7

First Steps in Agricultural Finance

Few aspects of the working of the Reserve Bank have been so striking, in comparison with other central banks generally, as its evolving role in the sphere of rural finance. The Bank's responsibility in this field has its origin in the predominantly agricultural basis of the Indian economy and in the urgent need to expand and co-ordinate the credit facilities available to the agricultural sector. For the fulfillment of this important role, as mentioned in Chapter 3, the Reserve Bank of India Act itself laid down, in Section 54, that the Bank should set up a special Agricultural Credit Department, to study the problems of agricultural credit, to be available for consultation by Central and Provincial Governments, provincial co-operative banks and other banking organisations and to co-ordinate the operations of the Bank with those of the agencies engaged in purveying such, credit. In terms of Section 55(1)(b), the Bank was required to submit to Government a report, with proposals, if it considered fit, for legislation on 'the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the Bank'. While, for various reasons, the activities of the Bank in this sphere did not blossom till about the 'fifties, modest beginnings were made in the early years of the Bank.

The Reserve Bank Act also imposed an obligation [in Section 55(1)(a)] on the Bank to submit a report on ' the extension of the provisions of this Act relating to scheduled banks to persons and firms, not being scheduled banks, engaged in British India in the business of banking '. This concerned what is commonly referred to as the problem of linking the unorganized sector of the money market with the organised sector, in particular with the Reserve Bank. Government's view, which was also fully explained in the Legislature in the course of the debate on the Reserve Bank Bill, was that the services of the indigenous bankers and moneylenders should, after suitable adaptation of their methods, be utilised in any scheme for provision of credit to the economy. Very little progress was made in this area in the manner envisaged by the Legislature. Over the years, there have of course been sporadic references to' this subject, but nothing concrete has emerged. Indeed, even to this day, the progress made has been negligible and it is doubtful if there was at all any scope for progress. An account of the history of the early efforts at integration is given in this chapter.

The Agricultural Credit Department was set up on the inauguration of the Bank in April 1935. Mr. K. G. Ambegaokar, I.C.S., who had had experience in the field of co-operation as Senior Deputy Registrar of Co-operative Societies in the C.P. and Berar, was appointed as the Officer-in-Charge of the Department, which started functioning with a skeleton staff. One of the earliest tasks of the Department was to study the Darling Report.

It was only after the coming in of Mr. (later Sir) Manila1 B. Nanavati, as Deputy Governor, 'in December 1936, that the Agricultural Credit Department got into stride. Mr. Nanavati put considerable life into the Department by bringing to bear on his new responsibilities in the Bank the rich experience he had gained in the field of co-operation and rural development. He took the initiative to organise several studies on the working of the co-operative movement as a whole as well as individual institutions. Mr. Nanavati also paid considerable attention to the task of devising suitable operational principles and procedures for the extension of financial assistance, by way of loans and discounts, from the Reserve Bank to the co-operative institutions.

Darling Report

The Government of India took special steps to ensure that the Agricultural Credit Department was organised in the best possible way. Since it was recognised on all sides that the co-operative institutions, despite their shortcomings and deficiencies (which have been briefly indicated in Chapter 2), constituted the most suitable agency for dispensing rural credit, Government were keen to have the position of the co-operative movement in the various Provinces investigated, to enable the Bank to take appropriate organisational and policy measures. Accordingly, in May 1934, Mr. (later Sir) Malcolm Darling, I.C.S., an officer who had long practical experience of co-operation and agricultural credit problems in the Punjab and had also studied the cooperative movement in other countries, was appointed by the Central Government to examine and report on the most suitable organisation for the Bank's Agricultural Credit Department and the manner in which it might most effectively work with the co-operative banks and other agencies for providing credit to the agriculturists and landowners. He was later informed by the Finance Department that his primary duty would be to study the co-operative movement in various parts of. India, to indicate how and to what extent it could suitably be financed by the Bank, and only incidentally to examine the question of how agricultural finance -could be afforded through channels such as scheduled banks or indigenous bankers. Subsequently, Mr. Darling was also asked by the Member, Department of Education, Health and Lands, to examine the position of the co-operative movement in different Provinces to see how it could be strengthened. His report on the constitution of the Agricultural Credit Department, together with his note on the co-operative movement in the major Provinces, was received by the Bank in June 1935.

Pursuant to the instructions of the Finance Department, Mr. Darling devoted the larger part of his report and recommendations to the assistance to be afforded through co-operative banks (including land mortgage banks) and dealt somewhat sketchily with the other possible channels of assistance.

As regards the Agricultural Credit Department, Mr. Darling's views, as summed up by him, were as follows:

Firstly, it must be in a position to advise the Bank in regard to its financing of the co-operative movement, especially in the field of land mortgage banking; and for this purpose it must be expert in co-operative finance and familiar with the working of the movement throughout India, And since co-operation is a world movement, it will be well advised to gain some knowledge of the movement in countries whose conditions at all resemble those in India. Secondly, it must get into touch with all commercial banks in any way financing agriculture and examine whether their operations can be co-ordinated to the advantage of the agriculturist. Thirdly, it must explore the whole field of indigenous banking and obtain the information that the Bank will require for its report under section 55 (1) (a) Finally, it must make a systematic study of the whole field of agricultural credit in India in order to be able to advise the Bank as to what action it should take in regard to section 55(1) (b).

In Mr. Darling's opinion, the Head of the Department had to be an officer of not less than fifteen years' service with at least three years' experience of co-operation. Concerning the Reserve Bank's relations with the co-operative institutions, Mr. Darling was of the view that:

(1) In provinces where there is a provincial (co-operative) bank, the Reserve Bank should deal with it alone; and where there is no Provincial

Bank, it should deal, if necessary, with one central (co-operative) bank in each province,
2) It should deal only with the provincial or central banks that are thoroughly sound, and the movement behind them must also be sound,
(3) Assistance to the co-operative movement should be given in the following ways:

> (a) subject to what is said above, provincial banks, or central banks if necessary, should be supported in any emergency for which they are not responsible;
> (b) all central banks should be classified as A, B, C or D, and for this purpose co-operative paper of A and B banks should be rediscounted under section 17(2) (b) of the Act;
> (c) the amount to be advanced in this way should not exceed 50 percent of the average amount recovered by the central banks concerned during the three years prior to the advance: in insecure tracts, a 5-year average should probably be taken;
> (d) advances might also be made under section 17(4) (d) against promissory notes supported by documents of title to agricultural produce.

(4) Advice should be given, as required, on land mortgage banking, and it will be useful if the Reserve Bank could invest a limited amount of its capital in debentures issued by a Central Land Mortgage Bank which is working to its satisfaction, provided that the debentures were guaranteed by the local Government as to both principal and interest.
(5) The financial activities of the provincial banks might possibly be co-ordinated.
(6) The Reserve Bank should use its influence to secure a proper level of financial efficiency and soundness in the co-operative credit movement.
(7) . . . .
8) The assistance should be conditional on:

> (a) the necessary statements being regularly supplied, and
> (b) the banks concerned allowing themselves to be inspected.

The conclusion of Mr. Darling was that the Bank could, under the prevailing circumstances, make advances to only three provincial banks, namely, those of Bombay, Madras and the Punjab, but since these three banks had ample surplus funds, assistance was not likely to be required by them in the near future. He expressed the view that, for some years, the help that the Bank would be able to give to the agriculturist was likely to be of the most modest description, and if there were no co-operative movement, it would probably be unable to help him at all. This, according to him, called for strengthening the movement, 'for it is no use attempting to fit an old bullock cart with a powerful engine'.

Follow up and Preliminary Report

The Bank's Central Board considered the Darling Report in November 1935. The Bank's management took the view that:

> Without further investigation and information it would be inadvisable for the Bank to commit itself to the acceptance of these proposals, nor is it necessary for it, at the present stage, to do so, because, ... he (Mr. Darling) considers that there are at present only three provincial banks to whom it would be prudent for the Reserve Bank to make advances, and they have so much surplus funds that they do not require any.

The first task of the Bank was to have a clear picture of the working of co-operative banks, by obtaining more detailed and up to date information on important aspects of their working, viz., the manner in which their share capital had been built up, i.e., whether by voluntary subscriptions or by compulsory deposits or deductions from loans, the .extent of overdues and the manner in which the overdues under principal and interest were treated. The Bank had also to examine how and to what extent credit agencies other than the co-operative banks could be developed and fitted into the general system. The Central Board endorsed this approach and it was decided to call for detailed information from the Provincial Governments, through the intermediary of the Central Government, regarding co-operative societies, indigenous bankers, moneylenders, etc., engaged in the business of agricultural finance.

The replies received from the Provincial Governments indicated that they preferred to wait and see how the newly enacted legislation relating to rural indebtedness functioned in practice before committing themselves to any expression of opinion on matters referred to them. The Governor, however, felt that action on this question should not be delayed on this account and, in a memorandum submitted to the Central Board, in May 1936, he set out the broad features of the problem to serve as a basis for the preparation of the report under Section, 55(1) of the Act. The memorandum, which was also circulated to the Local Boards of the Bank for eliciting their comments, viewed the problem of agricultural credit both from its long-term and short-term aspects. It pointed out that long-term credit should not be dealt with by a bank and still less by the Reserve Bank, which must keep its resources liquid ; the proper agency for meeting such credit needs would be land mortgage corporations. On the other hand, short-term advances for marketing of produce should be regarded, in a primarily agricultural country like India, as one of the most important items of banking business, for which assistance might be provided by the Bank, when necessary, under the existing provisions of the Act. The memorandum discounted the possibility of the Bank’s investing in land mortgage debentures on grounds of lack of liquidity. The Local Boards, by and large, endorsed the policy set out in the memorandum, but the Calcutta Local Board advocated a bold and progressive policy on the part of the Bank, instead of too rigid an adherence to orthodox central banking principles.

Incidentally, on orders of the Government of India, the Darling Report was not made available to Local Board members, since some Provincial Governments had objected to certain portions of the Report. Some of the Local Boards were sore about this. Protracted correspondence by the Governor with Government for circulation did not meet with success.

Owing to the difficulty of framing constructive proposals, which would at the same time be practical, the Board considered that the Bank should issue a Preliminary Report, well in advance of the time limit given under Section 55(1) of the Act, setting out 'the main features of the problem and its difficulties and their (the Bank's) preliminary reaction to them with a view to clarifying the issues and ascertaining public opinion on them'. In August 1936, the Central Board approved the Preliminary Report for submission to Government. The Report was released for general information by the Government of India in December 1936.

The Preliminary Report contained a restatement of the peculiarities of peasant farming, its special features in India and the difficulties of financing agriculture under such conditions on a commercial basis. It drew attention to the urgent need for reducing the enormous burden of rural indebtedness, through the setting up of. debt conciliation boards for reducing accumulated debt, and simplification of the procedure for recovery. The suggestions for the reorganisation of the cooperative movement, with particular reference to the problem of over-dues and the broad guidelines for the future operations of co-operative agencies, formed the core of the Report. For meeting the long-term credit needs of agriculture, it recommended the establishment of land mortgage corporations, run preferably on commercial lines. As regards indigenous bankers, the Report did not favour direct discounting of their paper by the Bank, but envisaged the possibility of registering those carrying business on proper lines so that the Bank could accept the names of such parties as one of the names on two-name paper coming through scheduled banks. The advantage of this arrangement, according to the Report, was that such recognised parties would be able to obtain better terms from the scheduled banks than before. The Report also recommended a reduction in stamp duty on usance bills. As regards moneylenders, the Report was of the view that even with the revitalisation of the co-operative movement, they would 'continue to be an important and indispensable factor in the rural economy of the country'; however, a radical reform in their methods was called for and the Report suggested legislation regulating money lending, especially compulsory licensing of all and registration of approved moneylenders by Provincial Governments. The Bank would then be prepared to help by extending to approved moneylenders, registered by Provincial Governments, facilities analogous to those proposed to be given to indigenous bankers, namely, accepting them as one of the names on two-name paper.

Generally speaking, the Preliminary Report evoked more criticism than appreciation. Not many reactions were similar to that of the Times of India †, which considered that the Bank's proposals formed 'a healthy relief to the sentimental and unreal atmosphere in which too often co-operation and rural credit are discussed'. The Hindustan Times† remarked: 'a more fatuous document than the Report of the Reserve Bank . . . . . , it has scarcely been our misfortune to read '. The Madras Journal of Co-operation †† regarded the Report as 'a very disappointing document'. Even Mr. Darling, while calling the Report 'valuable and suggestive', remarked : 'some of us may think that the report makes no great attempt to discriminate between the areas where the movement is sound and those where it is unsound, and that it does not make sufficient allowance for the features that distinguish cooperative from ordinary commercial banking '. *

Statutory Report

The Bank, of course, studied carefully the comments and criticisms on the Preliminary Report, in its preparation of the Statutory Report. In this task, the Bank had the guidance of Mr. Manila1 Nanavati, who, as already mentioned, joined the Bank as Deputy Governor in December 1936. The Bank submitted the Statutory Report to Government by the end of 1937.

The Statutory Report, which was complementary to the Preliminary Report, described the features of agricultural finance with special reference to the role of various agencies such as Government, commercial banks, moneylenders and the co-operative movement. Of these, the moneylenders supplied the bulk of agricultural finance. However, as the various enactments relating to agricultural debts had impaired their activities in many parts of the country, the Report suggested 'reasonable' legislation for regulation of moneylending.

The Report was categorical that the co-operative movement was the most suitable agency for the supply of agricultural finance, and that, although the movement in this country had not come up to the standard required to meet adequately the credit needs of farmers, it was capable of playing its proper role in this sphere if it was suitably reconstructed

† December 31, 1936. †† April 1937.

* Presidential address at the U.P. Co-operative Conference, Madras Journal of Co-operation, March 1937.

and revitalised. Such reorganisation should be directed mainly towards tackling the problem of overdues, building up strong reserves and effecting prompt recoveries of loan instalments out of the harvest. The foundations of the movement ought to be sound and the primary societies should build up their own funds with share capital and reserves and attract deposits from members by teaching them the lesson of thrift and prudence. Further, they should not be merely agencies for supplying finance, but an influence for the all-sided development of agriculture and the betterment of the life of villagers. Co-operative marketing had also to be developed from the bottom, right from the level of primary societies. There was also large scope for reform of the central and provincial co-operative banks on sound banking lines through contacts with commercial banks of standing and proper training of the staff.

About the role which the Reserve Bank could play in the sphere of agricultural credit, the Report stated that it would not be possible for the Bank to advance large sums to co-operative banks or indigenous bankers, for being lent out to cultivators, as a matter of course. Its resources, which largely consisted of the cash reserves of scheduled banks, were in the nature of a reserve against their deposit liabilities, to be drawn upon in times of emergency, and had, therefore, to be maintained in a liquid form. Hence, co-operative banks, like commercial banks, would have to stand on their own legs and obtain their normal finance from deposits, and could not expect the Reserve Bank to supply such finance or act as the apex bank of the movement. The Reserve Bank could come to their aid only when the ordinary pool of commercial credit appeared inadequate to meet the reasonable business requirements of the country. In such conditions also, the Reserve Bank would have to follow the same basic principles in making advances to co-operative banks as those for other forms of credit. The types of paper and security against which the Reserve Bank was authorised to lend to provincial co-operative banks and central land mortgage banks were already laid down in Section 17 of the Reserve Bank Act.

The up shot of the Report was that, while the advice and guidance of the Bank for the improvement of the co-operative movement and other matters relating to agricultural finance would be available, it would not be able to come to the aid of co-operative banks, save as the lender of last resort against securities eligible under the Act. The Bank's attitude to the co-operative institutions was more or less identical with its attitude to commercial banks, although the importance of the rural sector was repeatedly stressed by everybody. The Bank's thinking, in this matter was similar to that of the Government expressed by Sir George Schuster in the Legislative Assembly, in December 1933, that the Bank was there to provide proper co-ordination, control and support by means of reserves, for the general banking system of the country and it was not intended to go out itself and ‘ usurp ’ the functions of the banks or other organisations which were dealing direct with individuals. The Report recognised that one of the charges against the Bank levelled by the public was that it had failed not only to assist agricultural credit by direct monetary help but also to give an indication of the lines on which it would be prepared to grant such help. This charge, said the Report, was clearly due to a misapprehension of the legitimate functions of a central bank in the sphere of agricultural and other credit. The Report discounted as premature or undesirable the various demands made by the co-operative associations from time to time for the extension of the provisions of the Act so as to include supply of normal agricultural credit to co-operative banks, application of the provisions of Sections 17(2) (a) and 17(2) (c) to provincial co-operative banks and investment in debentures of land mortgage banks.

The Statutory Report aroused little enthusiasm and the comments were generally to the effect that the Bank did not envisage for itself an active role in the sphere of agricultural credit beyond studies and offer of advice, though the importance attached to the co-operative organisation was noted with satisfaction. The Bombay Co-operative Quarterly* remarked:

> The sum and substance of the lengthy memorandum is that while the Reserve Bank is willing to offer advice and even to direct and control co-operative finance it is not willing at present, for various reasons, to deal with provincial co-operative banks -in the case of some because they are not creditworthy, in the case of others because they have established their credit and possess resources themselves.

The comment of the Indian Finance † was:

> The Reserve Bank has through the medium of this exquisite report told an expectant world where they stand in regard to agricultural credit -that they stand miles away and cannot afford to get mixed up in such things just yet.

The approach of the Statutory Report, which might look excessively orthodox when considered in the light of the policies adopted or proposed by the Government and the Bank today, has to be viewed in the context of their generally conservative attitude thirty years back. The Central Board of the Bank was of the view that it was not to be expected to put forward a final scheme within the short initial period of three years and that it did ‘not consider its labours ended with this report ’. The Board also stated in its annual reports that it was giving its continuous attention to these important problems and hoped to be able to make useful contributions towards their solution as it acquired

*** March 1938.** **† January 22, 1938.**

experience by experiment. However, the Governor's own approach was that credit was the, least important aspect of agricultural development. Outlining his views in his speech to the shareholders in February 1938, the Governor stated that the problem of agriculture was obviously far more deep and difficult than that of indebtedness and expansion of credit and could only be met if the wider problem was tackled, of improving the whole position of the agriculturist, both social and economic, and raising his own standard of living. A 'comprehensive attack from all sides' was required and 'when it has been done it will be seen that the problem of credit will fall into a comparatively minor place and will present fewer difficulties '.

Accommodation from the Reserve Bank -Circular of May 1938

As a corollary to the Statutory Report and with a view to explaining the procedure to be followed and the conditions to be fulfilled by cooperative banks desirous of obtaining financial accommodation from the Reserve Bank, a circular letter was issued on May 14, 1938, to all provincial co-operative banks and central land mortgage banks. The principal contents of the circular were as under:

1. The Reserve Bank will deal with approved provincial cooperative banks and through them with eligible co-operative central banks placed in A and B classes in audit.

2. Provincial co-operative banks which desire to be classed as approved should make an application to this effect to the Bank through the Registrar of Co-operative Societies. The application should be accompanied by copies of their audited balance-sheets, profit and loss accounts and annual reports for the last three years as well as a copy of their bye-laws *. If it is desired to rediscount, or obtain advances against the promissory notes or bills of A and B class central co-operative banks, similar statements for such banks should also be enclosed. After scrutinising the financial statements and making such further enquiries as may be necessary the Reserve Bank will prepare a list of approved and eligible banks, which will be revised from time to time.

3. In deciding the question of admission to the list, the Reserve Bank will not be guided merely by the classification of a bank according to the audit but will consider whether its business is carried on generally on sound banking lines and will in particular pay attention to the following matters :

(i) maintenance of adequate reserves and fluid resources ; (ii) strict separation of short-term loans repayable within a year and long-term loans, which should not constitute an unduly high proportion ;

* To ensure uniformity, the Bank also circulated a form of balance-sheet for consideration and adoption by the provincial banks.

(iii) proportion of overdues and bad debts to total loans and provision for them; (iv) distribution of assets in cash, investments, short-term loans and long-term advances; (v) rate of interest paid on deposits; and (vi) dividends distributed.

4. Provincial co-operative banks admitted as approved banks will have to agree to the following:

(i) Maintenance of a cash balance with the Bank, the amount of which shall not, at the close of business on any day, be less than 2 ½ per cent of the demand liabilities and 1 per cent of the time liabilities in India of each such bank;

(ii) Preparation and submission of the balance-sheets and annual reports on the lines laid down by the Reserve Bank, and such other periodical statements as may be prescribed by the Reserve Bank, and

(iii) Inspection of the banks by officers of the Reserve Bank from time to time.

5. After a provincial co-operative bank is informed of its inclusion in the approved list, if it desires any financial accommodation for the forthcoming season it should make an application to the Bank, through the Registrar, specifying its requirements under the various clauses of Section 17 of the Act. The Reserve Bank will fix the credit lines for each bank at its discretion; alter considering the bank's position as a whole. Fresh credit lines will be fixed every year and for this purpose the provincial bank should send its application at the beginning of every financial year through the Registrar.

6. Financial accommodation will be available under the following heads:

Section 17(4) (a) - Loans and advances for periods not exceeding ninety days to provincial co-operative banks and through them to co-operative central banks against Government securities and approved debentures of land mortgage banks.

Section 17(4) (c) -Loans and advances for periods not exceeding ninety days to provincial co-operative banks against promissory notes of approved co-operative marketing or warehouse societies endorsed by the provincial banks and drawn for the marketing of crops or against promissory notes of central co-operative banks endorsed by provincial co-operative banks and drawn for financing seasonal agricultural operations or the marketing of crops.

Section 17(2) (b) -Rediscount of promissory notes mentioned above maturing within nine months.

Section 17(4) (d) -Loans and advances for periods not exceeding ninety days against promissory notes of provincial co-operative banks secured by warehouse warrants issued by corporations independent of the borrower or on the security of promissory notes supported by documents of title to goods which have been assigned or pledged as security for cash credits or overdrafts granted by the provincial cooperative bank to approved marketing or warehouse societies.

7. In all cases of loans, advances or rediscounting, the provincial bank will be responsible for payment to the Reserve Bank on the due date and the amount will be recovered by the Reserve Bank by debiting the account of the provincial bank.

8. As regards land mortgage banks, the, Reserve Bank will deal with approved central institutions which are declared to be provincial cooperative banks under the Act. The Bank will, when necessary, advise them regarding the terms and the timing of the floatation of debentures. In emergency, the Bank will grant loans and advances up to ninety days, against approved debentures, to central land mortgage banks and to primary land mortgage banks coming through them. The Bank will also grant them loans and advances up to ninety days against Government paper.

The response of the co-operative sector to this circular was -poor. Only the Bombay Provincial Co-operative Bank took interest in the matter and held discussions with the Reserve Bank to have certain points clarified and to convey its views. The main points raised were whether the bills and promissory notes of primary societies, with whom the Bombay Provincial Co-operative Bank dealt with directly, would be eligible for advances or rediscounts and whether the inspection by the Reserve Bank would be 'a vexatious inquisition into details by subordinate staff '. The bank also protested against the need to maintain minimum balances with the Reserve Bank, though at half the rates fixed for scheduled banks. As regards the first point, it was clarified by the Bank that though legally it would be possible to accept bills of primary societies also, it was considered inadvisable to do so in the case of the Bombay Provincial Bank as its dues from societies under liquidation were of the order of Rs. 17 lakhs against which it had reserves of Rs. 3.50 lakhs only. It was suggested that it would be preferable for the bank to take advances against Government securities, of which it had enough holdings, than seek advances against pronotes of societies. In regard to the maintenance of minimum balances with it in cases of banks which wanted to borrow from it, the Reserve Bank insisted on this requirement in order to bring the co-operative banks also fully under banking discipline. The subject of maintenance of minimum deposits was raised by the co-operative banks again and again in subsequent years also, but the Bank stuck to its decision. As regards inspection by the Reserve Bank, an assurance was given that it would be undertaken by a responsible officer of the Bank. As a, matter of fact, the Bank did not take up the inspection of co-operative banks for more than a decade after the issue of the circular.

In January 1939, the Bombay Provincial Co-operative Bank approached the Reserve Bank for ‘permanent’ arrangements for financial accommodation against Government securities. A credit line was sanctioned in February 1939; while no specific figure was indicated to the bank, the Bank intended to limit it to Rs.10 lakhs. The provincial bank did not draw upon the limit during the period covered by this chapter.

Reorganisation of’ the Co-operative Movement: Circular of June 1939

Pursuant to the view that the co-operative agency was best suited for purveying rural credit but that it needed to be reorganised on banking lines, the Bank addressed to all provincial and central co-operative banks a comprehensive circular on June 12, 1939, indicating the lines of reorganisation of the co-operative movement. The circular outlined the Bank’s basic philosophy as under:

> In all essential respects the nature of the business of co-operative banks is the same as that of commercial banks. Both types of institutions accept deposits and are therefore responsible for investing their funds in such a way as to safeguard the interest of their depositors. The same considerations of safety and liquidity in the employment of funds are essential for the stability of both. The principal difference is that whereas commercial banks lend to trade and industry, co-operative societies make advances mainly to agriculturists. The fact that the agricultural cycle is longer than the commercial and that the co-operative banks are not primarily concerned with making profits for their shareholders does not make any essential difference in the fundamental principles which both types of institutions have to observe as banking concerns. As a matter of fact, the type of business the co-operative banks are called upon to undertake makes it. all the more necessary for them to observe strict business principles.

The circular also suggested operating norms to co-operative institutions, generally on the pattern of norms adopted by commercial banks in the U. K. and India, but with some modifications to suit their special type of business, viz., provision of agricultural credit. These related, in particular, to the maintenance of a sound pattern of assets distribution, restriction of loans generally to short-term periods (up to nine months) and limiting the amount of intermediate-term credit to the share capital and reserves of the banks, proper calculation of over-dues, avoidance of fictitious repayments, strengthening of reserve funds by regular allocation from profits and linking of interest rates on deposits and advances to the Bank rate.

The reaction of the Bombay Provincial Co-operative Bank, which was again the first to come out with its comments, was typical of the reaction of the co-operative sector to this circular. The Chairman of the bank, Mr. R. G. Saraiya and the Managing Director, Mr. V. L. Mehta, had discussions with the authorities of the Bank. It appeared that the provincial bank felt a sense of disappointment and irritation that the Reserve Bank should come forward with a lot of advice, while it did nothing by way of actual financing of co-operative banks. The question of maintenance of minimum balances was again raised and it was stated that in the absence of any quid pro quo from the Reserve Bank, the balances could as well be maintained in the shape of current accounts with other banks. About the suggestion for the restriction of advances by co-operative banks to periods within nine months, it was pointed out by them that agricultural advances for six or nine months were often extended owing to the poor paying capacity of the farmers and the vagaries of the seasons, with the result that agricultural banking became long-term banking. The generalisations regarding fictitious repayments were also objected to. The other suggestions made in the circular were considered as 'mere words which have no value unless concrete suggestions are made'.

Co-operative journals too made adverse comments on the circular. The Bombay Co-operative Quarterly editorially commented, in its issue of September 1939, that some of the recommendations were ' impracticable and hardly conducive to the development and progress ' of co-operative credit institutions and there was 'every justification for the feeling that the Reserve Bank is not in intimate touch with the position and working of co-operative credit institutions . . . . '

The Madras Journal of Co-operation also came out with an article* on the circular, in its issue of February 1940. The general reaction in this case too, was that the Reserve Bank lacked intimate touch with co-operative institutions and that many of its suggestions were impracticable and not suited to conditions in India. The article stated:

> There is not the slightest attempt on the part of the Bank to accommodate its business, even to a very small extent, to suit the special requirements of agriculture. Its suggestions smack something like chopping the head to suit the cap, as the Tax nil proverb goes.

The article was critical of the Reserve Bank for drawing comparison with joint-stock banks in Britain rather than with co-operative banks; Britain was a ' backward country ' in co-operative banking. It felt that it would have been better if the Bank had given the experience of German co-operative banks instead, for guidance, as ' Germany is more advanced in co-operative credit and we have to learn a great deal from their co-operative banking '. The article pointed out that no reference had been made to debentures of land mortgage banks as a mode of investment of liquid resources of co-operative banks and interpreted

* The Reserve Bank's Circular to Central and Provincial Banks, by V. S. Ramaswamy Iyer.

it as the Reserve Bank's lack of sympathy for such debentures - ' they have betrayed their unsympathetic attitude, by their hesitation to accept them as security for advances'. As regards limiting intermediate-term loans to the share capital and reserves of the banks, the article observed:

> They want to restrict intermediate credit (loans) to the owned capital of banks, and they stop there. They have not bestowed an iota of thought on the question whether the total requirements of agriculturists in this direction can be met. This limit will be far too small and may not meet even a small fraction of their requirements. Nor have they given any suggestion as to where to go for the balance. Should the co-operators go again to money-lenders for this? . . . The Reserve Bank is shirking its legal responsibility in not going further into the matter of intermediate credit and finding a way out.

These and other criticisms made in later years were studied carefully by the Bank and modifications were made from time to time, while generally adhering to the principles enunciated in the circular.

Direct Linking of Indigenous Bankers

The other part of Section 55, namely, the extension of the provisions of the Reserve Bank of India Act relating to scheduled banks to persons and firms other than scheduled banks, that is, the problem of direct linking of the indigenous bankers with the central banking institution, may now be dealt with.

The indigenous bankers, as mentioned earlier, played in the 'thirties a fairly substantial role in financing the inland trade and indirectly in supplying agricultural credit through assisting the movement of crops. The question of linking the indigenous bankers with the modern banking system and bringing them under the fold of the Reserve Bank, when established, engaged the attention of the Central Banking Enquiry Committee and figured prominently during the various stages of consideration of the Reserve Bank Bill. The Central Banking Enquiry Committee made definite proposals for the linking with the Reserve Bank, after its establishment, of such of the indigenous bankers as (a) were engaged in banking proper or were prepared to shed their business other than banking ; (b) had a minimum of capital and reserve (the Committee did not suggest what the standard should be) ; (c) kept accounts in the usual recognised manner, got them audited by recognised auditors and made them available for inspection; and (d) did not charge unduly high rates of interest. In the Committee's view, the bankers satisfying the above conditions could be placed in the approved list of the Reserve Bank on the same footing as joint-stock banks and be entitled to the benefits of rediscount facilities against bank endorsed paper and to remittance facilities. The Reserve Bank and the commercial banks could use such indigenous bankers as agents for collection of cheques and bills in the same manner as they might use a joint-stock bank or a co-operative bank. It was also proposed that such of the indigenous bankers whose deposits did not exceed five times their capital should, during the first five years of the working of the Reserve Bank, be exempt from the maintenance of compulsory deposits with the Bank. Recognising that a large number of indigenous bankers whose principal business was not banking would remain outside the scope of its proposals, the Committee recommended the adoption of a more liberal policy by the Imperial Bank of India in granting facilities to them.

Although the Central Banking Enquiry Committee had thus called for action regarding indigenous bankers with a view to integrating their operations into the modern banking system, Sir George Schuster, the Finance Member, was of the view that 'unfortunately, the problem was one which we could not possibly tackle in connection with the Reserve Bank Bill'. He took what appeared to be the line of least resistance by enjoining the Reserve Bank, under Section 55(1) (a) of the Act, to examine the question and submit a report within three years from the date on which the Section came into force, i.e., January 1, 1935. The question of indigenous bankers also figured in the terms of reference to Mr. M. L. Darling. However, Mr. Darling confessed in his Report that he had no time to make a full inquiry on the channels, other than the co-operative movement, through which agriculture could be financed. All that he was able to do was to interview certain prominent indigenous bankers and ascertain their views in regard to possible dealings with the Reserve Bank. His findings were that, outside Bombay, Madras and Burma, the large mass of indigenous bankers neither required nor desired to have access to the Reserve Bank.

The Bank, however, dealt with the matter, as thoroughly as was possible in the circumstances. As part of the enquiry on agricultural credit, the Bank solicited detailed information from the Provincial Governments whether the indigenous bankers were prepared to register themselves and maintain separate and standardised accounts of their banking and other business. As already mentioned, most of the Provincial Governments were not prepared to commit themselves to any expression of opinion on the matter. In view of this position, the Preliminary Report to Government under Section 55 did not go beyond suggesting the possibility of registering indigenous bankers and accepting the names of such parties as one of the two names on the paper routed through scheduled banks, After considering the comments and criticisms on the Report, in May 1937, the Reserve Bank sent a circular letter to scheduled banks and shroff associations, stating that in view of the large number of indigenous bankers and the highly personal and fluctuating character of their business, the Reserve Bank could only deal with them through some intermediate agencies which would share the financial responsibilities and undertake detailed examination of their transactions. The Bank was, however, prepared to consider most carefully any practical scheme, emanating either from the indigenous bankers themselves or from any other source, for organising their members to enable credit to be accorded to them direct. Such organisations were to be self-contained legal entities with a minimum of owned resources and were to maintain deposits with the Reserve Bank on the same basis as was applicable to scheduled banks; besides, they were to maintain separate and properly audited accounts of their banking and other business, the latter being confined to bona fide trading and not speculation. If indigenous bankers were prepared to accept these conditions, the Reserve Bank would be willing to implement a scheme which had been provisionally drawn up by it, under which it would provide accommodation against a bona fide trade bill originating with a merchant or an agriculturist and endorsed by the indigenous banker and rediscounted with a scheduled bank, or against a promissory note originating with an indigenous banker with a possible second signature and discounted by a scheduled bank. Scheduled banks were to maintain lists of the shroffs with whom they were prepared to do business, as also a record showing the credit limits which they could be safely accorded and the type of business which the shroffs carried on. Until the scheme developed and the Reserve Bank had acquired experience of the amount and character of credit which was likely to be involved, it would not discount such bills but only make advances against them under Section 17(4) (c) of the Act.

The circular was criticised by the Madras Local Board that it ran contrary to the declared intentions of the Government of India. It suggested that the indigenous bankers should be brought into direct relations with the Reserve Bank subject to equitable provisions with regard to conduct and control. The Bombay Shroffs Association regarded direct relationship between the indigenous bankers and the Reserve Bank as a 'cardinal and fundamental principle'. According to it, to ask the indigenous bankers to come to the Reserve Bank through scheduled banks was unjust to the former who were rivals of the latter. The Association wanted the Bank to maintain a register of private bankers, to which a banker having a capital of Rs. 2 lakhs would be eligible for admission, and to extend to such registered bankers all privileges enjoyed by scheduled banks. The Indian Merchants' Chamber also expressed almost identical views.

In the light of the replies to the circular letter, the Bank forwarded in August 1937 to the representatives of indigenous bankers and others a draft scheme for the direct linking of the indigenous bankers with itself, on the basis of the recommendations of the Central Banking Enquiry Committee and the regulations relating to banking companies contained in the Indian Companies Act, 1936. The scheme-intended to be an experimental measure for the first five years -was to be applicable to indigenous bankers confining their business to banking proper as defined by the Indian Companies Act and having minimum working capital of Rs. 2 lakhs (to be increased to Rs. 5 lakhs within a reasonable period). Their names would be registered in an approved list maintained by the Reserve Bank and they would be entitled to the privilege of rediscount facilities against eligible paper, the right of advances against Government paper and remittance facilities similar to those for scheduled banks. However, unlike the scheduled banks, they would be free from the obligation of keeping deposits with the Bank during the experimental stage unless it was seen from the weekly statements that their time and demand liabilities exceeded five times the amount of their capital in the business.

The indigenous bankers, who were already receiving as much assistance as they needed from the Imperial Bank and the other banks, reacted to the proposals quite unfavourably, as they were unwilling to curtail their activities and adopt forms of business which were inconvenient to them. Generally speaking, they disagreed with the Bank's suggestions regarding taking of deposits and giving publicity to their accounts. Many of them were not agreeable to the maintenance of accounts in the approved form. Though there was general agreement that speculative business should be ruled out, they were not prepared to confine themselves to banking business. In short, they wanted the scheme to be so modified as to be incompatible with the main proposals. The following extract from the letter dated September 27, 1937 of Seth Fatichand Gokaldas of Madura is typical of their reactions:

> Our business is based on strict privacy and it will greatly hamper our business if we make up our minds to show our account books. Besides, like the Reserve Bank, every other blessed bank having dealings with us will call upon us to produce our accounts at any time and the result will be, we will be at the mercy of the scheduled banks . . . . If the Reserve Bank wishes to do business with the indigenous bankers on the lines of the Imperial Bank and other banks, this step will be most welcome . . . but on the terms and conditions mentioned by you we may assure you no banker with self respect would come to your door to have the facility of discounting bills with you.

The Bank authorities were not surprised at these reactions. The Governor was aware that there was a 'good deal of unreality' about the question of direct link with the Reserve Bank, which it would seem was not strictly necessary for either the indigenous bankers or the

Reserve Bank's monetary management. The Bank informed the Government, in its Statutory Report, that it could not recommend any immediate legislation to amend the Reserve Bank Act for extending its provisions relating to scheduled banks to the private bankers. The offer made in the Bank's letter of August 1937 was still open and the Bank would be prepared to take up the matter with the Government with a view to amending the Act, if the indigenous bankers were prepared to conform to the conditions stipulated by it or suggested any other practical alternative. In the opinion of the Bank, the ultimate solution to the problem lay in the development of an open bill market in which first class bills were freely negotiated. It would then be possible for the Bank to extend its open market operations to trade bills thereby giving first class indigenous bankers the closer and, possibly, the direct relationship which they desired without compelling them to make any radical changes in the essential character of their business. The Bank recognised the onerous rates of stamp duty as one of the impediments in the way and pressed the Central Government and through them the Provincial Governments to reduce the stamp duty to a uniform level of two annas per thousand rupees, as recommended by the Central Banking Enquiry Committee.*

At the meeting of the Bombay Local Board of the Bank held in November 1937 to consider the Statutory Report, Sir Purshotamdas Thakurdas, one of the staunch advocates of the direct link, summed up the position in these words:

> the Bank had done all it could and since the indigenous shroffs were not prepared to accept the suggestions and no further constructive proposals had been made, that part of the Report could hardly be improved upon.

Simultaneously, the Bank made efforts to bring within the banking system the village moneylender, so as to make credit more extensively available to the agriculturists at reasonable rates of interest. It was felt that finance for marketing of crops might be made available to a much larger extent through the agency of the moneylender, if his advances to cultivators on the security of produce were to be drawn up as bills so that they could be discounted by scheduled banks and rediscounted by the Reserve Bank. Accordingly, a circular letter was addressed to scheduled banks on January 3, 1938, outlining a tentative scheme, to enable them to rediscount with the Bank bills of exchange or promissory notes of approved moneylenders drawn for the purpose of financing the marketing of crops and maturing within nine months. As a special inducement, the Bank offered to rediscount, at a concessional rate of 1 per cent below Bank rate, agricultural paper in respect of areas

* The duty was reduced only in January 1940.

where interest rates were. unduly high. The concession was to be available only if a scheduled bank agreed to charge the moneylender not more than 2 per cent over the Bank's rediscount rate and the moneylender, in turn, passed on the credit to the agriculturist with a further margin not exceeding 2 per cent. The scheduled bank discounting such paper was also responsible, under the scheme, for satisfying itself that the moneylender was creditworthy, his business was conducted on sound lines and he kept simple books of account in proper form.

In reply, the scheduled banks referred to various difficulties in working the scheme. The main difficulty was that the smaller agriculturist did not usually borrow against security of produce. He needed money for crop production than for its marketing. He generally obtained finance by keeping a running account with the moneylender and would not favour loans payable on a fixed date. Further, the banks would not be in a position to gauge the moneylenders' credit or to force the latter to reorganise their business; nor could the banks dictate the interest charged to the cultivators. Moreover, even first-class Multani bills were discounted by banks at very fine rates due to competition and there would thus be little scope for rediscount of the bills with the Reserve Bank even if the Multanis had borrowed for the purpose of advancing money to agriculturists. Lastly, agricultural debt relief legislation had created an atmosphere in which the moneylender was shy of utilising his own capital fully in business and this reduced the prospect of his borrowing from scheduled banks. Under these circumstances, the Bank felt that there was little likelihood of the scheme making a wide appeal and that until more experience was gained of the actual working of such legislation it would be hardly worthwhile to proceed with it. While communicating its views in the matter to Government, the Bank stated that the realisation of the objective of cheapening credit to agriculturists had to come about mainly through the regulation of moneylending, the development of branch banking and the strengthening of the co-operative movement.

Other Activities of the Agricultural Credit Department

While the Agricultural Credit Department gave increasing attention to the study of agricultural credit problems, its role in tendering advice to the Central and Provincial Governments on various matters pertaining to agricultural credit also steadily expanded. Under the able stewardship of Mr. Nanavati, the Department undertook intensive studies of the co-operative movement in India and Burma. The results of such studies were embodied in bulletins, four of which were published during the period, namely:

(1) Report on the Banking Union at Kodinar.

(2) Co-operative Village Banks.
(3) Recent Developments in the Co-operative Movement in Burma with suggestions for their applicability to India.
(4) Co-operation in Panjawar.

While the first three were based on studies conducted by the Department, the last one was written by an officer of the Punjab Co-operative Department.

Three of these Bulletins (Nos. 1, 2 & 4) were devoted to developing the idea that co-operative credit institutions should not confine themselves to the provision of credit but should expand their activities to cover all aspects of the life of agriculturists. Bulletin No.2, dealing with societies at the primary level, suggested that the activities of the village societies should be expanded so that in addition to supplying credit they could assist the members in obtaining their various requirements such as better quality seeds, manures, etc., at less cost and be instrumental for teaching their members the lessons of 'better living, better farming, and better business '. Bulletin Nos. 1 and 4 presented an objective study of the working of two successful banking unions, one at Kodinar in Baroda State and the other at Panjawar in the Punjab. The main theme of these Bulletins was briefly this: central co-operative banks as they were constituted in India had till then confined their activities to the supply of funds to their affiliated societies, while other functions such as supervision over the societies and the education of their members were left to other agencies. As such a division of functions was not found conducive to the healthy growth of the movement at the primary level, it was suggested that the societies should be federated into banking unions which would take up all these functions. The banking union, with its area restricted to a taluka or tahsil and its membership confined to primary credit societies, would, apart from financing the societies, take interest in all the activities undertaken by them and in addition take up supervision over them and education of their members. It may be of interest to mention that the banking union at Kodinar was organised and fostered by Mr. Nanavati himself.

Bulletin No. 3 described the steps taken for the rehabilitation of the co-operative movement in Burma, which was badly affected by the economic depression of the 'thirties, and discussed their relevance for the reconstruction of the movement in India.

One of the statutory functions of the Department was to be available for consultation by Governments and banks on all matters pertaining to agricultural credit. The Department, at the request of the Central and Provincial Governments, examined and expressed its opinion on several Bills relating to debt conciliation, land mortgage banks, moneylenders, regulation of interest rates, relief of agricultural indebtedness, etc. Among the more important of such Bills on which the Bank's opinion was invited, may be mentioned the Moneylenders' Bills of the Central Provinces and Berar, Bengal and Bombay, the Debt Conciliation Bills of Bombay, Madras and Assam and the Land Mortgage Bill of the Central Provinces and Berar. Besides, the Department was frequently consulted by the Registrars of Co-operative Societies and co-operative banks on matters concerning agricultural credit, as for instance, the manner in which land mortgage banks could extend their business, model bye-laws for land mortgage banks, comparative merits of sinking funds versus debt redemption funds, floatation of new debentures, accounting procedures in respect of overdue interest in co-operative societies and so on. At the request of some scheduled banks in Madras, a suggestion was made by the Bank to the Government of Madras that those banks might be exempted from the operations of the Agriculturists' Relief Act. The Department thus acted as a clearing house of information on agricultural credit.

The Deputy Governor and the Officer-in-Charge kept close and continuous touch with the co-operative movement, consulting with the Governments and co-operative agencies and attending conferences. The major conferences attended included the Twelfth Conference of Registrars of Co-operative Societies at Delhi in 1936, the Co-operative Conferences at Bangalore in 1937 and Gwalior in 1938, and the Thirteenth Conference of Registrars of Co-operative Societies held at Delhi in December 1939. In 1938, the. Officer-in-Charge, during his tour of Europe and America on furlough, visited the central banks of several countries. Among the subjects studied by him were the working of agricultural as well as consumers' co-operative societies; operations of co-operative and other agricultural credit agencies both for short and long-term finance ; measures taken by various Governments to improve agriculture and to enable the agriculturists to obtain a better price for their produce ; the manner in which studies relating to agricultural economics were carried out; the organisation of the statistical and research departments of central banks and the regulation and supervision of banks. He also made a special study of the Credit Agricole D'Egypt.

Apart from its principal sphere of activity relating to agricultural credit, the responsibility for giving continuous attention to the study of monetary and banking developments and problems also devolved upon the Agricultural Credit Department. In February 1937, a Statistical Section was started, the main duties of which were to collect and interpret the existing data on scheduled banks as well as to prepare periodical reports on the money and financial markets of India. The Section took over, in April 1937, the publication of the Reserve Bank's Monthly Statistical Summary, which was till then being handled by the Central

Accounts Office, Calcutta. The Bank also started issuing annually a publication entitled Report on Currency and Finance, with the first issue covering the years 1935-36 and 1936-37; this took the place of the annual report of the Controller of the Currency, which office was abolished from October 1937. In January 1938, a separate Banking Section was created within the Department and the duties performed by the Central Office of the Bank in regard to scheduled banks were transferred to it. These functions mainly related to the maintenance of records of scheduled banks' daily balances, the recovery of penal interest on shortfalls in statutory balances and dealing with loan applications of scheduled banks. Besides, the Section was also entrusted with the preparation of a weekly report on the main features of the money market to be submitted to the Committee of the Central Board. The Section also devoted attention to the problems of banking legislation and undertook in this connection the collection of information about foreign central and commercial banking legislation.

Thus, during these initial years, the Bank was mainly engaged in building up the necessary expertise for handling problems relating to agricultural credit and the co-operative movement. In its Statutory Report the Bank endeavoured to state, in broad terms, the salient features of agricultural finance in India and the scope of action which the Bank could undertake to begin with. The Bank made efforts towards an enlarged flow of agricultural credit through the agency of the moneylender and to bring the indigenous banker within the ambit of organised banking, though these efforts met with little success. Modest as these activities of the Bank were in the sphere of agricultural credit, they prepared the ground for a more active role in later years. To sum up, in the words of Sir Chintaman Deshmukh: *

> The activities of the Department have expanded and proliferated to an extent not realised by either the Governments in India or the public concerned with its operations. The foundations of the Department were laid under the experienced and solicitous eye of Sir Manila1 Nanavati, Deputy Governor from 1936-41, who brought to bear on the task all his rich administrative experience and his constructive talents.

* op. cit.