5

Early Central Banking Policies and Operations

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

The process of partial recovery of prices, however, received a setback with the emergence of recessionary conditions in the U.S.A. and other countries of the world about the middle of 1937. This had a depressing effect on prices in India due to the slackening of foreign demand for her products. The wholesale price level declined from September 1937 in sympathy with the general fall of prices in world markets and touched a low of 94 in April 1938; in particular, the price of raw cotton, the most important item of export, recorded a sharp fall in sympathy with the fall in the price of the commodity in the U.S.A. The downward trend in prices and business conditions in India was aggravated by the continuance of Sino-Japanese hostilities, which seriously curtailed the trading capacity of Japan, India's principal customer for raw cotton. These developments brought down the export surplus in favour of India and Burma to Rs. 39.80 crores in 1938.

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

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

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

The monetary data relating to the period would also seem to bear out the impression of an economy at a low ebb of activity. During the four-year period August 1935-July 1939, currency with the public, exclusive of rupee coins of which statistics are not available, recorded a rise of Rs. 21 crores to Rs. 170 crores. However, as there was a return of rupees from circulation to the extent of Rs. 33 crores during the period, there was an actual decline in currency circulation to the tune of Rs. 12 crores. There was, on the other hand, a rise of Rs. 39 crores in deposit money during the same period, so that overall money supply showed an expansion of Rs. 27 crores only in the four years ending July 1939. The actual increase in money supply would have been even smaller than indicated above, since part of the rise in deposit money may be attributed to the increased coverage of banks.

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

In India, on the other hand, official views on the role of Government in the economic sphere were still largely dominated by the doctrine of laissez-faire. Accordingly, the pursuit of socio-economic welfare policies or the undertaking of nation-building activities were still considered to be outside the scope of Government’s responsibilities. Further, influenced by the prevailing prejudice of the Home authorities against budgetary deficits, the financial policy of the Government was guided by a firm belief in the virtue of balanced budgets. The Government of India were rather anxious to put their finances in good shape by providing for small surpluses through economy, taxation and borrowing from the public. Actually, achievement of budgetary equilibrium had been regarded as a pre-condition for the establishment of the Reserve Bank of India and the inauguration of the new Constitution of India. The other major fixation of the Government at this time was their persistence in maintaining the exchange rate at 1S. 6d., regardless of the many arguments deserving of consideration in favour of the view that a lower rate would benefit the economy greatly. Naturally, the prevailing attitudes and policies, not to say prejudices, of the Government very largely determined what the policies of the central banking authority were to be in the circumstances. Thus, although the Indian economy was on the whole stagnant and the Indian financial press and the economic intelligentsia of the country advocated a reflationist policy, the horizon of economic and monetary policy was limited and current policy concepts were not attuned to the problems of developmental or anti-cyclical fiscal or monetary management. The limited objective of official policy is brought out in the following extract from Prejudice and Judgment, representing the personal and public recollections of Sir James Grigg, who was Finance Member of the Government of India during almost this entire period:

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

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

Monetary Management -General Aspects

Monetary management in the early years of the Bank had both potentialities and limitations. Much of the period was characterised by extremely easy money conditions but these reflected primarily the low tempo of economic activity. Easy conditions were also largely confined to the organised sector of the money market. There was the task of taking the benefit of cheap credit to the large unorganised sector, but the Bank’s links with this sector were, if anything, remote. The freedom of movement of funds across the country in the absence of exchange control, the need to find foreign exchange to meet Home Charges and the obligations placed on the Bank to maintain a fixed exchange parity, acted as constraints on the Bank's freedom and called for considerable skill and finesse on its part. The Bank had also to keep a sensitive ear to monetary and exchange developments abroad, especially in the U.K. While, on the whole, monetary management called for a great deal of vigilance, skill and adaptability, the scope for active policies to influence the range or level of economic activity was not large. It must also be recognised that the prevailing views on the subject in central banking circles generally were not oriented to any positive action bearing on the course of the economy.

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

The Reserve Bank's contacts were in effect confined to the commercial banks, in particular the scheduled banks. So far as this sector was concerned, by and large, there was adequacy of funds, having regard to the comparatively subdued tempo of economic activity and demand for funds. The growth in scheduled bank credit in the four years since July 1935 was only of the order of Rs. 16 crores. The banks had plenty of resources of cash (this was especially so in the case of the Imperial Bank) and Government securities, the credit-deposit ratio in those days being relatively low, generally in the range of 40 to 50 per cent. In the second half of 1935, the first year of the Bank's operations, there was in fact a substantial decline in scheduled bank credit, from Rs. 107 crores to Rs. 87 crores, part of this being seasonal. In the subsequent year, there was a fair measure of recovery and in 1937 too there was moderate expansion. In 1938, while there were seasonal variations in credit, there was no appreciable expansion over the year as a whole. Following the outbreak of war, there was of course a marked expansion in bank credit. Throughout, the resources of banks were, by and large, adequate to meet the seasonal expansion; they drew upon their substantially excess cash balances and also sold from their Government securities portfolio. Thus, during the busy season of 1936-37 (October-March), credit expansion was somewhat pronounced as the usual seasonal activity was reinforced by a wave of speculative buying of shares. Scheduled bank credit rose from Rs. 89 crores to Rs. 103 crores in the last quarter of 1936; this was largely met by banks by reducing their excess cash balances with the Bank from Rs. 19 crores to Rs. 6 crores. During the first quarter of 1937, there was a further rise in bank credit of Rs. 25 crores to Rs. 128 crores, which the banks financed mostly by running down their investments. Similar trends were also noticeable in the busy season of 1938-39, when excess balances came down significantly.

The general abundance of funds did not mean that there were no occasions when banks did not need some outside assistance temporarily. Apart from inter-bank call loans, the market in which was well developed, banks obtained their short-term accommodation mainly from the Imperial Bank of India. In July 1935, the Imperial Bank announced that it would extend to banks day-to-day loans against Government securities on a call loan rate basis; this rate, before long, came to be about ½ of 1 per cent above the inter-bank call loan rate. If the banks did not want to borrow on the basis of a fluctuating call rate, they could borrow at the Imperial Bank general advances rate, which was on par with the Reserve Bank rate. Moreover, from June 1, 1935, that is, about a month prior to the establishment of the statutory relationship between the Reserve Bank and the scheduled banks, the Imperial Bank removed the stipulation of a seven-day minimum interest. The presence of the Imperial Bank's branches all over the country also favoured the other banks' borrowing from the Imperial.

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

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

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

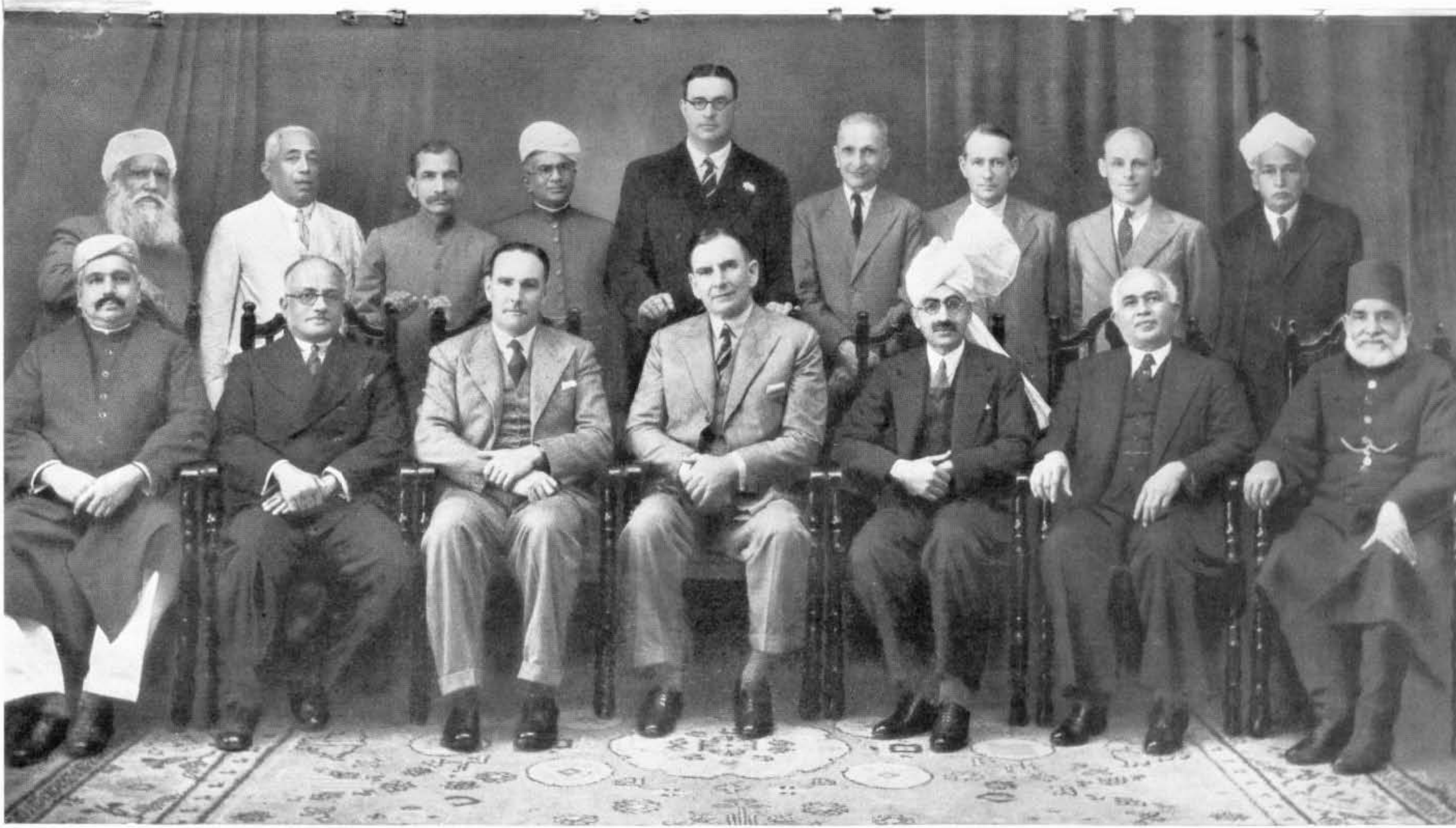
An important constraint on the freedom of the Bank in its operations was the need to maintain the exchange rate of the rupee at 1S. 6d. any marked expansion of credit and lowering of the interest rate pattern would have affected the acquisition of sterling and the inflow of banking funds. Since in the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

All this only indicates that in the light of the prevailing circumstances and views there was not much scope for monetary action. That is not to say that things were the same as in the days prior to the establishment of the Reserve Bank. There was of course, greater concentration on central banking functions than might have been expected from an institution which was essentially a commercial bank. There was considerable improvement and refinement in the handling of the money market and the foreign exchange. Also, while not much central bank credit was extended; a detailed study of the problems in this behalf was initiated. Perhaps something concrete would have emerged but for the outbreak of the war.

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

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

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



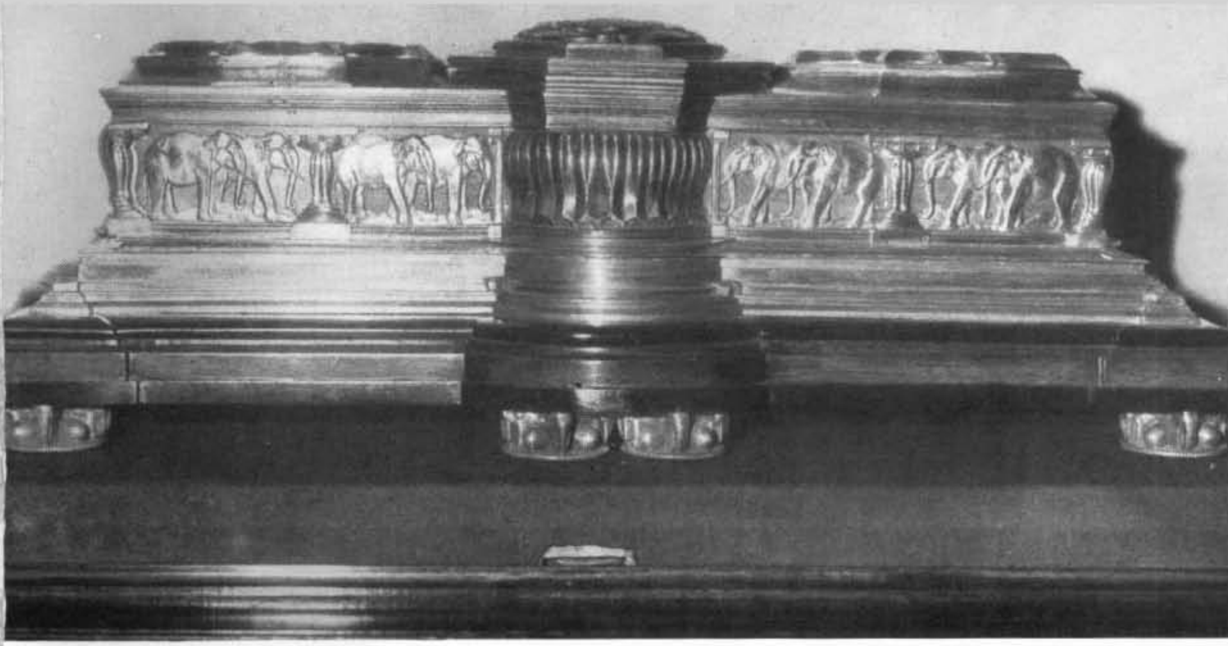
First Central Board of Directors

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

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

Bombay building of the Bank.

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



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

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

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

Bank Rate Procedures and Policy

The initial task of the Reserve Bank was to establish contact with the money market in its role as the lender of last resort through the normal channels of discounts and advances. The Reserve Bank fixed its first Bank rate at 3½ per cent; the decision was taken at a meeting of the Committee of the Central Board held on July 3, 1935. The announcement of the Bank rate was timed just before the day (July 5, 1935) fixed for the scheduled banks to lodge their statutory deposits with the Reserve Bank, so that, in the event of some banks requiring advances to meet their obligations, the Reserve Bank would be in a position to make advances to them at the Bank rate.

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

It would be of interest to know how the Bank rate of 3½ per cent stood in relation to the prevailing money rates in India and the U.K.

The principal official rates in the money market prior to the Reserve Bank's establishment, namely, the Imperial Bank of India Bank rate and the Imperial Bank of India Hundi rate, both stood at 3½ per cent, having remained unchanged since February 1933. The inter-bank call money rate in Bombay moved in the range of 2to 4 per cent in the first half of 1935, though the most usual rate was in the range of 3 to 3½ per cent. The three months Central Government Treasury bill rate varied in the first half of 1935 between Rs. 1-8-7 and Rs. 2-0-0 per cent. In London, the Bank rate was 2 per cent, having remained at this level since June 1932. The most important market rate in the U.K., namely, the Treasury bill rate, was as low as 0.2 per cent at the beginning of 1935, rising to 0.75 per cent by the end of the year; the average for 1935 was 0. 55 per cent as compared to 0.73 per cent in 1934.

In India, the only change in Bank rate during the period under study was in November 1935, when it was reduced from 3½ to 3 per cent, effective the 28th. The relevant minutes of the meeting of the Committee of the Central Board held on November 27, were as under:

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

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

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

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

The lowering of the Bank rate, which appears to have been widely anticipated, reflected a marked easing of monetary conditions and a sharp decline in money rates during the latter part of 1935. Call money rate in Bombay, for instance, was quoting at ¼ per cent in November, as compared to 2 to 4 per cent in January-June 1935 ; the Treasury bill auction rate was quoting at about 1 per cent as compared to 1½ to 2 per cent in January-June 1935. There had also been a marked contraction of scheduled bank credit since July.

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

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

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

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

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

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

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

* November 30, 1935. † op. cit.

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

Low Volume of Loans and Discounts

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

(Rs. crores)

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

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

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

Open Market Operations

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

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

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

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

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

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

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

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

In the four fiscal years ending with 1938-39, the funded rupee debt recorded no net change at Rs. 438 crores. There was a decrease of Rs. 12 crores in 1935-36 and more or less an equal increase in the following year. In 1937-38 and 1938-39, there was hardly any change. Except in 1937-38, there was a loan issue in every year, with a coupon rate of 2¾ or 3 per cent, the proceeds being used to pay off earlier loans with coupon rates ranging from 5 to 6½ per cent. Also, there was a net decline in outstanding Treasury bills in the first two years, from Rs. 54 crores to Rs. 29 crores and an increase to Rs. 46 crores by 1939 March end.

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

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

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

Treasury bills, not only to the Imperial but also to the other scheduled banks. For the Imperial, a special arrangement was made in February 1938 with regard to the rate, namely, the same as the average rate of the last preceding auction. This was in view of the fact that the Imperial was the main supporter of the Treasury bills, the quantum of its tender and the rate being guided by the Reserve Bank. At the same time, it was decided to extend facilities for discounting Treasury bills to other scheduled banks also. Accordingly, later in the same month (February 1938), the Bank informally notified those scheduled banks which had been regular tenderers for Central Government Treasury bills that it would be prepared from time to time to purchase Treasury bills at fine rates ascertainable on application from the offices of the Bank. In actual practice, however, this rate was ⅛ per cent above the previous week's average allotment rate, rounded off to the next anna above. Similar facilities were also available to Provincial Governments. In December 1938, Provincial Government Treasury bills were also made eligible for discount at suitable rates, these being somewhat higher.

Exchange Management and Policy

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

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

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

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

the balance of merchandise trade, despite the shrinkage in gold exports, which were mainly responsible for buttressing the exchange rate during the worst phase of the depression. The Bank was able to obtain its requirements of sterling by weekly tenders from scheduled banks at the rate of 1S.6⅛d. and occasionally through purchases of intermediates on tap at .6 5/32d. The sterling purchases of the Bank during the years 1935-3 7 amounted to £ 36.9 million †, £ 42.7 million and £ 33.9 million, respectively. Besides meeting the requirements of Government for normal remittances, the acquisition of sterling during this period was adequate to enable the Bank to put the Government in a position to repay the 5½ per cent India Bonds, 1936-38 for £ 16.9 million. In July 1935, the Government floated a sterling loan (3 per cent 1949-52, a £ 98) for £ 10 million to enable them to repay the 6 per cent 1935-37 sterling bonds for £11.9 million. The Bank's holdings of sterling recorded a net increase from Rs. 61 crores in April 1935 to a peak of Rs.108 crores in April 1937; the ratio of gold and sterling securities in the Issue Department to note issue rose from 50 per cent at the inception to 60 per cent in April 1937, which level seems to have been the goal.

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

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

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

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

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

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

Exchange Ratio Controversy

The exchange rate question was in a sense always active. In October 1936, for instance, the matter had figured in the Legislative Assembly and a motion to censure the Government on this issue was only lost by the casting vote of the President of the Assembly. The weakening of the exchange rate of the rupee in 1938 brought to the fore the ratio controversy associated with the demand for a lowering of the exchange rate. The Working Committee of the Indian National Congress took up the question and sought to bring pressure on the Government of India by directing the Congress Ministries in the Provinces to send representations urging on them the need for an immediate lowering of the rate. In May 1938, the Conference of the Prime Ministers of the Congress-governed Provinces at Bombay was reported to have considered the question and resolved to secure the co-operation of all Provinces in representing to the Central Government the case for a lower rupee-sterling ratio. The Government rightly sensed that the fall in the exchange to the lower point early in June would provide an edge to the agitation for a lower rupee and, to scotch any such move, promptly issued the following communique on June 6, 1938, affirming their determination to maintain the existing ratio:

> In view of the suggestions that have been given publicity in various quarters that the exchange value of the rupee should be altered, the Government of India wish to make it clear that they are satisfied that maintenance of the present value of the rupee is required in the interests of India, and that the resources available for this purpose are more than ample.
> In this connection, it may be pointed out that the gold and sterling assets actually in the hands of the Reserve Bank and the Government of India are at the present time worth more than Rs. 160 crores. The Government of India have no intention of permitting any alteration in the present statutory ratio.

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

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

> sterling since May and therefore the requirements of the Government of India had to be met by sale of necessary sterling assets against cancellation of rupee currency notes in the Banking Department. I apprehend that such contraction of currency without affecting the Bank rate or money market cannot be feasible for a long period, and therefore, unless exports improve materially and soon, contraction of currency actually in circulation will be inevitable in efforts to maintain the rupee at the lower point of 1s.6d. I consider this, unless restricted to a few crores, to be highly detrimental to the interests of the country as a whole, and desire to draw the attention of the Government of India and the Legislature to the serious position facing the country.
>
> I have noted the Press Communique issued by the Government of India on 6 June last. I desire to record that I do not agree that the gold and sterling resources of the Bank were Rs. 160 crores as stated in that communique; if such calculation is based on valuation of the gold in the Issue Department at current market rate (140s.), the Government of India appear to have presumed that the Legislature would agree to an amendment of section 33(4) of the Reserve Bank Act which lays down the price at which gold is to be valued (84s.). This point may be made clear to the public by Government.
>
> I consider any effort to change the existing basis of valuation of gold as inequitable and consider it to be the duty of the Government of India to bring the existing situation to the notice of the Legislature without delay to enable them to decide, after review of the existing economic conditions in India, on such policy regarding devaluation as would prevent depletion of India's currency assets entailing contraction of her currency.

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

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

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

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

The serious attention which the members of the Central Board gave to the ratio question was part of the wider agitation in the country at large on the subject; very likely, there was co-ordination in this matter. Following the lead given by the Congress Ministry of Bombay, most of the Provincial Governments made representations to the Government of India regarding their views on the ratio question. It appears that nearly all of them sought to present the case for a reduction of the rupee ratio with a reiteration of the familiar arguments in support of it. The memorandum submitted by the Government of the Central Provinces and Berar, however, struck a different path by examining the basic issues from a wider angle rather than the narrower question of the exchange ratio and by advocating a mildly reflationary policy to assist economic recovery and growth. It is of interest to record that this document owed its inspiration to Mr. C. D. Deshmukh, who was then the Finance Secretary of the Government.

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

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

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

To consider the Government's press communique, the matter was again brought before the Central Board by Sir Purshotamdas at the meeting held in January 1939. The Board, by a majority of eight to five, passed a resolution deploring the attitude of the Government and trusting that they would be pleased to reconsider their decision. The resolution also stated that 'if the opinion of the elected members of the Board is set aside in this manner by the Government of India, the very purpose and motive of starting the Reserve Bank is, to a considerable extent, discounted '. The Government representative, of course, disowned any intention on the part of the Government 'to discount in any way the importance of the Board of the Bank or to refuse to give due consideration to its views on any matter', but at the same time reaffirmed Government's inflexible stand. It appears that the Government even considered the question of superseding the Central Board ' to prevent an increasing element of futility creeping into their relations with the Board, should this difference of opinion in regard to this vital matter of the ratio persist '. * The Board did not press the matter any further 'possibly on recognising the fact that the ratio agitation did not apparently command more than a formal support from the major political party in the country'.* The agitation for a lower rupee rate lost most of its force as the exchange steadied and withered away with the outbreak of war and a change in the entire outlook.

Conclusion: Impact on the Money Market

The efficacy of monetary management, in the circumstances prevailing at that time, has to be judged among other things by the narrowing of the seasonal and regional variations of money rates. Despite the limited extent of the Bank's intervention, this object appears to have been achieved to a modest extent in the formative years of the Bank. It may perhaps be argued that it would be difficult to say whether the Reserve Bank's policies could take credit for this state of affairs or whether it was inherently due to a generally languishing economy and the very plentiful supplies of short-term money. While, obviously, the general abundance of short-term funds assisted the stability of rates, the Reserve Bank's presence and its policies would also appear to have helped this. The Bank made it a conscious policy not to vary the Bank rate frequently, as was the practice of the Imperial Bank prior to 1933, which used to put up the rate during the busy season. Stability of its lending rate induced stability in the rates of the Imperial Bank, which continued to play to some extent, the role of a bankers' bank.

Secondly, the Bank was able to co-ordinate fairly effectively the various elements that influenced the state of the money market. Its management of the foreign exchange as well as public debt, including in particular the management of the Treasury bill market, and its centralisation of the reserves helped the Bank maintain the money market on an even keel. Unlike the Imperial Bank or the Government, which had to pursue only limited objectives, the Reserve Bank had to

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

take a harmonious view of the various considerations. It did not allow, for instance, the Treasury bill rate to go too low, lest it should have an adverse impact on the exchange; for this purpose, among other things, the Bank raised the bill offerings. On the other hand, on occasions it restrained the uptrend, by reducing the Treasury bill offers, by requesting the Imperial Bank not to put up the rate and giving facilities to the bank for the rediscounting of Treasury bills, and finally by increasing the tenders for the purchase of sterling. Likewise, the Bank varied its sterling tenders also having regard to the state of the money market, rather than the requirements of exchange only.

Thirdly, the Reserve Bank's operations in Government securities were primarily designed for maintaining orderly conditions in the money market, whereas earlier in the case of the Imperial Bank, purchases and sales of securities were guided by its resources position. Although the Imperial Bank largely met its busy season requirements for funds by reducing its cash holdings, it also used to resort to sales of Government securities to some extent, thereby adding to selling pressure on the market. On the other hand, the Reserve Bank's operations, even if modest on the whole (at times they were substantial), had a compensatory effect; the Bank purchased during periods of stringency and sold during periods of ease.

It should also be noted that remittance facilities provided by the Reserve Bank were much more liberal than those obtaining prior to its establishment. The easier movement of funds no doubt helped to equilibrate regional imbalances in the demand for and supply of funds.

It is undeniable that the benefits of cheap money did not percolate widely into the interior. Nor did the Bank give any special assistance to the growth of banking facilities, although the importance of this was obvious to the Bank. The Bank was optimistic that cheap money conditions would stimulate banks to extend their operations up country; to some extent this happened, but not on an adequate scale, and in some areas like the South, the growth had elements of instability. However, although statistical evidence cannot be adduced much in this behalf, it is unrealistic to hold the view that the unorganised and organised sectors were so watertight that the easy conditions in the one did not get transmitted even mildly to the other. In any case, it is a fact that the bazar bill rates too declined in the cheap money era and the spread of these rates during the year was much narrower than in the pre-Reserve Bank days, though how far this was due to the existence of the Reserve Bank will always remain an open question.