THE PREPARATORY YEARS

1

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 interconnection 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 aurungs, 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 aurungs 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. 1lakh 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 Rank 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 o 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;
(c) 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 0. 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, GeorgeSchuster, 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.