when the Governor was asked by the Finance Minister, Mr. Shanmukham Chetty, for his personal views on the question of nationalising the Imperial Bank, he had expressed himself against it. However, the Finance Minister announced in February 1948 Government's decision to implement nationalisation of the Imperial Bank after a careful examination of the various technical questions involved and following this again he wrote to the Governor for his recommendations in the matter. Meanwhile, the Central Board of the Imperial Bank of India gave urgent consideration to Government's announcement and passed a resolution opposing nationalisation. A copy of the resolution together with a memorandum on the subject was forwarded to the Reserve Bank for transmission to

Government. The Governor considered that while forwarding these papers it was desirable to convey the Bank's views also in the matter. Accordingly he drew up a short memorandum which set out his reasons against nationalisation at that stage. The memorandum was considered by the Committee of the Central Board, at its meeting of April 14; the Committee concurred with the Governor's views and agreed to his conveying them to the Government.

In his memorandum, the Governor stated that after studying the matter in detail, he was 'more than ever convinced' that nationalisation of the Imperial Bank would be a serious mistake. He was impressed by the various arguments put forth in the memorandum drawn up by the Imperial Bank and considered by its Central Board, and he felt that if Government gave those arguments 'the most careful consideration', they would come to the conclusion that 'nothing is to be gained, and much is likely to be lost, by nationalising the Imperial Bank, at any rate, at this stage'. The Governor mentioned two arguments which, in his view, deserved special attention, viz, (i) the State would be acquiring an asset, the value of which was bound to diminish following the closure of the Imperial Bank's offices in Pakistan, Ceylon and Burma, and (ii) as a result of nationalisation, the 'cream' of the business was expected to be transferred from the Imperial Bank to the other banks in the country. The Governor also remarked that Government had not indicated on what consideration their decision to nationalise the Imperial Bank was based. 'Public interest demands,' he observed, 'that when decisions of such magnitude are taken, they should be supported by a full statement of the considerations which influenced the decisions'.

The Governor drew attention also to another important point made in the Imperial Bank's memorandum. If Government used the method of issuing bonds for acquiring proprietorship in other schemes of nationalisation, 'the market would be flooded with Government bonds which the holders would be anxious to pass on to others even at a sacrifice,' and there was a real danger of such a policy adversely affecting the credit of Government.

Government also examined the matter, and in early February 1949, in reply to a question in Parliament as to what steps Government were taking to nationalise the Imperial Bank, Dr. John Matthai, the then Finance Minister, declared that Government did not consider it feasible to proceed with the nationalisation of the Imperial Bank in the light of the examination of the various issues involved and in view of possible repercussions on the investment market and the unsettled economic conditions in the country.

The question of ensuring greater Government control over the Imperial Bank, whose functioning was subject to considerable criticism,

was also examined by the Rural Banking Enquiry Committee which submitted its report in May 1950. The Committee did not suggest nationalisation of the Imperial Bank, but favoured greater Government supervision and control over it and for that purpose suggested certain changes in the constitution and the working of that bank, the more important of which are mentioned here. The Committee recommended that (a) the appointment of the Managing Director and the Deputy Managing Director of the Bank should be subject to approval of the Central Government, who should also have the right to demand their removal from office if necessary; (b) the Government Director on the Board of the Bank should have power, as was the case prior to 1935, to ask for the postponement of decisions on questions having a bearing on the national policy of the Government and for the review of those already taken; and (c) Government representation on the Central Board should be made more effective and that Directors nominated by Government should have seats on the Committee of the Central Board and be entitled to participate and vote at all Committee meetings. The Committee was not in favour of any interference from Government in the day-to-day working of the Imperial Bank.

An alternative plan suggested by the Committee was to reconstruct the Central Board of the Imperial Bank on the model of other commercial banks. The overall policy and the general superintendence of the bank should be placed in the charge of a Chairman whose appointment would be subject to Government's approval, and a Board of Directors, two of whom would be nominated by Government on the Reserve Bank's recommendations; the day-to-day working would be entrusted to a General Manager, who would be an employee of the Bank and would not have a seat on the Board. Governor Rama Rau, in his memorandum dated December 18, 1950 to the Central Board, expressed himself in favour of the second alternative suggested by the Committee, subject to certain modifications.

At its meeting on December 23, 1950 the Central Board, however, favoured, by a majority, the first alternative; this involved the retention of the existing constitution of the Central Board of the Imperial Bank, but required Government's approval in respect of the appointments of the Managing Director and the Deputy Managing Director. The Board, however, did not agree with the Rural Banking Enquiry Committee that Government should have power to demand the removal of the Managing Director and the Deputy Managing Director from office. Likewise, the Board (by a majority) was not in favour of the Government officer on the Board of the Imperial Bank having the power to ask for the postponement of decisions on questions having a bearing on the national policy of Government, and for a review of decisions already taken.

The Central Board of the Imperial Bank which had opposed both the alternatives earlier, reconsidered the matter in January 1951, and revised its views. While the first alternative was totally unacceptable to the Board, it decided by a majority vote, to assure Government that if they decided to implement the second alternative, the Board would offer its fullest co-operation in the working of the new arrangement 'on the lines suggested by the Governor of the Reserve Bank in his informal discussions with the Calcutta Members of the Central Board'. The Governor had suggested: (i) the creation of a new office of Chairman, who would be elected by the Board, subject to approval of Government or more appropriately of the Reserve Bank ; the existing Chairman or Presidents of the three Local Boards would continue to discharge their functions ; (ii) three directors would be nominated by Government or more appropriately by the Reserve Bank, one for each of the three circles, who would attend the meetings of the Central Board Committee; (iii) the Chairman of the Central Board should not be removable by Government; (iv) the Chairman should not have power to issue orders to the General Manager or Managing Director, and (v) the main duties of the Chairman would be to keep himself fully acquainted with the working of the bank.

In view of the Imperial Bank Board's modifying its views, and the fact that Sir Purshotamdas Thakurdas, who was the Chairman of the Rural Banking Enquiry Committee, could not attend the December 23, 1950 meeting, the subject was reconsidered at the February 8, 1951 meeting of the Reserve Bank's Central Board. The Board broadly supported the second alternative recommended by the Rural Banking Enquiry Committee; the main feature of the arrangement would be the creation of a new office of part-time Chairman, who would be elected by the Imperial Bank Board, subject to Government's approval. The Board's views were conveyed to Government. Pending consideration of these proposals, Government, at the instance of the Reserve Bank, advised the Imperial Bank to authorise Government nominated directors to attend the meetings of the Committee of the Central Board. The bye-laws of the bank were accordingly amended in July 1952.

The demand for the nationalisation of the Imperial Bank, however continued, and following one of the major recommendations of the All-India Rural Credit Survey Committee in its report submitted towards the close of 1934, the bank was de facto nationalised, or the 'undertaking' of the Imperial Bank was transferred to the 'State Bank of India, as the official reports describe it. The bulk of the share capital came to be held by the Reserve Bank of India. The new institution started functioning on July 1, 1955.

DIRECTORS AND ACCOUNTS*Central and Local Boards*

The Central and Local Boards of the Reserve Bank had to be reconstituted on new lines on the transformation of the Bank into a Government-owned Bank, effective January 1, 1949. In conformity with the earlier practice, the Governor was consulted by Government informally in regard to the formation of the new Boards; to be able to make concrete recommendations to Government, he ascertained in advance, the willingness of the existing elected as well as nominated members of the Local Boards to serve on the new Boards. On January 15, 1949, the four Local Boards were freshly constituted by Government in the manner laid down in Section g of the Reserve Bank Act as amended. It would appear that the intention was to limit the changes to a minimum; thus, to each of the new Local Boards were nominated three out of the five elected members and one out of the three nominated members of the previous Local Boards for the respective areas, there being only one new nominee to fill the fifth place. The Central Board was then reconstituted by Government by the nomination of four Directors, one from each of the four Local Boards, under clause (b), six Directors under clause (c), and a Government official under clause (d) of the revised Section 8(1) of the Reserve Bank Act. Sir Purshotamdas Thakurdas, Mr. B. M. Birla, Sir Shri Ram and Mr. C. R. Srinivasan, who had been the Presidents of the old Local Boards and had been nominated members of the new Local Boards, were appointed Directors under Section 8(1) (b). In making these nominations, the wishes of the Committee of the Central Board (that the Government nominate the Chairmen of the Local Boards to the Central Directorate) were heeded. Incidentally, all of them were later elected Chairmen of the respective new Local Boards under Section 9(2) of the Act. The Directors nominated under Section 8(1) (c) were Sir Rustom P. Masani, Sir Manilal B. Nanavati, Mr. Dharendra Nath Sen, Mr. Shrinivas, Dewan Bahadur C. S. Ratnasabhpathi Mudaliar and Mr. Ramrao Madhaorao Deshmukh. Mr. K. G. Ambegaokar was nominated Government Director.

Directors Sir Manilal B. Nanavati and Mr. R. M. Deshmukh were selected, by lots drawn by the Central Board in terms of the provisions of Section 8(6) of the Act, to retire on January 14, 1950, i.e., on the expiry of one year from the date of their nomination. They were renominated as Directors for a fresh term of four years. It fell to the lot of Messrs D. N. Sen and Shrinivas to retire at the end of the second year, on January 14, 1951. The former was renominated by

Government and the second vacancy was filled by the nomination of Sahu Jagdish Prasad.

The period before nationalisation also saw a few changes in the composition of the Bank's Central Directorate, covering both the elected and the nominated elements. Sir Purshotamdas Thakurdas and Mr. Kasturbhai Lalbhai, Directors from the Bombay Local Board, were re-elected on the expiry of their term in December 1945 after fresh elections to the Local Board had been held; Mr. B. M. Birla was likewise re-elected in December 1946 from the Calcutta Local Board. The second Director elected for the Calcutta area was Mr. K. P. Goenka, who took the place of Mr. A. K. Ghose, who had resigned his Directorship as well as his membership of the Local Board in April 1946 consequent on his election to the Bengal Legislative Assembly.

After the termination of the India and Burma (Burma Monetary Arrangements) Order, 1937, with effect from April 1, 1947, the Rangoon share register was wound up and the elective Directorship of the Rangoon register was abolished in terms of the Reserve Bank of India (Amendment) Act, 1947. A second elective Director's seat was simultaneously allotted to the Southern (Madras) area, on the initiative, mainly, of the Central Board. Hence, after the elections to the Madras Local Board in November 1947, two Directors had to be elected to represent the Madras area on the Central Board. Mr. C. R. Srinivasan was re-elected and the second post went to Mr. R. Ramanathan Chettiar. The elections to the Northern (Delhi) Area Local Board were not held in December 1948 in view of the impending nationalisation of the Bank.

As for the nominated Directors, there were two changes before the Bank was nationalised. The first of these occurred when Sir Arthur A. Bruce resigned on July 1, 1947; in the resulting vacancy, Mr. Nazir Ahmed Khan was nominated early in January 1948, but he remained for only a short while. Mr. Khan and Sir Syed Maratib Ali, an existing nominated Director, represented the Pakistan Government on the Board; more of this is said in the next chapter. The second change occurred due to the tragic death in an air crash of Sir Homi Mehta on April 15, 1948. Sir Rustom P. Masani was nominated in his place on May 22.

Sir Syed Maratib Ali ceased to be qualified to be a Director under Sections 10(1) (e) and 4(3)(a) of the Act, consequent on his appointment by the Government of Pakistan as one of the first Directors of the State Bank of Pakistan on May 27, 1948. Accordingly, the Government of India accepted his resignation from the Central Board. Neither this vacancy nor the one which arose earlier when Mr. Nazir Ahmed Khan resigned was filled before the Bank was nationalised on January 1, 1949.

The post of Government Director on the Board was held by Mr. V. Narahari Rao for nearly two years from February 1946. Other incumbents of the Directorship were Mr. K. G. Ambegaokar, Mr. M. V. Rangachari, Mr. B. K. Nehru and Mr. P. C. Bhattacharyya. As mentioned elsewhere, Sir Benegal Rama Rau was also Government Director, from May 2, 1949 till June 30, 1949, before assuming the office of Governor.

Bank's Accounts

The abnormal circumstances responsible for the continuous and steep rise in the Bank's profits during the war time having disappeared, there was a declining trend in the immediate post-war years. The Bank's income, expenditure on establishment and agency charges (which constituted the major, items of expenses) and the net profits transferred to Government during the six years ended June 30, 1950, are given in the following table.

(Rs. crores)

| July – June | 1944-45 | 1945-46 | 1946-47 | 1947-48 | 1948-49 | 1949-50 |
|----------------------------------|---------|---------|---------|---------|---------|---------|
| 1. Income . . . | 16.68 | 15.59 | 10.12 | 12.73 | 11.70 | 12.90 |
| 2. Expenditure | 1.79 | 1.96 | 2.10 | 2.35 | 2.64 | 2.99 |
| Establishment | 0.61 | 0.96 | 1.10 | 1.33 | 1.50 | 1.61 |
| Agency Charges | 0.42 | 0.28 | 0.29 | 0.28 | 0.29 | 0.29 |
| Other | 0.72 | 0.72 | 0.71 | 0.74 | 0.85 | 1.09 |
| Expenditure | | | | | | |
| 3. Gross profits | 14.89 | 13.63 | 8.02 | 10.38 | 9.06 | 9.91 |
| (before pay ment of dividend) | | | | | | |
| (1-2) | | | | | | |
| 4. Dividend paid | 0.20 | 0.20 | 0.20 | 0.20 | 0.10* | --- |
| to shareholders | | | | | | |
| (at 4 per cent) | | | | | | |
| 5. Surplus trans | 14.69 | 13.43 | 7.82 | 10.18 | 8.96 | 9.91 |
| ferred to Govern | | | | | | |
| ment (3-4). | | | | | | |

- For six months ended December 31, 1943.

The sharp fall in income from Rs.15.59 crores in 1945-46 to Rs. 10.12 crores the next year was caused to a small extent by a reduction in the Bank's total sterling holdings but was mainly the result of the reduced yield for a full year, available on these assets. The Bank's establishment charges rose sharply in 1945-46 on account of the allocations made to cover the estimated cost of the major revision in the emoluments of the staff; these charges crossed the Rs.1 crore mark in 1946-47, and thereafter increased steadily-owing to the additions to the staff necessitated by the expansion in the Bank's activities, including the establishment of new offices and branches.

The Reserve Bank of India (Limitation of Dividend) Ordinance, 1943, continued to be in force even after the termination of the war,

until the Bank was nationalised effective January 1, 1949; the rate of dividend thus remained unchanged at 4 per cent. The Central Board drew Government's attention in April 1947 to the changed circumstances which made the restriction imposed on the Bank's dividend no longer necessary; however, Government took no action in view of the decision already taken to nationalise the Bank.

The Bank And The Partition

The partition of India into the new Dominions of India and Pakistan, in 1947, posed several delicate problems. The Bank was an adviser to a departmental committee set up by the Interim Government to reach agreement on several issues relating to currency and coinage arrangements, management of exchange and public debt, transfer of the Bank's staff and property, and division of the Bank's profits, assets and liabilities. The Bank endeavoured to fulfil this role efficiently and impartially. Under the arrangements agreed upon, the Bank was to be the currency authority in Pakistan and banker to the Central and Provincial Governments in Pakistan till the end of September 1948. It was also required to manage Pakistan's exchange control and public debt till the end of March 1948.

The Bank was confronted with some unusually difficult problems during the period when it was the common central bank for the two Dominions. Despite its best efforts at impartiality, the Bank incurred the displeasure of the Pakistan authorities who complained that the attitude adopted by the Bank was 'not in keeping with its duty as the banker of the Pakistan Government and its currency authority'. The result was that the Bank ceased to function as the central bank for Pakistan three months earlier than the scheduled date, i.e., as from July 1, 1948. The biggest hurdle was the division of the assets and liabilities of the Bank, and even to this day some differences on this issue have remained unresolved.

The partition and the widespread disturbances which followed it had an adverse impact, though temporarily, on banks operating in the border Provinces; the Bank rendered timely assistance to the banks to avoid damage to the banking structure. Developments in this sphere are narrated in Chapter 22.

Another development with regard to the Bank's responsibilities outside the country was that with effect from April 1, 1947, the Bank's central banking functions in Burma ceased in terms of the notice which the Burma Government gave on October 1, 1946, for the termination of Part II of the India and Burma (Burma Monetary Arrangements) Order, 1937.

Consequent on attainment of Independence and the accession of the princely State of Hyderabad to the Indian Union on January 26, 1950, the Indian currency assumed legal tender character in the Hyderabad State as from that date; the Hali Sicca rupee ceased to be legal tender effective April 1, 1955.

THE PARTITION

Following the acceptance in principle of partition of the country by the major political parties in India, a special committee of the Cabinet was set up by the Interim Government 'to examine the administrative consequences of partition and to take necessary steps for the transfer of power to the two Dominions'. The Committee was replaced, from July 1, 1947, by the Partition Council, which had the Governor General as its Chairman and two representatives each of the Indian National Congress and the Muslim League as its members. The Cabinet Committee and later the Partition Council worked through a Steering Committee comprising two officers, viz., Mr. H. M. Patel and Mr. Mohamad Ali. Ten Expert Committees were appointed to deal with matters connected with partition; the Bank was concerned with Expert Committee No. V (i) *. The Committee was required (i) to make recommendations regarding currency and coinage arrangements for the two Governments, (ii) to formulate proposals for the division of the assets and liabilities of the Reserve Bank and the organisational consequences of partition in respect of 'its administrative machinery, (iii) to make recommendations regarding exchange control for the two States and (iv) to report on the position of the two States in regard to the membership of the International Monetary Fund and the International Bank for Reconstruction and Development.

PARTITION ARRANGEMENTS

The Committee faced no easy task. It was required within about a month's time to complete the study of the several complex problems involved and as far as possible reach agreements. The Committee was to be assisted by the Finance Department and the Reserve Bank, who

* The members were (1) Ghulam Mohammad, (2) Zahid Hussain, (3) K. G. Ambegaokar, (4) Sanjiva Row, (5) I. Qureshi, (6) M. V. Rangachari
Secretaries: H. S. Negi and Anwar Ali.

were to prepare material on each term of reference, to enable it to reach decisions. The Bank proved equal to the occasion; the preparation of notes dealing with the various aspects of the problems connected with the partition of India, insofar as they concerned the Bank, had indeed been taken up in the Bank long before a formal request to that effect came from the Government. Two notes, in particular, deserve mention, viz., one dealing with currency and coinage arrangements, division of assets and liabilities and of profits of the Bank, transfer of staff and of movable and immovable property, administration of public debt, etc., prepared by Mr. N. D. Nangia, the Deputy Chief Accountant, and the other on the impact of partition on India's position in the I.M.F. and the I.B.R.D., prepared by Mr. Ram Nath, the Secretary. All notes, excepting a technical one, were signed by the departmental officers; in one of his letters the Governor explained 'this was done advisedly in order not to commit even the executive, much less, the Committee or the Board'.

Bank as an Adviser to the Committee

The Governor persuaded both the sides to agree that the Reserve Bank 'should be consulted only in an advisory and not in a partisan capacity'. He suggested also that it would be convenient if the Committee came to Bombay for consultations, so that all the executives and important Directors of the Committee of the Central Board would be available for consultations. This, however, did not suit one of the members on the Committee, and the Bank was requested to send its experts to Delhi. As the Committee was only a departmental one (with two non-official advisers on the Pakistan side), a delegation comprising the two Deputy Governors (Messrs Trevor and Mehkri) and the Secretary to the Central Board was considered sufficient.

The delegation was in Delhi from July 6 to July 12, 1947, and attended the two full meetings of the Expert Committee held on July 8 and 11. While the Expert Committee succeeded in reaching agreement on several matters, there were quite a number of issues on which the two groups of members were sharply divided; these had to be referred to the Steering Committee.

At this stage, it would be useful to indicate the role of the Bank's Central Board in the consideration of the various matters relating to the partition arrangements. As regards placing matters before the Board, the Governor took the view that the Board should come in only at the level of the Partition Council, i.e., it would be sufficient if a report of all that happened before the Expert Committee was made to the Board for its consideration and approval before the Expert Committee actually submitted its report. Hence, on his return from Delhi

in the last week of June after discussing the preliminaries of the procedure and composition of the Expert Committee, and the role to be assigned to the Reserve Bank, the Governor included in the agenda for the July 21 meeting of the Central Board the subject 'Consequences of Partition'. The Governor also arranged to circulate a copy each of the notes forwarded to the Finance Department amongst the Directors on the Committee of the Central Board early in July, immediately after they were sent to Delhi, and to the other Directors in the second week of July. The report of the delegation on the discussions with the Expert Committee and a few notes prepared in the Bank after the delegation's return from Delhi were also forwarded to the Directors. At the weekly meeting of the Committee of the Central Board, held just prior to the Central Board meeting, the Governor also placed a matter that had been subject to much controversy, namely expansion of currency against ad hots (this is referred to in detail in a later paragraph).

The Board, in its resolution passed at the July 21 meeting, generally approved the advice tendered to the Expert Committee, 'as set forth in the Notes submitted to the Central Board', subject to a slight modification mentioned below. The resolution stated:

adequate legislative safeguards shall be introduced by the Government of Pakistan as well as the Government of the Union of India to provide that such overprinted Bank Notes* shall be payable on demand (1) only at the offices of the Reserve Bank of India situated in Pakistan, and not at offices of the Bank situated in the Indian Union, during the period the Bank manages the currency of Pakistan, as agents for the Government of Pakistan or otherwise, and (2) only by the Government of Pakistan thereafter.

It may not be out of place to mention here a small incident as a sidelight on the interest which the Directors took in the affairs of the Bank, and the strong view they held that the Board should be consulted before views on important matters on behalf of the Reserve Bank were expressed. One of the Directors, it appears, remarked, two days after the Central Board meeting, that is on July 23, that the question of seeking confirmation by the Board of the advice tendered by the delegation to the Expert Committee occurred to the executive only on receipt of complaints from Directors. The Governor, in a written reply, objected to this remark very strongly, and to convince the Director that his belief about the chronology of events was wrong, he presented the facts to him with dates. The Governor explained also why he thought it fit to bring in the Board only at the level of the Partition Council, and observed that the formal and final advice was to be that of the Board contained in its resolution passed

* These refer to Pakistan overprinted notes.

on July 21, 1947. While acknowledging this communication from the Governor, the Director made no reference to his earlier remark that the matter was referred to the Board only on receipt of a complaint, but stated in general terms that the Board or the Committee could not have any useful function, if views on important matters were expressed without its previous consultation and consent. According to him, this particular matter was so important and of such far reaching consequence that the Board should have been consulted before any views were expressed to the Expert Committee.

In anticipation of the possibility of the matter being raised again at the August meeting of the Board, at the Governor's instance, the Finance Department sent a telegram to the Governor on August 2, explaining that he could not have put any matter before the Committee earlier than he did, and expressing their regret that misunderstanding had been created. The Director concerned also wrote to the Governor that it was never his intention to allege that the Governor submitted the matter to the Board only on complaints but that if he had used inadvertently words which created such an impression, he was sorry for it.

Report of the Expert Committee

The Expert Committee submitted its main report on July 28 and a supplementary report on August 5. The supplementary report related to the treatment of the sterling assets held by the Bank. Though the Committee did not succeed in reaching agreement on all issues, it was creditable that it completed the discussions on all relevant matters speedily, thus simplifying considerably the Steering Committee's work. The following paragraphs deal with the more important issues concerning the Bank in respect of which the Expert Committee reached unanimous decisions.

(1) It was agreed that the existing currency and coinage would remain common to both the territories up to March 31, 1948. The subsequent six months, April-September 1948, would be a transitional period, during which only Pakistan overprinted notes would be issued in Pakistan areas but India notes already in circulation in Pakistan would continue to remain legal tender in Pakistan. The minting of Pakistan new design coins would start from March 1, 1948 or possibly earlier, and these would be issued in Pakistan from April 1, 1948 up to the extent available; any excess demand in Pakistan for coins would be met by India coins.

The Reserve Bank was to be the currency authority for both the countries during the period the currency remained common and also during the transitional period, April-September 1948. This was subject to agreement being reached on points 1 to 4, mentioned on page

544. The Committee suggested that a legal provision should be made to the effect that overprinted Pakistan notes and Pakistan coins would be received by the Reserve Bank only at its offices in Pakistan and that the Bank was not liable to receive them at its offices in India. This suggestion was in pursuance of the recommendation made by the Central Board of the Reserve Bank in its resolution passed on July 21, referred to earlier.

Agreement was also reached that from October 1, 1948, the Reserve Bank would cease to be the currency authority for Pakistan. Also, from that date, India notes would cease to be legal tender in Pakistan; however, the Pakistan currency authority and Treasuries might accept them for encashment for a further period of say three months*. The liability in respect of overprinted Pakistan notes would be taken over by the Pakistan currency authority; the Reserve Bank would have no liability in respect of these notes after September 30, 1948. These recommendations of the Committee were broadly in line with the suggestions contained in the note forwarded by the Bank.

(2) The Pakistan Government proposed to have their own separate Public Debt Office and run their exchange control from April 1, 1948. In respect of other matters like remittance facilities within each Dominion, control over banks and maintenance of Government account, it was agreed that no change was to be made so long as the Bank remained the common currency authority.

(3) The Muslim members wanted the Bank to open a branch at Dacca and the Bank agreed to do so as soon as necessary arrangements could be made regarding office accommodation and staff.

4) The Bank was agreeable to transfer all its moveable and immoveable property situated in Pakistan to the new Pakistan currency authority, at its book value, on October 1, 1948.

Regarding staff, the Bank undertook to make recruitment for the new currency authority in Pakistan. In respect of the existing staff, the Bank stated that while Muslim employees having their places of domicile in Pakistan areas would, of course, have to go over to those areas, the transfer of Muslim employees having their domicile in India and of non-Muslim staff serving in the Pakistan areas would be on a voluntary basis. Further, the Bank agreed to make available to the Pakistan Government, on deputation basis, any further staff required by them. The Bank's proposals were considered suitable by the Committee.

(5) The Committee suggested the adaptation of the Reserve Bank Act to include Pakistan territories for the period the Bank acted as a

* A different length of time was mentioned elsewhere in the report. While discussing division of assets and liabilities, the non-Muslim members recommended a six-month period for retirement of India notes, while the Muslim members considered even this inadequate.

central bank for Pakistan to enable the Bank's shareholders in Pakistan to continue as such. It was agreed that the adaptation would cease to have effect from October 1, 1948; thereafter, only residents in India would be qualified to be shareholders, those in Pakistan ceasing to exercise the rights of a shareholder, otherwise than for the purpose of sale of the shares. The shares would have to be transferred to residents in India gradually by private sales; the same procedure had been adopted in respect of Burma.

(6) It was agreed that the profits of the Bank should be shared between India and Pakistan in the ratio of Pakistan overprinted notes in circulation on September 30, 1948, plus India notes returning from circulation in Pakistan from October 1, 1948 to March 31, 1949, or any extended date agreed upon, to total notes in circulation in India and Pakistan on September 30, 1948.

(7) The Bank was of the view that a thorough system of control of exchange transactions between the two countries was extremely difficult and administratively expensive in view of the extensive land frontiers and the absence of natural boundaries. It was also considered doubtful whether the banking system would be capable of shouldering the burden. As the Muslim members desired to introduce exchange control from April 1, 1948, and considered that the customs cordon essential for this purpose could be established by that date, the Bank agreed to give assistance to Pakistan for setting up the administrative machinery in this behalf. It suggested that an officer of the Pakistan Government might be deputed to the Bank to undertake a detailed study of its methods and procedures. Also, as the Bank would be functioning in Pakistan up to September 30, 1948, it undertook to work out, in consultation with the Pakistan Government, the consequent changes to be effected and volunteered to provide the necessary administrative staff at the Bank's Karachi office, strengthened, if necessary, by transfers from other centres.

The Expert Committee was not in a position to make specific recommendations regarding allocation of foreign exchange for use in each territory up to March 31, 1948, and suggested that the two Governments should arrange for consultations and arrive at some agreement. However, it was decided that the foreign exchange allocated to Pakistan would be administered by the Reserve Bank according to the directions of the Pakistan Government till March 31, 1948. The Committee considered it desirable that both the Governments should follow a uniform policy in respect of all matters connected with foreign exchange during the transitional period up to March 31, 1948 and should co-ordinate their policies even thereafter, particularly during the period the Bank was to be the common currency authority. This was in line with the recommendation made by the Deputy Governor,

Mr. Trevor, in a memorandum (dated July 15, 1947) which was forwarded to the Committee. The Deputy Governor had observed that there were strong grounds for advocating continuance of the existing system even after introduction of a separate currency for Pakistan. However, as that was not considered to be suitable, he strongly recommended that a system of exchange control should be devised which while maintaining separate controls might so dovetail their activities so as to function for the mutual advantage of both the territories.

Main Points of Disagreement

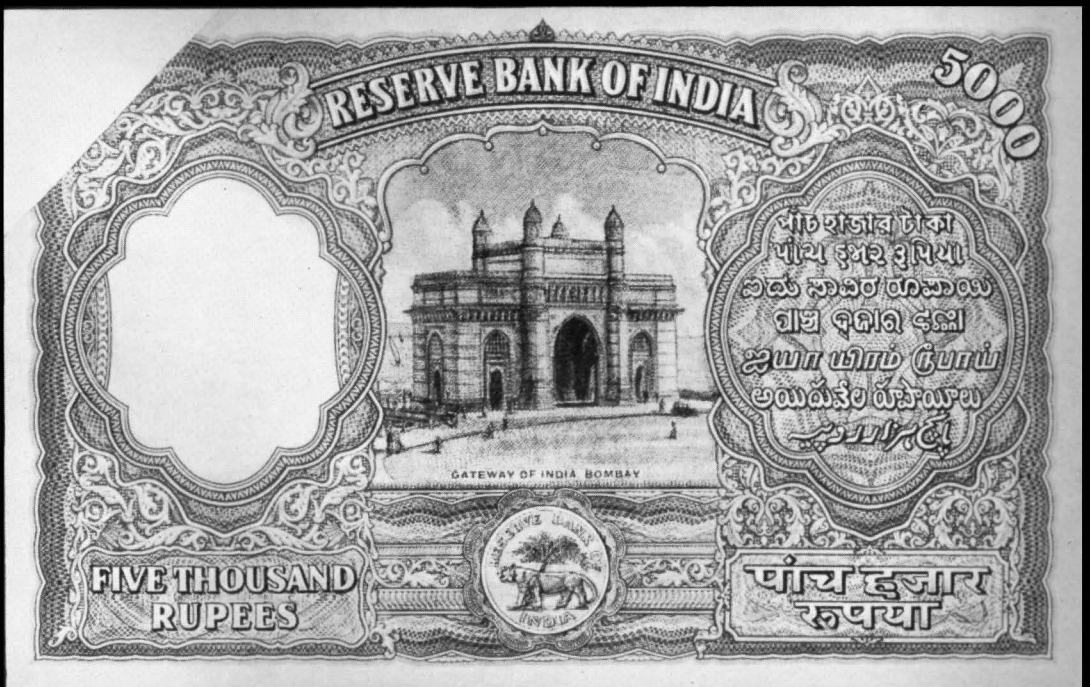
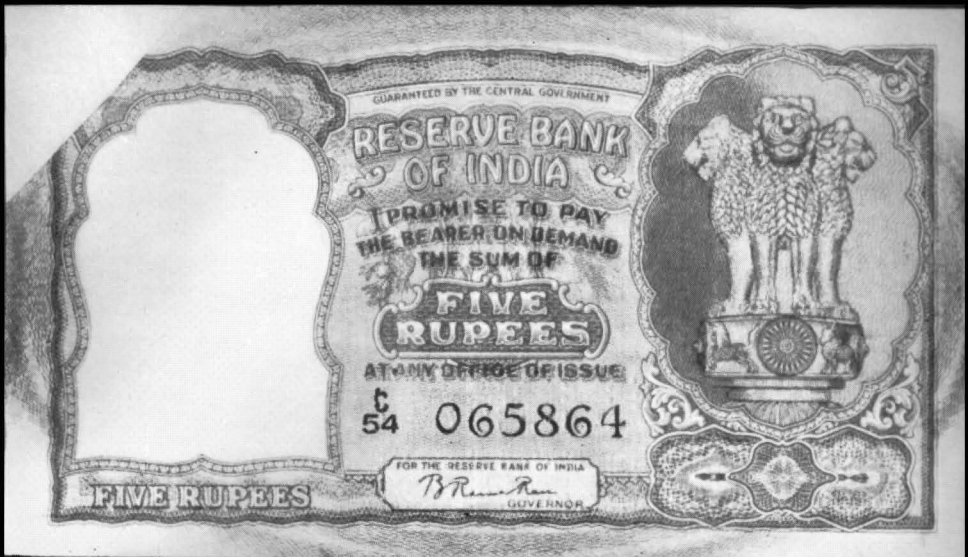
There were several issues -very vital in fact -on which the two sides had serious differences. The more important of these were:

(1) The Muslim members demanded that the Pakistan Government should appoint a Deputy Governor of the Reserve Bank. This was not acceptable to the non-Muslim members, whose argument was that Governors and Deputy Governors did not represent any Government as such and were responsible to the Central Board and that a Deputy Governor could not act on behalf of the Pakistan Government. The Bank was in complete agreement with the non-Muslim members.

(2) The Muslim members claimed that the Pakistan Government should directly nominate two out of the four nominated Directors on the Central Board, of whom one should be a member of the Committee of the Central Board. The non-Muslims had no objection to a convention being established that the Government of India would accept the nominations of the Pakistan Government, but they did not agree to the Act being amended for the purpose.

(3) The Muslim members desired that (a) in matters concerning Pakistan, the Bank should consult the Pakistan Government, (b) in matters concerning both India and Pakistan the Bank should consult both the Governments, and (c) differences, if any, between the two Governments, should be left to be resolved through the normal diplomatic channels. The non-Muslim members agreed to (a) and (b), but in respect of (c), they wished to add that, if the matter could not be resolved in the manner suggested, the final decision should rest with the Government of India.

(4) The Muslim members desired that a provision should be made in the Reserve Bank of India Act for expansion of currency required by Pakistan Government against that Government's securities. This was a very important issue and needs to be dealt with at some length, especially since it was specifically referred to the Committee of the Central Board. The non-Muslim members did not agree to these proposals, but the Reserve Bank representatives did not see any





Staff housing colony at Byculla, Bombay.

objection provided (a) a total limit was fixed for both the Dominions, and (b) Pakistan agreed that on the handing over of the assets against Pakistan note issue, such ad hots would be deducted first before proceeding to a pro rata allocation of the remaining assets. The Governor shared this view, but at the same time he considered that the matter was too important for the executive to take a decision on their own, and a brief memorandum by the Governor together with a note prepared by the Deputy Governor, Mr. Trevor, was submitted to the Committee of the Central Board, at its meeting on July 16, 1947 for its consideration.

In his note Mr. Trevor stated that though normally the Reserve Bank's temporary accommodation would take the form of ways and means advance, it might not entirely meet the requirements of the Pakistan Government. On the other hand, recourse to accommodation against ad hots should only be made as a last resort. The Deputy Governor submitted some proposals aimed at avoiding, or at any rate restricting, unnecessary expansion. These were:

- (a) As a part of the settlement, a proportion of Government's cash balance sufficient to meet the Pakistan Government's reasonable cash requirements during the period the currency of the two Dominions was jointly managed by the Reserve Bank, should be transferred to that Government;
- (b) cash requirements of the Pakistan Government not covered by the cash balance thus transferred and by their revenue receipts would be met from ways and means advances from the Bank as long as there were sufficient notes in the Banking Department of the Bank; a special rate of interest of $\frac{1}{2}$ per cent would be charged on such advances; and
- (c) only when the cash balance of the Pakistan Government augmented as above was exhausted and the Reserve Bank was unable to provide finance from its Banking Department, should currency be expanded against ad hots, the issue of which would be subject to two conditions, viz., (i) limits would have to be fixed up to which ad hots would be accepted by the Bank and (ii) the Pakistan Government would have to undertake to redeem the full amount of advances or ad hots at the time of the division of assets and liabilities on September 30, 1948.

On the assumption that, as in the past few years, the Bank's holdings of rupee securities in the Issue Department would remain in the neighbourhood of Rs. 60 crores for some years, the Deputy Governor considered a limit of Rs. 20 crores for creation of ad hots by the Pakistan Government as reasonable. Though it was unlikely that India would require to expand currency against ad hots during that period, the Deputy Governor suggested a limit of Rs. 40 crores for such expansion.

The stipulation regarding the redemption of ad hots by Pakistan at the time of division of assets and liabilities, on September 30, 1948, meant that Pakistan's ways and means advances or ad hoes would be set off against the note liability taken over by Pakistan and only in respect of the balance of the note liability the other assets in the Issue Department would be shared pro rata.

The Committee of the Central Board, at its July 16, 1947 meeting, passed the following resolution:

That Government of India be advised of the Committee's view that in order to avoid the dangers to both Dominions inherent in any unnecessary expansion of currency, the portion of the Cash Balance to be handed over to Pakistan should be sufficient to meet their normal requirements during the period of joint management of the currency and that as long as notes held in the Banking Department are sufficient for the purpose the Pakistan Government's further requirements should be met by ways and means advances at a special rate of $\frac{1}{2}$ of one per cent; only when these sources are exhausted should recourse be had to expansion of currency subject to an overall limit.

The Muslim members accepted all the proposals of the Bank excepting the limit of Rs. 20 crores for issue of ad hots. They feared that such a limit would put them in a difficult situation if unforeseen developments necessitated a larger amount. Also, since the Act did not prescribe any limit, India would be free to expand currency against its ad hots, and it was unfair they argued, to impose any restriction on similar action by Pakistan. The non-Muslim members, on the other hand, considered the limit on total expansion against ad hots an essential condition, and suggested a limit of Rs. 40 crores for India and Rs.10 crores for Pakistan.

(5) The Muslim members wanted to leave it open to the Pakistan Government to entrust the administration of their currency to the Reserve Bank for a further period after September 30, 1948, on an agency basis. The Deputy Governor considered this practicable if the Act was amended but the non-Muslim members regarded such an arrangement as inappropriate.

(6) In respect of the Issue Department, the only point of agreement was that the Pakistan Government should take over from the Reserve Bank, on October 1, 1948, the liability in respect of all the Pakistan overprinted notes of the Reserve Bank issued up to that date; against this currency liability, there was to be provisional allocation of assets to the Pakistan Government on September 30, 1948, in the ratio in which the various assets were held in the Issue Department on that day. With regard to India notes in circulation in Pakistan areas, the liability for which also was required to be assumed by Pakistan, there was disagreement between the non-Muslim and Muslim members

concerning the time that should be allowed for the final allocation of the assets to be made over to Pakistan against these India notes. The non-Muslim members considered that this should be done on March 31, 1949, and should be equivalent to overprinted notes taken over by the Pakistan Government on September 30, 1948 and India notes returned from circulation in Pakistan between October 1, 1948 and March 31, 1949; the Muslim members considered that this period was not adequate and desired to have a provision leaving it open to the Pakistan Government to extend the date. The non-Muslim members argued that since the notice regarding the demonetisation of India notes would have been given on April 1, 1948, a period of one year was more than sufficient for the withdrawal of India notes. India notes coming into the hands of the Pakistan Government after March 31, 1949 could be exchanged, they observed, in the normal manner as foreign exchange. The Bank's representatives were in agreement with the non-Muslim members.

(7) It was agreed that so far as the cash balances of the Pakistan Government and the deposits of Pakistan scheduled banks were concerned, the Reserve Bank would 'discharge its obligations in cash in the normal manner'. What this 'normal manner' meant was not indicated. The non-Muslim members wanted the surplus assets of the Bank including the Reserve Fund to be shared on the basis of note ratio, after deducting from the value of such surplus assets on September 30, 1948 two items, namely, (i) sums payable in respect of the current financial year till that day to Government and the shareholders and (ii) Burma's share which had not been determined till then. The Muslim members, on the other hand, were of the view that the Reserve Fund, which had been contributed by Government, should be allocated in the same manner as the uncovered debt of the then Central Government.

(8) The non-Muslim members observed that the Dominion of India would be 'the international personality of present India', and would therefore continue to remain a member of the I.M.F. and the I.B.R.D. Consequently, Pakistan should apply for membership of these institutions; India should sponsor the membership and give all assistance to enable Pakistan to secure it. The Muslim members held that both India and Pakistan were successor Governments and both should jointly approach the institutions for membership and division of the existing quota. The non-Muslim members argued that it was for the I.M.F. and the World Bank to decide whether India continued to retain the membership and whether its quota should be reduced and that it was not for India to take the initiative.

The issue had been considered in the Bank by Mr. Ram Nath, Secretary to the Central Board. In a note submitted to the Expert

Committee, Mr. Ram Nath observed that the more appropriate course would be to ask for a separate quota for Pakistan, as gold payment in that case would be only 10 per cent of the official holdings of gold and dollars in terms of Section 3(b) (ii) of Article III of the Fund's Articles of Agreement. If, on the other hand, an increase was asked for in India's quota and the increased amount thereafter divided between the two countries, then 25 per cent of the increase in quota would have to be paid in gold in terms of the Fund's Articles, and consequently a smaller amount of gold and dollars would be available for distribution between the two territories. The note suggested a figure of \$100 million for Pakistan's quota in the Fund.

Supplementary Report on Sterling Balances

The Supplementary Report on division of sterling balances submitted by the Expert Committee on August 5 was in the nature of separate memoranda embodying the views of the Muslim and the non-Muslim members of the Committee.

The Muslim members contended that sterling securities were really in the nature of loans advanced by the Government of India to the British Government to facilitate their war expenditure, and involved heavy sacrifices for the masses. In view of this, the most equitable basis for dividing sterling balances, they contended, would be with reference to the sacrifice made by the people. According to them, the average per capita income of Pakistan areas as a whole was 32 per cent lower than that of the Indian Union. Therefore, Pakistan should get, they argued, a share in the sterling balances determined on the basis of population plus 32 per cent; this worked out to 30.5 per cent of the total sterling balances. Also, in their view, it was not necessary to keep large sterling reserves in the Issue Department. They suggested that it was enough if the total of gold and sterling was kept at 40 per cent of the note issue and that the rest should be treated as an asset of the Government. However, they should not be distributed as the other assets of the Government, but should be divided on the basis suggested by them (that is, population plus 32 per cent). In the Reserve Bank's books, such sterling securities transferred should be replaced by ad hoc securities of the Government of India, and the share of India and Pakistan in those securities should be on the same basis as in respect of sterling securities. In respect of sterling in the Banking Department, they suggested that after keeping an amount equivalent to Rs. 50 to 60 crores, the rest should be treated in the same way as sterling in the Issue Department.

The views of the non-Muslim members were substantially the same as Mr. Ram Nath's. In a note which he prepared after attending the

Expert Committee meetings, Mr. Ram Nath observed that the sacrifices which resulted in the accumulation of sterling had their counterpart in the amount of notes and bank deposits held by the public in various parts of the country. The division of sterling must therefore follow the territorial location of the liabilities it was intended to safeguard. Mr. Ram Nath also pointed out that Government had no prior claim on the sterling balances. Any such claim, in his view, would correspondingly prejudice the convertibility of the rupees in the hands of the public. Also, if such a course was adopted, the note pointed out, the Government would be acquiring sterling against their I.O.U.s, without being required to raise necessary funds through taxation or borrowing. Pakistan's share of sterling in the Issue Department should be entirely on the basis of the amount of notes in circulation in that Dominion. For apportionment of sterling in the Banking Department, the only practicable method, Mr. Ram Nath observed, would be 'according to the respective proportions of bank deposits in the two territories including their share of the cash balance of Government'.

Steering Committee

The Steering Committee reached conclusions expeditiously. These were approved by the Partition Council and were embodied in the Pakistan (Monetary System and Reserve Bank) Order, 1947, issued on August 14, 1947. The Order did not refer to some important matters on which agreement was reached by the Steering Committee; a few of these may be mentioned first, since agreement on these was a prior condition for the issue of the Order.

(1) It was agreed that the appointment of a Deputy Governor by the Pakistan Government would not be appropriate; there would be no objection to the appointment by the Pakistan Government of an Officer on Special Duty for maintaining contact with the Reserve Bank.

(2) The Government of India should agree to take two nominees of the Pakistan Government on the Central Board of the Reserve Bank; it was not considered necessary to amend the Reserve Bank of India Act for the purpose.

(3) The Committee recognised that it was not in the interest of both the countries to encourage unnecessary currency expansion against cash hoards and considered an overall limit of Rs. 60 crores -Rs. 20 crores for Pakistan and Rs. 40 crores for India-reasonable, provided the proposals put forward by the Bank were adhered to. It was further provided that in the event of an unforeseen contingency, the Pakistan Government would have the right to ask the Government of India for a further expansion up to Rs. 10 crores if the latter agreed to it and also did not want to utilise substantially their limit of Rs. 40

crores; the limits proposed were to apply, the Committee stated, until Pakistan issued her own notes, i.e., April 1, 1948. The fixation of this date required confirmation by the Reserve Bank. The Bank did not, however, agree with this date and observed:

As our objections to the issue of ad hots were based on financial considerations, viz., to prevent unnecessary inflation of currency in either of the Dominions, we fail to see why the Steering Committee should have interpreted our proposals to mean that the restrictions were to apply only up to the 31st March 1948 the limits should therefore apply for so long as the Reserve Bank continues to be the Central Bank of Pakistan, and is entrusted with the management of currency of that Dominion.

Pakistan (Monetary System and Reserve Bank) Order, 1947

The main provisions of the Pakistan (Monetary System and Reserve Bank) Order, 1947, are explained below.

Banker to Government: The Bank was to continue to function as banker to the Central and Provincial Governments in Pakistan up to September 30, 1948. However, after March 31, 1948, it was not to be entrusted with the management of public debt, issue of new loans and exchange control operations.

Currency and Coinage: The Bank was to have the sole right to issue notes in Pakistan up to September 30, 1948. While India notes were to continue to remain legal tender in Pakistan up to September 30, 1948, the Order provided for the issue by the Bank, from April 1, 1948, of notes in Pakistan, carrying the inscription 'Government of Pakistan' in English and Urdu. The Government of India were not liable to pay the value of any notes so inscribed; the Bank's liability in respect of such notes was to cease on September 30, 1948.

The Order did not specify the date on which the Government of Pakistan would issue their coins, but it provided that if any Pakistan coins had been issued, the Bank was not to issue India coins in Pakistan after March 31, 1948, except to the extent that Pakistan coins were not available in sufficient quantities. India one rupee notes were not to be legal tender in Pakistan after September 30, 1948; these were to be withdrawn in order to allocate the liability between the two Governments.

Management of Foreign Exchange: Up to March 31, 1948, the Bank was to sell to or buy from any authorised person in Pakistan, on demand, foreign exchange at such rates and on such conditions as the Government of Pakistan would determine from time to time, in consultation with the Government of India.

Control of Scheduled Banks: The Government of Pakistan were empowered to declare as Pakistan scheduled banks, any bank which fulfilled certain requirements and which did not fall under the jurisdiction

of the Government of India, The Reserve Bank was to have the same control over Pakistan scheduled banks as it had over scheduled banks in India; the Banking Companies (Restriction of Branches) Act, 1946, and the Banking Companies (Inspection) Ordinance, 1946, were to be applicable to the whole of Pakistan up to September 30, 1948. The Bank could call upon any Pakistan provincial co-operative bank, with which it had transactions under Section 17 of the Reserve Bank Act, to furnish weekly returns.

Adaptation of the Reserve Bank Act: The Order listed the amendments to be effected in the Reserve Bank Act to enable the Bank to carry out its functions in relation to Pakistan.

Remittance Facilities : The Bank was required to provide up to March 31, 1948 remittances at par between its offices in Pakistan and such offices in India, as might be prescribed by the Bank, in such amounts and subject only to such rate or rates of commission as might be approved by both the Governments.

Division of Bank's Profits: Since the Reserve Bank's profits mainly represented the return on assets held in its Issue Department against note issue, the formula for the allocation of profits of the Bank was based on the relative share of each in the total value of notes in circulation in the two territories. Pakistan's share in the Bank's profits was to be in the same proportion as that of the total value of overprinted Pakistan notes in circulation in Pakistan on September 30, 1948, plus the total value of India notes returned from circulation in Pakistan between October 1, 1948, and March 31, 1949, to the total value of notes in circulation in India and Pakistan on September 30, 1948. However, if a unanimous declaration was made by or on the authority of the two Governments that on or around January 1, 1949, India notes returned from circulation in Pakistan in considerable quantities, then India notes returning up to September 30, 1949 were to be taken for the purposes of this Section as well as for the purposes of division of assets of the Issue Department, referred to below.

Division of Assets of the Issue department: The basic principle observed in the division of the Bank's assets derived from the fact that in the case of every financial institution assets match liabilities. The transfer of assets had therefore necessarily to be balanced by a transfer of equivalent liabilities. Since the assets of the Issue Department were held against liability for note issue, the extent of assets transferred to Pakistan was equivalent to the note issue liability assumed by Pakistan. Thus, the Order provided for the transfer to the Government of Pakistan from the Issue Department of the Bank, as soon after September 30, 1948 as practicable, assets equivalent in value to the total liability in respect of Pakistan overprinted notes outstanding on that day. India notes in circulation in Pakistan on September 30, 1948

were to be accepted by the Government of Pakistan at par up to March 31, 1949, or if the two Governments considered it necessary, up to September 30, 1949, and assets from the Issue Department equivalent in value to such India notes retired were to be transferred to the Pakistan Government on demand. The Bank's holdings of Pakistan's rupee securities and advances, if any, taken by the Pakistan Government from the Bank were to be first set off against the liability for Pakistan notes and India notes returned from circulation in Pakistan and only in respect of the balance, the other assets of the Issue Department, consisting of gold, sterling securities*, India rupee coin, Pakistan rupee coin and Government of India securities, were to be transferred in the proportions in which they were held in the Issue Department on September 30, 1948. Pakistan rupee coins remaining with the Bank after the division of assets were to be made over to the Government of India for disposal otherwise than as coin.

Reserve Fund: The amount of Reserve Fund to be distributed between the two Governments was to be that which would have accrued to the Government of India in terms of Section 57† of the Reserve Bank of India Act, if the Bank were placed in liquidation in the prescribed manner. Of this amount, Pakistan's share was to be the same fraction as the fraction of the uncovered debt of the Government of India for which the Pakistan Government became liable on August 15, 1947. This was so because the Reserve Fund of Rs. 5 crores transferred to the Bank on its inception in the form of Government paper was included in the total debt of the Government of India.

Other Surplus Assets: The 'other surplus assets' of the Bank were to be divided between the two Governments in the ratio of their respective shares of assets of the Issue Department. Amount due to Pakistan was to be credited as a capital payment in reduction of the debt, if any, due by that Government to the Government of India.

Bank's Property in Pakistan : The Order required the Government of Pakistan to take over, if the Bank so desired, at book value all or any of the property held by the Bank in Pakistan for the purpose of carrying on its business.

Imperial Bank: The Imperial Bank was to act as the Reserve Bank's agents in Pakistan up to September 30, 1948.

Status of the Bank in Pakistan: The Reserve Bank Act was to 'cease to be part of the law of Pakistan', and the status of the Bank in Pakistan was to be 'that of a corporation existing only by virtue of the law of India and capable of suing and being sued as such in Pakistan'.

* The division of sterling assets in the Issue Department on the basis of note ratio was only provisional, pending the Partition Council's decision on sharing of sterling assets of the Bank.

† Section 57 provided for the distribution of the Reserve Fund and surplus assets between the Central Government and the shareholders in the proportion of 75: 25, in the event of the liquidation of the Bank.

Significant Omissions: As mentioned already, the sharing of sterling assets in the Issue Department in the ratio of note circulation, provided in the Order, was only provisional, pending decision by the Partition Council. The Order did not make any reference to the division of sterling assets of the Banking Department, as the Partition Council had to take a decision on that issue too.

Another significant omission related to the fixation of limits on holdings of Government of India securities and Pakistan Government securities in the Issue Department. The draft Order, which was discussed at a joint meeting of the representatives of the two Governments held on August 13 and 14, 1947, did contain a provision to the effect that the Government of India rupee securities in the Issue Department should not exceed by over Rs. 40 crores the amount held on August 15, 1947, while the amount held in Pakistan Government securities should not exceed Rs. 20 crores. Later, however, there were differences between the Muslim and the non-Muslim members regarding the interpretation of this clause and so this matter did not figure in the Order.

Partition Council's Decisions

The question of division of sterling assets, which had caused the biggest headache to the two parties, was at last resolved by the Partition Council on December 1, 1947. The Partition Council announced two other decisions also on the same day; these related to (i) limits on expansion of currency against ad hots after March 31, 1948 and (ii) clarification in respect of payment for I.M.F. quotas.

Sterling Assets of the Reserve Bank : In addition to the sterling which was to be transferred to Pakistan in terms of the Pakistan (Monetary System and Reserve Bank) Order, 1947, Pakistan was to be entitled to an amount of sterling calculated as under : From the total of the sterling assets in the Issue and Banking Departments as on September 30, 1948, the lump sum payable to the British Government on account of capitalisation of pensionary liability, military stores and fixed assets, as on April 1, 1947, in India, etc., would be deducted. Of the balance, an amount in sterling, which taken together with the entire amount of gold held in the Issue Department would constitute 70 per cent of the liabilities of the Issue Department, was to be allocated to Pakistan in the proportion of note liability; let us say this amount was the equivalent of Rs. A crore. Of the remainder, 17 ½ per cent was to be allocated to Pakistan (let us say Rs. B crores). The difference between the total amount of sterling thus worked out (i.e., Rs. A + B crores) and the amount Pakistan was to receive as her share of the sterling assets of the Issue Department in terms of the

Pakistan Monetary Order was to be the additional sterling to be made available to Pakistan. India was to sell to Pakistan this amount of additional sterling for Indian rupees on demand being made by Pakistan up to December 31, 1967.

The two Dominions were to negotiate separately with the British Government for releases of sterling beyond January 1, 1948. The Reserve Bank was to open a separate account or accounts with the Bank of England, and transfer to it/them from its No. 2 Account a sum equivalent to the release made by the British Government to Pakistan and also the amount fixed as Pakistan's working balance. Pakistan's exchange operations were to be conducted through those accounts.

It was also agreed that from January 1948 each Dominion would retain separately its foreign exchange earnings, foreign exchange expenditure being debited against respective earnings. There was to be no exchange control between the two Dominions up to March 31, 1948.

Expansion of Currency Against Ad Hoc: As regards expansion of currency against ad hocs, the decision reached by the Partition Council was:

It was agreed that Pakistan would seek the Reserve Bank's view on the abolition or the stepping up of the limit for expansion of currency against Pakistan ad hocs after 31-3-1948. Pakistan would also consult the Bank about their desire that they should not be required to take ways and means advances before resorting to expansion of currency in the case of need. India would not object to any arrangement in respect of these matters that the Bank may agree to, having regard to the interests of both the Dominions.

The Council's decision thus related to the position after March 31, 1948. For the period up to March 31, it will be recalled that the Steering Committee had recommended, and the Partition Council had approved, a limit of Rs. 40 crores for India and Rs. 20 crores for Pakistan; the latter figure could be increased to Rs. 30 crores with the Government of India's consent. However, the entire clause imposing the limits was deleted from the draft Pakistan (Monetary System and Reserve Bank) Order, 1947. The position whether the Bank could expand currency against ad hocs till March 31, 1948, thus remained ambiguous.

Quota in the I.M.F.: The Partition Council's decision was in the nature of clarification of the recommendations made by the Steering Committee in August 1947[†]; it provided that India should give to Pakistan in gold and in U.S. dollars or other acceptable foreign

[†] The Steering Committee had merely stated 'when Pakistan becomes a member of International Monetary Fund and the International Bank, the Dominion of India will make available to Pakistan its ascertained share of the gold and dollar assets or equivalent value thereof in the form of dollars or any other foreign exchange acceptable to the Fund and the Bank'.

exchange, an amount equal to 17 ½ per cent of what undivided India had paid by way of subscription to the Fund and the World Bank. However, gold payment by India was not to exceed what Pakistan would actually be required to pay to the I.M.F.

Cash Balances: A few days later, an agreement was also reached in respect of distribution of cash balances. The Government of India's cash balances at the time of the partition were a little under Rs. 400 crores, inclusive of the securities held in the Cash Balance Investment Account. Of these, Pakistan's share was fixed at Rs. 75 crores; this was inclusive of Rs. 20 crores made available to Pakistan as a working balance on August 15, 1947.

FUNCTIONING OF THE BANK AS CENTRAL BANK OF PAKISTAN

The Bank set out promptly to fulfil its role as the central banking authority for Pakistan scrupulously in accordance with the provisions of the law. But before long, the Bank's relations with Pakistan turned out to be far from smooth.

Staff and Board Arrangements

The reallocation of the Bank's staff between its offices in India and Pakistan did not present any serious problem. In line with the arrangements made by the Partition Office in respect of Government employees, the Bank afforded all its employees in July 1947 an opportunity (through a questionnaire) to select the areas in which they desired to serve. The employees were given appropriate assurances regarding the continuance of their existing terms and conditions of service. The inter-Dominion transfers of staff were more or less completed by May 1948. Arrangements were also concurrently made to engage and train new staff to man the Bank's offices in Pakistan in replacement of the non-Muslim staff who were evacuated from that Dominion as also to meet the requirements of those offices for additional staff. Another measure taken to ease the acute staff position of these offices, at the special request of the Pakistan Government, was the further opportunity given in June 1948 to those of the Muslim staff who had finally opted for India to alter their option in favour of Pakistan if they wished to do so.

As regards the Central Board, according to the Partition Council's decision, the Government of India had to appoint two nominees of the Government of Pakistan to two of the four seats on the Board reserved for nominated Directors. The Pakistan Government desired that Sir

Syed Maratib Ali, a nominated Director on the Board, continue as one of their nominees; as regards their second nominee, they proposed the name of Mr. St. John Turner, an official of the Bank of England who had been brought over to assist their Finance Ministry in matters relating to banking, etc. The proposal regarding Sir Syed Maratib Ali was accepted by the Government of India. As for Mr. Turner's nomination, the Government of India's view was that on account of his being on deputation with the Pakistan Government, he was in effect an official of that Government and was therefore precluded from being nominated, by virtue of the provisions of Section 10(1) (a) of the Reserve Bank of India Act as amended by Section 1 (4) in Part III of the Pakistan (Monetary System and Reserve Bank) Order, 1947. Even if his temporary appointment with the Pakistan Government were ignored, his nomination would still infringe Section 10(1) (d) of the Act which disqualified employees or officers of any bank. The Government of India apprised the Pakistan Government of the difficulty. Later, on January 12, 1948, in the vacancy caused by the resignation of Sir Arthur Bruce, they nominated Mr. Nazir Ahmed Khan, an advocate of Lahore, as proposed by the Pakistan Government. However, as Mr. Khan continued to be a Member of the Pakistan Constituent Assembly after his nomination as Director -this fact does not appear to have been within the knowledge of the Government of India at the time of his nomination -the nomination became void on March 12, 1948, in terms of Section 11 (5) of the Act; Mr. Khan formally tendered his resignation from the Directorship with effect from March 11.

Pakistan's Request for an Advance and Transfer of Cash Balances

The Bank's functioning as banker to the Pakistan Government was smooth in the first four-and-a-half months, but in early January 1948 serious trouble arose on two very important issues raised by the Pakistan Government. The two issues were: (i) grant of accommodation to the Pakistan Government and (ii) transfer of Rs. 55 crores of cash from the Government of India's cash balances with the Bank to Pakistan Government's account. The final outcome was the earlier termination of the Bank's role as currency authority and central bank in Pakistan.

Even before the Pakistan Government approached the Bank in regard to the above matters, exchange of views had taken place between the Governor and the Government of India. Following press reports regarding the Government of India's decision not to implement the financial settlement with Pakistan, especially that regarding the cash payment, in view of the deadlock over Kashmir, the Governor sent a telegram to the Finance Secretary of the Government of India on December 24,

1947, saying that having regard to the large volume of Indian currency held in the currency chests in Pakistan area, and the temptation for that Government to draw on them for want of funds, it would be wise to start paying them the remainder of the cash balance agreed to in lots of say Rs. 3 crores a week. Governor prefaced his telegram by saying:

While recognising decision influenced by political considerations, I feel it is my duty to draw attention to considerations of currency which may not appear clearly to Government.

Sir Purshotamdas Thakurdas, whom Governor consulted, concurred with him. The Finance Secretary's reply was that Government did not propose to release any part of the cash balance for the present and 'as regards the request by Pakistan to Reserve Bank of India for accommodation, it is obvious for Bank to decide and Government do not wish to be party to it'.

Meanwhile, the Bank received a request dated December 25, 1947 from the Pakistan Government for an advance of Rs. 10 crores against ad hoc securities; the Pakistan Government hoped to repay the advance out of the cash balance of Rs. 55 crores yet to be released. The Bank offered to consider their request as one for a ways and means advance at the special rate of $\frac{1}{2}$ per cent indicated by it earlier, to which the Pakistan Government agreed. Accordingly, in exercise of the discretion vested in the Executive and as an interim measure, the Bank credited the Pakistan Government's account with Rs. 5 crores. The Governor then called for certain information from the Pakistan Finance Ministry to enable the Bank to come to a decision regarding the granting of the balance of Rs. 5 crores after a reference to the Committee of the Central Board. The Governor was, however, anxious that the Pakistan Government should not misconstrue the Bank's action as treating them differently from the undivided Government of India. In his letter to the Pakistan Finance Secretary, the Governor explained that there were definite limits on ways and means advances to Provincial Governments; in respect of the Central Government, though no such limit was fixed, advances to the Central Government had not been in excess of Rs. 20 crores. The consideration influencing the Bank in granting such advances to the Central and Provincial Governments was the same, the Governor pointed out, namely, there should be a fair chance of repayment of the advance within three months. Further, while the Bank had a fair idea of the budgetary position of the Indian Government, it had no idea at all of the budgetary position of Pakistan to determine whether any accommodation to them would be a sound banking proposition.

As regards the Pakistan Government's expectation to repay the advance out of the cash balance, the Governor remarked that the

payment appeared to be very uncertain in the light of pronouncements made on both sides and that unless the Bank had a firm statement from the Government of India indicating the date by which, or the rate at which, the amount would be paid to Pakistan, the Bank could not take it into account for purposes of determining accommodation to Pakistan. The Governor concluded that there was no prospect of the Bank's considering anything beyond Rs. 10 crores as the permissible limit for Pakistan. The Governor also drew the Pakistan Government's attention to the fact that in the absence of an agreement between the two countries on the amount of ad hoc treasury bills Pakistan could issue, no provision had been made in the Reserve Bank of India Act for holding such bills of the Pakistan Government in the Issue Department.

The Governor's explanation was not acceptable to the Pakistan Government; they were of the view that to restrict ways and means advance to Pakistan Government to Rs. 5 crores would be 'in direct conflict with and in violation of' the undertakings given by the Bank at the time of partition. As regards the Governor's statement that ways and means advances subsequently converted into ad hoc Treasury bills would not be available for transfer to the Issue Department, Pakistan's Finance Secretary remarked:

since these ad hocs have in any case to be set off first against the India notes returned by the Government of Pakistan at the time of the division of assets of the Bank on 1-10-1948, it is hardly necessary that the treasury bills should necessarily be transferred to the Issue Department of the Bank from its Banking Department. Even under the Act as it stands, therefore, there is nothing to prevent the Reserve Bank providing accommodation to the Government of Pakistan against its ad hoc treasury bills. In the circumstances, we cannot recognise any validity in the objection raised.

The Finance Secretary went to the length of suggesting that the Bank was departing from fair dealing at the interference of the Indian Government. To quote:

The Pakistan Government find it difficult to believe that a responsible institution like the Reserve Bank would wish to risk its reputation for fair dealing were it not for the interference of the India Government who are determined to strangle Pakistan financially and economically. In the circumstances the straightforward course for the Reserve Bank would be to inform the Government of Pakistan that it finds itself unable to continue as its Banker and currency authority, and to effect a division of the assets of the Bank forthwith.

In a separate memorandum, the Finance Secretary demanded that the Bank should transfer Rs. 55 crores of cash balance to the account of the Pakistan Government; otherwise, the Bank should not allow the

Government of India to operate their account without the Pakistan Government's consent. 'We hereby demand that the Reserve Bank should treat both Dominions on an equal footing in this respect', the memorandum concluded.

The Governor emphatically repudiated the charge that the Bank was departing from fair dealing with Pakistan due to the 'interference' of the Government of India. Informing the Pakistan Finance Secretary that the Committee of the Central Board had decided (on January 7, 1948) to grant a further advance of Rs. 5 crores to the Pakistan Government, the Governor added that in view of the 'gravity' of the issues raised by Pakistan, he would leave the question of any further accommodation to them to be decided by the Central Board at its emergency meeting on January 14. The Governor referred to the Finance Department's telegram of August 14, 1947, asking the Bank to transfer Rs. 20 crores to Pakistan and the balance to the Indian Dominion as opening balance on the 15th, and pointed out that the Bank saw no justification for imposing an embargo on operation by the Government of India on their account with the Bank. Further, the Bank had not received any documents regarding the reported financial settlement between the two countries. The Governor, therefore, requested both the Governments to furnish him with relevant documents to enable him to consider the question.

Emergency meetings of the Central Board were convened on January 14 and 15, 1948. After the discussions, at the meeting on the 15th, Mr. Nazir Ahmed Khan proposed and Sir Syed Maratib Ali seconded resolutions providing that (i) the due share of Pakistan Government in the cash balances having been determined at Rs. 75 crores, a sum of Rs. 55 crores should be credited to the Pakistan Government account in addition to Rs 20 crores already so credited; (ii) in regard to ways and means, the Bank should abide by the decision of the Partition Council which was on the basis of advice tendered by the Bank, viz., ways and means advances would be given to Pakistan without any limit so long as notes were available in the Banking Department of the Bank; and (iii) there should be no limit in respect of expansion of currency against Pakistan Government securities after March 31, 1948, when Pakistan notes would begin to be issued and expansion would be effected through Pakistan notes.

The resolutions were put to vote and lost, the voting being nine against and two in favour, with one abstention.

Thereafter, Mr. C. R. Srinivasan proposed and Mr. Ramanathan Chettiar seconded the following resolutions:

- (1) Resolved that (i) in view of the fact that the Reserve Bank is not concerned with the allocation of cash balances between the two Governments for which it acts as Banker, that it maintains two accounts only

one in the name of the Pakistan Government and the other in the name of Government of India, and that it can transfer funds from one account to the other only on the instructions of the Government from whose account funds are to be transferred, the Reserve Bank is unable to comply with the request of the Pakistan Government to transfer Rs. 55 crores from the Government of India without requisite authority from the latter;

(ii) nor is the Reserve Bank able to accept the contention of the Pakistan Government that the Reserve Bank shall not permit the Indian Government to operate against the cash balances without the consent of the Pakistan Government in the event of such a transfer not being made.

(2) Resolved that the Reserve Bank never contemplated, and is unable to accept the position that ways and means advances should be made to unlimited amount and the views of the Partition Council incorrectly put cannot bind the freedom and discretion of the Reserve Bank to take note of relevant factors in deciding the limit of such advances.

(3) Resolved that expansion of currency against Pakistan ad hoc treasury bills is not permissible under the Reserve Bank Act and the Board is unable to accept the responsibility for such expansion or advise such a course, and that in regard to expansion of Pakistan Government overprinted currency against their ad hoc treasury bills and the position of the Reserve Bank under the Pakistan Monetary Order, the possibility of advancing the dates mentioned in Sections 4 and 5 of Part II of the Pakistan (Monetary System and Reserve Bank) Order, 1947, be considered in consultation with the two Governments and a report made to the Board at their next meeting.

The resolutions were carried by ten votes to two.

The Government's stand on the cash balance issue was explained by the Deputy Prime Minister, Sardar Vallabhbhai Patel at a press conference held in New Delhi on January 12, 1948. Sardar Patel said that soon after the informal and provisional agreement on cash balances had been reached, he had made it quite clear to the Pakistan authorities that the Government of India 'would not regard the settlement of these issues as final until agreement had been reached on all outstanding issues'. He added, 'I made it quite clear then that we would not agree to any payment until the Kashmir affair had been settled'. According to him, the Pakistani authorities did not raise any objection then. It was only on December 22, 1947, at the time of the final talks on the Kashmir issue, that the Pakistan Prime Minister objected to the treatment of the financial issues and the Kashmir question together and demanded immediate transfer of Rs. 55 crores to their account. The Government of India's reply was that they stood by the agreement but that in view of the hostile attitude of the Pakistan Government regarding Kashmir, the payment would have to be postponed in accordance with their stand throughout the negotiation.

However, Mahatma Gandhi was very unhappy about this matter. His view was that the balances must be released to Pakistan. In this

connection, he even undertook a fast. In the circumstances, the Government of India reviewed the matter and on January 15, 1948 announced their decision to implement immediately the agreement in regard to cash balances, by way of 'Government's contribution, to the best of their ability, to the non-violent and noble effort made by Gandhiji, in accordance with the glorious traditions of this great country, for peace and goodwill'. Prime Minister Nehru made it clear that the decision 'does not mean any change in our unanimous view about the strength and validity of the Government's position as set out in various statements made by distinguished colleagues of mine. Nor do we accept the facts or arguments advanced in the latest statement of the Finance Minister of Pakistan'.

Loan Floatations

In September 1947, Deputy Governor Mr. Trevor received a letter from Pakistan's Joint Finance Secretary stating that the Finance Minister was considering the issue of 3 per cent bearer bonds repayable not earlier than 1977. The Joint Finance Secretary wanted to know the prospects for the issue and the earliest date by which the bonds could be issued. The Deputy Governor was very much against issue of bearer bonds in Pakistan for a number of reasons, which he listed in his letter. In his words, 'its introduction by Pakistan at this stage would be a retrograde step, against which I would strongly recommend'. Mr. Trevor also pointed out that the conditions in the money market were very unstable and that he could not offer any encouragement for the successful floatation of a loan. He suggested that the question might preferably be deferred till April next year, by which time the Bank would be in a position to tender advice regarding the terms and the nature of the loan to be issued by the Pakistan Government. Mr. Trevor also suggested that the scrips issued should be in the same form as the current loans of the Government of India, viz., Government Promissory Notes and Stock Certificates. The Bank's advice was heeded and no issue was made in 1947.

In January 1948, however, a few days after the cash balance transfer episode, the Bank was informed by Pakistan's Finance Secretary of his Government's decision to float simultaneously three loans, short, medium and long. The Bank was asked to make necessary arrangements to receive subscriptions for these at its offices and at the offices of the Imperial Bank of India in India, in addition to receiving such subscriptions at the Bank's and Imperial Bank's offices in Pakistan and at Treasuries in Pakistan. The Bank was also asked to make arrangements at its and Imperial Bank's branches in Pakistan and Treasuries in Pakistan for issue of 1½ per cent tax-free Bearer Bonds, which the

Pakistan Government proposed to issue. The Finance Secretary further enquired whether the Bank would be prepared to take over from the Government of Pakistan at current market rates, Government of India securities, which they proposed to acquire from Provincial Governments, semi-Government bodies and institutions in Pakistan, in lieu of their own securities.

After reference to the Committee of the Central Board, Mr. Trevor Wormed the Pakistan Government that

(i) the Bank would have to ascertain from the Government of India whether they were agreeable to the Pakistan Government competing with them in the Indian money market, and

(ii) the Bank would have to consider whether the purchase of Government of India securities from Pakistan would suit its investment portfolio and whether or not expansion of currency would be involved. The Government of India would also be consulted as the arrangement involved a serious inflationary potential.

Mr. Trevor considered that the conditions in the securities market were far from favourable from the point of view of a new floatation, and repeated his earlier advice that issue of loans should be deferred for another two to three months.

The idea of raising funds in India was dropped by the Pakistan Government but they went ahead with other arrangements relating to the floatation; four loans, namely, (i) 2 $\frac{3}{4}$ per cent Loan 1953-54, (ii) 3 per cent Loan 1960, (iii) 3 per cent Loan 1968, and (iv) 1 $\frac{1}{2}$ per cent Income-Tax Free Bearer Bonds 1958, were issued in mid-February 1948. Total subscriptions received till March 31, 1948 in respect of the four issues, which were on tap, aggregated about Rs. 32 crores.

TERMINATION OF BANK'S ROLE IN PAKISTAN

The termination of the arrangements for the Bank's role as Pakistan's central bank may now be mentioned briefly. Relations between the Pakistan authorities and the Bank were strained because of the events mentioned earlier. In the circumstances, the Governor declined two invitations extended to him by the Pakistan Finance Minister to visit Karachi, and offered to depute a Deputy Governor, Mr. Trevor or Mr. Mehkri, instead. In his telegram of January 31, 1948, declining the visit to Karachi, the Governor observed:

I am not prepared to risk lack of consideration and courtesy which wholly unwarranted accusation lead me to fear.

When the Pakistan Finance Secretary brought to the Governor's notice that the Pakistan Government deplored the attitude taken by him and took exception to it, the Governor sharply retorted:

you could not deplore my attitude more than I deplore your Government's action in dragging Reserve Bank unnecessarily into a public controversy. The Bank has always recognised its responsibility to your Government and discharged it to the best of its ability.

The Governor had another complaint against the Pakistan Government. In a memorandum to the Committee of the Central Board prepared in some other connection, he referred to the difficulties the Bank experienced owing to the Pakistan Government's refusal to allow the Bank necessary facilities for redistributing India notes held in the currency chests in Pakistan and which were surplus, considering the requirements of that Dominion till March 31, 1948; from April 1, 1948, Pakistan overprinted notes were to be issued in Pakistan. A protest was lodged on January 14, 1948, and in early February 1948 the Governor deputed Mr. McCallum, the Manager of the Bombay Office of the Bank, to Karachi for settling the issue. The question of destruction and removal of surplus India notes from Pakistan was discussed and a phased programme of destruction, removal and cancellation of India notes was worked out, subject to confirmation by the Reserve Bank.

Following exploratory talks at New Delhi between the Governor and Mr. Zahid Hussain, High Commissioner for Pakistan in India and later the first Governor of Pakistan's central bank, the Pakistan Government sent, in February 1948, a communication to the Bank to say that it had been agreed that Pakistan should take over the responsibility for currency and banking arrangements in Pakistan, effective April 1, 1948, and that Indian currency notes in the chests located in Pakistan would be returned to the Bank before that date. The removal and destruction of notes would be so arranged as to leave, in currency chests in Pakistan, Indian currency notes equivalent to Pakistan's credit balance with the Bank. The Bank's Board, which considered the matter on February 24, 1948, had no objection to Pakistan's assuming responsibility for its currency and banking arrangements from April 1, 1948, provided the agreement between Pakistan and the Reserve Bank regarding withdrawal and/or destruction of notes in chests located in Pakistan was carried out 'both in letter and spirit', and provided appropriate amendments were made to the Pakistan (Monetary System and Reserve Bank) Order, 1947, and other relevant agreements between the Governments of India and Pakistan in consultation with the Reserve Bank.

Tripartite talks were accordingly held between the representatives of the Governments of India and Pakistan and the Reserve Bank in

Bombay between March 10 and March 13, 1948, and later continued at Delhi. During the talks, the Government of Pakistan withdrew their original proposal to terminate the Monetary Arrangements on March 31, 1948; it was agreed that the termination should be effective three months later, viz., on June 30, 1948, or three months earlier than the original date of September 30, 1948; an agreement was signed on March 31, 1948. The decisions reached were embodied in the Pakistan Monetary System and Reserve Bank (Amendment) Order, 1948, issued on the same day. The main provisions of the Order are given below.

Pakistan Monetary System and Reserve Bank (Amendment) Order, 1948

Division of Issue Department's Assets: Pakistan's share in the Issue Department assets was to be equivalent to the value of Pakistan notes outstanding on June 30, 1948, plus the total value of India notes which were legal tender in Pakistan on June 30, 1948, or in respect of which the rights of encashment in Pakistan existed on that date, and which were retired thereafter and delivered by the Government of Pakistan to the Reserve Bank till the end of June 1949.

Allocation of Sterling and Rupee Securities: The basis for the division of sterling assets laid down in the Amendment Order was, on the whole, favourable to Pakistan; her share worked out higher than what she would have got under the earlier arrangement. It will be recalled that the Pakistan (Monetary System and Reserve Bank) Order of August 1947 had provided for distribution of each item of the Issue Department's assets, including sterling, in the ratio of notes in circulation in the two Dominions. In addition to the sterling thus transferred to Pakistan, the Partition Council's decision of December 1, 1947 required India to sell to Pakistan on demand, for Indian rupees, an additional amount of sterling until December 31, 1967; this additional amount was to be worked out according to a formula laid down by the Council (see page 553). The relevant provisions in the Amendment Order differed from the arrangement described earlier in two important respects, viz.,

- (i) The sterling assets of the Issue Department were to be distributed in the proportion of note issue only after certain deductions were made there from, and
- (ii) Pakistan was to be paid wholly in sterling in respect of cash balances of the Central and Provincial Governments of Pakistan with the Bank to the extent Pakistan currency in the Banking Department was inadequate. Any amount that banks in Pakistan might require the Reserve Bank to transfer out of their deposits with the Bank to the Government of Pakistan was also to be paid in sterling, if the transfer was made after June 30, 1948.

While Pakistan was thus to receive sterling in full, subject to minor adjustments, for its cash balances and deposits of banks in Pakistan with the Reserve Bank, India was compensated by providing that her No.1 Account with the Bank of England* was to be kept intact and was not to be available for distribution between the two countries. The sterling holdings of the Banking Department were not adequate to meet payments to be made to Pakistan Central and Provincial Governments in respect of their cash balances, amounts that banks in Pakistan might require the Reserve Bank to transfer to the Pakistan Government, and payment to be made to the British Government in respect of pensionary liability, defence stores, etc., and also to keep intact an amount equivalent to the balance at the credit of the Bank's No.1 Account. The Order therefore provided that for determining Pakistan's share of sterling securities in the Issue Department, under sub-section (3) of Section 4 (Part IV) of the Pakistan (Monetary System and Reserve Bank) Order, 1947, the amount of sterling securities held in that Department on June 30, 1948 was to be deemed to, be reduced by an amount by which sterling held in the Banking Department of the Bank fell short of the aggregate of the various claims. These were:

- (i) payments to be made in sterling to the U.K. Government in pursuance of any agreement that might be reached regarding the final settlement of the sterling balances;
- (ii) the amount standing to the credit of the Government of Pakistan and the Provincial Governments in Pakistan to the extent they were payable in sterling;
- (iii) the amounts that banks in Pakistan might require the Reserve Bank to transfer out of their deposits with it to the Government of Pakistan ; and
- (iv) the amount of the balance at the credit of the Bank's Account No.1 with the Bank of England.

The Order provided that to the extent sterling securities in the Issue Department were deemed to be reduced rupee securities in that Department should be deemed to be increased for purposes of distribution.

Return of Notes, Coins in Chests: The Government of Pakistan were required to return, as expeditiously as possible, to the Bank at its offices in India all India notes, India rupee coin and Pakistan rupee coin held in the currency chests of the Bank in Pakistan on June 30, 1948, and no such notes or coins were to be put into circulation from those currency chests in Pakistan after that day.

Transfer of Assets: The Bank was required to transfer from its Issue Department to the Government of Pakistan, as soon after June 30,

* No.1 Account was for current transactions and No.2 Account for capital transactions.

1948, as practicable, assets of a total value equivalent to the total liability in respect of Pakistan notes outstanding on that day. India notes which might be legal tender in Pakistan on June 30, 1948, or in respect of which the rights of encashment in Pakistan existed on that date, were to be accepted by the Government of Pakistan at par until June 30, 1949. On the delivery of such notes to the Bank from time to time in instalments of not less than Rs. 5 crores each, assets of equivalent value were to be transferred from the Issue Department to the Government of Pakistan. The Order, however, provided that no assets of the Issue Department of the Bank were to be transferred to the Government of Pakistan, until that Government returned to the Reserve Bank, India notes and India and Pakistan rupee coins held in the currency chests in Pakistan on June 30, 1948, at least to the extent the value of these notes and coins exceeded the value of Pakistan notes in circulation on June 30, 1948. The Bank was entitled to withhold from the value of all or any of the assets to be transferred to the Government of Pakistan from the Issue Department of the Bank an amount equal to the value of India notes and coins which were, for the time being, held in Pakistan.

Exchange Control: There was to be no exchange control between India and Pakistan till June 30, 1948, nor were any restrictions to be placed on the transfer of funds or securities from one Dominion to the other, whether on current or capital account.

Bank's Offices in Pakistan

Earlier, at the urgent request of the Government of Pakistan, an office of the Bank was opened at Dacca with effect from February 9, 1948, to undertake the supply of fresh notes to and the removal of soiled notes from the currency chests located in East Pakistan. From the same date, the office also accepted deposits from banks and afforded exchange and remittance facilities to the public. A branch of the Exchange Control Department was opened at Dacca on March 19, 1948. As it was necessary that before the monetary arrangements with Pakistan were actually terminated the office assumed its full responsibilities, it was converted into a full-fledged branch of the Issue Department with an independent circle of issue on April 1, 1948. Thus, from the above date, the office began to discharge the full issue and banking functions, except the conduct of Government business which continued with the Imperial Bank branch at that centre.

With a view to assisting the Pakistan Government in taking over the management of the existing public debt of the Provincial Governments in Pakistan in terms of the Pakistan (Monetary System and Reserve Bank) Order, 1947, new Public Debt Offices were established at all of the Bank's offices in Pakistan; the one at Dacca started functioning

on February 21, 1948, while those at Karachi and Lahore were opened on March 1 and March 8, 1948, respectively. These offices were also to undertake the issue and management of any new loans of the Pakistan Government. Securities Departments were also organised at all these offices. A wing of the Central Accounts Section, which maintained the principal accounts of the various Governments and cleared inter-Government adjustments, was transferred to Karachi to form the nucleus of a similar organisation for Pakistan.

Distribution of the Bank's Assets

As already mentioned, in terms of the Pakistan Monetary System and Reserve Bank (Amendment) Order, 1948, the Bank ceased to function as central bank for Pakistan from July 1, 1948, its functions being taken over by the newly established State Bank of Pakistan. The remittance facilities existing between the two Dominions were withdrawn. The Bank's offices at Karachi, Lahore and Dacca were also taken over by the State Bank of Pakistan.

The transfer, to the State Bank of Pakistan, of its share of the assets and liabilities of the Banking Department of the Bank was a relatively simple affair. The Bank advised the Bank of England to transfer, as on July 1, 1948 (though the transfers were actually made between July 2 and 5), to the State Bank of Pakistan No. 1 and 2 Accounts in all £75.56 million (equivalent to Rs. 100.74 crores), the amount being arrived at as follows:

| | (Rs. crores) |
|--|--------------|
| Deposits of the Central Government of Pakistan | 69.27 |
| Deposits of the Provincial Governments in Pakistan .. . | 5.66 |
| Deposits of banks | 25.65 |
| Transfer made at the instance of the Federal Reserve Bank of New York | 1.50 |
| Miscellaneous | -0.33 |
| | ----- |
| | 101.74 |
| Less amount retained as opening balance of State Bank of Pakistan Account at Calcutta | 1.00 |
| | ----- |
| | 100.74 |

The transfer of the assets of the Issue Department, on the other hand, turned out to be a difficult task. To start with, the Bank was required to make, as explained earlier, a notional reduction in sterling assets and corresponding increase in rupee securities as held on June 30, 1948, to arrive at the divisible volume of sterling assets and rupee securities.

For this purpose, a notional figure of Rs. 450 crores was taken as the payment to be made to the British Government; the actual figure turned out to be Rs. 325 crores, and corresponding adjustments in each Dominion's share of sterling and rupee securities were made later. Pakistan became entitled to a larger release of sterling assets, against return of equivalent rupee securities which it had received earlier.

As against the total assets in the Issue Department on June 30, 1948 of Rs. 1,351 crores, assets earmarked for Pakistan came to Rs. 133 crores, in respect of Rs. 51.57 crores of Pakistan inscribed notes and Rs.82 crores of India notes returned from circulation after June 30, 1948. Thus Pakistan's share in each asset of the Issue Department worked out to 9.900795 per cent. The actual assets released (and taken delivery of) amounted to Rs. 127 representing mainly the value of rupee coins held in Pakistan. The itemwise distribution was as under:

| | (Rs. crores) | | |
|---------------------|---------------------------------------|-----------|---|
| | Total Assets As on June 30,1948 | Earmarked | Pakistan's Share Realised and taken delivery of |
| Gold | 44.41 | 4.40 | 4.21 |
| Sterling Securities | 1,135.33 (1,027.61) | 101.74 | 97.33 |
| Rupee Coin----- | | | |
| India | 40.19 | 3.98 | 3.50 |
| Pakistan | 3.32 | 0.33 | 0.31 |
| Rupee Securites | 127.84 (235.56) | 23.32 | 22.31 |
| Total | 1,351.09 | 133.77 | 127.67 |

Figures in brackets represent the effect of the final adjustment ,in terms of the Pakistan Monetary System of Reserve Bank(Amendment) Order,1948.

The transfer of the assets was mostly effected between September 1948 and March

Difficulties arose in respect of India notes transferred to Pakistan after June 30, 1948. It was estimated at the time of the partition that total note circulation in Pakistan would be Rs.120 to Rs. 130 crores. Inscribed Pakistan notes on June 30, 1948 were of the value of Rs. 51.57 crores, Therefore, on the basis of the above estimate, about Rs. 80 crores of India notes were due to return from circulation after June 30, 1948. As against this, the actual value of India notes delivered to the Reserve Bank by the State Bank of Pakistan in the first six months July-December 1948 came to as much as Rs. 103 crores, while even thereafter, the weekly remittances continued to be sizeable. Investigations revealed that a fair percentage of remittances received

from Pakistan contained notes issued in India after March 31, 1948. Enquiries instituted by the Bank also revealed that substantial quantities of India notes did pass over to Pakistan, the main leakage having occurred on the eastern border. The transfer was mainly for payment of goods, e.g., jute, purchased from Pakistan. The results of the investigations were conveyed by the Bank to the Government of India in February 1949.

In early March 1949, the matter was taken up by the Government of India with the Government of Pakistan. In a letter dated March 3, 1949, to the Pakistan Government, they observed that it had been clearly established that the remittance of India notes the Bank received from the State Bank of Pakistan included both notes issued in India after March 31, 1948, i.e., after India notes ceased to be issued in Pakistan by the currency authority and also notes issued in India for the first time after June 30, 1948. Also, the Pakistan Government had kept alive the legal tender character of such notes by providing facilities for their encashment, which encouraged import of India notes into Pakistan. Continuing, the Government of India observed that in their view the agreement had been 'totally vitiated' and that the matter required 'to be examined afresh in order that the object of the agreement, namely, to determine the proper shares of India and Pakistan in the assets of the Issue Department of the Reserve Bank on the basis of note circulation in the two Dominions on the 30th June 1948 may be fulfilled.' They suggested that the matter should be considered at a meeting of the representatives of the two Governments and of the Reserve Bank and the State Bank of Pakistan at an early date about March 21, 1949.

The Government of India also informed the Bank that 'the intention is that pending negotiations with the Pakistan Government further releases to them should be withheld'. With a view to restricting further transfers of India notes, the Reserve Bank of India issued a notification on March 4, 1949, prohibiting the export to Pakistan of currency notes of the Government of India and the Reserve Bank of India notes; bona fide travellers to Pakistan were, however, permitted to carry amounts not exceeding Rs.50 in all. On the same day, a notification banning the import into India of India one rupee notes from Pakistan was issued by the Government of India.

The Pakistan Government strongly protested against Government's instructions to the Reserve Bank not to transfer, until further notice, assets against India notes returned by the State Bank of Pakistan. The Government of India's reply was that notes tendered to the Reserve Bank included notes which were not in circulation in Pakistan on June 30, 1948, and therefore it was not possible for the Reserve Bank to continue to make payment.

A meeting of the representatives of India and Pakistan was held in Bombay on April 6 and 7, 1949, to discuss this matter. The representatives of India explained that Pakistan was entitled to a share in the assets only in respect of notes which were in circulation and legal tender in Pakistan on June 30, 1948 and which the State Bank of Pakistan could encash and deliver to the Reserve Bank by June 30, 1949. Pakistan's representatives contended that the movement of notes across the border was inherent in the agreement and this was supported by the subsequent agreement (Payments Agreement) which did not place restrictions on the exports of currency notes from one Dominion to the other. The Indian representatives pointed out that the restrictions had not been imposed on transfers of currency to save harassment to travellers. The meeting did not lead to any agreement.

The matter was again considered at a conference held at New Delhi on July 29 and 30, 1949, to discuss mainly extension of the Payments Agreement. Pakistan's representatives observed that they were entitled to a share of Rs. 176 crores of the assets and if it was a question of a small adjustment they would agree to it. The representative of the Reserve Bank pointed out that according to the West Bengal Government's estimate, India notes of the value of Rs. 55 crores had been transferred to East Bengal after June 30, 1948 in payment of goods and services, while there was evidence that notes of the value of a few crores of rupees had been transferred to West Pakistan from the Hyderabad State. However, he said he would be satisfied if the estimate of the Bank's Research Department in respect of the notes transferred, namely Rs. 44 crores, was accepted and an adjustment made. The subject was discussed again in 1950 but no progress was made and the position remains the same today.

While the amount of India notes returned from Pakistan and qualifying for a share in the Bank's assets was the major issue involving protracted correspondence between the two Governments and the two central banks, there were other points of disagreement too, including the payment of interest and discount on the securities transferred to Pakistan and division of the Reserve Bank's profits and surplus assets. As regards interest and discount on securities, for instance, the Reserve Bank allowed the State Bank of Pakistan interest from July 1, 1948 on that portion of the interest bearing assets which was earmarked on June 30, 1948 against Pakistan note circulation. But the Pakistan State Bank claimed such interest and discount as from July 1, 1948, even in respect of securities transferred to it against delivery of India notes retired from circulation in Pakistan after June 30, 1948. The Reserve Bank's argument was that interest on securities held as cover against notes in circulation must obviously accrue to the Reserve Bank, since the Bank was liable for the notes. Under the Reserve Bank Act, the

liability for India notes collected by Pakistan after June 30, 1948 was not terminated until the notes were actually delivered to the Reserve Bank and the notes removed from its circulation account under the provisions of that Act. The question remains unresolved to this day.

Bank and Indo-Pakistan Payments Agreement

During the course of the tripartite talks between the Governments of India and Pakistan and the Reserve Bank held in Bombay in March 1948 to modify the monetary arrangements between India and Pakistan, it was agreed that exchange control and also restrictions on transfer of funds or securities between the two countries should be avoided and that instead a payments agreement should be entered into. Initially, the agreement was to be for a period of one year, the main feature being that each country should hold the other's currency up to a certain amount. Such an agreement was entered into on June 30, 1948, that is, just on the eve of the Bank's withdrawal from Pakistan, and was to be effective July 1, 1948.

The Agreement provided for the official rate of exchange between the India rupee and the Pakistan rupee to be at par; it was not to be altered by either Government 'except after due notice and mutual consultation'. There was to be no exchange control between the two countries and no restrictions were to be placed on the transfer, on current or capital account, of funds or securities from one country to the other, particularly on transfer of evacuee funds in private hands. In respect of evacuee funds in the hands of Custodians of Evacuee Property, the Agreement provided for mutual consultations between the central banks of the two countries, so as to ensure that such transfers were effected without undue strain on the country's exchange resources. The Agreement left both the Governments free to impose restrictions on transfer of gold and silver, subject to such exemptions as might be agreed upon by the two Governments in respect of evacuee property.

Under the Agreement, the two central banks, acting as agents of their respective Governments, were required to sell to each other their own currency to the extent of Rs.15 crores against the currency of the other country; sale beyond this limit and up to a maximum of £7.5 million was to be against sterling to be credited to the selling Bank's No.1 Account with the Bank of England, while further sales were to be against sterling to be credited to the selling Bank's No. 2 Account with the Bank of England. Each Bank had the right to sell to the other Bank, at any time, against all or part of its own currency held by that Bank, that Bank's currency or sterling from its No.1 Account with the Bank of England. It was also provided that in the event of

devaluation, the holdings of the depreciated currency held by the other central bank would be revalued on the basis of the new parity and the account of the central bank incurring a loss as a result of such revaluation would be written up by the credit of additional India rupees or Pakistan rupees, as the case might be. The Agreement provided that the two central banks would collaborate to maintain the India and Pakistan rupees at parity and to that end they were to take steps to enforce the use of the official rate as the basis of all transactions.

A couple of days before the Agreement was signed, the Bank issued a press release stating that from July 1, 1948 its offices at Bombay, Calcutta, Delhi, Madras and Cawnpore would buy from and sell to, scheduled banks in India, Pakistan rupees at India rupees 99 31/32* buying and 100 1/32 selling. The corresponding rates at which scheduled banks were to buy from or sell to the public amounts over Rs. 5,000 were not to be lower than India rupees 99 15/16 for buying and higher than India rupees 100 1/16 for selling.

Initially, such purchase and sale transactions by the Bank were restricted to scheduled banks, but from August 21, 1948, they were extended to the public too, the rates being 99 15/16 buying and 100 1/16 selling. The State Bank of Pakistan, on the other hand, had authorised its offices from July 1, 1948 to purchase from and sell to the public direct in addition to scheduled banks.

Discussions between the two countries on the question of continuance, or otherwise, of the Payments Agreement were held in June 1949 at which the Bank was also represented. It was decided to extend the principal Agreement for a further period up to June 30, 1950, subject to certain modifications. The supplementary agreement was signed on September 10, 1949, but within a few days, on account of the devaluation of the Indian rupee and the non-devaluation of the Pakistan rupee, the Payments Agreement between the two countries became inoperative. The subsequent developments are reviewed in the section on exchange relations with Pakistan, in Chapter 20.

TERMINATION OF MONETARY ARRANGEMENTS WITH BURMA

Even before the partition of India, that is to say, with effect from April 1, 1947, the Reserve Bank of India ceased to be Burma's central bank; this did not, however, create any serious difficulties, unlike in the case

* With a view to discouraging large import of Pakistan notes into India, the rate of discount was raised in February 1949 to eight annas per cent with a minimum of four annas except in cases where notes were tendered by Government Departments or refugee organisations.

of the cessation of the central banking functions for Pakistan. The Government of Burma gave notice, effective October 1, 1946, determining the operation of the provisions of Part II of the India and Burma (Burma Monetary Arrangements) Order, 1937. The notice meant that the arrangements which were put into force on the political separation of Burma in 1937, and under which India and Burma continued to share a common currency and banking system under the aegis of the Reserve Bank of India, would cease from April 1, 1947, on the expiry of six months from the date on which the notice came into effect.

Amendment of the Burma Monetary Arrangements Order, 1937

The Government of Burma returned to their headquarters in Rangoon in October 1945 but they did not take over the financial responsibility from the British Military Administration (B.M.A.) until February 1, 1946. On that date, the responsibility for currency and coinage in Burma was also transferred by the B.M.A. to the Government of Burma. Thus, the Bank's responsibility for currency in Burma, which had ceased in June 1942, was not restored to it even after the return of the civil Government to Burma. The Bank's Agreement with the B.M.A. lapsed on February 1, 1946, but the Bank continued as banker to the Government of Burma and as its agent in currency matters. The Burma Monetary Arrangements Order of March 18, 1937 was amended on June 4, 1946 by an Order in Council [The India and Burma (Burma Monetary Arrangements) Amendment Order, 1946] to regularise with retrospective effect the position regarding the Bank's limited functions in Burma. In terms of the Amendment Order, during the period commencing with October 16, 1945 and ending on such a date not later than September 30, 1946 as the Governor of Burma might determine, the provisions of the 1937 Order in regard to the Bank's functions of note issue in Burma, issue of India rupee coin in exchange for legal tender notes and of such notes against legal tender coin (including India subsidiary coin) in Burma and control of Burma scheduled banks were to cease to be operative. In other words, the Bank's functions were limited to those of being banker to the Government of Burma, purchase and sale of sterling and provision of remittances between India and Burma. Through the facilities for the free exchange of Burma and British India currency through the Reserve Bank, the currencies of India and Burma continued to be linked together as before the war. The Amendment Order also provided for the transfer of the liability for Burma notes issued prior to May 1, 1945 (excluding notes of Rs. 1,000 and Rs.10,000 denominations which had ceased to be legal tender in terms of the

Proclamation issued by the B.M.A. in May 1945) from the Government of India to the Government of Burma along with payment of equivalent sterling as cover; thus, the manner of payment was different from that prescribed in the 1937 Order for transfer of assets of the Issue Department. The transfer took place on June 5, 1946; with the payment of the sterling equivalent of Rs.10.08 crores, representing the balance of Burma notes in circulation.

The Currency Notes Act, 1946 (Burma Act No. XXV of 1946), which was passed on July 6, 1946 but was deemed to have come into force with effect from October 16, 1945, vested the sole right for issue and management of currency and bank notes in Burma in the Governor of Burma; in exercise of this right, he could issue B.M.A. overprinted India notes. This Act also regularised the position with regard to the transfer of the liability for the notes already issued by the B.M.A. to the Burma Government. In terms of this Act, Burma notes issued by the Reserve Bank (other than those of Rs. 1,000 and Rs. 10,000 denominations) and India notes continued to be legal tender in Burma.

In respect of the Bank's role as banker to the Government of Burma, as mentioned in Chapter 9, there had been no interruption to this function even when that Government moved to India during the war. In March 1946 it was decided not to insist on their maintaining the customary minimum balance with the Bank, as the maintenance of a balance in Burma notes with the Bank would only have resulted in swelling the sterile balance of these notes with the Bank; instead, a suggestion was made that for the period from February 1, 1946, until such time as the permanent currency and financial system of Burma had been decided upon, the Government of Burma should compensate the Bank for its services on the same basis as the B.M.A. did previously, viz., the actual expenditure incurred on maintaining its office in Burma plus 12½ per cent of its establishment charges. This was accepted by the Burma Government.

Severance of the Currency Link

In June 1946, the Government of Burma decided in principle to sever the currency link with India and to establish an independent currency to be managed by a Currency Board situated in London. However, as the earliest date by which the Currency Board could begin to operate was April 1, 1947, the Burma Government enquired of the Bank whether the existing arrangements in regard to its functions in Burma could be allowed to continue for a further six months after September 30, 1946. Also, as it was not considered possible for Burma to design and provide entirely new notes and coin by April 1, 1947, they desired that the Burma Currency Board be permitted to use India coin and

Reserve Bank notes with an overprinted inscription 'Burma Currency Board -Legal Tender in Burma only'. The Bank agreed to the joint monetary arrangements being continued until March 31, 1947. The Bank had no objection also to the use of its notes by the Board provided the Government of Burma and the British Government joined to indemnify it against all liability on any such notes issued in Burma. In other words, as in the case of the overprinted B.M.A. notes, the Reserve Bank would have no liability for these notes, although its name appeared on them. The Burma Monetary Arrangements Order was thereafter amended in August 1946 by a further Order in Council, [The India and Burma (Burma Monetary Arrangements) (Second Amendment) Order 1946] with a view to enabling the termination of the joint monetary arrangements with India on six months' notice. This notice was served on the Government of India by the Burma Government to run from October 1, 1946; and after its expiry, that is to say, on April 1, 1947, the currency system of Burma was delinked from that of India.† The Bank also ceased to be banker to the Government of Burma with effect from that date

Disposal of Surplus Burma Notes

Paragraph six of the India and Burma (Burma Monetary Arrangements) Amendment Order, 1946, had made it obligatory on the part of the Burma Government to sell to or purchase from the Reserve Bank currency which was legal tender in Burma, in such amounts as the Bank might require or offer as the case might be, against payment by or to the Bank of the purchase price in India rupees or, if mutually agreed, in sterling. For the purpose of this provision, the Burma rupee and the Indian rupee were deemed to be at par.

It was mentioned that when responsibility for the coinage and currency in Burma was transferred to the Military Administration and later to the Government of Burma, the currency link between India and Burma continued; in other words, the responsibility of the Reserve Bank for maintaining exchange rates between Burma and India and Burma and London remained unaffected as the provisions in the Burma Monetary Arrangements Order and the Reserve Bank Act [Section 41(A)] to sell remittances at specified rates were not repealed. As a result of the war, the Government of Burma were faced with large budgetary deficits. As Burma had no regular money market on which the Government could draw, they had to adopt the somewhat unorthodox

† The new Burma currency was to be the Burma rupee, and it was to have a direct link with sterling and not via the Indian rupee. Issue of B.M.A. overprinted India notes was discontinued from April 1, 1947, and for a period of one year from that date, the Burma Currency Board issued its own overprinted India notes, with the Reserve Bank's concurrence.

method of financing their deficits by the issue of fresh notes convertible only with the aid of the Reserve Bank into means useful for obtaining supplies of goods and services. As the Bank was under a statutory obligation to exchange Burma currency into Indian rupees and sterling, the result was a heavy accumulation of Burma and B.M.A. notes with the Bank. In effect, India was being called upon to meet a large portion of the external obligations of the Burma Government. The Burma Government were not in a position to implement their undertaking in paragraph 6 of the Amendment Order of June 1946 and take over the Burma rupees which the Bank found surplus to its requirements. The Bank took up the matter with the Government of Burma several times from March 1946 onwards but they took no steps to rectify their cash position and take over the Bank's surplus stock. Early in December 1946, the balance of these notes with the Bank stood at over Rs. 19 crores, the amount being actually in the nature of an interest free advance to the Burma Government.

At the request of Director Mr. C. R. Srinivasan, the Central Board was apprised of these and the other developments with regard to Burma at its meeting held on December 9, 1946. On a review of the facts, the Board resolved 'that the attention of the Government of India be drawn to the unsatisfactory state of the monetary connection between India and Burma. The Board are convinced that it would be against the interests of the Reserve Bank to allow further amounts of Burma and B.M.A. notes to accumulate with the Bank after the 1st January 1947 in the existing manner'. The Board was also against the Bank's accepting sterling instead of Indian rupees for any amounts of Burma and B.M.A. notes held by it if offered by the Government of Burma, in view of the Bank's already heavy holdings of that currency.

The Board's views were conveyed the Government of India on December 17, 1946. The Government were informed that on a further effort being made the Government of Burma had actually expressed their inability to liquidate their liability to the Bank unless they were granted a loan by the Government of India and that they had already approached the latter for such a loan. The Bank added that it was requesting the Government of Burma to pay, on the surplus notes, interest at the rate of 2 per cent which was the prevailing rate charged on ways and means advances to Government. If the Government of Burma were, for any reason, unable to meet the Bank's claim forthwith, the Bank proposed that the Government of India might consider adjusting the amount due to the Bank on this account in the settlement which would be made between the two Governments under Part IV of the Burma Monetary Arrangements Order, 1937; this Part detailed the manner of computation of Burma's share in the Bank's profits, its surplus assets (including the Reserve Fund), the Government of

India's silver stocks, etc., during the currency of the Order and after its expiration. No progress towards a settlement was, however, possible owing to the Government of Burma's other domestic preoccupations as well as several complications in connection with the question of the settlement of Burma's pre-war debt to India and the adjustments under Part IV of the Order of 1937.

The Government of Burma were, in the meantime, in urgent need of at least a part of the Burma and B.M.A. notes in the Bank's own holdings to meet certain large payments, as owing to shipping and other difficulties, the stocks of fresh Burma notes with the Rangoon Office could not be replenished in time. Early in March 1947, they requested the Bank to release the whole or at least Rs. 10 crores worth of Burma notes out of its holdings immediately, without prejudice to the Bank's right to claim settlement of the whole amount in sterling or in Indian rupees at a future date. The Government of India were, on the other hand, unable to take a decision on the question of accepting sterling from, or sanction of a rupee loan to, the Burma Government until the final result of the negotiations with the British Government on the utilisation of the sterling balances was known and the desirability or otherwise of acquiring further sterling from Burma in exchange for the notes could be assessed.

The Bank agreed to grant ways and means advances to the Burma Government at its Rangoon Office to enable them to tide over their acute temporary difficulty. It did not, however, consider this a suitable remedy; nor could it hand over the notes to the Burma Government, as desired by that Government, without receipt of equivalent assets. Therefore the Bank suggested to the Government of India that the best solution would be for them to take over the Bank's entire surplus holdings of Burma notes as on March 31, 1947, and any ways and means advances granted by it to the Burma Government in this connection, against payment in cash or securities and to make available to the Burma Government their immediate requirements of notes pending the completion of the loan negotiations or a decision to accept sterling.

With a view to easing the Burma Government's difficulties and at the same time wishing not to saddle the Bank with further sterling, the Government of India agreed to the Bank's handing over Rs. 10 crores of Burma notes to the Burma Government in exchange for sterling as a temporary measure on the 'clear understanding' that if the rupee loan was granted, the Burma Government would repurchase the whole of this sterling from them against Indian rupees if they so desired. Subsequently, on March 28, 1947, a meeting was held in New Delhi between the representatives of the two Governments when the Government of Burma desired that the Bank should accept sterling for the rest of its stock of Burma and B.M.A. notes and also waive completely its claim

for interest at 2 per cent. Taking all considerations into account, the Government of India thought it best to accept Burma's offer to pay in sterling; they were also agreeable to reduce the interest rate to $\frac{3}{4}$ per cent which was the prevailing Treasury bill tap rate of the Government of Burma, but not to waive the claim altogether. An agreement was reached between the two Governments on this basis. The Bank was thus credited by the Government of Burma with £14.68 million (excluding £7.5 million received earlier) being the sterling equivalent of Rs. 29.58 crores of Burma and B.M.A. notes held by it; besides, interest of Rs. 13.87 lakhs was received in rupees.

Withdrawal of the Bank from Burma

The Bank's office in Rangoon formally ceased to function from April 1, 1947. To enable the Bank to wind up its affairs in Burma, the Reserve Bank of India (Amendment) Act, 1947, was passed on March 17, 1947, providing for the deletion of all references to Burma in the Reserve Bank of India Act, 1934; it came into force on April 1, 1947. The Amendment Act repealed all the emergency Ordinances promulgated in 1942 to deal with the situation that arose on the occupation of Burma by the Japanese and the one issued in 1945 to enable the Bank to act as banker to the B.M.A. The Bank's properties in Rangoon were transferred to the Government of Burma at an agreed price as provided in Part IV of the Burma Order of 1937. Such of the staff of the Rangoon Office as desired to stay on in Burma were taken over by the Burma Currency Board and the Government of Burma. The remaining staff were absorbed by the Bank in its Indian offices. The existing remittance facilities between India and Burma under the Scheme introduced in October 1 1940 were also withdrawn from April 1.

The Reserve Bank of India (Amendment) Act, 1947, provided also for the winding up of the Rangoon share register. There were, however, only 8,525 shares on that register on March 28, 1947 as against the 30,000 shares originally allotted to it. On and after April 1, 1947, the shareholders on the Rangoon register, excluding those residing in the Andaman and Nicobar Islands whose names were to be transferred to the Calcutta share register, ceased to be qualified to be shareholders of the Bank. As mentioned in Chapter 17, the elective Director's seat for the Rangoon area was allotted to the Madras area.

It may also be mentioned here that the Bank's claim on the Government of Burma for an amount of Rs. 12.85 lakhs was eventually dropped. The amount comprised the Bank's cash balances at its Rangoon Office (Rs. 10.11 lakhs), balances of India notes at certain chests in Burma (Rs. 2.65 lakhs) and the cash balances at the Imperial Bank branches at Moulmein and Mandalay (Rs. 0.09 lakh), all of

which could not be evacuated in time before the Japanese occupation and were presumed to have fallen into enemy hands. The claim was not admitted either by the Government of Burma or the Secretary of State for Burma. Eventually, after an overall settlement of all the outstanding financial issues (including those regarding the amounts due to Burma on the termination of the joint monetary arrangements) was reached between the Governments of India and Burma, the Bank was advised by the Government of India in June 1958 to write off its loss (of Rs. 12.76 lakhs) from its Profit and Loss Account as the claim could not thereafter be separately proceeded with. The adjustment was made in the Bank's accounts for the year ended June 30, 1958.

With the attainment of political independence by Burma, the Government of Burma terminated with effect from July 1, 1948, the legal tender character in Burma of the Reserve Bank 'India' notes and the Government of India one rupee notes without the superscription 'legal tender in Burma only'. With effect from June 1, 1950, the Government of Burma divested the old overprinted prewar Burma notes as well as the Burma notes of distinctive design issued by the Rangoon Office of the Bank and the B.M.A. notes issued since 1945 first by the B.M.A. and later by the Government themselves, of their legal tender character in Burma.*

The facilities granted for the encashment of Burma notes in India from January 1942 (these notes were not legal tender in India) at the offices of the Bank, certain branches of the Imperial Bank of India and certain Treasuries, to enable refugees from Burma to realise their value without difficulty, were continued for several years after the end of the war by arrangement between the Government of India and the B.M.A./Government of Burma. There were slight modifications from time to time as to the offices where the facilities were to be made available, the commission chargeable for the exchange and the limits up to which exchanges were permitted; in the later years, the facilities were extended to cover B.M.A. notes and Burma Currency Board notes. When the Government of Burma terminated the arrangements with effect from May 1, 1950, they permitted banks in Burma to import and sell Indian currency to travellers to India within the framework of their exchange control regulations.

The Government of Burma opened a Central Treasury to take up Government banking work in Burma from April 1, 1947, with the assistance of selected local bankers.† Exchange control work was taken

* The overprinted India notes issued by the Burma Currency Board ceased to be legal tender in Burma with effect from December 20, 1952.

† Under an Act which came into effect on October 1, 1947, the Union Bank of Burma was established with the obligation to act as banker to the Government and to manage the public debt. It could also act as the agent of the Currency Board on terms mutually agreed upon and approved by the Governor of Burma.

over by the Finance Department, an officer of which was got trained in the Bank's Rangoon Office. At the request of the Government of Burma, the Bank agreed to continue to act as their bankers in India, after the termination of the joint monetary arrangements. However, while under Section 17(1) of the Reserve Bank Act, the Bank was empowered to open and maintain accounts for any person and could therefore legally maintain the Burma Government account on its books, with the coming into force of the Reserve Bank of India (Amendment) Act, 1947, it was permissible for it to enter into an agency agreement with only the principal currency authority of Burma under Section 17(13) of the main Act. Hence, the services it could render to the Government of Burma were necessarily limited; in particular, the Bank was no longer authorised to grant overdrafts or advances to the Government of Burma.

In terms of the arrangements made, the Government of Burma agreed to maintain a specified minimum interest free balance in account with the Calcutta Office of Bank to remunerate it for the services rendered. The Bank undertook to meet the Government's disbursements from that account, to invest their surplus funds in Government of India Treasury bills and to replenish the account by rediscounting these bills whenever necessary. The was to be fed periodically by remittances in sterling from London. The Bank undertook also to issue remittances on behalf of the Government of Burma from their account to other centres in India at the rates applicable to the Provincial Governments in India for extra-provincial remittances. The continuance of the Burma Government account with the Bank facilitated the settlement of inter-governmental adjustments between India and Burma through its medium as was the case before April 1, 1947.

These arrangements continued till December 15, 1964, when at the request of the Revolutionary Government of Burma, the Burma Government's account at Calcutta was closed and the balance therein transferred to the Union Bank of Burma's account at the Bombay Office of the Reserve Bank.

INTEGRATION IN THE CURRENCY AND BANKING SPHERES

Partition meant a curtailment of the geographical area of the Bank's operations; on the other hand, the process of political and financial integration of the former British Indian Provinces and the princely States meant an extension of the Bank's role, in the spheres of currency and banker to Government. While British Indian currency circulated

freely in these States and in most if not all States it was the only or predominant type of currency, some States issued their own coins and the Hyderabad State issued currency notes too. The aggregate amount of such currency in circulation was, however, very small in relation to British Indian currency. It may be sufficient to mention briefly the facts of the replacement of the Hyderabad currency by Indian currency. This did not, however, pose any knotty problems; nor did the Reserve Bank have much to do by way of offer of advice in the matter.

Hyderabad Currency

Though Hyderabad had its own currency notes (Hali Sicca currency), and the Indian rupee had never been legal tender in Hyderabad, Indian currency circulated freely in that State till about the close of 1947. Also, in December 1947, as much as 30 per cent of the cover in respect of the State's note circulation was in the form of Indian rupees and another 60 per cent in the form of Government of India securities. There were no restrictions on the exchange of Hyderabad currency into Indian currency, which throughout had a higher value. The Hyderabad Government had undertaken, through the agency of the Hyderabad State Bank, to buy and sell, out of the cash assets of the Currency Department, Indian currency from and to any person who made a demand in that behalf, at rates* fixed by Government from time to time.

On December 21, 1947, however, the Nizam's Government promulgated an Ordinance (effective December 22) in terms of which all cash receipts and payments in respect of goods sold, property conveyed or services rendered in Hyderabad were to be made only in the currency of the State, viz., the Hali Sicca currency. The Ordinance did not affect the position of banks in respect of accounts opened in Indian rupees and also did not restrict the free transfer of funds for settlement of trade and other liabilities in Indian currency outside the State.

The promulgation of the Ordinance was followed up by the institution of certain new arrangements which became operative from February 27, 1948. In terms of these arrangements, there was to be no restriction on the withdrawal of funds in cash from accounts maintained with banks in Indian currency and on the exchange of Hali Sicca currency into the Indian currency, when the amounts exchanged were paid into the credit of accounts in Indian currency. This arrangement helped flight of capital from Hyderabad to India; it appeared that some funds were transferred to Pakistan also. As a result of these developments, the Bank received urgent requests from the Hyderabad branch of the Imperial Bank to replenish the currency chest at Hyderabad.

* In December 1947, the rate was Hali Sicca Rs. 116-7-0 for India Rs. 100.

The requests were scrutinised and supplies were made on a rationed basis under either the general or specific authority of the Government of India. The Bank considered the question of continuance or otherwise of the currency chest in Hyderabad and since it was not under an obligation either under the Reserve Bank Act or under the agreement with the Imperial Bank to maintain chests at places outside British India, it was decided on June 24, 1948, with Government's concurrence, to abolish the chests at Hyderabad and Secunderabad. Remittance facilities between India and Hyderabad were also suspended.

Following the 'successful conclusion' of the police action in September 1948, the currency chests were re-established and remittance facilities resumed. The restrictions imposed on the use in Hyderabad of Indian currency were removed. A programme for the withdrawal of Hyderabad currency and its replacement by Indian currency was drawn up by the Government of India in consultation with the Bank.

In terms of the plan, the Hyderabad Government issued, on January 25, 1950, the Indian Currency (Legal Tender) Regulation, 1359 Fasli, in terms of which, effective January 26, 1950, the date on which Hyderabad acceded to the Indian Union, all coins, bank notes and currency notes which were legal tender in India became legal tender in the State of Hyderabad too. The Hali Sicca currency circulating in Hyderabad State also continued to be legal tender; arrangements were made for its conversion into India notes and coin at the rate of Hali Sicca Rs. 116-10-8 for India Rs. 100. Effective April 1, 1951, the Indian Coinage Act, 1906 and the Currency Ordinance 1940 were extended to the Hyderabad State under the Part B States (Laws) Act, 1951, and the corresponding State laws (the Hyderabad Currency Ordinance and the Hyderabad Currency Act) were repealed. With effect from April 1, 1955, Hali Sicca currency ceased to be legal tender.

On January 26, 1950, the circulation of Hali Sicca currency (notes, rupee coin and small coin) amounted approximately to Hali Sicca Rs. 48 crores or India Rs. 41 crores. With the progressive replacement of Hali Sicca currency by Indian currency as from that date, the circulation of Hali Sicca currency steadily declined and stood at Hali Sicca Rs. 6.4 crores (or India Rs. 5.5 crores) at the end of March 1955.

Banker to Part B States

Action was also initiated, during the period, for bringing Part B States (that is, former princely States) into the same pattern of relationship with the central bank of the country as Part A States (the former British Indian Provinces). With the coming into force in January 1950 of the Constitution of India, the Reserve Bank of India Act was amended in 1951 (effective November) by the insertion of Section

21 A which authorised the Bank to act, by agreement, as banker to the Governments of Part B States and manage their public debt and loan floatations. The relation of the Bank with the Part B States was somewhat different from that which obtained between the Bank and the Government of India or the Governments of Part A States; while in the case of these latter Governments, the Bank had a right to perform their banking operations in terms of Section 21 of the Reserve Bank of India Act, in view of the peculiar circumstances of Part B States, the new Section 21A was made permissive in character and laid down that the Bank's appointment as banker was subject to agreement with them in this behalf. The first of the agreements to be entered into in this connection were those with the Governments of Madhya Bharat and Travancore-Cochin, which came into effect from July 1, 1952. The culmination of the process of financial integration of the erstwhile Part B States was reached on November 1, 1956, when the Bank started functioning as banker to the Rajasthan Government. In fact, with effect from the same date, the classification of the States into Part A, Part B, etc., was discontinued, with the coming into effect of the States Reorganisation Act. Accordingly, the basis of the relation of the Bank with all States was also made uniform and the new Section 21A as amended by the States Reorganisation Act, 1956, laid down that the Bank's right or duty to act as banker to the States was to be by agreement with them in that behalf.

International Financial Institutions and Sterling Balances

The period 1945-51 witnessed important developments in the sphere of India's external financial relations. Outstanding among these were India's joining the two Bretton Woods institutions, the I.M.F. and the I.B.R.D., and the successful conclusion of a series of agreements regarding the utilisation of accumulated sterling balances. In respect of both these matters, the Reserve Bank played a very important role.

The Governor of the Bank as head of the Indian Delegation gave effective leadership at the inaugural meeting of the Board of Governors of the I.M.F. and the I.B.R.D. held at Savannah in March 1946, where far-reaching decisions affecting India's place in the two institutions were taken. He was also largely responsible for persuading the Committee of the Indian Legislature on Bretton Woods Conference Agreements to endorse Government's action in joining the Fund and the Bank as an original member. As Governor for India on the Boards of Governors of the two institutions, Sir Chintaman Deshmukh played an important role in those formative years both in safeguarding India's interests and in establishing sound traditions of international monetary co-operation. Officers of the Bank also served in these institutions either as members of the Executive Board or as staff members.

The successful negotiations for the settlement of the question of sterling balances, ending as they did in India's realizing fully value for war-time accumulations of these balances, constitute a saga in international financial relations, with few known parallels. In the face of the tremendous propaganda in the British press that was let loose against India concerning this subject, unfortunately aided to an extent by the British politicians and the American Government, it was extraordinary that the accumulated balances came to be drawn upon fully

and freely-perhaps too freely one might say in retrospect. The happy outcome of the negotiations was doubtless due as much to the sagacity and the sense of fair play of the British Government, with substantial support in this behalf from the British officials in charge of the Government of India at New Delhi, as to the strong attitudes taken by Indian national interests. The uncompromising stand taken by the Reserve Bank Board as well as the Governor on the question of arriving at a settlement satisfactory to India helped to strengthen considerably the Government of India's hands in taking a firm line with Whitehall. The Bank's expert technical analysis of the problems involved in the repayment of the sterling balances made it clear that the task was not an impossible one for the U.K. The Bank's representatives took an active part in the entire series of negotiations and also assisted the Government in working out the technical details of implementing the decisions reached.

There were other important events in the sphere of external finance, namely, a substantial extension of the scope of exchange control, for which purpose a comprehensive Act was passed in 1947, and devaluation of the rupee in terms of the U.S. dollar in September 1949.

All these developments are narrated in this and the following chapter.

MEMBERSHIP OF THE I.M.F. AND THE I.B.R.D.

SIGNING OF THE BRETTON WOODS AGREEMENTS

The Articles of Agreement of the International Monetary Fund and the International Bank for Reconstruction and Development adopted at the Bretton Woods Conference, in July 1944, were to become effective any time after May 1, 1945 when the Agreements were signed on behalf of countries with at least 65 per cent of the total quotas in the Fund and the same percentage of total subscriptions in the Bank. The Articles provided that the Bretton Woods participants, i.e., countries which were represented at the Bretton Woods Conference and included in Schedule A of the Articles, were to qualify as original members only if they signed the Agreements by December 31, 1945. Under the Articles, member Governments were required to transmit to the Government of the U.S.A., at the time the Agreements were signed on their behalf, 1/100 of 1 per cent of their total subscriptions in gold or United States dollars for meeting the administrative expenses of the Fund. If the Agreements did not come into force by December 31, 1945, the Government of the U.S.A. were to return the above amount.

Though the Articles were adopted as early as July 1944, the Government of India did not seem to be in a hurry to take up for consideration the question of India's joining the two institutions; their intention was to wait till the attitudes of the U.S.A. and the U.K. were known. The U.S. Congress ratified the Agreements in July 1945, but it was only in December 1945 that the relevant legislation was passed in the U.K. In India, the Legislature had been dissolved on October 1, 1945. However, with a view to securing for India the advantages of original membership, the Government of India decided to adhere to the Agreements before the close of 1945 and then place the matter before the Legislature for its approval. The Agent-General for India in Washington was therefore authorised to sign the Agreements on behalf of India on December 27, 1945, along with the representatives of other participating countries, including the U.S.A. and the U.K. In consultation with the Reserve Bank, the Government of India also issued, on December 24, 1945, an Ordinance to provide themselves with the necessary legal authority for the assumption by India of the obligations imposed by the Agreements. A press communique was issued along with the Ordinance, explaining the advantages of original membership and declaring Government's intention to place the matter before the new Legislature whose decision, whether in favour of continuance of membership or of withdrawal, was to prevail.

The International Monetary Fund and Bank Ordinance, 1945, empowered the Central Government to make from time to time necessary payments to the Fund and the Bank, in terms of the Articles, out of the revenues of the Central Government and to create and issue to the Fund and the Bank, if Government thought fit, any non-interest bearing and nonnegotiable notes or other obligations in place of any portion of Indian currency. The Reserve Bank was to be the depository of the British Indian currency holdings of the Fund and the Bank. In terms of the Ordinance, the Central Government, and also the Reserve Bank, if so authorised by the Central Government, could require any person to furnish such information as might be required by the Fund. The Ordinance also empowered the Central Government to make rules for carrying out the purposes of the Ordinance.

Efforts to Secure Legislative Approval

The matter came up for ratification by the Legislative Assembly on January, 28, 1946. To assist the deliberations, Dr. B. K. Madan, who it may be recalled had been Secretary of the Indian Delegation to the Bretton Woods Conference, was nominated by the Government as a Member of the Legislature.

At the outset, the Finance Member, Sir Archibald Rowlands, moved a resolution to the effect that the House welcomed the proposals for setting up the two institutions and also the action taken by Government in adhering to the Agreements as an original member. The Finance Member observed 'that the issue before the House, from Government point of view, is whether or not India has now to withdraw from the Bretton Woods arrangements'. The Finance Member explained the circumstances in which Government were not able to honour the pledge to bring the matter before the House for decision before adhering to the Agreement. What led the Government to take quick action was explained by the Finance Member in the following words:

Indeed, I have no doubt that if Government had not adhered, another motion of adjournment would have been put down censuring Government for not doing so. It would have been alleged that this irresponsible Government does not hesitate to break pledges when it pleases it to do so but is prepared to take its stand on the sanctity of a pledge when it is not in its interest to break it. I, therefore, proceeded on the principle that whatever you do is likely to be wrong and so you might as well do it quickly.

Referring to one of the amendments proposed to be moved by a Member suggesting that the question should be referred to a committee of nine Members elected by the House, before final decision was taken, the Finance Member observed that he was prepared to accept the amendment on behalf of Government, as in his view it was advantageous to have the matter thrashed out by selected Members of the House, since the details were highly technical. The Finance Member concluded his speech thus:

This Agreement affords India the opportunity, at a moment of grave import to the whole world, of taking full part in a new organisation of great significance and thus of assisting to shape the future course of world monetary history. It is not merely that by not joining the Fund and the Bank India runs the risk that decisions may be taken which are not to her interest or that by non-adherence she would be debarred from the benefits of these new organisations. These are important considerations, but to my mind they are not the decisive ones. The decisive reason is that India is now by far the strongest and economically best organised country in Asia and should feel that economic leadership of the East is her proved prerogative.

Following the Finance Member's speech, two Members, Mr. Manu Subedar and Seth Yusuf Abdoola Haroon, moved that for the original motion of the Finance Member, the motions moved by them be substituted. Mr. Subedar's motion was in two parts. The first part

condemned Government's action in joining the institutions in disregard of the assurances given to the House that such action would not be taken till full information was given to the country at large and till the assent of the Assembly was secured; the second part recommended the appointment of an ad hoc committee consisting of three nominees of the Congress Party, two nominees of the Muslim League Party and two Government nominees, to go into the question and report at an early date 'in order to determine what steps should be now taken'.

Seth Yusuf Abdoola Haroon's motion just recommended the constitution of a Committee of nine Members to be elected by the House for examining the proposals for setting up the two institutions and to report before March 1, 1946, as to what action would be 'in the highest interest of India'.

A few amendments to these two motions were moved by Members. All excepting one related to the Committee to be appointed and its terms of reference; an amendment moved by Mr. Ananthasayanam Ayyangar sought to prevent Government from taking further action in respect of the Fund or the Bank pending the consideration by the Assembly of the Committee's report.

The debate which followed indicated that in defining their attitude towards membership of the Fund and the Bank, Members seemed to have been concerned more with the future of India's accumulated sterling balances than with the many advantages the membership conferred on India.

Amendments to Mr. Subedar's motion were then adopted and the amended motion was put to vote. The Assembly was equally divided in respect of the first part of the motion condemning Government's action. The President observed he would go with the ayes 'on the merits'; part one of the motion was thus adopted.

The second and third paragraphs of Mr. Subedar's amended motion which proposed that:

- (i) a committee of the House consisting of nine Members be elected to go into the question and report at an early date to the House, and
- (ii) pending consideration by the Assembly of such Report, no further action be taken by Government in respect of the Fund or the Bank

were then put to vote and adopted.

As only nine* nominations were received for serving on the Committee, they were all declared duly elected, on February 1, 1946.

* These were: Archibald Rowlands, Geoffrey W. Tyson, N. V. Gadgil, K. C. Neogy, Manu Subedar, M. Ananthasayanam Ayyangar, B. K. Madan, Sir Zia Uddin Ahmad and Yusuf Abdoola Haroon.

First Interim Report of the Bretton Woods Committee

First Interim Report of the Committee on the Bretton Woods Conference Agreements was presented to the Legislature by the Finance Member on February 26, 1946. It became necessary to submit an Interim Report, as decision had to be taken about sending India's representative to attend the inaugural meeting of the Boards of Governors of the I.M.F. and the I.B.R.D. to be held at Savannah (Georgia, U.S.A.), from March 8, 1946.

The Committee's Report was unanimous, but subject to a supplementary note signed by four Members. The Committee strongly endorsed the Finance Member's statement made during the course of a debate that India was not bound in any way by the terms of the Anglo-American Loan Agreement * of December 1945. In the Committee's view, the final decision whether it would be to India's advantage to remain a member of the Bretton Woods institutions might be determined to a very considerable extent by the outcome of the negotiations on sterling balances. If the negotiations were unduly delayed, India might find it necessary to withdraw from the institutions even before the negotiations took place, being unable to shoulder commitments which she might be called upon to undertake under the Bretton Woods Agreements. Similarly, India might withdraw from the two institutions if the proposals for the settlement of sterling balances were not satisfactory to India. The Committee observed that it had been informed by the Finance Member that Sections 40 and 41 of the Reserve Bank of India Act, under which the Bank was legally compelled to sell and buy sterling in exchange for rupees, would be amended as part of the action of adherence to the I.M.F. Agreement.

The Committee recommended to the Assembly to authorise the Government to appoint, when necessary, a Governor, an Alternate Governor, and Executive Directors and Alternates, but no further financial commitments were to be undertaken by the Government before the matter was further considered by the Committee. The Committee was to have from the Governor of the Reserve Bank, who was appointed Governor for India on the Boards of the two institutions, a report on the inaugural meetings of the Fund and the Bank. 'We expect', the Committee observed, 'that he may be able to bring additional information bearing on the probable scope and manner of operations of these international institutions in relation to the requirements of this country, which may assist the Committee in arriving at a

* Clause 10 of the Agreement provided for dividing the accumulated sterling balances into three categories viz., (1) balances to be released at once, (2) balances to be released by instalments over a period of years and (3) balances to be adjusted as a contribution to the settlement of war and post-war indebtedness.

considered recommendation to the Assembly on the question of continuance or discontinuance of membership’.

Four members* of the Committee, in a supplementary note, urged Government to act promptly to put a stop to sterling accumulations by amending relevant sections of the Reserve Bank of India Act, or otherwise.

On March 1, 1946, the Finance Member moved a motion in the Legislative Assembly stating that the Assembly agreed with the interim Report of the Bretton Woods Committee. A few amendments were tabled, an important one amongst them being:

That the Governor, his alternate, the Executive Directors and their alternates, in the Bank and the Fund shall be Indians approved by the Committee.

The Finance Member assured the House that the nominees would, no doubt, be Indians, but pointed out that making appointments was an executive act, and he considered it ‘inappropriate and contrary to all constitutional practice to set the approval of a particular nomination by a committee of the House’.

The Finance Member’s motion was adopted without any amendment.

INDIAN DELEGATION AT THE SAVANNAH MEETING

Even before the first interim Report was presented to the Legislature, the Finance Secretary wrote to Governor Deshmukh stating that Government desired to appoint him (the Governor) as the Indian Governor on the Boards of Governors of the I.M.F. and the I.B.R.D. and that they would be grateful if he could accept the nominations and obtain the Central Board’s approval. In the event of his accepting the Governorship, he was required to attend the Savannah meeting and to send a report to Government on the proceedings of the meeting. The proposed nomination was approved by the Central Board: which suggested as Alternate Governor Sir Manilal B. Nanavati or Sir A. Ramaswami Mudaliar, in that order.

The Indian Delegation left India on March 1, 1946 and comprised Sir Chintaman Deshmukh, Mr. J. V. Joshi, the Bank’s Economic Adviser, who was to be nominated as Executive Director for India on the International Monetary Fund and Mr. H. D. Cayley, Deputy Controller of Exchange in the Bank. Owing to restricted plane service

* These were: Manu Subedar, M. Ananthasayanam Ayyangar, K. C. Neogy and N.V. Gadgil.

and also bad weather and engine trouble, the Delegation could reach Savannah only on March 12.

The Government of India, anticipating that the Delegation would not be in time to attend the meeting, instructed Sir A. Ramaswami Mudaliar, who was in Washington in connection with the Indian Food Delegation, to act as temporary Alternate Governor of the Fund and the Bank until Sir Chintaman Deshmukh arrived.

It would appear that a highlight of the meeting was the close collaboration between the U.K. and the Indian Delegations. To quote Sir Chintaman: *

this meeting remains memorable mainly as the occasion when the Indian delegation worked in effortless accord with the British delegation under Lord Keynes and there were many occasions when there happened to be agreement between us on the need to take some step which would increase the utility, independence and creativity of the international bodies.

At the first business meeting of the Boards of Governors held on March 11, 1946, the Governor for the United States (Mr. Fred M. Vinson) was appointed Chairman and the Governors for the U.K., China, France and India (countries with the largest quotas after the U.S.A.), were appointed Vice Chairmen. Separate committees for the Fund and the Bank but composed of identical delegates were set up for dealing with matters like membership, site, bye-laws and functions and remuneration of Executive Directors; India was represented on all these Committees.

India's Permanent Directorship Uncertain.

It will be recalled that on the basis of quotas fixed at the Bretton Woods Conference, India stood sixth, the first five countries with largest quotas being the U.S.A., the U.K., the U.S.S.R., China and France. However, as the U.S.S.R. did not sign the Agreements before December 31, 1945 -the date laid down in the Articles of Agreement -India became the fifth largest quota country entitled to appoint an Executive Director on the Boards of management of the Fund and the Bank.

During the deliberations of the Membership Committee, the U.S. delegate proposed the extension, by six months from the date of the resolution, of the time limit up to which a country which participated at the Bretton Woods Conference but which had not signed the Agreements by December 31, 1945, could join the Fund and the Bank on the same terms as original members. † This was a matter of vital

* Economic Developments in India -1946-1956, being the Dadabhai Naoroji Memorial Prize Fund Lectures, delivered at Bombay in February 1957.

† The resolution finally adopted extended the time limit up to December 31, 1946.

importance to India, for if the U.S.S.R. joined the international institutions during this extended period, the right of India to have an appointed director would be in jeopardy. India considered that, apart from the size of the country and the population, her economic importance justified that she should have a seat in her own right on the Board of management of any international institution.

A study of the Articles of Agreement of the Fund and the Bank revealed that there was inconsistency between Sections 3(b) (i) and 3(f) of Article XII of the Fund's Articles of Agreement. The relevant portions of these Sections read as under:

Section 3(b) There shall be not less than twelve directors who need not be governors, and of whom

i) five shall be appointed by the five members having the largest quotas;

Section 3(f) Directors shall continue in office until their successors are appointed or elected.

There was also some lack of conformity between the Articles of the Fund and the Bank in respect of the period for which an appointed Director was to remain in office. In the Fund Article, no time limit was specified for the appointed Director, whereas in the Bank it was fixed at two years*. Another point of difference was that Article XII Section 3(b) of the Fund's Articles laid down that 'there shall be not less than twelve Directors . . .' whereas according to Article V, Section 4(b) of the Bank's Articles, 'there shall be twelve Executive Directors . . .'. All these aspects were of considerable importance to India, if her right to appoint a Director were to continue even if Russia joined. The Indian Delegation's efforts to retain the appointed director for India on the Board of Executive Directors of the Fund and the Bank till the next regular election, even if the U.S.S.R. joined the institutions during the extended period, met with success.

At the meeting of the Membership Committee held on March 12, Sir Ramaswami Mudaliar sought clarification as to what would be the position of (i) a country with a quota entitling it to appoint an Executive Director, if it were to become a member within the extended period, but after the election of the Executive Directors, and (ii) the country which already had an ex-officio (appointed) Director and which had the smallest quota of the ex-officio Directors.

The Membership Committee considered that the question raised was an important one, but that it was not within its province to decide and therefore it requested the Board of Governors to consider the same. When the Committee's Report was discussed at the full meeting of the Board of Governors on March 13, Sir Ramaswami referred to the difference in the Articles of the Fund and the Bank regarding the term

* Article V, Section 4(b) of the Bank's Articles of Agreement stated ' Executive Directors shall be appointed or elected every two years'.

of the appointed Directors and suggested that in the Fund at least, the position of the old member should be safeguarded, probably by increasing the number of appointed Directors from five to six, if necessary. In the case of the Bank, it was necessary to ensure that the appointed Director served for a minimum period of two years. He wanted the Board of Governors to consider the question at that stage only, and not leave India's position 'in an uncertain state'.

Separate Ad Hoc Committees for the Fund and the Bank to consider the matter were set up, with the U.K. as Chairman and Chile, China, Czechoslovakia, France, India and U.S.A. as members. The question before the Committee was 'what steps could be taken to protect the position of India, now entitled to appoint an Executive Director, if a Schedule A country with a larger quota than India should become a member prior to the second election of Executive Directors'. The Committee recognised that the problem arose through 'inadequate foresight in drafting the Articles of Agreement', and was not the result of the resolution extending the period during which Schedule A countries could sign the Agreements. In view of the inconsistencies between Sections 3(b)(i) and 3(f), a suggestion was made that Section 3(b)(i) be interpreted to mean:

that any member having one of the five largest quotas at the date of a regular election, or at any date between regular elections, shall be entitled to appoint an Executive Director, who shall hold office until the next regular election. This interpretation would be without prejudice to the right of a subsequently admitted member to appoint a director if it has one of the five largest quotas.

There was another suggestion, which was submitted in the form of a resolution, as under:

The Board of Governors of the International Monetary Fund Resolves: There shall be one additional Executive Director who shall hold office until the second election of Executive Directors if, at any time before the second election, both of the following conditions exist:

1. There have been admitted to membership the governments of one or more countries not listed on Schedule A; and
2. The members not entitled to appoint Executive Directors, whose votes are not included in those entitled to be cast by Executive Directors holding office at the time the additional director is elected, have votes totalling 4,000.

Those members not entitled to appoint directors, whose votes are not included in those entitled to be cast by directors holding office at the time the additional director is to be elected, shall participate in the election

This resolution and a similar one for the Bank too, were agreed upon. However, to meet the situation of there being no election to choose an

additional Director, which would have meant that India had no Director for some time, the Committee further recommended as under:

if, in spite of the foregoing resolution, a member now included in the five members having the largest quotas were to be placed in the position where it might be represented, neither by an appointed nor by an elected director until the next regular election, the Executive Directors should immediately reconsider the position, with the object of preventing such a situation from eventuating, either by an interpretation in accordance with Article XVIII of the Articles of Agreement or otherwise,

A similar recommendation was made by the Ad Hoc Committee of the I.B.R.D.

At the meeting of the Board of Governors on March 15, the Reports of the Ad Hoc Committees were approved. In this connection, the Governor for India, Sir Chintaman Deshmukh, made a statement explaining India's position fully. In his view, when inconsistencies in the Articles of Agreement were discovered, and when there was a danger of such inconsistencies imperilling the position of a member, the 'obvious course' was to amend the Articles of Agreement, 'because the best way of dealing with a Gordian knot is to cut it'. However, he realised the practical difficulties in promoting amendments to the Articles at the inaugural meeting of the two bodies and therefore he had provisionally agreed to the conclusion reached by the Ad Hoc Committees. In saying this, however, the Governor made certain reservations:

The first is, that if, and when, the contingency which we anticipate arises, we should have the right to urge the interpretation of these two provisions which were just read out. In other words, we should claim that, so far as the appointment by us of an executive director to the Bank is concerned, we are amply protected by the Articles of Agreement as they stand, and insofar as the Fund is concerned, there is at least the view possible that there is no term to the appointment or that if there is, then that particular clause is subject to the ingenious interpretation which has been urged here in the report of the Ad Hoc Committee.

The interpretation was that India could continue to have its appointed director until the next election. The Governor made it clear that he was not promising that he would not urge the Board to give a ruling regarding the interpretation of the Articles, till the contingency he had referred to arose, viz., till the election took place and India failed to obtain a seat.

Later, at the Board's meeting on March 18, when the United States and the United Kingdom delegates sought interpretations of certain Articles, under instructions from their respective Governments,

Sir Chintaman urged that the interpretation regarding the appointed Director for India should have the same order of priority and this was agreed to. The Governor sent to the Fund Secretariat a draft of a resolution he wished to refer to the Board of Executive Directors of the Fund for their decision. The draft resolution read as:

that with reference to the Ad Hoc Committee's report on the position of the Executive Director for India adopted by your Governors at their meeting on the 15th of March and in view of the inconsistency between Section 3(b)(i) and Section 3(f) of Article XII that these sections be interpreted to mean that any member having one of the five largest quotas at the date of a regular election or at any date between regular elections shall be entitled to appoint an Executive Director who shall hold office until the next regular election without prejudice to the right of a subsequently admitted member to appoint a Director if it has one of the five largest quotas.

The meeting of the Executive Directors of the Fund decided on May 8, 1946 that the interpretation suggested by India was the correct one. A similar resolution was passed the next day by the Board of Directors of the Bank, according to which it was decided that India, which had once appointed her Director, could not be deprived of her representation until the next election even though a country with a larger quota joined within that period.

Directors: Remuneration and Functions

The remuneration of the Executive Directors and whether they should devote full time or part time to the business of the Fund/Bank were other points of dispute. The Committee on Functions and Remuneration agreed that the Executive Directors and Alternates should devote all their time and attention to the business of the Fund/Bank and, between them, be continuously available at the principal office of the Fund/Bank. Lord Keynes considered that the Executive Directors were national delegates and that their remuneration should be provided or shared by the appointing Governments. He was also opposed to Executive Directors and Alternates devoting full time to the business of the two institutions.

The real point at issue in this matter was the concept of functions which the institutions were to undertake. The U.K. wanted the work to be limited to the purposes set out in the Articles, while the U.S.A. visualised a wider and active role to be played by the two institutions. The U.S. view was that the staff should make studies and be in a position to offer assistance and advice, so as to forestall the development of exchange and financial difficulties and not deal with problems

only when they reached a stage necessitating reference to the institutions. Sir Chintaman, in his report on the proceedings, observed:

It is difficult to say now what will be the result of this wider concept of the functions of the Fund and Bank, as any attempt by either institution to interfere in the financial or fiscal policies of a member country might well be strongly resented.

Location of Fund/Bank

Another matter which proved extremely controversial was the location of the principal offices of the Fund and the Bank. Under the Articles of Agreement, the principal office was to be located in the territory of the member having the largest quota/holding the largest number of shares -i.e., the, U.S.A. According to Sir Chintaman's report on the proceedings of the inaugural meeting, the U.S. representative had recommended Washington but the U.K. delegate proposed New York, the reasons advanced in favour of New York being (i) the institutions would lose their international character if they were in Washington and the Executive Directors would be subject to political influences,(ii) it was desirable that the Fund should be located in a financial centre, and (iii) since the principal seat of the U.N. was to be New York, it was desirable to have the Fund and the Bank in New York to facilitate co-operation. Canada, France and India supported this view, but the selection of New York was vigorously opposed by the United States delegate, who argued that the Fund was an international organisation dealing with Governments and therefore it was more appropriate that it should be situated in the administrative capital of a country, rather than its financial centre, where it might be subject to private business interests; the U.S.A. was supported by Mexico and China. Since Canada and France later agreed that the final decision of the choice of site should rest with the host country, the U.K. delegate agreed to accept Washington, though Lord Keynes remarked that the U.K. Government considered the selection 'a grave error'. India, France and Canada withdrew their objections to the selection of Washington in order to make the report unanimous.

Referring to this matter about ten years later in the Dadabhai .Naoroji Memorial Prize Fund Lectures delivered by him, Mr. Deshmukh observed:

the fact that we, on the threshold of national independence, could and did take an independent line on such questions was warmly appreciated, particularly by Lord Keynes personally.

Governor's address at the Closing Plenary Session

It will be appropriate to close this section on the Savannah Meeting with a few extracts from Sir Chintaman's valedictory speech at the

closing plenary session of the meetings of the two institutions on March 18, 1946.

Much earnest labour and deliberation have contributed to the creation of these institutions and many hopes and aspirations have been expressed for their success in the future. I do not therefore feel called upon to say much on this occasion. We may however pause to glance at and admire the edifice we have all helped to build and say with pride "this is the house that Jack built", on foundations well and truly laid by John Maynard and Harry under the judicious eyes of Fred.

We have fashioned a bright and shining instrument of global importance, but we must remember that it is only an instrument, and that the conditions in which it is to be wielded are yet to be established. To vary the metaphor, we have the cart all tight and ready, well sprung and well oiled, with attentive coachmen, but the horse has yet to be selected and put between the shafts. That horse is the trade and commercial policy that the world will elect to follow. He is rash who predicts unqualified success for our twin institutions in advance of a satisfactory agreement on the trade and commercial policies of the nations of the world. For, easy optimism is the twin brother of a surprised defeatism. The coming international parleys on trade and commercial policies are therefore of the utmost importance, and the success of these parleys will depend on you, and by you, I mean largely the U.S.A. and the U.K.

On India's behalf I confidently give a pledge that we shall give of our best to the Fund and the Bank and that we shall choose men who would play their part worthily, with dignity and independent judgment and we shall see that they are placed in a position to give to these institutions the time and attention that the interests of the institutions demand. Sir, we shall remain as members of these institutions only so long as India can play her part in them worthily and with profit not only to herself but also to the world.

APPROVAL OF LEGISLATURE OBTAINED

Second Report of the Committee of Legislature on Bretton Wood

The Governor's report on the proceedings of the Savannah meeting and the discussions with him were of considerable assistance to the Bretton Woods Committee of the Legislature. The Committee's second interim Report presented to the Legislative Assembly on April 17, 1946, while taking a note that no clarification had been made by the British Government on the issue of sterling balances, reiterated what it had said in the first interim Report, viz.,

- (i) it endorsed the Finance Member's statement that India was not bound by the terms of the Anglo-American Loan Agreement of December 1945, and

(ii) the final decision whether to remain a member of the Bretton Woods institutions would be determined by the outcome and the timing of the sterling balances negotiations.

Since the whole question of India's constitution was under examination, the Committee suggested postponement of further action till the outcome of such examination became known. The Committee, therefore, recommended that Government should take advantage of every possible provision in the Articles to postpone payment of subscriptions to the Fund and the Bank till the last moment, but if it became necessary to take a final decision before the Assembly met again, Government should summon the Committee and a decision should be taken in consultation with it.

A motion approving the course of action proposed in the Report was moved by the Finance Member on the 18th and was adopted after some discussion. During the course of the debate, tributes were paid to the Governor for his work at Savannah. Mr. Geoffery Tyson (belonging to the European Group), a member of the Bretton Woods Committee, stated:

We have had the benefit of meeting the Governor of the Reserve Bank since he returned from Savannah and he has presented a long and interesting report to the Bretton Woods Committee. I do not think that any of us are in two minds at all about the question that we got in the person of Sir Chintaman Deshmukh the best possible Governor which India could send to this International Institution. When this subject was first introduced into this House, now nearly three months ago, I said on behalf of the European Group that what we wanted was that India should exercise full responsibility as a member of the Fund and that it should be exercised on behalf of India by an Indian and in the interest of India. I would like to say that I repeat what was then said and I am quite sure that the report which Sir G. D. Deshmukh has presented to the Bretton Woods Committee endorses the very considerable confidence which the Legislature, the banking community and the country at large has reposed in this distinguished officer of the Government.

In his concluding speech, the Finance Member, while endorsing the tribute paid to the Governor by Mr. Tyson, remarked:

I am glad to have the opportunity of saying that I have, from independent sources, evidence of the admiration which his dignity, his ability and his general handling of the situation evoked in Savannah in the recent negotiations. It was of the very highest.

The Governor's own account of what happened in the Legislative Assembly and the role he played in getting the Legislature to approve India's membership of the two institutions is given below*:

* Economic Developments in India -1946-1956.

The performance of our delegation was praised with unwonted warmth but the concern with sterling balances arrangements still predominated and bedevilled any final decision. It was then my duty to try and exorcise what Dr. Sir Zia Uddin Ahmad -who was, incidentally a contemporary of Keynes at Cambridge -had called “the bogey of the present session”. I met the members of the Bretton Woods Committee and sought to remove misunderstandings and apprehensions regarding the financial involvements resulting from our membership as also to inform them about the widespread benefits bound to flow from them if we then co-operated in the establishment of such bodies. I was gratified to see that subsequently, in October, the Legislature decided that India should, join the Fund and the Bank.

Between April and October 1946, there were other developments with regard to the organisation of the Fund and the Bank, including the declaration of initial par values. These may now be described before coming back to the matter of the Legislature’s approval.

Appointment of Executive Directors and Alternates

Once the Bretton Woods Agreement was signed, the next important step was to select really able persons to represent India on the Board of Executive Directors. The Finance Member, Sir Archibald Rowlands, sought the Governor’s advice in the matter sometime in January 1946. The Governor indicated that he could think of only two suitable persons of the requisite experience, standing and technical competence, viz., Mr. N. Sundaresan (Joint Secretary in the Finance Department) and Mr. J. V. Joshi (the Bank’s Economic Adviser). He was also of the view that the appointment should not be for more than two years. The Governor further suggested that whosoever was selected should have an Alternate ‘to learn the ropes, stand by in emergencies and help organize a small economic advice section in the Office of the Agent-General for India’. The Governor’s advice was accepted. On April 22, 1946, a notification was issued announcing the appointments of Sir Chintaman Deshmukh as Governor of the I.M.F. and the I.B.R.D., Mr. N. Sundaresan as Alternate Governor of the Fund and the Bank and also Executive Director of the Bank and Mr. J. V. Joshi, as Executive Director of the Fund. No Alternate Executive Director was appointed to start with.

However, within a few months, it was realised that full-time Alternates were absolutely essential. On request to that effect from Messrs Sundaresan and Joshi, the Governor in consultation with Mr. Joshi, decided that Dr. B. K. Madan (the Director of Monetary Research), whose services had been loaned to the Tariff Board, would be the best choice as Alternate at the Fund. The Governor considered that pending the choice of another suitable Alternate for the Bank,

Dr. Madan would be to work as an Alternate for both Mr. Joshi and Mr. Sundaresan. The Government issued a notification on September 4, 1946 appointing Dr. Madan as Alternate Executive Director in the I.M.F. and Mr. Joshi, who was Executive Director at the fund as Alternate Executive Director in the World Bank (i.e., the I.B.R.D.). Shortly thereafter (i.e. on February 14, 1947), however, Dr. Madan was appointed as Alternate Executive Director in the World Bank too. Following the completion of Mr. Joshi's term, Dr. Madan was appointed India's Executive Director at the I.M.F., effective November 1, 1948. His place as Alternate was taken by Mr. D. S. Savkar, an Officer of the Bank's Department of Research and Statistics. Mr. Joshi was reappointed Executive Director, effective January 11, 1950.

It appears that at the time of Dr. Madan's appointment as Alternate, the Viceroy remarked that all the appointments made till then had gone to Hindus. The Finance Member, Sir Eric Coates, explained that such 'representative' appointments needed men with special training and experience in financial matters and that no non-Hindus with the necessary qualifications were immediately available. He, however, added that for future appointments, both in 'representative' capacity and on the staff of the two institutions, the Governor 'would no doubt be looking out for qualified persons from different communities'; this was communicated by Sir Eric to the Governor. The Governor replied in very strong terms, remarking that he nominated the best men available irrespective of any communal considerations. The letter observed:

It must be remembered that we are dealing with a very specialized field and are making whole-time appointments to very important international bodies on which there should be no occasion for India to hold down her head by reason of having failed to send of her best I might add that even if I had been looking out for persons from different communities, by which I take it is meant the Muslim community, I could not have recommended anyone else in either case. The only field in which conceivably one would look for suitable material would be the Indian Audit and Accounts Service, and so far as the Executive Director of the Fund is concerned, I should not have agreed to the appointment of anyone from that service who had no knowledge of current economic problems, especially problems of currency and exchange. I suggested him† as an Alternate primarily to the Director on the Fund, which Government have conceded would be the body dealing largely with problems cognate with the Reserve Bank's activities. It follows that India's representative should be someone on the staff of the Reserve Bank, and I am in the position to say that I have no Muslim officer who could be considered for a moment for an appointment of this kind I submit that it would have been harmful to India's interests to have ignored him and to have selected "a qualified person from a different community" merely for the sake of achieving political

† Dr. Madan.

balance. So far as these representative appointments are concerned, I regret it will not be possible for me to undertake to nominate any but the best, irrespective of community. My advice to Government would also be to ignore communal considerations in making these appointments on international bodies, where we must hold our own with the best of other nations.

Later, in March 1947, when the Governor was consulted by the Finance Department regarding India's Delegation to the Annual General Meetings of the World Bank and the Fund, the Governor considered it desirable to state the background to the nominations he was required to make in his capacity as Governor for India on the two bodies in regard. to the posts of Executive Directors. In the Governor's words:

I had had a general talk with him* about the matter and, although it is nowhere set down in my records, we had agreed that while the Executive Director on the Fund should be the principal concern of the Reserve Bank in that he will have to attend to matters intimately connected with Exchange Control and pars of exchange, the nomination of the Executive Director on the Bank should be principally the concern of the Finance Department, as he would have to deal with long-term schemes of development and the finance required for the purposes. I imagine that Finance Department will not wish to make any modification in this basic division of responsibility as long as they wish me to continue as Governor for India.

In another connection, the Governor reiterated in December 1948 that in the light of his own four years' experience from the very inception of the two institutions, he felt that two different types of Directors were required for the two institutions, one with a good background of economics and the other with considerable experience of Government finance and administration.

The functional relationship between the Government, the Governor and the Executive Directors was clarified by the Governor with the Finance Department at a very early stage. The Finance Department's letter dated June 17, 1946, to the Governor stated:

I confirm that Government's view of the position is the same as yours, namely, that with regard to the Bank and the Fund the Governor of these institutions is responsible to Government and the Executive Director is responsible to the Governor, there being no direct constitutional relationship between either Government and the Director or Government and the Alternate Governor who, though he may exercise the Governor's powers vis-a-vis the Bank and the Fund, may not exercise those powers vis-a-vis Government.

As regards channel of communication, the letter observed that 'there should be no direct correspondence between Government and the Executive Directors or Government and the Alternate Governors'.

* Sir Archibald Rowlands.

However, as the Government and the Governor were situated at a considerable distance from each other, the Finance Department was to make routine enquiries from the Executive Directors direct through correspondence.

Indian Representation on the Fund/Bank Staff

In terms of Article XII Section 4(d) of the Articles of Agreement of the Fund (Article V, Section 5(d) of the Bank), the selection of staff was to be on as wide a geographical basis, as possible, subject to the paramount importance of securing the highest standards of efficiency and of technical competence. Though India did not have much of a locus standi, since the appointments were to be made by the Fund's and Bank's management, the Governor, in his capacity as the Governor for India on the Fund and the Bank, was keen that India should not miss any opportunity of staking her claim for appointment on the Fund and the Bank staff. The search for the right men took some time, and Mr. Sundaresan, in his letter dated June 3, 1946 to the Managing Director of the Fund (in his 'capacity as Director Joshi's Vice and Governor Deshmukh's Alternate') explained that the delay was due to 'the preoccupations of the political issue now on the anvil', and requested him to defer finalisation of recruitment proposals till the end of the month to enable India to make suitable recommendations in the meantime. To quote the letter:

I am not unmindful of the need for efficiency -which will rule out National considerations -in an International Organization but I venture to state that even as man does not live by bread alone, international organizations cannot thrive on efficiency alone. Good will is equally essential. Unless we give appropriate consideration at this stage to possible candidates from such countries as China and India, we are likely to be accused of having made this institution an asylum for unsuccessful economists of various countries (however theoretically proficient they may be), whose names seem to have been presented to us. China and India are unknown except geographically and historically to the rest of the world and if they cannot conjure up names of people who have published theses, it does not follow that they have not men of the calibre we require.

Mr. Sundaresan's letter was circulated amongst Board members; it was decided that the Managing Director would not fill all the posts till he had an opportunity of reviewing recommendations from India.

The Governor, in the meantime, sought talent outside the Bank and the choice fell on Dr. Gyan Chand, Professor of Economics and Head of the Department of Economics in the Patna University and Mr. J. J. Anjaria, Reader in Economics at the Bombay School of Economics

and Sociology, for the posts of Chief of Division and Assistant Chief, respectively. Later, for about a decade Mr. Anjaria was Economic Adviser to the Union Finance Ministry and from August 1961 through January 1967, he served as India's Executive Director at the Fund, and from February 1967 through February 1970 as a Deputy Governor of the Reserve Bank of India.

The Governor was requested to suggest a third Indian for another post, and Dr. P. J. J. Pinto, an Officer in the Bank's Department of Research and Statistics, was deputed. Later, two other Officers of the Bank's Research Department, Messrs B. R. Shenoy and S. L. N. Simha, were deputed to serve on the Fund's staff for a period of about two years. All the three of them later returned to the Fund as Alternate Executive Directors for India. From the Universities, three more appointments were made in the Fund, namely, Dr. S. A. Pandit, Dr. I. G. Patel and Dr. A. K. Dasgupta; Dr. Patel later became India's Alternate Executive Director and also Executive Director. As regards the World Bank, the first and for many years the only Indian staff member was Mr. S. R. N. Badri Rao, an employee of the Ministry of Finance, who later was deputed to study at the Harvard University.

Fixation of Par Value of the Rupee

Under Article XX Section 4 of the Articles of Agreement, the Fund was required, when it considered that it would shortly be in a position to begin exchange transactions, to notify members and request them to communicate within thirty days the par value of their currency based on the rates of exchange prevailing on the sixtieth day before the coming in to force of the Agreement, i.e., on October 28, 1945. A period of ninety days from the date of the receipt of the request was allowed to a member, under the same Section, within which it could notify the Fund if it regarded the par value communicated as unsatisfactory, or conversely the Fund could notify the member that in its opinion the par value could not be maintained. The Fund's request was sent on September 12, 1946; the par value was thus to be notified by October 12, 1946.

It appears from Finance Department's letter to the Governor in July 1946 that even before the Fund's request for communicating the par value of the rupee was received, the informal understanding was that the then existing par value was not to be changed the decision was based on memoranda prepared by Mr. J. V. Joshi and Sir Theodore Gregory, the Economic Advisers to the Bank and Government, respectively, which recommended no change. The Governor was also requested to communicate to Government the Bank's formal views on

the matter. After the receipt of the Fund's request a couple of days before mid-September 1946, the Government of India invited Chambers of Commerce, Bankers' Associations and other interested bodies or persons to send their views in writing to them before October 31, 1946. Views of the members of the Bretton Woods Committee and a few other Members of the Legislature were also sought; the majority expressed themselves in favour of the maintenance of the status quo. On October 10, 1946, the Government of India communicated to the Fund the par value of the rupee at .0086357 ounce of fine gold per rupee; this worked out to Re. 1 = 1S. 6d.

In the Bank, the matter was placed before the Central Board at its November g, 1946 meeting. A memorandum prepared by Deputy Governor Trevor, together with notes by Mr. J. V. Joshi and Professor D. R. Gadgil, Director of the Gokhale Institute of Politics and Economics and a nominated member of the Western Local Board, whose views the Governor had sought, had been circulated to the Board members earlier.

Mr. Joshi's note pointed out that the attempt to fix the exchange rate of any currency immediately after the war presented almost insurmountable difficulties, as neither the price levels nor wages nor cost levels reflected the true purchasing power of the currencies. Prices of many commodities were controlled by Governments, but with uneven success in different countries; the same was even truer of wage rates and cost levels. Further, changes in the terms of trade and the balance of payments position had been completely held in check as a result of trade controls and such devices as lease-lend or other methods of financing war purchases. With the end of the war, the special devices were expected to be removed; the resulting position regarding the country's balance of payments was therefore difficult to predict. In the circumstances, the fixation of the exchange rate of any currency, the note remarked, was 'bound to be a shot in the dark or a plunge into the unknown'. However, for the restarting of international trade and exchange, some exchange rate would have to be provisionally fixed.

The note pointed out that much of the relevant data for the fixation of the exchange value of the rupee were not available in India, the only data available being in regard to monetary circulation and prices. Even in regard to monetary circulation, the data were incomplete. On the basis of certain reasoning, the note came to the conclusion that Indian prices, in all probability, would decline during the early post-war period and the index might be stabilised at about double the pre-war level, i.e., at 200. On the other hand, prices in the U.K. were likely to rise by about 5 to 10 per cent to 180-190. The note mentioned other factors which were likely to exert an upward pressure on the exchange

value of the rupee. For instance, India had paid off all her foreign debt on Government account. Mr. Joshi's conclusion was that the exchange value of the rupee might be left undisturbed at 18 pence for the time being.

From the point of view of countering inflationary tendencies, the note considered it safer for India to err on the side of a slight overvaluation of the rupee rather than its undervaluation. If, later, some modification in the value of the rupee was necessary, this could be carried out by the exercise of the right of every member country to change the par value of its currency by 10 per cent unilaterally. Even a change of greater magnitude could be accepted by the I.M.F. if it was required 'to correct a fundamental disequilibrium'.

Professor Gadgil, in his note, observed that at the then existing rate of exchange the external value of the rupee was much higher than its internal purchasing power, but he was not in favour of a lower rupee ratio immediately. In his view, as soon as the scarcity of supplies which obscured the effects of the disparity disappeared, full results of the maladjustments would become apparent and a depression and at least a partial devaluation would be inevitable. This could be avoided, he observed, only if Government planned an intelligent policy for the period of transition and successfully carried it out through that period.

The note laid stress on measures to be taken by Government to bring about the necessary adjustment between the internal and external values. Government should aim at bringing down over the next three-year period the controlled prices of cereals and oilseeds by about a third and of cloth by at least a quarter of the existing levels. 'This is the central and the most important of the problems of adjustment', Professor Gadgil observed. To ensure that the supply position regarding imports was not exploited solely to the advantage of the foreign producer and the Indian intermediaries, purchases on Government account, control of prices, control of distribution, etc., should be tried. Action should also be taken in the form of 'detailed and specific regulation' of certain types of imports to protect the claims of smaller industries started during the war.

The Central Board concurred with the recommendation of Mr. Joshi and Professor Gadgil. At its November 9, 1946 meeting, the Board resolved:

That a recommendation be made to Government that no change be made in the par value of the Rupee already communicated by the Government of India to the International Monetary Fund on the 10th October 1946 viz., 0.086357 ounce of fine gold per rupee.

It was further resolved that Government be requested to consider the economic implications of this decision on the lines indicated in Professor D. R. Gadgil's Note on Exchange Parities circulated to Directors of the

Central Board, and to take appropriate measures from time to time in order to ensure that the rate decided upon is not out of equilibrium.

The recommendation was accepted by Government. Although in view of this there was no need to send any fresh communication to the Fund, the Government of India wrote to the Fund stating that in the interests of accuracy, they preferred the par value to be expressed as under:

Using gold as common denominator, Rupee one is to be regarded as having a theoretical gold content of 4.145142857 grains of fine gold; this weight of gold producing Rupee /Dollar rate of Rs. 3.3085194 per U.S. Dollar and a parity price of gold of Rs.115-12-9.25056 per ounce of fine gold.

In the earlier communication of October 10, 1946, the par value had been expressed in terms of ounce of fine gold, calculated only up to 7 decimal points; this worked out to 4.1451360 grains, and was therefore not quite accurate. It may be mentioned that as early as October 9, 1946, Deputy Governor Trevor had suggested that the par value should be fixed in terms of grains troy of fine gold.

Third Interim Report of the Bretton Woods Committee

It will be recalled that the Bretton Woods Committee in its Second Interim Report of April 17, 1946, had recommended that the Government should postpone payment of subscriptions to the Fund and the Bank till the last moment, but if it became necessary to take a final decision before the Assembly met, the Committee should be summoned and a decision should be taken in consultation with it. Accordingly, on being informed that the World Bank was likely to start making calls on the share capital towards the end of June 1946, the Government of India instructed the Indian Executive Director on the Bank's Board to find out whether it was possible to postpone payment so that the final decision might be taken by the new Government, in consultation with the Legislature; the Government were informed that it was not permissible.

On June 19, 1946, the World Bank notified the Government of India that it would start operations on June 25, 1946 and that India should pay (i) 2 per cent of the subscription (i.e., \$8 million less \$40,000 already paid) in gold or U.S. dollars on or before August 24, 1946 and (ii) 3 per cent of the subscription in rupees on or before November 25, 1946. A further 5 per cent in rupees would also become payable on or before November 25, 1946; a formal demand for this was to follow later.

The Bretton Woods Committee was assured by the Finance Member that the dollars required for payment of subscription would be made

available from the Empire Dollar Pool, the effect of which would be an equivalent reduction in sterling balances. He also informed the Committee that the British Government had indicated that they would be ready to issue an invitation for commencing negotiations on sterling balances, as soon as a representative Government was formed in India.

The Committee in its Report* dated July 29, 1946, observed that in considering the three alternatives before it, viz.,

- (i) to authorise the payment for which demand had been made,
- (ii) to instruct Government to withdraw from the membership of the Bank, and
- (iii) to continue membership but default in payment,

the Committee had the benefit of the advice** of the Reserve Bank Governor (who was also the Governor for India of these two institutions). Of the three alternatives, the Committee 'unhesitatingly' rejected the third. As regards the second, it was not sure whether it 'would be correctly interpreting the wishes of the Assembly in recommending withdrawal'. The Committee, therefore, recommended to Government to pay \$7.96 million, which had to be paid on or before August 24, 1946, leaving it to the Legislature to decide whether to pay the remaining 8 per cent of the subscription by November 25, 1946. The Report observed:

We do not wish, however, to take upon ourselves the responsibility of authorising payment of the remaining 8 per cent of the subscription which has to be paid by the 25th of November. We strongly recommend, therefore, that, irrespective of the political situation at the time, a session of the Legislative Assembly should be called on or about the 10th November 1946 at the latest, in order to allow the Assembly to make up its mind finally whether it wishes to continue India's membership of the Bank or whether it wishes India to withdraw from that institution.

Mr. Manu Subedar, a member on the Committee, submitted a Minority Report, in which he observed:

I have no hesitation in saying that India should withdraw from the membership of the Bank at this stage.

The main reason advanced by him was that India would be unable to shoulder further credit obligations, until her own position regarding repayment of sterling balances was made clear.

* The Report was signed by only four members viz., K. C. Neogy, N. V. Gadgil, Zia Uddin Ahmad and M. Ananthasayanam Ayyangar.

** It appears one of the members on the Committee told Sir Chintaman after the meeting in which the Committee examined him:

We are satisfied that it will be in India's interests if India joined the Bank -if you say so, -you are one of us.

The Committee's Report was presented to the Legislative Assembly on October 28, 1946, when the second session commenced.

The Finance Member of the Interim Government, Mr. Liaquat Ali Khan, moved:

That this Assembly having considered the third report of the Committee on the Bretton Woods Agreements do hereby approve India's continued membership of the International Monetary Fund and the International Bank for Reconstruction and Development.

The Finance Member pointed out that he was seeking the approval of the House not only for the immediate payment of 8 per cent of the subscription which had to be made, but 'for a declaration of its policy with regard to these international organisations'. He urged Members to look at the problem 'only from the point of view of India's interests and of no other interests'. The motion approving India's continued membership of the Fund and the Bank was adopted.

FORMATIVE YEARS OF THE FUND AND THE WORLD BANK

In the formative years of the International Monetary Fund and the World Bank, there was much work for the Board of Executive Directors and the Governors. Since India was one of the big five, she had an active share of responsibility in the formulation of policies and procedures for the grant of assistance and in the interpretation of the flexible Statutes, especially in the case of the Fund. With Sir Chintaman Deshmukh as the Governor for India on the Fund and the World Bank, the Reserve Bank was in intimate touch with the working of these two institutions. The Executive Directors kept the Governor informed of all the developments and took instructions from him regarding the stand they should take on various matters coming up before the Fund and the Bank Boards. There was of course very close consultation between the Reserve Bank and Government on all important issues.

Even after his retirement as Governor, Sir Chintaman continued to be the Governor for India on the I.M.F., while Sir Benegal Rama Rau was appointed Governor for India on the World Bank. Effective August 2, 1950, Mr. Deshmukh, who had then become Finance Minister, became the Governor for India on both these institutions, while Mr. Rama Rau was appointed Alternate Governor.

The Reserve Bank was designated as the depository for all the Fund's and the World Bank's holdings of rupees and rupee securities. Also, India being the fifth largest quota country, was entitled to designate a

depository in which the Fund and the World Bank might hold their other assets, including gold; the Reserve Bank was thus designated by the Government of India as a gold depository of the Fund and the Bank.

Payments towards India's quota of \$400 million (Rs. 132.34 crores) were made as under:

| | |
|--|--|
| (1) Gold subscription: (equivalent to 10 (equivalent to India's official holdings of gold) | \$27.53 million or Rs. 9.11 crores |
| (2) Currency subscription (i.e. rupee subscription) | |
| (i) Cash | \$40.00 million or Rs. 13.23 crores |
| (ii) Non-negotiable non-interest bearing securities | \$332.47 million or Rs. 110.00 crores |

The gold payment was made not out of the Reserve Bank's holdings but out of the Bank of England's gold stocks held by the Reserve Bank, which credited the Bank of England's account with the rupee equivalent. The gold, cash and securities, in connection with India's quota, were all held by the Reserve Bank on the I.M.F.'s account.

In respect of the World Bank, 20 per cent of the subscription of \$400 million was payable initially, of which 2 per cent (i.e., \$8 million less \$40,000 paid on December 27, 1945 towards administrative expenses) was to be paid in gold or U.S. dollars before August 24, 1946; this was paid, the dollars being made available from the Empire Dollar Pool. The remaining 18 per cent was paid in three calls between November 25, 1946 and May 26, 1947. Almost the entire amount was in the form of securities. The Bank held the cash and the securities on the World Bank's account. Taking cognisance of a communication from the Government of India embodying a copy of the Indian Independence (International Arrangements) Order, 1947, it was decided at the second annual meeting of the Fund and the World Bank that the quota of the pre-partition India in the Fund and her subscription to the capital stock of the World Bank should continue to be the 'quota' and 'subscription' of the Dominion of India.

Following devaluation of the rupee in September 1949, additional contribution equivalent to the reduction in the gold value of the Indian currency held by the two institutions became payable, Rs. 68.66 crores in respect of the Fund and Rs. 10.46 crores in respect of the World Bank, and these were paid in the form of non-negotiable non-interest bearing securities.

It is outside the scope of this chapter to deal with the operations of the two institutions. A brief reference will be made to the assistance which India received from the two institutions in the period covered

by this narrative. On account of the difficulties in the way of conversion of India's sterling balances to dollars and other hard currencies under the Sterling Balances Agreements, India had undertaken to purchase from the I.M.F. a maximum amount of about \$150 million during the eighteen-month period January 1948 to June 1949. In January 1948, a request for a drawing was conveyed to the Fund. The Fund agreed, and drawings for a total of \$100 million were made in seven instalments beginning with March 1948 and ending with March 1949.

In March 1949, the first fact-finding mission from the Fund, under the leadership of the Director of Operations, Mr. (later Sir) M. H. Parsons visited India, for the study of economic and financial trends, especially of the balance of payments, and discussions with the Indian authorities. An I.B.R.D. mission, led by Assistant Loan Director of the Bank, Mr. A. S. G. Hoar, also visited India early in 1949, to study the Indian economy in all its aspects and particularly the development programmes in regard to railways and agriculture, which had been put forward by the Government for the World Bank's consideration for loan assistance. The mission was also to judge the safety of the loan and the possibility of India earning sufficient dollars to repay the loan. In connection with the visit of these missions the Reserve Bank compiled a great deal of background material. The I.B.R.D.'s first loan to India was granted in August 1949. This was for \$ 34 million for railway development. Towards the close of September, another loan of \$10 million was made for the purchase of agricultural machinery. In April 1950 a third loan of \$18.5 million was sanctioned for electric power development. The total amount disbursed to India against these loans till the end of June 1951 aggregated \$ 42.98 million.

Over the years, the assistance received by India from the Fund and the World Bank has been substantial, India being the largest recipient of aid from the World Bank Group, that is, from the I.B.R.D. and its two affiliates set up later, namely, the International Finance Corporation and the International Development Association.

STERLING AGREEMENTS

Further Sterling Accumulation

The immediate post-war period was characterised by further substantial accumulation of sterling with the Bank. These balances, which stood at Rs. 1,363 crores at the end of March 1945, rose to Rs. 1,507 crores by the end of August and further to a peak of Rs. 1,733 crores in the first week of April 1946. The rise in the financial year 1945-46 was

Rs. 361 crores, as compared to Rs. 418 crores in the year 1944-45. The problem of the continuing accretion of sterling, which was of constant concern to the Central Board throughout the war years, engaged its attention again early in 1946. A new factor in the situation was the possibility that a portion of the sterling balances might be scaled down as a contribution by the Government of India to the Allied war effort. The Anglo-American Loan Agreement announced in December 1945 in fact contained proposals to this effect.

Towards the end of January 1946, Director B. M. Birla informed the Governor of his desire to move a resolution at the next meeting of the Board, with the object of bringing to the notice of Government the unsatisfactory position regarding India's earnings of dollars and the mounting sterling balances of the Bank. The Governor himself was equally convinced that it was high time that the Government of India took the matter up with the British Government and had already impressed upon the Finance Member the urgent need to obtain clarification from the British Government of their intentions with regard to the liquidation of the balances that had accumulated during the war and of the methods they proposed to adopt for financing their subsequent expenditure in India.

The Government of India were not too pleased at the prospect of a discussion of these subjects at the Board meeting scheduled for February 25, 1946, owing to the close proximity of the budget. The Finance Member was to deal with these questions in some detail in his budget speech three days later. The rate of accretion of sterling was already substantially reduced. In regard to the Empire Dollar Pool the position was that India's balance of payments with the hard currency countries was actually running against her and some delay in the discussion seemed to be beneficial rather than otherwise. Besides, the termination of the Dollar Pool arrangements was already in a fair way of being settled, either as a result of the operation of the Anglo-American Loan Agreement * or of the inauguration of the I.M.F. For these reasons, Government earnestly hoped that the Board would agree to postpone consideration of Mr. Birla's resolution until its next meeting.

The Board did not comply with the Government's request. After discussing the matter from all angles, it passed the following resolution:

Resolved

That the Board of the Reserve Bank is alarmed at the continued accumulation of sterling even after the termination of the war and requests

* The Agreements contained a clause to the effect that the U.K. Government would complete arrangements as early as practicable and in any case not later than one year after it came into effect, under which the sterling receipts from current transactions of all sterling area countries would be freely available for current transactions in any currency area without discrimination ; in other words, any discrimination arising from the Sterling Area Dollar Pool was to be entirely removed and each member of the sterling area was to have its current sterling and dollar receipts at its free disposition for current transactions anywhere.

the Governor to apprise the Government of India of the considered views of this Board- That all disbursements in future made by His Majesty's Government in rupees must be paid for either in free foreign currencies or in capital goods or in such consumer goods as are acceptable to India or in bullion.

Mr. Birla's earlier proposal that the Board should also insist 'that all foreign exchange accruing to India on account of her surplus exports should be made available for meeting the requirements of Indian trade' was, however, dropped when the Governor pointed out that it would be against India's interests to force that particular issue. Thus, the general purport of the resolution finally adopted was almost the same as that of the resolution passed in December 1944.

It would appear that the Board received no reply from Government although the question was raised again at the Committee meeting of May 8, 1946, when it was suggested that the Governor should remind Government, which the Governor did, urging them to send 'an early and considered reply'.

In his budget speech, the Finance Member (Sir Archibald Rowlands) dealt at length with these issues which agitated the public mind greatly. On the question of the further accruals of sterling with the Bank, he said that alternative methods of financing the British Government's expenditure in India were engaging the closest attention of Government, although the amount involved for the year 1946-47 (estimated at Rs. 42 crores) was insignificant as compared with the total of the sterling assets acquired by the Bank till then. There was even the possibility, he added, of the U.K.'s increasing her exports to India to such an extent as to avoid any further sterling credits. As for convertibility of the existing sterling balances, negotiations were to take place in the course of the year between the two Governments, the arrangements to be made being a matter for bilateral settlement between India and the U.K. The Finance Member also repeated his earlier assurances to the House, viz., that he would associate representatives of the leading political parties in the country and other non-officials with the delegation to be appointed for the purpose of discussions with the British Government and that 'India will be entirely free to take any line that she may see fit to pursue at these negotiations and any idea that she is committed in advance to a scaling down of the balances or to a continuance of arrangements under which such balances will continue to accrue is entirely without foundation'.

On the question of India's withdrawal from the Empire Dollar Pool, the Finance Member expressed the view that it would be 'premature and unprofitable' to do so. India's net contribution of hard currencies to the Pool during the period between September 1949 and

March 1945 had been Rs. 99.31 crores and after allowing for the net import of gold from the U.K. during the same period, valued at the world price of the metal, the balance in India's favour was Rs. 49.23 crores. If India could at all establish any claim on the Pool, he added, it would almost certainly be for a much smaller amount than what India could obtain by way of free foreign exchange by negotiation with the U. K. Government.

Mr. Joshi's Memorandum on Sterling Balances

While the Finance Member's attitude to the subject of sterling balances was thus on the whole satisfactory, the Bank, as a guardian of the national interests, considered it prudent to have a detailed study prepared, answering in particular the arguments for a scaling down of the balances. The study, which involved several technical matters relating to the transfer problems, was made by Mr. J. V. Joshi, the Bank's Economic Adviser. It was circulated to the Directors on March 20, 1946, apparently not so much for the purpose of bringing the matter up for discussion at a Board meeting later, as the Board and the management held similar views on the question, as for keeping the Bank's arguments ready for being made known to the Indian public, should the Government of India wilt under pressure from Whitehall and accept arrangements disadvantageous to India. Copies of the study were also sent to Government.

Mr. Joshi's memorandum contained an effective rebuttal of the arguments for the scaling down of the sterling balances. The argument that these balances were the result of the War Financial Settlement which was most generous to India and unfair to Britain was not tenable. It was, among other things, based on a misconception that the entire sterling balances of India were due to the Financial Settlement and the credits received by her under it from the U.K. Actually, out of the total sterling of about £1,515 million which accrued to India till the end of March 1945, the credits received from the Secretary of State accounted for. £ 969 million, the rest being the result of regular commercial transactions between the two countries.

Another fallacious argument of the scaling down school was that the Allied purchases in India were made at inflated prices. Mr. Joshi pointed out that there was no justification for making any such charges after the publication of the Fourth Report of the Select Parliamentary Committee on National Expenditure (Session 1944-45) which made an independent investigation of British expenditure in India and was satisfied that fair prices had, on the whole, been secured for war stores and food bought by the U.K. in India.

Mr. Joshi also established that Britain had the ability to repay the sterling debt. In this connection he quoted from the findings of a

study made by the well-known U.K. organisation, the Political and Economic Planning Group (P.E.P.), the, conclusion of which was:

Of the two problems as they apply to our total war debt, the physical problem is likely to prove less difficult than the financial, at least after the post-war period of scarcities. To see the physical problem in its correct perspective, the rate of repayment should be compared with our national income. An annual payment of £100 millions for instance would represent little more than 1 per cent of the nation's present income. This should not put an excessive strain on our national economy and the standard of living even if we fail to achieve full employment. Indeed, in such conditions debt repayment would contribute valuable employment-creating expenditure. It is in the financial mechanism of transferring such a large volume of goods and services that the strain may occur and, failing world-wide full employment, it will be the absorptive power of the creditors, specially of our wealthier creditors rather than the productive power of the debtor that is likely to be strained.

After considering all the possibilities concerning the manner in which India should receive repayment of the sterling balances, Mr. Joshi concluded that it would be in India's interests to receive repayment by expanding her imports rather than by cutting down her exports. In this connection, Mr. Joshi stressed the need for careful and comprehensive planning and a predetermined schedule of priorities for imports on both Government and private account so as to secure that while absolutely essential consumption needs were met the country's external resources were not frittered away on luxury imports, and that the balance was spent on the purchase of construction goods vital for the country's economic development programme. In the context of the large unilateral transfer of wealth represented by the repayment of the sterling balances, Mr. Joshi felt the situation needed careful watching to see that the rupee was not undervalued.

Mr. Joshi concluded his memorandum with suggestions for realisation of the sterling balances in the extreme contingency of Britain defaulting on her obligations. The sterling balances amounting to something over £1,000 million could be realised completely, he said, by offsetting an amount of about £ 250 million against a lump sum payment to the British Government to cover the Indian Government's liability for the pension and provident fund monies of the British personnel and by the legal acquisition of British private investments in India estimated at £900-1,000 million.

Governor's Views

As mentioned in an earlier chapter, the Governor had, for quite some time, been stoutly opposed to India's continuance in the Empire Dollar

Pool for the reason that India's surplus dollars which went into the Pool were not necessarily going to be available to her as a reserve for the future. The Finance Member's justification of India's continued membership of the Pool in his 1946 budget speech must, therefore, have irked him greatly. Finding that Government were contemplating the establishment of clearing agreements with certain countries in order to ensure that India's export surpluses with the countries concerned were kept out of the Sterling Area Dollar Pool, the Governor wrote again to Mr. Ambegaokar in the Finance Department in April 1946 to say that these proposals touched only the fringe of the problem as India's balance of payments with these countries was of minor concern as compared to that with the United States. He emphasised that a bolder and more straightforward policy was called for. As a way out, a suggestion was to be made to the British Government that the favourable balance that India would have with the United States after January 1, 1946, as might be agreed upon between the Reserve Bank and the Bank of England, 'should be earmarked for India's future needs and should be excluded from any other allotments of foreign exchange that may be agreed upon in view of India's contributions to the Dollar Pool up to the 31st December 1945' (e.g., the Post-War Dollar Fund).

There was no immediate reply to the Governor's proposals from Government. Not, unnaturally, therefore, the Governor chose to express his views on the Finance Member's budget speech at the following annual meeting of the Bank's shareholders in August. Without making so much as an oblique reference to the budget speech, the Governor disagreed with the Finance Member over even his description of the Empire Dollar Pool as a modification, caused by war conditions, of the sterling area arrangement which had been in existence for a century. The war-time sterling area system, the Governor explained, was evolved essentially for purposes of exchange control, and although the pooling of scarce currencies had grown out of the sterling bloc system of 1931-39, it differed both in its structure and in its aims from that system which was organised for providing a limited amount of multilateral convertibility and avoiding the deflationary influences of the gold standard.

The Governor also challenged the view that it was 'premature and unprofitable' for India to dissociate herself from the Pool as statistics of the succeeding months had invalidated the Finance Member's argument about India's draws from the Pool exceeding her contributions to it. He disputed also the suggestion that the gold sales of Rs. 50.crores made in India on behalf of the U.K. and the U.S. Governments should be set off against India's contribution to the Dollar Pool; the gold sales had to be regarded as indicating only the extent to which

further accumulations of sterling were obviated. Summing up, he made it clear that in his opinion, the Empire Dollar Pool had outlived its utility and, 'as far as India is concerned, can no longer exist, once the International Monetary Fund starts operations' in the beginning of the next year. The Governor was equally critical of Government's restrictive import policy which was resulting in shortages of much needed supplies of capital equipment and essential consumer goods. The Governor also referred to the inflationary aspect of export surpluses.

Finally, referring to the mounting public criticism in India of the rising volume of sterling balances 'in the face of increasing demands on the other side for their scaling down' and the widespread resentment in regard to the provisions of the Anglo-American Loan Agreement contemplating the scaling down of a proportion of the balances held by third parties without reference to them, he expressed satisfaction at Government's stand as declared by the Finance Member in his budget speech.

This speech to the shareholders was yet another occasion when the Governor found it necessary to assert the Bank's independence from Government. Commenting on the draft speech which it was customary for the Finance Member to see beforehand, the latter (Sir Eric Coates) felt that the Governor's observations and criticism of the Empire Dollar Pool and import control would be 'most embarrassing' to Government and 'might also lead to counter-attack from financial circles in the U.K.'. Moreover, the Government had already heeded the Governor's advice to relax control on the dollar exchange and imports. It was therefore the 'earnest' suggestion of the Finance Member that:

it would be more helpful even from the public point of view if you confined yourself to a brief statement that now that the war is over, the dollar position is getting easier and the Government of India are fully alive to the importance of making dollar exchange available, especially for obtaining capital equipment, which it may be necessary to obtain from U.S.A.

Sir Chintaman could not see his way to acceding to the Finance Member's request; he felt that no embarrassment could be caused to the Government by stating facts and arguments which were solely in India's interests. Nor did he 'wish to be associated with the incorrect view expressed in the last budget session'. He then went on to justify the observations he wished to make at the meeting:

I attach no importance to reactions in financial circles in the U.K., have already let loose a flood of anti-Indian material during the last two or three years. I also do not agree that disclosure of facts and arguments is prejudicial to our interests, especially as the possibility of "adjusting" our sterling balances has been embodied in the Anglo-American Loan Agreement. In the first place, they are my own personal

opinions reflecting generally the sense of the Reserve Bank Board, but I do not venture to assume that these sentiments are shared by the Government of India, who are free to disown them if they wish to. The Empire Dollar Pool and Import Control have, in my opinion, no vital relevance to sterling balances negotiations. If the assumption is that India is at present making no net contribution to the Pool, then there can be objection to its early termination. As I consider that Government has not taken early enough or sufficient action as regards dollar exchange, I prefer to adhere to my observations. As regards import control, since I am reviewing the happenings in the Bank year, I cannot see how the trend of my argument can prove inconvenient to Government I regret, therefore, that I shall not be able to incorporate in my speech the general optimistic sentiments you have indicated.

Sir Eric Coates recognised that it must be left entirely to the Governor's discretion to say what he felt in his speech. Apparently fearing that he had been misunderstood, he even hastened to assure the Governor that he had also India's interests 'very much at heart'. Adverting to the 'flood of anti-Indian material' released in the U.K. mentioned by the Governor, the Finance Member pointed out that what mattered was not what the press of either country said but the opinion of responsible authorities; no such authority in the U.K. had till then said anything prejudicial to India's interests. The best way of getting as favourable a settlement as possible out of England was to be 'quite friendly but quite firm' and to avoid mutual irritation and resentment in public in the meantime; 'if England goes sour', Sir Eric said, 'we stand to lose a lot'. As for the Empire Dollar Pool, the Finance Member added confidentially that he was willing to withdraw from the Pool at once, subject to the Executive Council's approval and to the Bank working out the necessary details. He was not, however, in favour of the Governor's suggestion (made in earlier correspondence) that India should claim her entire past net contribution of dollars to the Pool apart from and in advance of the sterling balances negotiations.

The Governor supplemented his remarks at the shareholders' meeting with further suggestions in a letter he wrote to Sir Eric Coates again a few days later. Since he had written to Mr. Ambegaokar in April advocating India's immediate withdrawal from the Pool, he had grounds to modify his recommendation to the effect that the withdrawal from the Pool or from the sterling area should not take place until the International Monetary Fund had come into operation in the new year; India had considerably to gain by the various monetary agreements made by the British Government. He therefore suggested advising the U. K. Government at that stage that the general pooling of U.S. dollars should be regarded as having ended on December 31, 1945 and that any dollars earned by India and paid into the

Pool since January 1, 1946 should be isolated and not taken into account when negotiating the general settlement on the sterling balances and the division of the Pool. The latter earnings were not to be taken back by India straightaway but allowed to be retained with the British Government for meeting India's expenditure in the U.S.A. during the rest of the year, as large disbursements of U.S. dollars on account of food imports were expected to be made during 1946-47. The Governor suggested also that as from October 1, 1946, banks should be instructed to transfer their surplus dollars (accruing from private merchandise transactions) to the Reserve Bank instead of surrendering them to the Bank of England, as this would enable the Bank to build up a dollar balance to meet the immediate requirements when the sterling area arrangement terminated. In case India's dollar earnings since January 1, 1946 proved to be insufficient to meet her requirements, he expected the U.K. Government to provide the necessary dollars, perhaps by 'marking it off' against India's dollar surplus in previous years. Thus, the arrangement that the Governor had contemplated earlier, viz., immediate withdrawal from the Pool along with a claim on the British Government for India's past credits to the Pool, gave place to a suggestion for continuance in both the sterling area and the Pool until the International Monetary Fund began operations.

Sir Eric could not, however, deal with the Governor's proposals as he was stepping down from office on September 2. It would appear that these were not pursued further either by the Governor or the next Finance Member, as India had begun to be a net drawer from the Dollar Pool from the end of 1946. The Government, however, issued a press communique on October 7, to remove 'the considerable misgivings in the public mind about such matters as India's earnings and expenditure of dollars, the Empire Dollar Pool and the Post-War Dollar Fund'. The main theme of the communique was that India's expenditure of hard currencies was not related to or limited by what she had contributed to the Pool.

Beginning of Negotiations with the U.K.

The first official discussions between the Governments of the U.K. and India for exploring avenues of settlement of the sterling balances question did not take place until the beginning of 1947, although there were press reports that the British Treasury had asked the Government of India to send a delegation to London for discussion in July or August 1946. A British delegation consisting of Sir Wilfrid Eady of the Treasury and Mr. (later Lord) Cobbold, Deputy Governor of the Bank of England, visited India early in February 1947 for talks with the Government of India. The Indian side, headed by Mr. V. Narahari Rao (Finance

Secretary) included two officials from the Bank, Mr. J. V. Joshi and Mr. Ram Nath. The talks were intended to be largely exploratory, but they covered, in fact, the entire field. It was finally agreed that the existing arrangements should continue on the understanding that an early settlement would be reached providing for a ceiling on withdrawals for current expenditure, the regulation of capital transfers and other connected matters. Declaring that the talks were 'extremely useful to both sides', the Finance Member (Mr. Liaquat Ali Khan) announced in his budget speech in February 1947 that they were expected to be resumed on a more formal basis in April. He repeated the assurances of Sir Archibald Rowlands in the preceding year's budget speech and his own in October 1946 in the matter of securing a 'just settlement' of India's claims and stressed the importance of an early solution in view of the imminence of constitutional changes.

The actual position of the Reserve Bank's sterling balances at this juncture needs to be mentioned here. After having reached a peak figure of Rs.1,733 crores on April 5, 1946, the balances declined to Rs.1,602 crores by March 31, 1947, owing to the cessation of the Allied Governments' war expenditure and the heavy imports of food-grains, consumer goods and equipment. There was also some private capital repatriation, largely British.

At the talks in February 1947, the British delegation had admitted that both India and the U.K. had made the maximum sacrifice for the war. Also, there was no suggestion that the Financial Settlement by itself had been inequitable either to the U.K. or to India. The British delegation agreed further that no question would be raised as to the prices charged for war supplies. Thus, there was good reason to hope that the ghost of scaling down of the sterling balances had been finally laid, although at the end of the discussions the British Government reserved their right to reopen all the issues. Indian hopes were therefore completely shattered when Dr. Dalton, Britain's Chancellor of the Exchequer, addressing the Brazilian Chamber of Commerce in London in May 1947, declared that Britain should refuse to take on 'fantastic commitments which are beyond her strength and beyond all the limits of good sense and fair-play', that the war debts amounting 'nominally' to more than £3,000 million were an 'unreal, unjust and unsupportable burden' and further that they 'must be very substantially scaled down'.* This outburst, from the most responsible sources in Britain, evoked strong protests all over India. Although the matter did not come up before the Central Board formally, individual Directors like Mr. B. M. Birla were extremely concerned and they wrote to the Governor about it. The Governor did not share their gloomy prognosis, and felt that the Chancellor's speech might well be

* The New York Times, May 7, 1947.

merely 'part of a war of nerves'; there was no information officially that the U.K.'s attitude to the Indian debt was any different from that expressed earlier in February.

First Interim Agreement -August 1947

Fresh discussions with the U.K. Government could be held only in July 1947. For this purpose a delegation headed by the Finance Secretary, Mr. V. Narahari Rao, visited London. The meetings took place between July 9 and 25. The Reserve Bank was represented on the delegation by Mr. H. D. Cayley, Deputy Controller of Exchange. The British delegation was led by Sir Wilfrid Eady. In view of the far-reaching political changes in India, the scope of the talks was restricted to arrangements to be made for a period of six months in order to provide India with sufficient foreign exchange to cover the estimated deficit in her balance of payments during that period. These meetings were in a way the most important of the whole series, because the basic principles and the mechanism relating to the execution of all subsequent agreements were evolved at this time.

After exhaustive discussions, both sides agreed to treat the arrangements to be made up to the end of December 1947 as purely of an interim nature, and without prejudicing either side in any manner in regard to a final or another interim agreement later on. The agreement was to be made with the existing single Government of India, it being a domestic matter between the two new Dominion Governments and the Reserve Bank to make the necessary arrangements for dealing with import, export and exchange controls while the agreement was in operation. The Indian delegation opposed the proposal of the British delegation for freezing the outstanding balances at a certain figure on a given date by the issue of a formal freezing order, whereupon it was given the alternative of accepting the concept of two accounts, one available for being drawn upon freely and the other a blocked one. The arrangement was to cover only the sterling balances of the Reserve Bank, leaving out of account those of commercial banks and private individuals.

To enable India to meet certain heavy payments in early July 1947 outside the releases to be made under the interim agreement, the zero date was taken as July 14 and the Reserve Bank's balances taken at the figure of £1,160 million, being approximately the balance on that date. The U.K. delegation proposed a release of £65 million out of this balance for that year, of which £30 million would be treated as a 'working balance' and the balance of £35 million as a straight release. Although the 'working balance' was in the nature of a reserve which was expected to be replenished in due course by the flow of trade, it

was not envisaged that the whole amount would remain intact at the end of December 1947. Thus it was, in fact, available for drawal in addition to straight releases for meeting any temporary deficits.

The Reserve Bank's balances with the Bank of England were to be divided into two accounts designated No.1 and No. 2. On the date of the agreement, the No. 1 Account was to be credited with the release of £65 million less all amounts expended between July 15 and the date of the agreement. The balance in this account was to be available for all current expenditure in any part of the world; all future currency earnings and expenditure were to be credited and debited to this account. The remainder of the Reserve Bank's sterling holdings was to be transferred to the No. 2 Account and this was to be utilised for specified purposes only where the transactions were of a capital nature or involved 'once-for-all-payments'. It was also agreed that certain specified capital payments due from the U.K. to India were to be credited to the No. 2 Account.

The Government of India consulted Governor Deshmukh before signifying their assent to the terms negotiated by the Indian delegation in London, which the delegation itself considered to be very satisfactory in the prevailing circumstances. Under the proposed arrangements, India would remain in the sterling area with the benefit of all the monetary agreements entered into by the British Government. The agreement came into force on August 14, 1947 and was to terminate on December 31, 1947. The value of the Bank's sterling assets at the close of August 14 was £1,134 million, which was lower by £26 million than the notional figure of £1,160 million. Hence Account No. 1 was opened on August 15 with £39 million, being £65 million less £26 million by which the balance of £1,160 million had decreased since July 14. Account No. 2 was opened with £1,095 million, being the remainder of the sterling assets.

Apart from the agreement itself, some points of understanding reached during the discussions were embodied in a series of letters exchanged between the leaders of the two delegations. The points covered related to the treatment of the sterling assets held in Government's Silver Redemption Reserve, the balance in India's Post-War Dollar Fund and Indian private sterling balances (comprising those of individuals and banks) and the manner of investment of the Bank's sterling holdings. In regard to the last, it was agreed that during the currency of the agreement, the Reserve Bank would not alter the disposition of its sterling assets in such a manner as to increase 'appreciably' the 'overall' rate of interest which such assets were then earning; subject to this understanding, the Bank was free to alter its investments 'in accordance with normal central banking practice'. (At that time approximately £250 million were invested in medium and long-term

securities and the remainder in Treasury bills; the average yield on the Bank's sterling investments as on August 14, 1947 was 0.8101 per cent).

The service Mr. Cayley rendered to the Indian delegation came in for warm appreciation from its leader, Mr. Narahari Rao, on the team's return to India. In a letter to the Governor, Mr. Rao stated that he wished to place on record the immense help which his vast knowledge gave the delegation, especially in the technical discussions with the Bank of England. He went on to say that:

Throughout his association with us, he displayed not only great ability and quickness of perception, but also a deep sense of loyalty to truth and fair-play. He showed great concern to ensure that India got a fair deal and spared no pains in the examination of the somewhat complicated proposals in connection with capital transfers and other operations on the No. 2 Account.

Second Interim Agreement -February 1948

With the attainment of independence and with the fears of scaling down of the sterling balances laid to rest, the Reserve Bank's role was mainly one of making its expertise in the spheres of balance of payments and exchange control available to the Government to enable them to negotiate for releases adequate for meeting the estimated balance of payments deficits in both hard and soft currencies. As mentioned in an earlier chapter, the Bank began to take special steps during this period to compile scientifically balance of payments data, the lack of which was proving a great handicap to the Government in their formulation of trade and payments policy. Being responsible for implementation of the agreements, the Bank remained in close touch with both the Bank of England and the Government of India throughout, for watching the pace of withdrawals as well as for deciding the eligibility of various transactions for releases from the blocked Account (No. 2).

A delegation from the U.K. under Sir Jeremy Raisman visited India in January 1948 for further negotiations with the Government of India for releases from January 1, 1948. Although the negotiations led only to the extension of the agreement of 1947 on the same basic principles, and the new agreement was also an interim one to cover the period up to the end of June 1948, there was a significant modification caused by the failure of the convertibility experiment in the U.K.* and the worsening in that country's balance of payments position. There was

* Sterling became fully convertible on July 15, 1947 (in accordance with the Anglo-American Loan Agreement of December 6, 1945) but convertibility was suspended after a brief while, from August 21 of the same year.

also the partition of the Indian sub-continent consequent on which separate releases had to be made for Pakistan's account. From the Reserve Bank Mr. Cayley was again the participant in these talks which, on the Indian side, were conducted by Mr. Narahari Rao.

Under the extended agreement, which was entered into by exchange of letters between the leaders of the two delegations on February 15, 1948, a sum of £18 million was transferred from the No. 2 to the No. 1 Account of the Reserve Bank for meeting current expenditure up to June 30, 1948. However, unlike the earlier agreement where the entire £65 million was convertible into dollars, a sum of £ 10 million* only could be converted out of this release. India was expected to draw from the International Monetary Fund an additional sum of between \$40 million and \$52 million to make good the estimated deficit in her dollar payments. Although the convertibility of sterling had been suspended soon after the terms of the first interim agreement were negotiated, India's current earnings of sterling as well as the amounts released under this agreement had not been rendered inconvertible. The U.K. Government had, however, made an appeal to India to keep her U.S. dollar expenditure to a minimum. The proposed limitation on the extent of convertibility introduced a new factor in India's relationship with the sterling area which had so far permitted each of its members to draw on the foreign exchange resources of the area according to its needs. While the Government of India sympathised with the U.K.'s dollar position, they regarded the proposed limit of convertibility as low and hoped the restriction would be removed soon. †

As regards Pakistan, it was mentioned in the previous chapter that she was to negotiate separately with the British Government for releases beyond January 1, 1948. Thus, under the extended agreement, the Reserve Bank was to transfer from its No. 2 Account to the Pakistan Account (opened in terms of the Partition Council's decision of December 1947) the sums agreed between the Governments of the U.K. and Pakistan to be made available to Pakistan for her current requirements. The Reserve Bank was also to transfer from its No. 1 Account to the Pakistan Account a sum representing the receipts less payments on behalf of Pakistan between January 1, 1948 and the date of opening of the Pakistan Account in addition to the amount arrived at in terms of the Partition Council's formula on account of imports into Pakistan ports between July and December 1947. It was also agreed that in view of the arrangements in connection with the partition, the question of providing gold and dollars which it might be

* This included the U.S. dollar balances as on December 31, 1947 of banks in India in excess of their normal working balances, which by agreement was fixed at £1 million, and the whole of the remaining balance (of about £2 million) in India's Post-War Dollar Fund.

† Finance Minister's budget speech for the year 1948-49, paragraph 16.

necessary for Pakistan to pay by way of subscription if and when she became a member of the I.M.F. and the World Bank would be a matter between the Governments of the U.K. and Pakistan and not between India and Pakistan.

The Three-Year Agreement of July 1948

When the negotiations with the British Government were renewed in London in June-July 1948, the aim on the Indian side was to secure a long-term settlement to cover at least three years, with adequate safeguards for later years. It was also decided to take up at this time, the questions of fixation of a price for the British military stores and installations taken over by undivided India on April 1, 1947, settlement of all outstanding matters under the Defence Expenditure Plan and, if possible, reaching agreement on a scheme for capitalising the sterling pensionary and Provident Fund liabilities of the Government of India through the purchase of an annuity. The Indian delegation was a high-powered one led by the Finance Minister Mr. R. K. Shanmukham Chetty and consisting of the Reserve Bank Governor (Sir C. D. Deshmukh), the High Commissioner for India in the U.K. (Mr. V. K. Krishna Menon), two members of the Constituent Assembly (Sir V. T. Krishnamachari and Mr. T. T. Krishnamachari), Sir Purshotamdas Thakurdas and Mr. Laljee Mehrotra, President of the Federation of Indian Chambers of Commerce and Industry. The Governor was accompanied by Mr. P. J. Jeejeebhoy, who had since become the Deputy Controller of Exchange, and Mr. P. S. Narayan Prasad, Director of Monetary Research, as his official advisers. The Government of Pakistan also sent a delegation for participating in the talks.

The negotiations resulted in an extension of the agreement of August 1947 for three years, up to the end of June 1951, with some modifications. Letters were exchanged between Sir Stafford Cripps, Chancellor of the Exchequer, who headed the British delegation and Mr. Shanmukham Chetty on July 9, 1948, setting out the terms of the extended agreement. The main features of the agreement were:

- (a) A fresh release of £80 million from the No. 2 Account was to be made for the whole period, to be made available in annual instalments of £40 million each for the two years ended June 30, 1950 and June 30, 1951. No transfer was to be made for the year July 1, 1948 to June 30, 1949 in view of the balance already available in the No. 1 Account. At the time the negotiations began, India had accumulated current sterling of the order of £8 million in the No. 1 Account, as a result of the restricted import policy initiated in the middle of the previous year, and the anxiety not

to overstep the limit on convertibility fixed by the February 1948 agreement. It was, however, agreed that the arrangement for the release of the stated sums would be worked with flexibility and that the British Government would make advance transfers should India find during any period that she was running short of foreign exchange, that is to say, if the balance in the No. 1 Account fell below £30 million at any time during either of the first two years.

(b) Drawal on the central reserves of hard currencies for the first year July 1948 to June 1949 was fixed at £15 million (\$60 million) on the basis of an estimated hard currency deficit of \$160 million, of which India was expected to finance a portion, viz., \$ 100 million, by borrowing from the I.M.F.; this was in addition to India's own earnings of hard currencies during the period. For considering the adequacy of this amount, two important factors were borne in mind, viz., the removal of certain currencies from the hard currency list as from July 1, 1948 and the special arrangement proposed with regard to the convertibility of India's favourable balance with Japan.

(c) India was to pay to the U.K. a sum of £100 million in full and final settlement of the cost of the military stores and installations taken over.

(d) The outstanding amount due from the U.K. Government under the Defence Expenditure Plan was agreed at £55 million; of this, £8.95 million was to be paid to Pakistan as her share and the balance to India.

(e) An agreement was reached in respect of the sterling pensionary liability both of the undivided Government of India, which had been assumed by the Indian Dominion, and of the Provinces of India. The Government of India were to pay to the U.K. Government capital sums of £147.6 million and £ 20.5 million for the Central and Provincial pensions, respectively, in return for which they were to receive from the latter over the next sixty years tapering amounts for paying the pensions as they fell due. The immediate annual requirements were estimated at £6.3 million for the Central pensions and £950,000 for the Provincial pensions. The capital sums were to be paid from the No. 2 Account. The arrangement thus obviated the recurring drain on the No. 1 Account in respect of the pensionary liabilities. These amounts were arrived at on the basis of a rate of interest somewhat higher than that earned by the sterling balances as a whole.

(f) Further, the U.K. Government undertook to explore the possibility of securing for India from sterling area sources, certain raw materials which the latter used to obtain traditionally from

soft currency or sterling area sources, but which she had been forced to buy lately from the hard currency countries.

(g) There was to be 'continuing and close co-operation' between the two Governments to enable India to obtain the maximum benefit out of the agreement. This was done through the machinery of the Joint Consultative Committee consisting of representatives of the two Governments, which met periodically to review the working of the agreement.

As on July 2, 1948, the balances in the No. 1 and No. 2 Accounts were £80.58 million and £1033.23 million, respectively, as against £41.41 million and £1088.86 million, respectively, at the beginning of the year (January 2). During the half-year, drawings from the I.M.F. amounted to \$44.12 million. (The drawings which were first credited to the Reserve Bank's account with the Federal Reserve Bank of New York were immediately made over to the Bank of England, i.e., to the central reserves, against which a corresponding credit in sterling was made to the No. 1 Account.) The transfers to No. 1 Account together with £5 million transferred to Pakistan No. 1 Account opened on February 28, 1948 accounted for the fall in the No. 2 Account.

There were heavy demands on the balance in the No. 1 Account during the year July 1948 to June 1949 due to a liberalisation in the import policy, begun in the middle of 1948; Indeed, by the end of June 1949, advance transfers to the extent of £81 million had been made by the Bank of England from the No.2 Account to the No.1 Account so as to maintain the balance in the latter at about the agreed minimum of £30 million. There was also a heavy decline of over £400 million in the balance in the No. 2 Account due to the payment for capitalising the pensionary liabilities and for acquisition of the defence stores and installations, release of Pakistan's share of assets and the transfers to the No. 1 Account.

India's hard currency deficit also turned out to be much larger than could be financed by the drawal of the equivalent of £15 million from the central reserves, and the drawings from the I.M.F. which amounted to \$55.86 million (i.e., about £14 million) since July 1, 1948. The British Government agreed in February 1949 to advance India the necessary hard currency as an overdrawal till the next agreement. As on June 30, 1949, the overdrawal was estimated to be \$84 million; this was to be reimbursed to the U.K. from the convertible sterling to be made available to India for the period 1949-50.

Further Negotiations in mid-1949

An Indian delegation headed by Dr. John Matthai, Finance Minister of the Government of India, held discussions with the British Government

in London in June-July 1949 for the purpose of fixing the multilateral release for the 12 months ended June 1950, making arrangements for dealing with the overdrawal of £81 million during 1948-49, obtaining an additional release sufficient to meet the unexpectedly heavy drain caused by the operation of Open General Licence XI (introduced in July 1948 for imports from soft currency areas, as part of the liberal import policy initiated then) and increasing the previously agreed annual release of £40 million to £50 million. As in the past, the Reserve Bank assisted the Government in these negotiations, its representative being Mr. Jeejeebhoy from the Exchange Control Department. Sir C. D. Deshmukh, who was to relinquish charge of his post as Governor at the end of June, took part in the talks as Adviser to the Finance Minister at the latter's request. These bilateral discussions, particularly on the convertibility question, inevitably merged into the talks then being held with the Commonwealth Finance Ministers in London. As a result of the negotiations, not only was an additional release of £81 million made available for the year 1948-49, for which the 1948 agreement had made no provision, but the annual releases for the two years 1949-50 and 1950-51 were also raised to £50 million. The new agreement also provided for the release of an additional but unspecified sum sufficient to meet the cost of liabilities entered into under the old O.G.L. before its cancellation in May 1949. These liabilities were roughly estimated at £50 million. The existing arrangements for advance transfers from the No. 2 to the No. 1 Account to maintain the balance in the latter Account at an agreed minimum of £ 30 million were to continue.

Insofar as convertibility was concerned, the quantitative limitations on India's right to draw dollars from the central reserves were removed, that is to say, India was readmitted to all the rights (and duties) of full membership of the sterling area. However, as decided at the Commonwealth Finance Ministers' Conference, India, along with other members of the Commonwealth in the sterling area, was to keep her dollar-imports during the 12 months ended June 1950 down to 75 per cent of the level of such imports during the calendar year 1948. This in effect meant that India could draw on the central reserves to the extent of \$140-\$150 million, as compared with \$60 million (£15 million) in the previous year. Any imports financed from loans obtained from the World Bank were to be excluded from these calculations. Further, it was agreed that the overdrawal of \$84 million from the central reserves made during the previous year need not be reimbursed to the U.K.

The Reserve Bank was a net purchaser of sterling during both the financial years 1949-50 and 1950-51. With the introduction of severe restrictions on imports in the latter half of 1949 the trend of excess sales

over purchases which began in June 1948 was reversed in August 1949. The sharp improvement in India's exports after September (when the rupee was devalued) coupled with the decline in imports, was responsible for a net purchase of sterling to the tune of Rs. 186 crores by the Bank for the whole year, as against net sales for Rs. 70 crores in 1948-49. The foreign exchange position improved further the next year with a continued increase in exports, caused partly by the outbreak of the Korean War, and decline in imports; the Bank's net purchases of sterling in 1950-51 were thus larger than in 1949-50, at Rs. 314 crores. The trend was reflected in the balance in the Bank's No. 1 Account which went up from £39.3 million at the end of September 1949 to £137.5 million in the middle of May 1951.

Owing to the favourable balance of payments position during the year 1950-51, India had no occasion to use the sterling releases negotiated with the U.K. in July 1949. The decision to restrict dollar purchases to 75 per cent of the 1948 level was reviewed at the Commonwealth Finance Ministers' Conference in London in September 1950, and while the quantitative limitation was removed, the obligation still rested on members to secure the maximum economy in their dollar expenditures.

A brief mention may also be made here of the last of the series of sterling balances agreements although the formal exchange of letters took place only in February 1952. The agreement covered a period of six years from July 1, 1951, on the expiry of which the No. 1 and No. 2 Accounts were to be amalgamated. Discussions were held between the Indian Finance Minister (Mr. C. D. Deshmukh) and the British Chancellor of the Exchequer (Mr. Gaitskell) towards the close of 1950 in London, and broad agreement was reached on the size of the annual releases, etc. As with the earlier agreements, the Bank's Deputy Controller of Exchange (Mr. Jeejeebhoy) played a useful role in working out the detailed terms of the agreement. The agreement provided for the immediate transfer from the No. 2 Account to the No. 1 Account of a sum of £310 million, to be held by the Reserve Bank as a currency reserve; the Government of India were not to draw upon this sum without previous consultation with the British Government. The agreement also provided for an annual drawal of £35 million for each of the six years, with a measure of flexibility in that un drawn releases were available for being carried forward to later periods and limited advance transfers were also permissible.

The negotiations for extension of the 1949 agreement resulted also in the Bank being left free to conduct the investment of its sterling assets 'in accordance with general central banking principles and their (the Bank's) own statutory obligations'. There was an exchange of letters between the Bank of England and the Reserve Bank in October

1951 confirming the restoration of the Reserve Bank's freedom of operations which had been taken away in August 1947. This was, of course, to be subject to prior consultation between the Reserve Bank and the Bank of England as in the past, so as to avoid any undue disturbance in the London market as also to enable the former to avail itself of the advice of the Bank of England.

Exchange Control And Management

In the post-war years, there was hardly any evidence of the dismantling of the exchange control system built during the war. In fact, the general tendency, especially in the developing countries including India, was to widen the scope of the control and to put it on a permanent footing, with the necessary legislation to support it as an integral part of greater Government control over the economy, in the interests of speeding up economic growth. In India a separate Foreign Exchange Regulation Act was passed in 1947. In the early post-war years, while there was an attempt to relax the rigour of the controls in countries like India, which had built up substantial foreign exchange reserves, the position of debtor countries, especially the U.K., remained difficult. With few exceptions, like the U.S.A., member countries found it difficult to implement the International Monetary Fund's objective of restoring freedom in respect of current transactions between members. In fact, all but five members chose to avail themselves of the transitory provisions under Article XIV, permitting continuance of the exchange restrictions for some time until they were able to strengthen their balance of payments position sufficiently to do without them. It was only in 1961 that the Western countries and Japan were able to assume the formal obligations of convertibility under Article VIII of the I.M.F. The majority of the developing countries have not yet been able to opt for this status.

Exchange control in India continued to be modelled closely on the British pattern, as India remained a member of the sterling area and a participator in the Empire Dollar Pool. Modifications in the Indian exchange control system were brought about from time to time principally by the U.K.'s balance of payments position, general as well as

vis-a-vis the dollar area, as this determined to a large extent the amount of sterling available for India's use as also its convertibility into hard currencies. The two years 1945 and 1946 constituted a distinct phase of exchange control, when the system was gradually changed from one based on war-time conditions to one suitable for peace-time conditions. Particular mention should be made here of the numerous payments agreements which the U.K. entered into with European countries in order to facilitate the resumption of commercial and financial transactions with them and of the introduction, a little later, of the Transferable Account area with the ultimate objective of making sterling fully convertible. These arrangements affected India also, either directly or indirectly.

An important development in the field of Indian exchange control during this period was the introduction of control on exchange transactions with the U.K. and the other sterling area countries in July 1947.

As during the war years, the Reserve Bank acted as Government's adviser on all aspects of exchange control policy during the postwar years. The Bank had a vital advisory role in matters relating to import control, which largely set the pace for exchange control policy since expenditure on imports constituted the largest item of foreign exchange disbursements. The drafting of the Foreign Exchange Regulation Act was done mostly by the Bank. During this period, there were also some changes in the area of the control, consequent on the complete monetary separation of Burma and the partition of India.

In the field of exchange management, an important development was the *de jure* severance of the sterling-rupee link as a corollary to India's membership of the International Monetary Fund and the declaration of the par value of the rupee in terms of gold. The relevant provision of the Reserve Bank of India Act were suitably amended for the purpose. The Bank was also authorised to buy and sell foreign exchange, although actually it did not deal in foreign exchange other than sterling and Pakistan rupees. Another landmark was the devaluation of the rupee, effective September 22, 1949, by 30.5 per cent, that is, to the same extent as that of sterling. Many difficulties arose consequent on Pakistan's decision not to devalue her currency simultaneously, which disrupted trade and the payments arrangements between the two countries and led ultimately to the introduction of control on financial transactions with that country in February 1951. The Bank's advice was sought on these matters.

In this chapter, the fields of control where the Bank made significant contributions have been dealt with in some detail while other developments are touched upon briefly.

EXCHANGE CONTROL

Foreign Exchange Regulation Act

The powers under which the exchange control system was operated during the war were derived from the Defence of India Rules, which expired in September 1946. These were continued in force for a further six months (up to March 25, 1947) by the Emergency Powers (Continuance) Ordinance, 1946, promulgated on September 25, 1946, during which period a permanent legislative measure for the control of foreign exchange was drafted. This measure, called the Foreign Exchange Regulation Bill, 1946, was introduced in the Legislative Assembly in November 1946 and was passed in February 1947. The Act (VII of 1947) came into force on March 25, 1947.

The point whether the powers to control transactions in foreign exchange needed to be continued after the cessation of hostilities had engaged the Government's attention long before the end of the war. At one time, the Finance Department believed that exchange control would terminate with the close of the war but later, in September 1944, on a closer study it felt that the retention of the powers in this behalf was necessary at least temporarily until the post-war commercial and financial position was clear. It was however of two minds about having a single comprehensive legislation for the control of imports and exports as well as of exchange. As usual, the Bank's counsel was sought, both as to the need for an Exchange Control Act and the lines on which it could be framed. The matter was examined at length in the Bank. Its view was that whatever the policy in the future might be, a system under which operations in foreign exchange were completely unregulated was unlikely to return in any country; the monetary authority in India should therefore be given powers to control and regulate foreign exchange transactions within certain statutory limitations, in the same way as it had been given the power to control the internal supplies of money. The Bank thought also that the legislation should be framed in such a way that it would not only serve to carry on the existing system but would also allow this system to be modified or altered to meet post-war conditions without further amendment by the Legislature. The Government concurred. Matters relating to the legislation were not referred to the Central Board or its Committee at any stage. Mr. Cayley, Deputy Controller, was closely associated with the drafting of the Bill and its passage; he was also a member of the Select Committee on the Bill.

Before drafting the Bill, Mr. Cayley made an exhaustive study of the Defence (Finance) Regulations of the U.K. and the National Security Regulations relating to exchange control in Australia. Generally the draft followed the lines of the Defence of India Rules but several new sections were added, based on the U.K. or Australian regulations, which appeared to be necessary either to prevent the existing control being evaded or to fill certain lacunae in the rules. The first object of the new Act was to be to continue the existing powers given by the Defence of India Rules; the second was to establish a system of exchange control that would enable India (a) to carry out the obligations incumbent on members of the I.M.F. and (b) to manage her foreign exchange resources should the I.M.F. not come into existence or India not become a member.

Mr. Cayley suggested that a single Act be framed entitled the Import, Export and Exchange Control Act, which would be divided into parts covering Imports, Exports, Exchange and Securities. Exchange considerations would, in the post-war period, be the overriding reason for both import and export control and these control systems had, therefore, to be worked in very close liaison with the Reserve Bank. If two separate 'measures were enacted, he felt, the clause covering control over the proceeds of exports should be included in the Exchange Control Act rather than in the Import and Export Control Act, as it was primarily an exchange control measure. Eventually, it was decided to legislate separately for exchange control and for the other two control systems. *

Although the Bill for an Indian Exchange Act drafted by Mr. Cayley was sent to the Government of India in October 1944, Government could scrutinise it only after almost a year had elapsed, on account of other urgent preoccupations. Meanwhile, Mr. Cayley who had proceeded to the U.K. in July 1945 on furlough found that a new Exchange Control Bill had been drafted there to take the place of certain provisions of the Defence (Finance) Regulations. The Bill had not, however, been presented to the Parliament and was, therefore, still secret. The Governor, Sir Chintaman, who was also then in the U.K., considered that it would be prudent to delay the preparation of the final draft of the Indian Bill until the Government had had an opportunity of studying the British Bill. The Government were, however, keen to finalise the draft in time for its submission to the Legislature in the budget session of 1946 and desired that Mr. Cayley be made available to assist them in this work as also in drafting the Statement of Objects and Reasons and Notes on Clauses. The Governor thereupon again pointed out to the Government on January 17, 1946 that the Bank of England had informed Mr. Cayley before he left the U.K.

* The Imports and Exports (Control) Act, 1947 also came into effect on March 25, 1947.

that the authorities were postponing their Exchange Control Bill until the implications of the U.S. Loan Agreement had been fully worked out, e.g., it might not be possible to use the phrase 'sterling area' in the future; thus, it was desirable to put off the finalisation of the Indian Bill until these points were clear. Incidentally, Government modified the title of the Bill from 'Indian Exchange Bill' to 'Indian Exchange Control Bill'; it was later modified to Foreign Exchange Regulation Bill as possibly being more acceptable to the Legislature which disliked the idea of 'controls'. Simultaneously, the Governor requested the Bank of England to indicate, if it was possible for it to do so, whether the terms of the American loan, if sanctioned, would necessitate any radical alteration in the sterling area system, for the Indian Bill was drafted on the lines of the Defence of India Rules which permitted transactions freely within the sterling area. The Governor also desired to know if the introduction of the Bill in the U.K. was being postponed specifically for these reasons.

The Bank of England replied more than a month later, on February 22, 1946, after consulting Whitehall. The introduction of the U.K. Bill was being delayed for various reasons, of which one was that a public discussion of the issues involved was undesirable when the question of ratification of the loan was before the U.S. Congress. The Bank of England added, however, that the general lines of the exchange control administration would not be greatly modified, though it was probable that the Bill would be drawn in wider terms than the Defence (Finance) Regulations and would reflect the more permanent nature of the new legislation. The concluding remarks of the Governor of the Bank of England were:

The main purpose of our exchange control in future will be to supervise capital transactions between residents of the Sterling Area and nonresidents. I believe this policy to be essential during the very difficult conditions we shall meet during the next few years. It rests on the assumption that India and the Dominions will enact comparable legislation.

From then onwards, there was close consultation with the Bank of England, both directly and through the Secretary of State for India, on the various aspects of the control system that were to be covered by legislation. There was, however, no suggestion from the British side that the Indian legislation should be held up pending the decision of the U.S. Congress on the Loan Agreement. Nevertheless, the Indian Bill was not introduced in the budget session of the Legislative Assembly in 1946. Meanwhile, the draft Bill was revised further in the light of the discussions which Mr. Cayley had with officials of the British Treasury and the Bank of England in March 1946 on his way back from the U.S.A. after the meeting of the I.M.F. in Savannah

(where he had accompanied Sir Chintaman) but the material could not be sent to Government before the middle of July 1946.

The Defence of India Act was to lapse on September 30, 1946, and it was clear that the Bill could not be passed by the Legislature before that date. Of the two alternatives proposed by Government for continuing the legal backing for exchange control pending the enactment of the Bill, viz., to enact by Ordinance the revised Bill prepared by Mr. Cayley or to continue by Ordinance the relevant Defence of India Rules under which the system was being operated, the Governor favoured the first alternative. The reasons, in Mr. Cayley's words, were:

It seems to us that with the general prejudice against the Defence of India Rules even though the measures framed thereunder are desirable and in the interests of the country, it would be easier to get a new Exchange Control Act passed which is a continuation and in confirmation of an existing measure even if it had been promulgated by Ordinance than it would be to put through a Bill which is intended to carry on powers derived from the Defence of India Rules. Also, if there are fundamental constitutional changes in the near future in order that Government can continue at all, it will probably be necessary to pass a general measure for the continuation of existing legislation with modifications as to area of application, etc., and if the Exchange Control regulations are based on an Act even though it had been enacted by Ordinance, it will probably be a simple matter for it to be continued along with other Statutes, while the framing and passing of a new Act in continuation of the Defence of India Rules might on the other hand be difficult to accomplish in time.

With regard to the objection raised by you to this proposal, I do not think that the present draft Bill goes beyond the Defence of India Rules except to a very small degree, as the additions in the Act are merely the conversion of existing rules which have been made by Reserve Bank into legislative form, while in certain instances the new Bill has less stringent provisions than the Rules especially in regard to penalties, powers of search, etc.

Government, however, preferred the other alternative as a matter of general policy. The Emergency Provisions (Continuance) Ordinance 1946, promulgated on September 25, 1946 and which came into effect on October 1, 1946, continued for six months from the date of its promulgation the validity of the Defence of India Rules pertaining to exchange control as well as many other aspects of control in regard to which permanent legislation was necessary but had not yet been undertaken.

The Foreign Exchange Regulation Bill was introduced in the Legislative Assembly on November 6, 1946, and came up for consideration on November 12. The Finance Member, Mr. Liaquat Ali Khan, who piloted the Bill, explained in his opening remarks that after very careful consideration Government had come to the conclusion that it was

necessary to continue exercising control over foreign exchange transactions not only in India's own interests so as to ensure the best use of the foreign exchange resources in implementing the Government's programme of industrialisation and development, but also in virtue of her position as a member of the I.M.F. to promote exchange stability and to maintain orderly exchange arrangements. After a short debate on November 12, the Bill was referred to a Select Committee consisting of 17 members. The Bill was welcomed generally by all the Members who spoke. As Mr. Cayley reported to Mr. P. S. Beale of the Bank of England, 'the only criticism that was voiced against the Bill was doubts as to whether it was sufficiently stringent. There is of course under present conditions no opposition in the Assembly'.

The main feature of the Bill was that it was purely an enabling measure, and the majority of the clauses would not come into effect except under notification by the Central Government. As the Statement of Objects and Reasons put it:

the provisions of the Bill have been drafted in such a manner that the degree of restriction on foreign exchange transactions can be relaxed or increased by executive orders, either generally or for particular foreign currencies, in accordance with the needs of trade and finance or international agreements thus ensuring that flights of capital or wild speculation, which proved so injurious to foreign trade in the period between the two wars, can be immediately controlled.

The legislation was to extend to the whole of British India and also to all British subjects in India even if they were resident outside British India. This provision was necessary to guard against evasions of the Act by persons residing in Indian States operating through agents in British India. The Bill incorporated the provisions of the Defence of India Rules or of notifications issued thereunder relating to the licensing of authorised dealers in foreign exchange, the imposing of restrictions on the acquisition of foreign exchange and on payments to or on behalf of non-residents, the opening of blocked accounts, exercising control over exports, placing restrictions on transactions in securities and on the export of gold and currency, and the vesting of powers in Government to call for information regarding private holdings of foreign securities as well as foreign exchange and to requisition such holdings if necessary. The import of gold, silver and currency notes, which was hitherto regulated by the issue of notifications under the Sea Customs Act, was also covered; as the restrictions were being imposed for exchange control purposes it was considered desirable to have the powers incorporated in this Bill. Government also reserved the right, as in the Defence of India Rules, to levy a licence fee on imports of gold and silver and took powers to regulate the use of imported gold and silver.

There were several new provisions, such as: the restriction on the rates at which transactions in foreign exchange could be entered into, necessitated by the provision in the Articles of the I.M.F. which set a limit to the fluctuations in exchange rates; the prohibition on the creation of trusts in favour of non-resident beneficiaries in order to supplement the regulations on the transfer of money or securities to nonresidents ; the provision empowering Government to require the deposit of bearer securities in authorised depositories or to prohibit the issue of bearer securities, for preventing transfers on capital account evading the control imposed by the restrictions on transfer of securities to nonresidents; the prohibition on the transfer of the controlling interest in a company from Indian or British* hands to non-residents; the restrictions on the grant of accommodation to companies controlled by nonresident interests other than British* interests; and the provision empowering the Government to set up special or clearing accounts which would be necessary for the working of bilateral trade or payments agreements with countries which were not members of the I.M.F. The Government also took powers to call for information of a general or special nature so as to be able to fulfil the obligation to supply information to the I.M.F. as and when required. Another important provision was the power of Government to give directions to the Reserve Bank for the purposes of the Act, the Bank being obliged to comply with such directions. In regard to securities control, the Reserve Bank did not consider it necessary to go as far as the Bank of England wished to, as enemy or non-sterling area holdings of rupee securities were negligible and the market in bearer securities in India was also small.

The most important feature of the Bill was, however, that unlike the Defence of India Rules: the use of the term 'sterling area' was avoided throughout and powers were taken to impose exchange control between India and the rest of the world including the sterling area countries. Apart from the consideration that a term such as the sterling area could not be used for the purpose of singling out countries outside the group for the application of exchange control without infringing the obligations under the Bretton Woods Agreement, it was impracticable to include it in a permanent legislative measure as it was likely to lose its existing meaning in the course of the next few months. When sterling became multilaterally convertible under the terms of the Anglo-American Loan Agreement, the U.K. would possibly be precluded from controlling transfers from the sterling accounts of residents in India to the sterling accounts of U.S. residents. Thus, if transfers between India and the U.K. remained unrestricted, it could result in unauthorised

* The preferential treatment accorded to British companies, which was necessary in view of certain provisions in the Government of India Act, 1935 (which required that no distinction should be made between Indian and U.K. commercial interests) was withdrawn by an amendment to the Foreign Exchange Regulation Act in April 1950.

transfers to the U.S.A. or other 'hard' currency countries for purposes for which India herself would not have granted any exchange. It was, therefore, considered necessary to provide for control between India and the U.K. (and other sterling area countries) being exercised without amending the Act. At the same time provision was made for the granting of exemptions by the Reserve Bank and it was intended that when the Act came into force transactions with sterling area countries should be exempted.

In the U.K. Bill, certain territories were specified in the First Schedule, the Treasury having powers to add to, or exclude territories from, it. There was to be no exchange control on transactions with these 'scheduled territories', which were the same as those in the existing 'sterling area' group. Thus, the position under the Indian and the English Bills was, in effect, the same. The Select Committee on the Indian Bill considered recasting the Bill on the lines of the British Bill as certain members considered that restrictions on transactions with the U.K. were unnecessary in view of the large holdings of sterling, but decided against that course, the reason being that 'in view of India's new status it was not desirable to include in a new Act a schedule of territories to which exchange control restrictions would not apply, as this might give the impression that India wished to continue permanently the system of pooling her foreign exchange resources which is a feature of the present sterling area arrangements'.

The Select Committee's report which was submitted on February 3, 1947 was almost unanimous, there being a minute of dissent by Sir Cowasjee Jehangir on only one recommendation. viz., the decision not to exclude the sterling area by providing a Schedule of 'scheduled territories' and making Government's intentions explicit. An important change made by the Committee was to limit the validity of the Act to five years in the first instance, giving powers to the Government to extend it by a further period not exceeding three years. † The Bill, as amended by the Select Committee, was passed by the Legislative Assembly without any change on February 10, 1947, and by the Council of State on February 25. It received the assent of the Governor General on March 11 and came into force on March 25, 1947, the date on which the Emergency Powers (Continuance) Ordinance, 1946 expired.‡

The Finance Member's speech at the second reading of the Bill was devoted, at the Bank's instance, to a statement of the policy which the

* Finance Member (Mr. Liaquat Ali Khan)' speech on February 10, 1947 during the second reading of the Foreign Exchange Regulation Bill.

† This clause was amended in February 1952, extending the life of the Act till December 31, 1957. The Act was made a permanent measure by an amendment, deleting the clause, in September 1957.

‡ The British Act was also passed in March 1947 but came into force much later, on October 1, 1947.

wide powers given under the Act would be used to implement. He stated that India had advised the I.M.F. that she wished to take advantage of the transitional arrangements under Section 2 of Article XIV of the Fund which would permit her to continue for a minimum of three years any exchange control measures she considered necessary in order to maintain her balance of 'payments in equilibrium. Thus there would be no appreciable changes in the existing system of exchange control when the I.M.F. commenced operations in March that year. (As the Governor had pointed out to Government earlier, even the U.K. had elected to avail herself of the transitional arrangements, which meant that although she had undertaken to make sterling multilaterally convertible by the middle of July, she was not prevented from maintaining general restrictions on current payments so that she could limit the amount of fresh convertible sterling created.) However, Government's aim and policy were to achieve the multilateral convertibility of all currencies including the rupee as soon as possible and therefore to confine the restrictions to those necessary to ensure control and regulation of capital movements. In the words of the Finance Member, the exchange control system would be operated so as

to permit nearly all transactions of a current nature subject to certain restrictions as to amount, to ensure that capital is not being transferred in the guise of a current payment and in addition to allow moderate transfers of capital where such amounts are required for trade purposes such as for the establishment of overseas branches of Indian trading firms and for banking and insurance operations.

The Governor had also brought to the Government's notice in January 1947 that there were persistent reports, particularly among the European community, that as soon as the Act was passed the Government would place an immediate embargo on all sterling remittances. In fact, there had also been reports in the press to the effect that sterling might be declared as a 'foreign currency' and British employees were so alarmed that many even contemplated giving up their jobs so that they could transfer their savings, etc., in time before the freedom of transfer of capital was extinguished. The position was complicated by the fact that the British Government might not release any extra sterling, outside the balances with convertible rights, to meet an adverse balance of payments between India and the U.K., in which case some regulation of movements of capital to the U.K. would have to be introduced. This would, of course, not have meant imposing any restrictions beyond what already existed in the case of non-sterling area nationals, who were permitted to take their Provident Funds and reasonable savings with them when they retired to their own countries; but to allay popular misapprehension, the Governor suggested that Government issue a press note. The Bank later suggested that the matter be covered

in the Finance Member's speech very tactfully so as to avoid a panicky flight from the rupee. The Finance Member dwelt on the subject thus:

the Act was not framed by Government with the intention of making any sudden changes in the existing Exchange Control system immediately it comes into force and it is the present intention of Government to instruct the Reserve Bank to issue the necessary notifications to allow payments to continue to be made freely to other countries in the sterling area. It is only common prudence to recognise, however, that circumstances might arise or develop in which it may not be possible to continue this system indefinitely as freedom to allow capital payments as distinct from current transactions must depend on our having freely available to us sterling to meet any resulting adverse balance in payments.

I am hopeful, Sir, that conditions will not emerge in which any restrictions on the release of sterling to meet the repatriation of British capital from India are called for. But whatever the occasion or extent of any such restriction might be, I cannot foresee any set of circumstances, of which India has control, in which Government would deem it essential to apply such restrictions to transactions other than large transfers of capital, and to place restrictions on normal remittances from India to the United Kingdom or on the transfer of provident funds and savings by British nationals returning to their own country.

Following the introduction of the Act fresh notifications corresponding to those so far in force, covering the import and/or export of money, gold and silver, and jewellery, the surrender of U.S. dollar balances, the registration of U.S. dollar securities and the surrender of the foreign exchange proceeds of exports to certain countries, were issued both by the Government of India and the Reserve Bank for continuing the existing scheme of control. General permission was granted by the Reserve Bank for the continuance of transactions with countries inside the sterling area as under the Act this had been prohibited except with the sanction of the Reserve Bank.

In order to simplify the existing procedure and to obviate delays in dealing with applications, authority was delegated to the authorised dealers to approve certain types of remittances which hitherto had to be referred to the Reserve Bank for prior sanction. The process of delegation of powers by the Reserve Bank to the authorised dealers was in fact a continuing one; from time to time powers to administer new regulations were transferred to banks after the Bank had gained sufficient experience of their working and devised adequate safeguards against evasion.

Extension of Control to the Sterling Area

When the Finance Member announced during the second reading of the Foreign Exchange Regulation Bill in the Legislative Assembly that Government did not intend to impose any restrictions on transactions

between India and the rest of the sterling area, no agreement had yet been reached on the withdrawals from the sterling balances, although negotiations had commenced with the U.K. Government during the visit to India in February 1947 of the mission headed by Sir Wilfrid Eady. The announcement was intended to dispel the widespread fears that with the passage of the Bill, there might be a flight of British capital from India in anticipation of the imposition of such restrictions particularly in the absence of any agreement between the two Governments on the free availability of the sterling balances even for the purpose of meeting an adverse balance of payments between India and the U.K. or to meet the repatriation of British capital from India. Even otherwise, there was the possibility that when sterling became multilaterally convertible on July 15 and the sterling area arrangements were either terminated or modified, some restriction on payments in sterling area currencies would become necessary, as all foreign currencies would then be of *equal* value to India and her sterling resources would have to be conserved and used judiciously in much the same way as U.S. dollars or Swiss francs. With a view to keeping a close watch on remittances from India in sterling area currencies, pending the completion of satisfactory arrangements with the U.K., the Bank instituted, in April 1947, steps to collect detailed statistics of such remittances from the authorised dealers. To be able to act quickly if the need arose the Bank also got ready in May in consultation with Government, the necessary notifications and circulars to authorised dealers.

On July 1, 1947, the India Office alerted the Government of India of the possibility of large scale capital transfers from India following the announcement, to be made shortly, of Egypt's decision to leave the sterling area, and suggested that early joint action should be taken to control Indian balances until an interim arrangement was agreed upon. The Bank of England took up the matter simultaneously with the Reserve Bank and emphasised the need for immediate extension of exchange control in India to cover sterling payments in all directions. The Government of India and the Reserve Bank did not think that the announcement of Egypt's agreement with the U.K. would precipitate any such development as was feared by the British authorities. Besides, Sir Chintaman felt that the balance of advantage lay in not advancing the date of imposition of the various controls that would have to come in on July 15; in fact, it was considered preferable to wait until after the return of the Indian delegation (for the sterling balances negotiations) from London in the beginning of August, as it was not even clear whether India would remain in the sterling area and it would be impracticable to introduce radical changes on July 15 and to follow them up with further changes a week or two later. Should there be any evidence of commencement of a flight from the rupee, capital transfers were to be

prohibited immediately, the new general measures of control coming later, after the results of the London discussions were known. Government advised the Secretary of State that they were watching the situation closely and had found no signs of any substantial movement of funds from India to the sterling area in anticipation of impending changes in the exchange control regulations. They added, however, that arrangements were well in hand to meet any situation arising from an indiscriminate remittance of funds from the country. The Reserve Bank replied to the Bank of England similarly.

While the Bank's reply went out on July 2, and Government's on July 4, 1947, the situation changed within a few days. Heavy sales of sterling to banks by the Reserve Bank averaging £1½ million a day since July 5 and the large sales of rupee securities by the Hyderabad State to the Bank for the purpose of investment of the proceeds in sterling securities led the Governor (who had been given full discretion to act) to decide that it was time to introduce the contemplated restrictions on sterling. As arranged, the Government of India issued a direction to the Bank on July 7, under the provisions of the Foreign Exchange Regulation Act (Section 25), to the effect that all capital remittances outside India were prohibited with immediate effect. On its receipt on July 8, the Bank issued notifications cancelling the general permission granted for transactions in sterling area currencies and authorising the maintenance of existing accounts in these currencies by persons domiciled in India. Limits were laid down for the various classes of remittances to the sterling area countries, normal trade payments being however allowed without any restrictions. The controls imposed were in the nature of a standstill arrangement pending the institution of more definite measures in the light of the result of the negotiations then being held in the U.K.

To ensure that the restrictions on capital remittances to sterling area countries introduced in July were not evaded, on August 4, 1947 the Government of India issued two notifications extending as from August 19 the export control procedure to all countries outside India except Afghanistan, Tibet, Nepal and Portuguese and French India.

India continued to remain in the sterling area under the interim agreement on sterling balances with the U.K. Government concluded on August 14, 1947, but further restrictions were imposed on remittances in sterling area currencies. This was necessary because of the limited drawal on the sterling balances agreed to by the U.K. The arrangements now made between India and the U.K. were similar to the transferable account arrangements entered into by the U.K. with the other countries, except that owing to India's remaining a member of the sterling area, the suspension of the convertibility of the sterling held in such accounts into U.S. dollars (with effect from August 21, 1947) was

not applied to her holding in the No. 1 Account. Remittances against imports from sterling area countries were as from September 1 subject to the same conditions as for imports from non-sterling countries; in many other directions also remittances to countries in the sterling area were to be treated in the same manner as those to countries outside it. It was also found necessary to introduce certain restrictions on the operations of authorised dealers in sterling and to bring under control their own holdings of sterling and sterling securities. This was done in terms of letters exchanged between the Governors of the Bank of England and the Reserve Bank after the conclusion of the interim agreement on sterling balances which made no reference to, and therefore excluded from its purview, the sterling holdings of banks authorised to deal in foreign exchange in India. In order not to restrict unduly movements of capital in the sterling area, a provision was made under the agreement for certain capital sums, e.g., the savings of British nationals retiring from India and taking up permanent residence in the U.K., to be paid out of the No. 2 Account (that is, the blocked Account) of the Reserve Bank with the Bank of England. Control over transactions in sterling area currencies continued thereafter, its nature and extent varying with the balance of payments position of the country from time to time and the quantum of the releases made by the U.K. under the subsequent sterling balances agreements.

Import Control Policy

In the immediate post-war years, there was need for large imports of capital goods as well as food, besides consumer goods, for meeting the backlog of war-time demand. On the other hand, there was uncertainty over India's continuance in the sterling area Dollar Pool; the scale of withdrawal from the accumulated sterling balances was itself a matter for negotiation with the British Government. In these circumstances, and with the restoration of communications and the reopening of trade with the enemy countries which made a wider choice of the sources of supply possible, exchange considerations became more important than freight in determining the countries from which imports could be permitted and their quantities.

As already mentioned, from September 1, 1947, the conditions applicable to remittances against imports from non-sterling countries were extended to remittances in respect of imports from the sterling area; in other words, duplicate copies of import licences and Customs bills of entry had to be issued for exchange control purposes, in regard to sterling area imports also, as from that date. This brought in its wake an enormous increase in licensing work. The availability of multilaterally convertible sterling in terms of successive sterling balances agreements

set a new limiting factor to imports. Throughout these years, the Government relied much on the Bank to advise them on the direction of import control policy. In fact, it would be correct to say that changes in the policy, particularly during 1946-48, were made almost entirely on the Bank's advice and initiative. The Bank, with its close contact with the authorised dealers and through them the import trade, made many suggestions (which were implemented practically in toto) for streamlining the administration of import control and for removing vexatious delays.

The 'Consumer Goods Drive' which the Government of India had started at the close of 1943 to relieve the very serious inflationary position had led to a substantial increase in the licensing of imports of consumer goods even from countries outside the sterling area, including the U.S.A., during 1944-45. When the U.K. gradually became able to meet more of India's demands, they were switched back to the U.K. In July 1945, the British Government decided to allow small quantities of imports from Canada and the U.S.A., even if these goods were available in the sterling area, provided that the goods were essential and there were established trade connections through which the U.S.A. was the normal supplier of such goods before the war. The Government of India fell in line with this policy.

A major change in the import policy for the half year July-December 1946 was initiated by Governor Deshmukh in April 1946. The figures of India's balance of payments during the preceding few months showed that contrary to the earlier fears India was running an increasingly favourable balance with almost all countries, owing to an increase in exports combined with an extremely restrictive licensing policy for imports from the U.S.A. following the cessation of Lend-Lease aid in September 1945 and the stringent dollar position of the sterling area. Hence the Governor urged the Government strongly to adopt a more liberal import policy which would slow down the rate of sterling accumulation without harming India's interests and also serve as an anti-inflationary device. He advocated increased purchases from outside the sterling area also.

The Governor was also greatly concerned with the delays experienced by Indian importers in obtaining licences from the Import Trade Controller, which prevented India from getting a share of the limited supplies of goods available from Continental sources. The Import Licensing Department was not administratively geared to handle the large increase in applications and a thorough reorganisation and expansion were called for immediately. While not overlooking the need to control the import of goods which would compete with those produced by nascent Indian industries, the Governor suggested that the import of certain ranges of goods which was only subject to restrictions

on exchange grounds be allowed under *open general licence* as this would give considerable relief to the Import Trade Controllers and speed up the issue of licences for goods whose import had to continue to be restricted.

The Governor's suggestions resulted in the addition, early in July, 1946, of a large number of items to the existing Open General Licence No. VII (introduced in January 1946) which permitted the import of goods from Empire countries within the sterling area without individual licences and the issue of a new *universal* Open General Licence No. VIII covering the import of a limited range of goods from all countries. At the Bank's instance, the validity of import licences was also raised in July 1946 from six months to one year, to assist importers as well as the authorised dealers through whom the letters of credit were opened. Henceforth, Government's policy was to allow import of goods from outside the sterling area provided two conditions were fulfilled, viz., that (1) the goods were 'essential to the maintenance and development of the national economy or the maintenance and increase of the standard of life' and (2) they were not available in the sterling area. There was to be no question of imposing any ceiling on dollar (or other difficult currency) expenditure for the import of goods. Thus an impetus was given to the import of a large variety of consumer goods.

However, much to his chagrin, the Governor found very soon that his representations to Government in April 1946 had resulted in a more or less complete abandonment of all control over the import of consumer goods. The full effects of the relaxation began to be felt in the last quarter of 1946 when imports began to arrive in large quantities. The value of licences issued during the quarter October to December 1946 for imports from the U.S.A. was well over \$500 million. Alarmed at the huge orders already-placed for such articles as fountain pens, pencils, parachutes, combs, mirrors, imitation jewellery and toilet requisites, the leading banks themselves, the Governor found, were tightening up their policy for granting letters of credit facilities to holders of import licences and were also raising the margin requirements. What was even more disconcerting was that control was still exercised over essential goods such as machinery, tools and agricultural implements for which licences were only issued on a quota basis to established importers often on the basis of the value of their pre-war imports, even these being subject to inordinate delays.

In January 1947, Sir Chintaman wrote strongly to Government, bringing these facts to their notice. The inflationary dangers apparent in April 1946 having receded now, he urged that Government should lose no time in taking stock of the position and reimposing restrictions wherever required. He also suggested that Government consider introducing the same system of licensing imports of consumer goods on a

quota basis to established importers as operated in the case of the more essential goods.

Simultaneously, the Governor made certain other suggestions for a thorough revision of the import licensing policy to meet the needs of the situation when sterling became multilaterally convertible. Nearly 75 per cent of the reduction of £ 100 million in India's sterling balances since April 1946 represented a deficit in India's balance of payments on current account. In the Governor's view, India could not afford such a large adverse balance of payments in the future especially as drawings from the I.M.F., permissible up to Rs. 33 crores in a full year, would have to be reserved for meeting unexpected deficits caused by monsoon failures or other unforeseen contingencies. Steps would have therefore to be taken immediately to bring such a situation under control.

The Governor reasoned that the only practical method by which import control could be administered in the future was to constitute a standing departmental policy committee as in the U.K. or a Foreign Exchange Control Board as in Canada on which representatives of the spending departments of Government (e.g., Industries and Supplies, and Food), the Commerce Department and the Reserve Bank met under the chairmanship of the Finance Department to allocate the available foreign exchange, including sterling, among competing demands. In other words, the existing qualitative licensing had to give way to a system of quantitative licensing. The tasks of this committee were elaborated by the Governor thus:

The first action of this Committee must be to make an estimate of foreign exchange resources both actual and prospective. This will have to be based on crop forecasts and calculations as to the volume of exports of primary commodities. The statistical tables compiled by the Reserve Bank on a monthly basis and the Customs returns will act as a check on the estimates and show to what extent they can be relied on. Once this is done, the Committee must fix the amount of foreign exchange that can be allotted for different categories of imports, food, fertilisers, capital goods, consumer goods, petroleum products, raw materials such as cotton and wool, and miscellaneous commodities, and on the basis of these allotments import licences can be issued. The Committee must work out long term plans covering import programmes for a year or longer, but it must always be prepared to revise its policy with changing conditions. For that reason, the Committee must meet regularly and frequently. When sudden and unexpected demands for foreign exchange arise, the importance of the new demands must be considered in relation to the existing programme and adjustments made by reducing expenditure on other goods which are less essential. Alternatively, in the event of an unexpected expansion in exports resulting in an increase in foreign exchange holdings, a decision must be made whether to let the foreign exchange accumulate to meet the cost of capital goods imports in the future or whether to allow the windfall to be used to relieve existing shortages in goods for current consumption.

The Governor also suggested to Government that advantage be taken of the offer of Sir Wilfrid Eady to allow some of their officers to study the *modus operandi* of the Treasury Committee which had the task of estimating and allocating the foreign exchange resources of the U. K. To this end, he proposed that the officer of the Finance Department who would be associated with the committee and the Chief Controller of Imports be sent to London. Taking up the theme with the Chief Controller of Imports, the Governor made detailed suggestions for facilitating the change-over of the licensing system to one based on allotments of foreign exchange, and to enable it to operate with flexibility and efficiency. He also urged that senior officials of the Commerce Department should study the practices and procedures of the Board of Trade in the U. K., which had gained considerable experience in this difficult matter.

The Governor's advice to Government resulted early in March 1947 in the cancellation of O.G.L. VIII and in the termination of the validity of all import licences issued since January 1, 1947 and permitting shipment up to December 31, 1947 (other than those for the import of capital goods) on June 30, 1947. During the next few months, there was almost complete chaos as considerable time elapsed before procedures were devised for extending beyond June 30 the validity of those licences which covered essential imports, and for issuing licences for import of articles covered by O.G.L. VIII where firm commitments had already been entered into by the Indian importers with the overseas suppliers. Besides, the issue of new licences against all types of commodities other than those covered by O.G.L. VII and capital goods was suspended by Government for quite a while pending a decision as to the articles whose import was to be restricted. In the middle of May, the Government announced that on a review of the entire import trade control policy they were cancelling forthwith O.G.Ls. I and III applicable to imports from Ceylon, Portuguese possessions in India and other neighbouring countries and substituting O.G.L. VII applicable to imports from the U.K. and other Empire countries (except Canada, Newfoundland and South Africa) by a new O.G.L. IX covering a limited number of items. Goods covered by these cancelled Open General Licences (including O.G.L. VIII) were, however, to be allowed to be imported without a licence provided shipment was made on or before June 30, 1947. Where such shipment was not possible but firm orders had been placed or letters of credit opened before the dates of cancellation, licences were to be issued valid for shipment up to September 30, 1947. Licences expiring on June 30 under the March order were to be similarly revalidated up to September 30, on individual application.

These far-reaching changes in import policy as well as the extension of exchange control to sterling area imports threw an almost impossible burden of work on the Import Trade Controllers and importers were put to extreme difficulties and inconvenience by the delays that occurred in the revalidation of licences or in the issue of new ones. There was also delay in the announcement of the policy for the second half of 1947. Throughout, Mr. Cayley kept in close touch with banks and importers in the ports and made innumerable suggestions to the licensing authorities for speeding up the work. The confusion continued till practically the end of 1947 but Government did not realise the seriousness of the situation, as could be seen from the Finance Department's remark that 'in the period of administrative change through which we have been passing, a certain amount of confusion was inevitable'. This attitude was not relished by the Bank and on its strong recommendation as well as in the interests of the reputation in the foreign markets of not only the Indian importers concerned but also the country at large, the Government agreed to remittances of foreign exchange being made against all goods actually imported into the Dominion of India up to December 31, 1947, regardless of whether the importers had import licences or not. In order that the flow of trade might not be interrupted and the commitments already made might be honoured, the Government also extended the validity of the licences issued or revalidated up to September 30, 1947 for a further period up to December 31, 1947; imports under the cancelled O.G.Ls. were likewise allowed to be made during this extended period without licences if certain conditions were fulfilled.

The licensing policy for the half year July-December 1947, which Government announced on July 3, 1947, classified imports into three categories, namely, (i) free (food, capital goods and certain essential raw materials and consumer goods), (ii) restricted (certain raw materials and consumer goods which would be licensed up to specified value ceilings) and (iii) prohibited (luxury items). There was to be no distinction between hard, soft and sterling area currencies, all foreign exchange being considered equally difficult. Thus, the Governor's suggestion for quantitative licensing of imports had been accepted by the Government fully. Individual import licences also came to be issued thereafter with the c.i.f. value as the limiting factor in all cases.

There were many other problems faced by the import licensing authorities, on which the Bank made suggestions to Government. The Bank also made recommendations with regard to export promotion, being an essential concomitant of the policy of restricting imports.

After 1947, the Bank's role in this field was more in regard to advice on administrative problems, particularly in the matter of the types of payments for imports from different countries, which changed frequently,

rather than in the sphere of policy. Import policy in the subsequent years was determined largely by India's balance of payments position, with the hard and soft currency countries separately and the ceilings imposed on the drawals from the sterling balances. An important change made early in 1948 was the abandonment of the policy of non-discrimination regarding the sources of imports, which had been a feature of import control earlier; a distinction between dollar and non-dollar sources of supply was made so as to bring imports from the former under stricter control. A noteworthy step towards the smooth and efficient administration of import controls, the origin of which could perhaps be traced to the Governor's suggestion for the constitution of a departmental policy committee, was the announcement by Government on September 27, 1948, of their decision to set up an Import Advisory Council. Consisting of representatives of industry and commerce and of the different Government Departments, Members of the Legislative Assembly and non-officials, the Council met for the first time on February 26, 1949. In September 1948, it was also arranged that the Deputy Controller of Exchange should visit New Delhi twice a month and also attend the inter-Ministry meetings whenever possible, with a view to establishing closer, liaison between the Bank and the Government in matters pertaining to import, export and exchange policies.

When the Post-War Dollar Fund was established, the Government of India worked out a procedure in consultation with the Bank to ensure that drafts were made upon it only in appropriate cases. Expenditure was debitable to the Fund in respect of specific categories such as the import of capital goods which came under the Capital Goods Registration Scheme (introduced in December 1944 for registration with the Chief Controller of Imports of orders placed or to be placed for capital goods), import of heavy electrical plant (these two categories of licences bore special notations, viz., C.G.P.W. and H.E.P.), imports of capital goods on Government account and the employment of American technicians on new industrial undertakings. Under the arrangements made, the expenditure was initially to be financed by drawings from the Pool and the Bank of England was to debit the Fund and credit the Pool on receipt of periodical statements from the Reserve Bank showing the allocations made against the Fund and the expenditure incurred against these allocations.

As mentioned in Chapter 12, the Post-War Dollar Fund ceased to exist after June 30, 1948, the unexpended balances therein having been treated as part of the amount of convertible sterling released under the second interim agreement of February 1948 on the sterling balances with the British Government.

Bullion

The licensing of imports of gold and silver bullion was a function of the Reserve Bank and not of the Import Trade Control.

Since 1940, a system of licensing imports of silver had been operated by the Reserve Bank, the object of which primarily was to control the price of silver in India. A licence fee was charged, taking into account the current parity with the country concerned, so as to reduce the margin of profit to the importer to a level of about Rs. 3 per 100 tolas. From about the middle of 1943 onwards, the Bank's licensing policy was based on the essentiality criterion in line with the general licensing system operated by the Chief Controller of Imports. The imports were thus generally for small amounts, from sterling area countries and the Middle East. The bulk of the supplies of silver to the market during the war period was made by official sales amounting to about 181 million ounces.

After the close of the war, both the Government and the Bank felt that in view of the demand for silver in India and the prevailing high prices, imports of small quantities of the metal should be allowed even from non-sterling area sources provided the currencies of those countries were not regarded as 'difficult'. The Secretary of State who was consulted saw no objection to this but urged the Government of India to go slow so as not to push prices up against both the U.K. and India. The Governor also thought that the imports should be permitted only on the basis of a licence fee as hitherto so as to secure the bulk of the profit for Government. Another suggestion of his was that if any large offers were forthcoming from sterling area sources, these could be taken advantage of by Government and the import arranged by them on their own account outside the scope of the licensing scheme. Licences for imports involving payments of U.S. dollars were not, however, to be granted. This policy was continued up to March 1947, but the upward trend of domestic silver prices continued. While in the early part of 1946, imports were mainly from sterling area sources, from August 1946 there were imports from the U.S.S.R., Iran and Spain also, via London.

With the enhancement of the existing import duty on silver in the budget for the year 1946-47, the Bank discontinued the levy of a licence fee on silver imports except for a nominal levy to cover administrative expenses. The import duty on silver was halved with effect from August 12, 1946.

The position in regard to imports of gold was more or less similar. It was late in 1944 that the Government of India amended the Defence of India Rules so as to authorize the Reserve Bank to levy a licence fee on the imports of gold allowed by it in the same way as on imports

of silver. The licence fee was to represent a proportion of the premium ruling in India over the London parity price. The licensing scheme was not, however, actually operated as it was finally decided early in 1945 to prohibit the import of gold altogether from foreign countries. The supplies to the market in the war period came mainly from official sales to the extent of 7.5 million ounces.

Following the imposition of an import duty on gold bullion and coin at the rate of Rs. 25 per tola in February 1946 (pari passu with the increase in the existing duty 'on silver mentioned earlier) by the Government of India, in view of the abnormally high and artificial level of the Indian price of gold as compared with the prices in the U.K. and the U.S.A., the Bank began to allow imports of gold from the sterling area countries, but without levying a licence fee. A few months later, the Bank began to authorise imports from outside the sterling area also if the currency in which the payment was to be made was 'easy' regardless of the country of origin of the gold. This policy of allowing imports freely against easy currencies was adopted as the Bank considered that the anti-inflationary effects of the imports of bullion justified the expenditure of foreign exchange. With a view to encouraging the import of gold bullion, the duty thereon was halved, along with that on silver, on August 12, 1946.

However, as in the case of silver, the limited imports of gold did not help restrain the price rise. In the circumstances, the continuance of imports of bullion would only have meant depletion of the country's sterling balances needed for essential imports. Besides, the Bank's policy enabled merchants in Continental Europe (e.g., Belgium and Holland which were short of sterling) or China, who obtained gold at parity prices from various sources and sold it at the Indian inflated prices, to lay down sterling funds at well below the official rates of exchange. Further, with the introduction of the system of 'transferable accounts' in respect of Belgium, Holland and Portugal, payments in sterling to these countries were as good as payments in U.S. dollars. Consequently, the licensing of further imports of gold and silver from any source was stopped on March 6, 1947, outstanding commitments being allowed to be completed.

The total amount of gold imported between July 1946 and March 5, 1947 was 765,000 ounces; the amount of silver imports licensed between August 1946 and March 5 next was 39.76 million ounces.

As for the future policy regarding the allocation of foreign exchange for imports of bullion, the Governor considered that this should be a matter for decision by the foreign exchange policy committee the creation of which he had recommended to the Government only in February 1947. Unlike in the U.K., the demand from industrial users in India was likely to be small and the Governor felt that this could

be met, if necessary, by sales by Government from their own stock. Import of bullion for the making of jewellery was not, of course, to be permitted.

There was a sharp rise in the prices of both gold and silver following the imposition of the ban on their imports on March 6, 1947 as this meant, once again, the isolation of the Indian market from the rest of the world. The ban on bullion imports was further tightened by an amendment to the Foreign Exchange Regulation Act, 1947, later in December that year, making it illegal to import gold or silver into any port in the Provinces of India without the permission of the Reserve Bank even though the bullion so brought was in transit to a place outside the Dominion of India, say an Indian State; the object was to prevent the smuggling into India of the gold imported into such territories.

There were also some purchases of silver by the Reserve Bank on Government account in the London market commencing from December 1946. Some months earlier, the Governor had considered that in view of the advantageous prices of silver obtaining in London - it was 63d. per ounce in July 1946 - Government should utilise the opportunity to purchase as much silver as possible on their own account, with a view to building up reserves so that India would in due course be in a position to return the whole quantity of Lend-Lease American silver without allowing the price to go against her. Government agreed with the proposal. Purchases could, however, commence only in December as the prices in London began to rise soon afterwards. Between December 1946 and February 1947 the Bank was able to purchase 4.3 million ounces, the bulk of it at 55d. and the balance at 54½d. The Governor discontinued the purchases with the imposition of the ban on private imports on March 6, 1947 ; if sterling was soon going to become as difficult as dollars, it was 'clearly illogical to continue buying silver at 55d. per ounce in London when it is as now available in New York at about 86 cents or roughly 51 pence '.

In April 1948 again, Government wished to take the opportunity offered by the 'unexpectedly large' sterling balances in the Bank's No. 1 Account with the Bank of England to replenish their stocks to meet the future liability to the U.S. The Governor saw no objection to utilising part of the balances towards the purchase of silver, if it was available at a reasonable price. A million ounces were purchased by the Bank partly in London and partly in Hong Kong before the purchases were called off by the Government shortly afterwards for fear of the possibility that such purchases might prejudice the course of the forthcoming sterling balances negotiations with the U.K.

Foreign Capital Investment in India

One of the important aspects of exchange control policy in the postwar years concerned the extent of facilities to be offered for repatriation of capital by foreign companies established in India. The problem engaged the attention of the Bank towards the close of the war in the context of the growing demand for ensuring Indian participation in existing foreign business ventures in India. The view then held by the Bank was that the repatriation of British capital would present no difficulty in view of the abundant sterling balances; the only problem would be in regard to the provision of dollars for paying out American interests. Following the British policy the Bank was not then granting repatriation facilities for withdrawal of American capital. The Governor considered that if a new policy of a minimum of Indian participation was brought into force it would be necessary to allow these companies to repatriate their capital. However, not being current transactions, the necessary dollars for these remittances would have to come from the special allocations for post-war capital development (viz., the Post-War Dollar Fund). The Bank's views underwent a change in the middle of 1946 as India's balance of payments with the U.S.A. had been favourable to a far greater extent than anticipated. There was also the added advantage that if repatriation facilities were allowed that would encourage the inflow of fresh American capital. The Governor therefore recommended to Government that the earlier policy of refusing repatriation facilities be reversed and the transfers of American holdings to Indian hands allowed if the operations were otherwise unobjectionable.

As the year 1946 drew to a close, and the balance of payments with the U.S.A. began to show an adverse trend, the Bank's opinion veered round to its original view that repatriation of American capital, on the basis of knocking the amount off the Post-War Dollar Fund, would retard the rate of industrial expansion. It would not also be possible to draw from the I.M.F. to buy out foreign investments as the Fund's resources were not available for meeting capital-transfers. The Bank, however, welcomed fresh American investment in India in the form of participation in rupee companies; the bigger the American subscription to a new issue of capital in India, the less dollars India would have to find to pay for imports of machinery, etc., for the project.

Owing to the unsatisfactory exchange position and the absence of any clear idea as to the extent of availability of India's foreign exchange resources pending agreement on the utilisation of the sterling balances, the Bank advised the Government in February 1947 that each application for repatriation of capital could be considered on its merits, that is to say, depending on factors such as whether the capital was being

taken out for failure of the Indian company to establish itself or whether the foreign interests were selling out in view of the good prices offered or for fear of the worsening of the Indian economic or political outlook. The Government of India concurred in this view. They also agreed that if the foreign interests were compelled by Government policy (e.g., by nationalisation or insistence on a certain minimum Indian participation) to repatriate their capital, it would be the duty of the Control to afford them facilities for doing so.

With the conclusion of the first interim sterling balances agreement in August 1947, capital transfers between India and the U.K. and the rest of the sterling area came to be governed by letters exchanged between the Reserve Bank and the Bank of England in terms of Article VIII thereof. The 'agreed' transfers of capital covered by the letters were to be accounted for through the Reserve Bank's No. 2 Account, i.e., by transfer from the No.2 to the No.1 Account or vice versa as the case might be. While the voluntary repatriation of sterling area investments in India and Indian investments in the sterling area were to be allowed freely and adjusted through the No. 2 Account in the aforesaid manner, the question whether transfers representing fresh capital investments both in the sterling area by Indian companies and in India by sterling area concerns should qualify for similar treatment was to be subject to mutual consultation in each case. Transfers between the two Accounts of the agreed amounts were to take place at monthly intervals.

In his reply to the letter from the Bank of England confirming the proposed arrangements, the Governor made it clear that the Reserve Bank would not allow the sale of sterling either from the No.1 or the No.2 Account purely for purposes of investment, e.g., investment in sterling area stock exchange securities, as this would lead to the deflection of Indian capital from the finance of Indian enterprise. In regard to transfers from other countries of the sterling area to India, the Governor explained that it was not the policy of the Government of India to allow the No. 2 Account to be used as a means of facilitating further British capital investment in India, as this would have the effect of increasing the accumulated balances (on which the interest earned was nominal) and also create an additional charge on the No.1 Account for interest and profits earned on the investments. Approvals would, therefore, be given only 'in exceptional cases where the advantages to India's economy were clear and substantial'.

The formulation of a definite policy regarding investment of foreign capital in India was first made in the Industrial Policy Resolution of April 1948. Till then the Bank had to refer every application to the Government for a decision, resulting in considerable delay and inconvenience to both the overseas investor and the Indian party, if any,

sponsoring the venture. The Bank was particularly concerned with cases where the total capital investment was less than Rs. 5 lakhs as these were outside the scope of the Capital Issues Control. The provisions of the Foreign Exchange Regulation Act were being used to control such investments in India involving foreign capital; In the case of inward capital movement from the U.K., there was a further reason for control as the transfers might be effected through the No.2 Account if both the Governments were agreeable. Taking up the matter with Government in December 1947 the Bank pointed out that in the past few months, while there had been no large movements of foreign capital to India, a number of proposals had been received from foreign interests for starting small companies with capital of less than Rs. 5 lakhs. The risks of the pioneer plant were to be borne by the overseas investors and a public issue of rupee capital was intended to be made only at a later, date if the ventures proved successful. The Bank felt that there were great advantages to India in giving facilities for the establishment of such concerns as the investment would act as a pump primer for considerable industrial development in the future. The capital amounts being small, there was also no question of such permission resulting in foreign control of any key or basic industry or the domination of Indian enterprise by foreign interests. The Bank therefore proposed to Government that pending the formulation of a general policy, it should be empowered 'to allow the issue of shares in new concerns to non-residents where capital is less than Rs. 5 lakhs or such lower figure as Government care to name, provided the concerns are directly concerned with the establishment of manufacturing projects, or performing useful services in the expansion of overseas trade or in assisting Indian industry '. Government were unable to take a decision immediately on this proposal also.

Early in 1948, the Finance Ministry invited the Bank's comments on a note prepared in its Research Section on the investment of foreign capital in India. The note traced the historical developments in regard to the steps taken till then and the recommendations of responsible authorities from time to time. Its conclusion was that foreign capital should be welcomed in certain restricted spheres subject to essential safeguards, in the interests of rapid industrialisation. The matter was examined at length in the Bank by the Department of Research and Statistics and the Governor placed its proposals before the Committee of the Central Board at its meeting on March 17, 1948. The Committee approved the Department's recommendations generally but Director Kasturbhai Lalbhai suggested certain modifications which also commended themselves to the other Directors. In view of the importance of the subject the Committee desired that it should be placed before the Central Board for consideration at its next meeting on April 5. The

Board considered the issues involved very carefully and made several positive recommendations to the Government in a lengthy resolution which it would be appropriate to quote here in full:

RESOLVED

- (1) That in view of the urgency of raising the already low national standard of living, the inadequacy of national savings to meet the requirements of rapid economic progress and the country's balance of payments difficulties, the Central Board of the Reserve Bank of India are strongly of the view that, generally, definite encouragement should be given to the investment of foreign capital in India, and that, in particular, Government must so determine and inspire confidence in their policies as to establish such conditions as would prove attractive to the foreign investor who is prepared to invest his capital in India purely with economic and business objectives ; that to this end Government should restrict the field of nationalisation of industries to the minimum necessary in the interests of the country and avoid making loose or general pronouncements about nationalisation likely to scare away the potential foreign investor.
- (2) That although Government would always have to bear in mind the necessity of ensuring that control of investments by foreigners did not lead to political difficulties, the Board did not deem it to be desirable in India's interests to recommend a hard and fast rule that in every case control should remain vested in Indian hands through a majority of nationals on board of management of any enterprise having foreign participation.
- (3) That in order to ensure that essential national interests were safeguarded, it should be prescribed that the previous sanction of the appropriate Ministry of Government be required where the interest proposed to be retained by the foreign investor was over 24 per cent, only such concerns being regarded as foreign concerns.
- (4) That in addition to the safeguard referred to in (3) above, the following safeguards be also laid down, namely-
 - (a) That Government reserve to themselves or to, the nationals of the country industries which they determine to be of basic importance;
 - (b) Foreign concerns engaged in primary production should undertake that, wherever possible, they develop processing and complementary industries in the country ;
 - (c) Foreign concerns should follow a consistent policy of reinvesting a part of their profits in the country ;
 - (d) That foreign concerns should agree to the training of nationals in the technique of industry where foreign capital has brought with it foreign technicians ;
 - (e) That foreign concerns do not discriminate between foreign technicians and nationals, other things being equal, and do not exploit labour in the country ;
 - (f) That no foreigners are allowed, in future, to participate in the managing agency of any concern, or, if any such participation became inevitable, it is not allowed to exceed 24 per cent; and

- (g) That Government retain the freedom to discriminate against foreign concerns in appropriate cases in respect of tariff, bounties and subsidies.
- (5) That, to counter balance the safeguards, foreign capital be given an assurance in respect of-
- (a) Equality of treatment regarding taxation ;
 - (b) Protection of patents and copyrights ;
 - (c) Adequate compensation in the event of nationalisation ;
 - (d) Inviolability of person and property of foreigners ;
 - (e) Facilities for the transfer of capital and profits ; and
 - (f) Provision for the avoidance of double taxation of any burdensome character, both corporate and individual, as, for instance, for foreign technicians.

In addition, the Board desired that the Governor should separately advise the Government that:

in view of the terms of the Indo-British Financial Agreement, they see how further investment of British capital could be permitted take place, unless it is demonstrably advantageous to the country, or necessary from some national point of view. The Board were inclined to the view that considering the difficulties of the availability of capital and other goods today, encouragement should be given to the invest of private American capital in the country, in addition to financing the purchase of capital and other essential goods through loans obtained from the Export Import Bank or the International Bank for Reconstruction and Development.

The Board's resolution, passed on the eve of the debate on Government's Resolution on Industrial Policy in the Legislative Assembly, would seem to have been of much assistance to Government. Paragraph 10 of the Resolution, the whole of which was accepted by the Assembly, welcomed the participation in Indian industry of foreign capital and enterprise, particularly as regards industrial technique and knowledge, but contemplated the enactment of legislation providing for the scrutiny and approval by the Government of every case of foreign participation. The legislation was also to provide that as a rule the major interest in ownership and effective control should always be in Indian hands. Besides, in all cases, the training of suitable Indian personnel for eventually replacing foreign experts was to be insisted upon.

The Industries (Development and Control) Bill introduced in the Legislative Assembly on March 23, 1949 did not, however, make any specific provision covering the participation of foreign capital in Indian industries.* As the Prime Minister, Mr. Nehru, announced in the

* The Bank's Central Board, which considered the draft Bill in a special meeting held on August 31, 1949, at the Government's request, felt that the powers of control contemplated were so drastic that they would seriously affect investment of domestic as well as foreign capital and hamper industrial development.

Legislative Assembly on April 6, 1949, Government had come to the conclusion that such regulation as was necessary ' to secure the utilisation of foreign capital in a manner most advantageous to the country ' could be secured through existing laws. In regard to the foreign exchange aspects of such participation, the Prime Minister announced that (i) remittances of profits earned by foreign interests would be allowed freely as heretofore; (ii) Government had no intention to place any restriction on withdrawal of foreign capital investments, but remittance facilities would naturally depend on foreign exchange considerations; and (iii) if any foreign concern came to be compulsorily acquired, Government would provide reasonable facilities for the remittance of proceeds. Referring to the British interests in India which formed the largest part of foreign investments in the country, the Prime Minister stated that even with Government's policy to encourage the growth of Indian industry and commerce, there would continue to be considerable scope for the investment of British capital in India. ' The Government of India ', he concluded, ' have no desire to injure in any way British or other non-Indian interests in India and would gladly welcome their contribution in a constructive and co-operative role in the development of India's economy '.

The procedure for consideration of applications for foreign capital investment was revised by the Government in March 1949. The decisions were to be taken by an Inter-Ministerial Committee consisting of representatives of the Ministries concerned. All applications received by the Reserve Bank were therefore continued to be referred to Government who placed them before the Committee.

Following a communication from the Bank of England in January 1950 about the British Government's decision that capital directly invested in the U.K. after January 1, 1950 by non-residents (i.e., by those resident outside the sterling area) in projects approved by the Government might be allowed to be repatriated at any time thereafter to the extent of the original investment, i.e., excluding any appreciation thereon, and from the proceeds of that investment, a similar policy with regard to non-sterling area investments was adopted in India on the Reserve Bank's recommendation. As an incentive for ploughing back into the business a part of the profit earned by foreign companies, the Bank suggested that such capitalisation of the profit as had received the prior sanction of the Government should be treated as additional investment eligible for repatriation facilities. The facilities were not to be available in respect of purchase of shares on the stock exchange unless this formed an integral part of an approved investment project. In regard to whether the facility should also be extended to existing foreign investments, although the amount of such investments was not large the Bank did not think it was desirable for Government to accept

the responsibility for their repatriation. All these recommendations were accepted by the Government. * Remittances to residents of the Scandinavian countries were however allowed freely in respect of investments made before January 1, 1950 also, in line with the U.K. policy; and, of course, in the case of sterling area investments where transfers took place through the No. 2 Account, no restrictions existed or were contemplated.

These decisions were made known to the public in a press note issued by the Government of India on June 2, 1950. The policy of repatriation of foreign capital investments in India remains largely the same to this day.

Exchange for Foreign Travel, etc.

With the opening up of communications after the close of the war and the emphasis on the rapid industrialisation of the country, increased visits abroad by businessmen for purchase of plant and machinery, and reviving old contacts and establishing new ones for rebuilding trade, became necessary as well as practicable. To facilitate such visits, relaxations were made in the exchange control restrictions on foreign travel, including the abolition in February 1946 of the Exit (Finance) Permit system. In September 1946, the Reserve Bank was authorised to deal with all applications for purposes of travel for business without reference to Government. The rules for release of exchange for journeys abroad for medical treatment and for education were also liberalised in the immediate post-war period. Foreign exchange was also granted for visits abroad for reasons of personal convenience, but the amounts varied according to the overall foreign exchange position and the degree of softness of the currencies of the countries visited. In these as also in matters relating to release of exchange for emigrants, the policy of the Bank of England was followed closely.

Jurisdictional Changes

There were also some changes in the Bank's jurisdiction for administration of exchange control during the years 1945 to 1951. After the reoccupation of Burma, the Government of India amended the Defence of India Rules so as to restore the position that existed prior to the Japanese occupation in 1942; this had the effect of removing all restrictions on financial transactions between India and Burma except that on the export of gold from India. When the Rangoon Office of the

* Capital appreciation in the value of any investment made after January 1, 1950 (including profits reinvested in the projects) with Government approval, was also allowed to be repatriated from March 1953.

Bank was reopened, it continued to administer the exchange control regulations in Burma, which were the same as those in force in India. When the Bank severed its last links with Burma in April 1947, it gave up the control of foreign exchange in Burma also. As regards the Persian Gulf area, where the administration of exchange control was in the hands of the Reserve Bank, control was taken over by the Political Resident, Bahrein, acting under the supervision of the Bank of England, on July 1, 1948. The changes in the Bank's functions in relation to exchange control in Pakistan are mentioned in a separate section.

In regard to the Indian States, which were part of the sterling area, following the passage of the Foreign Exchange Regulation Act the Political Department of the Government of India arranged with most States for the enactment of parallel legislation delegating to the Reserve Bank powers to operate exchange control in their territories with a view to ensuring uniformity in the system of exchange control throughout the country. In terms of the Foreign Exchange Regulation (Amendment) Act, 1950, which came into force on April 18, 1950, the main Act was extended to all the Indian States, then known as the Part B States, except the State of Jammu and Kashmir.

EXCHANGE MANAGEMENT

Separation of the Rupee-Sterling Link

An important development in the post-war period relating to the Bank's function of maintaining the exchange value of the rupee was the formal severance of the rupee-sterling link as an offshoot of India's membership of the I.M.F. The rupee-sterling link was ensured through

(1) the obligation placed on the Reserve Bank through Sections 40 and 41 of the Reserve Bank of India Act to sell and buy sterling for rupees on demand without limit at certain fixed rates and (2) the power conferred on the Bank by the Defence of India Rules to license dealings in foreign exchange, in terms of which the Bank did not permit authorised dealers to alter their quotations. To enable banks to transact business at fixed rates in spite of fluctuations in demand and supply, the Bank bought and sold sterling, both ready and forward*, for unlimited amounts and gave them facilities to cover their foreign exchange transactions with the London Control at its fixed rates.

Under the Bretton Woods Agreement (Article IV, Section I), the par value of the currency of each country adhering to it was to be

* The Bank began to sell sterling forward in October 1946 only. This is mentioned later in this section.

expressed in terms of gold or U.S. dollars. It followed, therefore, that once India signified her acceptance of membership in the International Monetary Fund, the external value of the rupee would no longer be tied to sterling alone but would be determined directly by its par value compared with the par values of the currencies of other member countries. If in these circumstances the statutory link with sterling was to be continued, it could only be ensured by changing the par value of the rupee identically with sterling whenever sterling was appreciated or depreciated, whether or not the situation required it.

As early as March 1946, the Government of India sought the Bank's views on whether the repeal of Sections 40 and 41 would be necessary or desirable in India's interests both if she continued to be a member of the I.M.F. and if she withdrew her membership. However, the Bank was not in a position to make any specific recommendation, in view of the prevailing uncertainties in regard to the ratification of the Anglo-U.S. Loan Agreement by the U.S. Congress, continuance of India's membership in the I.M.F. and the arrangements to be made for realisation of the sterling balances. It indicated the possible courses of action in very general terms.

With the settlement of the question of India's membership of the I.M.F. in sight, the issue of amendment of Sections 40 and 41 again became a live one. On October 9, 1946, the Bank sent its 'provisional views on the various points in issue' for Government's consideration. The Bank agreed with the Finance Secretary's view that the par value of the rupee should be stated in concrete terms in the Reserve Bank Act and that the Bank should be authorised to buy and sell foreign exchange at such rates and on such conditions as might be specified by Government. It suggested amendment of Section 17 of the Act for conferring on it the authority to enter into foreign exchange transactions, the authority being designed to cover transactions both on its own account and on behalf of Government. The Bank also suggested the addition of two new clauses in Section 17 for authorising it (i) to purchase and sell securities issued by foreign Governments expressed payable in a foreign currency and maturing within a period of ten years from the date of purchase and (ii) to open accounts with or make agency arrangements with foreign banks other than the currency authorities of those countries, to enable the Bank to utilise their services in cases where the currency authority might not be considered the most appropriate agency.

In regard to what new provisions should replace Sections 40 and 41, the Bank considered that it was first necessary to decide whether the existing arrangement under which the foreign exchange resources of the country were held by the Bank should continue or whether there should be a change to the British system under which they were held

by the Government in the Exchange Equalisation Account and were operated by the Bank of England acting on behalf of the Treasury. The Bank was in favour of allowing the existing practice to continue, an important reason being that since the currency circulation in India formed by far the greater portion of the monetary media it was desirable that the responsibility for maintaining the exchange value of the rupee should rest with the note issuing authority. Examining the question further in November 1946, Deputy Governor Trevor told the Government that amendment of Sections 40 and 41 was intimately bound up with the revision of Section 33 covering the forms in which the assets in the Issue Department were to be held: points such as the revaluation of the gold, the determination of the proportion of sterling backing to the note issue and the inclusion of other foreign currencies in such backing had to be settled, while the final decision would also have to depend to a certain extent on the outcome of the sterling balances negotiations. However, he felt that as long as the existing par value of the rupee was not altered, there was no need for any urgent action to amend Sections 40 and 41. Since the amendments to Sections 33, 40 and 41 were of a controversial nature, he preferred that the amendments to Section 17 alone be enacted as early as possible and the others held over until the future policy could be clearly worked out.

However, it was finally decided to retain the existing system under which the Bank operated in foreign exchange on its own account and to replace Sections 40 and 41 by a new Section 40, which enjoined the Bank to sell to or to buy from any authorised person, on demand, ' foreign exchange at such rates of exchange and on such conditions as the Central Government may from time to time by general or special order determine, having regard so far as rates of exchange are concerned to its obligations to the International Monetary Fund '. There was, however, to be no statutory provision defining the par value of the rupee. The Bank's other proposals regarding the amendments to Section 17 were broadly accepted by Government. The Reserve Bank of India (Second Amendment) Act, 1947, giving effect to these changes was passed by the Legislative Assembly on April 8, 1947 and came into force on April 18. Amendment of Section 17(3) authorising the Bank to purchase and sell foreign exchange and foreign bills of exchange (instead of sterling and sterling bills only) from and to scheduled banks and of Section 33 permitting it to hold foreign securities (instead of sterling securities) in the Issue Department assets was made separately in 1948 when the Act was amended for the purpose of transfer of the Bank's ownership to Government.

The obligation of the Bank under the new Section 40 was limited to transactions with 'authorised' persons, i.e., persons entitled under the Foreign Exchange Regulation Act to buy or sell foreign exchange.

The minimum amount to be bought or sold was fixed at Rs. 2 lakhs as against £10,000 earlier.

In pursuance of the powers conferred by the new Section 40, the Government of India issued on April 19, 1947 notifications fixing a new selling rate of IS. 5 55/64d. and a new buying rate of IS. 6 9/64d. Since the notifications only prescribed the rates at which the Bank was bound to sell and buy sterling without limit, their issue did not affect in any way the rates at which the Bank conducted its day-to-day operations with the authorised dealers, which was under Section 17 of the Act. The new spread between the buying and selling rates for exchange transactions conformed to the Articles of the I.M.F. which required that the maximum and minimum rates, in the case of spot exchange transactions, should not differ from parity by more than 1 per cent. As mentioned in an earlier section, for the same reason, the Bank was also given power under the Foreign Exchange Regulation Act [Section 4(2)] to prescribe the rates at which authorised dealers could transact foreign exchange business.

From the inception of exchange control, all authorised dealers in foreign exchange were required to operate at the rates fixed by the Exchange Banks' Association. As there was no uniformity in the rates quoted by the Association at the different centres -it was the practice for the Association in certain upcountry centres to quote wider rates there was a disparity in the rates quoted by the authorised dealers in the same town: while the branches of some banks in the port towns quoted the port rates upcountry, others operated at the rates published by the local Exchange Banks' Association. With the coming into force of the Foreign Exchange Regulation Act, it was decided to ensure a uniform practice and to this end, the Bank advised all authorised dealers that they should henceforth operate on the basis of the rates published by the Exchange Banks' Association, Calcutta. A further step in the direction of uniformity was taken in 1950 when, in consultation with this Association, the Bank standardised the rates quoted by the authorised dealers in foreign exchange and the authorised money changers for the encashment of foreign currency notes.

A few other developments of some interest or importance could suitably be mentioned here. Unlike the war years, the post-war period up to 1951 did not find the Bank a net buyer of sterling throughout. During the two years 1946-47 and 1948-49, the Bank made net sales of sterling owing to the disappearance of the major factors responsible for sterling acquisitions as also a liberal import policy. Figures of the Bank's net purchases or sales of sterling during the years 1945 to 1951 are given on page 664. The substantial net purchases during 1949-50 and 1950-51 reflected a favourable balance on private account caused by restrictive import policies and the spurt in exports

(£million)

| April-March | Purchases | Sales |
|-------------|-----------|-------|
| 1945-46 | 79.27 | |
| 1946-47 | — | 65.54 |
| 1947-48 | 91.48 | |
| 1948-49 | — | 52.66 |
| 1949-50 | 139.55 | |
| 1950-51 | 235.56 | |

consequent on the devaluation of the rupee. However, foreign exchange reserves registered a modest fall during 1949-50 and a relatively much smaller rise during 1950-51 due mainly to imports on Government account. For a brief while (between January and June 1948), the Bank operated on Pakistan's account also, the net purchases amounting in all to £23 million.

A sudden demand for forward sterling became evident in October 1946 owing to public uncertainty over the par value of the rupee to be declared by the Government of India to the I.M.F., and in order to assist banks to meet the demand the Reserve Bank commenced selling as from October 7, 1946, sterling T.T. for delivery up to six months forward at IS. 5 31/32d. maintaining the ready rate unchanged at IS. 5 63/64d. Like the ready selling and the spot and forward buying rates, this rate also remained unchanged until the devaluation of the rupee in June 1966. The demand for forward sterling from the banks subsided, however, after some time, and was negligible during the rest of the period covered by this volume.

Devaluation

In the field of exchange management a major event was the devaluation of the rupee in September 1949, by 30 '5 per cent, following an identical devaluation of the pound sterling. Sterling devaluation was followed immediately by the devaluation of a number of other currencies, as part of what looked like concerted action to correct the over-valuation of currencies in relation to the U.S. dollar. Of considerable significance to India was the non-devaluation of the Pakistan rupee. As under the Payments Agreement between India and Pakistan, the exchange rate between the two countries was to be at par and was not to be altered without due notice and mutual consultation, controversy started between the two Governments as to which of them acted contrary to the Agreement, and trade relations between the two countries were disrupted for quite some time.

The devaluation of the pound sterling was the result of a general view in the U.S.A., and in the I.M.F. circles too, that exchange rate

adjustment was necessary, and of the substantial loss in the sterling area's gold and dollar reserves partly under the influence of speculative forces. On September 17, the U.K. Government intimated to the I.M.F. that they proposed to devalue the pound by 30.5 per cent (from \$4.03 to the £ to \$2.80); the Fund Board accorded approval. The order of devaluation (effective September 18) was appreciably larger than had been anticipated, apparently to set at rest any possible doubts regarding the ability of the U.K. to maintain the new rate. Other sterling area countries (excepting Pakistan) and several Western European countries followed suit.

In India, the Government made an announcement to the press in the early hours of September 19, to the effect that September 19 to 21 had been declared as public holidays, with a view to obviating speculation and dislocation of the markets following the devaluation of the pound sterling. The communique also stated that the Government proposed, in consultation with the I.M.F., to devalue the rupee to the same extent as sterling. This was followed by another communique issued on September 20 stating that the Government of India's proposal to devalue the rupee to the same extent as pound sterling had been accepted by the I.M.F. and that the rupee was to be equivalent to 21 U.S. cents as against the prevailing rate of 30.2250 cents. Its par value in grams of fine gold per rupee was to be 0.186621 giving a value of Rs.166.6666 per fine ounce of gold. The new rate was to become effective immediately; as September 20 and 21 were holidays, it came into effect on September 22, 1949. The exchange rate between the pound sterling and the rupee remained unchanged at IS. 6d. a rupee.

The press communique explained the reasons for the devaluation, as under:

Devaluation as a corrective to the balance of payments difficulties in regard to dollars has been urged for some time. The Government of India did not favour such a course as it was felt that in view of the general conditions of Indian economy, devaluation was not likely to solve India's problem of dollar shortage. India's imports are regulated by controls, and the deterrent effect of high prices resulting from devaluation is therefore neither necessary nor desirable. Since the supply of India's exports is inelastic, her aggregate export earnings are not likely to increase by reducing export prices through devaluation. However, the decision of the United Kingdom to devalue Sterling, followed by similar devaluation by other countries, created a situation in which it became impossible for India to avoid similar action without detriment to her economy. India's trade, both export and import, being so largely a trade with sterling area countries and the price level being already high, it was clear that the Rupee could not be allowed to appreciate against Sterling without undermining India's competitive position and endangering the markets for most of her exports and ultimately being compelled to reduce the volume of imports still further.

Over and above the pure economic factors of relative competitive positions, current expectation that India would not be able to avoid devaluation in the face of the action taken by other countries would have acted as a powerful psychological barrier to any transactions at the old rate of exchange, and trade might have been brought to a standstill. There was thus no alternative for India but to follow the other sterling area countries and devalue the Rupee as a defensive measure. As regards the actual extent of devaluation, it was clear that a smaller measure of devaluation of the Indian Rupee than Sterling would not have met the requirements of the new situation created in world export markets. A larger measure of devaluation than Sterling was equally out of the question as it would have meant creating greater difficulties in regard to essential imports and aggravating the loss in export earnings due to inelasticity of supply.

The Government of India have taken this decision after the most careful consideration of all the factors and they have no doubt that it will work out in the best interests of the country. This is in consonance with the view in favour of maintaining the existing Rupee-Sterling rate expressed almost unanimously two years ago when the par value of the Rupee was first discussed.

In his speech in the Legislative Assembly on October 5, 1949 moving the motion 'that the situation arising out of devaluation of the rupee in terms of the dollar be taken into consideration', the Finance Minister, Dr. John Matthai, mentioned a further consideration which influenced Government's decision to devalue the rupee. India, being a member of the sterling area, was under an obligation to ensure that whatever she did was in keeping with the general objective of that area, which was 'to enable the countries included in that area to achieve a balance of trade at the highest possible level, partly by expanding exports and partly as a temporary measure -if that was necessary in order to restore equilibrium -by reducing imports also '.

The authorities also considered and rejected the alternative of not having a fixed parity, allowing the rupee to fluctuate. The reasons for this decision were set out in the note which Mr. J. V. Joshi prepared for the information of the Bank's Central Board which considered the matter at its meeting on October 13, 1949. Mr. Joshi observed:

even in the period after 1931 when sterling went off gold and was fluctuating vis-a-vis dollar freely, yet, as far as parity with countries in the sterling area was concerned it was fixed and that area covered a major portion of Britain's foreign trade. And even then in order to minimize the evil effects of fluctuating dollar rate Britain had to institute an Exchange Equalisation Fund, the function of which was to iron out temporary and abnormal fluctuations in the exchange value of sterling. The realisation of the disadvantages of a fluctuating rate made the framers of the constitution of the International Monetary Fund at Bretton Woods to emphasize the need for the declaration of the par value and its maintenance as well as the consequent maintenance of cross-rates. The Fund has always been against a free and fluctuating

exchange rate except in most abnormal circumstances and that too for very short periods
. . . Our foreign trade would have been adversely affected by such a free market.

Mr. Joshi also pointed out that India would have been forced to leave the I.M.F. and consequently the I.B.R.D., as the Fund would not have approved a free and fluctuating rate. India would have been forced to leave the sterling area too. 'India would have been ill-advised to follow such a course', he concluded.

While there was some criticism in the country and the Legislature regarding Government's decision to devalue, by and large, it was realised that such a decision could not have been avoided. Among financial journals, the *Indian Finance* and the *Eastern Economist* supported Government's decision. In fact, in a leading article published as far back as May 14, 1949 the *Indian Finance* had expressed the view that:

With Britain if possible, and without Britain if necessary, India must devalue her currency.

Referring to the devaluation of the pound sterling, the *Eastern Economist* * observed:

The hammer has fallen. It was, indeed, due to fall, and those who saw it poised, knew it was only a question of time and a question of the force with which it would descend.

As regards the devaluation of the rupee, the journal's comments were:

The problem of the Rupee has not so far been examined in detail. And to examine it at this stage is very much like bolting the stable after the horse has galloped away. For the moment we are concerned with the consequences of a decision which has been taken - we believe rightly - in circumstances which broadly offered us no choice.

Although India resorted to devaluation as a defensive measure following the devaluation of sterling, it resulted in an improvement in the country's balance of payments in respect of the over-all position, as well as in the dollar sector, through both expansion of exports and the curtailment of imports.† It was of course difficult to estimate to what extent the fall in imports was due to devaluation and to what extent to other factors like import controls. Similarly on the side of exports, while devaluation did provide a considerable stimulus to jute manufactures and cotton textiles, it was not possible either to estimate the contribution made by other causes or to assess how long the improvement brought about by devaluation was expected to last. The declining trend

* September 23, 1949.

† See *Devaluation and After*, by P. S. Narayan Prasad, in the November 1950 issue of the *Reserve Bank of India Bulletin*.

of exports during the second quarter of 1950 was probably an indication that the effect of devaluation had 'neared exhaustion'. The improvement in exports from the middle of 1950 was largely due to the Korean War and the resultant world-wide stimulation of demand for essential raw materials. The problem of achievement of a more permanent equilibrium was linked up with the elimination of shortages of raw materials like cotton and jute. The nine-month period between devaluation and the outbreak of the Korean War was characterised by price stability; the general index of wholesale prices recorded a rise of only 6 points, from 390 to 396, over this period.

Exchange Relations with Pakistan

Exchange relations with Pakistan posed many difficult problems, especially after the devaluation of the Indian rupee in September 1949. The Bank not only participated in all the discussions between the two Governments for resolving the various issues but also drew up the detailed regulations for enforcing exchange control with Pakistan. The latter proved a difficult task and called for close consultation between the Bank, the Export and Import Trade Control authorities, the Customs and the Railways, owing to the extensive land frontiers and the peculiarities of the border trade.

As mentioned in Chapter 18, on the partition of India the Bank, in its capacity as banker to the Government of Pakistan, also became the authority responsible for the administration of exchange control in Pakistan. On July 1, 1948, when the Reserve Bank ceased to be banker to the Government of Pakistan, exchange control in Pakistan was taken over by the State Bank of Pakistan. There was however to be no exchange control *between* India and Pakistan even after the complete monetary separation in July 1948; a Payments Agreement was entered into to regulate monetary relations between the two countries, the salient features of which have also been mentioned in Chapter 18. Remittances from one country to the other were free of exchange restrictions and cover was provided by the central banks of the two Dominions to banks for the purchase and sale of each other's currencies at rates based on the parity between the two rupees.

There was uncertainty about the renewal of the Payments Agreement on its expiry at the end of June 1949; the imposition of exchange control vis-a-vis Pakistan was inevitable if the Agreement was not extended. However, the two countries reached a decision on June 29, 1949 to renew the Payments Agreement for another year (on the basis of the same holding limit of Rs. 15 crores for each other's currency as before and an enhanced limit of £15 million for settlement in No. 1 Account sterling).

Trouble arose very soon by the non-devaluation of the Pakistan rupee in September 1949. The Payments Agreement required, for its working, the maintenance of parity between the Indian and Pakistan rupees. Neither Government could alter it 'except after due notice and mutual consultation'. However, as the Finance Minister later explained to the Legislative Assembly in early October, the circumstances in which the sterling devaluation occurred were such that India had to take action urgently but effort was made to inform Pakistan and Ceylon promptly after the I.M.F. was notified on September 17 of India's desire to devalue the rupee by 30.5 per cent. The Pakistan Government's reply to Dr. Matthai's telegram of September 18 was sent only on the 22nd, intimating that they had decided not to devalue. This news item had in fact appeared in Indian newspapers on the 21st morning; the news item also stated that the new rate of exchange between India and Pakistan had been announced by Pakistan as Pakistan Rs. 100 = India Rs. 144.

The Finance Minister defended India's action and met the charge that India (and not Pakistan) was responsible for the disturbance that had occurred in the economic relations between the two countries by reference to the fact that the trade and payments agreements were, inter alia, based on the consideration that the final settlement would be made in sterling. Besides, since Pakistan was not yet a member of the I.M.F., the only standard in terms of which the value of the Pakistan rupee could be determined was sterling or the Indian rupee. It was, therefore, the appreciation of the Pakistan rupee which had caused the rupture.

There was rather protracted correspondence between the two countries, each charging the other with breach of the Payments Agreement. Normal trade relations between the two countries came to a standstill. On September 21, the Reserve Bank issued a press communique informing banks that it would not be in a position to quote any rate for the purchase and sale of Pakistan rupees, thus suspending the cover facilities it had hitherto provided. But banks were free to carry out such remittance transactions as they could within the limits of their resources at whatever rates they liked. Later, on September 27, 'solely with a view to facilitate resumption of business between the two countries', the Government of India informed the Pakistan Government of their preparedness to allow transactions to commence on the basis of the new rate of Pakistan Rs. 100 equal to India Rs. 143 15/16 as decided upon by the Pakistan Government. The Pakistan authorities, however, wanted the Reserve Bank to transfer sterling in respect of the balances of the State Bank of Pakistan with the Reserve Bank under the Payments Agreement, but this was flatly refused by the Finance Ministry.

In the absence of fixation of the exchange rate between the two currencies, the deadlock in Indo-Pakistan trade relations continued. Meanwhile, on September 28, Mr. Ambegaokar, Additional Finance Secretary, sought the advice of Sir Chintaman Deshmukh who by that time had retired as the Reserve Bank's Governor and was in Washington in his capacity as India's representative in matters of external finance. After considering the various alternatives placed before him, Sir Chintaman supported the alternative of not recognising officially the new parity fixed by Pakistan but of letting the rates find their own level.

The actual rates prevailing in the free markets were nowhere around the Pakistan official parity of Rs.100 Pak. = Rs.144 Indian. It appears that there were at least four different rates prevailing in the Calcutta market in mid-October 1949. Probably the most important rate, according to a Government investigation, was in respect of transactions by people who had money in India as well as in Pakistan or people who wished to transfer money from one side to the other agreeing to accept payment in Calcutta against an advance in Dacca or vice versa; such transactions began on a ratio of India Rs.102 to Pakistan Rs.100, but the rate later went up against India, being India Rs.115 = Pakistan Rs.100 in mid-October.

There was also consultation between a few senior officials of the Bank and the Government of India regarding exchange policy, trade and payments arrangements, etc. A few notes were prepared in the Bank and were forwarded to Government for consideration. There were sharp differences of opinion at the Secretariat level over the methods to be adopted to tackle the problem of the exchange rates.

Exploratory talks were held on October 22, 1949 between Mr. Ambegaokar of the Ministry of Finance and Mr. Mumtaz Hasan of the Pakistan Finance Ministry. The two main issues that required to be considered were the treatment of accumulated balances under the Payments Agreement and the basis for resumption of trade between the two countries. As regards the first, the Pakistan Government wanted their balances (of the order of Rs. 25 crores) to be written up and then paid to them in terms of the Payments Agreement, i.e., Rs.15 crores in Indian rupees and the balance in sterling, but Mr. Ambegaokar argued that since the Payments Agreement had ceased to be operative, the settlement of balances was not automatic but should be negotiated between the two Governments. In regard to the second, Mr. Ambegaokar's suggestion of a free rate of exchange was not acceptable to the Pakistan representative, who hinted at the possibility of Pakistan imposing exchange control.

The difficulty of making remittances through the banking system added to the hurdles to trade caused by the suspension of the Open

General Licences and other restrictions. While banks in India had the freedom to deal in Pakistan rupees out of their own resources at the free market rates, in Pakistan directives were issued to banks to operate in Indian- rupees only at the official rate (the State Bank of Pakistan issued an order on November 15, 1949 making transactions between the Pakistan rupee and the Indian rupee illegal at a rate other than the official rate which was declared to be Rs.14311/16 selling and Rs.1443/16 buying for Pakistan Rs.100). The State Bank of Pakistan was not, however, prepared to support this new official rate and except for a very few selected transactions (which included transactions under the April 1950 trade agreement described later), did not extend cover facilities for remittances from Pakistan to India. In other words, banks in Pakistan could purchase and sell India rupees within the limits of their own resources but only at the official rates.

Trade between the two countries therefore remained restricted to exchange of commodities on the frontiers. Such transfers of funds as took place to finance these transactions were effected at rates which, though initially at varying premiums in favour of the Pakistan rupee, soon approximated to the pre-devaluation parity between the two currencies, the Indian rupee ruling on occasions at a premium.

A Bill authorising Pakistan to become a member of the I.M.F. and the I.B.R.D. and to pay her share was passed by the Pakistan Parliament only in early April 1950. The declaration of her par value was therefore awaited in India with interest. Pakistan had, in the meantime, i.e., since the devaluation of the Indian rupee, taken -certain steps which could only be interpreted as a preliminary to the introduction of full exchange control. Soon after devaluation, the Pakistan Control began to insist on what it called ' proof of remittance ' in respect of pre-devaluation purchases of jute. Attempts were also being made to repatriate Pakistan's capital assets in India through the permission given for the import of Pakistan bonds purchased out of funds held by Pakistan banks with their Indian correspondents. Rules were prescribed, effective June 1,1950 requiring the proceeds of exports from Pakistan to India (other than those in respect of which trade was to be allowed freely in terms of the trade agreement of April 21,1950), to be surrendered to the Control in full. On the Indian side, it was previously thought that the high parity of the Pakistan rupee which was not justified by the facts of Pakistan's trade with India would itself provide the necessary check on capital exports to Pakistan. The continuance of the movement of funds in spite of the obvious unprofitableness to the holder showed that factors other than purely economic ones were also in operation. India had, therefore, no option but to impose exchange control as soon as she was in a position to do so, i.e., as soon as the rate of exchange with the Pakistan rupee was settled. Control was

felt to be necessary not only on dealings with Pakistan but also on financial transactions with Afghanistan (which were hitherto free) in order to prevent the former restrictions being circumvented by persons professing that their dealings were with Afghanistan.

With a view to reopening trade relations, negotiations were held between the two Governments early in 1950, at which the Reserve Bank was also represented. As a result, a short-term trade agreement was signed on April 21, 1950, valid in the first instance up to July 31, 1950. The agreement provided for a limited resumption of trade; the movement of commodities was so arranged as to achieve a balance between imports and exports in terms of the Indian rupee. The pivot of the agreement was a deal between the Indian Jute Mills' Association and the Pakistan Jute Board for the sale by Pakistan of 8 lakh bales of raw jute in terms of Indian rupees which were to be credited to a special account of the State Bank of Pakistan with the Reserve Bank of India and made available to Pakistan for the purchase in India of specified commodities, e.g., jute manufactures, cotton textiles, woollen goods, tobacco, mustard oil and steel. The practical difficulties encountered in operating the agreement were considerable, 'necessitating its extension up to September 30, 1950. In the meantime, Pakistan had become a member of the I.M.F. in July 1950 and had communicated to it the par value of her currency for acceptance. In anticipation of the Fund's decision, there were again close consultations between the Reserve Bank and the Government of India regarding the detailed arrangements for imposing exchange control with Pakistan. In September 1950, the Bank's offices were also alerted, as in June 1949, to keep themselves in readiness to extend the control to Pakistan and Afghanistan immediately Government's decision was known.

The fixation of the par value of the Pakistan rupee by the I.M.F. however got postponed beyond September. In November 1950, at the Government of India's instance the Bank examined whether in the event of further delay in the settlement of the exchange rates, such exchange control measures as might be practicable should not be introduced immediately, and came to the conclusion that the imposition of exchange control should await a fuller resumption of trade with Pakistan.

The outbreak of the Korean War in June 1950 however brought an entirely new factor into the situation. With the development of a strong sellers' market for primary products, India began experiencing an acute shortage of raw jute at a time when demand abroad for jute manufactures was at a peak. Therefore India on her own initiative resumed trade negotiations with Pakistan in February 1951 and an agreement was concluded on February 25 between the two countries. At the same time, India also accepted the official par value of the Pakistan rupee as

communicated by the Government of Pakistan to the I.M.F. Shortly thereafter, that is on March 19, the I.M.F. accepted the par value communicated by Pakistan, namely, Pakistan Re.1 =30 .225 U.S. cents. *

The trade agreement valid for a period of 16 months up to the end of June 1952 provided for the export and import between the two countries of specified quantities of certain commodities. Another feature of the agreement was that a number of commodities were placed on the Open General Licence both for import and export by the two countries.

Following the trade agreement and the acceptance of the exchange rate, exchange control was extended to Pakistan and Afghanistan on February 27, 1951 ; from that date the Pakistan and Afghan currencies were treated as foreign currencies for all purposes and financial transactions with these two countries became subject to the restrictions imposed under the Foreign Exchange Regulation Act,1947. Although, with the introduction of the control, the settlement of surpluses or deficits arising out of transactions with Pakistan had to be made in sterling as in the case of other sterling area countries, it was the intention that financial transactions between India and Pakistan should continue to be conducted in rupees, either Pakistan or Indian. For this purpose, the two central banks undertook to buy and sell from and to authorised dealers in the respective countries Pakistan or Indian rupees, as the case might be, on a ready basis. The Reserve Bank's buying and selling rates for Pakistan rupees were Rs. 69-8-3 and Rs. 69-6-6 for Indian Rs.100 respectively, while the State Bank of Pakistan's rates were Rs. 144-0-9 buying and Rs.143-13-3 selling for Pakistan Rs.100. The rupee balances accumulated by the two central banks on account of current transactions taking place on or after February 27, 1951 were to be convertible into current sterling at any time, without any restrictions whatsoever. † Agreed capital transfers were to be settled between the two banks in blocked sterling.

In order to facilitate trade with Pakistan and Afghanistan, the Reserve Bank was prepared to consider granting limited licences to scheduled banks, which were not authorised dealers then, to undertake exchange dealings with these countries. The Bank was also prepared to consider the claims of indigenous bankers who had conducted hundi business in the past with these countries. Exports to Pakistan and Afghanistan also became subject to the normal export regulations, the Control's requirements being however varied to suit the particular needs of trade with these countries. In the case of large firms which regularly imported goods from and exported goods to these countries,

* The Pakistan rupee was devalued on July 30, 1955 resulting in its being at par with the Indian rupee again.

† The outstanding balances in the State Bank of Pakistan's accounts under the 1948 Payments Agreement and the 1950 trade agreement were thereafter not operated upon.

the Bank was prepared to grant permission to set off the value of the exports and imports provided the firms had the necessary valid import licences. Capital remittances to Pakistan were banned; the grant of exchange facilities for personal visits as well as for transfer of current items such as profits, dividends, interest and pensions, and maintenance remittances was also held in abeyance pending the establishment of corresponding facilities by the Pakistan Control for remittances to India.

As a further step towards facilitating trade between the two countries, with effect from April 16, 1951, the two central banks began to provide forward cover facilities also to banks for delivery up to six months, on a reciprocal basis, each bank squaring its overbought or oversold position in the other's currency through purchases or sales of sterling, as the case might be, from or to the other at the official rates applicable to such transactions. *

* These arrangements for the provision of both ready and forward cover by the two central banks were discontinued with effect from September 2, 1958 as financial transactions between the two countries from then onwards could be settled in Indian rupees, Pakistan rupees, sterling or any other sterling area currency.

Monetary Management And Allied Issues

The post-war period, 1945-51, is full of interest in the sphere of monetary management; the authorities in India, like their counterparts abroad, had to face many challenges. The prolonged political crisis, culminating in the transfer of power and the partition of the country, with its aftermath of vast social upheavals, added to the complexities of the situation. Largely as a result of this, Government's economic objectives and policies at times lacked the necessary continuity and cohesion, although this was also partly the unavoidable result of numerous changes at the topmost level affecting the direction of economic affairs. However, it was fortunate that in the Reserve Bank there was continuity of the top management, which by its clear, consistent and yet pragmatic approach exercised a salutary influence during this critical period. There prevailed a remarkable identity of views between the Bank and the Government and, even when there was a divergence of opinion between the two as on occasions in the immediate post-war years, the Government accepted the Bank's judgement on monetary matters.

The end of the Second World War ushered in a period of reawakened awareness of the vital importance of international co-operation in the economic and other spheres. It would be useful therefore to study the course of events in the Indian economy against the background of developments abroad. Generally speaking, despite the extensive damage suffered by industrial capacity, the recovery of national economies after World War II was spectacular compared to the experience after World War I as, profiting from its lessons, there had been in most countries advance preparations for meeting post-war problems. Intense domestic effort and substantial foreign aid from the United States, which had

nearly two-thirds of the official gold reserves and had its productive capacity almost intact, enabled most of the belligerent countries not only to restore pre-war levels of output of goods and services but even surpass them within a period of three or four years. A substantial measure of relaxation of war-time controls was generally brought about, though price controls continued to be retained in a number of countries as a check against inflationary forces. In some countries, drastic measures of monetary reform had to be undertaken to eliminate the bloated money supply and thus remedy the abnormal war-time inflation. Gradually there was also a return to monetary orthodoxy, that is to say, a retreat from war-time cheap money. Adjustments of exchange rates vis-a-vis the U.S. dollar, as an essential corrective of inevitably inflationary war finance, were also brought about, such changes occurring on an extensive scale and in an orderly way in September 1949. The post-war period was especially characterised by growing international monetary co-operation under the aegis of the International Monetary Fund and the International Bank for Reconstruction and Development. The substantial assistance provided by the United States for the rehabilitation of devastated areas, especially under the Marshall Plan, symbolised the growing awareness of the economic inter-dependence of nations. Also, financial assistance towards achievement of stability as well as for reconstruction and developmental needs began to flow, albeit on a modest scale, from the twin Bretton Woods institutions.

In India, mainly because of political uncertainties relating to the transfer of power, the course of the economy was far from smooth. On the whole, economic problems received less than due attention and growth during the post-war years was insignificant; indeed, industrial production, an important segment, received a set-back. There was even some confusion in authoritative quarters in the analysis of the economic situation and in policy prescriptions. In the beginning, although there was concern regarding the prolongation of inflationary pressures, the view prevailed for a while that a depression was likely soon after the war as a result of the abrupt contraction of public expenditure; it is worth noting that a similar view was widely held in the developed countries abroad. It would appear that the problem of a vast pent up demand and the consequent danger of latent inflation were not so prominently studied or sufficiently understood. Hence, at first, a policy of fiscal relaxation was pursued and there was also an attempt on the part of Government to cheapen money, despite resistance from the Reserve Bank. The only noticeable effort to tackle inflation took the form of a feeble attempt to mop up money accruing from tax evasion through demonetisation of high denomination notes early in 1946. However, it soon became clear that it was not any

depression but inflation that would be the aftermath of war, and with the intensification of the inflationary pressures arising from the withdrawal of controls and the marked stepping up of private spending, as well as budgetary deficits, a reversal of policies in the fiscal and monetary spheres became necessary. There was indeed a sharp departure in taxation policy underlying the budget for 1947~48, as it was, additionally, directed towards egalitarian social objectives through heavy direct taxation. Subsequently, taxation policy was gradually oriented so as to serve the twin objectives of withdrawing surplus funds from the community to counter inflation and at the same time of providing selective incentives for stimulating production and investment. There was also a gradual retreat from the abnormal cheap money conditions of the immediate post-war period. Also, in the beginning, there was much confusion and indecision in regard to physical controls. This resulted in too rapid a swing in the direction of decontrol ; but when this resulted in a sudden and serious rise in prices, there was a return, albeit reluctant, to controls, the desire to do away with restrictions ultimately being affirmed at the same time.

The frequent changes in fiscal policies during the period perhaps stemmed, to an extent, from the fact that in the five post-war years the country had no fewer than five Finance Members/Ministers! Fortunately, however, there was no change in the Governorship of the Bank till the end of June 1949 and this made for some continuity and stability in fiscal/monetary policy-making.

From the very beginning the Bank was aware of the danger of intensification of inflationary pressures in the post-war period. It therefore counselled great caution in the matter of dismantling the various physical controls and pleaded for their retention in the case, especially, of essential articles, like food and clothing. The Bank was also opposed to the further cheapening of money; it successfully resisted the suggestion of Government, in 1945-46, to lower the Bank rate as part of Government's drive to cheapen money. In fact, before long, the Bank skilfully piloted a modest retreat from cheap money. At the same time, the Bank's open market operations were reoriented to maintain confidence of the gilt-edged market in a period of successive shocks to confidence arising from political and other factors and to facilitate the return of the banking system to the normal credit-deposit ratio as also to enable it to move out of a Government securities portfolio with an excessive concentration of long-dated scrips. In the result, the Bank had to buy substantial quantities of Government securities. These purchases did not contribute much to monetary expansion because of the contractionist effects of heavy deficits in the balance of payments.

By about the close of 1949, the rupee had been devalued (in company with some thirty other currencies), and a substantial measure of normalcy had been achieved in the monetary sphere; latent inflation had been worked off to a considerable extent partly through a rise in prices and partly through balance of payments deficits met by drawing on war-time sterling accumulations. However, the trend towards stability in the economy received a set-back in June 1950, with the outbreak of hostilities in Korea which at one time threatened to assume larger dimensions. About the time our narrative in this volume comes to a close, namely, around March 1951, the Korean boom had started subsiding, although it was not till a year later that a sharp break in prices occurred.

MONETARY MANAGEMENT

Economic and Financial Trends

The developments in the economy may now be narrated in some detail. For a review of economic trends and policies, the post-war period falls into five phases, namely,

- (1) August 1945 to mid-August 1947, that is, the pre-partition period ;
- (2) mid-August 1947 to June 1948, the period when the Reserve Bank was the common central bank for India and Pakistan;
- (3) July 1948 to September 1949, the devaluation phase;
- (4) September 1949 to June 1950, the return of normalcy, and
- (5) June 1950 to March 1951, the period of the Korean boom.

(1) 1945-47: During the early part of this period there were apprehensions in India, as in other advanced countries, that deflationary tendencies in the economy would dominate the scene. The Finance Member (Sir Archibald Rowlands), in the course of his speech presenting the budget for 1946-47, referred both to the existence of 'pockets of inflationary forces which require to be closely watched and controlled' and the likelihood of deflationary tendencies in Indian conditions following the cessation of war expenditure. Accordingly, he stated that the objective before Government in the following year should be to avoid 'the Scylla of increasing inflation and the Charybdis of too precipitate a deflation'. In fact, economic policies and measures of Government were mainly in the direction of avoiding deflation and rebuilding the economy. To this end, the budget for 1946-47 provided various tax reliefs, including the abolition of the Excess Profits Tax and introduced special initial depreciation allowances in respect of new buildings and plant and machinery for promoting investment.

The Government also embarked on a policy of gradually withdrawing controls. The Finance Member stated in his budget speech in February 1946 that some 150 control measures had already been withdrawn. The Hoarding and Profiteering (Prevention) Ordinance of 1943 and the Consumer Goods (Control of Distribution) Order of 1944 lapsed on September 30, 1946, with the expiry of the Defence of India Act. However, the continuance of controls in respect of certain essential commodities including foodgrains and cloth was ensured by the passage of the Essential Supplies (Temporary Powers) Act, 1946, in November. In view of their reservations in the matter of decontrol, the Government of India appointed in February 1947, a Commodities Prices Board, for keeping under review the movements of commodity prices and to advise Government in the formulation and administration of appropriate price policies. The Board did not favour the abolition of the system of controls but urged its improvement.

As already mentioned, the Government also endeavoured to bring about a further cheapening of money. It is hard to say whether this step was motivated only by the desire to fight the threatened slump. In any case, the boom in share and property values resulting from such a policy, reinforced by large tax reliefs, was of help to the British investors to sell their holdings at good prices and transfer the proceeds to the U.K. The Government's plan was apparently to bring down their borrowing rate by $\frac{1}{4}$ to $\frac{1}{2}$ per cent. The Government were also most keen to carry out conversion of outstanding $3\frac{1}{2}$ per cent undated Rupee Paper to a 3 per cent basis. To facilitate this objective the Government also unsuccessfully tried towards the close of 1945 to persuade the Reserve Bank to lower the Bank rate. The conversion was announced in May 1946 and this led to an intensification of the boom in the share and commodity markets and added to the inflationary psychology. The situation was further aggravated by industrial unrest and a trend towards upward adjustment of wages and prices to compensate for the rise in the cost of living that had already taken place; this very adjustment constituted a factor of further inflation.

Besides, during the first post-war year, sterling continued to accumulate in a fairly large amount (Rs.190 crores) and although Government made strenuous efforts to counteract its expansionary impact through achieving a budgetary surplus, there was monetary expansion of the order of a little under 10 per cent. At the same time there was a marked expansion of commercial bank credit, of over 50 per cent, due partly to increased trade activity, particularly of imports, and a rise in advances against shares and securities. The result was a further marked rise in commodity prices, the Economic Adviser's general index (base: week ended August 19, 1939 = 100) rising from 244.1 in August 1945 to 271.3 in August 1946, i.e., by over 11 per cent in a year.

In the second post-war year, there was no sterling accumulation but, on the contrary, a substantial decline of Rs.180 crores, on account of payments on current and capital accounts. At the same time, a deficit on Government's budgetary account began to emerge. Commercial bank credit recorded hardly any net change over the year. The net impact of these factors was a modest contraction in money supply, of about 3 per cent. Commodity prices continued to advance, the general index rising to 299 by August 1947, or about 10 per cent higher than a year earlier. However, the unhealthy boom that characterised the stock market in 1945-46 -the rise in the share index (1927-28 = 100) was 48 per cent between August 1945 and August 1946 -received a set-back in September, when a sharp decline set in, owing among other reasons to the conviction that there would be no further cheapening of money and to the disturbed political situation in the country,

(2) 1947-48: The second phase, namely, mid-August 1947 to June 1948, was a period of great stress and strain. The loss of predominantly agricultural regions, consequent on partition, meant a reduction in the supply of food and other primary commodities. There was also a decline in agricultural production on account of the dislocation caused by communal disorders and the failure of crops in parts of the country. Industrial production also continued to suffer as a result of widespread civil disturbances, mounting labour unrest and the general atmosphere of uncertainty affecting business activity. The growing imbalance in the economy arising from the worsening supply position was aggravated by the broadening demand of individuals and industry for satisfying their deferred wants. There was substantial deficit in the Central Government budget as a result of the large expenditure on the relief and rehabilitation of displaced persons. This, as well as the Reserve Bank's open market operations (which were continued partly on account of extra-monetary factors), contributed to a substantial expansion in money supply.

Aggravating these inherently inflationary forces in the economy, the first post-Independence Government also ventured on a policy of substantial decontrol of the production, distribution and prices of important commodities like foodgrains and cloth, towards the close of 1947 and early in 1948. This decision was taken by the Government against the advice of the Commodities Prices Board, the Reserve Bank management and the opinion of the financial press. By and large, the expectations of Government with regard to larger availabilities on decontrol and consequent decline of prices were not fulfilled and there was a sharp rise in prices, especially of foodgrains and cloth, transport bottlenecks also being a contributory factor. The rise in the general index of wholesale prices in the period August 1947 to June 1948 was of the order of 30 per cent.

(3) 1948-49: During the third phase, from about the middle of 1948 till September 1949, the general index of wholesale prices remained more or less stationary and in fact recorded a temporary decline to 370 by March 1949 which was no doubt partly seasonal in character and was also in part due to a reimposition of controls on prices and distribution of many essential articles like foodgrains and cloth. However, this price stability would appear to have been substantially due to a large import surplus, representing imports both of consumption goods and capital equipment for the rehabilitation and modernisation of industry. Government pursued a very liberal policy with regard to imports through the institution of two Open General Licences. The large current account deficit and the sizeable outflow of capital on official account had a heavy impact on foreign exchange reserves, as reflected in the decline of sterling balances by Rs. 273 crores in the 14month period July 1948-August 1949; this more than neutralised Government's budgetary deficit. The net impact of these factors on money supply was a decline of over Rs. 300 crores or 15 per cent.

Government were much exercised during this period over the rise in prices that had occurred since December 1947 and held a series of discussions with economists and industrialists to evolve an anti-inflationary policy; the Reserve Bank's economists also participated actively in these discussions. The main features of this policy, announced in October 1948, were to enlarge availability of goods, through both increased domestic production and larger imports and to restrain the aggregate demand through the avoidance of Government's budgetary deficits and increased saving, personal as well as corporate. The introduction of a new form of short-term Government obligation, viz., the Treasury Deposit Receipts, raising of permissible limits for investment in small savings media, the promulgation of an Ordinance to limit dividends payable by public limited companies, the liberalisation of depreciation allowances, exemption from taxation of new industrial undertakings, abolition of capital gains tax, reduction of super tax and of import duties on plant and machinery as well as essential industrial raw materials were some of the measures taken to implement the above objectives. Although these measures were nearly all essentially long range ones, they did produce an immediate favourable psychological impact.

During this period bank credit recorded a net decline. Banks also experienced a substantial contraction in deposits, necessitating sales of Government securities which the Reserve Bank had to buy to help maintain orderly conditions in the gilt-edged market. The decline in deposits stemmed mainly from the very sharp balance of payments deficit which the country experienced during the year. By this time the abnormally low money rates prevailing during the war and immediate

post-war years had given way to a phase of stringency, the short-term rates ruling higher in the range of $\frac{1}{2}$ to $1\frac{1}{2}$ per cent as compared with a mere $\frac{1}{4}$ per cent in the latter part of the war period. There were distinct signs of the revival of the seasonal pattern of short-term interest rates characteristic of the Indian money market. The long-term gilt-edged yield also was restored to the level of slightly over 3 per cent prevailing at the close of the war. The higher yield basis and the petering out of inflationary forces were also reflected in a further substantial marking down of share prices, a process which began in the autumn of 1946. The index of equity prices (1938 = 100) declined from 262.5 in June 1946 to 112.9 in June 1949.

By about the middle of 1949, it could be said that the economy had returned substantially to normalcy. The latent inflation had been worked off to a considerable extent. The banking system had also reverted to the traditional pattern of assets. Economic and financial policies had fairly crystallised. This process was consummated so to say by the devaluation of the rupee in September 1949, which helped to a certain extent in restoring balance of payments equilibrium, through larger exports and restraint on imports.

(4) 1949-50: The year 1949-50 witnessed Government's endeavour to realise the benefits of devaluation as also to restrain the inflationary impact of the measure. In October 1949, the Government announced a comprehensive eight-point programme, with the main objectives of bringing about a reduction in the level of prices and an increase in the country's foreign exchange resources. Special emphasis was laid on a rapid expansion of exports and reduction in imports from hard currency areas consistently with maintenance of the flow of essential goods. Bilateral agreements were entered into for the exchange of goods with several countries. Steps taken for tackling the problem of the price level included a cut in the prices of controlled commodities like foodgrains, cloth, yarn, pig iron and steel, a check on speculation through the prohibition of futures trading in several commodities, and the levy of export duties on some of the articles exported mainly to hard currency areas. Other steps taken were the reduction in Governmental expenditure, the regulation of credit facilities with a view to discouraging speculative holding of stocks and attempts to augment national savings. A scheme for compulsory savings applicable to Government employees was introduced as from December 1, 1949. The National Savings campaign was reorganised and substantial tax reliefs and other concessions to industries as well as to individuals were granted for encouraging investment.

These policies were largely successful. The Bank's sterling assets recorded a net increase of about Rs. 50 crores in the period September 1949-June 1950, from Rs. 779 crores to Rs. 827 crores. As regards

commodity prices, there was a rise of a little under 5 per cent in the 12 month period July 1949-June 1950 and of under 2 per cent in the period September 1949-June 1950. The expansion of money supply and of bank credit were of modest dimensions. There was no budgetary deficit. The Reserve Bank's net purchase of securities during the year was also very modest.

(5) 1950-51: The last phase witnessed mainly the impact of the Korean War boom. There was a substantial improvement in the balance of payments position on account of larger exports resulting in an increase in foreign exchange reserves of the order of Rs. 30 crores in the year 1950-51 (July-June). At the same time, in contrast to the position of the preceding two years, commercial bank credit recorded a phenomenal expansion, of almost Rs.100 crores. The banks financed this to a large extent by sale of Government securities, which were bought mostly by the Reserve Bank. In the result, there was a sharp expansion of money supply of the order of Rs.100 crores or 5 -6 per cent between July 1950 and June 1951. Commodity prices also rose sharply by over 15 per cent. The halting recovery of share prices in 1949-50 gave place to a mild boom, the general index of equity prices recording a rise of 18 per cent. It was only with the cooling off of the Korean War in the spring of 1951, supplemented by the imposition of large export duties in the Government of India's Budget for 1951-52, that the boom conditions in the economy began to taper off.

Altogether, by about the middle of 1951, the abnormal forces operating in the economy in the war and post-war years had been nearly worked off and the economy was poised to embark on a modest developmental effort. By this time the Planning Commission had been established and the preliminary outline of the First Five Year Plan had been prepared and circulated. Close relationships had also been established with the I.M.F. and the World Bank, assistance from both the institutions having already been obtained to some extent.

Looking at the period as a whole, the main features of the economy were as follows:

- (i) A substantial decline in foreign exchange reserves. The Bank's sterling assets which rose from Rs. 1,478 crores on the eve of the termination of the war in August 1945 to a peak of Rs. 1,733 crores in early April 1946, stood at Rs. 857 crores at the end of June 1951. About Rs. 500 crores of the decline was, however, accounted for by extra-ordinary transactions, namely, payment to Pakistan and payment to the U.K. towards sterling pensions, etc.;
- (ii) a large budgetary deficit on Government account. The balances of the Central Government with the Reserve Bank which reached a peak of Rs. 533 crores in April 1946 came down to

Rs. 163 crores at the end of June 1951; Rs. 75 crores of the decline was accounted for by transfers to Pakistan;

(iii) a considerable expansion of commercial bank credit. Scheduled bank credit which stood at Rs. 284 crores on the eve of the termination of World War II rose to Rs. 552 crores at the end of June 1951, the credit-deposits ratio almost doubling in this period from 32 per cent to 62 per cent. The expansion in credit was largely financed by sale of Government securities, which were mostly taken up by the Reserve Bank, whose purchases were substantial, of the order of Rs. 250 crores;

(iv) a rather modest monetary expansion, the expansionary effects of budgetary deficit and bank credit expansion being mostly neutralised by the deficit in balance of payments; and

(v) a marginal decline in industrial production and a sharp rise in the price level of the order of 90 per cent reflecting mainly the release of pent up demand in the system.

With this background of the developments in the economy, attention may now be turned to the details of monetary management. Principally, this will be an account of the Bank's efforts initially to restrain Government from their policy of further cheapening of money and then to 'consolidate' the cheap money, which really meant a gentle retreat from the position reached in the middle of 1946. The Bank had also the task of facilitating the return of the banking system to the traditional pattern of assets, that is, higher credit ratio and lower investments ratio as compared to the war years, and enabling the economy to finance the balance of payments deficit, on current and capital accounts, which was partly necessary and partly unavoidable. These involved substantial purchases of Government securities.

Matters relating to regulation and supervision of banking and the steps taken to deal with the banking crisis in Bengal are dealt with in Chapter 22. A brief account is also given in this chapter of the Bank's role in devising a suitable framework of regulation of the stock and commodity exchanges.

Retreat from Cheap Money

During the major part of the war period, official policy in India was to maintain a stable pattern of interest rates, with the Bank rate unchanged at 3 per cent and the Government borrowing rate also remaining at that level. In other words, while there was support to the doctrine of cheap money, there was no desire to proceed very far in that direction. Rather, the objective was to raise as much money as possible through sales of Government securities at stable rates. There was complete identity of views in this matter between the Finance Member

(Sir Jeremy Raisman) and the Reserve Bank authorities. The next British Finance Member, Sir Archibald Rowlands, who assumed office in April 1945, however, was desperately anxious to usher in an era of cheaper money after termination of the war. The Government's view then was, as already mentioned, that deflationary forces were likely to predominate after the cessation of hostilities. To counteract this, the Finance Member was anxious to use fiscal and monetary devices. Reference has already been made to the tax concessions given in the budget for the year 1946-47. The Finance Member was also keen that interest rates should be brought down and he wanted to signalise it by the redemption of the 3 ½ per cent Non-terminable Paper and its conversion to loan(s) carrying lower rate(s). Apparently, the Reserve Bank authorities were not enthusiastic about this but 'to give the views of the Finance Member a fair chance' the Governor suggested, in November 1945, that they 'should test the market with a suitable dated loan on distinctly ungenerous (to the market) terms'. The Governor also favoured the issue of a longish loan at 2 ¾ per cent, to be floated about the middle of January 1946. While accepting this suggestion, the Joint Secretary of the Finance Department (Mr. Sundaresan) sounded the Bank on a reduction of Bank rate. Wrote Mr. Sundaresan, on November 30, 1945:

Hon'ble Member would also like you to consider whether the Bank rate could not be reduced just before the floatation of the new loan in order to give it a chance of success by indicating to the market our new policy of inaugurating cheaper money.

Replying to this on December 5, the Governor suggested that the best time to put the matter of Bank rate reduction before the Committee of the Central Board would be after the announcement of the new loan but before the loan was open for subscription. Since the announcement of the new loan (2 ¾ per cent Loan 1960, at par) was scheduled to be made on January 8, the Governor suggested that if during the course of the next morning he received a telegram from the Finance Department requesting him to invite the Committee to consider the desirability of changing the Bank rate with reference to the new loan, he could place the matter before the Committee in the afternoon. The Governor added:

On the merits, I agree that there is something to be said for giving such an indication to the market of your new policy. It assumes, of course, that you are confident of your ability to maintain that policy by the sustained volume of your expenditure. If you feel confident in that respect, it would help if you included the expression of such confidence in the telegram which I have suggested your sending me on the morning of the 9th January.

Accordingly, on January 8 the Finance Department sent the following telegram to the Reserve Bank:

Secret. New Loan. As you will appreciate, 2 $\frac{3}{4}$ per cent Loan 1960 is being floated to signalize Government's intention to inaugurate a cheaper money policy which will be both necessary and helpful for development expenditure. We intend to maintain that policy by sustained volume of public expenditure and we should greatly appreciate if at tomorrow's meeting of your Committee you would invite them to consider desirability of immediately lowering Bank rate. As you know, list for new loan opens on fifteenth.

So, the Governor placed the matter before the Committee and, in fact, the draft of a circular to be issued to the scheduled banks, in the event of the Committee's agreeing to a reduction of the Bank rate, was kept ready; the new Bank rate mentioned in the draft of the circular was 2 $\frac{1}{2}$ per cent.

The Committee of the Central Board was attended, besides the Governor (he came down from his 'enforced rest' to guide the discussions 'in the right channels') and Deputy Governor (Mr. Trevor), by only two outside Directors, namely, Sir Purshotamdas Thakurdas and Sir Homi Mehta. The decision of the Committee was that 'on very careful consideration of all the relevant factors, it was resolved that the Bank rate remain unchanged at 3 per cent'. Sir Chintaman Deshmukh's account of what transpired in the Committee on this subject is contained in his D.O. letter of January, 1946 to the Finance Secretary:

Sir Purshotamdas, who said he had given his very careful consideration to the proposal, expressed the view that while Government's policy over the past few years had been to curb inflation, it appeared that their present intention was in a reverse direction, and that while a cheap money policy at the proper time would be of great advantage to the country, the indication is that inflationary conditions are still present. A decrease in the Bank Rate would unleash an unbridled bout of speculation. He also doubted Government's ability to maintain a cheap money policy throughout the full period of the country's postwar development, unless a full and restrictive control is continued over capital investments, which would be most unpopular with the general public, and considered it would be disastrous if Government had to revert to a higher rate after a short period through failure to implement its policy. The present rate is, to all intents and purposes, an ineffective one and does not reflect the true present rate for money, but why run the risk of reducing it to a rate which it might be found impossible to maintain? It is not anticipated that any benefit from a reduced rate would be passed on to agriculture, and the return on gilt-edged investments would become so unattractive as to discourage the general investor. Sir Purshotamdas considers there is a grave danger of overdoing the cheap money policy, and that further experience is necessary before running the risk of failure to implement Government's monetary

policy. To sum up, he considers that the time may soon come when, Government being fully satisfied as to their ability to maintain a cheap money policy throughout the full period of their development programme, it will be desirable to reduce the Bank Rate, but that time is not yet. In any case, he would like to see first what Government have planned for the next budget.

Sir Homi was in general agreement with these views, but held especially that a change in the Bank Rate will make no difference, although he did not quite see how lowering it would increase speculation.

In view of these expressions of views, I did not feel justified in pressing for a lowering of the rate.

It is interesting to note that the Indian Finance, which had campaigned vigorously for a reduction in Bank rate as also for the conversion of the 3 ½ per cent Paper, welcomed the decision not to reduce the Bank rate. Wrote this journal, in its issue of January 12, 1946, as under:

It may seem surprising that “ Indian Finance “, which has been the first and foremost to advocate a reduction in the bank rate, is pleased that the bank rate has been maintained in the current week. There have been wild fluctuations in prices in the share markets in Bombay as in Calcutta. If the Bank rate had been reduced, it might have induced an uncontrollable boom. The Reserve Bank has, therefore, adopted a very appropriate policy in withdrawing tap loans and thereby maintaining the bank rate at the unchanged rate of 3 per cent by inducing a flow of subscriptions to the New Loan, and thereby withholding what might have proved a highly inflationary stimulus to the share markets in their present state.

The issue of the 2 ¾ per cent Loan, 1960 was, however, a failure, in that out of an offer of Rs. 25 crores, as much as Rs. 22 crores had to be taken up by the Government and the Reserve Bank. The failure of the loan seems to have been due less to intrinsic market forces than to the temporary confusion caused by the Demonetisation Ordinance. It was not long before the gilt-edged market witnessed the return of firm conditions, the stimulus being provided especially by the bullish budget of Sir Archibald Rowlands. It was possible for the Government to come out with special issues of the 3 per cent Loan, 1970-75 and of the 2 ¾ per cent Loan, 1960 in February and April, 1946, respectively. The Finance Department was anxious that the Bank should so conduct its operations that security prices rose quickly. The Governor was in fact annoyed at what looked like pressure tactics of the Government in this matter.

Incidentally, in February 1946, the Governor recommended the issue of a short-medium (8 years) tax-free loan carrying an interest of 1 ¾ per cent and also having the feature of bearer security. This was intended to offer attraction to owners of high denomination notes wishing to invest the proceeds of their demonetised notes. ‘Our object in making this suggestion’, the Governor stated, ‘is merely that a facility

may be offered for investing in Government loans to those who would wish at the same time to keep their holding clear of the net of the tax gatherer '. For some reason this idea was not pursued.

In view of the improvement in the gilt-edged market, the Finance Department became keener and keener to announce the redemption of the 3½ per cent Loan. The cheap money operations undertaken by the U.K. Government in 1945-46 provided no doubt a further stimulus to Government thinking in this behalf. Sir Archibald Rowlands, who was due to relinquish the Finance Membership, was most anxious to tackle this before he left.

In the circumstances, the Governor agreed to the redemption operations. On April 27, 1946, he wrote to the Finance Secretary as under:

Having regard to the present money market situation and prospects, I am of the opinion that the time is opportune for reviewing the possibility of undertaking the redemption of 3 ½ per cent Paper. Although in earlier discussions on the subject I had expressed myself as being averse to carrying out such an operation on grounds of caution and circumspection, in view of the success of the 2 ¾ per cent 1960 loan which I had suggested as a tester, I now consider that the conditions in the money market have altered sufficiently to justify a revision of that opinion and that, judging from the prevailing situation and outlook an undertaking of this character would be attended by reasonable prospects of success. In forming this opinion, I assume that Government are satisfied that they would be able to exercise reasonable control with regard to the food and cloth position and that there will be no deterioration of the general financial and economic situation during the ensuing months.

As to the scrip into which facilities for conversion of the 3 ½ per cent Paper (which was redeemable only at the Government's option) should be offered, the Governor advised that while it should also be an irredeemable issue it should not carry a yield below 3 per cent. The Governor also suggested a 2 ¾ per cent dated issue maturing in 1985, the issue price being 98 per cent, giving a redemption yield of approximately 2.84 per cent. Notice of redemption was to be given about the end of May. To meet the Finance Member's doubt about unduly long maturity and low issue price, the Governor later suggested a 2 ¾ per cent Loan, 1976 at Rs.99 giving a yield of 2.80 per cent. The Government accepted the recommendations; the announcement of redemption was made on May 24.

The Governor desired that a 2½ per cent rate for medium-term loans should be established, and for this purpose he recommended to Government in June 1946 the issue of a loan with a maturity of 10 to 12 years. Unfortunately the letter, which had not been registered, was lost. Meanwhile the market had also improved and so the Bank recommended that the maturity could be lengthened for the same 2 ½ per

cent coupon rate. This was the issue of the 2 ½ per cent Loan 1961 at par. The loan was a success, no doubt largely under the bullish impact of the announcement of the redemption of the 3 ½ per cent Paper made in May.

The conversion operation was a complete success. Out of an outstanding amount of Rs. 273 crores, Rs. 263 crores were converted till the end of January 1947 -Rs. 249 crores into the 3 per cent undated Loan.

The conversion operation met with a mixed reaction. While a section of the financial press (*the Indian Finance and the Eastern Economist*) welcomed it, there was also widespread feeling that the conversion was uncalled for, having regard to the long run interest of the money and capital markets. The senior Director of the Bank, Sir Purshotamdas Thakurdas, in his capacity as Chairman of the Oriental Life Insurance Company, was highly critical of the conversion operation, especially on the ground that incomes of large numbers of people who had invested their savings in this would suffer. It should also be a matter of interest to mention that the 3 per cent Conversion Loan steadily declined over the years and is now (March 1970) quoting at Rs. 60; this loan (which may be called the 3 per cent Rowlands), incidentally, has fared better than the 2 ½ per cent Daltons, which are quoting at about £29 ½ !

Meanwhile, the Bank undertook a comprehensive study of the subject of cheap money, this being one of the first tasks allotted to the newly-created Department of Research and Statistics. The conclusions of this detailed study of the Bank's economists (Messrs Joshi, Prasad and Simha), which was completed in June 1946, was that while it was undesirable to reverse the policy of cheap money there was clearly no case for pushing this policy any further; what was called for was a consolidation of the position already attained and of ensuring that the benefits of cheap money percolated to all the different economic sectors in the country. The Governor accepted these conclusions and in his address to the shareholders at the annual general meeting of the Bank held in August 1946 made detailed observations on the subject. While noting the general desire all over the world to maintain cheap money conditions, the Governor pointed out that this policy involved Government regulation of economic activity, though the extent to which such regulation became necessary would vary from country to country. Discussing the subject of further advance in the direction of cheap money, the Governor mentioned that the matter would have to be considered carefully in the light of the conditions peculiar to each country. In India, where the percentage of saving to national income was smaller than in the developed countries, enforcing a given rate of interest needed a much greater degree of interference with the market forces, involving controls. On the other hand, the administration of

controls was difficult. Moreover, in India cheap money had to percolate to many sectors of the economy. The Governor also referred to the likelihood of cheap money policy intensifying the boom conditions in the share markets and of aggravating the inflationary potential in the country. The Governor concluded that 'our efforts should be directed towards consolidating the progress that has already been made'.

The press reaction to the Governor's views on cheap money was varied. While the staunch exponent of cheap money, viz., Indian Finance was disappointed, the Eastern Economist warmly welcomed the policy of 'thus far and no further'. In its issue of August 23, 1946, the paper stated as follows:

on a balance of conflicting considerations, the Government is justified in pursuing the cheap money programme to the extent that they have done ; but, the time has now come to take steps to make cheap money available for irrigating the channels of production investment, particularly in agriculture. We are glad to note that the Governor of the Reserve Bank is in substantial agreement with these views.

In October 1946 the Bank recommended the issue of an eight-year loan at 2 ¼ per cent at par for Rs. 35 crores. The Bank also recommended a long-term loan not open to banks for subscription, on the model of the U.S. practice followed in war time. The reasons for restricting the issue to the investing public, other than banks, were explained by Deputy Governor Trevor in his letter to the Finance Secretary. According to the letter:

The taking up of securities by banks is generally inflationary as additional purchasing power is created in this manner, whereas the issue of loans to investors other than banks draws off vagrant funds from the hands of the public. . . .The prohibition on banks holding this scrip will be in furtherance of Government's anti-inflationary programme, the proposed restriction being also desirable on the ground that banks should be discouraged from holding any significant amount of long-term loans in their investment portfolios.

The proposal for the long-dated issue was not, however, accepted by the Government. The lists for the 2 ¼ per cent Loan, 1954 were opened on November 15 and the loan was a failure, the Government and the Reserve Bank having to take up between themselves Rs. 30 crores. Apart from the fact that the sentiment in the gilt-edged market had changed following the Governor's warning about the further cheapening of money, the loan was floated after the busy season had well begun. For several months the market had been fed on speculation fervour and when once this bubble burst the sentiment turned adverse. Another important factor was the strained political situation in the country. The Bank was of the view that the Government's conversion operation had alienated to some extent the support of institutional

investors. Further, the yields obtainable from investments other than Government securities had gone up significantly. Moreover, there was a general desire to remit funds abroad partly on account of the political uncertainties and partly on expectations of lowering of the exchange rate of the rupee.

In the next 3-4 years the gilt-edged market continued to be on the whole uneventful. The Government were hardly able to get any net subscriptions to Government loans, the redemptions of maturing loans being about the same as, if not larger than, the subscriptions to new loans. Besides, the Reserve Bank had to make substantial purchases of the order of Rs.280crores, in pursuance of its policy of maintaining reasonable stability in the gilt-edged market and to restrain excessive rise of short-term interest rates. From 1946-47, the market witnessed the return of the pre-war pattern of slack and busy periods.

In his address to the shareholders of the Bank in August 1947, the Governor explained again the Bank's policy of consolidation of cheap money rather than further movement in that direction. Indeed, the Governor was more forthright in his warning against excessive cheapening of money. The Governor remarked that:

It is being increasingly recognised that, beyond a certain limit, cheap money not only ceases to be beneficial but in certain conditions, as for instance, when inflation outlives the forces that engendered it, becomes positively harmful to the economy. . . Indeed, even the maintenance of low yields, in the face of an upward pressure as a result of sales by individual and institutional holders for financing consumption and productive purposes, would itself be an achievement, involving a very heavy strain on the resources of the monetary authorities.

The Governor referred to the unpegging of short-term interest rates in the United States and the process of consolidation of cheap money in the U.K. after the conversion operations. The Governor also explained how the market had misread the Government's intention by concentrating too much on the coupon rate and ignoring the maturity of the loan. Thus, when the 2 ½ per cent 1961 Loan was issued, there was the superficial view that this was cheapening, though the maturity was 15 years -shorter as compared to the 2 ¾ per cent Loan, 1976. Finally, the Governor clarified that stable interest rates did not mean pegged rates and that the variation of yields within a certain range was not only inevitable owing to the operation of seasonal factors but was also necessary for providing the central bank with a certain measure of control over the money and capital markets.

The first Finance Minister of independent India, Mr. R. K. Shanmukham Chetty, echoed the Governor's views with regard to consolidation of cheap money, in the course of his budget speech in November 1947. In fact, on this subject there were questions in the Legislature

and in the debate on December 1, 1947, the Finance Minister clarified the Government's position further in wanting to adhere to the state of cheap money already attained. The Minister also referred to the extreme difficulty of retreating from the policy of cheap money.

These remarks of the Finance Minister provoked the *Indian Finance* to draw the conclusion, in its issue of December 6, 1947, that:

The ostentatious wobbling, which the Finance Minister indulged in regard to the cheap money policy in his budget speech, is slowly yielding place in his subsequent utterances to definite confessions of partiality for its opposite.

The journal referred to the views of the Governor of the Reserve Bank on this subject and desired that the Finance Minister must not merely endorse the views of the Governor; rather he should favour a policy of cheap money which would be 'of demonstrably wide benefit to the national finances and the national economy'. Apparently, the journal did not notice that maintenance of cheap money had meant substantial purchases of securities by the Reserve Bank. In 1946-47 (April-March) the Bank had to make net purchases of Rs. 62 crores.

Once again, in August 1948, using the occasion of the Bank's annual meeting of shareholders, and the last one, the Governor expounded the Bank's philosophy and operations in the field of interest rates. He drew the attention of shareholders to the phenomenon of central banks and Finance Ministers bowing with varying degrees of grace and reluctance to the inevitably upward trend of interest rates. The Governor pointed out how in India, despite the sweeping political and economic changes, the gilt-edged market had presented a remarkably steady appearance. The Bank had contributed to this by substantial and yet discriminating support to the gilt-edged market. The Governor also explained how indiscriminate purchases by the Bank would only have encouraged sales and pointed to the inflationary impact of such purchases by the Bank, especially in the context of the policy of decontrol on which the Government had embarked earlier. The Governor quoted chapter and verse to mention how even in foreign countries the short-term money rates and gilt-edged yields had gone up substantially in the post-war period.

The subject of cheap money continued to engage the attention of financial journals, bankers and industrialists. Some industrialists, notably Mr. G. D. Birla, were champions of the cause of cheap money at all costs. There were also protagonists of dear money policy. Thus, in his address to the shareholders of the Punjab National Bank, on April 8, 1949, the Chairman, Lala Yodh Raj, expounded the case for higher interest rates as follows:

The policy of cheap money has had its run for over 16 years and appears now to be out of tune with the economic forces in the country. The

demand for capital has outstripped its supply. The fundamentals have changed and the obvious remedy appears to be to use the monetary policy again as an active instrument of disinflation with its reliance on credit restrictions and increase in interest rates.

Another fact should not be lost sight of. Cheap money and disinflation necessitate a large and continuous surplus of revenue over expenditure in the national budget which means that the State saves instead of the general public. A budget surplus, however, cannot, in the long run, replace private savings. At best, it is a cumbrous form of saving and is likely to lead to equally cumbrous forms of investment. A heavily taxed nation is not, in the long run, going to bear still heavier taxes for the purpose of providing a permanent budget surplus. The weakening of the individual incentive to save, which must be the inevitable result of this policy, is also not desirable at all and the incentive to save has no meaning without the ability to save.

Considered from all points of view the benefits of higher interest rates very well outweigh the minor disadvantages. Other things being equal, the capital formation will also be encouraged.

In the context of the altered conditions in the gilt-edged market, Government's borrowing programme had to be kept modest and efforts to consolidate cheap money mainly took the direction of keeping the coupon rates unaltered but of substantially shortening the maturity. Thus, while in August 1946 a coupon rate of 2 ½ per cent was offered for a 15-year loan, in October 1948 the same rate was offered for a 15-year loan and in January 1950 for a 15-year loan. Similarly, whereas earlier a rate of 2 ¾ per cent had been offered for a 7-year loan, in June 1950 a rate of 3 per cent had to be offered. After the conversion operation of 1946, this was the first loan bearing a coupon rate of 3 per cent. The terms of the various loan issues in the period 1945-51 are summarised in the table on page 694.

As already mentioned, the Government's net borrowing during the 5-year period 1946-51 was negative, that is to say, there was a reduction in debt. The funded debt of the Government of India, which stood at Rs. 1,498.93 crores at the end of March 1946, declined to Rs. 1447.11 crores by the end of March 1951.

Trends in Gilt-edged Yields and Money Rates

The net result of the consolidation process was that the decline in yields that occurred between the end of the war and August 1946 was reversed. In fact, the pattern of yields in March 1951 was somewhat higher than that prevailing at the close of the war in August 1945. However, the general pattern of yields was still lower as compared to that prevailing on the eve of World War II. In other words, as compared to the pre-war years, there had occurred a noticeable progress in the direction of cheap money. These movements are well

LOAN FLOATATIONS, 1945-51 — CENTRAL GOVERNMENT

| <i>Date of issue</i> | <i>Name of loan</i> | <i>Period of loan</i> | <i>Issue price (Rs.)</i> | <i>Amount offered</i> | <i>Form in which subscriptions were called for</i> |
|-----------------------------|---|-------------------------|--------------------------|-----------------------|--|
| 2- 7-1945 | Special Issue of 3 per cent Loan, 1970-75 | 25-30 years | | Rs. 30 crores | |
| 16- 7-1945 | 2½ per cent Bonds, 1950 | 5 years | At par | Rs. 20 crores | |
| 29- 9-1945 | Special Issue of 3 per cent Loan, 1963-65 | 18-20 years | | Rs. 25 crores | |
| 13-10-1945 | Special Issue of 2½ per cent Bonds, 1950 | 5 years | | Rs. 15 crores | |
| 15-11-1945 | Special Issue of 3 per cent Loan, 1970-75 | 25-30 years | | Rs. 25 crores | |
| 15- 1-1946 | 2¾ per cent Loan, 1960 | 14 years | At par | Rs. 25 crores | Cash |
| 16- 2-1946 | Special Issue of 3 per cent Loan, 1970-75 | 24-29 years | | Rs. 20 crores | |
| 9- 4-1946 | Special Issue of 2¾ per cent Loan, 1960 | 14 years | | Rs. 20 crores | |
| 1- 8-1946 | 2½ per cent Loan, 1961 | 15 years | 100-0 | Rs. 35 crores | Cash |
| 5- 8-1946 | Special Issue of 2½ per cent Loan, 1961 | 15 years | | Rs. 20 crores | |
| 15- 8-1946 to 14-10-1946 | 3 per cent Loan, 1986 or later & 2¾ per cent Loan, 1976 | Non-terminable 30 years | 100-0 99-0 | | Subscriptions to be in form of 3½ per cent Loans (non-terminable). |
| 15-11-1946 | 2¼ per cent Loan, 1954 | 8 years | 99-8 | Rs. 35 crores | |
| 15-11-1947 | 2¾ per cent Loan, 1962 | 15 years | 100-0 | Rs. 40 crores | Cash & in 3½ per cent Loan, 1947-50. |
| 1- 6-1948 | 2¾ per cent Loan, 1962 | 14 years | 100-0 | Rs. 35 crores | Only in form of 2¾ per cent Loan, 1948-52. |
| 1-10-1948 | 2½ per cent Loan, 1955 | 7 years | 100-0 | Rs. 20 crores | Cash |
| 4- 7-1949 to 8- 7-1949 | 2½ per cent Loan, 1955 2¾ per cent Loan, 1962 | 6 years 13 years | 99-12 99-8 | | Subscriptions in form of 3 per cent Loan, 1949-52 to be accepted at par. |
| 16- 1-1950 | Special Issue of 2½ per cent Loan, 1955 | 5 years | | Rs. 15 crores | |
| 19- 6-1950 | 3 per cent Loan, 1964 | 14 years | 100-0 | Rs. 30 crores | In cash or 2½ per cent Bonds, 1950 at par. |

reflected in the yield of the 3 per cent Rupee Paper. From 3.54 in August 1939 it came down to 3.15 in August 1945 and further to 2.83 in August 1946, the lowest level of the cheap money era. Subsequently there was a rise in the yields, the level in March 1951 being 3.23.

The trend of the money market rates also reflected the departure from the post-war low levels as well as the increasing strength of demand for funds. Besides a marked increase in the requirement of funds for imports, the abnormal political conditions in the country also put a premium on liquidity. The decontrol experiment and the rise in commodity prices also accentuated the stringency in the money market. During the three years 1945-48, this was reflected in a marked expansion of scheduled bank credit. In the following two years, that is, 1948-50, there was not much of credit expansion but there was a marked decline of deposits. After the outbreak of the Korean War, however, there was large scale expansion of bank credit. The inter-bank call rate, which stood at $\frac{1}{4}$ of one per cent in 1945, steadily rose to $1\frac{3}{4}$ per cent in 1951. The rising trend of short-term rates is also evidenced by the raising of the Imperial Bank Hundi Rate from 3 to $3\frac{1}{2}$ per cent in January 1949 and further to 4 per cent in January 1951.

The Reserve Bank provided substantial assistance in mitigating monetary stringency. As already mentioned, this took mainly the form of purchases of Government securities, the bulk of the purchases representing sales by banks. The transactions year by year are given in the table below.

| (Rs.crores) | | | |
|---------------------------------|-----------|-------|--------------------------------|
| Financial Year (April-March) | Purchases | Sales | Net Purchases (+) Sales (-) |
| 1945-46 | 45.77 | 70.30 | - 24.53 |
| 1946-47 | 95.35 | 33.06 | +62.29 |
| 1947-48 | 75.76 | 23.42 | +52.34 |
| 1948-49 | 121.84 | 30.42 | +91.42 |
| 1949-50 | 89.22 | 70.68 | +18.54 |
| 1950-51 | 155.06 | 98.79 | +56.27 |

While the Bank purchased Government securities sold by the banks, it warned the banks, in March 1948, against the tendency to prefer long-dated securities, in view of the need for a more balanced maturity distribution to provide a stronger second line of defence in the shape of short-term securities. There was also a veiled threat that if the banks did not correct the position, legislation might have to be introduced to compel them to hold a certain percentage of short-dateds. To enable the banks to follow this advice, the Bank was prepared to make swap

transactions, that is, buy long-dateds in exchange for short and medium-dateds. In his address to the shareholders in August 1948, the Governor repeated the advice. To the extent the banks followed this, they would have been better prepared to face the Bank rate rise of November 1951.

Measures to Relieve Seasonal Stringency

The Reserve Bank also made larger short-term advances to the scheduled banks, to relieve seasonal stringency. The advances were insignificant till 1948, but thereafter they became rather significant. Thus, whereas the borrowings from the Reserve Bank rarely exceeded Rs. 1 crore during the war time, they were somewhat larger in 1946 and 1947. However, from September 1948 onwards borrowings were substantial. Thus, in 1948, the peak of borrowing was reached at the end of December at Rs. 17.28 crores. In 1949 and 1950 the average outstanding was of the order of Rs. 6-7 crores.

The Bank authorities gave considerable attention to the policy aspects of loans and discounts to the scheduled banks to relieve seasonal stringency and also to meet abnormal situations as a result of loss of confidence on the part of depositors. The subject figured at several Board meetings, namely, December 1946, February, April, and December 1947, and February, April and July 1948. Matters relating to banking crisis, especially in Bengal, and the arrangements for making emergency advances will be discussed in detail in Chapter 22. It will be convenient to discuss in this section the policy with regard to meeting the stringency in the money market owing to the operation of normal economic factors. In a very comprehensive memorandum submitted to the Central Board for consideration at the April 1947 meeting, the steps to relieve seasonal stringency in the past 25 years, that is to say, even in the days prior to the Bank's existence, were described. The Governor's view was that the best method of relieving seasonal stringency was the purchase, rediscount or advance against bills of exchange and promissory notes, arising out of bona fide commercial or trade transactions, under Sections 17(2) (a) and 17(4) (c). This device would enable the Reserve Bank to follow and exercise control over the end-use of credit which was not possible in the case of purchase of securities by the Reserve Bank. The reluctance of banks to disclose to their clients that they were borrowing from the Reserve Bank and their unwillingness to convert their advance into bills were noted but it was expected that these prejudices would gradually disappear. Also, with experience, the Reserve Bank would be able to complete its enquiries about the standing of the constituents of banks quickly and provide credit promptly.

This conclusion of the Bank was, however, only the reiteration of what had been clearly recognised by the framers of the Reserve Bank of India Act. It was, however, worth emphasising, particularly in view of the likely expansion of bank credit and the depleted Government securities portfolio of banks. (Progress in this direction, however, occurred only early in 1952: following the raising of Bank rate and the suspension of purchase of securities to relieve seasonal stringency announced in mid-November 1951.) It was possible for the Central Board to consider this matter only at its December 1947 meeting, on account of the preoccupation with many matters relating to partition. Meanwhile, at the Bank's suggestion, Government had promulgated an Ordinance on September 20, 1947, amending Section 18 of the Reserve Bank of India Act, to enable the Bank to make advances to scheduled and non-scheduled banks against such form of securities as the Bank considered sufficient. Later, the Board also asked for a memorandum examining the practicability of making advances against demand promissory notes. The conclusion of the Bank was that the existing facilities for meeting seasonal requirements were adequate and that there was no need to amend Section 17. This matter was not, however, formally considered by the Board again.

Another device to provide some relief to the stringency in the market was continuously to reduce Treasury bill offerings. Thus, the annual Treasury bill tenders were reduced from Rs.160 crores in the year 1945-46 to Rs. 44 crores in the year 1949-50. Treasury bill sales were suspended from December 1949 to early September 1952. Treasury bills outstanding with the public steadily declined from Rs. 37 crores at the end of March 1945 to nil by the end of January 1949. On the other hand, the Provincial Governments took greater interest in Central Treasury bills, the outstanding of their holdings going up from Rs. 46.18 crores in March 1946 to Rs. 83 .51 crores in March 1951.

Besides reduction of Treasury bill offerings, the Reserve Bank also provided greater facilities to scheduled banks for rediscounting these bills. The Bank reduced, effective July 1, 1946, the minimum interest charged for rediscounting Treasury bills from one anna per cent to half anna per cent actual, i.e., the price that could be paid for any bill was raised from Rs.99-15-0 to Rs. 99-15-6 per cent. The rate of discount continued to remain the same, viz., one anna above the average rate for Central Government bills at the preceding auction rounded off to the next anna above. The minimum of one anna per cent was originally fixed (in 1938) to represent interest for a period of about a fortnight. At the rates prevailing in 1946, viz., eight annas, the minimum of one anna per cent represented interest for a period of about 45 days. In the changed circumstances, the minimum was reduced to half an anna, which, it was considered would not be penal

and yet would be sufficiently high to eliminate any abuse of the concession by the scheduled banks.

While on the subject of discounting of Treasury bills, reference may be made to the withdrawal of a concession which the Imperial Bank had enjoyed for many years. It will be recalled that in view of the support accorded by the Imperial to Government's Treasury bill policy, the Reserve Bank allowed it a concessional rate for discounting both Central and Provincial Treasury bills, the rate for Central Treasury bills being the average rate of the last preceding auction, whereas the other banks had to pay a slightly higher rate. In November 1939, the general question of the rate to be charged for discounting Treasury bills was examined by the Bank and it was decided that the special terms set out for the Imperial Bank were no longer necessary. But something went wrong in implementing this decision and the Bank continued to rediscount bills at the concessional rate. The position was reviewed again in April-May 1946 and the concession was withdrawn. In respect of Provincial Government Treasury bills, however, the Bank did not withdraw the concessional rate, as in respect of these bills, the Imperial Bank's support was regarded as essential.

Ways and Means Advances to Provincial Governments

During the period under review, the Reserve Bank had to provide substantial short-term accommodation to Provincial Governments too, in the form of ways and means advances. The Provinces made comparatively little use of Treasury bill tenders to obtain short-term requirements. In 1946-47, Assam and Bengal were the only Provinces to resort to Treasury bill borrowing; in 1947-48, West Bengal alone issued the bills and in the following two years only Madras and the U.P. issued these bills. From January 1950, Provincial Governments stopped issuing Treasury bills. As compared to sales of Rs. 35.5 crores in 1946, sales in the following 4 years were Rs.16.50 crores, Rs. 4 crores, Rs.1.54 crores and Rs.13.50 crores, respectively. Public interest in Provincial Treasury bills was even less than in the Central bills. The Imperial Bank was the main subscriber; the Reserve Bank and the Provincial Governments themselves were other subscribers.

The Bank's policy regarding ways and means to Provincial Governments as laid down in Clause 6 of its Agreement with the Provinces, viz., (1) outstanding ways and means were not to exceed the amount of the minimum balance prescribed for the Provincial Government concerned and (2) the advances were to be fully paid off at intervals not exceeding three months, continued to remain basically unchanged. However, on several occasions, the Bank considered it expedient to grant, only as a temporary measure, ways and means advances to

certain Provincial Governments considerably in excess of the prescribed limits; a substantial portion of the excess advances was against cover of Government of India securities. Also, in exceptional cases, advances were allowed to remain outstanding beyond the prescribed period of three months. Total ways and means taken by Provincial Governments rose from Rs. 7.67 crores in 1945-46 to Rs. 38.22 crores in 1948-49 and further to Rs. 64.74 crores in 1949-50; in 1950-51 they were lower at Rs. 42.15 crores.

As large advances tended to become a chronic feature of State Government finances, the Bank decided in May-June 1950 to call a halt to this practice and regularise its ways and means transactions with the State Governments. The Bank submitted a memorandum to the Government of India in June 1950, drawing their attention to the situation and emphasising that ways and means were not intended to be an expedient for financing Governments for any long period. When such advances could not be repaid from the resources at the disposal of State Governments, the Bank observed, the States should resort to one or more of the following courses, viz., (i) floatation of public loans, (ii) issue of Treasury bills, (iii), obtaining loans from the Centre and (iv) sale of their investments. The Bank, however, pointed out that the mere holding of Government of India securities did not entitle State Governments to claim encashment thereof at any time they wished. The Bank required reasonable notice for framing its programme of sale of securities on several accounts. The Bank also stressed the desirability of evolving a uniform and well integrated plan in dealing with the four courses indicated by it and requested the Government of India to initiate suitable action. The Bank's views were communicated by the Finance Ministry to the Governments of Part A States on July 8, 1950. Even subsequent to this communication the Bank received requests from a few States for temporary relaxation of limits, but initially these were declined by the Bank in consultation with the Central Government, who commented:

The States must realise that they cannot continue to live beyond their resources by running a deficit account for an indefinite period and hope for the Reserve Bank or the Centre to finance them for their requirements either direct or by purchasing their investments.

The Bank, however, realised that in view of the busy season which was then about to set in, the State Governments had hardly any chance to secure funds by floating Treasury bills, while other alternatives for raising funds were also not feasible. The Bank's advice to the State Governments, therefore, was a severe curtailment of their expenditure supplemented by such temporary accommodation as the Government of India would grant them. Earlier, the Bank had suggested to the

Central Government to consider the expedient of granting advances to States against their share of income-tax receipts to the extent of 50 per cent.

One of the State Governments approached the Bank for its formal approval to an arrangement the State proposed to enter into with a commercial bank for cash credit accommodation for financing their foodgrains purchase scheme; this was accorded. It was considered that such financing was outside the scope of the Bank's function as a central bank and that an advantage in letting private banks undertake such financing was that it was not inflationary in character so long as banks were able to finance State Governments without recourse to the Reserve Bank.

The Governor, Mr. Benegal Rama Rau, was sympathetic to a request from another State Government for financial assistance needed among others, for financing food procurement, even if it meant an amendment of the Act. However, after discussion with the Finance Secretary, Government of India, it was agreed that the Bank should not press for an amendment of the Reserve Bank Act, and that the State Governments should be advised to approach commercial banks for such accommodation. Any impact emanating from such a procedure was to be absorbed by the Reserve Bank in its open market operations. The same State Government requested a ways and means advance for financing capital expenditure; their schemes were in an advanced stage and any slowing down would have delayed the returns expected from them. Although a ways and means advance was not appropriate for financing capital expenditure, the Bank agreed, with reluctance, to grant the advance against Government of India securities. The reasoning of the Bank, as stated by the Deputy Governor, Mr. Sundareshan, in his letter dated December 8, 1950, to the Finance Ministry was:

If we declined to come to the assistance of., the Government of India will be under pressure to find out the necessary funds, which may result in the Reserve Bank expanding currency to the extent required by the Central Government. The whole problem resolves then to the appropriate procedure to be followed. If the Central Government took over the responsibility to find funds, you may run the danger of setting up a bad precedent and may even be induced to treat the amounts as fairly long term loans on a favourable rate of interest. From that point of view, it may be the lesser evil to let the Reserve Bank grant ways and means advances during the current financial year on the usual terms on the distinct understanding that this will be an exceptional treatment accorded to State Governments where in the opinion of the Central Government it would be a loss of public money if an abrupt termination of a project in progress were to be allowed. The position then will be that the temporary relaxation of the Reserve Bank's policy not to finance capital expenditure by means of ways and means advance will be at the special request of the Central

Government for one single year, pending a review by the Planning Commission or any other appropriate authority of the works in progress and the need for their completion.

The Provincial Governments were also sources of substantial short-term funds, which they invested in Central Treasury bills. Effective October 22, 1949, a new procedure was introduced for meeting the requirements of these Governments and special public bodies for investment in Central Government Treasury bills. Till then, the Bank had been selling Treasury bills to Provincial Governments and other bodies out of its own Issue Department holdings; this was done with a view to precluding them from competing with regular institutional investors at open auctions of Treasury bills. Whenever Treasury bills were thus sold out of Issue Department holdings, fresh bills were created in their place. As investments by Provincial Governments were made for varying amounts and on different dates, the ad hoc Treasury bills created in lieu of the bills issued to them and available for future sales consisted of various denominations with maturities varying from a few days to three months. Also, at times, a number of bills had to be issued to the same party resulting in a considerable waste of Treasury bill forms and clerical labour. It was therefore decided, with the Central Government's approval, that instead of selling Treasury bills from the Bank's Issue Department holdings, special ad hoc bills should first be created for the actual amount required in favour of the Reserve Bank at the bulk of tender rate of the immediately preceding Central Government Treasury bills auction, and thereafter those bills would be sold by the Bank to the party concerned at the usual rate of 3 pies above the bulk of tender rate. The whole transaction would pass through the Banking Department of the Bank, and would be shown as ' Treasury bills sold in favour of the Reserve Bank of India ', instead of ' Treasury bills sold in favour of the Issue Department '.

Provincial Loan Floatations

Market borrowing by the Provincial Governments, in the post-war period, was of smaller dimensions than in the war period, although the need for such borrowing was larger. However, because of the diminished capacity of the market to absorb Government securities, their issue had to be pruned. The aggregate borrowing in the period 1946-51 was Rs. 24.50 crores, as compared to Rs. 41 crores in the period 1940-46.

Except in 1947-48, the Provincial Governments raised loans from the market in all the four years, namely, 1946-47 and 1948-49 through 1950-51. Eight issues for a total amount of Rs. 24.50 crores were floated by four Provinces; Bombay, three for Rs. 11 crores; Madras and C.P.

(M.P.), two each for a total amount of Rs. 8 crores and Rs. 3 crores, respectively; and U.P. one for Rs. 2.50 crores. The two loans floated in 1946-47 were with 2 $\frac{3}{4}$ per cent coupon rate and were issued at Rs. 100-8, the yield working out to 2.71 per cent. The loans were to mature in 1961. All loans floated subsequently, i.e., during the years 1948-49 to 1950-51 were with a higher coupon rate, viz., 3 per cent, and the issue prices were below par, the discount ranging from eight annas in the case of the Bombay loan to Rs.1-8 in the case of the Madhya Pradesh loan; the yields worked out higher, varying from 3.06 to 3.18 per cent. The maturity period, which was fifteen and sixteen years, respectively, in the case of the loans floated in 1946 and 1948, was reduced to ten years for the floatation in 1950-51, in accordance with the stringent trend of the gilt-edged market. Excepting one loan, viz., the 3 per cent Tapti Irrigation Development Loan, 1961, for Rs. 2 crores, issued in March 1951 by the Bombay Government, subscriptions, in respect of which were confined to the Surat District, all the loans were underwritten; in respect of two loans, the Bank had to underwrite small amounts to make up the deficit in acceptable tenders.

While eight loans aggregating Rs. 24.50 crores were actually floated, another four loans for Rs. 13 crores had been contemplated and offered for underwriting, but were dropped subsequently, as in respect of three issues (two in 1949-50 and one in 1950-51), the amount underwritten fell far short of the amount proposed to be issued, while in respect of the fourth loan (in 1948-49), the issue price fixed on the basis of underwriting tenders was considered unfavourable by the Provincial Government concerned.

Of the seven loans underwritten and offered for public subscription, five were oversubscribed, while two loans (one floated in 1946-47 and the other in 1949-50) were undersubscribed to the extent of over 20 per cent. The underwriters were called upon to take up the unsubscribed portion; the Bank had underwritten one of these issues. In respect of the other issue underwritten by it, the Bank subscribed at the time of public subscription the amount it had underwritten; there was no call on the underwriters.

Beginning with 1946, the Bank made two important changes in the underwriting system. In order to meet the wishes of Provincial Governments, the Bank started, as an experimental measure, the system of calling tenders in quarter rupees too, instead of in even rupees and half rupees as had been the practice till then. Provincial Governments were of the view that if tenders were invited in quarter rupees, it might enable them to issue a loan at a price four annas higher than otherwise. The other change made by the Bank was the reduction in underwriting commission from eight annas to four annas per cent; such a reduction

was expected to check excessive competition amongst the underwriters. In the Bank's view, the generous rate of commission, viz., eight annas, acted as an incentive for the underwriters to overreach themselves when tendering for the underwriting; also it afforded a margin which enabled them to sell their surplus holdings at a discount without loss to themselves but to the detriment of investors subscribing to the public issue of loans. The reduced commission was, however, considered inadequate and was raised to six annas in respect of loans floated in 1950.

A serious drawback of the underwriting system was its rigidity either a loan would have to be issued at the lowest rate quoted by the underwriters to secure the full amount of the loan (even though a substantial portion of the amount might have been tendered at more favourable rates) or the loan issue abandoned altogether. A modification of the scheme to enable the Bank to reserve to itself a right to accept whatever amount it considered as suitable at rates acceptable to the State Governments was considered in June 1950. There was also an informal suggestion by the Governor for revival of the Provincial Loan Fund system*. It was, however, decided that for the loan floatations in 1950, the Bank should first ascertain carefully from selected underwriters and brokers the amount of Provincial loans likely to be successfully underwritten at an acceptable rate and then advise the Provincial Governments concerned regarding the amount to be floated. This worked reasonably well in 1950, but in 1951, in view of the lack of interest among the underwriters for the proposed issue, it was decided to dispense with underwriting and thereafter the underwriting practice was not revived.

Although the possibility of different issue prices was inherent in the system of underwriting of individual Provincial issues, the Bank was criticised for the disparity in the issue prices of the loans floated in 1950. According to the Hindustan Times† :

The Reserve Bank; with all its careful generalship and active sponsoring of the loans has not been able to secure more even terms as between the various borrowers. In this connection, it is relevant to point out that it is the Reserve Bank which is reported to have persuaded the State Governments that the issues should be underwritten. But the bank

* The Local Government Borrowing Rules framed under the Act of 1919 empowered Provincial Governments to raise loans in India for specified purposes, but it was found that they had to pay rates of interest higher than those paid by the Government of India. It was, therefore, found more advantageous for the Provinces to borrow from the central exchequer, and to systematise such borrowings a Provincial Loans Fund was established in 1925. Its object was to regulate the terms and conditions, the rates of interest and the period of amortisation of all advances made by the Central Government to the Provinces. With the adoption of Provincial Autonomy, the Provincial Loans Fund was wound up on March 31, 1937 and all Provincial debts to the Government of India were consolidated on the terms set forth in the Niemeyer Report (see page 317, foot-note, of this volume).

† July 26, 1950.

has not been successful in ensuring that, by agreeing to have their loans underwritten, States other than Bombay, would get reasonable terms. There is not much substance in the argument that the financial affairs and the budgetary position of the Madhya Pradesh Government is not as satisfactory as that of Bombay or Madras. . . . In view of the fact that there will be numerous occasions on which the State Government may have to enter the capital market in the future, it is not too soon for the Reserve Bank to realise that the present technique of floating State Government loans is completely unsatisfactory and to set about fashioning a different technique, such as lump sum borrowing by the Centre on behalf of the States, which will help to eliminate illogical and fanciful preferences and prejudices. Otherwise, barring the luckier ones, other State Governments will have to borrow money on burdensome terms, as is the *case* with the Madhya Pradesh Government or may be compelled, like the Uttar Pradesh Government, to keep away from the capital market indefinitely.

The issues stated in the above editorial have been raised again and again, but it has not been possible either to confine all borrowing to the Central Government or have identical terms for all the State Governments.

Bank's Attitude with regard to Controls

The principal developments with regard to the Bank's monetary policy and its role as banker to Government have been narrated in the preceding pages. Before proceeding to cover developments with regard to currency and coinage and the Bank's advisory role in the regulation of the stock and commodity markets, it is necessary to refer in some detail to the Bank's attitude with regard to physical controls, a brief reference to which has been made earlier. In the post-war period, few aspects of economic policy were more controversial and confused than the matter of controls. Government's views underwent frequent changes; it would appear that while the Government recognised the necessity of controls, they found that administration of controls was unsatisfactory and caused widespread public discontent. So they embarked on decontrol, while being prepared to restore it if the experiment was unsuccessful. On the other hand, the Bank's management was clear and consistent in its views on this subject. These are best expressed in the Governor's address to the shareholders in August 1947:

Vitally connected with the immediate problem of stabilisation is the question of controls, which in the case of some commodities has been lifted, and the removal of which in other cases is being urged. Whilst the maintenance of demonstrably needless controls only clogs the administrative machine and irritates the public into infractions of the law, there seems to be every need for the continuance of controls in the case of essential commodities. But to be effective such controls should be integrated and administered with efficiency and thoroughness. Controls are very essential for any project or large-scale economic

planning, and it would seem to be necessary to educate public opinion and seek its whole-hearted co-operation in their enforcement. The political developments resulting in the partition of the country emphasise the need for the maintenance of controls as the trade between the two areas which was hitherto internal trade will, in the future, partake of the character of foreign transactions. In the long run it is probable that most prices will come down, owing not only to increased output at home but also to larger imports. It is necessary that whenever it comes, the decline in prices should be orderly, causing the least dislocation to the productive system, and this will appear to be best achieved not only by resisting any further rise in prices, but also by inaugurating a policy of voluntary price reduction as is being attempted in the U.S.A.

In the report of the Central Board of Directors for the year 1947-48, there was again a long discussion on the subject and the general tenor of the report was on the lines of the Governor's address to the shareholders in 1947. After referring to the experiment of decontrol, after the war, in a number of countries including the U.S.A., the report commented as follows:

But it cannot be concluded that removal of controls, therefore, is generally the prescription for all countries for regaining economic health. The rate at which readjustment to normality could be induced through the removal of controls will necessarily vary from country to country. In a comparatively backward economy like that of India production is not very elastic to price changes and the degree of scarcity even in regard to the ordinary needs of life is very high. In such an atmosphere where the root of the trouble is not so much over-spending as under-production, the removal of controls has to be especially slow and cautious. Otherwise the restoration of freedom is likely only to lead to an increase in the price levels, not necessarily accompanied by an increase in production of the required magnitude. In fact in the kind of small-scale agricultural economy which is not geared too well to a market economy it is even likely that increased prices might, at the margin, actually lead to a lower volume of output. If this were to happen, decontrol can only lead to a high and rapid rise in prices with all the attendant consequences of an inflationary spurt. This undoubtedly is what is being witnessed to-day so vividly in the movement of the price structure in this country.

Two Directors, namely, Messrs B. M. Birla and K. P. Goenka, placed on record, in the report, that they did not subscribe to the views expressed in the report in connection with controls. This is the first occasion, and so far the only one, on which individual Directors have recorded their dissent from the views of the Board, in the Bank's annual report.

In his speech to the shareholders in August 1948, the Governor again referred to the subject of controls. After giving a sympathetic account of the reasons which had prompted the Government to embark on the

policy of decontrol, the Governor pointed out how Government's expectations had not been fulfilled, by and large. To quote him:

From the meagre data that is available it would appear that there has been improvement in production in a few directions since November 1947 but that is far below expectations, the present output still being far short of even the existing productive capacity in the major industries. In the short run production is in any case very inelastic, especially in the context of the prevailing shortages of capital equipment, technical personnel and essential raw materials, and above all the break down of the country's transport system. There does not seem to have been much dehoarding either, partly because the hoarded stocks themselves were not probably large and partly because stocks continued to be withheld from the market in anticipation of higher prices. The gap between supply and demand has therefore come to be covered predominantly by a rise in prices.

From the foregoing it will be seen that so far as the Bank was concerned, it anticipated clearly the need for a system of controls, conceived in a co-ordinated manner and effectively implemented, for a programme of integrated development of the Indian economy.

CURRENCY AND COINAGE MATTERS

In regard to currency, two developments have to be recorded. The first, the demonetisation of high denomination notes, was a fiscal measure, taken against the Bank's advice. The second was the replacement of silver coinage by nickel, the Bank lending strong and active support to the change-over.

Demonetisation of High Denomination Notes

Soon after the war, while Government were giving attention to ways and means of averting the expected slump, thought was also given to check black market operations and tax evasion, which were known to have occurred on a considerable scale. Following the action in several foreign countries, including France, Belgium and the U.K., the Government of India decided on demonetisation of high denomination notes, in January 1946. It is interesting that as early as April 7, 1945, in an editorial on the tasks before the new Finance Member, Sir Archibald Rowlands, the Indian Finance referred to the action of the Bank of England in calling in notes of £ 10 and higher denominations and suggested similar action in India as 'one more concrete example for the Indian Government to follow in its fight against black market money and tax evasions which have now assumed enormous proportions'.

It is not known when the Government authorities started thinking on the demonetisation measure, but the final consultation with the Governor and Deputy Governor Trevor took place towards the end of 1945, when Mr. N. Sundaresan, Joint Secretary, Ministry of Finance, called for a discussion, for which he had earlier prepared a note and the drafts of the Ordinances to implement the scheme. According to a note recorded by Mr. Sundaresan, it would appear that the Reserve Bank authorities were not enthusiastic about the scheme. The Governor stated that the Finance Member had given him the impression that the scheme would be launched only when there were signs of the onset of an inflationary spiral. The Governor saw no special signs of such a situation. 'It appeared to him that the main object of the scheme was to get hold of the tax evader. The Governor wondered if this could be called an emergency to justify the promulgation of an Ordinance, just before the newly elected Legislative Assembly met. The Governor wanted Government to be satisfied that there was no harassment to honest persons. As a currency authority, the Bank could not endorse any measure likely to undermine the confidence in the country's currency.

The Governor agreed that about 60 per cent of the notes would be in the Indian States and so co-operation of the State Governments was very necessary. Apparently he had some doubts about this. According to Mr. Sundaresan, the ideal thing was to block high denomination notes, but this course was not favoured by either the Finance Member or the Governor.

Subject to these observations, the scheme as drafted by Mr. Sundaresan was considered by the Governor to be theoretically all right, but he and the Deputy Governor pointed out the considerable administrative difficulties involved in covering nearly 5,700 offices of scheduled and non-scheduled banks. The Governor's concluding remarks, as recorded by Mr. Sundaresan, were as under:

Sir Chintaman Deshmukh felt that we may not get even as much as Rs. 10 crores as additional tax revenue from tax evasion and that the contemplated measure, if designed to achieve such a purpose, has no precedent or parallel anywhere. If value is going to be paid for value (no matter whether such value is in lower denomination notes), it is not going to obliterate black markets. His advice is that we should think very seriously if for the object in view (as he deduces from the declaration form) whether this is an opportune time to proceed with the scheme. Provided Government are satisfied on the points of (i) sparing harassment to the unoffending holders and (ii) a worthwhile minimum of results in the shape of extra tax revenue, he does not wish to object to the scheme as drafted, if Government wish to proceed with it notwithstanding the administrative difficulties involved.

The Government went ahead with the scheme. On January 12, 1946, two Ordinances were issued, demonetizing notes of the denominational

value of Rs. 500 and above. The first Ordinance, viz., the Bank Notes (Declaration of Holdings) Ordinance, 1946, required all banks and Government Treasuries in British India to furnish to the Reserve Bank of India by 3 p.m. on the same day, a statement of their holdings of bank notes of Rs.100, Rs. 500, Rs. 1,000 and Rs.10,000 as at the close of business on the previous day. January 12, 1946 was declared a bank holiday. The second, the High Denomination Bank Notes (Demonetisation) Ordinance, 1946, demonetised bank notes of the denominations of Rs. 500 and above with effect from the expiry of January 12, 1946. This Ordinance provided that a non-scheduled bank could exchange high denomination notes declared by it under the Bank Notes (Declaration of Holdings) Ordinance at the Reserve Bank or a scheduled bank, for value in one hundred rupee notes or for credits with the Reserve Bank or a scheduled bank. Scheduled banks and Government Treasuries could obtain from the Reserve Bank value in one hundred rupee notes or in deposits with the Reserve Bank in exchange for high denomination notes declared by them under the above mentioned Ordinance. Other holders of high denomination notes could get them exchanged at the Reserve Bank, a scheduled bank or a Government Treasury on presentation of the high denomination notes and a declaration in the form prescribed in the schedule to the Ordinance, within 10 days of the commencement of the Ordinance. Under a press note issued subsequently by the Government of India on January 26, 1946, Managers and Officers in charge of offices and branches of the Reserve Bank of India were authorised to allow exchange of high denomination notes, up to and inclusive of February 9, 1946, on production of sufficient and valid reasons for delay in the presentation of notes. Thereafter the Governor and the Deputy Governor of the Bank were authorised to allow exchanges up to and inclusive of April 26, 1946. The power for the extension of the time limit beyond April 26, 1946 was reserved for the Government of India.

The provisions of the second Ordinance, which was applicable to British India, were also extended, with suitable modifications, to the Administered Areas on January 22, 1946. Many Indian States also issued parallel Ordinances. States which did not enact such legislation were required to exchange their holdings of demonetised notes before March 7, 1946.

The measure did not succeed, as by the end of 1947, out of a total issue of Rs. 143.97 crores of the high denomination notes, notes of the value of Rs. 134.9 crores were exchanged. Thus, notes worth only Rs. 9.07 crores were probably 'demonetised', not having been presented. The results of the demonetisation measure were summed up by Sir Chintaman, in his Dadabhai Naoroji Memorial Prize Fund Lectures, delivered at Bombay in February 1957, as under :

It was really not a revolutionary measure and even its purpose as a minatory and punitive gesture towards black-marketing was not effectively served. There was no fool-proof administrative method by which a particular note brought by an individual could be proved as the life-savings of the hard-working man who presented it or established as the sordid gains of a black-marketer. Another loophole of which considerable advantage was taken was the exemption of the princely States from scrutiny or questioning when such notes were presented by them. In the end, out of a total issue of Rs.143.97 crores, notes of the value of Rs.134.9 crores were exchanged up to the end of 1947 as mentioned in the Report of the Board of Directors of the Reserve Bank. Thus, notes worth only Rs.9.07 crores were probably “demonetised”, not having been presented. It was more of “conversion”, at varying rates of profits and losses than “demonetisation”.

There was an echo of this measure in 1948. In September, while Government were considering anti-inflationary measures, rumours spread that the 100 rupee notes would be demonetised and that bank deposits would be frozen. The Prime Minister had to make a statement in the Legislature, categorically denying any such intentions on the part of Government.

Nickel Coinage

Advising the Government on matters relating to coinage is an important responsibility of the Reserve Bank, though often such matters tend to be regarded as routine affairs. The Governor put his considerable weight in favour of nickel coinage and his urging no doubt helped expedite the changeover from silver to nickel in the matter of coinage of higher denomination, that is, quarter rupee, half rupee and one rupee. In May 1944, the Mint Masters considered a number of matters relating to coinage in the post-war period. They suggested the introduction of decimal coinage. They also discussed in detail the pros and cons of replacing silver coinage by pure nickel ones, although on this matter the opinion among the Mint Masters was not unanimous. The Finance Department was naturally conservative in its approach to these matters. While decimalisation of coinage was regarded as beneficial, it was considered desirable to go slow in the matter, and for this purpose ascertain public opinion fully. The Department was, however, opposed to the changeover from silver to nickel on the score, among others, that it would give a shock to the public. These proposals were referred to the Reserve Bank and the Governor generally endorsed the views of the Finance Department.

However, about the middle of 1945, the Governor came to support the view that in the interests of conserving silver, particularly for the purpose of repaying the lend-lease silver to the U.S.A., nickel coins

of one rupee, half rupee, etc., should be introduced expeditiously. Further, with the same object in view, he proposed (in August 1945) not only the stoppage of sales of silver to the public but also purchases of silver by Government, preferably through the agency of the Imperial Bank, at a price around Rs.125 per 100 tolas, the price at which the bulk of the sales had been effected. The Government, however, seemed to be in no hurry to purchase the metal, towards meeting the lend-lease obligation, since they anticipated a substantial fall in the price in due course; however, they were prepared for extending support to the market by purchases at 'Rs.120 per hundred tolas or below' for the purpose of preventing 'too precipitate a fall' in price. The Governor did not attach much importance to the principle of supporting the market. He considered that if the decline in silver price was temporary there would be an automatic recovery. If, on the other hand, it was part of a downward trend, then it was undesirable on the part of the Government to interfere with it. The Governor also felt that purchasing silver gradually, as he had suggested, was better than extensive purchases towards the end of the five-year period, when the lend-lease silver would be due to be returned. The price then might be higher, what with the silver interests in America clamouring for a higher price for the metal. It is interesting that at about the same time the British Treasury Delegation in Washington, headed by Lord Keynes conveyed more or less similar views to the British Government and the Government of India. There was a distinct possibility of the price of American silver going up and the British Mission was anxious that every effort should be made to conserve the existing stocks of silver and reduce the use of silver in coinage. While forwarding a copy of the cable from the British Treasury Delegation, the Finance Department clarified that their objective was to prevent a collapse in silver price spreading to other markets and they gave the Governor discretion to buy silver when the price fell below Rs.120.

The Governor continued to urge the Government to introduce nickel coinage which, according to him was 'the only card which we can play in order to win the trick against American silver interests'. On May 23, 1946, the Government issued a notification, discontinuing the mintage of half and quarter quaternary rupees, these to be replaced by nickel coins. In June 1946 the issue of quaternary whole rupee was discontinued. The proposal to introduce nickel rupee was approved by the Cabinet in January 1947 and in February, legislation was introduced to amend the Indian Coinage Act for the purpose. The amending Bill was passed in April 1947, authorising the Government to use any metal for coining rupees. The new nickel rupees were issued in June 1947. Pending approval of the introduction of nickel rupees by the Cabinet and the Legislature, the Government, under

the urging of the Reserve Bank, had acquired sufficient quantities of nickel, to put the coins into circulation as soon as possible after the legislative sanction was obtained. The Bank's initiative in the matter helped conservation of large quantities of silver in the form of bullion as well as quaternary coins, enabling the Government to return without any difficulty the silver loan to the U. S. A., in 1957. None of the fears entertained with regard to the introduction of nickel coinage materialised, the public taking to these coins as well as to the decimal coins later with remarkable ease and confidence.

ADVISORY ROLE IN THE REGULATION OF STOCK AND COMMODITY MARKETS

In the post-war years the Government of Bombay and the Central Government gave much attention to the regulation of commodity and share markets. It was only in 1950, that is to say, with the coming into force of the Constitution, that regulation of these markets came to be done through Central legislation. Till 1950 such regulation was done on a comprehensive basis by one State only, namely, Bombay; in Bengal, there was Government regulation of futures trading in jute and jute goods, The Reserve Bank's advice was sought on various matters relating to regulation; especially in respect of the regulation of trading in bullion and stocks and shares, on account of the intimate contacts which the Bank had with these markets. In fact, in this matter on a number of occasions the initiative came from the Bank itself. The Bank was favorably placed both to urge the Government to initiate regulatory action and also to restrain Government from embarking on excessive -or impracticable regulation. The Bank also agreed to Government's requests to have its officers nominated on the governing boards of the recognised associations engaged in trading in bullion, shares; etc.

Stock Exchange Regulation

Although Central enactment to regulate transactions in securities was accomplished only in 1956, considerable preparatory work was done from as early as 1948, by Government and the Reserve Bank. The Government arranged for a detailed study of the subject of regulation of stock exchanges to be made by its Economic Adviser, Dr. P. J. Thomas, who submitted his report in 1948. The Reserve Bank also devoted considerable attention to the subject. One of the first tasks allotted to the newly created Department of Research and Statistics in

1945 was to collect detailed information on the working of stock exchanges in India and abroad and to formulate concrete proposals for their regulation, after discussions with the different stock exchange authorities and leading brokers. These studies were made in 1945 and 1946 and were published in the Reserve Bank of India Bulletin * (January and February, 1948), to enlighten the public on various aspects of the subject and to stimulate public discussion. In May 1948, the Finance Minister (Mr. Shanmukham Chetty) took a decision to initiate comprehensive legislation to regulate stock exchanges all over the country; he also indicated the general principles which should govern such legislation. To work out detailed proposals for drafting legislation and also, examine specifically certain issues such as the abolition of blank transfers, he appointed a committee of officials with Mr. K. G. Ambegaokar, Additional Finance Secretary (who later became a Deputy Governor and for a brief while also the Governor, of the Bank), as Chairman, and including representatives of the Bombay Government and the Reserve Bank. The Bank's representative (Mr. S.L.N.Simha) was appointed as Member-Secretary of the Committee, which submitted its report in August 1948. Later, the Member-Secretary toured Madras and Calcutta to have discussions with the stock exchange authorities, leading stock brokers and the Provincial Governments, on various matters relating to statutory regulation of stock exchanges, and submitted a comprehensive report to Government.

The Bank's views with regard to regulation of stock exchanges are best summed up in Governor Deshmukh's address to the Bank's shareholders in August 1948:

Extraneous factors apart, the health of the stock exchanges can only be preserved by the observance of their professional code by those that operate there. In order to assist them in securing this, the management need the guidance of a modicum of legislation. It may not be out of place here if I make a few observations about the form such legislation should take. I am of the view that the proposed legislation should attempt to curb only unhealthy speculation, which implies recognition of the fact that healthy speculation if properly directed contributes a great deal to the efficient performance of the essential functions of the securities market. Informed and moderate speculation contributes to liquidity and price continuity of the market and any attempt to deny the requisite facilities for such speculation would, besides defeating its purpose, prevent the orderly working of the market. I am inclined to favour Government's framing minimum legislation covering only the vital aspects of reform, rather than its attempting a complete regimentation of the stock exchanges. It is also very necessary that the regulation should be conceived in practical rather than theoretical terms, for, failure to enforce any measure or measures will

* *Stock Exchange Reform*, by S. L. N. Simha.

create a state of affairs which is worse than what is sought to be remedied. Further, before finalising proposals for regulation the Government should hold consultations with the authorities of the various stock exchanges, explaining its point of view to them and getting to know the practical difficulties of the exchanges. What emerges in the final shape should, without compromising on fundamentals, be such as to cause the least inconvenience to the exchanges as regards their day-to-day working. The success of stock exchange regulation depends to a large extent upon the active co-operation of the members and the authorities of the exchanges and it is therefore desirable that the Government should enlist it, and I am sure such co-operation will be readily forthcoming in a matter that concerns, in the long run, the well-being of the exchanges themselves.

Early in 1951, an informal committee was set up to process the recommendations of the official Committee of 1948 and to prepare a draft Bill. The work of this Committee was guided by the Bank's Executive Director, Mr. B. Venkatappiah. Thereafter, in all the stages leading to the passing of the law -the Securities Contracts (Regulation) Act, 1956 - the Bank was closely associated. The Bank's officers also came to be appointed as Government Directors on the principal stock exchanges.

The Bank also endeavoured to restrain the extension of bank credit for speculative purposes. In the immediate post-war year, stock exchange speculation assumed dangerous dimensions, this being accentuated by the tax concessions announced in the Rowlands' budget and the announcement of the conversion of the 3l/s per cent Paper. When the speculative fervour in the equities market was in full swing, the Bank issued in May 1946 a circular to the scheduled banks, drawing their attention to the unhealthy rise in share prices during the previous half year and the dangers of granting accommodation purely for speculative purposes. To ascertain the factual position, the Bank called for information regarding the banks' outstanding advances against shares (excepting those below Rs. 25,000), classified according to the margins taken. On a study of the information thus obtained the Bank found that advances against shares had recorded a much faster rise than the total advances of all types and that in some cases they exceeded 25 per cent of the total advances of the banks. A circular was issued in January 1947, drawing the attention of the banks to the need for restricting advances to a reasonable proportion of their resources or total advances and the advisability of fixing an absolute maximum for advances per share in the case of speculative counters. When this step was misconstrued as an advice to the banks to suspend the extension of credit to the market, the Governor explained the position in his address to the shareholders at the annual general meeting held in August 1948, as follows:

the Reserve Bank has at no time asked the banks to suspend the extension of credit to the market. What it has done is to warn the banks against excessive and indiscriminate granting of credit for speculative purposes, and had the Bank not done so, it would have failed in its duty as the watch-dog of the country's banking and financial interests.

When the share market took its long downward course in September 1946, despite the prevalence of inflationary forces in the economy, there were many suggestions that the Reserve Bank should have asked the banks not to lighten then commitments in equities. The Bank made it clear that such a direction would not have been proper, since under the law it was not possible for the Bank to come to the aid of the banks either by purchases of or advances against shares, as part of the Bank's normal operations, besides the inflationary impact of such operations. There were also proposals that Government support should be extended to the share market either through the agency of the Reserve Bank or a newly created National Investment Board. It was believed that share prices in general were standing much below their intrinsic levels and that open market operations would help. prices to go up. It was also suggested that the National Investment Board might conveniently combine with the function of open market operations in shares, other functions such as control of capital issues and regulation of joint-stock companies and stock exchanges. Early in 1949, the Bank examined the proposals in great detail and came to the conclusion that the proposal to give open market support to shares raised complex issues of principle and administration and that it, was not feasible. However, the Bank saw merit in the proposal to have some organisation for co-ordinating the regulation of new capital issues, joint-stock companies and stock exchanges, generally on the lines of the Securities and Exchange Commission in the U.S.A. The Government were in agreement with the Bank's views.

Regulation of Forward Trading in Bullion

The Bank also took much interest in the regulation of forward trading in bullion. During the war time, forward trading in bullion as well as options had been banned under Defence of India Rule 90-C. The ban had not been very effective and in February 1946 the restrictions on forward trading were removed, as part of the policy of gradual dismantling of controls. Speculation in the bullion market continued to be rampant, since, except for a brief period in 1946-47, imports of bullion were banned, and the Bombay Government desired to regulate trading in bullion as part of the general framework of regulation of forward trading in commodities and shares. The Bank rendered much assistance in the preparation of a questionnaire to elicit public opinion

on the regulation of trading in bullion. Later, in November 1947, the *Bombay Forward Contracts Control Act* was passed, enabling the Government to regulate forward transactions. In terms of this Act, the bullion trade in Bombay City came to be regulated under a scheme of unitary control, the three associations then dealing in bullion futures trading being compelled to form a single association, namely, the Bombay Bullion Association. The Association was formed in September 1948 and in October the Government of Bombay requested the Reserve Bank to agree to the nomination of an Officer of the Bank as Government Director. The Government had always intended that one of their two Directors should be an Officer of the Bank, conversant with the working of forward markets. The Bank agreed to the request, the first nominee being Mr. S. L. N. Simha

The Bank was closely associated with the framing of the bye-laws of the Association and of dealing with important and complex matters that came before the Board of the Association from time to time. Over the years, the Bank took considerable interest and initiative in the matter of devising a stringent system of margins to check unhealthy speculation which was inherent in the context of a ban on imports of bullion. The Bank's general view was that notwithstanding the ban on imports, it was desirable to permit forward trading under the auspices of a recognised Association and subject to the discipline of the Forward Contracts Act, rather than allowing it to take place in the street in an unorganised way.

Central Legislation on Futures Trading in Commodities

In 1950 the Bank was also called upon to give its comments on the draft of the Futures Markets (Regulation) Bill, prepared by a Committee of which Mr. A. D. Shroff was Chairman. The Committee of the Central Board, and later the whole Central Board, considered the matter on the basis of detailed memoranda drawn up by the Bank's Economic Adviser (Dr. B. K. Madan), which had taken into account the comments and criticisms of the various associations engaged in futures trading, such as the East India Cotton Association. The memoranda generally endorsed the provisions of the Bill. Among the suggestions made in the memoranda were that where Government revoked recognition granted to an association, there should be a provision for a right of appeal, the desirability of bringing under the scope of the Act all delivery contracts whether transferable or nontransferable, the reduction of the penalty of imprisonment from three years to one year and the imposition of an obligation on Government to collect and furnish to producers, consumers and distributors information regarding demand, supply and prices and other conditions

regarding operations in the markets of commodities brought under regulation.

While the Bank management favoured statutory regulation of futures trading, it also struck a note of caution in regard to Government's intervention in the working of these markets. In his memo 1 andum of August 5, 1950, to the Central Board, Governor Rama Rau made the following observation:

Government should not lightly interfere in the delicate working of futures markets in commodities, that the diversity of conditions in respect of trading in the different commodities should be duly taken into account in the actual application of regulatory measures, and that the building up of a suitable machinery in the form of technically competent personnel equipped with a knowledge of the working of the markets in commodities is an essential pre-requisite to the satisfactory exercise of powers of control by the Government in respect of any commodity.

Later, as in the case of the bullion and share markets, the Bank's Officers were nominated to the Boards of the East India Cotton Association and the Bombay Oilseeds Exchange.

A Commercial Bank Regulation Act At Last

During the war years the Indian banking system witnessed substantial expansion, with an all-round increase in the number of banks, their branches and deposit resources. Establishment of banks and securing deposits had been all too easy, while there was scope to make considerable profits. The absence of adequate statutory authority to regulate the establishment and running of banks had led to various unsound practices, as already described in Chapter 15. However, under the artificial conditions of the war, with a continuous rise in capital values, the weaknesses in the banking system remained obscured. It was obvious that with the return of peace, the banking system would have to face hard times, possibly leading to a crisis for a number of new and small units in particular, if adequate precautionary measures were not taken by the authorities. Hence, the Reserve Bank's main concern at the close of the war was to consolidate the war-time growth and ensure the development of banking on sound lines by eliminating the unhealthy features at an early stage. The Bank tried its utmost to get the Banking Companies Bill enacted on a priority footing, but the constitutional changes and the Government's preoccupation with the more pressing problems following the partition of the country delayed the passage of the Bill till March 1949. However, owing mainly to the Bank's insistence, interim regulatory measures were adopted between 1946 and 1948, bringing into effect in advance some of the more important provisions of the Bill.

The post-war transition was marked by the occurrence of localised banking scares, arising in some cases from the unsound policies pursued by banks, and precipitated in others by the disturbed conditions accompanying the partition of the country or by the failure of certain

banks. These, however, did not assume serious dimensions as the Reserve Bank stood by to provide necessary assistance to banks through purchase of Government securities. Besides, the Bank came in to provide special assistance to banks in deserving cases by getting its Statute amended for the purpose. The dislocation of banking business in the border areas of the Punjab in the wake of civic commotions also necessitated special measures to alleviate the difficulties of banks and their depositors in the area.

While banking regulation took up the major part of the Bank's attention during the period, the promotional and developmental aspects of banking were not overlooked. The gradual adaptation of trade and industry to normal peace-time conditions brought with it increased demands for bank credit. The banking system had to find the necessary resources for meeting these demands by bringing about a gradual reduction of their swollen holdings of Government securities. The purchase of Government securities by the Bank on a substantial scale and its advances against these securities enabled the banks to meet their requirements in an orderly manner.

On the Bank's initiative, the Rural Banking Enquiry Committee was appointed by the Government in 1949 to consider important policy issues relating to the extension of banking facilities in the country. This will be covered in Chapter 23. The Bank also played an active role in the establishment of the Industrial Finance Corporation of India and of State Financial Corporations.

INTERIM BANKING LEGISLATION AND CONTROL

Banking Companies (Inspection) Ordinance, 1946

We may begin with the regulatory measures taken on an interim basis prior to the adoption of full-fledged banking legislation.

Addressing the shareholders of the Bank in August 1945, the Governor warned that 'while the general banking picture continues to be healthy and encouraging, there are certain undesirable- tendencies, which, if not checked in time, might react unfavourably on the country's -banking structure '. The Bank was strongly of the view that during the difficult years of transition from war to peace, it was essential that the Government and the Reserve Bank should be armed with effective powers to safeguard the health of the banking system. Apart from suggesting the, inclusion in the Banking Bill of a system of licensing of banks and branches in India, the Bank recommended to the Central Government in September 1945 the promulgation of an Ordinance to

bring into immediate effect the provisions in the Banking Bill regarding inspections; the Ordinance was to be operative until the enactment of the Banking Bill. Accordingly, in January 1946, the Banking Companies (Inspection) Ordinance was promulgated.

Under the Ordinance, the Central Government were empowered, at any time, to direct the Reserve Bank to undertake an inspection of the books and accounts of any banking company incorporated under the Indian Companies Act and to make a report to the Central Government. If, after considering the Bank's report of inspection, the Central Government were of the opinion that the concerned bank's affairs were being conducted to the detriment of the interests of its depositors, the Government could prohibit the bank from receiving fresh deposits or refuse its inclusion in the Second Schedule or, if it had been so included, direct its exclusion from the Schedule. The Ordinance further prescribed penalties for contravention of its provisions and empowered the Central Government to publish the whole or any part of the inspection report after giving reasonable notice to the concerned bank.

Incidentally it may be pointed out that the drafting of the Ordinance was found to be somewhat defective. In terms of the Ordinance, a 'banking company' referred to a company 'as defined in Section 277F of the Indian Companies Act, 1913'; this meant that it was applicable only to banks in British India, other than the Imperial Bank and the exchange banks, and that the Reserve Bank had no authority to inspect banks incorporated in the Indian States or branches in Indian States of banks incorporated in British India. This serious lacuna was pointed out to the Government by the Bank, 'but the matter was not proceeded with owing to the inadvisability of amending the Ordinance and the fact that the inconvenience was only a temporary one since the Banking Companies Bill would soon be replacing the Ordinance'.

Prior to the promulgation of this Ordinance, the inspections carried out by the Bank to determine the eligibility of banks for inclusion or retention in the Second Schedule were confined to ascertaining the real value of the paid-up capital and reserves of banks. The scope of inspection under the Ordinance was much wider as it involved a qualitative assessment of a bank's management, policy and methods of business from the point of view of the depositors' interests. Soon after the promulgation of the Inspection Ordinance, the Central Government issued instructions, on the suggestion of the Bank, that all inspections of banks incorporated in British India should thenceforth be carried out under the provisions of the Ordinance, including those for the purpose of determining the eligibility of banks for inclusion or retention in the Second Schedule.

The vesting of the power of inspection in the Bank naturally imposed on it the necessity of maintaining a large establishment for the purpose. The Central Government suggested in February 1946 the levy of a licence fee on the banks inspected, since the cost of inspection would have to be borne by the Government. The Bank was, however, of a different view. It wrote back to the Government in the same month thus:

The protection of depositors and the development of banking in India on sound lines are a national interest and any administration costs that may be incurred by the Reserve Bank in the course of inspection and in fulfilment of its duties as the mentor of the Indian Banks should, in our opinion, be borne by the Reserve Bank, i.e., indirectly by the State. Moreover, the inclusion of a provision for the levy of fees on banks to cover the cost of inspection would only increase the opposition of banks to the Bill. The amount of licence fees obtained from the banks would also be only a small percentage of the costs the Reserve Bank will have to incur. In view of these considerations, we are inclined to think that it would not be either justifiable or desirable to levy a licence fee at this stage.

The Government dropped the proposal.

The Bank carried out the inspection of 41 banks under the Inspection Ordinance, as of the end of June 1949. In some cases, the affairs were found to be conducted so badly that the Bank recommended to the Government drastic remedial action such as prohibition of acceptance of fresh deposits or removal from the Second Schedule. On the public coming to know, in a few recalcitrant cases, that Government had taken or contemplated taking serious steps, there were heavy withdrawals of deposits from the banks concerned and they had to suspend payment. The events leading to the failure of two banks, viz., the Exchange Bank of India and Africa and the Nath Bank are discussed briefly later in this chapter, since the Reserve Bank was directly affected by their liquidation, having granted emergency advances to them in a futile attempt to rescue them.

Banking Companies (Restriction of Branches) Act, 1946

The second important interim regulatory measure taken was the passing of the Banking Companies (Restriction of Branches) Act, 1946. From its inspections the Bank found that most of the banks which failed had embarked, soon after their scheduling, on a spree of expansion by opening several branches, which ultimately proved uneconomical to maintain. Also, during the war years, many of the offices had been opened in places already having adequate banking facilities. The Governor took a serious view of the lop-sided opening of branches and suggested to the Central Board in December 1945 that a new

clause should be inserted in the proposed Banking Bill, requiring banks to obtain Reserve Bank's sanction for the opening of a new branch and providing that, before granting any such permission, the Bank be required to satisfy itself that the interest of the public would be served by the opening of the branch. The Central Board approved the Governor's proposal but watered it down by resolving that 'should it be found that this clause provoked strong opposition, the provision may be dropped if pressure from non-official members is brought to bear upon Government'. However, in July 1946, the Board, on reviewing the position, felt the need for urgent action and decided that Government should be addressed to consider the desirability of passing an Ordinance, giving the Reserve Bank the power to license branches of banks.

The Bank's proposals for the Ordinance enlarged the scope of the branch licensing provisions envisaged previously, inasmuch as its approval was to be obtained even for changes in the location of existing branches. The Bank also recommended that, besides public interest to be served by the proposed branch, the other factors to be taken into account before issue of licence should be the financial history and condition of the bank concerned, the general character of its management, the adequacy of the bank's capital structure and its future earning prospects. The Government signified to the Bank in September 1946 their opposition to legislation by Ordinance 'save in the most exceptional circumstances'. Government were, however, agreeable to introduce a bill in the next session of the Assembly if more factual evidence was produced in support of the measure.

In October 1946, the Bank furnished the Government with a comprehensive note on the subject, giving facts and figures of the unhealthy trends prevalent in branch banking. The Bank's reasoning convinced the Government, which introduced the Bill in the Legislative Assembly immediately. The Banking Companies (Restriction of Branches) Bill was passed without practically any discussion or any adverse public comment as apprehended by the Board of the Bank and by the Government and the Act came into force in November 1946.

The drafting inadvertence that had crept in the Inspection Ordinance was repeated in the Restriction of Branches Act, as it was made applicable to banking companies incorporated under the Indian Companies Act, i.e., to banks registered in British India. An anomalous position arose in that a British Indian bank had to take permission to open a branch in British India, while a bank incorporated in an Indian State or an exchange bank could open a branch in British India without any such permission. Further, any bank -British Indian or otherwise - could open a branch outside British India without the Reserve Bank's permission. The Bank issued a circular to all banks in

December 1946 explaining the legal position, whereupon the Government remarked in their letter of. January 2, 1947, as follows:

As you are aware, the exclusion of banks incorporated outside British India and of branches of British Indian Companies outside British India was inadvertent. It was not, therefore, desirable to bring this fact specially to the notice of all banks. It is true that in view of the lack of legal power you cannot refuse permission in such cases but it would have been as well to allow the banks to apply where they thought such permission necessary.

However, the position was rectified with the promulgation of the Banking Companies (Control) Ordinance in 1948, in terms of which all banks were required to obtain the Reserve Bank's permission for opening new branches and changing the location of existing branches in India. As a result, the pace of branch expansion slowed down. This is evident from the progressive decline in the number of applications received by the Reserve Bank for permission to open new branches or change the location of existing branches, as may be seen below:

| | Number of applications Received | Allowed | Rejected |
|------|------------------------------------|---------|----------|
| 1947 | 487 | 370 | 117 |
| 1948 | 352 | 272 | 80 |
| 1949 | 173 | 125 | 48 |
| 1950 | 120 | 92(6)* | 29 |

* For opening offices in places outside India.

The following table gives a picture of the progress of branch banking during the years 1946-50.

| Year (End of) | All banks | Total scheduled banks | Imperial Banks of India | Exchange banks | other scheduled banks | Non scheduled banks |
|------------------|-----------|-----------------------------|-------------------------------|-------------------|-----------------------------|---------------------------|
| 1946@ | 4,886 | 2,857 | 358 | 58 | 2,441 | 2,029 |
| 1947@ | 4,819 | 2,987 | 362 | 60 | 2,565 | 1,832 |
| 1948.. | 4,674 | 2,963 | 367 | 62 | 2,534 | 1,711 |
| 1949 | 4,441 | 2,852 | 377 | 64 | 2,411 | 1,589 |
| 1950 | 4,353 | 2,779 | 382 | 62 | 2,335 | 1,574 |

@ Figures relate to Indian Union.

In contrast to the continuous and substantial growth in the number of offices during the war period, there was a steady fall from the middle of 1948. While the decline was partly due to the effects of partition, the

restrictions imposed by banking legislation restrained a mushroom growth of branches and also compelled banks to close some of their unremunerative branches.

There was also a decline in the number of offices of Indian banks abroad, mainly in Pakistan, as shown below:

| End of | Scheduled banks | Non-scheduled banks |
|------------|--------------------|------------------------|
| 1946 | 628 | 153 |
| 1947 | 463 | 68 |
| 1948 | 226 | 46 |
| 1949 | 144 | 31 |
| 1950 | 125 | 26 |

Notwithstanding the operation of statutory control over branch banking for about four years, there was no significant change in the matter of regional imbalances in banking offices. For one thing, as already mentioned, there was a net decline in the number of branches in the postwar years. For another, in the initial years of branch control the Reserve Bank's policy was not so much one of bringing about a balanced branch expansion regionally as that of curbing large scale expansion generally, with a view to consolidating the substantial growth that had occurred during the war years. At the end of 1950, out of a total of 2,478 towns in the Indian Union, as many as 1,015 towns were not served by an office of any bank. Again out of the aggregate of 5,077 banking offices in the Indian Union (including 724 offices of co-operative banks), 2,896 offices (47 per cent of the total) were concentrated in 175 towns with a population of 50,000 or more (according to the 1941 census). The offices of scheduled banks were concentrated in the States of Madras, Bombay, Uttar Pradesh, the Punjab and West Bengal and those of the non-scheduled banks in Madras, Bombay, West Bengal, and Travancore-Cochin.

Banking Trends, 1945-51

At this stage, it may be useful to refer to the trend of bank deposits, advances, etc., in the post-war period, up to March 1951. In analysing the banking trends, three broad phases may be discerned, viz., (a) from the close of the war till June 1948, when both deposits and advances registered a more or less continuous rise, (b) July 1948 to December 1949, which witnessed a steep fall in deposits and a moderate decline in advances barring seasonal expansion, and (c) from the beginning of 1950 onwards when the earlier uptrend in deposits and advances reappeared.

The consolidated position of scheduled banks for (i) undivided India for 1945 through June 1948 and (ii) the Indian Union for 1947 through March 1951 are presented in the following page. Since, for purposes of analysis, it would be more convenient to take the post-war period up to June 1948 as a whole, the figures for undivided India for 1947 and June 1948 have been derived from the totals for the Indian Union and Pakistan. From July 1948, the analysis is based on figures relating to the Indian Union.

During the first phase, i.e., from the end of the war till June 1948, the war-time uptrend in deposit liabilities continued; total demand and time liabilities rose from Rs. 865 crores at the end of June 1945 to Rs. 1,112 crores by the last week of June 1948, a rise of 28.6 per cent over the three-year period. There was some decline in the proportion of demand liabilities to total deposit liabilities but, around 70 per cent, it was still substantially higher than in the pre-war period. With the gradual adaptation of trade and industry to peace-time conditions, advances and bills rose sharply by almost Rs. 200 crores in the three-year period, from Rs. 292 crores to Rs. 487 crores, the advances-deposits ratio rising from 33.8 to 43.8 per cent. On the other hand, investments in Government securities, which had risen sharply and approximated to about one-half of the deposit liabilities in December 1945, recorded some decline. Scheduled banks' borrowings from the Reserve Bank remained insignificant throughout the period; excepting a few weeks during January and August-October 1946 and January 1947, the weekly outstandings were less than a crore of rupees.

During the second phase, July 1948 to December 1949, aggregate deposits* registered a steep fall of Rs. 139 crores, from Rs. 974 crores to Rs. 835 crores. This was the combined result of a number of factors, in particular the heavy adverse balance of trade and the repatriation of some foreign capital. During the same period, advances and bills also recorded a net decline, though there was substantial expansion in the busy season. The large decline in deposits was met by the disinvestment of Government securities; the decline in this item was from Rs. 467 crores in October 1948 to Rs. 357 crores by the end of 1949. Scheduled banks' borrowings from the Reserve Bank were higher during the greater part of the period, moving between Rs. 4 crores and Rs. 22 crores.

In the third phase, i.e., from the beginning of 1950, deposits registered a moderate but almost a steady rise, from Rs. 835 crores in the last week of 1949 to Rs. 881 crores by the end of March 1951 - a rise of Rs. 46 crores over the fifteen month period. Advances and bills rose substantially during the period from Rs. 412 crores to Rs. 547 crores,

* i.e., deposit liabilities excluding borrowings from banks. These data are available only from July 1948.

TRENDS IN SCHEDULED BANKS' DATA, 1945-51

TRENDS IN SCHEDULED BANKS' DATA, 1943-51
(Rs. crores)

| Last Friday of | Undivided India | | | | | Indian Union | | | | | |
|--|-----------------|---------------|---------------|----------------|-----------------|---------------|----------------|---------------|---------------|---------------|---------------|
| | June 1945 | 1945 | 1946 | 1947 | June 1948 | 1947 | June 1948 | 1948 | 1949 | 1950 | March 1951 |
| Number of Reporting Banks .. | 86 | 91 | 96 | 99(I) 50(P) | 100(I) 45(P) | 99 | 100 | 95 | 95 | 93 | 93 |
| Demand liabilities .. | 626 | 673 | 730 | 727 | 782 | 648 | 664*† | 637* | 565* | 580* | 593* |
| Time liabilities .. | 239 | 280 | 332 | 342 | 330 | 316 | 310*† | 298* | 270* | 281* | 288* |
| Total Demand and Time liabilities .. | 865 | 953 | 1,062 | 1,069 | 1,112 | 965 | 974*† | 934* | 835* | 861* | 881* |
| Cash and Balances with the Reserve Bank .. | 119 | 122 | 117 | 146 | 147 | .. | 118† | 108 | 114 | 95 | 93 |
| Advances and Bills Discounted .. | 292 (33.8) | 327 (34.2) | 465 (43.8) | 445 (41.6) | 487 (43.8) | 406 (42.1) | 452† (46.4) | 443 (47.4) | 412 (49.3) | 445 (51.7) | 547 (62.1) |
| Borrowings from the Reserve Bank .. | — | 0.8 | 0.4 | — | — | — | — | 17 | 7 | 0.8 | 12 |
| Investments in Government Securities .. | — | 496 (52.0) | 494 (46.5) | 484 (45.3) | — | — | — | 450 (48.2) | 357 (42.8) | 366 (42.5) | 316 (34.7) |

Figures in brackets are percentages to total demand and time liabilities up to June 1948 and to total demand and time deposits thereafter.

* Deposit liabilities only.

† Relate to July 2, 1948.

(I) India.

(P) Pakistan.

the credit-deposits ratio rising sharply from 4g to 62 per cent. The demand for credit was aggravated, apart from seasonal requirements, by the post-Korean boom. in commodity prices, speculative hoarding of commodities in short supply and liberalisation of imports. The sharp increase in bank credit was financed largely by liquidation of investments, and to some extent, by the drawing down of cash and balances with the Reserve Bank and by borrowings from the Bank.

In the post-war years, generally, the scheduled banks (and state cooperative banks) resorted to the Bank for short-term accommodation on a much larger scale than in the war or pre-war years. The following table gives the aggregate of the gross advances made to scheduled banks during the years 1937-51; almost the whole of such assistance was by way of advances against Government securities under Section 17(4) (a).

| Year ended March | (Rs.lakhs) | Year | (Rs.lakhs) |
|------------------|------------|------|------------|
| 1937 | 72 | 1945 | 1, 75 |
| 1938 | 21 | 1946 | 24, 70 |
| 1939 | 2, 87 | 1947 | 3, 08 |
| 1940 | 27 | 1948 | 22, 02 |
| 1941 | 59 | 1949 | 35, 61 |
| 1942 | 64 | 1950 | 13, 72 |
| 1943 | 4, 03 | 1951 | 76, 57 |
| 1944 | 2, 53 | | |

The non-scheduled banks, though numerous, accounted for only a small part of the resources of the banking system. Their number had recorded considerable increase during the war with the establishment of several mushroom banks, many of them with little chance of survival. Hence, the post-war years witnessed the phenomenon of a number of these small banks going out of existence, either as a result of the operation of the natural law of survival or the coming into force of the new legal provisions for regulating banking business. The number of nonscheduled banks declined from 542 at the end of 1946 to 48 by the close of 1951. During the same period, deposits of these banks came down from Rs. 97 crores to Rs. 69 crores, credit extended by them from Rs. 54 crores to Rs.46 crores and their investments from Rs.34 crores to Rs. 27 crores.

Banking crises, 1946-49

The interim banking regulation measures introduced during the war and post-war years, pending the passage of the Banking Companies

Bill, were mainly designed to weed out the unsound units and generally to ensure the proper management and conduct of the affairs of banks. It was, therefore, but natural that, soon after the Inspection Ordinance and the Restriction of Branches Act had been brought into force in 1946, many of the banks-especially the less viable ones -got into difficulties, resulting in minor crises in the areas of their operations.

In this regard, the banks in Bengal presented a particularly difficult problem. There were far too many of them. The Registrar of Joint-Stock Companies, Bengal, estimated that 850 to 900 non-scheduled banks were functioning in that Province, more than half of which were only loan companies and did not do any real banking business. Nearly 75 per cent of the non-scheduled banks had paid-up capital of less than Rs. 75,000 and some even below Rs.500. The deposits of this class of banks in Bengal had risen from Rs. 5 crores to Rs.31 crores between 1940 and 1946; those of Bengali scheduled banks had increased from Rs.5 crores to Rs.70 crores during the same period. The vulnerable position of many of these banks came to a head during 1946 when 26 non-scheduled banks were black-listed by-the Calcutta Clearing Banks' Association for non-compliance with accepted banking practices. Towards the end of that year there was a run on several banks in the area, including three scheduled banks. Four non-scheduled banks suspended payment and were granted interim moratoria by the Calcutta High Court.

The Government of Bengal issued a press communique at the end of November 1946 dispelling mischievous rumours that all nonscheduled banks were in difficulty or were financially unsound and averring that a substantial number of banks were reported to be working on sound banking lines. The Government also stated that the list prepared by the Calcutta Clearing Banks' Association contained the names of some banks which had ceased working as early as 1944-45 and that there was no ground for panic. The crisis subsided after this press communique and the issue on similar lines of a press communique by the Calcutta Manager of the Reserve Bank, as also the fixing of minimum selling price of shares by the Calcutta Stock Exchange. One of the scheduled banks had to get itself affiliated to a bigger scheduled bank to ward off the crisis. In order that the situation might not get aggravated, inspections by the Reserve Bank of banks in the Eastern Area were suspended temporarily.

The unhealthy practices followed by a number of non-scheduled banks in Bengal and their tendency to open an excessively large number of branches and to grant loans without security were mainly responsible for the difficulties of the banks. Thus, for instance, the four banks which were granted moratoria had too many branches in relation to their paid-up capital and reserves, as under:

| | Capital and reserves (Rs.lakhs) | No. of branches |
|--------|------------------------------------|--------------------|
| Bank A | 2.33 | 23 |
| Bank B | 0.69 | 50 |
| Bank C | 9.36 | 67 |
| Bank D | 1.33 | 77 |

Lack of proper personnel at the helm of affairs of the banks was also an important contributory factor to their unsatisfactory working. In the case of some banks, there was large scale lending against speculative shares and investments in shares of associated companies. During the last quarter of 1946, owing to a combination of political and economic factors and labour troubles, there was a slump in share prices and the banks which had made large advances against shares or invested in them were adversely affected.

The conditions in the Eastern area returned to normalcy by about the end of January 1947, but during the same month there were disturbances of a serious nature in the Punjab leading to a large scale destruction of property and loss of human life. Banks operating at centres affected by these disturbances sustained losses partly owing to the destruction of some of their offices but mainly because a sizeable portion of commodities against which they had granted advances was gutted by fire, particularly in Amritsar. The civil disturbances led to serious disruption of communications and also to some extent nervousness among the depositors of some banks. In the Western area also, a few banks experienced difficulties following the failure of the Associated Banking Corporation of India in March 1947.

A few of the affected banks made large drawings from their balances with the Reserve Bank. They also sold Government securities to the Bank on a large scale and availed themselves of advances against Government securities from the Bank, to meet the run and also as a precautionary measure. In this situation, the Bank issued a circular letter in March 1947 to all banks reminding them that they should be in close touch with the Bank's Managers at different centres and should keep the Bank posted with detailed information regarding their financial condition, so that the Bank could assist them when necessary without delay.

After the partition of the country, certain relaxations were also made in existing banking laws at the instance of the Reserve Bank, to avoid damage to the banking structure in the border areas and unnecessary distress to their depositors, many of whom were refugees. The Banking Companies (East Punjab and Delhi) Ordinance was promulgated in September 1947, empowering the Central Government to

make an order staying for a period of three months the commencement or continuance of all actions and proceedings against an applicant bank whose registered office was situated in East Punjab or Delhi. During this period the bank concerned was authorised to make payments to each depositor not exceeding ten per cent of the total amount of the current and deposit accounts at each branch in India or Rs. 250 whichever was less and was also permitted to make similar payments to the depositors who could satisfy the bank about their deposits in branches outside India. Beyond such payments and its normal running expenses, the bank was not allowed to dispose of any of its assets or accept any deposits. The Central Government were empowered to advance to the bank the amounts necessary to enable it to make payments to the depositors. In pursuance of this measure, three banks were granted interim relief by way of moratoria.

The Government of India also issued in December 1947 the Negotiable Instruments Act and the Indian Limitation Act (Temporary Amendment) Ordinance, temporarily amending the Negotiable Instruments Act, 1881, and the Indian Limitation Act, 1908. The Ordinance was intended to safeguard the interests of banks which experienced difficulties in dealing with bills drawn on firms and companies situated in the Punjab and other disturbed areas. Under the Ordinance, the banks were given powers to treat bills as dishonoured when presentment was impossible owing to the prevalence of riots or other disturbances. It was also provided that any suit, which could not be instituted within the period of limitation on account of riots or disturbances, could be admitted after the period of limitation provided the plaintiff satisfied the court that he was unable to file a suit within such period owing to disturbances.

The Reserve Bank of India (Temporary Amendment) Ordinance, promulgated by the Government in September 1947 itself, amended Section 18(3) of the Reserve Bank Act, to enable the Bank to grant emergency advances to banks against such form of security as it might consider sufficient. The genesis of this measure is described in some detail later in this chapter.

Excepting the Banking Companies (East Punjab and Delhi) Ordinance, which bristled with difficulties in implementation, the other two Ordinances remained virtually a dead letter. All these three Ordinances lapsed in March-June 1948.

Although the 1946 crisis subsided early, some of the Bengali banks were not able to retrieve their lost position in the succeeding years. Their efforts to prevent a debacle by impressing upon their depositors by advertisements that they were 'scheduled banks' and 'clearing banks' did not help restore much public confidence in them. The aggregate liabilities of non-scheduled banks in Bengal fell from Rs.31

crores in July 1946 to Rs. 8 crores in December 1947 ; those of scheduled banks declined from Rs. 70 crores in September 1946 to Rs. 64 crores in June 1948 and Rs. 46 crores in December 1948. The descheduling of the Bank of Commerce, Calcutta, in April 1948 gave another jolt to public confidence and resulted in steady withdrawals of deposits, including time deposits, particularly from the smaller Bengali scheduled banks. Owing to their unsound financial position and blocked advances, those banks were unable to cope even with the small demands of their depositors. Four scheduled banks, viz., the Calcutta Commercial Bank, the Pioneer Bank, the Mahaluxmi Bank and the Noakhali Union Bank, had to suspend payment in September 1948.

In the early part of 1949, there was a run on some of the foreign and Indian branches of the Exchange Bank of India and Africa and the Reserve Bank had to grant substantial assistance to it to prevent further withdrawals, as described later in this chapter. There was a widespread belief that the run would extend to other banks in the Bombay area, but luckily the scare did not last long.

In the post-war period, for all the stresses and strains, bank failures were fewer than in the war years. The post-war failures, however, involved, on an average, larger banks. The total paid-up capital of the 207 banks that failed in the period 1946-50 was Rs. 533 lakhs as compared with Rs. 68 lakhs in respect of the 365 banks that failed in the war years. Annual figures for the period 1945-51 are given in the table below.

(Rs.lakhs)

| Year | No.of Banks | Capital | | |
|------|----------------|------------|------------|---------|
| | | Authorised | Subscribed | Paid-up |
| 1945 | 27 | 81 | 9 | 5 |
| 1946 | 27 | 250 | 12 | 9 |
| 1947 | 37 | 753 | 105 | 87 |
| 1948 | 45 | 1,278 | 245 | 179 |
| 1949 | 53 | 996 | 179 | 117 |
| 1950 | 45 | 737 | 190 | 140 |
| 1951 | 62 | 918 | 92 | 62 |

Reserve Bank's Policy regarding Special Assistance to Banks

The Bengal banking crisis of 1946 brought once again to the fore the question of the Bank's policy regarding the provision of financial assistance to banks in difficulties. In November 1946, one of the Bengali banks -a scheduled bank -affected by withdrawals requested the Reserve Bank for financial accommodation against the security of shares held by it in its investment and loan portfolios.

This bank was a frequent borrower from the Reserve Bank in the latter half of 1946 against Government securities; the bank did not disclose the real reason for its borrowings which, it later transpired, was the fall in its deposits. In spite of a fall in deposits by Rs. 44 lakhs between May, and November 1946 -which was not, however, revealed as the bank's demand loans from other banks offset the decline in deposits -the bank had increased its advances by Rs.1 crore. Despite the warnings of the Bank against extension of credit for speculation in shares (for which purpose the Bank issued a circular in May 1946), the bank's advances against shares formed 63 per cent of its total advances, in December 1946. In a falling market, the margins maintained by the bank were only 25 to 30 per cent. Apart from the question whether the Reserve Bank should go to the assistance of such a bank, it was doubtful whether the Bank was authorised to make advances to the bank against bills covering advances against shares, since such bills could not be considered to be drawn for bonafide trade or commercial transactions. Further, under Section 19 of the Reserve Bank of India Act, advances against shares were specifically prohibited. The request of the bank was, therefore, turned down.

The Bank, however, took up the question of amending the Act to enable it to advance on occasions of special urgency against shares or, generally speaking, against any type of security deemed suitable by it. The point to be considered was whether the amendment, if proposed, should be carried out under Section 17 or under Section 18 of the Act. No doubt, under Section 18 of the Act the Bank was authorised to grant accommodation against eligible paper to non-scheduled banks when it was satisfied that a special occasion had arisen for action under the Section; the fact was that the banking crisis in Bengal affected primarily the non-scheduled banks. However, most of the nonscheduled banks in Bengal had hardly any assets eligible for rediscount or advances under the Act; their financial position and methods of operation and the policies pursued by their managements were very unsatisfactory. In practice, therefore, it would have been impracticable for the Bank to assist any considerable number of non-scheduled banks even if the Act was amended.

The Governor, therefore, recommended to the Central Board in December 1946 the amendment of Section 17 of the Act. The Central Board agreed with the Governor and resolved:

That, after consideration of the Governor's memorandum, the Central Board recommend that, to widen the powers of the Reserve Bank of India to enable them to extend credit to banks beyond the existing provisions of the Act by which they are governed either in a particular instance or where there is a threat to the banking structure of the country, Government should promote legislation on the lines of Section

10(b) of the Federal Reserve Act, * to empower the Reserve Bank of India to make advances against promissory notes which are secured to their satisfaction.

The Board resolved further:

That, in order to enable the Reserve Bank to meet any urgent demand for assistance which might arise before the proposed legislation can be acted in the normal course, Government should prepare and hold in readiness an Ordinance to the same effect for promulgation immediately should the necessity arise.

Later in the month, the Governor submitted a memorandum to the Committee of the Central Board advising amendment to Section 18(3) † of the Act, instead of Section 17 as previously recommended by him. The reasons given by him were: (a) limitations imposed on the Bank under Section 17 of the Act, (b) the absence of the bill habit in India and (c) the inapplicability of Section 17 to non-scheduled banks which were actually the ones that had experienced the greatest strain. He felt, on a reconsideration of the problem, that for the purpose of assistance in the event of an emergency, both scheduled and non-scheduled banks should be treated on par and the Bank should be in a position to assist any bank provided it was solvent and its methods of operation were satisfactory. After all, he argued, the failure of sound nonscheduled banks might spread to scheduled banks needing larger assistance from the Bank. The Banking Bill also made no distinction between the scheduled and non-scheduled banks. Further, some of the non-scheduled banks-their number, of course, small-were run on proper lines and were rendering useful service in their own sphere.

In the memorandum to the Committee, the Governor also indicated certain guidelines for the grant of advances under Section 18 of the Act, if amended. Firstly, the powers were to be used only in case of an emergency when the assistance that could be granted under Section 17 of the Act was found to be inadequate. Secondly, the Bank had to be satisfied as to the solvency and methods of operation of the bank concerned and for this purpose a rapid inspection of its books and accounts might be required. Assistance was to be refused if the difficulties were due to over-trading or lack of normal precautions taken by well-managed banks. Stock exchange securities and immovable properties would be taboo as security for advances. However, the Bank might grant advances against bills not eligible under Section 17 by reason of their longer usance or against bills drawn by parties who

* Any Federal Reserve Bank, under Rules and Regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve Bank.

† Renumbered as 18(1) (3), effective September 20, 1947.

had taken advances from banks by way of pledge of goods. All applications for advances under the new amendment had to be carefully examined by the Governor or, in his absence, by one of the Deputy Governors and the approval of the Committee obtained.

The Committee approved the Governor's proposal, and accordingly, the Government were advised to amend Section 18 of the Act.

In a subsequent memorandum placed before the February 1947 meeting of the Central Board, the Governor counselled that the greatest amount of circumspection had to be exercised in granting accommodation even if the Act was amended, in order to avoid the possibility of throwing good money after bad. He explained:

There is already a considerable pressure on the Reserve Bank to assist banks, whether run on sound lines or not, and there is a general tendency both in the press and elsewhere to criticise the Reserve Bank for not assisting every bank which finds itself in difficulties. Sufficient attentions not, however, given to the bank's financial position and methods of operation and to the fact that it may not have been in difficulties if it had run its business on approved lines. The public has yet to realize that ultimately the progress of banks depends more on good bankers managing the institutions under their control on sound principles than on the assistance of the Reserve Bank. The present tendency of excessive reliance on and undue criticism of the Reserve Bank is likely to be accentuated when our Act has been amended on the lines proposed. It is, therefore, necessary that we should be very careful and not allow ourselves to be stampeded into hasty action by pressure from interested quarters under any circumstances and thereby hamper the development of the Indian banking system on sound lines by prolonging the existence of unsound institutions or by encouraging banks to overtrade.

Government agreed to the Bank's proposal to amend Section 18 of the Reserve Bank Act, but instead of promoting separate legislation they intended to incorporate the provision in the Banking Companies Bill itself. Meanwhile, at the request of the Indian Banks' Association and in view of the general stringency in the money market, in April 1947 the Bank abolished the seven days' minimum interest clause on loans and advances granted to scheduled banks under Section 17(4) of the Reserve Bank Act. Thus, interest was to be charged only for the actual number of days a loan or advance remained outstanding.

Apprehending delay in the enactment of the Bank Bill and having in view the coming busy season and the difficulties experienced by certain banks on account of partition of the country, the Bank recommended to Government in August 1947 the issue of an Ordinance amending Section 18(3) of the Reserve Bank Act. Accordingly, the Reserve Bank of India (Temporary Amendment) Ordinance was issued in September 1947, enabling the Bank to grant emergency advances to scheduled and non-scheduled banks against such forms of security

as might be considered sufficient by the Bank. The implementation of the Ordinance was, however, not easy since under Section 17 or Section 18 of the Act, the Bank could lend only against securities which were acceptable to the Bank. Most of the banks in difficulty had no such security to be offered to the Bank. The Ordinance was, therefore, of no practical value and it lapsed in March 1948.

However, the Bank continued to explore ways and means of helping banks in times of crises. It moved the Government to incorporate a permanent provision under Section 18(3) of the Act for enabling the Bank to advance sums of money against securities not mentioned under Section 17 of the Act, provided it was satisfied with the soundness of the concerned bank. The Bank also suggested that in cases where it advanced such monies under the amended Section 18(3) *, a stipulation might be made to enable the Bank to get a lien over the banks' general assets in preference to unsecured creditors. In anticipation of these amendments with retrospective effect, the Bank granted, in August September 1948, advances aggregating Rs. 3.69 lakhs to a Calcutta bank, against shares, gold ornaments, goods, etc. In fact, a limit exceeding Rs.10 lakhs was sanctioned to this bank, but it failed to produce eligible securities to that extent. The other three Bengali scheduled banks which had suspended payment did not approach the Reserve Bank for any assistance.

The Committee of the Central Board also decided in August 1948, that in an emergency the Governor should be authorised to make advances on suitable security at 2 per cent interest with a margin of 5 per cent of the market value against Government promissory notes and at reasonable margin against other securities. Such advances were to be subject to the conditions that the banks assisted agreed to furnish details of their assets to the Reserve Bank from time to time as directed (whether or not there was a statutory provision for furnishing such information) and also accepted the Bank as the final authority to decide whether the emergency existed or had ceased.

In accordance with the Bank's proposal for amendment of Section 18 of the Act, the Central Government included under the Banking Companies (Control) Ordinance, promulgated by them in September 1948, a clause amending Section 18(3) * by adding the following words in that Section :

or, when the loan or advance is made to a banking company, as defined in the Banking Companies (Control) Ordinance, 1948, against such other form of security as the Bank may consider sufficient.

The Ordinance also inserted the following additional provision as a new sub-section(2) under Section 18 :

* Renumbered as 18(1)(3).

Where a banking company to which a loan or advance has been made under the provisions of clause (3) of sub-section (I) is wound up, any sums due to the Bank shah, subject only to the claims, if any, of any other banking company in respect of any prior loan or advance made by such company against any security, be a first charge on the assets of the banking company.

These amendments were given retrospective effect from September 20, 1947. The amendments were later placed on a permanent basis in the Banking Companies Act.

These provisions were of immediate significance. For, in the same month that they were first brought into force, i.e., September 1948, on panic appeals for assistance by the Bengali banks in trouble and the West Bengal Government, the Deputy Governor (Mr. Mehkri) visited Calcutta and conferred with the officers of the Bank and some of the local banks, including the Nath Bank which was facing a closure if urgent financial assistance were not forthcoming. The Deputy Governor sanctioned limits to the Nath Bank aggregating Rs. 72.50 lakhs initially against its over-all assets. The limit was almost fully utilised and the advances were subsequently secured by repledge of shares and sub-mortgage of immovable properties belonging to the bank's constituents.

The advances to the Nath Bank were ratified by the Committee of the Central Board soon after they were granted. Still, the Reserve Bank had misgivings about the validity of the securities created in its favour, since there was a technical difficulty that the advances had been made without a definite expression by the Central Board that a special occasion had arisen 'making it necessary or expedient that action should be taken under this section for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture '. The Nath Bank went into liquidation in May 1950 and after protracted legal proceedings lasting for eight years, the Official Liquidator of the bank admitted, by way of compromise, the Reserve Bank's first charge on the securities pledged to it. The Bank was able to realise most of the money due to it.

A similar difficulty cropped up, in February 1949, in the case of the Exchange Bank of India and Africa (Exchange Bank, to be brief) also. This bank experienced a run on some of its foreign branches and it was feared that the panic would have repercussions on the bank's branches at Colombo, Madras and Bombay. Since a major portion of its advances was locked up in airline interests, the bank was unable to meet the withdrawals and frantically appealed to the Reserve Bank for assistance. Advances aggregating Rs. 85 lakhs were sanctioned to it by the Bank under Section 18(1)(3) of the Act, during February-April 1949, against deposit of title deeds of immovable properties

belonging to the bank, the sub-mortgage of properties belonging to its constituents and against the rehypothecation/repledge of other securities in its possession. The advances sanctioned by the Governor/Deputy Governor were ratified by the Committee of the Central Board and the Central Board itself between March and June 1949. Despite the assistance given by the Bank, the Exchange Bank had to suspend payment in May 1949 and was ordered to be wound up in July 1949. The failure of this bank did not, however, cause a run on any other bank in the Western area.

In the liquidation proceedings of the Exchange Bank, the Reserve Bank, being the largest single creditor, claimed the first charge on the assets of the bank, under Section 18(2) of the Act. The Official Liquidator of the bank challenged the Reserve Bank's claim contending that, in order to admit or deny the validity of the Reserve Bank's first charge, it would be necessary for the Bank to prove that the advances were made in accordance with the formalities laid down under Section 18(1) of the Act. The position was, as in the Nath Bank's case, that the advances had been granted without a previous expression of opinion by the Central Board that a special occasion had arisen making it necessary or expedient that the advances had to be granted. The Bank consulted its Counsel who held:

The matter 'is not free from difficulty. I take the view, not without considerable hesitation, that the Governor is competent under section 7(3) to form the opinion which the Central Board is empowered to form under sub-section (1) of section 18.

Another difficulty was that the particulars of the mortgages or charges had not been registered by the Reserve Bank with the Registrar of Companies as required by Section 18 of the Indian Companies Act. These issues were raised by the Official Liquidator while filing a petition in the Bombay High Court in March 1950 disputing the claims of the Reserve Bank. The Official Liquidator's contentions against the Bank were supported by another creditor of the Exchange Bank who had a charge on the same goods, securities and assets which had been offered to the Reserve Bank as security and who had, besides, taken the precaution of registering his charge with the Registrar of Companies. In January 1951, at the initiative of the High Court and the Official Liquidator, a suggestion was made to the Reserve Bank's solicitors and Counsel that, since the legal position regarding the validity of the Reserve Bank's claims was not beyond doubt, the Liquidator would be agreeable to a compromise in the interest of all creditors, subject to the sanction of the Court. The Governor of the Bank (Rama Rau) obtained the approval of the Finance Minister (Deshmukh) for the compromise under which the Reserve Bank was

entitled to 50 per cent of the net assets realised by the Official Liquidator after deduction of trust monies, preferential claims payable under Section 230 of the Indian Companies Act and costs of liquidation. The recoveries of assets in the liquidation proceedings of the bank were effected at a slow pace spread over a number of years and the Reserve Bank, ultimately, had to forgo a good part of its dues.

Ever since the crash of the TNQBank there was criticism that the Reserve Bank was not helping banks in difficulties and was needlessly insisting on eligible securities, but in 1949-50 the tide of comments turned against the Bank for its large advances to the Exchange Bank. In the Union Parliament, Mr. R. K. Sidhva, in particular, raised the above issue, time and again. The Finance Minister, replying on March 22, 1950 to the questions asked by Mr. Sidhva, was clear in his mind that in exercising its discretion as it did, the Reserve Bank was perfectly justified; its action had been in the best interests of the country.

In view of the compromise arrived at between the creditors and the Official Liquidator of the Exchange Bank, the main points at issue (viz., whether the Governor had the powers of the Central Board in regard to declaration of emergency under Section 18 of the Act and granting of advances under that Section) were not determined by the Court. It was, however, considered necessary by the Bank to clarify the intention of the Act so as to save the Governor from any possible embarrassment in the future caused by a judicial decision regarding his powers. Since the inception of the liquidation proceedings of the Exchange Bank, both the Government and the Bank were considering the manner in which the Reserve Bank Act should be amended to protect the official acts of the Governor under Section 18 from being impugned in a court of law. Further, it was recognised that, in the emergency of the kind contemplated in Section 18, it might be detrimental to the general banking business to hold over action until after a meeting of the Board could be convened for prior consultation. The object was achieved in May 1951 when the Reserve Bank Act was amended making it clear under Section 18 read with Section 7(3) that the Governor (or in his absence, the Deputy Governor nominated by him) or the Central Board could validly grant the emergency advances. The amendment was made retrospective from January 1, 1949.

EFFORTS FOR A COMPREHENSIVE BANK ACT

The Bank's efforts for a comprehensive banking legislation continued all through with undiminished vigour. The Banking Companies Bill

which, it may be recalled, lapsed in October 1945 with the dissolution of the Legislative Assembly, was reintroduced in the new Assembly in March 1946. The intervening period gave an opportunity to the Government for considering the amendments suggested by the Bank in May 1945 as also certain additional provisions recommended by it in December 1945.

In October 1945, the Government conveyed their approval of all the amendments suggested by the Bank in May 1945, except the one recommending reduction in minimum capital requirements for banks operating outside the State or Province of their incorporation, from Rs.20 lakhs to Rs.10 lakhs. The Bank's Board, however, reiterated at its meeting in December 1945 the earlier recommendation that the limit should be lowered to Rs.10 lakhs, if strongly pressed by nonofficial members in the Legislature.

The Board also considered at this meeting a memorandum prepared by the Governor suggesting amendments to the Banking Companies Bill to provide for a 'comprehensive' system of licensing of banks and for licensing of branches of banks too. In the Bill as it then stood, only banks incorporated outside British India or the United Kingdom were required to obtain licences to start banking business in British India. The Governor recommended that the clause should be altered so as to require all banks other than the then existing scheduled banks to obtain licences from the Bank within a period of five years after the provision came into force. The Board approved the Governor's recommendation with the addition of a further stipulation that a bank incorporated in a country the Government or law of which discriminated in any way against banks registered in British India should also be required to take out a licence. In effect, the Bank's revised recommendation could hardly be called comprehensive since, among the then existing banks, licences had to be taken out by only (a) non-scheduled banks and (b) the National City Bank of New York and the American Express Company. The licensing provision was to be applicable to these two American banks, as there were a few States in the U.S.A. which either prohibited the acceptance of deposits by branches of foreign banks or made such acceptance dependent on special permission from the State banking authorities.

The Governor thought it essential to introduce a comprehensive licensing system in the context of a provision under the Banking Companies Bill in terms of which the work of liquidation of banks was to be entrusted to the Bank. The Governor's view was that by enforcing the licensing provisions, a number of petty banks, whose assets had been dissipated by mismanagement, would go out of existence, thereby lessening the Bank's responsibility for undertaking liquidation proceedings. Indeed, the Governor's preference was for deletion of the

provision appointing the Reserve Bank as the Official Liquidator, as the task might prove to be beyond the Bank's administrative capacity. The Board did not, however, consent to this.

Banking Companies Bill, 1946

The recommendations of the Board (excepting those relating to the reduction of minimum capital requirements for banks operating outside their Province or State from Rs.20 lakhs to Rs.10 lakhs and reduction of the percentage of minimum liquid assets from 25 to 20 and some other minor amendments) were incorporated in the Banking Companies Bill which was reintroduced in the Legislative Assembly in March 1946. This Bill also contained important amendments, mooted by the Bank, to the provisions of Section 42(6) of the Reserve Bank Act ; the amendments sought to confer on the Bank the power of inclusion in or exclusion from the Second Schedule, whereas previously the decision in this regard rested with the Central Government. The Bank was also to be given the necessary powers to satisfy itself that the real or exchangeable value of the paid-up capital and reserves of the bank concerned was not less than Rs. 5 lakhs and the bank's affairs were not being conducted to the detriment of the interests of the depositors.

A motion to refer the Bill to a Select Committee was adopted by the House in April 1946, but, owing to constitutional developments, the Committee could not meet until November 1946. In the meantime, as already mentioned, at the Bank's instance, the Government promulgated the Banking Companies (Inspection) Ordinance and secured the passage of the Banking Companies (Restriction of Branches) Bill.

The respite afforded by the delay in the meeting of the Select Committee till November 1946 gave the Bank the chance of having yet another look at the Banking Companies Bill and recommending to the Government fundamental changes in the provisions relating to inspection. The relevant clause, as it stood in the Bill, provided for inspection by the Reserve Bank only when the Central Government. had misgivings about the condition of a bank. The point had been made that the commencement of an inspection of a bank under such circumstances might cause a run on it and impair its credit irretrievably. To avoid such untoward consequences, a system of regular inspections was suggested by the Bank's management in a memorandum to the Central Board in July 1946. The clause was to be altered on the lines of the provisions of the Inspection Ordinance which provided that the Central Government could at any time direct the Bank to cause an inspection to be made and make report thereon to the Central Government. The Bank's Board, at its meeting in August 1946, not only agreed with this recommendation but also resolved that the authority

to inspect a bank should vest in the Reserve Bank itself without requiring it to obtain a direction from the Central Government. This was, indeed, a far cry from the 1939 proposals which had deliberately by-passed inspection as not practicable nor desirable ! This also underlined the flexible approach adopted by the Bank's Board in the light of war-time banking developments.

The Select Committee, which examined a number of expert witnesses, held meetings in November 1946 and January and February 1947. In the discussions among the members, several interesting suggestions, and some radical ones too, were made. For instance, Mr. Manu Subedar brought up the question of the abolition of the many distinctions that existed in the Bank Bill among banks- scheduled and non-scheduled, those registered earlier and those registered later, Indian and foreign, British Indian and those of Indian States and so on. The suggestion found general support. Mr. Subedar also suggested the appointment of a Curator, an official of the Reserve Bank, to take over from the Registrar of Companies the functions relating to banks and 'be a guide and friend and not always a schoolmaster with a rod'. This suggestion was opposed by members as 'a mere detail' of how the Reserve Bank had to implement its powers. The third suggestion of Mr. Subedar was the constitution of a bank rehabilitation fund of Rs. 5 crores, out of the Reserve Bank's profits, for helping banks in trouble. While this suggestion was opposed by many other 'members, they expressed the view that the Bank came in at the last minute in a crisis and gave only advice without any prompt help. Despite the strenuous efforts made by the Bank's representative (Mr. Ram Nath) to explain the role of the Bank in a crisis, the general trend of opinion among the members was that the Bill should contain provisions spelling out the powers and responsibilities of the Reserve Bank.

Regarding the scope of the Bill, Mr. M. Ananthasayanam Ayyangar wanted it to be extended to nidhis and indigenous bankers and the definition of 'banking' to be elaborated so as to include acceptance of time deposits. Sir Cowasjee Jehangir did not see why the Imperial Bank had to have an Act of its own and could not be brought under the new Act, so as to be within the control of the Reserve Bank. These suggestions found general acceptance. Mr. Sasanka Sekhar Sanyal made several interesting observations concerning the responsibility of big banks in financing agriculture, the need for a central advisory board and the proper attitude of the Reserve Bank. He observed:

you cannot expect the small bank alone to invest in agriculture. The big Banks should be made to help rural industries more and more. Otherwise it would be a competition between a giant and adward. The responsibility of the Reserve Bank should not be whittled down to any extent. We must have a central advisory body consisting

of officials, with provincial branches and provincial legislatures must be represented therein and the centre also must be represented. We must have good non-official spokesmen having direct day to day voice in the matter of administration. The Reserve Bank looks at things more or less as a paper proposition. It is neither responsible nor responsive. Within the present framework of the Reserve Bank we must have provisions which will keep the non-official spokesmen alert and vigilant on the one hand to see that operations are made according to law and at the same time see that the central authority namely the Reserve Bank is not lukewarm, and does not show favouritism between one bank and another.

Besides the above suggestions emanating from the members of the Select Committee, there were several changes and additions suggested by the representatives of the banking industry -Indian scheduled and non-scheduled banks, exchange banks and nidhti-and the Bombay Shareholders' Association.

The report of the Select Committee was presented to the Legislative Assembly in February 1947. The Committee observed:

. . . . as the Bill is drawn it is applicable only to banking companies and we are advised that there were constitutional reasons against extending its provisions, as we would have liked, to partnerships or even individuals carrying on banking business. We desire to suggest that the question should be examined with a view to introducing subsequent legislation extending so far as possible the provisions of the Bill to other banking concerns.

The ' constitutional reasons ' the Committee had in view were that this sector of banking lay within the Provincial sphere and not of the Central Legislature and that there were also practical difficulties of extending the provisions of the Indian Companies Act, which were primarily intended for joint-stock companies, to individuals and partnership firms.

Since the amendments and additions recommended by the Select Committee were of a fundamental nature and formed the basis for the Banking Companies 'Act, 1949, they are briefly recounted below:

(i) DEFINITION OF BANKING

The Committee elaborated the definition of ' banking ' to include acceptance of time deposits and added a new clause prohibiting companies other than banking companies from accepting deposits repayable on demand. The new definition read as follows: 'accepting, for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise '. This definition was incorporated in the Banking Companies Act and has withstood the test of time to this day.

(ii) MINIMUM CAPITAL REQUIREMENTS

In the Bill referred to the Select Committee, the minimum capital requirements were based on population. The Committee introduced a more workable basis, viz., the territorial range of a bank's activities. It introduced the conception of 'regions' or 'areas' of operation, the overriding minimum for a bank incorporated in India being Rs.15 lakhs and for banks incorporated outside India Rs. 20 lakhs. The absolute minimum for a unit bank was, however, suggested at Rs. 50,000. Exchange banks had to deposit cash or approved securities with the Reserve Bank of an amount equivalent to the minimum capital requirements. These provisions have remained practically unaltered save for the additional provision, introduced in 1962, that no new unit bank could start business with less than minimum capital and reserves of Rs. 5 lakhs, as compared with the earlier minimum of Rs. 50,000.

(iii) CASH RESERVE

The Select Committee did away with the difference between scheduled and non-scheduled banks in the matter of maintenance of cash reserve. All banks were to maintain minimum cash reserve amounting to 5 per cent and 2 per cent of their demand and time liabilities, respectively; previously the percentages were 5 and 2 for scheduled banks and 5 and 1 ½ for non-scheduled banks.

(iv) PROHIBITION OF PREMATURE PAYMENT OF DIVIDEND

The Select Committee introduced a new clause prohibiting banks from paying dividends on their shares unless all the capitalised expenses (including preliminary expenses, organization expenses, share-selling commission, brokerage, amount of losses incurred and any other item of expenditure not represented by tangible assets) were completely written off. This provision has remained unchanged till now.

(v) RESERVE FUND

In the Bill referred to the Select Committee, only non-scheduled banks were required to build up and maintain a reserve fund out of their profits till the fund equalled paid-up capital. The Committee extended the obligation to all Indian banks, scheduled and non-scheduled.

(vi) PROHIBITION OF COMMON DIRECTORS

With a view to preventing interlocking of bank directorates, the Select Committee added a new clause debarring a bank from

taking on its Board any person who was a Director of another bank. This provision has remained unaltered.

(vii) RESTRICTIONS ON LOANS AND ADVANCES

In the earlier version of the Bill, grant of unsecured loans and advances to Directors and to firms or companies in which the bank or its Directors were interested as partner, Director or managing agent was prohibited. It was represented that this prohibition would seriously interfere with established practices. The Select Committee felt that the only relaxation that could be justifiably made was to exclude from the scope of the section the grant of unsecured loans and advances to public companies in which the bank or its Directors were interested in the manner as mentioned above. However, a provision was inserted requiring returns to be furnished of such advances, which would enable the Bank to know whether excessive advances were granted to such companies.

(viii) LICENSING OF BANKS

The Select Committee extended the licensing provisions to all banks except the Imperial Bank; All new banks were to be required to apply for licence before starting business. Existing banks had to apply for licence within six months of the coming into force of the Section but could carry on business until the Reserve Bank conveyed its decision regarding the issue of licence. Before granting licence, the Reserve Bank could inspect a bank to find out whether it would be able to repay the depositors in full as their claims fell due, and its affairs were being properly conducted, In the case of banks incorporated abroad, the Bank was required to ensure that the Government or the law of the foreign country did not discriminate against Indian banks.

(ix) MAINTENANCE OF LIQUID ASSETS

The percentage of approved liquid assets to total demand and time liabilities to be maintained by each bank was reduced from 25 to 20. This had been proposed by the Bank, but was not incorporated in the Bill by the Government. Later, in 1964, the percentage was raised to 25.

(x) INSPECTION

The clause was redrafted somewhat on the lines of the Banking Companies (Inspection) Ordinance, 1946. The Reserve Bank was given full discretion to inspect a bank at any time so that the public might

have no ground for drawing any unfavourable inference from the fact that a bank was inspected. Other important features of the new clause were that the Reserve Bank should employ only its own officers to conduct the inspections and that a copy of the Bank's report on the inspection should in all cases be sent to the inspected bank.

(xi) FURTHER POWERS AND FUNCTIONS OF THE RESERVE BANK

In view of the much publicised criticism regarding the aloofness of the Bank, a new clause was added enlarging the Bank's powers and functions in relation to banks. The clause empowered the Bank to caution and advise banks, to assist them as intermediary or otherwise in proposals for amalgamation and to grant loans to them [under amendment proposed by the Select Committee to Section 18(3) of the Reserve Bank Act referred to later] against any security the Bank might consider sufficient. The Bank could also call upon an inspected bank to hold a meeting for considering matters relating to the inspection and to make such changes in its management as might be necessary thereupon. The Bank was also placed under a statutory obligation to submit an annual report to the 'Central Government on the trend and progress of banking in the country.

(xii) APPLICATION OF CERTAIN PROVISIONS TO THE IMPERIAL BANK

The Select Committee considered that, although the constitution of the Imperial Bank was regulated by a separate Act, all the major provisions of the Bank Act excepting those pertaining to minimum capital requirements, licensing, submission of balance-sheet and exercise of powers of advice, caution and help by the Reserve Bank should be extended to the Imperial Bank. This was designed to meet one of the main criticisms levelled against the earlier proposals for banking legislation.

(xiii) AMENDMENT OF SECTION 18(3) OF THE RESERVE BANK ACT

The Select Committee proposed an amendment to Section 18(3) of the Reserve Bank Act, to enable the Bank to come to the aid of a bank through granting a loan secured to the Reserve Bank's satisfaction by forms of security other than those permitted by that Act as it then stood.

In the minutes of dissent appended to the Select Committee Report, some of the suggestions made were: (a) a statutory maximum should be fixed for the dividend for all banks at 9 per cent; the savings thus effected should be utilised to increase the rate of interest paid on

deposits and to reduce the rate of interest charged on loans given by banks up to a maximum rate of not more than 3 per cent over the discount rate of the Reserve Bank; (b) a provision should be made for representation of depositors on the directorate of a bank; (c) a statutory limit might be fixed in respect of salary or remuneration for the manager, managing director, or other employees of a bank; and (d) all banks should be nationalised at an early date and that as a first step, the Reserve Bank and the Imperial Bank might be made State Banks.

The Bank considered the Select Committee's recommendations in detail and was agreeable to many of the changes.

Postponement of the Bill

The 1946 Bill, as amended by the Select Committee, could not be taken up for final consideration during the Budget Session of the Assembly in 1947 owing to very heavy legislative programme; a motion for continuance of the Bill from the old Assembly was adopted by the Constituent Assembly (Legislative) in November 1947. However, the constitutional changes necessitated a number of formal amendments. In addition to these, several further amendments, albeit of a minor nature, were proposed by the Bank. Government, therefore, considered that the passage of the measure would be facilitated if the Bill as reported by the Select Committee were withdrawn and a fresh Bill incorporating all the amendments were introduced and referred to another Select Committee. Accordingly, the Bill was withdrawn from the Constituent Assembly (Legislative) in January 1948, and a new Bill, called the Banking Companies Bill, 1948, was introduced in March 1948. The only important new amendment incorporated in the new Bill was the insertion of a clause providing for a ceiling of 9 per cent on bank dividends.

The Bill was, once again, subjected to delay due to pressure of legislative and other business and could be referred to a Select Committee only in August 1948. In order, however, to deal with certain features in the banking situation requiring urgent attention and in particular to enable the Reserve Bank to assist banks in difficulties, the Government promulgated, in September 1948, an Ordinance, viz., the Banking Companies (Control) Ordinance, containing some of the important provisions of the Banking Companies Bill.

Select Committee on the Banking Companies Bill, 1948

The new Select Committee on the Bill held meetings between November 1948 and January 1949. The witnesses examined by the Committee included representatives of some of the leading commercial banks

headed by Sir Homi Mody, Chairman of the Indian Banks' Association. The bankers also submitted a memorandum to the Select Committee containing their views. The amendments recommended by them included (i) raising the minimum capital requirements in respect of unit banks from Rs. 50,000 to Rs.2 lakhs, (ii) removing the ceiling in respect of dividend payment and (iii) exempting banks having paid-up capital and reserves of more than Rs. 50 lakhs from the restrictions on opening of branches. An important suggestion made by the bankers was the setting up of an Advisory Board for the Reserve Bank. Sir Homi argued:

Large powers are sought to be conferred on the Reserve Bank and some provision should be made by which the Reserve Bank which is not a commercial bank may be advised by a board of commercial bankers say, people representing the Indian Banks' Association which includes all the largest scheduled banks in India. The Advisory Board may consist of three members appointed by the Banks' Association, one appointed by Government and one appointed by the Reserve Bank itself. The overriding powers would be with the Reserve Bank but the Advisory Board would submit advice and criticism from time to time.

The example of the U.S.A., Brazil and Pakistan where there were provisions for the appointment of Advisory Boards or Councils was cited. The Bank was not in favour of such an Advisory Board. Its view was that, if banks were so represented, they might not agree to adverse action being taken by the Bank against some among them. They might also come to know the secrets of other banks' affairs. Moreover, under the Reserve Bank Act, there was already a Central Board of Directors and representative Local Boards composed of men of wide experience and knowledge of banking, trade and agriculture. Later, in the course of the debate in the Legislature, an amendment was moved by Mr. Lakshminarayan Sahu, for the constitution of an Advisory Committee for the Reserve Bank. The Reserve Bank was to exercise control over banking companies under the guidance of this Committee, which was to consist of five members, three nominated by the Indian Banks' Association, and one each by the Central Government and the Reserve Bank. The meetings of the Committee were to be presided over by the Governor or in his absence by a Deputy Governor. The amendment was rejected.

The report of the Select Committee was presented to the Legislative Assembly in February 1949. The Committee, at the outset, mentioned that it had 'considered the possibility of extending the scope of the Bill to cover partnership or individuals carrying on banking business but found the same constitutional objections as were present before the previous Select Committee'. The Committee dropped the clause added by the previous Select Committee prohibiting companies

other than banks from accepting deposits repayable on demand, as it was considered ' unnecessary to include in a Bill for the regulation of banking companies, a prohibition in respect of demand deposits on companies which to the knowledge of the lender are not banking companies and of the nature of business of which he is aware '. Another clause omitted was that limiting bank dividends to 10 per cent. The Select Committee was of the view that this issue had to be considered with reference to companies generally and that it was not desirable to make a provision for banks alone in that matter in anticipation of any general decision that might be arrived at. Yet another relaxation recommended by the Committee was the restoration of the percentage for a bank's shareholding in another company to a maximum of 40 per cent (as against 20 per cent suggested in the 1945 Bill). An important clause redrafted by the Committee concerned the appointment of the Reserve Bank as official liquidator. In the opinion of the Committee, it would be impracticable for the Bank to undertake the liquidation of all banks ordered to be wound up, although there was no doubt that the Bank would be willing to undertake the task where large public funds were involved. The discretion in this matter was therefore left to the Bank. Two important clauses added by the Select Committee were those (a) empowering the Reserve Bank to give directions to banks in regard to their lending policies so that credit facilities might be controlled, if necessary, with a view to checking speculation or rising prices and (b) giving the Government powers to exempt from the provisions of the Act any bank or class of banks either generally or for such period, as might be specified, on the recommendation of the Reserve Bank.

A comment on these changes is provided by the Hindu in its issue of February 12, 1949

The Select Committee's amendments to the Banking Companies Bill are all mainly in favour of the banks rather than the depositors. The Finance Minister, in his speech on the Bill on Tuesday, defended these changes on the ground of expediency.

Three separate minutes of dissent signed by Mr. T. T. Krishnamachari, Mr. M. Ananthasayanam Ayyangar and Professor K. T. Shah were appended to the Select Committee's Report. Messrs. Krishnamachari and Ananthasayanam Ayyangar wanted the clause relating to limitation of dividends to be retained. Mr. Krishnamachari, later participating in the debate on the Bill, made the important point that control of banks was needed not so much for the protection of depositors (' an erroneous idea which has been given the go-by long time back ' he said) but as a corollary to Government's monetary policy.

Professor K. T. Shah, in his minute of dissent, observed that his differences with the majority report were fundamental; notwithstanding this statement, he signed the majority report! The main points of differences he had were: (i) the Bill was not comprehensive enough to include the indigenous bankers. ; (ii) there was no provision to ensure that only those persons who were properly qualified by knowledge, experience and training were placed in responsible posts of management (including Directors) in banks ; (ii;) agricultural financing had been wholly ignored ; and (iv) the Bill showed no conception of banking as an integral and important public utility and social service, a part of the aggregate national economy, which had a vital role to play in the material development of the country, its resources and also its potentialities. Professor Shah suggested (a) giving right to depositors to appoint their own directors, (b) making provision for appointment of a Director by the Reserve Bank on the Board of Directors of every bank and (6) insertion of a new clause to facilitate acquisition by the State of any or all banking concerns.

The Bill as amended by the Select Committee was introduced in the Legislative Assembly on February 8, 1949; it was passed by the Assembly on February 17, the debate lasting 7 days. While a large number of amendments were moved, most of them by two members, namely, Professor K. T. Shah and Mr. Naziruddin Ahmad, less than a third of them were accepted, these being relatively unimportant. The Bill received the assent of the Governor General on March 10 and came into force on March 16.

Commenting on the powers and responsibilities vested in the Bank under the Act, The Eastern Economist* stated:

This detailed narration of the duties and powers of the Reserve Bank have been given deliberately to impress upon the public the colossal burden that a single institution is being called upon to have in policy-making as well as day-to-day administration of the country's banking system. It is a responsibility, which may not weigh on the Old Lady of the Thread-needle Street. But the Reserve Bank is by no means an old lady or even an elderly one. It is, in fact, a very young maiden just fifteen years old -possibly sure of its ability, as young things usually are, but not yet very sure of its experience in a difficult world.

The Banking Companies Act, 1949

The main provisions of the Banking Companies Act and their legislative history have been surveyed in detail in this and earlier chapters. It should be useful to list the principal sections below:

* February 18, 1949.

- (I) Application of the Act to all banking companies, except cooperative banks, transacting banking business in India (including the acceding States) (Sections 1 and 3) ;
- (2) definition of ‘ banking ‘, ‘ banking company’ and ‘ company ’ and forms of business in which banks may engage [Sections 5 and 6(1)] ;
- (3) prohibition of a bank from engaging in trade or business other than banking and requiring it to dispose of non-banking assets, except such as are required for its own use, within the prescribed period (Sections 8 and 9) ;
- (4) prohibition of employment, among others, of managing agents or any person whose remuneration is on a commission or profit-sharing basis or is excessive (Section 10) ;
- (5) requirement as to minimum paid-up capital and reserves (Section 11) ;
- (6) regulation of the proportion,inter se, of authorised, subscribed and paid-up capital and voting rights of shareholders (Section 12) ;
- (7) restriction on commission, brokerage, discount; etc., on sale of shares ; prohibition of creation of charge on any unpaid capital of the bank ; and prohibition of payment of dividends unless the capitalised expenses are completely written off (Sections 13 to 15) ;
- (8) prohibition of common directors among banks (Section 16) ;
- (9) provision for building up the reserve fund (Section 17) ;
- (10) maintenance of minimum cash reserve by non-scheduled banks either with themselves or with the Reserve Bank similar to that prescribed for scheduled banks to be kept with the Reserve Bank under the Reserve Bank Act (Section 18) ;
- (11) restriction on formation of subsidiary companies except for certain purposes and on holding of shares in other companies (Section 19) ;
- (12) prohibition of loans and advances on the security of a bank’s own shares or unsecured loans and advances to its directors or firms or private companies where it or any of its directors is interested as partner, director, managing agent or guarantor (Section 20) ;
- (13) empowering the Reserve Bank to determine policy regarding advances to be followed by banks and to give directions to banks as to purposes for which advances may or may not be made, margins on secured advances and rates of interest to be charged on advances (Section 21) ;
- (14) comprehensive system of licensing of banks by the Reserve Bank (Section 22) ;
- (I 5) licensing of new branches and of transfer of existing branches (Section 23) ;
- (16) stipulation as to maintenance. of sufficient liquid assets in India to meet liabilities in India (Sections 24 and 25) ;

- (17) empowering the Reserve Bank to call for periodical returns and to publish consolidated information about banks (Sections 27 and 28) ;
- (18) provisions as to balance-sheet, its audit and publication (Sections 29 to 32) ;
- (19) conferment of powers on the Reserve Bank to inspect the books and accounts of banks and on the Central Government to take drastic action, if considered necessary, on the basis of inspection reports (Section 35) ;
- (20) (a) empowering the Reserve Bank:
 - (i) to caution or prohibit banks generally or any bank in particular against entering into any particular transaction or class of transactions, and generally give advice to them,
 - (ii) to assist as intermediary or otherwise, in proposals for the amalgamation of banks,
 - (iii) to grant loans and advances to any bank under Section 18(1) (3) of the Reserve Bank Act,
 - (iv) to require a bank, during the course, or after the completion, of its inspection, to make such changes in its management as the Reserve Bank considers necessary;
- (b) requiring the Reserve Bank to make an annual report to the Government on trend and progress of banking in India (Section 36) ;
- (21) provisions as to grant of moratorium to a bank temporarily unable to meet its obligations; procedure for winding up by court; and restrictions on voluntary winding up and on amalgamations (Sections 37 to 45) ;
- (22) provisions prescribing penalties for contravention of the provisions of the Act (Sections 46 to 48) ;
- (23) application of certain provisions of the Act to the Imperial Bank (Section 51) ;
- (24) amendment of Section 18 of the Reserve Bank Act to enable the Bank to make loans and advances to a bank in an emergency against such form of security as the Bank might consider sufficient, and entitling the Reserve Bank to a first charge on the general assets of the bank concerned, in the event of its being wound up, subject only to the claims, if any, of any other banking company, in respect of any prior loan (Section 55) ; these amendments were deemed to have had effect from September 20, 1947 (Section 55); and
- (25) amendment of Section 42(6) of the Reserve Bank Act detailing the conditions for inclusion or exclusion of banks from the Second Schedule (Section 55).

The Banking Companies Act repealed Part XA of the Indian Companies Act, 1913, and the whole of the Banking Companies

(Restriction of Branches) Act, 1946, the Banking Companies (Inspection) Ordinance, 1946, and the Banking Companies (Control) Ordinance, 1948.

1950 Amendment of the Act

Soon after the enactment of the Act, the Bank found that the provisions of the Act relating to amalgamation and liquidation of banks did not lay down the procedure to be followed by the banks, the liquidator or the Court, as the case might be, for expeditious disposal of the proceedings. As the Legislature was not in session, the Bank moved the Government to issue an Ordinance in September 1949 to give effect to the additional provisions. Subsequently, in March 1950, the Ordinance was replaced by the Banking Companies (Amendments) Act, 1950. According to the amending Act, any scheme of amalgamation of banks, before its submission to the Reserve Bank for sanction, had to be approved by the shareholder of each of the banking companies by a resolution passed by a majority in number representing two-thirds of the shareholders of each of the banks, present either in person or by proxy, at a meeting called for the purpose. The scheme, when sanctioned by the Reserve Bank, would be binding on the concerned banks. A dissenting shareholder was entitled to such compensation from the amalgamated bank as might be determined by the Reserve Bank when sanctioning the scheme. The Act also provided for automatic transfer of all assets and liabilities of the amalgamated bank to the transferee bank. A compromise or arrangement between a bank and its creditors become effective only if certified by the Reserve Bank as not being detrimental to the interests of the depositors.

In the matter of liquidation of banks, besides prescribing special provisions for speedy disposal of winding up proceedings of banks, the Act empowered the Court to try in a summary way any offence committed by any person who had taken part in the formation or promotion of the bank, which was being wound up, provided the offence was one punishable under the Indian Companies Act, 1913. The Reserve Bank was authorised to examine the records of any liquidation proceeding where its advice was solicited by the official liquidator on direction of the Court and to tender such advice as it might think fit.

The amending Act also contained an important provision extending the Reserve Bank's powers of licensing to the opening of branches outside India.

The salutary effects of the Banking Companies Act were in evidence fairly soon after it came into effect. There was a tendency amongst banks to put their house in order and the beginnings of bank mergers

were also noticed. Two notable mergers took place, in the Eastern and Northern area, respectively, thereby averting a possible banking crisis. In December 1950, four scheduled banks in West Bengal, viz., the Bengal Central Bank, the Comilla Union Bank, the Comilla Banking Corporation and the Hooghly Bank, which had all been subject to a run after the failure of the Nath Bank, were amalgamated into the United Bank of India, the Reserve Bank playing an important role in this. In March 1951, the Punjab National Bank took over the entire liabilities in respect of deposits in the Indian Union of the Bharat Bank against the transfer of equivalent assets.

Administrative Arrangements for Banking Regulation

In an earlier chapter, reference was made to the establishment, with effect from August 1, 1945, of the Department of Banking Operations, to provide the administrative machinery for discharging the several duties and responsibilities of the Bank under the proposed Banking Companies Bill. The Chief Officer of the Department was deputed in September 1945 to the U.S.A. for making a study of bank supervision and inspection in that country so that the machinery for banking regulation in India could be organised on sound lines. The functions of the Department in the initial stages related mainly to inspection of banks for inclusion or retention in the Second Schedule, fixing of credit limits for scheduled banks, scrutiny of balance-sheets and other returns submitted by banking companies, rendering of advice on banking and financial matters to banks as well as Governments and banking legislation. Its activities steadily expanded with the additional responsibilities vested in the Bank under the various interim or transitional banking measures.

With the increase in work, branches of the Department were established in other places such as Calcutta, Madras and Kanpur. The work at the Central Office of the Department at Bombay came to be organised in three Divisions, dealing respectively with operations, inspection and liquidation. The staff of the Department was augmented from time to time. Arrangements were also made to recruit staff from outside, especially persons with practical banking experience. Thus, when Banking Companies Act came into effect, the Department was reasonably equipped to take up the duties devolving on it under the Act.

Shortly after the Banking Companies Act came into force, the Bank decided to institute a system of periodic inspection of all banks covered by the Act. Besides general inspection of banks, special inspections were undertaken for specific purposes under the Act, namely, issue of a licence under Section 22, grant of moratoria, inclusion in the Second

Schedule of the Reserve Bank of India Act and examination of schemes of arrangement and, amalgamation.

RESERVE BANK AND INDUSTRIAL FINANCING

The vastly expanded role which the Bank has played in the field of financing of industries is an interesting facet of the Bank's post-war career. In this sphere, as in others, the Bank's approach underwent a change in response to the needs of the economy.

It will be recalled that the Central Banking Enquiry Committee recommended the creation of provincial Industrial Credit Corporations and an all-India institution for the purpose of meeting the requirements of industries of regional and national importance, respectively. It also advocated 'mixed banking' for the Imperial Bank and other well established commercial banks. For a long time, very little was done in the direction of these recommendations. In fact, hardly any thought was bestowed on these matters till the early forties.

With the prospects of the war drawing to a close, the problem of industrial development in India on organised lines gained increasing attention of the Central Government. Interest in the question was stimulated by the publication of the *Bombay Plan* for the economic development of the country and by the setting up of a special department by the Central Government, in charge of Sir Ardeshir Dalal, to study and plan post-war industrial development. The rapid growth of indigenous industries during the war period and the necessity of protecting them against foreign competition, the problem of preventing indiscriminate utilisation of the large accruals of sterling balances and the enthusiastic popular support for a national plan for industrial progress were some of the factors which necessitated thinking on the subject of finance for industry.

In pursuance of the suggestion of the General Purposes Sub-Committee appointed by the Department of Planning and Development of the Central Government, that the urgent question of adequate arrangements for the provision of industrial finance be examined by the Finance Department in consultation with the Reserve Bank (referred to in Chapter 15) a detailed note was drawn up on the subject, in May 1945, by the Secretary, Mr. Ram Nath, under the direction of the Governor. The note analysed the problem of industrial finance and reviewed the institutional arrangements in this behalf in other countries. The note proceeded on the basis that specialised institutions should be set up both at the all-India and the regional levels; it also indicated, fairly

elaborately, the respective fields of operations of the all-India and the provincial institutions. In considering these issues, the note, *ab initio*, excluded public sector projects from the scope of assistance from the proposed specialised institutions. Provision for those enterprises, said the note, was a matter for the Governments to arrange and fell within the scope of such general budgetary and borrowing programmes as might be drawn up by Governments for the purpose of implementing their reconstruction and development plans.

As regards the type of all-India institution which was the most proper in the prevailing conditions, the Bank management rejected alternatives such as a wholly private-owned corporation or a wholly State-owned corporation. It favoured an arrangement whereby there was shareholding of 20 per cent each by Government and the Reserve Bank and 60 per cent by institutional and other investors. Such an institution would enjoy the advantage of having available to it the intimate knowledge of industry and wide business experience. At the same time, the presence on its Board of Directors and probably on its executive of nominees of Government and the Reserve Bank would serve as a guarantee that the policies pursued by the institution were conceived in the broad national interest.

Coming to the field of operations of the all-India institution, the Bank's study was of the view that it would be undesirable for the corporation to participate directly in industry by purchasing shares of industrial concerns. It was, however, considered all right for the proposed institution to participate in the underwriting of shares issued by industrial concerns. On the whole, the stress was on the provision of loan capital rather than equity capital.

To finance its operations, the corporation could be permitted to raise foreign currency loans, when necessary, through the International Bank proposed to be set up, or directly in foreign markets through the issue of bonds and debentures secured against the various assets mortgaged to the corporation by the industrial concerns which had borrowed from it. According to the note, a provision permitting the institution to borrow from the Government was undesirable; Government assistance, if any, could only take the form of either a share in the capital or guarantee of principal and interest, the corporation's other resources being derived from the issue of debentures and, if necessary, from long-term deposits received from the public.

About the types of provincial corporations to be set up, the note took the view that they could be owned jointly by Government and private investors, the proportion of share capital held by the former being limited to, say, 40 per cent. Such a corporation could raise funds through issue of debentures and proceed on lines somewhat similar to those proposed for the all-India institution, except that in the case of

the provincial body, no borrowing power outside India was presumably necessary. The type of industry to be financed by a provincial corporation varied with local conditions, but it would be desirable to restrict the operations of the corporation to small and medium sized businesses that required finance, say, up to Rs. 50,000.

The note was forwarded by the Bank to the Finance Department, Government of India, for their comments. The Finance Department, while generally concurring with the Bank's views, was of the opinion that, having regard to the investible funds then in existence, Government guarantee of principal and interest in respect of share and debenture capital of the corporation seemed hardly necessary and might be avoided if possible. The Government had also doubts whether it was necessary to confer underwriting powers on the proposed all-India institution and whether the corporation should be empowered to accept deposits. In their view, underwriting powers, if conferred, should be exercised only for special reasons and should be confined to issue of debentures and possibly of preference shares. The minimum period of acceptance of deposits, if any, by the corporation should be fixed substantially in excess of five years.

In considering these views of the Government, the Governor was firm that a Government guarantee was an integral part of the proposals as envisaged by him and that, as a concomitant, there should also be a limitation on the dividend payable to the shareholders. In his view, being a quasi-Government institution with Government guarantee, its surplus profits, after payment of dividends, would have to be transferred to the Government. About Government's opinion on the underwriting powers of the corporation, the Governor thought it was a question of the latitude to be allowed to the proposed institution in its character and would depend in practice on the degree of discrimination exercised by it in the selection of ventures it was prepared to assist.

The subject was placed before the Central Board at the July 1945 meeting. The Board generally agreed with the scheme as outlined by the Bank's management and endorsed the Governor's remarks regarding Government guarantee. It was also of the unanimous opinion that the power of underwriting should not be circumscribed and that the discretion in this matter should be left to the Board of the institution, since the industries which would approach the institution were mostly those failing to raise capital in the ordinary way but which, nevertheless, required development in the larger interests of the country. The Board was also of the view that the corporation should be given latitude to accept fixed deposits at attractive rates for periods not less than five years. The Board differed from the Governor on one point, viz., about the transfer of surplus profits to Government; it thought it more desirable that such surplus should be transferred to the reserves. It

resolved that a detailed scheme including the necessary proposals for legislation for submission to Government should be taken in hand. Accordingly, in January 1946, the Bank forwarded to the Government a draft Bill for giving effect to the proposals for the establishment of an Industrial Finance Corporation. After detailed examination by the Government of India, the Bill was introduced in the Legislative Assembly in November 1946.

The salient features of the Bill may now be briefly touched upon. These were:

- (i) The Corporation's share capital was to be Rs. 5 crores, divided into 2,000 shares of Rs. 25,000 each, of which 20 per cent each was to be held by the Central Government and the Reserve Bank and the balance of 60 per cent by scheduled banks, insurance companies, investment trusts, and other like financial institutions;
- (ii) the Board of Directors of the Corporation was to consist of 12 members, of whom six, including the Managing Director, were to be nominated/appointed by the Government/Reserve Bank;
- (iii) the Corporation was to be authorised to issue bonds and debentures to the extent of four times the share capital, guaranteed by the Government as to principal and interest;
- (iv) acceptance of fixed deposits was to be permitted, with a minimum maturity of ten years, and up to a maximum outstanding of Rs.10 crores;
- (v) as regards types of assistance, the Corporation could grant secured loans (rupee as well as foreign currency), subscribe to debentures, underwrite the issue of securities and also provide guarantees; the aggregate accommodation to a single party was not to exceed 10 per cent of the share capital of the Corporation; and
- (vi) the Corporation was required to establish a reserve fund out of profits. The dividend payable was limited to 2 ½ per cent per annum until the reserve fund equalled or exceeded share capital; thereafter, the balance of profit, after payment of dividend up to a maximum limit of 5 per cent, had to be transferred to Government.

The Bill could not be proceeded with, owing to constitutional changes, till November 1947, when the Constituent Assembly (Legislative) adopted a motion to refer the Bill to a Select Committee. Replying to the debate in the Assembly, the Finance Minister, Mr. Shanmukham Chetty, explained that the proposed Corporation was not intended to supply all the finance or even a substantial part of the finance necessary for the large scale industrialization of the country. The Corporation was only intended to help, to a limited extent, the large scale industries started by private entrepreneurs. The Finance Minister was not in favour of enlarging the categories of shareholders

of the Corporation. He said: 'By deliberately restricting the shareholding to certain specified institutions, it was the intention of this Bill to bring to the service of the State under the control of the State the experience gained by-private captains of industry '.

The Select Committee which met in December 1947 and January 1948 adopted several amendments and its report was presented to the House by the Finance Minister in the latter month. A minute of dissent was recorded by Professor K. T. Shah and Mr. Diwan Chaman Lall, who tried to make out a strong case for the Corporation to be owned, controlled and managed by the State. The Bill was taken up for consideration in February 1948 and after lengthy discussion was passed in the same month. The original Bill underwent the following changes, as passed by the Legislature:

- (a) The authorised capital of the Corporation was fixed at Rs.10 crores consisting of 20,000 shares of Rs. 5,000 each, while retaining the issued capital at Rs. 5 crores with power to increase it from time to time after obtaining the sanction of the Central Government and providing for guarantee of share capital by the Central Government as to the repayment of the principal;
- (b) 10 per cent of the share capital of the Corporation was to be set apart for subscription by co-operative banks; this proved to be a very controversial matter; the Reserve Bank had not favoured shareholding by co-operative institutions;
- (c) discretion was to be allowed to the Central Government in the matter of fixing the minimum rate of dividend to be declared by the Corporation and the rate to be offered on bond issues of the Corporation to be guaranteed by Government;
- (d) in discharging the functions the Board of Directors was to act on business principles; it was to be guided on questions of policy by such instructions as might be given to it by the Central Government;
- (e) two places on the Board of Directors were to be reserved for the co-operative interests;
- (f) the Corporation was empowered to appoint Advisory Committees and Advisers in order to secure the efficient discharge of its functions ;
- (g) the Corporation was authorised to invest in Government securities -an omission in the original measure -, to issue debentures to the extent of five times the paid-up share capital and reserve fund (as against four times share capital), to accept fixed deposits repayable after a period of five years (as against ten years previously) and to provide assistance to any single industrial concern up to a maximum of Rs. 50 lakhs. The Corporation's assistance was to be confined to only public limited companies or co-operative societies.

The Industrial Finance Corporation of India came into being on July 1, 1948, with its Central Office at Delhi. Mr. Ram Nath, who was closely connected with the formulation of the proposals and the piloting of the legislation, was appointed as the first Managing Director of the Corporation, on the recommendation of the Central Board of the Reserve Bank, as provided in the Statute.

In 1951, the Parliament passed the State Financial Corporations Act, with a view to enabling the State Governments to set up similar corporations for providing long-term finance to medium and small scale industries. Under this Act, nearly all the States have established their own financial corporations.

Concluding Observations

From the foregoing pages, it will be seen that the post-war period was an eventful one for Indian banking, the outstanding development being the passing of the Banking Companies Act, about a decade after the proposals in this behalf were originally formulated. Despite periods of stress and strain, the Indian banking system as a whole displayed resilience and strength. There remained, however, the task of weeding out the weak elements and streamlining the banking system so as to full3 its role in the economic development of the country, a task that necessarily required years to accomplish. The foundation for this was partially laid in the post-war period.

Over the years, the Reserve Bank's vigilance came to be increasingly felt, with improvement in the operations of banks taking place steadily, though silently. Simultaneously, the Bank began giving increasing attention to developmental matters such as rapid and balanced expansion of bank branches, training of bank personnel, development of the banking habit and creation of adequate institutional facilities for the provision of finance for the development of the private sector.

Progress in the Sphere of Agricultural Credit

The period of five and odd years from the close of World War II covered in this chapter marked a fairly progressive phase in the evolution of Bank's policies in the sphere of agricultural credit. During this period, the Bank and the co-operative institutions came closer and there was a further liberalisation of the terms of financial accommodation provided by the Bank to the co-operative sector, especially for the financing of seasonal agricultural operations and the marketing of crops. It will be recalled that the Bank initiated during the war years a fresh move to induce provincial co-operative banks to utilise the Bank's credit facilities, by providing accommodation at a concessional rate of interest. Even so, their response remained no more than nominal. This was partly due to the lack of demand for funds from the co-operative banks on account of the war-time boom in prices of agricultural commodities and partly because they considered the rules and conditions governing the Bank's assistance too stringent to be fulfilled in practice. The co-operative sector was also critical of the limited scope of accommodation provided by the Bank and urged an extension of the period as well as some enlargement of the purposes for which its facilities might be availed of. In the light of such representations and its own experience the Bank gradually modified its policies suitably.

Several factors contributed to the Bank's beginning to take an active role in the sphere of agricultural credit. Firstly, the Bank was enabled to bring to bear on the consideration of policy issues a sound practical approach by the better understanding of the problems of rural credit in general and of co-operative finance in particular, gained by it through correspondence, meetings and discussions with officials and leaders of co-operation, and through the visits of senior officers of

the Agricultural Credit Department to the various Provinces. Secondly, reorganisation of the co-operative machinery during the post-war years was the subject of comprehensive review by various expert committees and the Bank's close association with the work of these committees helped in crystallising its views and shaping its policies in this regard. Thirdly, after Independence and in particular after its nationalisation, the Bank was expected to play an active role in the promotion of a satisfactory system of agricultural credit. While the major policy measures adopted by the Bank in pursuance of this objective belong to a subsequent period in its history, some important steps were taken during the period under review and much progress was made in laying down the lines of future advance.

The co-operative movement itself underwent a transformation in the post-war and post-Independence period through the opportunities that presented themselves in tackling the problems emerging after the war and the partition of the country, such as, distribution of controlled and other essential commodities, alleviation of housing shortages and rehabilitation of displaced persons. The emphasis shifted from the credit to the non-credit aspects of the movement, although numerically credit institutions still occupied a predominant position. The multifarious activities taken up by the co-operative institutions called for the utilisation of all available resources and there was a substantial increase in the quantum of accommodation obtained from the Reserve Bank.

The remittance facilities available to co-operative banks and societies in British India* were extended during this period to similar institutions in Indian States. Besides, provincial co-operative banks which did not have offices at the places where they maintained their principal accounts with the Reserve Bank, were allowed reverse transfer facilities from their account with an office of the Reserve Bank of India to an account maintained by them with an agency of the Reserve Bank at their main place of business.

The Agricultural Credit Department of the Bank began to pay increasing attention to bringing about better co-ordination in the policies pursued by the co-operative departments of Provincial Governments and eliminating the undesirable tendencies observed in the working of co-operative financing agencies. The Department provided guidelines to the Registrars of Co-operative Societies regarding audit classification of co-operative societies and the maintenance of fluid resources by co-operative banks. The deficiencies observed in the working of co-operative institutions were promptly brought to the notice of the Registrars for corrective action. The practical working

* Details given in Chapter 16.

of co-operative institutions in the various Provinces was also kept under close study through the periodical visits of the Chief Officer of the Department, who also participated in all important co-operative conferences and served as a member of various committees pertaining to agricultural credit or co-operation. At the instance of the Government of India, the Department also undertook the preparation of a scheme for the establishment of a Central Agricultural Finance Corporation for India, though the Bank was not in favour of such an institution. The publication of the *Statistical Statements Relating to the Co-operative Movement in India* and the *Review of the Co-operative Movement in India*, which had been suspended during the war period, was resumed. A number of brochures were also published on matters relating to the co-operative movement and agricultural credit.

There were renewed demands from indigenous bankers for linking them with the organised banking structure. But there was little progress as they showed no willingness to accept the basic conditions laid down by the Bank.

EXPERT COMMITTEES ON AGRICULTURAL CREDIT AND CO-OPERATION

The problems of agricultural credit and co-operative development in the post-war years formed the subject of comprehensive review by a number of expert committees between the years 1944 and 1950. Reference has been made in Chapter 16 to the *Agricultural Finance Sub-Committee* and the *Co-operative Planning Committee*, which submitted their reports in May and November 1945, respectively. These were followed by the *Agricultural Credit Organisation Committee* constituted by the Government of Bombay in 1947 to recommend the terms and extent of governmental assistance to be provided to co-operative banks and the *Rural Banking Enquiry Committee* set up by the Central Government towards the close of 1949 to consider measures necessary for the extension of banking facilities in rural areas. Besides, at the beginning of 1948, the Government of India appointed a *Co-operative Sub-Committee* in accordance with one of the resolutions passed at the Fifteenth Conference of Registrars of Co-operative Societies held in 1947. The Reserve Bank was closely associated with the work of these committees, which among them covered major questions of policy and principles concerning the growth of the co-operative movement and rural credit. It is, therefore, necessary to provide some details of the recommendations of these committees.

The Agricultural Finance Sub-Committee

In September 1944, the Government of India appointed a Sub-Committee, under the Chairmanship of Professor D. R. Gadgil, to suggest measures for the scaling down of rural indebtedness and the provision of finance, both short-term and long-term, for agriculture and animal husbandry operations, under efficient control. Its report was submitted in May 1945. The Sub-Committee's recommendations concerning adjustment and liquidation of rural debt are not of direct concern here. As regards the building up of an efficient system of agricultural credit, the Sub-Committee considered that co-operative financing agencies provided the best and the most lasting solution to the problem and made a number of suggestions for improving their functioning. It recommended that the primary credit society should continue to be the nuclear unit of the co-operative credit structure and that it should try to finance all short-term needs of its members and also, subject to certain limitations, their intermediate-term credit needs. The efficiency of co-operative finance was to be enhanced by linking credit with marketing and ensuring, through constant and careful supervision, proper utilisation of loans taken by members. The cost of credit to the ultimate borrower had also to be brought down to a level not exceeding 6 ¼ per cent. The Sub-Committee emphasised the need for co-operative banks to work on sound banking lines in order to attract deposits at low rates of interest. Besides, it recommended increased use by the provincial co-operative banks of the accommodation provided by the Reserve Bank at a concessional rate. In this connection, it suggested an increase in the quantum of the concession (which was 1 per cent at that time) to 1½ or 2 per cent, with a view to making co-operative credit somewhat less costly.

The Sub-Committee, however, found that the co-operative movement covered only a small proportion of the rural population and met only a fraction of their credit requirements; except in a few regions, their working was also not satisfactory. In the circumstances, the extension of co-operative credit to meet the requirements of credit-worthy agriculturists all over the country, within a short period of time, was considered impracticable without substantial State assistance and control, which might seriously affect the democratic character of the movement. This was the main consideration behind the Sub-Committee's recommendation for the establishment of *Agricultural Credit Corporations* in those Provinces where the co-operative system was not adequately developed. The Corporations were to be autonomous institutions with one-half of the capital provided by the State and the rest by co-operative and other institutional agencies. The Sub-Committee envisaged that these Corporations would establish

branches and agencies over their respective regions and provide agriculturists with all types of credit through co-operative societies or 'borrowers' groups ' as well as directly. They were also to provide finance to co-operative societies where central financing agencies did not exist. The activities of the Corporations were expected to be co-ordinated with those of co-operative and other institutions. It may be mentioned that co-operative opinion in the country was highly critical of this proposal on the ground that, given the financial resources and assistance contemplated for the Corporations, the co-operative financing agencies could themselves meet the requirements of creditworthy agriculturists.

The other recommendations of the Sub-Committee related to the creation of conditions for the commercial banks to increase the volume and scope of their business in agricultural credit (through the establishment of regulated markets and licensed warehouses), improvements in legislation relating to money lending, etc., and the setting up of a Standing Committee in the Agricultural Credit Department of the Bank to serve as a general clearing house of information and a body for a continuous review of the progress of the co-operative movement. The Reserve Bank was directly concerned with two of the recommendations made by the Sub-Committee, viz., those relating to the increase in the interest rebate allowed to co-operative banks and the establishment of a Standing Committee in the Agricultural Credit Department. The former was implemented by the Bank in July 1946, while the latter was given effect to only in August 1951, after the Informal Conference on Rural Finance made the same suggestion in February 1951.

The Co-operative Planning Committee

In January 1945 the Government of India appointed a committee under the chairmanship of Mr. R. G. Saraiya, to draw up a plan of co-operative development. Its report was submitted in November 1945. The Committee made a detailed study of the problems facing the cooperative movement in the country and its recommendations ranged over both organisational and administrative aspects. The Committee recommended that the co-operative movement should endeavour to reach 50 per cent of the villages and 30 per cent of the rural population through agricultural credit societies within a period of 10 years and to bring at least 25 per cent of the marketable surplus of agricultural produce within the purview of co-operative marketing societies during the same period. The Committee was of the view that the co-operative form of organisation should embrace all aspects of the economic life of the rural population and, accordingly, favoured the development

of co-operative societies on the multi-purpose principle as well as the extension of co-operation to the fields of production and processing of agricultural commodities. It also recognised the useful role which co-operation could play in the non-agricultural sector and made suggestions regarding the formation of co-operative agencies for this purpose.

In the Committee's view, there was no need for any drastic reorganisation of the superstructure of co-operative credit and, hence, it did not favour the suggestion of the Gadgil Committee for the formation of Agricultural Credit Corporations. Rather, it was of the view that given the same measure of assistance proposed to be given to the new Corporations, the existing co-operative agencies could prove quite adequate to their task. The Committee felt that the aid to be given by Government to provincial co-operative banks might take the form of a contribution to their share capital and provision of finance at a concessional rate of interest. It also recommended that the period of accommodation provided by the Reserve Bank under Section 17(2) (b) should be extended to 12 months and that the meaning of the term 'crops' should be widened to cover animal products like milk, cream, butter, ghee, and wool as well as processed agricultural products like sugar, cotton that was ginned and pressed, decorticated groundnuts, vegetable oils and oilcakes. It also suggested that the scope of Section 17(2) (a) should be enlarged to include the activities of industrial co-operatives.

Finally, to ensure the development of the co-operative movement on right lines, the Committee emphasised the need for adequate arrangements for training co-operative personnel and increasing the participation of non-officials in the development of the movement. The Committee suggested a number of amendments to the existing Co-operative Societies' Acts keeping in view the past experience and future needs of the movement. It also recommended the establishment of co-operative training colleges at the provincial level and of an All-India Institute of Advanced Studies in Co-operation by the Central Government.

The recommendation of the Co-operative Planning Committee for extending the period of accommodation under Section 17(2) (b) to 12 months was accepted by the Bank at the meeting of the Committee of the Central Board held on March 17, 1948. In January 1949, the Bank wrote to the Central Government for promoting the necessary amendment to the Reserve Bank Act. The amendment, which was passed in February 1951, came into effect in November 1951. The other recommendations of the Co-operative Planning Committee for extending the scope of Section 17(2) (a) to industrial co-operative societies and widening the meaning of the term 'crops'

appearing in Section 17(2) (b), were not accepted by the Bank then. The Bank felt that industrial co-operatives were not sufficiently advanced and financing them' would be treading on rather risky grounds'; as for institutions requiring finance in respect of goods like animal products and processed agricultural commodities (to be covered by the extended meaning of the term 'crops ') there were not many of them and those in existence appeared to be in an experimental stage.

The Agricultural Credit Organisation Committee

In February 1947 the Government of Bombay set up a Committee, under the chairmanship of Sir Manilal B. Nanavati, in pursuance of the resolutions passed by the Bombay Co-operative Banks' Association, whose reactions to some of the recommendations of the Agricultural Finance Sub-Committee were called for by the Provincial Government. The Committee was asked to recommend the terms and extent of Government assistance to be provided to co-operative banks in the Province and to suggest amendments and modifications to the existing constitutions of co-operative and land mortgage banks. The Committee submitted its report in July 1947. The recommendations concerning the facilities available from the Reserve Bank to the co-operative sector are of particular interest in this context.

In its report the Committee pointed out that, although the Reserve Bank had a scheme for providing finance to provincial co-operative banks at $1\frac{1}{2}$ per cent (that is, $1\frac{1}{2}$ per cent below the Bank rate, then at 3 per cent), it had not been possible for co-operative banks to take full advantage of the facilities for various reasons. The Committee felt that a solution to the problem lay in the adoption of a more liberal policy by the Reserve Bank and it made various suggestions towards this end. The more important of these related to (i) the extension of the period of loans for agricultural operations from nine to fifteen months, (ii) the waiver of the condition regarding the maintenance with the Reserve Bank of minimum balances by provincial co-operative banks, (iii) the acceptance of debentures of land mortgage banks as eligible securities for advances from the Reserve Bank, (iv) waiving the condition regarding the borrower being independent of the warehouseman in the case of co-operative societies for purposes of advances under Section 17(4)(d) of the Reserve Bank Act and (v) making provision for advances under the same Section against promissory notes bearing the signatures of a marketing society and the provincial co-operative bank supported by stocks held with the former. The Committee also considered it essential on the part of the Bank to lay down the procedure and arrangements for assistance to provincial

co-operative banks in emergencies. The restoration of free remittance facilities originally enjoyed by the co-operative banks was also one of its recommendations.

The Co-operative Sub-Committee

In February 1948, at the instance of the Fifteenth Registrars' Conference, the Government of India appointed a Sub-Committee, under the chairmanship of Mr. R. G. Saraiya, mainly to consider the recommendations of the Co-operative Planning Committee for setting up an All-India Council of Co-operation and to combine the Registrars' conferences with the non-official all-India co-operative conferences. Its terms of reference also included the amendments to the Cooperative Societies Act suggested by the Co-operative Planning Committee and the statutory and procedural changes necessary for enabling the Reserve Bank to provide maximum possible assistance to the cooperative sector. The Sub-Committee submitted its report in January 1949.

The Sub-Committee felt that co-operative banks had been hesitant in approaching the Reserve Bank for finance owing to the existence of a feeling among them that the limitations placed by the Reserve Bank of India Act on the nature and extent of accommodation that could be given as well as the conditions that had to be satisfied before it could be availed of were discouraging. In its view, there were a few important considerations which should govern the Reserve Bank's role in financing co-operative banks. These were: (1) in respect of agricultural finance, the Reserve Bank should not look upon itself as a lender of last resort, stepping in only at times of extreme financial stringency, but should normally regulate the volume of credit so that no crisis was likely to occur; (2) it was but proper that the Reserve Bank should use the national credit pool to back up the securities offered, so that agricultural paper both for long-term and short-term funds would have a free and ready market; this could be done by purchase of debentures issued by accredited co-operative institutions and by a freer acceptance of the demand promotes of primary societies and central banks as collateral for advances made to provincial cooperative banks; and (3) unless the Reserve Bank spread its accommodation to cover activities like marketing and distribution, the movement was likely to lose the momentum which it had gained in the recent past.

The amendments to the Reserve Bank of India Act suggested by the Sub-Committee related to (1) inclusion of demand promotes of co-operative societies as acceptable collateral security for loans to provincial co-operative banks, (2) deletion of the word 'seasonal' in Section

17(2) (b) to avoid confusion that accommodation would be available only during certain seasons, (3) replacement of the term 'crops' by the words 'agricultural produce and other prescribed goods' which should include goods, such as, cloth, wool, sugar and products of cottage industries, and (4) extension of the period of accommodation from 9 to 12 months with provision for extending it to 15 months in respect of crops like sugarcane and bananas. The Sub-Committee also wanted industrial societies to be covered by the provisions of Section 17 of the Reserve Bank Act.

The Sub-Committee also considered it necessary for the Reserve Bank to make procedural changes in the following directions. First, the term 'marketing' should be interpreted liberally to include procurement operations undertaken by marketing societies. Second, the stipulation regarding maintenance of minimum balances by co-operative banks, while unobjectionable in principle, should not be enforced rigidly in respect of smaller institutions. Third, in view of the fact that in some Provinces new co-operative institutions were classified initially into 'C' class and were thus precluded from the purview of accommodation from the Reserve Bank, the Bank should relax the condition of audit classification in the case of societies which the Registrar certified to be creditworthy and working on sound lines.

The report of the Sub-Committee was signed by the Chief Officer of the Agricultural Credit Department, who was a member, with a qualifying note. In this, he signified his dissent to the suggestions made by the Sub-Committee for amending the Reserve Bank Act except in regard to the extension of the period of accommodation. In fact, even before the submission of the report, the Reserve Bank had, as stated earlier, moved the Government for amending Section 17(2) (b) for extending the period of accommodation from 9 to 12 months.

The Sub-Committee also recommended the amalgamation of the three all-India co-operative associations, viz., the Co-operative Institutes Association, the All India Provincial Banks' Association and the Co-operative Insurance Association into a body to be called the 'Indian Co-operative Association'. Further, it suggested that the two all-India Conferences the All-India (non-official) Co-operative Conference and the Conference of the Registrars of Co-operative Societies should be merged into one Indian Co-operative Conference to be convened by the all-India body proposed. The first suggestion was given effect to in May 1949, when a new body called the All-India Co-operative Union was formed by the amalgamation of the three all-India associations (now called the National Co-operative Union of India). The Government of India accepted the suggestion of the Co-operative Sub-Committee for merging the official and non-official Co-operative Conferences and asked the newly formed

All-India Co-operative Union to hold a combined conference called the Indian Co-operative Congress. The first *Congress* was held in February 1952.

Rural Banking Enquiry Committee

The advent of a national Government and the nationalisation of the Bank led to the focussing of attention on the promotional role, which a central banking institution had necessarily to undertake in a developing country like ours. The major problem was the provision of adequate credit facilities in rural and semi-urban areas for the financing of agriculture and other activities and mobilisation of savings in these areas. As fresh approaches had to be thought of in these matters, the Government of India, at the suggestion of the Reserve Bank, appointed in November 1949 a committee called the *Rural Banking Enquiry Committee*, headed by Sir Purshotamdas Thakurdas; a senior officer of the Bank (Mr. N. D. Nangia) served as its Member-Secretary. The Bank also provided the necessary secretarial assistance and various other facilities. The Committee's report, a unanimous one, was submitted in May 1950.

Taking a broad survey of the various agencies providing banking facilities in rural and semi-urban areas, the Committee found that the structure of rural credit societies, taken as a whole, was impressive and had improved in certain respects as a result of the changes brought about by the war. With a few exceptions, commercial banks had not found it possible to extend their operations beyond the *taluka* headquarters and a few *mandis* and other trading centres. The growth of commercial bank offices was lopsided, there being a heavy concentration in larger towns. Indigenous bankers and moneylenders continued to play a significant role in rural credit, but their importance and activities had generally been on the decline.

In dealing with the question of suitable machinery for providing rural credit, the Committee felt that the establishment of a single financial agency to cover the entire field of rural credit would not be feasible and that, in each region, a varied and adequate machinery would have to be developed. Such machinery should be able to raise funds by way of share capital and deposits or debentures as also by tapping rural savings. It also felt that any scheme for a sound and efficient system of rural finance should place adequate emphasis on the building up of a sound structure of primary institutions. The Committee envisaged the future structure of banking to consist of, (a) the Reserve Bank of India with a branch or an office in each major Province or State, (b) the Imperial Bank of India and other commercial banks extending their activities to *taluka* or *tehsil*

headquarters or other semi-urban centres, (c) the provincial and central co-operative banks with their branches or affiliated banks extending to all towns and large or centrally situated villages, and (d) a chain of land mortgage banks in each region for meeting long-term needs.

The Committee felt that the ideal credit agency at the village level was provided by co-operative society and commended the plan for establishing strong multi-purpose societies for each group of contiguous villages, manned by competent paid staff and supported by the Provincial Governments, particularly by providing the needed staff for inspection and supervision. As regards the co-operative superstructure, the Committee felt that full use should be made of the existing institutions as far as possible, and new institutions or machinery like the Agricultural Credit Corporations recommended by the Gadgil Committee should be set up only in regions where co-operative banks could not be developed. Commercial banks, the Committee felt, should be able to provide finance for the marketing of produce to a much greater extent, with the establishment of regulated markets, development of grading and standardisation of agricultural products and the provision of satisfactory warehousing arrangements. They should also be able to play a greater part in agricultural finance in the shape of advances against produce, gold, and loans for purchase of expensive agricultural equipment. As regards the moneylenders, the Committee cautioned that while attempting to enact or enforce any legislation for controlling their activities, Government should take into account the pace at which an alternative machinery for supply of credit to the agriculturists could be developed. In this connection, it suggested a review of the existing legislation concerning debt relief, money lending, tenancy and land tenure insofar as they affected the commercial, co-operative and land mortgage banks, in order to enable these institutions to work unhindered.

The proposals of the Committee for the extension of banking and credit facilities in rural and semi-urban areas were of two types viz.,

(a) general proposals for the removal of existing impediments and provision of some indirect types of stimuli, available to all types of sound banking institutions and (b) special measures for assistance to or improvement of co-operative banks and societies.

Under (a), the Committee indicated the long-term measures necessary for the gradual removal of impediments like the deficit character of agriculture, lack of communications, illiteracy and conservatism of villagers. It also suggested the association of local persons of importance with banks as directors or employees for generating confidence in the rural population and the exemption of branches of banks in mofussil centres from the provisions of Shops and Establishments Acts and Awards of Industrial Tribunals, for bringing down operating

costs. Further, the Committee recommended (i) reduction of remittance charges to half of the existing rates, making available free remittance facilities to scheduled banks and co-operative banks whether or not they maintained an account with an office at the place from which remittance was required, and allowing remittances from branches of the Imperial Bank to any account with the Reserve Bank and not merely the principal account; (ii) provision of adequate facilities for conversion and exchange of notes and coins at offices of the Imperial Bank and treasury agencies; (iii) provision of facilities for keeping safes and chests for safe custody in the strong rooms of treasuries and sub-treasuries; and (iv) promotion of warehouses.

Regarding special assistance to co-operatives, the Committee recommended lower rates for postal remittances between co-operative institutions, relaxation of rules regarding maximum amount of postal savings deposits and number of times of operations, appointment of co-operative banks and societies as authorised agents for sale of National Savings Certificates, provision of qualified and adequate staff to manage, supervise, audit and inspect co-operative institutions and a closer liaison between the Reserve Bank and co-operative banks.

The Committee felt that the conversion of non-banking treasuries into banking treasuries would provide greater opportunities for 'the rural people to come into contact with banks, enable banks to serve a larger section of rural population, encourage use of instruments like cheques and help reduce handling of cash. It also made some recommendations for the improvement of postal savings bank services.

The Government invited the views of the Reserve Bank on the recommendations of the Committee. The Bank's views were formulated and submitted to the Central Board for approval in September 1950; in view of the need for careful consideration, the memorandum submitted by the Governor was discussed by the Board only at its meeting in December 1950. The Board approved, among others, the Committee's proposals for an extension of remittance facilities at reduced rates, for the removal of impediments in the way of the expansion of commercial banks in rural areas, as well as for the improvement of the machinery of rural finance both as regards the mobilisation of rural savings and the extension of rural credit. Earlier, in October 1950, as mentioned in Chapter 17, the Department of Banking Development had been created mainly with the object of implementing the recommendations of the Rural Banking Committee and in particular to give concentrated attention to the extension of banking facilities to semi-urban areas and to the problems of rural finance. Further, with a view to formulating a long-term as well as short-term policy in regard to the problems of rural finance, the Reserve Bank also

convened, in February 1951, an Informal Conference of representatives of the co-operative movement and other experts on rural finance; a brief reference to this Conference is made in a later paragraph. The approach of the Reserve Bank to the problems of rural finance and banking development in relatively underbanked areas in the following years has been mainly along the lines recommended by the Rural Banking Enquiry Committee and the Informal Conference on Rural Finance.

LIBERALISATION OF THE SCHEME OF REDISCOUNTS AND ADVANCES

It was mentioned earlier that the period was marked by some liberalisation of the Bank's policy in the sphere of agricultural finance for enabling the co-operative sector to make a freer and fuller use of its credit facilities. The measures undertaken by the Bank in pursuance of this policy were, however, more in the nature of a gradual adaptation of existing arrangements, mainly in response to the representations of the co-operative sector, than the outcome of a well-defined long-term plan. The scope of accommodation which the Bank could provide was circumscribed by the limitations placed on it under its statute; any enlargement of the nature and duration of such accommodation required amendments to the Reserve Bank Act. Since changes involving fresh legislation necessarily took time, the Bank's efforts, in the first instance, were directed towards a gradual liberalisation of the operational terms and conditions prescribed under its Scheme of Rediscounts and Advances. Briefly, the modifications made in the Scheme provided for enhancement of the interest rebate on accommodation granted against eligible paper drawn for financing seasonal agricultural operations and marketing of crops; extension of similar concession to cover advances against Government and trustee securities availed of for the two specified purposes mentioned above; acceptance of the guarantee of the Provincial Government in lieu of the second signature required for rediscounting agricultural paper; inclusion of debentures of land mortgage banks as eligible security for advances in appropriate cases; and liberalisation and simplification of procedural requirements. A brief account of developments relating to these matters is given in the following paragraphs.

Interest Concession

The first post-war change in the Scheme of Rediscounts and Advances was the enhancement of the interest concession on accommodation

provided under Section 17(2)(b)/(4)(c) against agricultural paper drawn for financing seasonal agricultural operations and marketing of crops, from 1 to 1 ½ per cent *below* Bank rate, effective July 15, 1946. It may be recalled that a special interest rebate of 1 ½ per cent was allowed for these purposes, in April 1945, to the U.P. Provincial Co-operative Bank on account of the high rates prevailing in the region. This was made initially for a period of one year after which the position was to be reviewed. On a reconsideration of the position in 1946, it was felt that the enhanced concession should be extended to all Provinces as the rebate of 1 per cent introduced in 1942 had not evoked much response. Recommending such a step in his note dated June 6, 1946, the Chief Officer of the Agricultural Credit Department observed:

As we are anxious to play our full part in financing agriculture within the limitations imposed by the statute, and as our intentions in the matter are being measured by the amount of finance we make available to the co-operative banks, I feel that the rate of rebate should be increased so as to make our scheme more attractive.

It will be recalled that the Gadgil Committee (1945) had also recommended enhancement of the quantum of concession. The revised concessional rate remained unchanged during the rest of the period covered by this volume.

The extension of the concessional rate of interest to cover advances availed of by co-operative banks for financing seasonal agricultural operations and marketing of crops under Section 17(4) (a), that is, against Government and trustee securities, came about as follows. The Bombay Provincial Co-operative Bank applied to the Bank in December 1947 for a limit of Rs.3 crores, of which Rs.2 crores was to be against Government securities owned by the bank and those pledged to it by the central co-operative banks. The authorities of the provincial bank met the Deputy Governor twice in connection with the application, on December 18, 1947 and May 11, 1948. It was explained at the latter meeting that the bank, which was also financing societies directly, found it difficult to offer documents of the societies as collateral security; hence, it was suggested that advances obtained by the bank against Government and trustee securities should also be made eligible for the concessional rate of interest provided the funds were to be utilised for financing seasonal agricultural operations or marketing of crops. This was agreed to by the Deputy Governor. The bank, however, did not pursue its application made in December 1947. It was the C. P. and Berar Provincial Bank which first availed of this concession in respect of the accommodation sanctioned to it in May 1949 (against Government guarantee). The details in this regard are given in a subsequent

paragraph. The Bombay Provincial Co-operative Bank got its first accommodation under Section 17(4)(a) at the concessional rate in October 1949, when it was sanctioned a limit of Rs. 25 lakhs. In the meantime, as more and more use was sought to be made of Section 17(4) (a) for obtaining finance for seasonal agricultural operations and marketing of crops, the Bank considered it necessary to issue a general circular on July 7, 1949 to all Registrars and provincial cooperative banks intimating the availability of advances under Section 17(4)(a) at 1 ½ per cent below Bank rate, for the two approved purposes.

Period of Accommodation

The extension of concessional finance for agricultural purposes under Section 17(4) (a) raised a legal issue in regard to the period of such accommodation. This Section provided for the granting of loans repayable on demand or for fixed periods not exceeding 90 days. Since loans availed of for agricultural purposes were normally required for longer periods, the question arose whether it would be permissible for the Bank to allow such loans to run on beyond 90 days. The legal opinion obtained by the Bank from the Law Department of the Government of India, in December 1946, indicated that the expression 'not exceeding ninety days' applied only to fixed loans and that there was no objection under the Reserve Bank Act for a *demand* loan being extended for any period up to 3 years (Limitation Act) from the date of the loan. However, as a matter of general policy the Bank decided in January 1947 not to allow any type of loan taken under Section 17(4) (a) to run for more than 90 days.

The question came up for review in January 1949. The Ajmer-Merwara Provincial Co-operative Bank, which had taken an advance under Section 17(4) (a) against Government securities for 90 days, asked for extension of the loan for a further period of 90 days. The Legal Assistant of the Bank was of the view that it would involve no contravention of the Act even if a fixed loan was left outstanding for more than 90 days, as it was not obligatory on the part of the Bank to recall the loan after the expiry of the fixed period even though it had a right to do so. It was only a matter of policy for the Bank to defer calling in a loan when it became due or to have it renewed as it thought fit. Accordingly, the Bank allowed extension of the period sought for by the Ajmer-Merwara Provincial Co-operative Bank on an *ad hoc* basis. Subsequently, in the course of the same year, the C. P. and Berar, Orissa and Bombay Provincial Co-operative Banks were granted demand loans under Section 17(4) (a) on the understanding that they would not be recalled within a period of nine months as they were for

approved agricultural purposes. This fact was not, however, specifically stated in the sanction letters since Section 17(4)(a) prohibited contractual obligations having a duration exceeding 90 days.

As the number of cases in which the loans were to be allowed to run for periods exceeding 90 days were on the increase, to enable the Agricultural Credit Department to deal with such cases expeditiously, the Bank decided as a general policy, in January 1950, that loans under Section 17(4)(a) granted to provincial co-operative banks for financing seasonal agricultural operations and marketing of crops should not be recalled within 90 days, but allowed to run for periods not exceeding nine months. The exercise of discretion in the matter was left to the Agricultural Credit Department. This decision was communicated to the Managers of the regional offices of the Bank, in January 1950, and to the Registrars and co-operative banks in July 1951, in the form of a general circular.

There was also a general criticism voiced by the co-operative opinion that the period of advances for seasonal agricultural operations at a maximum of nine months provided for in Section 17(2)(b) of the Bank's Statute fell short of the actual requirements of cultivators. As was noted earlier, the demand for extension of the period from nine to twelve, or fifteen months in the case of special crops like sugarcane, was also raised from time to time by various Committees on Co-operation. Although this was accepted by the Bank and amendments for this purpose were recommended to Government in January 1949, it was only in February 1951 that these were enacted, the amendments coming into effect in November that year. The Bank had proposed extension of the period of accommodation for seasonal agricultural operations and marketing of crops, under Sections 17(2)(b) and 17(4)(c), from nine to twelve months and the Bill as introduced by Government incorporated these changes. The extension of the period to fifteen months was recommended by the Select Committee of Parliament and this was incorporated in the amending legislation. While giving effect to this amendment in its circular dated November 23, 1951, the Bank indicated that normally it would accept only bills and promissory notes maturing within twelve months for rediscount under Section 17(2)(b) or advances under Section 17(4) (c) and allow a period of fifteen months only in special cases. The circular also mentioned that demand loans granted under Section 17(4) (a) for financing seasonal agricultural operations and marketing of crops would not ordinarily be recalled before a period of twelve months.

It may incidentally be mentioned that the amendments carried out in November 1951 also provided for the extension, to co-operative banks, of facilities for accommodation against *bona fide* trade or commercial paper under Section 17(2)(a).

Acceptance of Government Guarantee

A further modification of the Scheme became necessary in connection with the Bank's attempt to help the co-operative credit structure in Central Provinces and Berar. This was in allowing the substitution of the second signature required on bills to be discounted with the Bank [under Section 17(2) (b)] by a guarantee from the Provincial Government. During the depression and immediately after, the central banks in that region had to face heavy overdues and could not rehabilitate themselves for a considerable time. The provincial co-operative bank, however, carried on the business of agricultural credit, utilising the central banks as agents for disbursal and recovery of loans to primary societies. As the provincial bank wanted additional funds to meet the demand for agricultural credit, it applied to the Reserve Bank for a loan of Rs. 42 lakhs in May 1947. The Reserve Bank, at first, took the stand that it would not be possible to provide accommodation against the second signature of central banks which were considered to be in a very bad state by audit authorities. The Bank suggested that accommodation might be availed of against bills and pronotes of societies which satisfied the conditions laid down by it; accordingly the provincial bank was asked to submit financial particulars of societies*whose bills were to be discounted.

The Food Minister of the C. P. and Berar thereupon took up the matter with the Governor in December 1948, requesting him to suggest a solution to the problem since the signatures of the central banks were not considered good enough and it was difficult to offer documents of a large number of societies to the Bank. The Governor arranged for a first hand study of the working of the co-operative institutions in the Province by the Chief Officer of the Agricultural Credit Department. The Chief Officer found that the movement there was in a generally unsatisfactory state and the central banks lacked popular support. Though the central banks had repaid their depositors in full and wiped out the losses incurred during 1929-39, they had not been able to attract sufficient deposits. Barring two or three, the central banks had a poor capital structure and many of them did not merit accommodation from the Reserve Bank on account of their smallness. In the circumstances, when an application for Rs. 35.35 lakhs was made by the provincial co-operative bank in March 1949 on behalf of twelve central banks, the Governor wrote to the Finance Minister on April 20, 1949, as under :

On a careful examination of the data received from the banks and also as a result of the tour of the Chief Officer, Agricultural Credit Department, in the Central Provinces and Berar in January last (1949), I feel that the banks have not yet recovered fully from their depression

troubles and their position and management are not such as to warrant our accommodating them individually. At the same time, I agree with you that some way should be found for assisting the agriculturists who need help in the shape of finance. The solution I would suggest is that we make a loan to the Provincial Bank for a consolidated amount under guarantee of the Government of Central Provinces and Berar.

The Governor also indicated that despite the Government guarantee loans taken from the Bank should be utilised strictly for the two specified purposes, viz., seasonal agricultural operations and marketing of crops. The Government agreed to give the guarantee and the limit applied for (Rs. 35.35 lakhs) was sanctioned on May 18, 1949.

Another provincial bank which was accommodated on the basis of Government guarantee in 1948-49 (July-June) was Orissa; in this case, the guarantee was taken to buttress the signature of the provincial co-operative bank itself, as it had been established only in 1947 and was not of sufficient strength for its signature to be acceptable to the Bank. The limit granted in this regard was Rs. 30 lakhs. The C. P. and Berar and Orissa Provincial Co-operative Banks could draw upon their limits only in 1949-50. These were also sanctioned limits of Rs. 100 lakhs and Rs. 35 lakhs, respectively, in the year 1950-51. In February 1951, the West Bengal Provincial Co-operative Bank was sanctioned a limit of Rs. 50 lakhs under Government guarantee for enabling it to make a fresh start in agricultural finance, since the co-operative movement in the State had almost become moribund after partition.

Procedural Reforms

Besides making the major changes set out above, the Bank also modified or simplified some of the procedural requirements laid down under the Scheme. One of the conditions to be satisfied by provincial cooperative banks for obtaining accommodation from the Bank under Sections 17(2)(b) and 17(4)(c), i.e., for seasonal agricultural operations and marketing of crops, was that their applications had to be accompanied by particulars of loans made by the central co-operative banks which were sought to be refinanced. The object of calling for the list of loans was to enable the Bank to satisfy itself that the funds provided by it were to be utilised only for the two specific purposes mentioned above or, at least, that an equivalent amount had already been so advanced. The Madras Provincial Co-operative Bank, however, took objection to this stipulation and wrote to the Reserve Bank in July 1946 stating that it was impracticable to comply with it. Although the Reserve Bank was of the view that the submission of such a list should not present any great difficulty it decided to take up a flexible attitude in the matter and agreed in August to waive this condition provided

the provincial co-operative bank furnished a certificate to the effect that the loans were used for the two approved purposes. However, the Bank desired that the information about the loans should be maintained by the institutions to be readily available for its scrutiny. This relaxation was communicated to all Registrars and provincial co-operative banks in September 1946 by transmitting to them copies of the correspondence with the Madras bank.

Another direction in which the Bank took action was in relaxing the norm regarding the quantum of credit limits sanctioned by it under the Scheme. As a matter of prudence, the Bank had been following the principle that the limits sanctioned should not exceed the 'owned capital' (that is, capital and reserves) of the central banks on behalf of which accommodation was applied for. Departure from this practice was first made in connection with an application from the Madras Provincial Co-operative Bank early in 1948 for a credit limit of Rs.90 lakhs in respect of eight central co-operative banks; the limits applied for were much in excess of their respective owned capital. The main considerations which weighed with the Bank in deciding to sanction limits exceeding owned capital were as under. Firstly, the borrowing powers of these banks provided for in their bye-laws generally ranged from twelve to twenty times of their owned funds and, in the circumstances, to restrict the Bank's accommodation to their owned capital would be of very little assistance to them. Besides, according to the Bank's new thinking, the owned capital had significance mainly in determining the borrowing power of an institution and counted very little as security for the Bank's loans as such, since depositors and other creditors as well had an equal claim over it. Secondly, as these limits were recommended by the Registrar of Co-operative Societies having intimate knowledge of their working, the Bank should normally accept them unless it had any specific reasons to act otherwise. Recommending the relaxation of the existing norm in his note of February 10, 1948, the Chief Officer of the Agricultural Credit Department observed:

The Reserve Bank has been subjected to a lot of unjust criticism that its attitude has not been very helpful to the co-operative movement and all our refutations of the charge and our reasonings have not been very successful in removing this impression. These applications seem to me to offer us a good opportunity to give the lie to the unjust accusation and prove that it is only the unsoundness of an application that makes us hesitant. Though the amounts asked for are large, the institutions appear to be sound both as regards their finances and their management and we shall not be taking much risk in being liberal in our consideration of the applications.

However, while sanctioning the loans the Bank made some discretionary reduction in the limits applied for, although the sanctioned limits

in the case of four out of the eight banks were in excess of their respective owned capital. Thereafter, the Bank generally refrained from applying this restriction in considering loan applications. As this relaxation concerned a matter of internal policy for the Bank and did not relate to any condition laid down under the Scheme, there was no question of communicating the decision to co-operatives at that stage. It should however be added that credit limits are still fixed as a multiple, a varying one from bank to bank, of the owned funds.

An aspect of the Scheme which required clarification on the Bank's part pertained to the concessional rate of interest. While introducing the scheme of concessional finance for marketing of crops in January 1942 (which was extended to seasonal agricultural operations in November 1944), the Bank required co-operative institutions to ensure that the benefit of the rebate was passed on to the ultimate agriculturist borrower. To enable the Bank to satisfy itself that this was done, the provincial co-operative banks seeking accommodation from the Bank were required to furnish a statement showing the respective rates charged by the provincial bank to the central banks, by the latter to the primary societies and by the primaries to the ultimate borrowers. In the case of loans sanctioned under the Scheme in the initial stages, for instance to the U. P. Provincial Co-operative Bank, the Bank observed that no commensurate reductions in the rates were effected at the various levels and, therefore, took up the matter through the Registrar of Co-operative Societies of that Province. The provincial bank replied that the funds provided by the Reserve Bank at the concessional rate formed only a fraction of the total loans extended by it and, therefore, an immediate and general reduction in the rate of interest was not possible. The Madras Provincial Co-operative Bank also represented the impracticability of conforming to this condition in its letter of July 29, 1946 referred to earlier. The Madras Bank wrote:

If this were to mean that the rebate allowed by you on the usance and promissory notes drawn by a particular central bank and endorsed by the provincial bank should be passed on to that particular central bank and in turn passed by the central bank to the societies which are financed with the funds arising from discounting that paper, it would result in an invidious distinction being made by the provincial bank between one central bank whose paper is discounted with the Reserve Bank and another whose paper is not so offered. Similarly, such invidious distinction will have to be made by the central bank as between societies for whom the proceeds of such discounted paper are disbursed and those societies which are financed with the funds of the central banks derived from their own deposits or by borrowings from the provincial or other banks.

The bank, therefore, desired that this condition should not be insisted upon and accommodation under the Scheme should be provided

freely to make it possible for the central banks and the primary societies to lower their general lending rate so that the ultimate borrower got funds at 5 per cent or lower. This goal was not reached as the rate to the ultimate borrower did not go below $6\frac{1}{4}$ per cent in Madras.

The Reserve Bank, in its reply dated August 27, 1946 (circulated to all Registrars and provincial co-operative banks), clarified its objective in stipulating this condition, in the following terms:

It is not our intention that this should be confined only to central banks (and societies and members in the chain) whose bills are rediscounted with us. What we expect is that all advances made by a provincial bank and the central banks and the societies (whether from the funds borrowed from us or out of their general resources) for the two purposes in question should be uniformly at lower rates. Assured of accommodation from us at 1½ per cent, it should be possible for the co-operative credit movement to reduce its borrowing and consequently lending rates on loans advanced for these two objects though we anticipate that this will also favourably react on the whole structure of interest rates in the movement and will contribute to the reduction of rates in general. Thus, we would be satisfied if as a result of the working of our scheme, the rates of interest charged on loans for the two objects in question are reduced in all institutions eligible for loans under it.

The matter, however, did not rest there. A revised circular on the Scheme was issued by the Reserve Bank on August 23, 1947, bringing together the changes made in it from time to time. This circular required the provincial banks to see that the benefit of the interest concession was passed on to the ultimate borrower and to furnish the Bank a certificate to this effect. This apparently was at variance with what was indicated to the Madras bank earlier and created some confusion. In May 1948, the Registrar of Co-operative Societies, Bombay, made a reference to this while forwarding the comments of the Bombay Provincial Co-operative Bank and the Bombay Co-operative Banks' Association on the circular of August 23, 1947. The Registrar referred to this point in the following terms:

The condition about passing on of the benefits of the low rate of interest to the agriculturists is also impracticable and unnecessary. In this Province, steps have already been taken to reduce the lending rates of interest of the central financing agency and the ultimate aim has been to make funds available to the agriculturists at $6\frac{1}{4}$ per cent. Infact the finance made by the Reserve Bank cannot be regarded as cheaper as in this Province, average borrowing rate of interest of central banks is about 1.8 per cent. In case the Provincial Bank has to keep a certain percentage of its balances free of interest with the Reserve Bank, the finance obtained from the Reserve Bank would actually be dearer because the Provincial Bank has then to charge at least half a percent (more) on the advances to be made to the central banks, on funds borrowed from the Reserve Bank. This pushes up the rate to 2 per cent.

This, therefore, would not be cheaper finance as it appears on the surface and the insistence on passing on the benefit of concession to the ultimate borrower as a condition prior to sanction of accommodation serves no purpose other than putting off of the actual provision of finance.

The Reserve Bank had, therefore, to issue a further clarification on this point in its circular dated July 28, 1948. This circular stated that what was expected was that all advances made by provincial and central banks and societies (whether from the funds borrowed from the Reserve Bank or out of their general resources) should be at uniform rates and that with the availability of accommodation from the Reserve Bank at the concessional rate it should be possible for the co-operative institutions to reduce their borrowing and lending rates which, in the long run would react favourably on the whole structure of interest rates.

Certain other procedural changes which were not in the nature of liberalisation of the conditions imposed under the Bank's Scheme of Rediscounts and Advances may now be referred to. In December 1948, the operational period for credit limits under the Scheme was altered from the calendar year to the twelve-month period October-September. This change was intended to wit the convenience of the agriculturists, as the harvesting and marketing of crops were generally completed only by April or May. However, as co-operative interests felt that this was not quite suitable to them, the period was changed in November 1951 to July-June.

The second change, also made in December 1948, related to the introduction of a new condition that all loans taken during a year (i.e., October-September) should be repaid before the end of the same year; this, too, was short lived as the Bank rescinded the stipulation in November 1951 on the recommendation of the Informal Conference on Rural Finance, along with the alteration of the operational period to July-June. The circumstances which prompted the Bank to introduce such a condition may, however, be indicated. The practice in force of allowing discounted bills to remain outstanding for the full period of nine months, going beyond the year in which they were discounted, appeared to have given room for banks making use of the Reserve Bank's credit limits for periods longer than those for which they were sanctioned. In October 1948, the Manager of the Madras office of the Bank made a reference regarding the premature retirement of bills discounted with the Bank by the Madras Provincial Co-operative Bank and substituting them by fresh bills with later dates of maturity, the intention being to have the period of the credit limit extended. The Madras Manager felt that this would in effect mean that the co-operative central banks would be availing of credit limits from the Bank all round the year. He suggested that a date might be fixed by which all

bills should be retired in any year. The Bank agreed with this view and issued the abovementioned circular in December 1948.

The Bank also noticed that central co-operative banks which were sanctioned credit limits through provincial co-operative banks resorted to the practice of drawing the entire amount under the limits fixed for them, repaid the loans in part or in full and again rediscounted fresh bills. This was apparently done under the impression that the limits fixed by the Bank were in force for the entire operational year and that, within that period, they could draw and repay as many times as they required, provided the outstandings at any time did not exceed the limits fixed. To stop this practice, the Bank issued a circular on June 1, 1950 to its Managers and all provincial co-operative banks. It pointed out that the credit limits were not in the nature of an overdraft or cash credit accommodation, but were to be regarded as fixed loans. While the central banks could draw and repay in parts, any part repaid could not be used again; once utilised, a limit ceased to have validity for rediscounting any fresh bills. However, this position was also reversed in November 1951 at the instance of the Informal Conference on Rural Finance.

Larger Credit Extension by RBI

The volume of short-term finance provided by the Reserve Bank to provincial co-operative banks at the concessional rate showed a marked increase over the period as a result of the liberalisation of the Scheme as well as the increasing demand for funds. The total credit limits sanctioned by the Bank increased from about Rs.7 lakhs in 1945-46 to Rs. 7.62 crores in 1950-51; the amounts availed of against these limits showed a corresponding increase from about Rs.1lakh to Rs.5.37 crores. The bulk of the accommodation was against agricultural paper under Section 17(2)(b)/17(4)(c), while the rest was against Government or trustee securities or Government guarantee under Section 17(4)(a). Besides, three provincial co-operative banks were sanctioned accommodation at the Bank rate. under Section 17(4)(a) for other purposes; practically the whole of this was accounted for by the Bombay bank, which borrowed in all Rs.7.33 crores out of a total lending by the Bank of Rs.7.44 crores. The year-wise and Province-wise lending by the Bank under the various categories are shown in the accompanying tables.

It will be seen that only two of the provincial co-operative banks, viz., Bombay and Madras, made any substantial use of the facilities. This was because the co-operative credit structure, especially at the provincial and central bank levels, was well-established in these Provinces only. In the other Provinces the co-operative credit movement

I. AT CONCESSIONAL RATE(i) *Against agricultural paper under Section 17(2) (b)/17(4)(c)*

(Rs. lakhs)

| July-June | Madras | | Bombay | | United Provinces | |
|-----------|--------|--------|--------|-------|------------------|------|
| | A | B | A | B | A | B |
| 1945-46 | — | — | — | — | 6.80 | 1.25 |
| 1946-47 | — | — | 1.00 | 1.00 | 5.65 | 0.50 |
| 1947-48 | 60.00 | 15.00 | — | — | 7.70 | 1.80 |
| 1948-49 | 101.00 | 91.81 | 11.50 | 6.50 | 2.40 | 4.35 |
| 1949-50 | 150.00 | 156.00 | 36.00 | 41.00 | 3.00 | 0.75 |
| 1950-51 | 320.00 | 224.50 | 105.00 | 66.00 | 2.00 | 2.50 |

(ii) *Against Government or trustee securities/Government guarantee under Section 17(4)(a)*

| | Bombay | | CP & Berar | | Orissa | | West Bengal | |
|---------|--------|--------|------------|-------|--------|-------|-------------|-------|
| | A | B | A | B | A | B | A | B |
| 1945-46 | — | — | — | — | — | — | — | — |
| 1946-47 | — | — | — | — | — | — | — | — |
| 1947-48 | — | — | — | — | — | — | — | — |
| 1948-49 | — | — | 35.35 | — | 30.00 | — | — | — |
| 1949-50 | 25.00 | 25.00 | — | 35.56 | — | 13.41 | — | — |
| 1950-51 | 150.00 | 150.00 | 100.00 | 53.10 | 35.00 | 26.70 | 50.00 | 15.00 |

A: Limit sanctioned.

B: Amount drawn.

NOTE: The explanation for the amounts drawn in some cases during 1949-50 being in excess of the corresponding limits is as follows. Since the operational period at the time was October-September, the drawals made in the last quarter (July-September) would naturally get included in the figures for the next year in the table.

II. AT BANK RATE*Against Government or trustee securities/Government guarantee under Section 17(4)(a)*

| | Bombay | Orissa | Ajmer-Merwara |
|---------|--------|--------|---------------|
| 1945-46 | — | — | — |
| 1946-47 | 30.00 | — | — |
| 1947-48 | 5.00 | — | — |
| 1948-49 | 518.00 | — | 1.50 |
| 1949-50 | 143.00 | 7.59 | — |
| 1950-51 | 37.30 | 2.00 | — |

was weak as a whole or at the apex and intermediate tiers, which affected their ability to make effective use of the facilities offered by the Reserve Bank.

Debentures of Land Mortgage Banks

The policy of the Bank in regard to the debentures of the land mortgage banks underwent a change during this period; the Bank agreed

to make advances against the debentures of the Madras Central Land Mortgage Bank and to subscribe up to 10 per cent of any issue of debentures floated by a land mortgage bank. The contribution was increased up to 20 per cent in August 1950.

ACCEPTANCE AS SECURITY: As mentioned in Chapter 16, the attitude of the Bank in regard to the acceptance of the debentures of the Madras Central Land Mortgage Bank as collateral for advances had softened in October 1941 itself following the Deputy Governor's discussions with the Madras Government. Apparently satisfied with the indication given by the Provincial authorities of their intention eventually to end Government guarantee of debentures and the measures taken by them for strengthening the apex institution, the Bank had then informed the Madras Government that it would be prepared to consider on merits any application for advances against the debentures and also support the guaranteed debentures by purchasing a small block of a new issue. The formal acceptance of debentures of the Madras Central Land Mortgage Bank as security for advances under Section 17(4)(a) was advised by the Bank, in its circular letter dated August 23, 1947, to all the Registrars of Co-operative Societies and provincial co-operative banks. The Bank explained this step as a sequel to its being satisfied about the marketability of these debentures. Such advances were to be available only in emergencies and to be restricted in amount to 80 per cent of the market value of debentures.

It may be mentioned here that the Madras Government, despite their avowed intent to end the guarantee, decided in December 1947 to continue the system indefinitely for the following reasons. For one thing, the Government felt that it would not be possible to eliminate the guarantee, because the demand for loans was increasing from year to year with changing conditions. Further, in agreeing to dispense with the guarantee earlier, the Government had overlooked the fact that these debentures had been made trustee securities by virtue of such guarantee; if the future issues ceased to be trustee securities by the withdrawal of the guarantee, the classes of investors who held most of the series would discontinue such investment in future, unless the Central Government were prepared to declare them as trustee securities even without the guarantee, which it was unlikely to do. Although the Bank had been critical of the system of guarantee as being inimical to land mortgage bank debentures acquiring inherent strength, the change in the policy of the Madras Government did not affect its decision to accept the debentures as security for advances under Section 17(4)(a).

The Bank's decision was welcomed in co-operative circles, but they were unhappy about the restriction of advances to emergencies only. The interests in Bombay were also unhappy at the non-inclusion of

the debentures of the Bombay Provincial Land Mortgage Bank as eligible security. The acceptance of land mortgage bank debentures in general as collateral for advances became normal policy in 1955 with the coming into prominence of the debentures of other central land mortgage banks.

SUPPORT TO DEBENTURE ISSUES: The decision to support the debentures of land mortgage banks by making a token purchase was taken in March 1948 though, as stated earlier, an indication of the Bank's attitude in this regard was given in 1941 itself. The ground for this was prepared during a visit of the Deputy Governor to the Madras Land Mortgage Bank in October 1947, when he agreed to consider favourably the question of the Reserve Bank's purchasing a part of the debentures floated by it. The actual request in this regard came in February 1948, when the Madras bank sought the assistance of the Bank for a series of debentures for Rs. 25 lakhs to be floated by it. The Bank signified its consent to support the issue by purchasing Rs. 2½ lakhs worth of debentures if they carried interest at 3 per cent and were issued at par. The Madras bank subsequently raised the total amount of the series from Rs. 25 lakhs to Rs. 40 lakhs and wanted the Reserve Bank to subscribe up to Rs. 4 lakhs, which was acceded to by the Bank. The floatation was a success and as the public subscription amounted to Rs. 38 lakhs, the Bank was called upon to take up debentures to the extent of Rs. 2 lakhs only.

The Madras bank decided to issue another series later in the same year (i.e., 1948-49) for a total sum of Rs. 50 lakhs. The Reserve Bank agreed to contribute up to Rs. 5 lakhs if the issue was not fully subscribed otherwise. The Bank had, however, to take up debentures of the value of Rs. 3.98 lakhs only. In the following year, the Bank was called to take up debentures for only Rs. 15,000, out of a Rs. 27 lakhs issue. Thus, out of a total issue of Rs. 117 lakhs made by the Madras Provincial Land Mortgage Bank during 1948-50, the Reserve Bank took up debentures of the value of Rs. 6.13 lakhs.

In August 1950, the Bank enhanced the ceiling of its support to the debentures to 20 per cent of the total issue again in response to a request from the Madras Central Land Mortgage Bank. Up to the end of June 1950, only one more central land mortgage bank, viz., that of Bombay, availed of this facility. The extent of Reserve Bank's support to the Bombay debentures was Rs. 4 lakhs out of the issue of Rs. 30 lakhs.

Co-operators' Demand for Other Concessions

Although the changes made in the policy and procedure for accommodation to co-operative banks under the Bank's Scheme liberalised

the position to some extent, they did not meet all the demands made by co-operative interests. Certain other concessions demanded by them, but which were not conceded by the Bank during the period are dealt briefly in the following paragraphs. Most of these demands, it may be noted, were later conceded by the Bank in November 1951 when it liberalised its policies further in the light of the recommendations of the Informal Conference on Rural Finance and the Standing Advisory Committee on Agricultural Credit.

FINANCE FOR PROCUREMENT OPERATIONS: One of the persistent demands of co-operative banks was for the inclusion of procurement operations as an approved purpose for which accommodation would be available from the Bank under its Scheme of Rediscounts and Advances for seasonal agricultural operations and marketing of crops. It may be mentioned here that, if procurement operations were not treated as marketing and brought under the 'scope of Section 17(2)(b), there was no other provision [until Section 17(2)(a) was extended to provincial co-operative banks in November 1951] in the Reserve Bank Act under which provincial co-operative banks could obtain accommodation from the Reserve Bank, even at the Bank rate, except borrowing against Government and trustee securities under Section 17(4)(a). On account of the food scarcity, many of the Provinces had resorted to intensive procurement and in some of them co-operative agencies like the consumers' stores and marketing societies were entrusted with the operations. These agencies needed financial assistance for the purpose and the problem assumed considerable importance in Madras. The Madras Provincial Co-operative Bank approached the Reserve Bank, in July 1946, to ascertain whether the Bank would provide funds at the concessional rate of 1 ½ per cent to finance procurement operations. This facility, the bank stated, would enable it to extend cheaper finance for the purpose and thereby help reduce the price of foodstuffs to the consumer. In a subsequent communication (September 1946), the bank pleaded that procurement should be treated as marketing of crops, as what co-operatives were doing was really *controlled* marketing of agricultural products. The Bank in its reply stated that these operations did not fall under either seasonal agricultural operations or marketing of crops, for which alone finance was available under its Scheme. The explanation was that co-operative marketing as envisaged in Section 17(2) (b) of the Reserve Bank of India Act was primarily in the interests of the producer, while the purpose of the procurement scheme was essentially to serve the interests of the consumer. When the matter was raised again, during the Fifteenth Conference of Registrars of Cooperative Societies held in Madras in May 1947, by the spokesman of the Madras Provincial Co-operative Bank, Shri. T. A. Ramalingam Chettiar, the representative of the Reserve Bank agreed to consider the

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demand favourably, if the co-operators could convince the Bank that the benefit of the concession would be passed on to the *producer*.

The Co-operative Sub-Committee (1948), referred to earlier, also considered this question and supported the contention of the Madras Provincial Co-operative Bank that procurement operations should be treated as marketing. It stated that the Reserve Bank, by sticking to a narrow interpretation of the word 'marketing', had put outside its scope of assistance a very large class of activity which was barely distinguishable from marketing and which in the context of the continuing food crisis and control had assumed great importance. The Sub-Committee, however, recommended the concessional rate only in cases where there were arrangements to pass on the benefit of the low rate to the producer. It remarked:

When procurement is made by marketing societies or growers' cooperatives for purposes of sale-it may be at rates and to parties directed by Government -the Reserve Bank need have no hesitation in classifying such activities as marketing. We would urge the Reserve Bank to reconsider their attitude and treat such procurement activities as marketing and provide the finance needed for the purpose. In case of societies, where under the bye-laws, or by other means, arrangements exist for the benefit of such activities to be passed on to the producers, we would recommend that the finance provided should be given at concessional rate.

The fact remains that the Reserve Bank has not so far accepted the contention that procurement operations should be treated as falling within the scope of marketing of crops.

MINIMUM BALANCES: The demand for exemption of provincial cooperative banks from the maintenance of minimum balances with the Reserve Bank -at half the rates prescribed for commercial banks -was made on more than one occasion during the period. The Agricultural Credit Organisation Committee (1947) had supported such exemption. The co-operators also suggested an alternative, namely, that Government securities be substituted for cash, in the maintenance of such balances. There was also the suggestion that at least banks whose borrowing was less than 5 per cent of their deposit liabilities should be exempted from the condition.

The Reserve Bank did not agree to a relaxation of this condition. It was contended by the Bank that maintenance of minimum balances by banks with the central bank of the country was a recognised practice the world over, because these balances, to an extent, provided the central bank the resources to manage the monetary system and to extend credit facilities to member banks in case of need. The Bank was also of the view that the maintenance of such balances would not result in any hardship or inconvenience to the provincial co-operative banks.

It was observed that banks which had started maintaining such balances were actually keeping them at much higher levels than those prescribed by the Bank. The demand for the abolition of minimum balances wore off after the Co-operative Sub-Committee expressed itself in favour of the maintenance of minimum balances by co-operative banks with the Reserve Bank, though it recommended some flexibility in enforcing the requirement on the smaller banks. The stipulation regarding minimum balances thus continued. Under the Banking Laws (Application to Co-operative Societies) Act, 1965, the state co-operative banks are now statutorily required to maintain minimum balances with the Reserve Bank on a par with those maintained by scheduled banks.

ELIGIBILITY STANDARDS FOR ACCOMMODATION: The co-operative sector also sought the relaxation of the condition that accommodation from the Bank would be available for financing only 'A' and 'B' class institutions*. It was the Madras Provincial Co-operative Bank which raised the issue in its letter dated July 29, 1946. The bank's view was that the Reserve Bank should look primarily to the provincial bank for due repayment of the usance bills irrespective of the audit classification of the central co-operative banks whose bills were discounted. Further, with 'A' and 'B' class central banks more or less managing with their own funds, the need for accommodation arose mainly on behalf of 'C' class institutions. The Reserve Bank did not agree to this demand as it felt that the special concession it was offering should not be extended to financially unsound institutions, as it would mean, to some extent, tolerating inefficiency and unsoundness if not actually putting a premium on the same. However, as part of the relaxations made in November 1951, 'C' class central banks became eligible for being financed from Bank's funds provided the Registrar of Co-operative Societies made a recommendation to this effect and the Bank was satisfied about their financial soundness. In this connection, it became necessary for the Reserve Bank to tackle the problem posed by the varying standards adopted by the Provinces for audit classification of co-operative banks. The Agricultural Credit Department, therefore, addressed the Registrars of Co-operative Societies in June 1949, stressing the need for evolving uniform standards for facilitating Province-wise comparison with regard to progress and also for enabling the Bank to assess the position of a central co-operative bank for purposes of financial accommodation. The matter was referred by the Bank to the first meeting of the Standing Advisory Committee on Agricultural Credit convened in August

* Broadly, co-operative institutions which are in a sound condition are classified by audit authorities as 'A', while those which are in a fairly sound condition are classified as 'B'. The other categories are: 'C' - mediocre ones; 'D' - those functioning in a bad way; and 'E' - utterly hopeless.

1951. The Committee drew up detailed standards for audit classification of the central co-operative banks, with the recommendation that the proposals might be placed before the next meeting of the Registrars, so that the matter could be examined on an all-India basis. These standards, which were accepted by the first Indian Co-operative Congress held in May 1952, were circulated by the Reserve Bank in June that year to the various State Governments for adoption. They found general acceptance among the various States and form the basis for the classification of central co-operative banks even now.

GOODS AS SECURITY UNDER SECTION 17(4) (d): Since documents of title to goods were required as collateral for advances under Section 17(4) (d) of its Statute, the Bank, as already noted, had suggested legislation for the establishment of licensed warehouses and circulated a model bill among Provincial Governments in 1944 so that accommodation could be made available against receipts issued by such warehouses. Some of the co-operators, especially those in Bombay, considered that insistence on a warehouse receipt was unnecessary and that the Reserve Bank should be prepared to accept goods pledged as security. The Bank was not prepared to accept this proposition as it was not feasible for it to have the goods inspected and ensure proper storage arrangements in respect of every advance made by it and further because the security offered to it was not negotiable.

It may be mentioned here that the Bank agreed to provide exemption to co-operative agencies intending to run warehouses from the stipulations in the model warehousing bill prohibiting a warehouseman, licensed under the legislation, from dealing in or lending money against goods stored in his warehouse either on his own account or that of others. This relaxation was incorporated in the revised warehousing bill circulated by the Bank in 1948. The change apparently satisfied co-operative interests. The Co-operative Sub-Committee referring to this, stated:

We are pleased to find that in the revised draft legislation for the regulation of licensed warehouses proposed by the Reserve Bank the condition that warehouses should be institutions independent of the warehouseman has been waived in respect of co-operative societies owning godowns. . . . Thus a central co-operative bank or a co-operative marketing society can keep warehouses and its receipts will be accepted as valid and negotiable documents of title to goods. We are impressed by the arguments of the Reserve Bank and are not pressing the suggestion that the Bank should accept goods in the possession of societies as valid securities.

Some of the other suggestions made by co-operators in the country, especially expert Committees on Co-operation, for widening the purposes of accommodation by enlarging the meaning of the term 'crops'

and inclusion of cottage industries and for the acceptance of demand pronotes of societies were not agreed to by the Bank during the period. It was only in 1953 that the Act was amended to include a special subsection [17(2)(bb)] enabling the Bank to finance cottage and small scale industries. The meaning of the terms 'seasonal agricultural operations' and 'marketing of crops' was also widened at the same time to include animal husbandry and allied activities jointly undertaken with agricultural operations and processing of crops prior to marketing respectively. The plea for acceptance of demand pronotes has not been conceded by the Bank so far.

Informal Conference on Rural Finance

The Reserve Bank's interest in rural finance was intensified from 1951 onwards, the lead for this coming from the Finance Minister. The scale of the Bank's financial assistance to the co-operative movement also recorded a marked expansion. The Bank geared itself to play an intimate and active role in the sphere of agricultural credit and as a first step convened, in February 1951, what has come to be known as the *Informal Conference* on the role of the Reserve Bank in the sphere of rural finance. This Conference was convened mainly at the instance of the Government of India and the circumstances may briefly be mentioned.

During the consideration of the Industrial Finance Corporation Bill in November 1947 by the Constituent Assembly, the then Finance Minister, Mr. R. K. Shanmukham Chetty, expressed himself in favour of setting up a separate institution in the nature of a Central Agricultural Credit Corporation which would be helpful in focussing attention on various problems connected with agricultural credit and which would also serve as an apex bank for provincial co-operative banks. This matter was referred to the Bank for its opinion in November 1947; the Bank, in its reply sent in June 1948, did not favour the establishment of such an organisation as it would be physically impossible for a central organisation to cover crores of agriculturists scattered over the country; it felt that the co-operative movement, backed by the facilities for accommodation offered by the Bank, could itself find all the finance necessary to meet the short-term credit needs of its members. As, however, the co-operative movement had not developed uniformly in all the Provinces, the Bank favoured the establishment of Provincial Agricultural Credit Corporations of the type recommended by the Gadgil Committee. The Central Government agreed with the Bank's view in this regard and after consulting the Provincial Governments, abandoned, in August 1950, the idea of establishing a Central Agricultural Credit Corporation and left the matter

of establishment of Provincial corporations to the discretion of the Provincial Governments.

The Finance Minister, Mr. C. D. Deshmukh, was, however, not content to allow the matter to rest there; he was keen that the Central Government should take further interest in the matter. During the debate on the Reserve Bank of India (Amendment) Bill, in November 1950, he had stated:

I personally agree with the view expressed that this is not a matter which can be handled through a Central Agricultural Credit Institution; and it seems that the Centre and the States and the Reserve Bank must get together and see how this matter can be furthered and what difficulties there are in the way of establishing such institutions (provincial corporations) and what part either the Centre or the Reserve Bank could, in consonance with their responsibilities, play in the matter.

Under the Finance Minister's instructions, the Finance Secretary wrote to the Reserve Bank in January 1951 asking it to take the necessary initiative in this regard, as it had all along dealt with rural credit and the Government had no machinery for dealing with it. The Finance Secretary stated:

It is true that in the past the Finance Ministry as such have not taken any specific lead in regard to rural finance, but even the old regime could not entirely divest themselves of the responsibility for doing something in the matter and the Government was forced during the last stages of the Reserve Bank Bill, to incorporate Section 54 for setting up an Agricultural Credit Department in the Reserve Bank. In the present set up it would be even more difficult for the Government of India to take up the attitude that they have no concern with agricultural finance and that it is entirely a matter for the appropriate State Governments. If we do not give our attention to this problem and formulate a considered policy, there is danger of the Government being rushed into committing themselves to some ill-considered, hastily devised and undesirable action at the demand of Parliament. It is therefore necessary that the matter should be considered on the lines of the undertaking given by H.M. in Parliament.

The Finance Secretary also suggested that the Bank should first under-take a fact-finding enquiry into the existing state of the country's agricultural economy to know its needs, 'qualitatively and quantitatively'. For this purpose, he added, the Bank might consolidate the existing information on the subject and then undertake consultations with the representatives of the Bombay and Madras Governments (presumably because these were the States where the co-operative movement had made substantial progress and possessed considerable experience) and also experts like Professor D. R. Gadgil in regard to the measures that should be adopted. After discussion with the Finance Minister, the Governor, Mr. B. Rama Rau, decided to convene an

informal conference to examine the various issues in their proper perspective.

The Conference, which was held at Bombay on February 2-3, 1951, under the Chairmanship of Professor D. R. Gadgil, was attended by official and non-official representatives of the co-operative movement from Bombay and Madras, besides senior officials of the Reserve Bank. The recommendations made by the Conference may be classified into three broad categories. These concerned measures : (1) for enabling the Reserve Bank to function more effectively within the existing framework, (2) for enlarging the framework, so far as that could be readily decided upon and carried out, and (3) for eventually designing a new and co-ordinated framework in the light of facts to be ascertained.

The procedural modifications suggested by the Conference under the first category were, mainly, relaxation of the condition regarding payment of all loans by the close of the operational year, extension of accommodation on behalf of ' C ' class institutions on the special recommendation of the Registrar of Co-operative Societies and greater flexibility in the utilisation of credit limits. These have already been referred to at appropriate places. As regards enlargement of the existing framework, the Conference took note of the amendment before Parliament for extending the period of short-term accommodation from nine to fifteen months and suggested in addition the following changes : (1) inclusion of mixed farming and processing of crops by agricultural producers among the purposes for short-term finance, (2) provision of short-term finance for production and marketing activities of industrial co-operatives, (3) extension of medium-term agricultural credit to cooperative banks for periods between eighteen months and five years to a limited extent and (4) making provincial co-operative banks eligible for accommodation under Section 17(2)(a), that is, for financing *bonafide* commercial or trade transactions. It also recommended that the Bank should assist effectively in the reorganisation of the co-operative credit structure, wherever necessary, so as to make possible a larger flow of credit to these areas. Finally, for enabling the formulation of a long-term policy, the Conference recommended that an All-India Rural Credit Survey should be planned and conducted under the Bank's auspices.

The other recommendations made by the Conference related to the promotion of a closer liaison between the Reserve Bank and the cooperative movement by the appointment of a small Standing Advisory Committee to be associated with the working of the Agricultural Credit Department and the periodical inspection of co-operative banks as was being contemplated by the Bank.

The Government of India and the Reserve Bank accepted most of the recommendations of the Conference. The Reserve Bank also took

immediate steps to implement the suggestions relating to matters of procedure, while in regard to those which required amendments to the Reserve Bank of India Act the necessary legislation was recommended to Government. The Bank also organised a comprehensive All-India Rural Credit Survey in October 1951, with a Committee of Direction chaired by Mr. A. D. Gorwala *. The recommendations of the Committee which submitted its report in December 1954 formed the basis for a rapid expansion of the Reserve Bank's role in agricultural credit.

Statistics of Co-operative Institutions

Before concluding the account of the Bank's rural credit policies, the statistical picture of the growth of co-operative institutions during the period may be given. The data are presented separately for primary societies, central banks and provincial co-operative banks, in the tables on next page.

The progress makes a fairly good showing save for the decline consequent on partition. While agricultural societies continued to occupy a predominant position at the primary-level of the movement, the growth of non-agricultural societies was much more impressive, particularly from the point of view of deposit mobilisation and provision of credit facilities. The numerical growth of primary societies in the country does not, however, bring out the unevenness in their regional distribution. There was a marked concentration, of both agricultural and non-agricultural societies, in the States of Bombay and Madras and to a lesser extent in Uttar Pradesh; on the other hand, States like Bihar, Orissa and Assam lagged considerably behind. Also, the movement in the Punjab which was fairly well-developed, and in Bengal suffered a set-back on account of partition.

The growing emphasis on the non-credit aspect of the movement was one of the noticeable trends during the period. In the atmosphere of shortages and rising prices, the distribution of rationed and other essential commodities, especially in urban centres, came to be increasingly organised on a co-operative basis. In the rural sector also, there was a tendency for credit societies to function on a multi-purpose basis, although their non-credit functions scarcely went beyond distribution of essential commodities. There was, thus, a steady growth in various types of non-credit co-operative societies such as, consumers' stores, milk supply societies and unions, weavers' societies, cottage industries societies, housing societies, co-operative workshops, and transport and industrial societies.

* Prof. D. R. Gadgil, Mr. B. Venkatappiah and Dr. N. S. R. Sastry (Director of Statistics in the Bank) were the other members; Dr. Sastry was the Member-Secretary.

A. PRIMARY SOCIETIES

| End of the year (July-June) | Undivided India | | Indian Union | | | |
|---|-----------------|--------------------------|--------------|--------------------------|---------|--------------------------|
| Particulars | 1945-46 | | 1947-48 | | 1950-51 | |
| | Total | Of which agricultural | Total | Of which agricultural | Total | Of which agricultural |
| 1. No. of Societies (000s) . . . | 171 | 147 | 149 | 126 | 177 | 149 |
| 2. Membership. . (lakhs) | 89.36 | 55.01 | 98.47 | 62.16 | 135.00 | 85.19 |
| 3. Capital and reserves | 35.14 | 16.46 | 39.54 | 16.82 | 59.07 | 25.26 |
| 4. Deposits. . . | 34.25 | 5.20 | 35.35 | 4.39 | 53.41 | 8.08 |
| 5. Borrowings. . | 16.27 | 11.36 | 20.58 | 13.49 | 37.02 | 24.16 |
| 6. Loans outstanding(a) | 39.59 | 18.92 | 47.07 | 20.63 | 77.38 | 33.07 |
| 7. Loans made. . during the year(a) | 37.27 | 14.60 | 49.28 | 18.57 | 85.20 | 33.52 |
| 8. Loans recovered during the year (a) | 36.20 | 13.78 | 42.44 | 15.52 | 72.17 | 28.28 |

(a) Figures are in respect of loans to individuals only.

B. CO-OPERATIVE CENTRAL BANKS

| End of the year (July-June) | Undivided India | | Indian Union | | | |
|---|-----------------|-------------|--------------|-------|---------|-------|
| Particulars | 1945-46 | | 1947-48 | | 1950-51 | |
| | Total | A | Total | A | Total | A |
| 1. No. of Societies (000s) . . . | 601 | — | 469 | — | 505 | — |
| | | (Rs.crores) | | | | |
| 2. Capital and reserves | 8.45 | — | 6.70 | — | 8.83 | — |
| 3. Deposits.(a) | 32.66 | 23.88 | 29.25 | 20.51 | 38.65 | 27.05 |
| 5. Borrowings (b) | 3.96 | 3.39 | 5.95 | 5.05 | 8.89 | 8.72 |
| 6. Loans outstanding(c) | 20.36 | 18.53 | 21.78 | 19.81 | 34.14 | 30.99 |
| 7. Loans issued (d) during the year | 43.07 | 37.64 | 62.91 | 58.13 | 82.84 | 75.24 |
| 8. Loans recovered (e) during the year | 41.96 | 36.96 | 60.83 | 55.94 | 77.19 | 69.98 |

(a) Figures in column (A) refer to deposits from individuals and non-co-operative institutions.

(b) Figures in column (A) relate to borrowings from provincial co-operative banks. (c), (d), (e) relate to transactions with co-operative societies.

C. PROVINCIAL CO-OPERATIVE BANKS

| End of the year (July-June) | Undivided India | | Indian Union | | | |
|---|-----------------|-------------|--------------|-------|---------|-------|
| Particulars | 1945-46 | | 1947-48 | | 1950-51 | |
| | Total | A | Total | A | Total | A |
| 1. No. of Bank | 13 | — | 11 | — | 15 | — |
| | | (Rs.crores) | | | | |
| 2. Capital and reserves | 3.03 | — | 2.60 | — | 3.80 | — |
| 3. Deposits(a) | 21.62 | 10.60 | 19.91 | 11.45 | 25.60 | 16.60 |
| 5. Borrowings(b) | 0.25 | — | 1.54 | — | 5.02 | — |
| 6. Loans outstanding(c) | 6.54 | 4.53 | 8.96 | 6.90 | 17.90 | 15.87 |
| 7. Loans issued (d) during the year | 16.88 | 8.44 | 21.78 | 15.02 | 42.13 | 34.40 |
| 8. Loans recovered (e) during the year | 17.15 | 9.08 | 21.87 | 15.52 | 38.21 | 30.78 |

(a) Figures in column (A) refer to deposits from individuals and non-co-operative intuitions.

(b) From Government and Reserve Bank.

(c),(d),(e) Figures in column (A) refer to transactions with central co-operative banks and societies.

The record of the fairly good progress of the movement presented above needs to be qualified in several respects. The general adverse features of the working of co-operative societies were their small area of operations and low membership, poor owned resources and deposits leading to excessive dependence on central financing agencies and lack of trained staff. The condition of co-operative banks, generally was also none too healthy. Many of the central banks were uneconomic units with meagre resources and their performance in tapping deposits from individuals and non-co-operative institutions was very disappointing; some of the apex co-operative banks also suffered from several weaknesses in their working. Though there had been a growth in deposits (from individuals and others excluding co-operative institutions) of co-operatives during the period from Rs. 60 crores to Rs.97 crores, it was largely accounted for by non-agricultural societies, particularly, urban banks and credit societies.

A few details of the working of co-operative land mortgage banks (now called land development banks), which provide long-term credit to agriculturists may now be given. The structure of co-operative land mortgage banks also presented a picture of uneven development. There existed only five central land mortgage banks at the close of June 1951, the same as at the end of June 1945; these were in Madras, Bombay, Orissa, Mysore and Travancore-Cochin. The number of primary land mortgage banks, which was 286 at the end of June 1951, showed practically no increase during the period. Of these 129 were in Madras and 79 in Mysore. The loans outstanding from members of the primary land mortgage banks amounted to Rs. 6.26 crores at the end of June 1951 as against Rs. 3.15 crores at the end of June 1945. Out of the total loans outstanding from members at the end of June 1951, as much as Rs. 4.53 crores were in respect of Madras while Mysore accounted for another Rs.0. 77 crore.

Conclusion

From the foregoing survey, it should be clear that the Bank's role in the sphere of agricultural credit entered an active phase in the late forties and there was also a considerable increase in the financial assistance provided by the Bank. Accommodation availed of by cooperative banks from the Reserve Bank increased from a little over Rs. 1 lakh in 1945-46 to Rs. 5.37 crores in 1950-51; the corresponding rise in gross advances of agricultural credit societies was from about Rs. 8 crores to Rs. 23 crores. Thus, finance provided by the Bank, which formed a negligible proportion of credit extended by agricultural societies at the beginning of the period constituted as much as 23 per cent of such credit in 1950-51. This has to be qualified by the fact that such assistance was mainly concentrated in the States

of Madras and Bombay, as it was only there that the co-operative banking structure was adequately developed to make effective use of the Bank's credit facilities.

It is difficult to say how far the finance provided by the Bank resulted in a lowering of the rate of interest charged -by co-operatives. An assessment made by the Agricultural Credit Department in a note submitted to the Informal Conference referred to earlier, indicates that in the Bombay and Madras regions, which made most use of Bank's accommodation, the co-operative agencies were able to provide funds at moderate rates to its members. It was stated:

In these two States, the financing banks are able to raise funds at 2 to 3 ½ per cent and the maximum lending rates of the primary societies have been brought down to 6 ¼ -7 ½ per cent. Elsewhere, however, conditions are not satisfactory. In several States such as Uttar Pradesh, Madhya Pradesh, Punjab, West Bengal, Assam, PEPSU, etc., the lending rates of primary societies are as high as 12 ½ per cent and even 15 per cent almost bordering the maximum rates which private moneylenders have been permitted to charge under the law.

Although, in absolute terms, assistance from the Bank was fairly large, it was far too little in relation to the estimated magnitude of overall credit needs of the rural sector. The problem brought out the need for a massive effort on the part of the Bank towards vitalising the co-operative credit structure and considerably widening the scope of its financial assistance. The Bank was poised for a leap forward in this regard towards the end of the period covered by this volume.

It may be appropriate to close this Chapter with the remarks of Shri R. G. Saraiya, an active co-operator and Chairman of the Bombay Provincial Co-operative Bank for over two decades, while presiding over the First Indian Co-operative Congress held at Bombay in February 1952:

A good deal is owing by all of us to the Reserve Bank of India not only for the financial assistance which it gives but also for the assistance and co-operation it gives us in all other directions. For example, I would like you to bear in mind that the Report of the Co-operative Planning Committee of which I had the privilege of being the chairman, would not have been completed but for the assistance which I got from the Reserve Bank of India, particularly from the late Mr. Wajahat Hussain who was then the Deputy Governor. I remember at the last meeting of the Joint Conference of the Registrars held in Bombay (held in rg44), it was the Reserve Bank which produced very useful notes on every subject and it was the real basis on which recommendations of the Planning Committee were made. The same spirit is followed here by the Officers of the Reserve Bank of India and, therefore, I think that although we may ask for more from them, more money, more guidance, more advice, we should not forget that the spirit of co-operation has now completely permeated the Agricultural Credit Department and the Governors of the Reserve Bank of India.

The Bank As An Employer

A chronicle of the Bank's functioning would not be complete without a reference, however brief, to its personnel policies and management. As a central bank, the Bank had special responsibilities as an employer. On the one hand, it had to provide sufficient remuneration and incentives to attract personnel of high calibre, with integrity and ability well above the ordinary; on the other hand, it had to be conscious of the fact that although beyond any fear of shortage of funds it was a public institution, with the need to avoid extravagance and to observe due canons of economy. The Bank had, of course, little need to choose its staff when it opened its doors in April 1935, for much of its establishment was transferred to it from the Imperial Bank and the Government of India. Nevertheless, rules were framed almost immediately for recruitment of suitable personnel as and when the necessity arose.

Jobs in the Bank were much sought after, a special reason for this being the prevailing unemployment among the educated youth, mainly in consequence of the economic depression of the 'thirties. For 'fifty and odd' temporary jobs announced by the Bank's Calcutta Office early in 1935 in connection with the share issue, it was reported that there were ten thousand candidates. Commenting on the scene, the Indian *Finance* said *:

It was not a rain, but a downpour, of applicants. They came from all corners of Calcutta from most mofussil stations of Bengal. The building was chokeful of crowding graduates. The overflow in the street was so heavy that the traffic was held up; and there was a perfect jam. The men who got into the building could not get out; the crowd in the street, who were all the time pressing towards the entrance of the building, were panting and perspiring; and some fainted in the crush, I understand. The officials, who were to make the selection, were nonplussed. Never did any advertisement in Calcutta papers have such

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pulling power. In sheer desperation, the police were rung up; and their assistance requisitioned to clear up the building and the streets.

In the spheres of both recruitment and promotion, the Bank learnt by experience and evolved policies to meet its growing needs. Consistently with its commitment to safeguard the interests of the transferred staff, promotions were made on the basis of the twin criteria of seniority and efficiency; similarly, while making direct recruitment to the higher cadres, a balance was sought to be achieved between the need to obtain highly specialised personnel and the need to offer adequate opportunities for betterment to its existing staff. Strangely, however, in the matter of systematic training of its employees in the different aspects of the Bank's work, little was done for a long time, the only-steps that were taken being those necessary to implement the decision to unify the staff of the Banking and Issue Departments. Even the encouragement given to the staff to pass the Institute of Bankers' examinations was not an original step; the management merely adopted what was the practice of the Imperial Bank. Consequently, there was not much mobility of staff between the different departments, though it must be added that having regard to the rather restricted scope of the Bank's activities in the early years, this was not a handicap to the operational efficiency of the Bank.

In the traditions of a progressive employer, welfare measures such as passage concessions, medical facilities and provision of housing accommodation were also taken, although in some directions the progress was rather slow.

Employer-employee relations in the Bank were, on the whole, cordial. This was conspicuous in the difficult years of the war, when the staff in general had to carry a very heavy load of work. Only once, after the close of the war, was there a threat of precipitate action from the employees, but this was averted by the adroit intervention of the Governor. A machinery for resolving differences by negotiations was then developed. The Bank was equally concerned with devising suitable machinery for settling disputes in the commercial banks; it was consulted by the-Government in connection with industrial legislation governing the settlement of such disputes.

With the increase in the activities of the Bank the strength of the different classes of staff grew steadily. The following table shows the increase in the number employed between 1936 and 1951:

| Year | Officers (including Treasurers) | Superintendents (including Deputy and Assistant Treasurers) | Assistants, Clerks, Coin/Note Examiners | Subordinate staff | Total |
|-----------|---------------------------------------|---|--|----------------------|-------|
| June 1936 | 51 | 120 | 1,568 | 715 | 2,454 |
| June 1951 | 184 | 469 | 4,006 | 1,564 | 6,223 |

Until the mid-sixties no systematic efforts were made to develop a specialised Personnel Department in the Central Office. For nearly thirty years since the Bank's inception, personnel problems were handled by the Chief Accountant's Office, which also dealt with general administration, the Bank's accounts and currency work. In regard to the branches a beginning was made in the late 'fifties by the appointment of Personnel Officers to attend to staff matters exclusively.

RECRUITMENT, TRAINING AND PROMOTION

The Bank's initial requirements of staff were met by taking over from the Government and the Imperial Bank of India the staff engaged in the discharge of functions transferred to it. The senior staff required was taken from the Government or the Imperial Bank, initially on a temporary basis. The majority of the junior staff came from the Currency Offices and the Audit and Accounts Department of the Government and the Public Debt Offices and Government Accounts Departments of the Imperial Bank; they were taken over, as far as possible, on a permanent basis. The transferred staffs were assured of their existing pay and conditions of service. It was the Bank's intention to form as soon as possible its own cadres through recruitment of its permanent staff and fixation of their pay and other conditions of service.

Classification of Staff

The transferred staff retained the respective gradations which were applicable to them before they came over. Such gradations were many and complex, this being particularly so in the case of those transferred from the Imperial Bank, where there were several grades of Clerks and the position differed from 'circle' to 'circle'. But gradually they were absorbed into the permanent cadres of the Bank's staff, who were originally classified as 'A'-Officers, 'B'-Assistants and clerical staff, 'C'-Treasurers and their staff and 'D'-Subordinate staff. In

1946, the cadre of 'Assistants' was substituted by that of 'Superintendents'. In 1946, when a comprehensive revision of pay scales took place, the staff belonging to the different categories were reclassified as 'A'-Officers, 'B'-Staff-General Department, 'C'-Staff-Cash Department and 'D'-Staff-Subordinate. A new grouping of staff was introduced in the year 1948 as under:

Class I - Officers

Class II - Staff Assistants, Superintendents, Deputy and Assistant Treasurers and other employees on grades the starting pay of which exceeded Rs. 200 per mensem

Class III - Clerical and Cash Department staff not included in
Class II

Class IV - Subordinate staff

Following the arrangement in vogue in the Imperial Bank and in the Currency Department, the clerical class was divided into two grades, namely, (i) those who performed routine work (Routine Clerks) and (ii) those whose work was of a more responsible character (Senior Clerks). This nomenclature was changed in 1946 to Clerks Grade II and Clerks Grade I, respectively.

Recruitment Policy

The services of Officers, who were initially taken in the Bank's service on temporary deputation, were retained on that basis for some time. The general principle followed was to replace them with the Bank's own permanent staff as rapidly as was consistent with the efficient working of the Bank. At the inception, the Governor felt that for some time the Bank should recruit Officers with special qualifications on separate contracts, or borrow them from other services, their terms of appointment being fixed according to their qualifications. The Governor also considered it necessary to 'provide from the start for a reasonable proportion of European officers'. To this end, he thought that it might be desirable to offer some of the European Officers, whose services were lent temporarily on deputation from the Imperial Bank, permanent positions in the Bank on suitable terms.

Except in the case of recruits of European domicile, or Officers appointed on special contracts for duties of an exceptional nature, the Officers' cadre of the Bank was to be ordinarily filled by recruits promoted from the Superintendents' grade, the latter being filled by promotion from the clerical grades. The object of this policy was twofold: first, to ensure that before promotion Officers had gone through the mill and become properly acquainted with the actual routine of the various departments of the Bank, and secondly, to stimulate efficiency in the clerical grades by affording the prospect of promotion to those who proved themselves capable of shouldering higher responsibilities.

The stages in the evolution of recruitment policy and practice are detailed in the following paragraphs.

Clerical Grades

Under the general promotion policy mentioned above, considerable importance was attached to the method of recruitment at the clerical level. An elaborate procedure of advertisement, test and interview for

preparation of an annual waiting list of suitable qualified candidates was prescribed as early as May 1935. Also, the Managers were made personally responsible for all such recruitment.* While no minimum qualifications were prescribed for entrants to classes 'C' and 'D', candidates for appointment to the lowest cadre in class 'B', i.e., those to be taken up in the clerical grade, were required to be at least matriculates of an Indian University. The maximum age limit for appointment was 22 years for undergraduates and 25 years for graduates. A *minimum* age requirement, at 18 years, was fixed later for all classes, in November 1940. The upper age limit for appointment was frequently relaxed, when qualified candidates were not available. Fresh recruits were normally appointed at the lowest pay in the scale, but in exceptional cases an appointing officer could recommend the grant of up to four initial increments. No minimum qualifications or age limits were prescribed for recruits to class 'A' as appointments in that class were ordinarily made by promotion from class 'B'.

At Bombay, the recruitment of Clerks for the Bombay Office, the Central or Chief Accountant's Office and the specialised departments (viz., the Agricultural Credit Department, the Department of Banking Operations and the Department of Research and Statistics), which was undertaken separately by the respective departments/offices themselves, was centralised in July 1947 when a Central Recruitment Board was set up in the Central Office. The Board, which did not include any outside member, consisted of the Chief Accountant, the Bombay Manager and any other 'Officer who might be co-opted as a member when recruitment of persons with special knowledge or experience was made. The Personnel Relations Officer was its ex-officio Secretary. The Board was also made responsible for the preliminary selection of candidates for posts which required advertisement on an all-India basis and selection by a higher authority.

During the period of World War II, the Bank experienced difficulties in recruiting persons of good academic qualifications as Routine Clerks. In departments like the Agricultural Credit Department, where the majority of clerical staff had to be graduates, preferably in Economics, there were many cases of resignations. Reviewing the situation in June 1942, the Governor (Sir James Taylor) felt that the Bank's scales of pay for the clerical posts were not sufficient for the better sort of graduates and candidates with other special qualifications, being incapable of either attracting new recruits in sufficient numbers or keeping them contented after they were recruited. The system of recruiting graduates as Routine Clerks also suffered from the drawback that better qualified men were required to go through long periods of mechanical work

* From August 1951, the Chief Accountant was associated with the final interview of candidates found to be successful in the written tests.

which provided little opportunity for testing their ability to undertake duties of a higher responsibility.

The Bank's scales of pay were framed at a time when it had to take its staff as it found them; they applied, moreover, to only a section of its heterogeneous staff. In the initial stages, promotions were fairly quick owing to the rapid expansion of the Bank's activities, but as things stabilised, the pace slowed down. Having visualised, in the light of some years of experience, the place of graduates in recruitment and promotion, it was considered necessary to give special encouragement to this section of the staff. The Governor, therefore, proposed to use his powers to grant advance initial increments more liberally to candidates with 'specially impressive academic qualifications'. Under this scheme, advance increments were sanctioned to double graduates and graduates who had passed in the second or a higher class, at the time of their recruitment as Clerks. Later on, the scheme was extended to cover also the members of the clerical staff who had either qualified earlier or acquired the qualification after joining the Bank's service.

The policy for grant of advance increments to graduates was revised in November 1946, by the removal of the distinction between pass class graduates and higher class graduates. Simultaneously, however, the Managers were advised that recruitment of staff should be more selective in the future, and every attempt made to get candidates of the highest calibre available. Also, they were to maintain 'a reasonable balance' between the proportion of graduate and undergraduate Clerks. After 1948, the benefit of the scheme of advance increments was extended also to the Cash Department staff.

Mention may be made here of an arrangement introduced in Calcutta as an emergency war-time measure, some time prior to 1942, for the recruitment of clerical staff. Under this, the Calcutta University Appointments and Information Board sorted out the applications (received in response to the Bank's advertisements), selected candidates for the tests, conducted the examinations and recommended a panel of names to the Manager who made the final selection after interviewing the candidates. The arrangement was discontinued in August 1951.

As the activities of the Bank, particularly in fields such as the provision of advice on matters of agricultural credit, expanded, the existing man-power in the clerical class proved qualitatively inadequate. The Agricultural Credit Department was also expected to serve as a training ground for executive appointments in the Bank so that in course of time an Officers' cadre with a good knowledge of central banking could be built up. In view of all this, a cadre, intermediate between that of a Senior Clerk and that of a Superintendent, designated as 'Research Assistants', was created in April 1939. The posts were

filled, either by promotion of the Senior Clerks who were in charge of the type of work for which the posts were being created and who had given evidence of possessing the required degree of ability and special knowledge, or by recruiting promising candidates from outside.

After the Agricultural Credit Department was reorganised into three departments in 1945, corresponding grades of Banking Assistants in the Department of Banking Operations and Economic and Statistical Assistants in the Department of Research and Statistics were created. Two years later, i.e., in the middle of 1947, a parallel cadre was created in the Bank's Central Office also; this grade was designated as 'Assistants - Central Office'.

The Assistants' cadre in the Bank was more or less comparable with that of their confreres in the Government, whose work was described by the First Pay Commission in these words: 'to note on cases, put up precedents and present an intelligent appreciation of facts for the orders of a superior officer'.

Cash Department Staff

The Bank had to devise special safeguards with regard to the day-to-day handling of its cash balances and their custody. The Cash Department at each office was in charge of a Treasurer; the Treasurers were required to furnish guarantee by way of cash and Government securities and were responsible to the Bank for any loss caused to it by the dishonesty or negligence of their subordinates. In the case of the latter staff, those transferred from the Imperial Bank or the Government had to give security comparable to what they were required to furnish earlier, by way of a fidelity insurance or contribution to a Guarantee Fund.

The Bank instituted a Co-operative Guarantee Fund on October 1, 1935; employees were to make graded half-yearly contributions to the Fund which accepted liability for losses occasioned by the guaranteed staff to the extent of the amounts for which they were guaranteed. All the Cash Department staff and those in classes 'A' and 'B' drawing more than a specified salary were to contribute to the Fund. On termination of their service with the Bank, or on transfer to appointments for which security was not required, guaranteed employees were eligible to receive a bonus from the Fund on the basis of a prescribed formula. Transferred employees were given the option either to retain their former conditions of service regarding the furnishing of security or to relinquish them and agree to be bound by the provisions of the Bank's Guarantee Fund.

In April 1936, it was considered whether the Treasurers should themselves be allowed to take guarantees from the staff under them in view

of their personal responsibility for losses but it was decided against adopting the proposal. In view of this special overriding responsibility, recruitment to class 'C', that is to say, the Treasurers' staff, was made by the Managers on the basis of nominations made by the Treasurers, care being taken to see that the field of recruitment did not thereby become unduly narrow. The chief qualification for appointment to a post in the Treasurer's Department was a sound financial position and a good character and not possession of good academic qualifications. Even the age limits fixed for recruitment of Clerks were not strictly observed for appointment of the Shroffs and Note Examiners.* As suitable personnel were more easily available with the end of the war, and in view of the improvement of the pay scales in the Bank in 1946, the minimum educational standards and age limits fixed for recruitment of clerical staff were made applicable to appointment of the Treasurers' staff also, in February 1947.

Officers

In the matter of recruitment of Officers the story is, throughout, one of efforts to get the best persons possible to fill this cadre. It cannot, however, be said that there was a conscious policy from the very early years enumerating the principles to be followed for appointment to this class. The number of Officers in the Bank (including the Treasurers) rose from 51 in 1936 to 82 in 1945; the figure more than doubled during the next quinquennium. From time to time reviews were undertaken to assess the requirements of the next few years and *ad hoc* steps were taken to meet them. Generally the Officers' posts were filled by promotion of suitable persons from the Superintendents' class, but this was augmented by direct recruitment of well-qualified and experienced personnel from outside. There was also direct recruitment of persons in a somewhat lower cadre for being given all-round training with the object of eventual appointment as Officers. When the needs were emergent, as when exchange control was introduced on the outbreak of the war and there was an acute problem of finding an adequate number of men conversant in foreign exchange banking, they had to be met by drawing temporarily on Government or other banks.

It was mentioned earlier that the Bank's initial requirements of Officers were met by the temporary deputation of Officers from the Government of India and the Imperial Bank on special terms arranged with reference to the terms and conditions of their own permanent services. The recruitment of Officers to form a permanent cadre in the Bank was to take place gradually as the needs became clearer. In

* In 1946, with the comprehensive revision of pay scales, the two grades were merged under a new nomenclature Coin/Note Examiners.

August 1936, when a review was made after allowing for the European recruitment effected by transfer from the Imperial Bank, it was decided to fill ten posts permanently, consistently with the need to avoid a block in the Officers' cadre and to maintain efficiency: five were to be filled by promotion from the Superintendents' cadre and five by direct recruitment. The new recruits were to be taken up as Clerks (with the initial advance increments permissible) and put through their paces under an intensive scheme of training before being appointed as Officers. The Deputy Governor, Sir Sikander Hyat-Khan, outlined their programme of work thus:

they should be appointed to the junior clerical grade in the first instance and required to work as clerks for the first twelve months and as junior superintendents for another year. Thereafter, subject to their receiving satisfactory reports, they will be promoted to Class A as probationers. They will also be required to work as Senior Superintendents for a period of at least 12 months before being confirmed in Class A, and for such further period after confirmation as the Governor may consider necessary, before they are entrusted with the duties of an officer. In addition it will be compulsory for these recruits to pass the examination of the Institute of Bankers within a period of 4 years from the date of their initial appointment. If they fail to pass Part I of the examination within two years their increments will be stopped, and if they fail to complete Parts I and II within 4 years they will be liable to be discharged. These recruits will eventually replace the Imperial Bank staff temporarily lent to the Bank.

In addition, an Officer was directly recruited for the Agricultural Credit Department in the middle of 1936 by selection through advertisement, for undertaking tours and relieving the Officer-in-Charge of the more routine duties. Mention may also be made here of the *first* direct appointment (i.e., not on deputation from the Imperial Bank) of an Indian Officer in the Bank a little earlier, viz., in January 1936. Mr. T. K. Ramasubramaniam, an employee of Lloyds Bank Ltd., was taken up as a special case, because of the shortage of trained Officers in the Bank and the inability of the Imperial Bank to spare any further Officers for transfer to the Bank.

In September 1937, another review was made of the prospective requirements of Officers in the next few years. The review revealed that the Bank was soon likely to experience a shortage of Officers, owing to retirements, etc. The most satisfactory way of providing for future requirements, Sir James Taylor felt, would be to recruit as probationers every year one or two men with very good educational qualifications as well as social standing with a definite assurance to them at the outset that if they shaped well, they would be placed as Officers on probation after a period of three years' intensive training in the Bank. With this aim, on September 20, 1937, the Bank advertised

in newspapers of all-India circulation for the posts of Probationary Assistants. From a very large number of applications received, the Bank selected its first two Probationary Assistants, Messrs Loqman Haider and D. N. Maluste. As appointments in this manner were not covered by the existing rules, the Committee's approval, in principle, to the scheme was obtained in December 1937.

At the same time, not to overlook the claims of promising members of its own supervisory staff, a number of such employees were promoted as Officers in the various departments of the Bank, on the strength of reports from the Managers.

The scheme of recruiting Probationary Assistants caused apprehension among the staff: it was urged that while direct recruitment might be resorted to to fill posts involving work which was essentially of a technical character, in other cases, it was likely to affect the staff morale adversely and impair their efficiency. The Bank clarified that though it reserved the right to recruit the necessary staff, it had no intention of ignoring the claims of the existing employees, and that it would strive to restrict direct recruitment to the absolute minimum.

More than three years went by before another assessment of the Bank's requirements of Officers on a long range view was attempted. It was found that having worked on a very fine margin all along, the Bank had not built up any reserve of Officers at all against leave, retirement or casualties, not to speak of future expansion or even meeting the demands of the war. The general accent on seniority in the case of promotions from the Superintendents' class to the Officers' class also created difficulties as many of the transferred staff were, in view of their age and background, immobile and not adaptable to new types of work. It was therefore decided in December 1940 that an adequate reserve should be created from amongst the younger and brighter set of Superintendents so that systematic arrangements might be made to train staff *in advance* of actual requirements. The scheme proposed that a small number of Senior and Junior Superintendents* who were likely to fit themselves for early promotion to class 'A' should be taken away from their normal duties and given intensive training in all the departments of the Bank for periods ranging from one to three years according to their ability and previous experience. Promotions would be made from this reserve as necessity arose. To be eligible for selection for such special training, the Superintendents had to be graduates and had to have passed at least Part I of the examination of the Indian or English Institute of Bankers. The selection was to be made from amongst those recommended by the Managers of the offices, having regard to their all-round efficiency and ability. The first selection under the scheme was made in March 1941; further selections were

* These were two separate grades until 1946.

made in 1942, 1945, 1947 and 1949. The selections were confined to those who were not above the age of 40 and had worked as Superintendent for at least two years.

Recruitment of Probationary /Staff Assistants -Scheme of 1944

The next major review of the policy of recruitment of Officers was made in January 1944 by Governor Deshmukh. The war, and particularly Japan's entry into it, had further accentuated the need for experienced Officers. Obtaining Officers from other banks, including the Imperial Bank, or from the Government even on temporary transfer was out of the question, except in cases of extreme emergency. The experiment made in 1935 and 1936 under the scheme of recruiting men with special qualifications as Clerks with advance increments and testing them for promotion to class 'A' was not a success and was therefore abandoned. As for the 1937 scheme, no recruitment of probationers had been made after the first two appointments and it was considered to have lapsed. Direct recruitment to the Officer class was also ruled out, except where it was required to meet emergent conditions or to fill posts calling for specialised training and experience.

Taking stock of the situation, the Governor felt that the future policy for filling posts of Officers should be such as would 'ensure not only that a sufficient' number of Officers of the right type are always available to handle our normal out-turn of work but also that a provision exists for any possible expansion which may have to be undertaken during the period of transition from war to peace, and in the post-war period, when, to keep in touch with the greatly extended banking system of the country, we shall have to consider opening branches at provincial headquarters where we are not represented '. For this purpose he considered it necessary to fix definite proportions of posts to be filled by the only two means available, viz., (a) by men of high educational qualifications, good social standing and ability, to be recruited specially for ultimate service as Officers, and (b) by giving accelerated promotion to particularly suitable employees already in the Bank's service.

In this context, it had also to be considered that while prior to the war young men of education and good family were prepared to enter the Bank at the bottom of the ladder, war conditions had created more lucrative openings elsewhere and persons of the standards required were no longer coming forward to join its clerical grades. However, as the majority of the Officers' posts were for discharge of work of a routine nature in the Issue and Banking Departments for which a grasp of procedural details, solidity, and trustworthiness were more important than academic brilliance, the Governor felt that the greater

number of vacancies arising in the future should be filled from the Superintendents' class. Accordingly, he laid down a ratio of two to one for promoted members of the staff and directly recruited staff, respectively, for filling every three vacancies arising in the Officers' cadre. As regards direct recruitment, the Governor considered that the most suitable course was to create a separate cadre of Assistants on the lines then obtaining in the Imperial Bank of India, and to fill the prescribed proportion of vacancies in the Officers' cadre from amongst the Assistants. All appointments of Assistants were to be made by selection through advertisement and the Bank's staff with the necessary qualifications were to be allowed to compete with the outside candidates.

The Central Board approved the scheme in February 1944. Detailed rules embodying the terms and conditions of service of the Assistants, entitled the Reserve Bank of India Staff (Assistants) Rules, 1944, were then drawn up; these rules were later incorporated in the Staff Regulations. The selection of candidates for appointment as Assistants was to be made by the Committee of the Central Board, from out of a panel of candidates considered suitable by the Governor. Director Mr. C. R. Srinivasan held that this procedure amounted to 'a denial of opportunity of service on the selection Board to Directors representing other circles' owing to the fact that the Committee met in Bombay for the greater part of the year. He offered two alternative suggestions -the constitution of an *ad hoc* Committee of the Central Board periodically to deal with matters of recruitment and service or of a Committee comprising the Presidents of the Local Boards. Although the Governor did not think that any change in the procedure was called for, the matter came up informally at the next Board meeting on April 17, 1944, when it was decided that the Committee of the Central Board should, for the purpose of selection, co-opt the President or in his absence the Vice-President of each of the Local Boards, if not already on the Committee. The arrangement of holding these special Committee meetings, which led to considerable delays in recruitment, was abandoned in April 1950, the selections thereafter being made by the Governor on the advice of the Deputy Governors, subject to confirmation by the Committee of the Central Board at its usual weekly meetings.

The first batch of Assistants was recruited entirely from amongst the staff, in December 1944. The staff recruited to this cadre were known as Probationary Assistants during the period of their probation, which was ordinarily three years. On the satisfactory completion of their probation, they were confirmed as Staff Assistants. The Probationary Assistants were given every facility to learn the work of the different sections and to prove their fitness in the service.

In accordance with the policy approved by the Board in February 1944, it was ensured that a very large percentage of higher appointments went to the staff who had entered the Bank's service in the lower grades and by dint of their merit and industry had worked their way up.

In 1945, when two new Departments were created, it gave rise to special staffing problems. Direct recruitment of Officers had to be resorted to on a fairly large scale to provide the Department of Research and Statistics with personnel possessing specialised knowledge and experience. The requirements of staff of the Department of Banking Operations also necessitated the recruitment of Officers directly from outside from among those experienced in co-operative or commercial banking. The various banking enactments threw a heavy responsibility and a large volume of work on the Reserve Bank, particularly in the domain of bank inspections. An examination of the inspecting staff requirements revealed that more supervisory than clerical staff were required. In order to reduce the cost of inspections it was proposed to employ Staff Assistants, who would in due course take the place of the inspecting Officers, and in the meantime assist the Officers in the inspection of branches and in writing the reports. The staff required for the inspections had to be recruited and trained. Apart from those appointed from the existing staff by normal promotion or those selected for their special qualifications, there was recruitment by advertisement, the eligible members of the staff being allowed to compete with the outside candidates.

Superintendents' Cadre

Placed between the Officers and the Clerks or Assistants, the Superintendents formed an important part of the Bank's establishment. Promotions to this class presented some difficulty in the initial years owing to the need to safeguard the interests of the transferred staff without compromising the efficiency of the cadre. The question had to be viewed by the Bank as one of balancing in a fair manner the claims of the transferred staff and those of Clerks directly recruited. The policy adopted was to permit transferred employees with good or even fair reports to have their normal promotion whilst, at the same time, giving such encouragement as was possible to direct recruits in the clerical cadre possessing outstanding qualifications. The Bank's view throughout was that too high a premium should not be placed on seniority and that efficiency and merit (not necessarily accompanied by high academic qualifications) should be the paramount considerations insofar as appointments to the Superintendents' grade were concerned.

Besides, the Bank had to look several years ahead in respect of its requirement of Officers, taking into account retirement and the growth of the Bank's operations. For the purpose of meeting a likely dearth of Officers in the Issue Department, arrangements were initially made to provide a few promising young Superintendents from the Banking side opportunities for being trained in the Issue Department procedure so as to be available later on as Officers, if necessity arose. Later, the Issue Department personnel were also given training in the Banking Department, with the same object in view.

Staff below the Clerical Level

Appointments of the class 'D' staff (such as Peons, Durwans, Coolies and Sweepers) were made by the Managers as occasions arose. Certain minimum qualifications for recruitment were specified in 1942, when the pay and allowances admissible to these categories of staff were raised. To assist members of the subordinate staff to compete with other applicants, for promotions to class 'B' or class 'C', the Bank waived the upper age limits prescribed for these posts; the number of promotions from class 'D' to a higher class was, however, insignificant.

Communal Representation

In pre-Independence days, much importance was attached to securing a balanced representation of the many communities in India on the Bank's staff. At the very inception of the Bank, it was laid down that the appointing officers should 'pay particular attention to the necessity of preventing the members of any one family or community from assuming an unduly predominant numerical position'. The former object was achieved by requiring each applicant to state whether he had any relative in the service of the Bank and leaving it to the discretion of the appointing officers to see that appointments were not made in such a way as to result in the creation of family cliques. However, in the case of the Treasurers' subordinates, this restriction was not imposed; in view of the Treasurers' overriding responsibility for losses, it was considered advantageous to have close ties amongst the staff, provided that the element of kinship was not so preponderant as to imperil the control of the executive.

In considering the allied question whether, in making recruitment, any preference should be shown to the sons and dependents of the Bank's employees, the Bank had to reconcile the genuine desire of the staff to see their children or dependents provided for by the Bank with the risk of deterioration in the quality of the staff recruited, owing to

a narrowing of the field of selection, and the possibility of undue influence being exerted by some employees. The view taken was that the Bank should not ordinarily recognise such claims. It was, however, felt that after the retirement of an employee, or in the event of his death, one of the members of the family on whom the family burden had come to rest might be given appointment, other things being equal, that is to say, provided he had the requisite qualifications. Such special cases were considered sympathetically, on their merits.

As for the communal principle, the objective was that, as far as possible, no single community formed more than two-thirds of the personnel in class 'B' at any one place. The time for rectifying any communal disproportion in the cadre of a particular office was when fresh staff were being recruited; however, staff once taken into the Bank's employment, either permanently or temporarily, in accordance with the prescribed procedure, were not to be penalised for the sake of adjusting communal representation. Until the desired proportion was secured, not less than 50 per cent of the new appointments were required to be distributed among the members of the other communities. Thereafter, the proportion was to be at least one in three. For appointments to classes 'A', 'C' and 'D', no such fixed proportions were prescribed, but the principles indicated for class 'B' were required to be followed as closely as circumstances would admit. In making nominations for appointments to class 'C', the Treasurer was not put under any restriction in view of his special responsibilities.

Among the Officers, the majority of whom had been taken over from the Government and the Imperial Bank of India, there was naturally a 'marked communal disparity' in the beginning. In this situation, the five posts of Officers proposed to be filled in 1936 by direct recruitment of suitable persons at the clerical level were decided to be distributed, subject to availability, among Muslims (2), Sikhs (1), Parsees (1) and Hindus (1). It was felt that this was 'the best that can be done in the circumstances and a fairly satisfactory beginning'.

The stress on securing a communal proportion was subject to the candidates being otherwise well qualified. In view of this, the proportions envisaged could not always be maintained in respect of all communities. Efforts were, however, made from time to time to secure a reasonable balance. In furtherance of this policy, the Bank made a special selection, in December 1945, of Probationary Assistants from out of candidates coming from the minority communities.

The Bank's policy regarding the recruitment of minorities, especially Muslims, on its staff was the subject of some comment in the press. The Finance Ministry as well as the Bank's Directors also received representations occasionally from communal organizations alleging

inadequate recruitment by the Bank from the communities whose interests they sought to promote. An exhaustive review of the steps taken to increase the proportion of minorities in the Bank's service, aimed at apprising the Directors and the Ministry of Finance of the correct position, was undertaken in February 1947. The review revealed that between 1935 and 1947, the percentage of Muslims in the Bank's service had increased from nil to 12 in class 'A', from 1.9 to 9 in the Superintendents' cadre, from 5.6 to 15.2 in the clerical category and from 16.2 to 18.7 in class 'D'. Stipulations regarding age limits were freely waived in the case of candidates belonging to the minority communities; high educational qualifications were also not insisted upon. Further, wide publicity to the Bank's advertisements was given by issuing them in important vernacular newspapers and also circulating them to the Muslim Chambers of Commerce and other institutions seeking to further Muslim interests. Again, Muslim institutions such as the Muslim Rights Protection Board, Lahore, were requested to assist in forwarding applications to the Bank from suitable candidates whom they came across; the response from these bodies was, however, very poor. The supersession of Muslim employees could not be ordered by branch Managers without the prior approval of Central Office.

With the partition of the country and the establishment of a Government committed to secularism, the emphasis gradually shifted to meeting the special needs of the economically and socially backward classes, i.e., the Scheduled Castes and the Scheduled Tribes. Various concessions in the matter of age, educational qualifications, application fees, priority in appointment, etc., were extended to members of these communities in line with Government's policy to encourage their appointment.

From time to time, relaxations of the age limits were allowed or preference for appointment shown to certain categories of applicants, depending on the nature of the handicaps from which they suffered; among these classes of candidates were ex-service personnel, refugees from Pakistan, those who took part in the national movements and retrenched bank employees.

As regards the European element in the Bank's staff, particularly in the higher cadres, besides the efforts to secure some Officers from the Imperial Bank, direct recruitment from the U.K. was also thought of; a provision for an overseas pay was also made for such Officers. However, there were in fact very few European recruits other than those who originally came from the Imperial Bank. This was mainly due to the efforts of Deputy Governor Nanavati who wanted the maximum opportunities to be given to Indians. In the matter of staff, he stood for Indianisation as much as in the buying of India-made articles. In

this connection, it is of interest to know that when the office raised objection to the buying of Indian made clocks on the ground that they stopped working frequently, Mr. Nanavati remarked that it did not matter even if all the clocks in the Bank came to a standstill!

There were hardly any women on the Bank's rolls in the early years, the few who joined being mainly telephone operators. The first ladies to be taken up for clerical work joined in the early forties, and the first to be recruited directly as an Officer (Miss Dharma Venkataraman) joined in March 1949. Gradually, the number increased, particularly in the Department of Research and Statistics, where many were recruited for the tabulation of statistical data. Nevertheless, women formed less than 8 per cent of the total staff in January 1968.

Mobility and Training of Staff

For well over two decades of the Bank's existence, except for the efforts made to train the staff of the Issue and Banking Departments in the work of both, with a view to unifying the two Departments, strangely enough, little was done in the direction of a systematic training of the newly recruited staff in the Bank's procedures and policies, although much emphasis was placed on the recruitment of men with a good academic background. Also, there was comparatively little mobility of staff; but this was necessarily so, in view of the nature of work in these departments being totally different from that in the Agricultural Credit Department. There was, however, a freer movement between the different departments, at the higher administrative levels.

As the range of the Bank's activities widened and there was increasing specialisation in the work done in the different departments, there were modifications in the groupings of staff with a view to securing that employees with special experience or qualifications suited to particular types of work were retained in departments where the work called for such knowledge or skills. After the Agricultural Credit Department was reorganised in August 1945, the staff of the Department of Research and Statistics and the Agricultural Credit Department were constituted as a separate group for the purpose of promotion at all levels as they held high academic qualifications and were recruited for specialised work. However, this did not preclude the Bank from transferring staff on the general list (which comprised the Issue, Banking and Exchange Control Departments, the Central Office and the Department of Banking Operations) to the new group or vice versa, if this was considered necessary in the Bank's interests. Effective April 1, 1951, the groupings were revised so as to constitute the Department of Banking Operations, the Agricultural Credit Department and the new Department of Banking Development into one unit,

while the Department of Research and Statistics and the other general departments remained as two separate units. The Agricultural Credit Department was formed into a separate group in April 1957.

The unification of the Issue and Banking cadres may now be referred to. The Issue Department of the Bank formed mainly out of the Currency Office staff, and the Banking Department constituted from staff belonging to the Public Debt Offices and the Government Accounts Departments of the Imperial Bank, functioned originally as separate units. This was also convenient, since the Departments were mostly housed at different places at each centre. This arrangement was, however, only temporary, the intention being that when the Bank had constructed its own buildings and the Banking and Issue Departments were housed under the same roof, their staff should also be amalgamated.

As mentioned already, early in 1938 a start was made in the direction of providing a nucleus of supervisory staff trained in the requirements of both the Departments; some of the staff from the Banking side were posted for training on the supervisory desks of the Issue Department. A few months later, as the Bank's buildings at Bombay and Rangoon were nearing completion, it was considered desirable to arrange for reciprocal transfers of staff between the two Departments. It was therefore decided that suitable employees who had two years' experience in either Department and, preferably, had passed Part I of the Institute of Bankers' examination should be posted to the other Department with a view to acquiring a working knowledge of its procedure. The training was also extended to those not satisfying these requirements, but who showed good ability and an aptitude for learning new work.

The inter-departmental training scheme did not for obvious reasons cover the staff working under the Treasurer. But academically well-qualified and promising employees were transferred to the non-cash side of the Issue or Banking Department with the approval of the Chief Accountant. These transfers were however very few.

It was years later, that is, in 1950, that steps were taken to combine the seniority of the Clerks Grade II attached to the Banking and Issue Departments at each centre, as a prelude to the maintenance of a combined seniority for all the cadres of these two Departments. With a view to equalising opportunities for promotion to the staff of both the Departments, and in view of the inter-departmental training already in vogue, the Bank acceded to the request of the Employees' Association made at the conciliation meeting held in October 1949 and introduced a common seniority at the lowest level, to begin with.

Following the practice in the Imperial Bank and other leading commercial banks, the Bank formulated a scheme in June 1936 to

encourage its non-officer staff to appear for the Institute of Bankers' examinations, by the grant of honoraria for passing such examinations. In 1946, the scheme was liberalised so as to allow an option to the non-officer staff either to prefer the honorarium or to get special increments, the latter being admissible only if the examinations were completed within a specified period. A library containing books on banking and kindred subjects was gradually built up in each office for the use of the staff to enable them to prepare for these examinations. Greater importance was attached to the passing of these examinations only long afterwards, by making promotion from the clerical to the higher grades conditional on the employees qualifying in these examinations; effective September 1, 1953, no employee was eligible for appointment as a Superintendent unless he had completed Part I, and no employee could be confirmed in such a post unless he had completed Part II also of these examinations. From then onwards, Probationary Assistants were also required to pass these examinations before their confirmation as Staff Assistants, whereas in the earlier years, they were ineligible for promotion to the Officers' grade until they had completed the two parts.

GENERAL CONDITIONS OF SERVICE

The terms and conditions of service governing the directly recruited staff of the Bank were embodied in rules called the Reserve *Bank of India Staff Regulations*, which were non-statutory. These Regulations were prepared on the basis that they should be confined to the more general conditions of service and that the actual pay scales and allowances, the numbers of the cadres, etc., should be relegated to appendices, the Central Board taking power to itself to modify these from time to time. The Regulations were based largely on Government rules. The first Staff Regulations came into effect on November 1, 1935. They were revised on a comprehensive basis in 1936. In August 1943, certain urgent amendments were carried out, pending a general revision to be undertaken after the war. The provisions of the Regulations were also supplemented and clarified by the issue of Staff Rulings from time to time. When the entire pay and allowances structure of the staff was revised, first in 1946, and later again in 1948, resulting in their liberalisation to a considerable extent, opportunity was taken to bring all the employees in the Bank, i.e., both the transferred staff and the direct recruits, under one set of service rules in order to simplify establishment administration, though option was given to the existing staff to continue to be covered by the old Regulations, including the pay scales. The new Regulations came into force on December 1, 1948.

Discipline

Service in the Bank called for high standards of integrity and faithfulness from its employees. The service rules drawn up in 1935 therefore prescribed a detailed code of conduct for observance by them. The Officer staff had to serve the Bank at any place and in any capacity as they might from time to time be directed, but other employees were not ordinarily liable for transfer. The strictest secrecy was to be maintained regarding the Bank's affairs and the affairs of its constituents; to this end, a Declaration of Secrecy to be furnished by all employees was added to the Staff Regulations in 1938. The rules exhorted the employees to 'use their utmost endeavors to promote the interests of the Bank' and to 'show courtesy and attention in all transactions and intercourse with the officers of Government and the Bank's constituents'. Active participation in politics or in any political demonstration as also engagement in any commercial business or pursuit or the acting as an agent for an insurance company was prohibited. Speculation in stocks, shares, securities or commodities of any kind was not permissible, nor was any connection with the formation or management of a joint-stock company. Employees in debt were required to disclose the actual position to the Bank and the steps being taken to rectify it; failure to do so or inability to liquidate the debts within a reasonable time rendered them liable to dismissal. Penalties of varying magnitude, the heaviest of which was dismissal, were prescribed for misconduct, negligence or breach of the Bank's regulations; any penalty could, however, be imposed only after the employee was given an opportunity to explain his action and to defend himself. The employees had also a right of appeal against the penalties to an authority higher than the one who imposed them.

When the Staff Regulations were revised in 1948 the provisions, which had proved inadequate and had been found to contain several lacunae, were tightened up on the basis of the Government Service Conduct Rules and other rules issued by the Government and the Imperial Bank of India.

Pay Scales

For the direct recruits, the Bank framed its own scales of pay modelled on the then existing scales under Government for comparable categories of staff. To enable him to place concrete proposals before the Board in this regard, the Governor called for suggestions from the branch Managers in May 1935. In the light of the replies received, the Committee approved a comprehensive set of pay scales at its meeting on September 18, 1935; it also fixed the number of posts in each

class/grade for each office. Two separate grades each for the Clerks (Routine and Senior Clerks) and the Superintendents (Junior and Senior Superintendents) were provided. The scales of pay originally prescribed for the several categories of staff were not the same at all centres, based as they were on living conditions and the emoluments for similar work in other institutions at those places.

The pay scales of certain categories of staff in classes ' C ' and ' D ' were revised by the Bank in August 1936, when some anomalies came to light. With the outbreak of the war, however, complaints began to be received from the employees and the Staff Associations that the Bank's scales of pay did not compare favourably with those obtaining in similar institutions; requests were also received for the grant of a 'dearness' allowance to the low paid employees to compensate them for the increase in the cost of living. A dearness allowance was granted to the staff in May 1941; this is dealt with in detail in another section. A change in the basic scales, however, had to be considered in the light of permanent factors. The matter was, therefore, examined in consultation with the Managers of all the offices. After considering the local conditions, the changes that had taken place in the organisation of the Bank since its inception, and the Managers' views, the pay scales of the staff below the clerical level were revised upwards in January 1942.

While making this revision, the Bank kept in view several points, namely, the pay scales allowed in other banks and Government offices to employees of the same category, the fact that it paid to its ' D ' class employees a bonus equal to one month's pay for each completed year of service when their services were determined, and also the advantage which the Reserve Bank employees had by way of regular rules of service.

The principal changes effected were the substitution of incremental scales for fixed pay, wherever it existed, *subject to efficiency*, and a reduction, in many cases, in the intervals at which increments could be drawn. The Managers were advised that in view of the higher salaries payable thereafter, it was desirable that there should also be a corresponding improvement in the level of efficiency of the subordinate staff. They were asked to make a special effort to ensure recruitment of the right type of staff possessing certain minimum qualifications; thus, a candidate selected for appointment as a Peon was required to 'be literate in the local vernacular, be able to take down verbal and telephone messages intelligently and be able to ride a bicycle' and 'be able to read English sufficiently to know to whom files, letters, etc., are addressed '. Increments were not to be granted as a matter of course, but 'should be made dependent on approved service and continued efficiency '.

Pay Revision after the War

The close of the war brought fresh demands from the Bank's employees for a comprehensive revision of the pay and allowances structure and in the context of the inflationary situation, the Bank recognised the need for an early and suitable improvement in the pay scales. However, in considering this question, it was first necessary to have some definite basis for determining what the cost of living would be in the immediate future years and where it was likely to settle down. At the informal meeting between the Governor and the representatives of the Employees' Association, Bombay, which preceded the Conciliation Conference * in June 1946, the Governor indicated the Bank's approach to the problem thus:†

although the Reserve Bank was an independent institution in the peculiar position of being capable of issuing as much of currency as it wanted, any grant by it to its employees should be based on some sort of general levels, and should not in any sense disturb the economic and commercial life of the country to a serious extent. He personally would only be too glad to see established in the country the basic conditions of living of the United Kingdom or the United States of America, but for obvious reasons, the Reserve Bank could not, by itself, create a new heaven on earth, and allow emoluments which had no relation to the economic set-up in which we are working, though he and the Directors were prepared always to view the cause of the staff sympathetically and have already laid down a policy that we should be prepared to give our staff slightly more than what other comparable institutions are prepared to pay, thus giving a lead to a policy of enlightened employment of white collar labour. The question, he said, was not as between the employees and the executive of the Bank or the Board; it was not even between the employees and the shareholders whose share of the dividend was limited by statute. Ultimately, the issue was between the employees and the taxpayer.

The question was not of money in view of the Bank's power to create more currency, but then the very fact that the Bank was in a position to create more money, placed it under a great responsibility to see that the emoluments paid by it were not unrelated to the current economic set-up.

At the Conciliation Conference, it was pointed out on behalf of the employees that the Bank's scales were based on the revised scales of pay introduced by Government in 1931, a year of depression, and since then radical changes had taken place in the conditions of living and of employment, more especially as a result of the repercussions caused by World War II. It was urged that the Bank should provide a decent living wage for its employees to enable them to maintain themselves and their families in a reasonably good condition. A model

* The events that led to the convening of the Conference are narrated later.

†Extract from the report on the meeting.

budget of a Clerk, based on a family of five, as well as a list of pay scales for the various categories of staff, based on that budget, were presented to the Bank for its consideration.

In the Bank's view, a revision of pay scales could not possibly be undertaken on the basis of a model budget as such a budget was not related to the economic wealth and productivity of the country. The Bank's representatives at the Conference felt that the proper method was to proceed by reference to the actual expenditure incurred by the employees and to attempt as far as it was practicable to adjust the war-time emoluments of the employees to the extent necessary to enable them to meet their current budgetary deficits. For this purpose, the Bank had tried to ascertain the budgets of the staff by an inquiry conducted by the Department of Research and Statistics, but the response to the questionnaires issued was very poor. Besides, the compilation of the data collected was expected to take some time, and it was not, in the existing circumstances, possible to await it. The Central Government employees' grievances were to be investigated by a full-fledged commission, viz., the First Pay Commission, but the Bank was denied the benefit of the Commission's views as it had to decide the question considerably in advance of the publication of its report. Since there were no middle class cost of living index figures, and it was not appropriate to base their recommendations on the working class indices, the Bank's representatives proposed to accept the report of an independent economist, namely, Professor J. J. Anjaria of the Bombay University, on an inquiry into the effects of war-time inflation on middle class families in Bombay city as a basis for considering a wage revision. The employees' representatives were not, however, inclined to accept the findings of this report and pointed out several limitations in it.

Considering all the circumstances, the Bank's representatives felt that the most practicable course was to adopt the method that had been followed in Ceylon where the wage system had been the subject of a detailed enquiry and the Government, on the basis of the recommendations of a Salaries Committee, had introduced a new salaries scheme which had assumed a permanent increase in the cost of living to the tune of $33\frac{1}{3}$ per cent above the pre-war level. On their part, the Bank's representatives were prepared to go a little further, at any rate in the case of the low paid employees, and to recommend to the Bank a 50 per cent rise in the basic starting salary of a Routine Clerk. They were also agreeable to recommend a higher rate of increment so that the employees might be able to reach the top of their grades at a much quicker pace than what was possible hitherto.

The Conciliation Conference resulted in an amicable settlement of the issues relating to the pay scales of the staff in classes 'B', 'C' and

‘ D’ and other items. The new scales were given effect to retrospectively from April 1, 1946, after they were approved by the Central Board at its meeting held on July 20, 1946.

Simultaneously, the pay scales of the Bank’s Officers and Treasurers were also revised. The Government Director on the Central Board felt that the revision of the Officers’ pay scales should be held over until the report of the Pay Commission was issued but that some adjustment in their dearness allowance might be made in the meantime, if necessary. The Governor and the other Directors considered, however, that a modest revision of these scales was desirable, in view of the large demand of commercial banks for experienced officers. The revision was then approved by the Board.

One of the objects of the revision was also to rationalise the pay scales. The cost of living at all centres having gone up on account of the war and in order to have mobility of staff, it was considered desirable to have uniform scales of pay at all centres, as far as practicable. Opportunity was also taken to have a common running scale for Junior and Senior Superintendents (the cadre itself being renamed as Superintendents) and for Shroffs and Note Examiners (the new grade being called Coin /Note Examiners).

In April 1947, a separate scale of pay, slightly higher than that of Clerks Grade II, was created for Typists; previously, the two classes of staff enjoyed a common grade and were mutually transferable and this created difficulties. With their segregation, separate recruitment began to be made for the Typists’ posts and Typists were eligible for promotion only as Stenographers. However, opportunities were provided for the Typists and Stenographers to get into the clerical and supervisory grades.

Not long after the pay scales in the Bank were revised in 1946, employees in several commercial banks both in Bombay and in Calcutta were able to secure higher scales of pay than those of the Reserve Bank, either under industrial awards or otherwise. The Reserve Bank employees therefore renewed in August 1947 their request for a further revision and, in particular, for a unification of the scales of pay of Clerks Grade I and II.

The Bank management recognised that there was justification for some revision in the scales. However, in view of the difficulty of prescribing a uniform scale of pay for all centres within the framework of the various bank awards, it offered to implement the awards *in toto* at centres where there was such an award, and at other centres to pay the clerical staff the average of the emoluments paid by three leading commercial banks, viz., the Imperial Bank of India, Central Bank of India and Bank of India. As part of this offer, the existing special allowances admissible to the Bank’s staff were to be withdrawn and

allowances granted to them at the same rates as in other banks. This offer was not, however, acceptable to the employees. Hence they withdrew their earlier demand for a unified scale for Clerks and were prepared to accept two scales for the clerical staff within the offer made by the Bank. The clerical scales so revised were approved by the Committee at its meeting on October 20, 1948 and were given effect to retrospectively from April 1, 1948.

Bonus Element

The Bank did not pay an annual bonus to its staff as was the practice in the commercial banks. The employees' demand was that either such a bonus should be paid to them or the element of bonus should be included while constructing the pay scales. In the Conciliation Conference held in 1946, the Bank's representatives made it clear that the grant of a bonus to the staff, on the ground of the Bank having made certain profits, would be indefensible in principle; there was no direct relation between the employees' efforts and the amount of a central bank's profits, the latter being 'the incidental results of policy decisions taken by the authorities charged with the responsibility of determining the volume and cost of the nation's supply of money'. The bonus admissible to the employees of the commercial banks could not also be taken into account in determining the pay scales of the Bank's staff as it was dependent on the profits earned by these institutions and was a variable factor. However, in determining the rates of allowances admissible to its employees, the Bank took this factor into account, the reason being that should the bonus granted by the other banks be reduced or totally withdrawn at any time, it would be possible for the Bank to make a suitable reduction in the allowances paid by it so as to bring the emoluments of its staff in line with those of the employees of other banks without disturbing their basic pay structure. In other words, the Bank sought to maintain broad parity with the emoluments awarded by adjudicators.

Dearness/Grain Compensation Allowance

One of the important components of the salary structure of the Bank's staff during the war time was the 'dearness' allowance, granted by the Bank for the first time in May 1941 to compensate the staff for the rise in the prices of essential articles. The allowance was liberalised gradually as the war progressed, both in its quantum and in its coverage. Originally intended to be purely temporary, it has continued to be a part of the employees' emoluments to this day! At every stage beginning with its introduction, there had to be a blending of two

objectives, namely, that of alleviating the genuine hardships of the staff and the equally important one of preventing an accentuation of the inflationary pressures in the economy. Although the Employees' Association began, after the commencement of hostilities, to make frequent requests for the grant of a war allowance to the staff, the Governor could not see his way to recommending the sanction of such an allowance to the Central Board. The question was one of general importance requiring uniform action by most employers; besides, the Government had adopted various control measures to keep prices within reasonable limits. It was only after most of the Provincial Governments had come to accept the principle of granting a dearness or grain compensation allowance to their low paid employees that concrete proposals were brought before the Committee at its meeting on May 14, 1941.

When the allowance was first sanctioned, it was confined to the low paid members of the subordinate staff of the Bank, and was based wholly on the pattern of the allowances sanctioned to Government employees by the Governments of the areas in which they were serving. The allowance was to fluctuate with the cost of living, and was to be discontinued on the return of normalcy.

As the year advanced, the cost of living in the bigger cities went up, and it became clear that the scale of this allowance as well as the categories of staff to whom it applied needed liberalisation. While the Government of India did not favour a revision in the basic rates of pay to make up for the increase in the cost of living as a result of war conditions, they were content to leave other employers, including even the Provincial Governments, to regulate the dearness allowance as they thought best. Towards the end of 1941, the Bank came to the conclusion that it should act on its own on the basis of data available with it comparing the concessions it granted not so much with corresponding concessions granted by the Provincial Governments but rather with those granted by the commercial banks and the other large private employers of labour. In January 1942, the Bank sanctioned its own scale of allowances, which was somewhat more liberal than that of the generality of provincial scales; the benefit of the allowance was extended also to the lower paid ministerial employees of the Bank. Further revisions of the rates of this allowance as well as the maximum pay limit up to which it was applicable were made in July 1942, October 1942 and January 1943.

While making these revisions, the Bank had fully in mind its general responsibility in regard to inflation. It proceeded on the principle that no public interest would be served by refraining, on grounds of inflation, from giving its lower paid employees sufficient to maintain themselves and their families at the minimum subsistence level. As Deputy

Governor Deshmukh reported to the Government in January 1943, the Directors had 'unreservedly' approved of the revisions made; indeed, being more familiar with the dearness allowances granted in the business world than with the much smaller allowances granted by the Governments, Central or Provincial, they had 'on occasions expressed mild doubts regarding the adequacy of the new scales'.

Reviewing, in June 1943, the quantum of relief necessary to meet the rise in the cost of living since January of that year, the Bank decided that rather than increase the dearness allowance further, which accentuated the tendency towards inflation, it could assist the staff by making arrangements to supply them with foodgrains at reasonable rates. Under the scheme approved by the Committee of the Central Board on June 30, the dearness allowance was to be frozen at the rates ruling on January 1, 1943. The Bank was to open grain shops and stock certain essential articles of food-stuffs like rice, wheat or wheat flour, pulses and sugar; supplies from these shops were to be made to the staff at prices prevailing on January 1, 1943. It was hoped that the Bank would be in a position to obtain bulk supplies at reasonable wholesale rates. The scheme evoked from Sir Purshotamdas Thakurdas the comment that whether the Bank gave a cash allowance or grain at reduced rates, the safeguard against inflation was a comparatively thin one!

By and large, the commodity scheme worked satisfactorily though on that account the Bank could not avoid subsequent increases in the dearness allowance. The quantity supplied to each employee was, as a rule, to be based in respect of each commodity on the ration fixed per head by the Provincial Governments but in actual practice this had to depend on what supplies the Bank was able to secure from those Governments or from the market. This aspect of the problem was brought to the specific notice of the Government of India at the instance of Sir Purshotamdas Thakurdas who recorded a minute, before the Committee met on June 30, on the dire necessity for increasing the supplies of food available to the public. The staff at certain centres who were unable to participate in the scheme were paid compensation in the form of a cash allowance. Suitable modifications were made to the scheme from time to time, having regard to the local conditions in each centre.

The grainshops were closed at the end of June 1954, in view of the general improvement in the supply position of foodgrains in the country.

A brief mention may be made here of the Bank's concern over the tendency of the great majority of industrial employers to pay liberal allowances and bonuses to their labour force, mainly at the cost of the State, and over its inflationary aspect. One of the Bank's suggestions

was that this tendency be countered by empowering Excess Profits Tax Officers to disallow deductions on account of bonuses, dearness allowances, directors' fees, etc., that they might consider excessive; another was that Government take some direct measures for controlling or regulating bonuses and allowances to employees by banks, factories and other large employers. These appear to have been unacceptable to the Government for the reason that they might give rise to serious discontent both among labour and employers of labour. The Government's policy, in regard to their own employees, was to hold down the scale of dearness allowances, and instead, try to make more food available and at reasonable prices. The Government contemplated addressing private employers to request them to keep in view the principles and rates adopted by them (the Government) while revising their scales of dearness allowance. The idea was however given up when Government were themselves forced to raise the dearness allowances of their own staff in the early months of 1943. Another proposal which they considered, but gave up, was that of asking employers to pay only a certain percentage of the bonuses declared by them in cash.

In January 1948, the question of giving a measure of relief, by way of a dearness allowance, to the supervisory and Junior Officer classes was seriously considered by the Bank. The Government, who were consulted, were opposed to the grant of dearness or war allowance to the Officers. However, faced with a serious threat of losing its experienced Officers to other banks (which did not hesitate to pay dearness allowance even to their highest salaried officers), the Bank extended its scheme of dearness allowance in August 1943 to cover Officers drawing pay up to Rs. 850. While advising the Government of this the Governor observed that the Bank was left with no alternative but to raise the upper pay limit for grant of the dearness allowance as the earlier expectations that there would probably be a fall, at any rate no further rise, in the price index did not materialise. The Bank's scheme of dearness allowance was enlarged, by stages, and in course of time covered Officers drawing higher pay also.

Local Pay/Allowance

The original scales of pay of the Bank were, as mentioned already, not uniform at all the centres for each category of staff, as they were based on an assessment of the differences in the cost of living at the places. In July 1944, when the Bank decided to grant some further relief to its employees in classes 'B', 'C', and 'D', it was decided to grant it in the form of a local allowance. This was because the Bank was opposed to the grant of a bonus; besides, the time was not considered

suitable for revising the pay scales, and the dearness allowance had reached what was then considered as 'a sufficiently high figure'. The staff at Bombay, Calcutta, Delhi and Karachi were given a local allowance at a higher rate than those at Madras, Kanpur, Lahore, Akola and Allahabad. A special *ad hoc* allowance which the Delhi Office staff were getting earlier was merged with this allowance.

In January 1945, the nomenclature of this allowance was changed to 'local pay' so that it could count for superannuation benefits; its rates were also increased. A year later, the scheme of local pay was further liberalised; its benefit was extended to the Junior Officers in class 'A'. But when the entire pay and allowances structure of the staff was revised later in that year, the local pay was merged in the pay scales of the employees. Under this revision, uniform scales of pay were introduced. The staff at Bombay and Calcutta were, however, granted a local allowance at specified rates. Local pay was reintroduced in October 1953.

House Allowance

The Officers of the Bank were entitled to a house allowance when residential quarters were not provided for them. This was largely on account of the frequency of their transfer from one office to another. It was not the intention that the quantum of the allowance should be governed by the actual expenditure incurred by an Officer in renting living accommodation. As transfers of the other staff were infrequent, this allowance was not extended to them.

The grant of house allowance to the non-Officer staff was claimed during the Conciliation Conference in 1946 but the request was not acceded to by the Bank. The Bank's representatives put forth their arguments thus:

the essential point for consideration was what could be regarded as adequate remuneration for the employees, and it was of little importance from the point of view of the employees how the remuneration thus arrived at was disbursed, and unless there were special reasons for breaking the amounts into several groups, it would be desirable to confine their number to as few categories as possible as that would simplify accounting.

They added that from this point of view the best arrangement would be to divide the remuneration of the non-Officer staff into only three categories: (i) pay, (ii) dearness allowance, and (iii) local allowance. House rent allowance came to constitute a distinct item of the pay structure of these employees only from October 1953.

Family Allowance

In 1945, with a view to considering the desirability of granting a ' Children's allowance ' in order to assist the lower paid members of the staff in bringing up their children, the Governor desired that the Department of Research and Statistics should ascertain and collate data relating to the marriage and/or children's allowances granted in other countries to black-coated workers. In October of that year, the Department gave the Governor details in respect of these allowances in various countries numbering 21 in all.

In 1946, at the Conciliation Conference, a scheme of granting a family allowance to the clerical, Cash Department and subordinate staff was recommended by the representatives of the Bank, partially at least to meet the claim of the employees' representatives for raising the maximum of the clerical scales. The scheme was, however, introduced to benefit only the staff in classes ' B ' and ' C ', as the subordinate staff preferred to have an improvement in their scales of pay in *lieu of* this allowance. The allowance was made admissible to employees who had attained the age of 30 and had put in a minimum period of service of five years in the Bank. These conditions were insisted upon as it was not the intention to encourage early marriages or an increase in population! The allowance was not fixed at a percentage of pay; it was a fixed sum per child, being admissible for not more than three children. In 1948 the condition that only employees who had reached the age of 30 would be eligible for this allowance was removed. Family allowance was sanctioned for the Class IV staff also, with effect from October 1, 1953.

There were also other special allowances sanctioned on an *ad hoc* basis to the staff to meet severe hardships or distress, e.g., to the staff of the Rangoon and Indian offices evacuated to other centres during the war and those of the Bank's offices in Pakistan following the communal disturbances after the partition of the country. The latter staff were also given monetary assistance to rehabilitate themselves in India.

These scales of pay and allowances did not apply to the staff of the Bank's London Office; except the Manager who was always sent from India, the staff comprised those initially taken over from the London branch of the Imperial Bank and local recruits.

SUPERANNUATION BENEFITS*Provident Fund*

The type of superannuation benefits to be given to the staff was decided simultaneously with the pay scales, although it appears that the impact

of these benefits on the pay structure as a whole was not taken into account in arriving at the decision. In the Governor's words:

I consider that it is better to give the staff a provident fund rather than pensionary rights, and that, to secure a contented staff, the contribution of the Bank to it should be fixed on a liberal basis. I propose that the Bank should make a contribution equal to the amount subscribed by the employee, with the interest thereon, up to a maximum of ten per cent of his pay and leave pay.

The Central Board approved the proposals in June 1935, and decided that the scheme should be made applicable compulsorily to all employees drawing a pay of Rs. 30 or more per mensem and that the minimum contribution should be 5 per cent of their pay. Accordingly, a Provident Fund was instituted by the Bank for its employees on October 1, 1935, after obtaining the approval of the Governor General in Council in terms of Section 58 of the Reserve Bank Act. The provisions of the Provident Funds Act, 1925, were extended to the Bank's Provident Fund which was also added to the Schedule to that Act; this enabled the subscribers to the Fund to derive the benefits of freedom from attachment under Court decrees for debt, etc., available under that Act, and of income-tax exemption,

For the transferred employees who had pensionary rights and who decided to retain them, the Bank constituted a Pensions Fund.

Retirement Bonus

The staff transferred from the Treasurer's Department of the Currency Offices were eligible to get a retirement bonus, at the rate of a month's pay for each year of service, calculated under their former rules. They were allowed to enjoy the benefit of this scheme instead of joining the Bank's Provident Fund, if they wished to do so.

This form of retirement benefit was considered more suitable than the Provident Fund in the case of the Bank's subordinate staff, as there were very few amongst them who earned more than Rs. 30 per month, and when they did, it was only for a short portion of their total service. It therefore appeared equitable to grant the bonus to all the employees of this class irrespective of the fact that some of them might also have a small compulsory Provident Fund. Under this scheme, which was introduced in 1936, the subordinate staff leaving the Bank after completing five years' service were given a bonus of one month's average pay for each year of their service. The scheme was abolished when their pay scales were liberalised in April 1946 as a result of which they had to contribute compulsorily to the Bank's Provident Fund and were entitled to contributions to their accounts from the Bank.

Gratuity

As early as January 1936, the employees asked that the Bank's monthly contribution to the Provident Fund be supplemented by a Gratuity payable in a lump sum at the time of retirement, similar to the scheme obtaining in the Railways and Local Bodies. The request was not acceded to.

In the Conciliation Conference of 1946, it was urged on behalf of the employees that the Provident Fund benefit was inadequate to enable them to maintain themselves and their families on a reasonable standard of living after retirement from service. Moreover, the principle of giving a Gratuity had been accepted by Government and quasi-Government institutions. While actual calculations of the amount that a Routine Clerk would get under the Bank's Provident Fund scheme and what he would get under the Railways' scheme showed that the Bank's staff were not worse off than the railway employees, the Bank's representatives recognised that as things then looked, an era of low interest rates would continue and the future price level would also be somewhat higher than what it was in prewar days. Hence they were prepared to recommend a scheme of Gratuity, to supplement the existing superannuation benefits, for acceptance by the Bank. The scheme contemplated the payment of a lump sum at the time of an employee leaving the Bank's service, equal to half a month's retiring substantive pay for each complete year of his service, and not exceeding such pay for 15 months. As Gratuity was a reward for long and meritorious service, it was to be admissible, under this proposal, only on the completion of a minimum service of 12 years. Gratuity on this scale was to be granted both to the transferred and the directly recruited staff, the amount being calculated in the case of the former with reference to their total permanent service and not merely service rendered since the Bank's inception. Besides, the transferred staff were to be eligible for Gratuity, irrespective of whether they had given up their former superannuation benefits or not. The Central Board accepted these recommendations in July 1946, with the proviso that the amount of Gratuity paid should in no case exceed Rs. 25,000. The scheme was proposed to be implemented by amending the Provident Fund regulations.

After consultation with the Central Government, the Bank framed separate (non-statutory) rules in October 1947 for the payment of Gratuity. The qualifying period of service was, however, put at 15 years' permanent service as suggested by the Government. The Bank also undertook to bear the income-tax payable on the amount of Gratuity. The rules were given effect retrospectively from April 1, 1946, the date on which the revised pay scales came into force. In the

case of the subordinate staff who ceased to be eligible for a retirement bonus after their pay scales were revised with effect from April 1, 1946, they were allowed Gratuity at the rate of one month's pay in respect of their service prior to that date; for service rendered after April 1, 1946, they were to be paid Gratuity on the same scale as the other categories of staff.

The Gratuity scheme was liberalised in stages over the years. On July 1, 1953, the basis of payment was raised to one month's pay for each year of service subject, however, to the same ceiling as before; for service rendered in excess of 30 years, an additional gratuity, over and above the prescribed maximum, was also made payable, at the rate of half a month's pay for each year of service. The minimum qualifying service was lowered to ten years in June 1956, in line with the direction of the Bank Award in this respect. At the same time, Gratuity ceased to be regarded as an *ex gratis* payment.

MEDICAL AND OTHER BENEFITS

Besides attempting to keep the staff contented with regard to their emoluments, the Bank introduced or encouraged many welfare schemes for them. The schemes were directed towards improving their health and efficiency or providing them with conveniences like residential accommodation. Quite often, the initiative for any new scheme or enlargement of the scope of an existing one came from the staff, e.g., the purchase and distribution of multi-vitamin tablets to the employees at cost price or the grant of subsidies to sports clubs organised by them.

A separate Staff Welfare Section was created in the Central Office, in charge of a Personnel Relations Officer, in 1947, for attending exclusively to matters pertaining to the introduction and implementation of the various welfare schemes. The Personnel Relations Officer was to provide a liaison between the Bank and the staff associations. He was to visit all the Bank's offices at suitable intervals to make contacts with the representatives of the staff of those offices. The Welfare Section was to study labour legislation and keep itself posted with current thinking on labour problems in the country. It was also entrusted with the duty of arranging the annual meetings between the Bank and the representatives of the staff and devising ways and means of promoting and maintaining harmonious relations between the two.

Medical Aid

The necessity of providing for the continuance of medical aid to the transferred staff, who were already in receipt of such aid, was the

immediate purpose of the Bank's initial scheme for giving medical aid to its staff. The Bank attached considerable importance to the physical fitness of its staff and gradually widened the scope of medical aid both on humanitarian grounds and with a view to maintaining and improving efficiency. No person could be appointed to the Bank's service unless he had been certified by an approved doctor to be 'of sound constitution and medically fit'.

Initially, the Bank undertook to provide for all its staff ordinary medical attendance free of charge. But this did not include the cost of surgical operations, nursing charges or specialists' fees. In exceptional cases, fees not regarded as coming within the scope of 'ordinary medical attendance' were also paid by the Bank at its discretion. The Bank appointed allopathic doctors as its Medical Officers on a part-time basis for giving medical attention to its employees, the first such appointment being at Calcutta soon after the Bank was inaugurated.

The first dispensary of the Bank was opened in Calcutta very early, i.e., on July 1, 1935, but it was only five years later that one at Bombay was established. The dispensaries at Kanpur, Madras and Delhi were started in the years 1942, 1944 and 1947, respectively. The dispensaries were a success, right from the start. Yearly reports were called for from the Medical Officers; these threw much light on the general health of the staff.

In 1945, with a view to improving the facilities in regard to medical attendance so that not only the staff but also their families might get prompt and expert hospital treatment, the Medical Officer at Bombay was requested to propose suitable schemes. After considering various possibilities, the K.E.M. Hospital Scheme was brought into force with effect from July 1, 1948. Under this scheme, the Bank paid a sum of Rs. 2.85 lakhs as a donation towards the building of a ward with equipment, the ward to be known as the 'Reserve Bank of India Ward'. In consideration of this, the Hospital undertook to provide beds up to a maximum of 20 for the Bank's employees and their families when required at any time. While the investigations, operations and routine treatment of the patients were free, the transfusion of blood, costly drugs and injections, and the patients' board were separately paid for by the Bank. The scheme was not, however, altogether satisfactory, in view of the delays in obtaining the necessary papers at the Hospital and the refusal of the Hospital authorities to give any preferential treatment to the Bank's employees in regard to the provision of beds.

After the finalisation of the K.E.M. Hospital Scheme at Bombay, similar facilities were extended gradually to the staff at other centres. Where beds were not reserved in hospitals at certain centres, the Bank's Medical Officers assisted the employees and their families in securing

admission in Government or Municipal hospitals, the charges for the hospital treatment being borne by the Bank. The Bank paid special attention also to the identification and treatment of tuberculosis among the staff and their families.

The Bank arranged, beginning from February 1948 in Bombay and later in other offices, to purchase multi-vitamin tablets in bulk and supply them to the staff at cost price; the facility was introduced at the request of some employees in Bombay who drew the Bank's attention to a parallel scheme already in existence in all Government departments.

With the construction of residential accommodation for the staff, dispensaries were opened at those colonies also and Medical Officers appointed on a part-time basis to attend the dispensaries. The process has been, in short, one of gradual liberalisation throughout, of the facilities available not only to the employees themselves but also to their families.

Passage /Leave Fare Concessions

The European Officers, both in Government service and in the Imperial Bank, were being given a certain number of free passages to England. When the Bank started functioning, it was considered desirable not only to continue this concession but also to extend it to the Officers of Indian domicile. The concession was considered to be conducive to a contented and efficient staff. The scheme provided for the Bank's meeting the cost of return fares to the country or place of domicile, as the case might be, of the Officers and their families once in 4 years in the first 12 years of service and thereafter once in 3 years. The passage concession was also available to Officers proceeding to their place of domicile or elsewhere on their retirement from the Bank's service.

Although the question of extending this concession to the other staff was considered from time to time, and was also discussed during the Conciliation Conference of 1946, it was not until 1948 that the Bank agreed to adopt a scheme for granting leave fare concessions to all categories of its staff if and when the Central Government issued orders on the Pay Commission's recommendations in this respect. Accordingly, a scheme to give passage concessions was introduced by the Bank in December 1948 after the Government's decision became known. The Government's scheme, which was effective January 1, 1948, provided for reimbursement of two thirds of the cost of railway fares for a Government servant and his family proceeding from his headquarters to any place in India, every year. As it was felt that it might not be administratively convenient for the Bank to allow every employee to proceed on

leave every year, under the Bank's scheme the employee and his family were allowed to proceed to his place of domicile once in three years, the Bank bearing the full cost of the fares both ways, not exceeding the fare for himself and four full fares for the family.

Housing Accommodation

In the matter of provision of housing accommodation to its employees, the Bank made a beginning only after the war, but once the principle was accepted, fairly rapid strides were made in a few years in securing residential buildings or plots of land for construction of houses at many centres. At the Conciliation Conference held in 1946, in support of their demand for house allowance the employees quoted a proposal by the Bombay Housing Enquiry Committee that every employer in Bombay engaging more than 500 workers should be required to build housing accommodation for his employees. While the Bank was willing to take advantage of any Government sponsored scheme for housing the staff, practical difficulties existed in undertaking such an obligation independently in view of the acute congestion in all the big centres and the prevailing extreme shortages in the supply of building materials of all kinds. But realising the need to assist its employees, especially its lower paid staff, the Bank agreed in principle to build residential accommodation wherever possible, for being let out at suitable rents.

In Bombay and Calcutta, Officers and Superintendents occupying Government requisitioned accommodation were asked to vacate those premises following the Government's decision to discontinue the provision of housing accommodation to the Bank's staff. As a consequence, the Bank purchased residential buildings in Bombay in 1947 and 1950 for housing some of its Officers. During those years, sizeable plots of land were also acquired in Bombay for construction of suitable quarters for nearly a thousand families of the non-officer staff, with amenities such as a playground, a kindergarten school and a community centre. In Delhi, the Bank joined the Government's scheme for providing quarters to its staff, and the construction work was entrusted to the Central Public Works Department. With a view to giving relief to the staff transferred from the Bank's Karachi and Lahore offices to Kanpur after the partition, the Bank constructed a number of family quarters and two or three dormitories in the compound of its office premises. In Calcutta, negotiations were completed for the purchase of a large plot of land for a modern housing colony. In later years, the Bank constructed residential accommodation at several other centres where it had offices, the number of such quarters standing at over 2,400 in 1969, against a total staff of around 19,000.

It is interesting to note that in August 1947, the Governor (Deshmukh) desired, on hearing of certain arrangements made by the Tata group of industries for assisting their employees to construct houses on a co-operative basis, that the Bank should examine the feasibility of encouraging the formation of co-operative housing societies among its staff and arranging for grant of financial accommodation to them on reasonable terms. However, a scheme to provide loans to such societies on easy terms was introduced in the Bank only 14 years later!

Sports Clubs, Canteen Facilities, etc.

From the very early years, the Bank encouraged and financially assisted the sports clubs of its employees at the different centres. Donations were given provided the membership was open to all the employees of the Bank, a reasonable number of the employees of all departments joined the club and the bulk of the money required was found by subscriptions from among the members.

At centres where the employees or staff associations wished to run canteens, the Bank made available to them the necessary space in the office premises. It also constructed a dining room and lounge on the terrace of its office premises in Bombay in 1948 for the use of its Officers and for entertaining distinguished visitors. An Officers' mess was run on a co-operative basis in Bombay; the Bank undertook to bear the cost of establishment, crockery and utensils, the Officers availing themselves of the facilities under the scheme being required to pay, on a pro *rata* basis, only the actual expenditure incurred monthly on the purchase of food-stuffs.

The Bank recognised co-operative societies formed by its employees provided there was nothing objectionable in their by-laws. It encouraged employees' co-operative credit societies by agreeing to the proposal for making deductions from the employees' salaries towards repayment of loans taken from the credit societies. But while doing so, it kept an eye on the affairs of the societies generally, and discouraged any tendency among their members to overborrow or incur debts unnecessarily. To ensure this, the Manager or, in his absence, a Senior Officer, presided over the meetings of the societies, as that helped the Bank to keep in touch with the members of the societies and exercise a check on their borrowings. The societies were asked to fix maximum credit limits and also limit the number of repayment instalments. The societies were permitted to open accounts with the Bank and were also provided accommodation on the Bank's premises.

STAFF RELATIONS

Relations between the Bank and the staff during the period covered in this volume were generally cordial. During the war, the employees rose to the occasion and gave of their best; despite their demands, frequently made, for monetary compensation in some form or other for the hardships they had to endure, and for the heavy demands made on their energies, there were no serious clashes with the management. The Bank, on its part, was sympathetic to the employees' demands and encouraged the growth of an esprit de corps. There was a threat of a showdown in 1946, but it was averted at the last minute, the staff agreeing to negotiate with the management. Important landmarks in the history of employer-employee relations in the Bank are mentioned in the paragraphs that follow.

Recognition of Staff Associations

Soon after the Bank was inaugurated, the management expressed its willingness to recognise the seven local currency staff associations as well as their federal organisation, namely, the All-India Currency Offices Union. In a letter dated May 9, 1935, to one of the Managers, the Deputy Governor indicated the conditions for such recognition:

The Bank will be prepared to continue the recognition which has been previously accorded by Government to the Currency Association provided that the latter maintains the same attitude as previously, that is to say, that its requests are limited to matters which concern the conditions of service of the staff and are put forward in moderate language, and that the Association continues to represent the large majority of the staff concerned.

Later, the associations changed their names into the Reserve Bank of India Issue Department Associations. With the Bank's permission, the staff of the Banking Department were also enlisted as members. The associations then became the Reserve Bank of India Employees' Associations.

In December 1942, the 'D' class staff of the Bank at Bombay formed a separate union, which was later on registered under the Indian Trade Unions Act, 1926. This Union was recognised by the Bank subject to the same conditions as were applicable to the other associations. This Union was subsequently allowed to represent also the 'D' class staff at Madras and Delhi. The Officers of the Bank also formed themselves into an association in February 1949 and obtained recognition from the Bank.

Associations formed on communal considerations were not eligible for recognition.

Stress on Conciliation

Discussions between the associations' representatives and the senior officials and top executives of the Bank promoted mutual understanding and created the necessary climate for a proper and amicable settlement of the employees' claims. However, an exceptional situation arose in 1946 when, feeling the impact of the steep rise in prices on their cost of living as a result of the war, the employees began to agitate for an improvement in their terms of service. A section of the employees took the extreme attitude that the unions should force a decision on the Bank by organising a strike. The Reserve Bank of India Employees' Association, Bombay, convened an extraordinary general meeting on May 9, 1946, to discuss the future line of action and resolved that should the Bank fail to give a favourable reply to the demands of the Association by May 27, the Association should serve the Bank with a 'proper and legal notice of strike'.

The Governor was, even otherwise, willing to consider the employees' grievances sympathetically. In view of the far-reaching character of the demands made by the Association on a wide variety of items, he considered that it would be advantageous if a special committee consisting of representatives of both the Association and the management was appointed under the chairmanship of the Deputy Governor, Mr. McCallum, to examine and report on them to him for submission to the Central Board, the next meeting of which was fixed for July 20.

Sir Chintaman met the office-bearers of the Association in Bombay on May 23 informally, at the latter's request, when he told them of the two methods open to them, viz.,

- (1) to see if by an exchange of arguments, which has not taken place, what the bases of your demands are and how far we can accede to them. It may be that an exchange of arguments might lead to some kind of reasoned accommodation and both parties may be satisfied.
- (2) to give notice of strike any time you like, and we ask the Government to appoint an Adjudicator under Rule 81A of the Defence of India Rules.

He made it clear to them that strike as a legal measure, which under the law was open to the unions, would not be available to them. The Bank being a public body, any stoppage of work meant not only public inconvenience but a complete cessation of all financial business in the country. Hence the Government could be expected to refer the dispute for compulsory adjudication once a strike notice was given, and resort to strike after such a reference was made would only be illegal. The Governor had also no reason to expect that an Adjudicator would be a social reformer; as his considerations would primarily be

the economic conditions of living and the conditions obtaining in other comparable bodies, he could not go beyond suggesting a few adjustments here and there. The Governor pointed out also that conciliation had the merit of being based on good-will, which had no place in adjudication. Explaining the composition of the committee he proposed to appoint, the Governor told the Association that there would be three representatives from the Bank, one of whom would be the Deputy Governor who would also act as its chairman. The Association was free to nominate its own representatives. The committee's report was not to be a majority report but was to reflect the views of both the sections represented on it.

While the Governor favoured conciliatory methods, he simultaneously took in hand arrangements to meet any direct action by the employees. He obtained the Government's agreement in principle to appoint an Adjudicator under the Defence of India Rules if the endeavours to persuade the employees to agree to settle their demands by negotiating with the Bank failed and the threatened strike materialised. Even the name of the person to be appointed as Adjudicator was settled in advance. Fortunately, the necessity to go in for compulsory adjudication was averted.

Conciliation Conference

As a result of further discussions, it was decided to rename the special committee as a Conciliation Conference, composed of representatives of the Bank and of the Council of the All-India Employees' Association, the staff having in the meantime decided that their demands should be negotiated by this Council. As already mentioned, the Chairman of the Conference was Mr. McCallum, Deputy Governor. The Conference met seven times during the month of June 1946. The Association represented the non-officer staff other than the 'D' class. The 'D' Class Union was separately consulted as regards matters concerning that class of employees. As a result of the deliberations, the Bank's representatives made specific recommendations, which were broadly agreed to by both sides. On the basis of these recommendations, which the Governor placed before the Board with his own comments, the entire pay and allowances structure of the non-officer staff in the Bank was revised. The Officers' and Treasurers' salaries were also revised at the same time.

Two years later, in December 1948, a further step was taken to consolidate the spirit of conciliation and good-will. The Bank decided, in consultation with the Association, that the representatives of the Employees' Association at each centre should meet the local Managers once every quarter and those of the All-India Association should meet

the representatives of the central executive of the Bank once every year for mutual discussions on matters affecting their common interests. By establishing more frequent contacts between the management and the staff at both the central and branch levels, this machinery helped to settle or minimise differences in an atmosphere of tolerance and to maintain the accord reached in 1946.

Employer-employee Relations in Commercial Banks

The Bank attached importance not only to the maintenance of cordial relations with its own employees but also to the quick and effective settlement of disputes concerning terms of service, etc., arising between other banks and their staff. Its advice was therefore often sought by Government with respect to the application of labour and trade union laws to the banking industry.

Prior to 1949, the responsibility for the settlement of disputes between banking companies and their employees was that of the Provinces, under the respective Provincial laws as well as in terms of the Industrial Disputes Act, 1947. On the initiative, largely, of the Reserve Bank, consequent on the serious developments in the United Provinces in the wake of the B. B. Singh Award in the dispute between 40 bank managements and their employees, this responsibility was transferred to the Central Government by an Ordinance entitled the Industrial Disputes (Banking and Insurance Companies) Ordinance, 1949, issued on April 30, 1949. The Ordinance amended the Industrial Disputes Act, 1947, so as to transfer the responsibility for settlement of industrial disputes in banking companies having branches or other establishments in more than one Province (including the Imperial Bank of India) from the Provincial Governments to the Central Government. * It also specifically prohibited the Provincial Governments from referring any industrial dispute in insurance or banking company for adjudication and provided for abatement of proceedings in any such dispute pending before Provincial Tribunals as on April 30. The Central Government also took powers to refer for readjudication awards already given by Provincial Tribunals.

The Ordinance was extended by a period of six months on its expiry on October 30, 1949, and was replaced by an Act in December 1949. An All-India Industrial Tribunal (Bank Disputes) was set up in June 1949 in pursuance of the Ordinance, to go into industrial disputes in more than 200 banks all over the country.

* The Central Government was made the 'appropriate Government' in relation to industrial disputes in the Reserve Bank only in August 1956 [cf. The Industrial Disputes (Amendment and Miscellaneous Provisions) Act, 1956].

The Bank was again called upon to tender opinion on the provisions of the Labour Relations Bill and the Trade Unions Bill, insofar as they applied to banking companies. The Bills were introduced in the Indian Parliament in February 1950.

The Labour Relations Bill agitated the banks considerably. To consider representations of banks and commercial interests as well as those from employees' organisations, the Ministry of Labour convened a Conference of Employers and Workers in Banking and Commercial Interests in New Delhi on May 18 and 19, 1950. A representative of the Reserve Bank also attended the Conference at the request of Government. Later, the matter was also considered at a special meeting of the Bank's Central Board held on July 3.

The Reserve Bank was of the view that in regard to banks there should be separate legislation. The object was not to place bank managements in a privileged position vis-a-vis their employees, but to devise a machinery designed to ensure justice to employees in regard to conditions of work, etc., without endangering the security of banking institutions in general. The Bank felt, however, that it could not undertake the formidable task proposed to be entrusted to it by the various Bankers' Associations of prescribing the conditions of service in banks and of settling disputes between employers and employees in individual banks. Regarding the type of machinery that should be set up for dealing with labour disputes in banks, the Bank's ideas were as follows:

- (1) A Statutory Board or Tribunal should be set up consisting of -
 - (a) a Chairman, who should be a High Court Judge, ex-High Court Judge or an officer of similar status, to be appointed by Government,
 - (b) a representative of the Reserve Bank, and
 - (c) a member nominated by Government.

It should be the duty of the Board to ensure that standing orders providing for all matters specified in the First Schedule of the Labour Relations Bill were adopted by banking institutions. In the case of any dispute between the bank employees and the bank authorities in regard to these standing orders or any other matter, the decision of the Statutory Board would be final.

- (2) Conciliation Officers should be appointed by the Finance Ministry on a regional basis to settle differences between bank employees and employers.

- (3) In every banking institution there should be annual meetings between the Staff Association representatives and the bank management at which the former should have opportunities of making representations in regard to modifications in the conditions of service, etc. If no agreement was arrived at, the dispute might be referred by either party to the Conciliation Officer for the region. If his efforts to arrive at a settlement failed, the question might be referred by the Central Government to the Statutory Board, whose decision would be final.

- (4) No strike should be permitted in banks. On the other hand, the Government should not have the authority either to amend or to set aside any award given by the Tribunal.

The Board broadly accepted the Governor's suggestions for recommendation to Government. The Board also wished to emphasise that any restrictions on bank managements that went appreciably beyond these proposals would seriously affect the position of the existing banks and prejudice the expansion of banking facilities.

As regards the Trade Unions Bill, the Bank's attention was directed to the question of recognition of unions of bank employees. The Board's views were:

In view of the key position which banking institutions occupy in the economic structure of the country and of the high standard of education required of bank employees, the Board consider that as in the case of civil servants, a trade union of bank employees should not be entitled to compulsory recognition by Government, if it does not consist wholly of bank employees or if it is affiliated to a federation to which trade unions of persons other than bank employees are also affiliated.

The Governor communicated the proceedings of the Board meeting to Government and left it to them to consider whether provisions embodying the Board's suggestions could be made within the framework of the Labour Relations Bill or whether separate legislation, ' which might take the form of a new Section in the Banking Companies Act ', should be introduced.

The Ministry of Labour was not in favour of incorporating in the Banking Companies Act regulations relating to labour matters. It was, however, agreeable to giving effect to most of the Bank's recommendations by suitable changes in the Labour Relations Bill; in fact, some of them were already covered by its existing provisions. Subsequently, on reconsideration, there was a veering round to the view that banks should be dealt with separately -either by adding a separate chapter to the Labour Relations Bill itself or by enacting an altogether separate piece of legislation. At the request of Government, the Bank, which was still in favour of a separate enactment for banks, drafted a tentative Bill entitled ' Labour Relations (Banking Companies) Bill ' and forwarded it to Government in June 1951, The measure was intended to ensure uninterrupted working of banks by providing, on the one hand, for the prohibition of strikes and lock-outs, and on the other, for a simple, speedy and automatic machinery for conciliation or adjudication of industrial disputes in banks. However, before these proposals could be considered, the Labour Relations Bill, 1950, itself lapsed on the dissolution of the provisional Parliament.

Epilogue

The first sixteen years of the Reserve Bank's functioning, covered in this volume, constitute an eventful period. The Bank was established in 1935 after long years of preparation, by the Reserve Bank of India Act, 1934, with unqualified support within the country and from the British rulers and with remarkable consensus as regards its functions. In two respects, however, nationalist opinion was not happy with the Act, namely, the status of the Bank as a shareholders' institution and the limited scope envisaged for the Bank's role in the sphere of agricultural credit. However, a redeeming feature was that an obligation was laid on the Bank to submit proposals for a more active role in the field of agricultural finance. The Bank was able to start under favourable auspices, drawing upon the experience and personnel of the Government's Currency Department and the Imperial Bank of India.

In considering the progress of the Bank during this period, several factors have to be kept in mind. In the first place, the Bank's functions as laid down in its Statute were, by and large, of the traditional type, namely (i) issue of currency, (ii) acting as bankers' bank and (iii) acting as banker to Government. No great promotional role was envisaged for the Bank, except to a limited extent in the sphere of agricultural credit. Secondly, during the major part of the period covered in the volume, limitations were imposed on the Bank's freedom of operations by the fact of the country's being a dependency. The early years of the period were characterised by lack of harmony among the top executives in the Bank as also between the Governor and the Finance Member, leading to the former's resignation. Furthermore, the major part of the sixteen-year period comprised abnormal years -six war years followed by over three years of political strife culminating in partition of the country and its aftermath. Normalcy could be said to have returned only in 1949.

The fundamental objective of establishing the Reserve Bank was the unification of the authority to discharge the functions mentioned earlier, so that there would be pooling of the country's monetary reserves and their employment in accordance with the needs of the economy. What was contemplated was a modest and purely temporary credit extension by the Bank to Government as well as commercial and co-operative banks, mainly with a view to narrowing significantly the marked regional and seasonal imbalances between the demand for and supply of currency and credit and the resultant large variations in interest rates; This objective appears to have been achieved broadly in that formal credit to Government was restricted, although the occurrence of World War II and the mode of financing war expenditure on behalf of the Allies led to considerable expansion of currency against foreign exchange resources. Through advances and open market operations, the Bank provided reserves to the banking system as it needed, though the requirements themselves were modest, largely reflecting the low tempo of investment activity in the economy for many years. The progressive liberalisation of the Bank's remittance facilities also helped considerably the integration of the country's money market and a reduction of the seasonal and regional variations in money rates.

The framers of the Bank's Statute also envisaged the development of a commercial bill market to provide elasticity to the currency and credit system. The Bank's efforts in the direction of developing a bill market comprised (i) getting the Government to agree to reduce the stamp duty on bills of exchange and (ii) urging the Provincial Governments to establish independent licensed warehouses. While the Bank was successful in the former, very little progress was made with regard to the latter. However, as in foreign countries generally, following the growth of branch banking, the functions of a commercial bill as well as its worthwhileness were rendered less significant.

In the sphere of currency management, there was not much scope for the Bank to attempt innovation or improvements in the mechanical field of the issue of currency, for the old Currency Department was fairly well organised. However, apart from increasing the number of currency chests and the places where these chests were kept, the Bank provided a measure of elasticity to the currency system through its loan and open market operations, including purchases and sales of sterling. The Bank also played an important role in the introduction of one rupee notes and in the gradual demonetisation of silver; the introduction of the pure nickel rupee, in particular, owed much to the Bank's vigorous canvassing. In the brief pre-war period, the obligation to maintain what was considered to be an overvalued exchange rate, namely, 1S. 6d., had acted as a constraint on the Bank's freedom

in the matter of expansion of currency. For the same reason, the Bank was not in a position to reduce the Bank rate for activating the economy in the closing years of the Depression. However, the real problem for the Bank was to ensure that the benefit of the prevalent low rates in the organised money market was extended to the rest of the economy.

As a bankers' bank, the Reserve Bank's duty was two-fold. First, it had to act as a source of reserves to the banking system, especially for meeting its seasonal requirements, apart from acting as lender of the last resort in times of emergency. The second responsibility of the Bank, which did not figure prominently in the early stages but which assumed importance after the failure of the Travancore National and Quilon Bank, was to ensure that banks were established, and run on sound lines, emphasis in those years being mainly on the protection of the depositors' interests rather than on credit regulation. So far as the commercial banks were concerned, the Bank appears to have reasonably fulfilled their needs for short-term financial assistance, though the banking system was unhappy that the scope of the Reserve Bank's accommodation was in effect limited to advances against Government securities. Considering the tempo of the economy and the liquid position of the banking system, this did not seem to impose much of a hardship on the banking system till the 1950s. As regards banking regulation and supervision, although the passage of a comprehensive Banking Companies Act was accomplished only in 1949, the Bank made very sustained efforts in this behalf from 1939 onwards. It was largely on the Bank's initiative that some interim measures of legislation were undertaken to achieve the main purposes of bank regulation. The Bank lost no time in building up adequate machinery for coping with its many responsibilities under the Banking Companies Act; as a matter of fact, some years earlier, in August 1945, it established a full-fledged Department for the purpose. The fact that, notwithstanding the rather haphazard and unhealthy growth of banks in the war and early post-war years, bank failures in the country were comparatively few bears testimony to the success of the Bank's regulatory efforts.

Till about the 1950s, the Bank did not take an active interest in matters like extension of banking facilities and promotion of the banking habit. The Bank's philosophy apparently was that its first responsibility was to help the establishment of a sound banking system, which it was hoped would indirectly assist both the growth of the banking habit and the extension of branches to underbanked and unbanked areas. It should moreover be added that in the war and early post-war years the problem for the authorities was mainly one of curbing the tendency to open branches indiscriminately.

Perhaps the most active part of the Bank's operations during the period covered in the narrative related to the Bank's responsibilities

as banker to Government. In this field, while there were no spectacular developments, the Bank took considerable pains to systematise the arrangements with regard to loan floatations of the Central and Provincial Governments and the issue of their Treasury bills. The large-scale borrowing by the Central Government during the war years was to some extent at least the result of the skilful operations of the Bank in this behalf. The Bank endeavoured to make the Treasury bill a money market instrument, but on the whole this did not meet with success. The Bank however succeeded in promoting financial discipline on the part of the Provincial Governments through regulating their borrowings in the form of market loans and Treasury bills or the Bank's ways and means advances to them.

An aspect of the Bank's functioning which came in for considerable criticism was the manner in which rupee resources were made available to the Government of India, against sterling assets, for meeting the expenditure of the U.K. and the Allied Governments in World War II. Many critics complained that the Bank's free supply of rupees to Government in this manner constituted a flagrant violation of the most important consideration mentioned by the Government for the Bank's being constituted as a shareholders' bank. This was that Government should not themselves be the authority controlling the creation of money but that when they wanted money they should go to an independent authority and make out their case just as any private individual had to do. This matter has been dealt with at length in Chapter 10 and all that one need say here is that the circumstances were abnormal and that the Reserve Bank Board showed much greater concern in the matter than is generally recognised. As regards the widely expressed view that the Central Board of Directors should have tendered their resignation rather than acquiesce in the policy of currency expansion against sterling, the question is whether that step would not have deprived the country of the vigilance and restraint which the Board exercised in many directions for safeguarding the national interest. In those years, ' with the resignation of the Congress Ministers in the Provinces and the absence of the Congress Party from the Legislatures, the Central Board of the Reserve Bank remained the only elected or representative custodians and trustees of India's economic and monetary interests '. The Board won a signal victory in having an Indian appointed as Governor and this was helpful to some extent in reorienting the Bank's attitude with regard to inflation and in putting pressure on Government to take action to contain it.

In the sphere of monetary policy there was not much experimentation in the period covered in this volume. In the pre-war years, on account of the stagnant conditions generally, demand for credit was on the whole at low ebb. While there were hardly any problems like restraining

inflation or curbing investment, management of the foreign exchange and especially the maintenance of the exchange rate at 1S. 6d. posed some problems. On the whole, the Bank carried out its responsibility with skill, mainly by varying its policy with regard to purchase of sterling by tender and by suitable modifications of the Treasury bill policy. In the war and post-war years there were no problems in regard to exchange management. The problem was one of countering inflation. The Bank's instruments of credit control were mainly two, namely, the Bank rate and open market operations. The Bank rate instrument was not used at all in this period, except once in November 1935 when the rate was reduced from 3 ½ to 3 per cent; the rate remained unchanged thereafter till November 1951. However, it would be incorrect to say that the instrument of interest rate was totally unused, for, the Bank did take a lead in bringing about appropriate changes in the Treasury bill rate, which was of some significance in influencing the flow of funds from abroad. Government bond yields were also suitably varied to meet the needs of the situation, within the general framework of stable rates. In the war and immediate post-war years the Bank resisted Government's wishes for cheaper money and in the subsequent years it worked skilfully to bring about a gentle rise in yields in the interests of credit regulation. The Bank also employed the instrument of open market operations in a fairly substantial way. It built up the necessary network of brokers and operational standards to sub serve the needs of Government borrowing as well as the requirements of the money market. From the very beginning, these operations of the Bank embraced all maturities and not merely short-term bonds as in the case of many other central banks, one important result of which was that the Bank's operations had an impact on the capital market too. In the post-war years, with the increasing needs of banks, the normal distinction between busy and slack seasons tended to be obscured and there was a steadily increasing resort to the Reserve Bank for accommodation, which put the Bank in a position to exercise a fair amount of control over the credit system.

It was perhaps the Bank's role in the sphere of rural credit that formed the main target of criticism during these years. The Government, at the time of the passing of the Reserve Bank Bill, did not envisage an active role for the Bank in the supply of finance for agricultural purposes. Its role was to be largely advisory, viz., to assist the Provincial Governments to reorganise and strengthen the co-operative movement. The Bank was also expected to make concrete proposals for the linking of the indigenous bankers and moneylenders with the organised money market. On the other hand, national opinion in the Legislature and outside and, in particular, of the co-operative institutions was that the Bank must play a very active role in the sphere of agricultural credit,

providing not only advice but substantial accommodation out of its own resources to the extent that might be necessary. In the earlier years, the Bank's policies largely followed the Government's conservative approach, as mentioned above. The Bank's view was that co-operative institutions, in order to be credit-worthy and eligible for accommodation from the Bank, must reform themselves and improve their operational standards so as to be on par with commercial banks. The Bank's emphasis on the co-operative institutions being run on sound lines was no doubt well placed and in fact the Bank helped a great deal by suggesting appropriate norms and guidelines for bringing about higher standards of operation and management. But the question was whether, simultaneously with the reform of the co-operative system, a substantial extension of credit by the Reserve Bank to the co-operatives was not called for. Gradually, as a result of continued pressure from co-operative interests as well as the enlightened leadership in the Bank itself under the guidance of its top executives, the Bank's approach became increasingly liberal. Many initiatives were taken to enlarge the flow of the Bank's assistance for agricultural purposes - seasonal operations as well as marketing of crops. The introduction in 1942 of a concessional element in the rate of interest on its loans and discounts to the co-operatives was an important step taken by the Reserve Bank authorities in this behalf. From 1949 onwards, the Government's and the Bank's interests in agricultural credit deepened considerably, leading to the appointment first of the Rural Banking Enquiry Committee in 1949 and the All-India Rural Credit Survey Committee in 1951. These paved the way for a marked expansion of the Reserve Bank's and Government's role in the sphere of agricultural credit and for radical organisational changes in the commercial banking system too, beginning with the transformation of the Imperial Bank of India into a public sector institution.

Another line of criticism against the Bank's working in a related field concerned its failure to bring the indigenous bankers into direct relationship with the Reserve Bank. The matter was unusually complex and the Bank had misgivings from the outset as to whether this was practicable. Nevertheless, it made repeated efforts to get the indigenous bankers to agree to a modicum of discipline, by shedding their non-banking business and maintaining proper books of accounts. But the indigenous bankers were not agreeable to these reforms. Directors like Sir Purshotamdas Thakurdas, who took much interest in the matter, conceded that the Bank had done all that was possible in this regard.

On the other hand, the Bank was actively and fruitfully involved in the building up of an adequate machinery for the provision of finance for industry, leading to the setting up of the Industrial Finance

Corporation of India and the passing of legislation for the setting up of State Financial Corporations.

Again, in the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development, the Bank played an important role. The Bank's executives and the Central Board took considerable initiative in these matters from very early stages. The Bank's efforts facilitated India's getting a better deal than looked likely in the early stages of the formulation of the international currency plans. For the first time India was enabled to become on its own right a partner of the international monetary system; this development has proved to be of great significance to India's economic development. It is true that in the final shape of these plans no provision was made for the liquidation of the sterling balances. Nevertheless, in the matter of rebutting British and foreign opinion for the scaling down of sterling balances and the successful negotiation of a series of agreements, the Bank's contribution was significant.

The Bank's organisation was steadily geared to meeting its increasing responsibilities. The Bank opened from time to time new offices and in particular new departments. In the beginning, the only important Department, and a statutory one, was the Agricultural Credit Department. But by the time this narrative ends, that is, around April 1951, the Bank had several full-fledged Departments besides the A.C.D., namely, the Exchange Control Department, the Department of Research and Statistics, the Department of Banking Operations and the Department of Banking Development, the last named also attending to matters relating to industrial finance. The establishment of the Department of Research and Statistics, in August 1945, reflected not only the concern of the Bank's management and Board for the discharge of the Bank's traditional functions efficiently, on the basis of comprehensive, accurate and up-to-date material (which was also to be placed at the disposal of the public through the Bank's publications) but also their tremendous foresight in regard to the expansion of the Bank's promotional role in the years to come. This was all the more commendable since at that time even in the developed countries generally the role of research in central banks had not received adequate recognition. The establishment of the Department of Banking Development in October 1950 was yet another landmark in the Bank's organisation, evidencing the Bank's intention to play an active part in developmental matters.

In the sphere of recruitment of staff, policies were gradually evolved with a view to ensuring efficiency, wide geographical and communal representation and reasonable prospects for promotion from within. Training of staff was to receive greater attention at a later period. On the other hand, the entire period was marked by remarkably harmonious employer-employee relations.

It could be said that on the eve of planned development in 1951, the Bank was organisationally well prepared to play its due role in the efforts to promote the country's economic growth. The Bank by then had acquired enough experience and expertise in the performance of the traditional functions of a central bank. It had obtained fairly adequate control over the money market. Its relations with the commercial and co-operative banks had become fairly intimate and cordial. Also, happily even in the formative years the Reserve bank enjoyed unquestioned leadership and confidence in the money market. From almost the very beginning it was regarded as the premier money market institution. The enactment of the Banking Companies Act gave special authority to the Bank to supervise the operations of commercial banks, so as to ensure their establishment and working on sound lines. The Act was responsible for the weeding out of the weaker elements of the banking system, which was now ready to march forward, not only by way of expansion of branches but also in the direction of a widened scope of operations in keeping with the requirements of the economy. Further, by 1951 it had become a well-established practice for commercial and co-operative banks to turn to the Reserve Bank for accommodation. In other words, the Bank was in a position to pursue a credit policy that was both expansionary and regulatory, broadly in keeping with the investment priorities indicated in the Plans. The Bank's involvement in industrial financing extended its influence in the capital market too, thus enabling it to make some impact on the short-term and long-term markets for money, in the larger context of development financing.

The substantial experience which the Bank acquired from 1939 onwards in administering exchange control put the Bank in a position to exercise such control during a period when there was likely to be considerable balance of payments strain in connection with the implementation of the development programme. The membership of the Bretton Woods institutions, the I.M.F. and the I.B.R.D., was an important element in the availability of short-term and long-term foreign exchange credit. The close contact which the Bank had with these institutions also widened its perspective with regard to monetary and developmental finance matters.

In these various ways the Bank was reasonably well equipped to participate in the developmental effort. As compared to its early years, attitudes had clearly undergone a marked change in the direction of involving the Bank in promotional tasks in an active way. The change reflected in part the change in the country's status from a dependency to an independent nation and the growing recognition in the post-war years of the importance of the role of the Government and public sector institutions in economic development. But it was also due to the initial

thinking and planning on some of these tasks, as exemplified by the proposals for setting up an industrial finance corporation, under the guidance of the first Indian Governor. After nationalisation, perhaps the Bank's executives were freer to embark on developmental tasks as compared to the pre-Independence and pre-nationalisation days. In earlier years, the Bank's management had to steer a course that did not clash with the Board's attitudes and the foreign Government's philosophy. In 1951, the position was, however, different. For one thing, the Board had nothing to do with the appointment of the Governors; for another, the Board itself was a wholly nominated one. It is difficult to say to what extent this change in the Board's position detracted from an active and independent role for the Board, such as was observed in the pre-nationalisation days. Undoubtedly, in these matters it is also a question of personalities, of the Governor, the Directors and the Finance Minister. All along, of course, the Governor's pre-eminent position for guidance and initiatives was recognised. The relationship of the Governor and Deputy Governors with the Board of Directors on the one hand and with Government on the other is a delicate one, calling for understanding, tact, self-confidence and courage. It has been recognised for long, as the Patman Committee 'of the U.S. Congress put it, that central banks should strive for independence within the Government rather than *from* Government. There is little doubt that in the period covered in this narrative, the Governors set for themselves high standards in the conduct of the Bank's affairs, harmonising the statutory requirements, the wishes of the Board of Directors and policies of the Government.

In the two decades or so from the time this narrative comes to a close, the Bank has made rapid strides in streamlining and expanding the credit system so as to serve the needs of an economy developing in terms of a series of five-year plans. The Bank has also witnessed the strains of development, necessitating the use of general and selective instruments of credit control. Perhaps it would not be out of place to give a bird's eye view as it were of the many developments in the promotional and regulatory spheres.

Commendable progress has been made in a sphere in which the Bank's role had come in for much criticism, namely, rural credit. The Bank initiated prompt action to implement the recommendations of the Rural Banking Enquiry Committee and later of the All-India Rural Credit Survey Committee. The quantum of financial assistance from the Bank to the co-operative institutions recorded a phenomenal rise over the years, from about Rs. 3 ½ crores at the end of March 1951 to about Rs. 300 crores in early February 1970. The forms of assistance provided by the Bank have also been diversified considerably. Among the noteworthy events in the sphere of institutional arrangement for agricultural development was the establishment,

in July 1963, of the Agricultural Refinance Corporation, as a subsidiary of the Bank; the total amount of refinance disbursed by the Corporation up to June 30, 1969, was of the order of Rs. 30 crores. Simultaneously, the Bank has also endeavoured to raise standards of co-operative management, an important step taken in this matter being the extension, in March 1966, of the provisions of the Banking Companies Act to co-operative institutions.

In the sphere of commercial banking, apart from further measures of a regulatory nature, the Bank has accomplished much in the sphere of banking development. The transformation of the Imperial Bank of India into the State Bank of India in July 1955 and that of a number of State-associated banks as subsidiaries of the State Bank of India helped both the opening of banking offices in the rural and semi-urban areas and the provision of credit to priority sectors hitherto neglected, such as small scale industries.

The institution in 1962, of a system of insurance for commercial bank deposits - India being the second country to do so - was yet another promotional measure for which initiative came from the Bank, which supervises the work of the Corporation set up for the purpose.

The Bank's participation in industrial financing has steadily and fruitfully increased, *pari passu* with the growing importance of industrial investment in the country's development. Besides its close association with the Industrial Finance Corporation of India and the State Financial Corporations, the Bank was closely connected with the establishment (and working) of the Refinance Corporation for Industry, in 1958, for the refinancing of medium-term loans for industry provided by commercial banks and State Financial Corporations. The Bank's involvement in industrial financing occurred in a big way with the establishment, in July 1964, of the Industrial Development Bank of India, as a wholly-owned subsidiary. The bank was conceived not only as a financing institution but also as a developmental agency, in preparation for the country's embarking upon the establishment of sophisticated and capital intensive industries, in the chemical and metallurgical fields in particular. This Bank is beginning to fulfil the role of an apex institution in the sphere of term financing, co-ordinating the operations of other term financing institutions.

Yet another institutional agency, in whose establishment the Bank took initiative, was the Unit Trust of India, to mobilise savings of small investors desirous of investing in corporate securities. The Trust, in which the Bank holds one half of the initial capital of Rs. 5 crores, was established in February 1964, and commenced operations in July that year.

From 1954, beginning with the establishment of the Bankers Training College, the Bank, in co-operation with commercial banks, co-operative

institutions and the Central Government, has been giving increasing attention to the training of personnel of commercial and co-operative banks. More recently, training of the Reserve Bank's own personnel has been taken up in some earnest. In the sphere of training, a new dimension was reached in 1969 with the establishment of the National Institute of Bank Management.

The path of development is not smooth and the Bank's role has been not merely promotional but also regulatory. The Bank has used extensively all the well-known instruments of credit regulation, general as well as selective, besides moral suasion. The performance of this difficult task has been facilitated by the wealth of financial data collected by the Bank itself and carefully analysed by its economists and statisticians. In 1956 the Bank was vested with the power to vary, within broad limits, the statutory reserves which commercial banks have to maintain with the Bank. There has been much experimentation with credit regulation instruments and it is beyond the scope of this chapter even to describe them in any detail. Bank rate was raised on several occasions, from November 1951 onwards, the rate reaching a peak of 6 per cent in February 1965; in March 1968 it was lowered to 5 per cent. The Bank has also tried the expedient of a system of penalty rates, originally based on the quantum of borrowing from the Reserve Bank in relation to the statutory reserve requirements, but later on the net liquidity ratio of the borrowing bank.

The Bank has also made some effort at credit planning, guiding the commercial banks with regard to both the aggregate quantum of credit creation, season-wise, and its sector-wise distribution, and employing the device of incentives and penalties in the rate structure. The Bank has also stood ready to provide temporary accommodation to banks for meeting their seasonal requirements of reserves, though the seasonal fluctuations in credit expansion are narrowing. For this purpose, as early as January 1952, the Bank instituted the Bill Market Scheme, enabling banks to borrow from the Reserve Bank against the security of their advances converted into usance bills -an example of the adaptation of the lending practices of banks to suit the provisions of the Bank's Statute. The changes in credit policy have been made generally after discussion with bankers; the contacts between them and the Reserve Bank have become close and cordial, in this process the Bank trying to get the best of moral suasion and statutory control.

No attempt has been made in this volume to assess the success of the Bank's regulatory efforts in the monetary sphere. In the best of circumstances, this is an exceedingly difficult task. The Bank's policies constitute only one element of the control mechanism, fiscal operations and policies exercising a much greater influence. Monetary policy has had to operate in the context of large-scale budgetary deficits, generally

speaking from the Second Plan onwards. Judged by criteria such as the rate of growth of real income, price stability and equilibrium of balance of payments, the achievement of policies in the fiscal/monetary spheres could be regarded as only partial and modest. There has been to an extent the need to balance the promotional and regulatory roles, a dilemma not unknown in developing countries.

What seems to be, however, beyond dispute is that the Bank is endeavouring to improve continuously its institutional machinery and operational techniques in the twin areas of development and control. Without doubt the Reserve Bank's hold over the credit system has increased considerably, with growing institutionalisation of credit. In this context, mention may also be made, without implying any judgement, of the restrictions imposed in 1966 on the acceptance of deposits by joint-stock companies.

The past two years have witnessed what might perhaps be termed dramatic developments in the banking world, namely, the experiment, for a short period, of social control and then the nationalisation of 'major' commercial banks. There is no doubt that the banking system is in the process of a far-reaching reorientation. Many new problems will arise in the coming years. Whatever be the emerging pattern of the banking and credit system, the Reserve Bank is reasonably well equipped to carry out the tasks allotted to it. In regard to the important aspects of the personality of the Governor and the spirit of objectivity and independence of outlook of the Board, generally, high traditions were built up during the period of the History covered in this volume, even as strong foundations were laid -perhaps a few floors also built for a large superstructure to grow.

APPENDIX

TABLE I
A. PAPER CURRENCY RESERVE

(Rs. crores)

| | As on March 31 | | | | | |
|--|----------------|--------------|---------------|---------------|---------------|---------------|
| | 1870 | 1900 | 1920 | 1930 | 1932 | 1935 |
| A. IN INDIA | | | | | | |
| Gold Coin and Bullion | 0.03 | 13.50 | 44.36 | 32.27 | 5.26 | 41.55 |
| Silver Coin | 5.35 | 5.24 | 33.22 | 108.11 | 101.96 | 77.25 |
| Silver Bullion | 1.48 | — | 6.63 | 2.85 | 9.23 | 13.12 |
| Rupee Securities | 3.60 | 10.00 | 10.00 | 33.85 | 57.94 | 35.90 |
| Treasury Bills | — | — | 9.59 | — | — | — |
| Internal Bills of Exchange | — | — | — | — | 3.75 | — |
| Total in India | 10.47 | 28.74 | 103.80 | 177.08 | 178.14 | 167.82 |
| B. IN ENGLAND | | | | | | |
| Gold Bullion | — | — | 3.45 | — | — | — |
| Silver Bullion | — | — | — | — | — | — |
| Sterling Securities | — | — | 67.27 | 0.15 | — | 18.28 |
| Total in England | — | — | 70.72 | 0.15 | — | 18.28 |
| Total Reserves (A + B) = Total Notes Issued | 10.47 | 28.74 | 174.52 | 177.23 | 178.14 | 186.10 |

B. GOLD STANDARD RESERVE

(£ sterling thousands)

| | As on March 31 | | | | | |
|-------------------------------|----------------|---------------|---------------|---------------|---------------|---------------|
| | 1902 | 1909 | 1919 | 1930 | 1932 | 1935 |
| A. IN ENGLAND | | | | | | |
| Treasury Bills | — | 1,468 | 2,938 | 9,105 | 4,220 | 11,630 |
| Loans | 3,454 | 5,946 | 26,792 | 28,739 | 6,475 | 26,216 |
| Gold | — | — | — | 2,152 | 2,152 | 2,152 |
| Cash | — | 470 | 6,016 | 4 | — | 2 |
| Total in England | 3,454 | 7,884 | 35,745 | 40,000 | 12,847 | 40,000 |
| B. IN INDIA | | | | | | |
| Gold | — | — | — | — | 27,153 | — |
| Rupee Coin | — | 10,587 | — | — | — | — |
| Others | — | — | — | — | — | — |
| Total in India | — | 10,587 | — | — | 27,153 | — |
| Total Reserve | 3,454 | 18,471 | 35,745 | 40,000 | 40,000 | 40,000 |

C. PAPER CURRENCY AND GOLD STANDARD RESERVES COMBINED

(Rs. crores)

| | As on March 31 | | |
|--|----------------|---------------|---------------|
| | 1931 | 1932 | 1935 |
| Gold | 37.05 | 44.33 | 44.42 |
| Sterling Securities | 42.13 | 14.26 | 68.74 |
| Silver Coin | 117.86 | 101.96 | 77.25 |
| Silver Bullion | 6.94 | 9.23 | 13.12 |
| Rupee Securities | 10.19 | 61.69* | 35.90 |
| Total | 214.17 | 231.47 | 239.43 |
| Of which Paper Currency Reserve = Total Notes Issued | 160.84 | 178.14 | 186.10 |
| Gold Standard Reserve | 53.33 | 53.33 | 53.33 |

* Includes Internal Bills of Exchange amounting to Rs. 3.75 crores.

TABLE 2
BALANCE SHEET OF THE RESERVE BANK OF INDIA, 1935-51
Issue Department

(Rs. crores)

| | December 31, 1935 | December 31, 1939 | June 30, 1945 | June 30, 1947 | June 30, 1951 |
|--|----------------------|----------------------|------------------|------------------|------------------|
| LIABILITIES | | | | | |
| Notes held in the Banking Department | 21.49 | 17.67 | 14.31 | 41.76 | 34.84 |
| Notes in circulation | 171.78 | 236.63* | 1,137.47 | 1,223.55 | 1,257.48 |
| Total Notes issued= | | | | | |
| Total Liabilities | 193.27 | 254.30 | 1,151.79 | 1,265.31 | 1,292.32 |
| ASSETS | | | | | |
| A. Gold Coin and Bullion :— | | | | | |
| (a) Held in India | 41.55 | 41.54 | 44.41 | 44.41 | 40.02 |
| (b) Held outside India | 2.87 | 2.87 | — | — | — |
| Sterling/Foreign Securities | 66.19 | 107.50 | 1,034.33 | 1,135.33 | 678.15 |
| Total of A | 110.61 | 151.92 | 1,078.74 | 1,179.74 | 718.17 |
| B. Rupee Coin | 57.12 | 64.04 | 15.20 | 27.73 | 57.52 |
| Government of India Rupee Securities | 25.54 | 38.34 | 57.84 | 57.84 | 516.63 |
| Internal Bills of Exchange and other commercial paper | — | — | — | — | — |
| Total Assets | 193.27 | 254.30 | 1,151.79 | 1,265.31 | 1,292.32 |
| Ratio of Total of A to Liabilities (per cent) | 57.231 | 59.739 | 93.658 | 93.237 | 55.572 |

* Of these, Rs. 11.43 crores of notes were legal tender in Burma only.

Banking Department

(Rs. crores)

| | December 31, 1935 | December 31, 1939 | June 30, 1945 | June 30, 1947 | June 30, 1951 |
|---|----------------------|----------------------|------------------|------------------|------------------|
| LIABILITIES | | | | | |
| Capital paid-up | 5.00 | 5.00 | 5.00 | 5.00 | 5.00 |
| Reserve Fund | 5.00 | 5.00 | 5.00 | 5.00 | 5.00 |
| Deposits :— | | | | | |
| (a) Government | | | | | |
| (1) Central Government | 6.05 | 6.73 | 277.97 | 390.70 | 162.79 |
| (2) Other Governments | — | 6.12† | 23.67† | 18.00 | 17.05 |
| (b) Banks | 28.34 | 18.87 | 80.19 | 88.91 | 58.74 |
| (c) Others | 0.26 | 1.16 | 17.93 | 30.96 | 71.43 |
| Bills Payable | 0.11 | 0.09 | 3.78 | 1.92 | 2.37 |
| Other Liabilities | 0.71 | 0.54 | 12.35 | 7.92 | 9.82 |
| Total Liabilities | 45.47 | 43.51 | 425.89 | 548.41 | 332.19 |
| ASSETS | | | | | |
| Notes | 21.49 | 17.67‡ | 14.31 | 41.76 | 34.84 |
| Rupee Coin | 0.04 | 0.04 | 0.16 | 0.09 | 0.13 |
| Subsidiary Coin | 0.04 | 0.04 | 0.01 | 0.01 | 0.01 |
| Bills Purchased and Discounted:— | | | | | |
| (a) Internal | — | — | — | — | 0.37 |
| (b) External | — | — | — | — | — |
| (c) Government Treasury Bills | — | 10.11 | — | 2.44 | 1.72 |
| Balances held abroad* | 17.39 | 6.98 | 388.13 | 430.82 | 178.35 |
| Loans and Advances to | | | | | |
| Government/s | 1.00 | 1.20 | 0.70 | 5.11 | 7.50 |
| Other Loans and Advances | — | — | — | 0.03 | 18.71 |
| Investments | 5.29 | 6.42 | 21.45 | 66.94 | 88.12 |
| Other Assets | 0.22 | 1.06 | 1.13 | 1.21 | 2.44 |
| Total Assets | 45.47 | 43.51 | 425.89 | 548.41 | 332.19 |

* Includes Cash and Short-term Securities. † Includes Rs. 1.54 crores and Rs. 0.71 crore of Government of Burma deposits at the end of December 1939 and June 1945, respectively. ‡ Of these, Rs. 0.07 crore of notes were legal tender in Burma only.

TABLE 3-A
SELECTED ECONOMIC INDICATORS, 1935-39

| | (Rs. crores) | | | | | | |
|---|--------------------------|---|--------|-------------------|-------------------|-------------------|---|
| | <i>April 5, 1935</i> | <i>As on the last Friday of the Calendar Year</i> | | | | | <i>Aug. 25, 1939, i.e., End of World War II</i> |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| 1. R.B.I. — Sterling Securities | 60.58 | 84.22 | 83.93 | 83.94 | 60.80 | 113.05 | 66.94 |
| 2. " — Rupee Securities | 48.05 | 30.77 | 29.74 | 33.65 | 37.90 | 44.65 | 44.21 |
| 3. " — Government Deposits | 18.36 | 7.08 | 6.93 | 9.76 | 11.25 (1.95) | 12.97 (1.54) | 15.13 (1.99) |
| 4. Money Supply (excluding rupee coin) ¹ | 259.14 (July 26) | 285.27 | 307.72 | 308.87 | 316.97 | 383.72 | 319.83 |
| 5. Absorption (+), withdrawal (-) of Rupee Coin during the year | | -6.84 | -6.89 | -3.56 | -12.63 | +0.97 | |
| 6. Scheduled Banks — Deposit, Liabilities | 207.53 (July 5) | 220.60 | 229.58 | 242.31 (10.81) | 238.59 (10.82) | 251.33 (11.27) | 249.45 (11.30) |
| 7. Scheduled Banks — Advances and Bills | 106.75 (July 5) | 86.84 | 102.92 | 114.88 (4.67) | 118.91 (4.35) | 147.85 (4.65) | 109.26 (4.23) |
| 8. Scheduled Banks — Investments ² | 82.80 (July 5) | 108.09 (Dec. 20) | 112.16 | 108.59 | 110.05 | 87.40 | 115.79 |
| 9. Index Number of Wholesale Prices — Calcutta (July 1914 = 100) monthly — December index for columns 2 to 6 | 88 (April) | 93 | 94 | 102 | 95 | 137 | 100 (Aug.) |
| 10. Interim Index of Industrial Production — unadjusted (1937 = 100) — annual index for calendar years | | | | 100 | 105.4 | 102.7 | |
| 11. Index Number of Share Prices — Variable Yield Industrial Securities (1927-28 = 100) — monthly — December index for columns 2 to 6 | 109.7 (April) | 108.6 | 119.4 | 115.2 | 107.3 | 130.7 | 98.5 (Aug.) |

TABLE 3-A—Contd.
SELECTED ECONOMIC INDICATORS, 1935-39

| | Average for December | | | | | | Average for Aug. 1939, i.e., Eve of World War II |
|--|---------------------------|-----------------------|---|---------|--------|-------------------------------------|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | |
| | Average for April 1935 | 1935 | 1936 | 1937 | 1938 | 1939 | (Rs. crores) |
| 12. Gold price (Spot) Bombay (per tola) Rs. a. p. .. | 35-14-4 | 34-14-1 | 35-1-4 | 34-7-5 | 37-4-5 | 41-14-4 | 37-7-2 |
| 13. Silver price (Spot) Bombay (per 100 tolas) Rs. a. p. .. | 73-2-7 | 56-10-8 | 52-7-6 | 47-11-3 | 51-0-2 | 61-15-7 ¹ / ₂ | 47-6-9 |
| 14. 3½ per cent Undated Rupee Paper Price (Rs. a. p.) .. | 91-10-8 | 96-5-4 | 100-0-8 | 98-5-8 | 98-6-5 | 87-10-0 | 96-11-3 |
| Yield ³ .. | 3.84 | 3.64 | 3.50 | 3.56 | 3.56 | 4.00 | 3.66 |
| 15. Call Money Rate ⁴ —Bombay (Per cent per annum) | April 1935 | April to Dec. 1935 | During the Month/Period/Calendar Year 1936 | 1937 | 1938 | 1939 | August 1939, i.e., Eve of World War II |
| Highest .. | 2 } July 1935 | 2 } July- Dec. | 1 | 1½ | 2½/4 | 2½/4 | { 1/4 |
| Lowest .. | 1 } | 1/4 } | 1/4 | 1/4 | 1/4 | 1/4 | |
| 16. Central Government Treasury Bills — Rate of accepted ten- ders & intermediates (Per cent per annum) | 2 } July 1935 | 2 } July- Dec. | 1 | 1½ | 2½/4 | 2½/4 | { 1/4 |
| Highest .. | 1 } | 1/4 } | 1/4 | 1/4 | 1/4 | 1/4 | |
| Lowest .. | 1-12-0 | 1-12-0 | 1-1-4 | 1-4-0 | 2-8-9 | 2-12-9 | 1-0-6 |
| Rs. a. p. .. | 0-11-8 | 0-11-8 | 0-7-0 | 0-7-0 | 0-9-8 | 0-13-6 | 0-14-2 |

Note : In respect of Reserve Bank and scheduled bank data, Burma figures, where separately available, have been shown in brackets below the totals for India and Burma.

TABLE 3-B
SELECTED ECONOMIC INDICATORS, 1939-45

| Absolute and percentage variations during the period/financial year April-March | | | | | | | | | | (Rs. crores) |
|--|--------------------------|--------------------|--------------------|--------------------|--------------------|-------------------|--------------------------|-------------------|-------------------------------------|--------------|
| August 1939 | Mar. 1940 over Aug. 1939 | 1940-41 | 1941-42 | 1942-43 | 1943-44 | 1944-45 | Aug. 1945 over Mar. 1945 | August 1945 | Aug. 1945 over Aug. 1939 | |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | |
| (Last Friday figures for items 1 to 7) | | | | | | | | | | |
| 1. R. B. I. — Sterling Securities | 67 | + 75 (+ 112.1) | + 2 (+ 1.8) | + 104 (+ 71.7) | + 261 (+ 105.1) | + 437 (+ 85.9) | + 417 (+ 44.1) | + 144 (+ 10.5) | 1,507 + 1,440 (+ 2,151.4) | |
| 2. R. B. I. — Rupee Securities | 44 | + 2 (+ 4.3) | + 49 (+ 106.1) | + 53 (+ 56.2) | + 32 (+ 21.3) | - 113 (- 62.8) | + 9 (+ 13.5) | + 7 (+ 8.9) | 83 + 39 (+ 87.2) | |
| 3. R.B.I. — Central Govt. Deposits | 9 | - 1 (- 10.7) | - 3 (- 38.1) | + 2 (+ 45.6) | + 12 (+ 161.0) | + 57 (+ 295.0) | + 177 (+ 232.2) | + 110 (+ 43.2) | 364 + 354 (+ 3,847.1) | |
| 4. Money Supply ¹ | 327 | + 98 (+ 30.1) | + 90 (+ 21.2) | + 168 (+ 32.6) | + 464 (+ 68.0) | + 428 (+ 37.3) | + 300 (+ 19.0) | + 79 (+ 4.2) | 1,955 (+ 498.4) | |
| 5. Scheduled Banks ² — Deposit | 238 | + 10 (+ 4.1) | + 25 (+ 9.9) | + 51 (+ 18.9) | + 172 (+ 53.2) | + 195 (+ 39.4) | + 124 (+ 18.0) | + 80 (+ 9.8) | 896 + 657 (+ 276.1) | |
| 6. Scheduled Banks ² — Advances and Bills | 105 | + 51 (+ 49.0) | - 32 (- 20.6) | - 9 (- 7.0) | + 19 (+ 16.0) | + 97 (+ 72.7) | + 66 (+ 28.7) | - 23 (- 7.7) | 275 + 170 (+ 162.0) | |
| 7. Scheduled Banks ² — Investments ³ .. | 116 | - 39 (- 33.9) | + 38 (+ 50.2) | + 53 (+ 46.2) | + 142 (+ 84.3) | + 87 (+ 28.0) | + 20 (+ 5.0) | + 74 (+ 17.9) | 491 + 375 (+ 324.0) | |
| 8. Index Number of Wholesale Prices — Sensitive Series (Base : Week ended Aug. 19, 1939 = 100) General index (average for the month) | 100.1 | + 29.2 (+ 29.2) | - 14.4 (- 11.1) | + 29.3 (+ 25.5) | + 69.3 (+ 48.1) | + 18.6 (+ 8.7) | + 15.7 (+ 6.8) | - 3.7 (- 1.5) | 244.1 + 144.0 (+ 143.9) | |

TABLE 3-B—Contd.
SELECTED ECONOMIC INDICATORS, 1939-45

| | (Rs. crores) | | | | | | | | | |
|---|---|--------------------------|-----------------------|------------------------|----------------------|----------------------|---------------------|--------------------------|-----------------------|--------------------------|
| | Absolute and percentage variations during the period/financial year April-March | | | | | | | | | |
| | August 1939 | Mar. 1940 over Aug. 1939 | 1940-41 | 1941-42 | 1942-43 | 1943-44 | 1944-45 | Aug. 1945 over Mar. 1945 | August 1945 | Aug. 1945 over Aug. 1939 |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | |
| 9. Interim Index of Industrial Production — unadjusted (1937 = 100) (annual index for 102.7 calendar years) ⁷ .. | | + 7.2 (+ 7.0) | + 7.9 (+ 7.2) | - 6.6 (- 5.6) | + 5.8 (+ 5.2) | (-) (-) | + 3.0 (+ 2.6) | 120.0 | + 17.3 (+ 16.8) | |
| 10. Index Number of Share Prices — Variable Yield Industrial Securities (1927-28 = 100) (monthly index) 98.5 | + 23.6 (+ 24.0) | + 1.7 (+ 1.4) | - 4.2 (- 3.4) | + 43.2 (+ 36.1) | + 32.5 (+ 20.0) | + 4.6 (+ 2.4) | + 12.7 (+ 6.4) | 212.6 | + 114.1 (+ 115.8) | |
| 11. Gold price (Spot) Bombay (monthly average) Rs. a. p. 37-7-2 | + 5-2-5 (+ 13.7) | + 1-0-3 (+ 2.4) | + 9-5-11 (+ 21.5) | + 17-0-0 (+ 32.1) | + 1-13-9 (+ 2.7) | + 0-11-5 (+ 1.0) | + 0-15-3 (+ 1.3) | 73-8-2 | + 36-1-0 (+ 96.3) | |
| 12. Silver price (Spot) Bombay (monthly average) Rs. a. p. 47-6-9 | + 10-4-8 (+ 21.7) | + 5-6-10 (+ 9.4) | + 22-10-3 (+ 35.9) | + 23-10-10 (+ 27.6) | + 20-5-3 (+ 18.6) | - 1-12-10 (- 1.4) | + 1-13-8 (+ 1.5) | 129-13-5 | + 82-6-8 (+ 173.8) | |

TABLE 3-B—Contd.
SELECTED ECONOMIC INDICATORS, 1939-45

(Rs. crores)

| | Average for Aug. 1939 | Average for March | | | | | Average for Aug. 1945 | |
|--|-----------------------|-------------------------|----------------|---------------|-----------------|---------------|-----------------------|------------------------|
| | | 1940 | 1941 | 1942 | 1943 | 1944 | 1945 | |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| 13. $3\frac{1}{2}$ per cent Undated Rupee Paper Price Rs. a. p. | 96-11-3 | 94-2-2 | 95-8-2 | 87-3-10 | 94-0-0 | 98-15-0 | 99-9-11 | 101-10-3 |
| Yield ^a | 3.66 | 3.72 | 3.66 | 4.01 | 3.72 | 3.54 | 3.51 | 3.44 |
| During the Month/Period/Financial Year April-March | | | | | | | | |
| | Aug. 1939 | Sept. 1939 to Mar. 1940 | 1940-41 | 1941-42 | 1942-43 | 1943-44 | 1944-45 | Apr. 1945 to Aug. 1945 |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| 14. Call Money Rate ⁴ —Bombay (per cent per annum) | | | | | | | | |
| Highest | $\frac{1}{4}$ | $2\frac{1}{4}$ | $1\frac{1}{4}$ | $\frac{3}{4}$ | $\frac{3}{4}-1$ | $\frac{1}{4}$ | $\frac{1}{4}$ | $\frac{1}{4}$ |
| Lowest | | $\frac{1}{4}$ | $\frac{1}{4}$ | $\frac{1}{4}$ | | | | $2\frac{1}{4}$ |
| 15. Central Govt. Treasury Bills — Rate of accepted tenders and intermediates (Per cent per annum) | | | | | | | | |
| Highest | 1-0-6 | 2-12-9 | 1-10-7 | 1-2-5 | 1-4-7 | 1-1-9 | 0-13-0 | 0-7-11 |
| Lowest | 0-14-2 | 1-12-0 | 0-10-0 | 0-6-0 | 0-6-6 | 0-8-8 | 0-5-0 | 0-3-11 |
| Rs. a. p. | | | | | | | | |
| | | | | | | | | |

TABLE 3-C
SELECTED ECONOMIC INDICATORS, 1945-51
(Rs. crores)

| Pre-Partition Period | | | Post-Partition Period | | | | |
|---|-----------------|--|-----------------------|------------------------------------|------------------------------------|------------------------------------|-----------------------------------|
| August 31, 1945 | Mid-August 1947 | Absolute and percentage variations of mid-August 1947 over Aug. 31, 1945 | August 29, 1947 | June 25, 1947 over August 29, 1947 | August 26, 1949 over June 25, 1948 | June 30, 1950 over August 26, 1949 | March 30, 1951 over June 30, 1950 |
| 1. R.B.I. — Foreign Assets | 1,507 | 1,516 + 9 (+ 0.6) | 1,518* | + 18 (+ 1.2) | - 756 ¹¹ (- 49.2) | + 48 (+ 6.2) | + 57 (+ 6.9) |
| 2. R.B.I. — Rupee Securities | 83 | 139 + 56 (+ 68.0) | 142* | + 39 (+ 27.2) | + 325 ¹² (+ 179.4) | + 23 (+ 4.5) | + 57 (+ 10.8) |
| 3. R.B.I. — Central Government Deposits .. | 364 | 377 + 13 (+ 3.6) | 357* | - 133 ¹⁰ (- 37.2) | - 115 (- 51.4) | + 31 (+ 28.8) | + 21 (+ 15.2) |
| 4. Money Supply .. | 1,955 | 2,067 + 112 (+ 5.7) | 2,069 | + 52 (+ 2.5) | - 312 (- 14.7) | + 25 (+ 1.4) | + 132 (+ 7.2) |
| 5. Scheduled Banks — Deposit Liabilities .. | 896 | 1,022 + 126 (+ 14.1) | 946 | + 60 (+ 6.3) | - 134 (- 13.3) | - 9 (- 1.0) | + 40 (+ 4.6) |
| 6. Scheduled Banks — Advances and Bills .. | 275 | 423 + 148 (+ 53.7) | 374 | + 80 (+ 21.3) | - 37 (- 8.2) | + 36 (+ 8.7) | + 94 (+ 20.8) |
| 7. Scheduled Banks — Investments ² | 491 | 466 - 25 (- 5.1) | 429 | - 9 (- 2.1) | - 76 (- 18.0) | - 14 (- 4.0) | - 49 (- 14.7) |

TABLE 3-C—Contd.
SELECTED ECONOMIC INDICATORS, 1945-51

| | Pre-Partition Period | | | Post-Partition Period | | | | | | (Rs. crores) |
|---|----------------------|------------------------|---|------------------------------------|---|---|---|--|---------|--------------|
| | August 31, 1945 | Mid- August 1947 | Absolute and Percentage variations of mid-August 1947 over Aug. 31, 1945 | Absolute and Percentage Variations | | | | | | |
| | | | | August 29, 1947 | June 25, 1948 over August 29, 1947 | August 26, 1949 over June 25, 1948 | June 30, 1950 over August 26, 1949 | March 30, 1951 over June 30, 1950 | | |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | |
| 8. Index Number of Wholesale Prices — General Index (average for the month) Sensitive Series (Week ended August 19, 1939 = 100) | 244.1 | 299.3 | +55.2 (+22.6) | | | | | | | |
| General Purpose Series (Year ended August 1939 = 100) | | | | 301.4 | +80.8 (+26.8) | +6.8 (+1.8) | +6.6 (+1.7) | +43.0 (+10.9) | 438.6 | |
| 9. Index Number of Share Prices — Variable Yield Industrial Securities (monthly index) 1927-28 = 100 | 212.6 | 189.7 | -22.9 (-10.8) | | | | | | | |
| 1938 = 100 | | | | 182.7 (Aug.) | -39.1 (-21.4) | -31.4 (-21.9) | +5.7 (+5.1) | +14.9 (+12.6) | 132.8 | |
| 10. Gold Price (Spot) Bombay (monthly average) Rs. a. p. per tola | 73-8-2 | 110-3-1 | +36-10-11 (+49.9) | 110-3-1 | +5-1-4 (+4.6) | -0-13-6 (-0.7) | +0-10-9 (+0.6) | -1-14-0 (-1.6) | 113-3-8 | |
| 11. Silver Price (Spot) Bombay (monthly average) tolas Rs. a. p. per 100 | 129-13-5 | 175-15-7 | +46-2-2 (+35.5) | 175-15-7 | -2-2-5 (-1.2) | -11-7-6 (-6.6) | +19-2-9 (+11.8) | +12-14-2 (+7.1) | 194-6-7 | |

TABLE 3-C—Contd.
SELECTED ECONOMIC INDICATORS, 1945-51
(Rs. crores)

| | Pre-Partition Period | | Post-Partition Period | | | |
|---|-------------------------|-------------|-------------------------|-----------------------------|--------------------------|--|
| | Calendar Years | | Calendar Years | | | |
| | 1945 | 1947 | 1947 | 1948 | 1949 | 1950 1951 |
| 12. Interim Index of Industrial Production — (annual index for calendar years). Unadjusted (1937 = 100) New Series (1946 = 100) | 120.0 | 102.4 | 97.2 | 108.4 | 105.7 | 105.0 117.2 |
| | Average for | | Average for | | | |
| | August 1945 | August 1947 | August 1947 | June 1948 | August 1949 | June 1950 March 1951 |
| 13. $3\frac{1}{2}$ per cent Undated Rupee Paper ¹³ | | | | | | |
| Rs. a. p. Price.. | 101-10-3 | 100- 9 -1 | 100- 9 -1 | 98-12-5 | 98- 0-0 | 97- 4-11 92-15-10 |
| Yield ¹³ .. | 3.44 | 2.98 | 2.98 | 3.04 | 3.06 | 3.08 3.23 |
| | During the Month/Period | | During the Month/Period | | | |
| | August 1945 | August 1947 | August 1947 | September 1947 to June 1948 | July 1948 to August 1949 | September 1949 to March 1950 July 1950 to March 1951 |
| 14. Call Money Rate ⁴ — Bombay (Per cent per annum) | | | | | | |
| Highest | 1/4 | 1/2 | 1/2 | 1/2 | 1/2 — 1 1/2 | 1 — 1 3/4 |
| Lowest | | | | | | |
| 15. Central Government Treasury Bills — Rate of accepted tenders and intermediates (Per cent per annum) | | | | | | |
| Rs. a. p. Highest | 0-7-0 | — | — | 0-8-0 | 0-9-0 | 0-8-11 ¹⁴ |
| Lowest | 0-5-11 | — | — | 0-5-9 | 0-6-11 | 0-8- 0 ¹⁴ |

FOOTNOTES FOR TABLES 3A TO 3C

1. Data of rupee coin in circulation are not available for the period prior to October 1943. However, figures of absorption (+) or return (-) of rupee coin are available and these have been shown separately below figures of money supply.
2. Weekly data on investments of scheduled banks are available only from November 1951. Figures of investments for these tables have been therefore worked out by deducting advances and bills discounted of other (i.e., other than the Imperial Bank) scheduled banks and their cash and balances with the Reserve Bank from the deposit liabilities of such banks. In the case of the Imperial Bank, figures of investments appearing in the weekly statement of affairs have been used.
3. Based on averages of daily quotations in Calcutta.
4. Based on weekly rates.
5. Data relating to rupee coin in circulation are not available prior to October 1943. Monthly figures of absorption or return of rupee coin are, however, available, and on the basis of these, figures of rupee coin in circulation have been worked backwards from October 1943; these have been used for arriving at figures of money supply with the public. However, it would appear that pre-October 1943 rupee circulation figures are underestimates; hence the percentage variations of money supply calculated on the underestimated base figures are somewhat overstated. Money supply figures are exclusive of Burma from February 1942.
6. Figures relate to scheduled banks in India.
7. Index numbers of industrial production are available only for calendar years. For the purpose of this table, the absolute and percentage variation shown under the column 1940-41 has been taken as variation of the index for the year 1948 over that for the year 1939, and not 1941 over 1940, since 1940 and 1939 are nearer to March 1941 and March 1940, respectively.
8. Combined figure for India and Pakistan; Pakistan was paid its share in instalments after the Bank ceased to be the central bank for Pakistan on July 1, 1948.
9. Excludes Rs. 20 crores paid to Pakistan at the time of partition in mid-August 1947.
10. The fall of Rs. 133 crores was partly accounted for by transfer of Rs. 55 crores to Pakistan in January 1948 as its share of Central Government deposits with the Bank.
11. The fall of Rs. 756 crores was over the combined figure for India and Pakistan for June 1948, and was accounted for mainly by adjustments in respect of (i) sterling amounting to Rs. 187 crores released to Pakistan upto this date as its share of Reserve Bank assets, and (ii) Rs. 296 crores of sterling paid to the U.K. for purchase of annuities for financing the payment of sterling pensions, and the acquisition of defence installations and stores left behind in India by the U.K. at the end of the war.
12. The increase of Rs. 325 crores was over the combined figure for India and Pakistan for June 1948 and was mainly the result of adjustments made in respect of rupee securities created to replace sterling paid to the U.K. for purchase of annuities for financing the payment of sterling pensions, and the acquisition of defence installations and stores left behind in India by the U.K. at the end of the war.
13. Quotations for August 1947 and later dates are for 3 per cent Undated Rupee Paper (1986 or later).
14. Sales of Treasury bills remained suspended from the last week of December 1949 till the first week of September 1952.

SOURCES OF MATERIAL

The material for the account of the developments in money, banking and exchange in India prior to the establishment of the Bank in 1985 is taken mostly from published sources, in particular, the reports of the various Commissions and Committees. As regards the account of the Bank's functioning in the period 1985-51, the Bank's internal files-notings, memoranda to the Central Board and its Committee and correspondence-constitute the most important source of material, supplemented by the many publications of the Bank, including the comprehensive statistical compilation, namely, the Banking and Monetary Statistics of India. The budget papers have been used freely in drafting the chapters on financial trends and monetary policies of the Bank. The debates in the Indian Legislature have been drawn upon extensively for the detailed account concerning the passage of the Reserve Bank of India Bill, the Foreign Exchange Regulation Bill, the Banking Companies Bill, the Bill to nationalise the Reserve Bank and other matters such as India's joining the I.M.F. and the I.B.R.D.

The Indian financial and economic weeklies, namely, the Indian Finance, the Capital, the Commerce and the Eastern Economist have all been referred; the Indian Finance was specially useful.

Correspondence between the Governors of the Bank and Directors of the Central Board, in particular Sir Purshotamdas Thakurdas, Mr. C. R. Srinivasan and Mr. B. M. Birla, proved extremely helpful.

The above material was supplemented by the discussions which the Member-Secretary of the Editorial Committee had with a number of distinguished persons who have had intimate connections with the Bank in some capacity or other, namely, former Finance Ministers, Governors and Deputy Governors of the Bank and Directors of the Central Board.

The list of important books and reports used in the compilation of the History is given below. It is in two parts, Part I relating to the material used primarily for the first three chapters, i.e., the Preparatory Years, and the other for the account of the Bank's actual functioning.

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