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The Reserve Bank of India Act

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

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

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

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

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

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

Applicability

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

Ownership of the Bank

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

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

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

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

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

Dispersal of Ownership

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

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

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

Government's Powers

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

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

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

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

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

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

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

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

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

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

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

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

Management

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

Nominated and Elected Directors

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

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

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

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

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

Election of Directors through Local Boards

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

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

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

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

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

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

The First Central and Local Boards

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

Meetings of the Central Board

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

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

Governor and Deputy Governors

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

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

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

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

> C1auise 12(1) -The meaning in the Bill as it stands seems quite clear and I am not in favour of tinkering with it. The suggestion of the Deputy Controller of the Currency might make the meaning somewhat clearer, but on the other hand it might create a discussion on the general question, and this seems undesirable.

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

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

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

Qualifications of the Governor

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

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

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

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

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

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

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

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

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

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

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

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

Share Capital

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

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

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

Offices of the Bank

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

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

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

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

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

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

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

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

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

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

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

Central Banking Functions

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

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

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

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

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

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

Banker to Government

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sole Right of Note Issue

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Bankers’ Bank

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

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

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

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

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

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

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

Credit Facilities available from the Reserve Bank

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

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

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

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

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

Instruments of Credit Control

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

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

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

Direct Discount

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

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

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

Linking of the Indigenous Bankers with the Reserve Bank

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

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

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

Agricultural Credit Department

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

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

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

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

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

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

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

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

All that the Bank could do, he went on, was to take a part in the scheme of agricultural finance conjointly with the co-operative credit movement. Charged as it was with working the currency and credit system of the country, it would be most undesirable for the Bank to undertake any business, whether it be rural credit or industrial credit, otherwise than on the lines laid down in the earlier clauses of the Bill. Besides, unless the Reserve Bank cou1d ‘ somehow or other get into gear with all the rather primitive credit machinery which exists in the country, the indigenous bankers and their whole business of rural finance,. . . . .it will remain the centre of an important machine no doubt, but out of touch with the main financial business of India’. On the other hand, the Bank could perform a very useful function by acting as a guide and an adviser to the whole of the co-operative financing machinery. With these objectives in view, and drawing support for them from the comments made by Mr. Macpherson, the co-operative expert from the Punjab who had given evidence in this regard before the Joint Select Committee, the Finance. Member moved an alternative amendment in terms of which a special Agricultural Credit Department was to be established immediately but with the limited functions of maintaining an expert staff to study all questions of agricultural credit and advising the Central and Local Governments, the provincial co-operative banks and other banking organisations on matters pertaining to agricultural credit, and of co-ordinating the Bank’s operations with those of other institutions purveying such credit. The alternative clause was adopted by the House (S.54) along with the clause recommended by the Select Committee, viz., that the Bank should make a report, with proposals for legislation, within three years on ‘the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the Bank’ [S. 55(1) (b)].

Exchange Obligation

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

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

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

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

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

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

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

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

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

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

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

Returns and Reports

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

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

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

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

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

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

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

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