
Financing Small Industries and Exports

The development of small-scale and cottage industries has remained an integral part of India's strategy for industrialization. A network of institutional agencies was set up during and after the first plan to accelerate their development. Yet, as late as 1962 despite nearly a decade of vigorous promotional efforts, institutional financial support for this sector remained unimpressive, with small industries accounting for a negligible proportion of the total credit extended by scheduled banks. Even state financial corporations (SFCs), which were set up principally to cater to their financial needs, hesitated to get too closely involved with them. This was mainly because banks and corporations tended to regard small-scale industries as rather bad credit risks. The relatively low stake entrepreneurs held in their enterprises and their inability to provide adequate security were other factors tending to increase the perceived risks of lending to this sector. The Bank played a key role in establishing or supporting institutions intended to enlarge the flow of credit to small industries and in encouraging existing institutions, notably the State Bank of India, to launch more liberal schemes to finance small industries in collaboration with state-level institutions. With these initiatives not yielding results, the Bank stepped up its engagement with the needs of this sector from the late 1950s. It took the lead to put in place and administer a scheme to guarantee institutional loans to small-scale industries and began refinancing commercial banks' lending to this sector at concessional rates of interest. The labour-intensive handloom industry was also accorded special treatment. Thus the Bank not only gained first-hand experience of the problems of financing small-scale industries, but also played a major role in attempting to resolve them.

THE BANK AND STATE FINANCIAL CORPORATIONS

Reference was made in the earlier volume to the Indian Central Banking Enquiry Committee's recommendation to set up industrial credit corporations

at the national and provincial levels, and to the formation, following an Act of the Constituent Assembly, of the Industrial Finance Corporation of India in July 1948 with Ram Nath, then Secretary of the Bank, as its first Managing Director. Piloting the motion to refer the IFC bill to a Select Committee, the Finance Minister, *Shanmukham Chetty*, informed the Constituent Assembly of the government's intention to follow up this piece of legislation with efforts to persuade provincial governments to establish similar institutions in the provinces, particularly to finance small-scale industries. Soon thereafter, in March 1949, the Government of Madras established the Madras Industrial Investment Corporation Limited. Incorporated under the Indian Companies Act, this corporation was modelled on similar institutions in the United Kingdom.

Other provincial governments too, favoured the establishment of industrial finance corporations in their provinces. The Bombay government was keen to set up a corporation by special statute to ensure that it could hold majority ownership, guarantee its debts, and restrict the distribution of its profits. The statute would also assign to the proposed corporation prior claim over the assets of its borrowers in the event of recovery proceedings being launched against them. Under the Government of India Act, 1935, the incorporation, regulation, and winding up of trading corporations fell within the purview of the central legislature. Consequently, the Union government, to whom the Bombay proposal was addressed, initiated consultations about it with the Bank and the Industrial Finance Corporation.

The Bank generally supported the idea of setting up provincial financial corporations. Existing arrangements to give loans to private industries, under the State Aid to Industries Act were, in its view, extremely limited in scope. Aid under this Act took the form of direct loans repayable in a fixed number of instalments at rather high rates of interest. The Act made no provision for working capital loans, nor for underwriting share issues or guaranteeing interest on debentures. It also assigned to state governments the responsibility for processing applications and sanctioning and disbursing loans. This inevitably led to lengthy delays. Besides, the Bank felt a specialized corporation would be more equipped than a government department to evaluate proposals from the technical and business points of view. While the Industrial Finance Corporation was better placed to advance loans to large industries, corporations were required at the state level to finance small and medium industries, particularly in the rural and semi-urban areas. Establishing corporations in the states was also superior, in the Bank's view, to the alternative of allowing the Industrial Finance Corporation to open branches in state capitals because the former would attract support from state governments and local institutional

investors whose resources might otherwise not be available for industrial development.

Doubts however persisted over the ability of provincial governments to raise the necessary share capital, and over the merits of granting these shares, which were unlikely to command a wide market, the *status of trustee securities*. Despite such doubts, it was felt no harm could arise from the passage of an Act that merely enabled provincial governments with the necessary resources to set up local corporations, and the Government of India expressed itself willing to sponsor the necessary legislation.

Discussions between the Bank, the Government of India, and the Industrial Finance Corporation culminated in the State Financial Corporations Bill. A draft of this bill was circulated in April 1950 and considered at length by the Bank's Central Board in November 1950. The Board made a number of suggestions, one of which was to throw open the share capital of SFCs to members of the public. While some of the changes proposed by the Bank were incorporated in the draft bill, the latter remained silent about the Board's proposal to set a ceiling on the Bank's contribution to the equity of these corporations or include a provision for determining the Bank's share capital contribution in consultation with it. Remonstrations with the government about this omission yielded an assurance that the latter would unfailingly consult the Bank before arriving at the distribution of a state financial corporation's share capital.

The State Financial Corporations Bill was introduced in the Lok Sabha towards the end of April 1951 and referred to a Select Committee. The revised bill, with amendments to more than half its forty-eight clauses, was tabled in the Lok Sabha in September. Debate on the bill in the Lok Sabha threw up the suggestion that SFCs should utilize the agency of commercial banks for dealing with borrowers in the more physically inaccessible areas. According to one version of this proposal, commercial banks would contribute the initial subscription towards industrial debentures and restore their own resources by selling or transferring these assets to state financial corporations. However, the proposal remained ambiguous in important respects. In particular, it was not clear whether loans would be selected by commercial banks or by financial corporations. The Bank canvassed commercial banks about the proposal and found the latter divided in their appraisal of its merits. While the Bank was not opposed to involving commercial banks in the activities of the proposed corporations, it was unwilling to support the idea in its present form. For example, it was not evident to the Bank's officers that the objects in view, viz. proper selection and effective supervision, would be met if commercial banks had the right to effect compulsory sales of their debentures

to the state corporation at prices that enabled them to recover their outlay on these assets. Nor was it clear which agency would supervise a loan after it was transferred to the state corporation. On the other hand, encouraging commercial banks to accumulate long-term industrial loans was not only imprudent, it would also defeat the intended objectives of SFCs. The Bank's own preference, therefore, lay in the direction of merely including a provision in the bill enabling SFCs to make loans to industrial firms in the more remote areas through the agency, should they wish to utilize it, of commercial banks and cooperative institutions.

The State Financial Corporations Act came into force on 1 August 1952. It authorized SFCs to grant loans or subscribe to debentures of industrial concerns repayable within twenty years, and guarantee loans floated by industrial concerns in the open market that were repayable within the same period. State financial corporations could also underwrite issues of stocks, shares, bonds, or debentures of industrial concerns, provided the assets thus acquired were disposed of within seven years. Loans and advances were to be fully secured. In order to ensure a balanced dispersal of their resources, SFCs were prohibited from lending to a single concern amounts in excess of a tenth of their paid-up capital or a maximum of Rs 10 lakhs. Shares of SFCs, which would have the status of approved and trustee securities, were to be distributed between the state government, the Bank, scheduled and cooperative banks, insurance companies, and other financial institutions. Unlike in the case of the Industrial Finance Corporation, the public was allowed to hold up to a quarter of the shares of SFCs. The Act obliged state governments to guarantee repayment of the principal and dividend at prescribed rates not exceeding 5 per cent. Dividends were not to exceed the guaranteed rate until a corporation had accumulated a reserve fund equal to its paid-up capital, and repaid the state government any subventions it had made towards fulfilling its guarantees. State financial corporations were also allowed to mobilize additional resources by issuing bonds and debentures, guaranteed by the state government up to five times their paid-up capital and reserves. They could, besides, accept deposits from the public up to the limit of their paid-up capital for a minimum period of five years. According to the Act, each state financial corporation was to be managed by a board of ten directors, of whom four, including the Managing Director, were to be nominees of the state government. A director each was to be nominated by the Industrial Finance Corporation and the Central Board of the Bank. Four nominees were to be elected by the other shareholders.

Punjab was the first state to set up a corporation under the Act in February 1953. Five more corporations followed in the course of the next year, and by

1960 sixteen corporations had been brought into existence. The reorganization of states in November 1956 led to the reorganization of SFCs as well. The financial corporations of Bombay and Saurashtra, and Andhra and Hyderabad were amalgamated in November 1956. In 1956 the State Financial Corporations Act was amended to allow joint financial corporations to be formed covering two or more states, and existing corporations to undertake activities in adjoining states which did not possess financial corporations of their own. Following this amendment, the Punjab corporation extended its activities to cover Delhi (1957) and Himachal Pradesh (1962), the Assam corporation to cover Tripura (1960) and Manipur (1963), and the Maharashtra corporation to cover Goa, Daman, and Diu (1964). The Gujarat State Financial Corporation was established in May 1960 after the bifurcation of the Bombay State Financial Corporation, and its activities were allowed to extend to Dadra and Nagar Haveli. The Madras Industrial Investment Corporation was brought within the scope of the State Financial Corporations Act in 1961 for the limited purpose of allowing inspections by the Bank and submitting returns to it. This reform enabled the Madras corporation to avail of assistance from the Refinance Corporation for Industry. With the division of Punjab in 1967, separate financial corporations were formed in Haryana, Himachal Pradesh, Chandigarh, and Delhi. The total share capital of fourteen SFCs at the end of March 1963 amounted to Rs 14 crores. The Bank's holdings of the shares of these institutions amounted to Rs 2.44 crores, about 17.5 per cent. State governments held about 46 per cent of the equity of SFCs, while scheduled banks and insurance companies held about 32 per cent. Other institutions, including the public, held a mere 3.7 per cent.

Although financial corporations functioned directly under the supervision of their state governments, the Bank was closely involved in monitoring their working and in devising ways to enhance their effectiveness, particularly in regard to the mobilization and utilization of resources. The annual conferences which the Bank convened of these institutions helped it build closer working relations with them and helped identify issues calling for its attention. These conferences were also attended by representatives of the Government of India and the Industrial Finance Corporation (and later by those of the Industrial Development Bank of India). The first such conference, which was convened in 1954, recommended amending the State Financial Corporations Act to bring it more in line with the Industrial Finance Corporation Act. The proposals emanating from the conference included allowing state corporations to finance new units (until then only existing units could be assisted), enabling joint financial corporations for two or more states to be set up, and extending to state corporations the facility available to the Industrial Finance Corporation

of being able to borrow for short periods from the Bank against government securities. Some of these amendments were incorporated into an amendment bill—the Industrial and State Financial Corporations (Amendment) Bill—which was passed by Parliament in its 1955 monsoon session. The State Financial Corporations Act was amended once again within a year, among other things, to allow the formation of joint corporations, and allow state corporations to borrow from the Bank against state or central government securities for up to ninety days. The legislation also made it mandatory for the Bank to be consulted before state governments issued policy directions to their state financial corporations.

Quite early in the career of SFCs, the Bank was called upon to intercede in the matter of the deployment of the resources of these institutions. The issue arose directly out of the proposal, incorporated in the 1956 bill, to allow SFCs to borrow short-term funds from the Bank. The Bank permitted SFCs to invest their surplus funds (i.e. funds not required for current business) in government securities or deposit them with commercial banks, often in the form of three-month deposits on which they earned an interest of 3 per cent or more per annum. The actual deployment by state corporations of their surplus resources varied considerably. In August 1956, for example, the Saurashtra corporation had all its surplus funds in government securities, while at the other extreme its Assam counterpart had its surplus funds entirely in the form of deposits. In the aggregate, at the end of August 1956, nearly a third of the paid-up capital of SFCs was held in the form of bank deposits.

In September 1956, the Finance Ministry wrote to state governments objecting to this practice and proposing that surplus resources of SFCs should be invested in government securities and treasury bills as the 'major portion' of their capital was subscribed from 'public funds'. The Ministry cited the precedent of the Industrial Finance Corporation which divided its surplus funds between treasury bills and demand deposits and suggested SFCs do the same. The new legislative provision allowing these institutions to borrow short-term funds from the Bank, the Ministry maintained, eliminated whatever inconvenience they may have earlier faced in investing surplus resources in government paper.

The Bank did not see much merit in the Finance Ministry's suggestion. Advising the government against insisting upon SFCs switching all their surplus funds from bank deposits to government securities, the Deputy Governor, K.G. Ambegaokar, alerted the Principal Secretary in the Finance Ministry, H.M. Patel, to the dangers of state corporations having to sell or borrow against these assets at regular intervals. State financial corporations,

the Deputy Governor underlined, should be allowed to maintain a working balance adequate for a year's lending requirements with banks, and invest their remaining funds in government securities of relatively shorter maturities. This would enable the corporations to have liquid resources at their command as and when they needed them and minimize the risk of capital losses. Following this intervention, the Finance Ministry advised state governments to allow their financial corporations to invest their funds along the lines recommended by the Bank.

In the early years, SFCs faced the problem of finding suitable projects to finance. But by the middle of 1956, some state corporations began turning their attention towards ways of augmenting their lending resources. The Travancore-Cochin Financial Corporation, which was the first to raise the issue, pointed out that it had unutilized resources of Rs 18 lakhs, while loans sanctioned and awaiting disbursement amounted to over Rs 20 lakhs. Applications for loans to the tune of Rs 24 lakhs were also under consideration. The Bombay, West Bengal, and Madras corporations were also expected soon to find themselves in a similar situation, while the Punjab corporation anticipated a shortage of resources arising from the expansion of its area of operation to cover Delhi.

It was not, on the face of it, clear how these additional resources could be raised. Additions to share capital were expensive. State governments had guaranteed tax-free dividends of 3.5 to 4.5 per cent. With corporations paying the income tax on dividends, the effective charge on capital raised by issuing shares was much higher. Nor did it appear possible to issue bonds at less than 4.5 per cent, an issue by the Madras corporation of guaranteed bonds for Rs 25 lakhs at 4.25 per cent having largely to be retained by the underwriters. With state financial corporations lending their resources at 6 to 7 per cent, they could not offer higher rates without increasing the already substantial subventions paid to them by their respective state governments. The stipulation forcing SFCs to accept fixed deposits of a minimum maturity of five years was also said to be hindering their efforts at resource mobilization.

Faced with this situation, SFCs made a number of suggestions to the Bank, including compulsory subscription by the Bank and nationalized insurance companies to their bonds. The Bank saw little merit in this suggestion. The precedent of its subscription to the debentures of land mortgage banks could not be used, in the Bank's view, to justify subscription to debentures of SFCs, since the Bank already contributed substantially to their share capital. Internal Bank notings also referred to the rejection in 1952 of a request from the Industrial Finance Corporation for loans from the Bank for two or three years against its bonds on the ground that such bonds would be no different from

ad hoc securities. Besides, as officials at the Bank underlined in 1956, making long-term loans to SFCs would 'in effect amount to our providing block capital to industries'

Officials were also unenthusiastic about other suggestions from state financial corporations to raise additional resources, including that for the Bank to undertake joint issues of bonds on their behalf at a uniform rate of interest and persuading nationalized insurance corporations to acquire these securities. According to one official, in the prevailing conditions of the money market, there was no alternative to SFCs raising their lending rates and matching their advances against the repayment of old loans. Nor could SFCs 'get away', in K.G. Ambegaokar's words, 'from the responsibility of raising ... money from the market' He pointed out that while it might be possible to make temporary arrangements with banks and insurance companies to lend resources to SFCs, the initiative and responsibility for mobilizing resources in this way rested primarily with the corporations themselves. Should all other courses of action fail, Ambegaokar suggested, the Bank might have to recommend to the government the case for extending, as a last resort, special accommodation to state financial corporations.

The problem of raising additional resources featured prominently at the third annual conference of state financial corporations in 1956. The subcommittee appointed by the conference to consider the issue took note of the prevailing high interest rates and the 'keen competition for funds' and felt 'conditions [were] ... not propitious' for state corporations to approach the capital market. Bond flotations during the year had amounted to a mere Rs 36.14 lakhs, and there was no immediate prospect, according to the subcommittee, of a significant improvement in the climate for these assets. Hence it proposed that corporations having an urgent need for funds should be accommodated by the central government, if necessary through the utilization of counterpart P.L.480 funds. In the longer run, the subcommittee felt, while there was no alternative to the capital market, the government might consider subsidizing the interest burden of SFCs. Besides, institutions such as the Life Insurance Corporation should be persuaded to be of 'substantial assistance' to these corporations by subscribing to their debentures. The conference endorsed the views of the subcommittee, though the Governor, who chaired the former, disassociated the Bank from the subcommittee's proposal for an interest subsidy.

The following year (i.e. 1957-58) was a much better year from the point of view of resource mobilization by SFCs, bond flotations rising steeply to Rs 3.17 crores. Yet the question (of additional resource mobilization) remained high on the agenda of the fourth conference held in November 1957, which

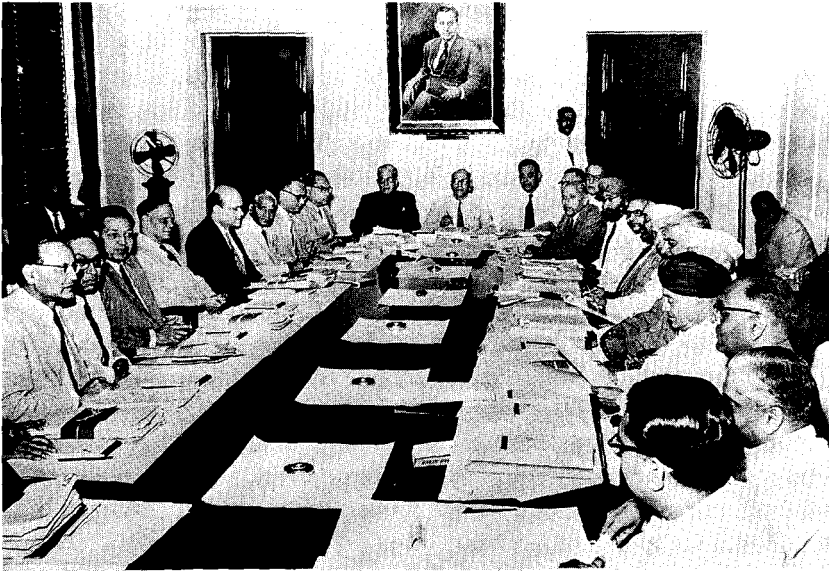
made a number of suggestions. These included allowing SFCs to borrow resources from the Bank for periods of up to eighteen months against government securities or their bonds and debentures, reducing the minimum period for which they could accept fixed deposits from five years to three and permitting them to accept deposits of governments and local authorities, providing state government guarantee for all deposits, and allowing financial corporations to borrow from their state governments and from scheduled banks against government securities. The Bank's attitude towards such proposals softened perceptibly after this conference. It had already initiated steps to administer the existing ninety-day limit for borrowing by SFCs flexibly and allow these institutions the same privileges in regard to such borrowing as state governments and scheduled banks. Overcoming earlier reservations about lending block capital to SFCs, the Bank now viewed the proposal for extending the period of their borrowing from it to eighteen months with greater sympathy. Such a practice already obtained in the case of the Industrial Finance Corporation which was also entitled to borrow against its bonds and debentures. The Bank's officers were originally in favour of lending to SFCs for the longer period only against government securities. The ease with which it could borrow from the Bank against its own bonds and debentures and renew such loans was felt to have discouraged the Industrial Finance Corporation from raising loans in the market, and officers at Mint Road were naturally wary of putting a similar temptation in the way of state financial corporations. On the other hand, as Ambegaokar took pains to stress, state corporations would soon run out of government securities to pledge, and the balance of advantage lay in allowing them to pledge their bonds, so long as these were guaranteed by state governments, against loans on which they could be charged a higher rate of interest. The Bank accordingly proposed inserting a new clause in section 17 of the Reserve Bank of India Act. This proposal was approved by the Central Board in August 1958.

The Bank also favoured reducing the minimum period for fixed deposits to three years. Shorter maturities had been envisaged in 1951 when the State Financial Corporations Bill was in draft. But it was not included in the final legislation as the then Finance Minister, C.D. Deshmukh, preferred a more cautious provision which made adequate allowance for the risks of undertaking longer-term financing operations on the basis of shorter-term funds. However, many corporations experienced difficulties in attracting deposits for five years, while the Madras Industrial Investment Corporation had shown that it was possible to attract deposits for durations of one to three years. The Madras corporation's success also owed to its deposits being guaranteed by the state government. Since deposits could be a flexible source of funds for corporations,

the Bank favoured reducing the minimum period and extending to them the same sort of guarantees available to bonds and debentures of state financial corporations. The Bank however rejected the proposal for SFCs being allowed to borrow funds from scheduled banks since, in the event of the proposed amendments to the Reserve Bank of India Act and the State Financial Corporations Act being passed, it would be in a position to extend accommodation to these institutions at lower rates of interest than commercial banks.

Keen to strengthen the financial position of SFCs, the Bank responded favourably to a proposal mooted first in 1956 and canvassed subsequently by many state corporations to forego its share of dividends from SFCs to enable them to set up special reserve funds. Having failed to meet their guaranteed dividend liabilities, many corporations had not managed to build up adequate reserve funds on their own. A committee set up by the 1956 conference pointed out that the 'high incidence of [income and super] taxation' reduced the net profits of SFCs 'to a figure which was inadequate to pay the minimum guaranteed dividend'. It underlined the increased risks inherent in long-term lending and the imperative need for SFCs to build reserves 'if for no other reason, then for ... (their) security ... as financial institutions ...', and endorsed, by a majority, the idea of transferring the Bank's and state governments' share of their dividends to the reserves of these institutions. However, the minority report, presented by the representative of the Kerala corporation, contended that state governments, which were already under attack for subsidizing their financial corporations, could not be expected to forego their dividends altogether, and proposed an arrangement whereby they continued to receive at least some portion of the dividend due to them. The recommendations of the majority report were reiterated at the sixth annual conference of state financial corporations in December 1959. The Bank and the central government were already committed to surrendering their shares of the dividends of the Industrial Finance Corporation to a special reserve fund until the amounts so credited exceeded Rs 50 lakhs. With the precedent already set, the Bank had little hesitation in accepting the conference proposal and foregoing its dividends from SFCs to the same extent as the state government concerned, provided these amounts went to a special reserve fund until the latter reached a tenth of the paid-up capital of the corporation. In addition, the Bank stipulated that no shareholder other than itself and the state government would have any claim on the fund which was to be used only for purposes approved by the two contributors.

Though accepted and drafted in 1958–59, these amendments hung fire for some years and were finally moved as part of the wider State Financial



Sixth annual conference of state financial corporations at the RBI, Bombay, December 1959, Iengar (third from left) presiding

Corporations (Amendment) Bill, 1962. Passed in March 1962 the Act came into effect from 16 April the same year. It allowed SFCs to guarantee loans raised by industrial concerns from scheduled or state cooperative banks and arrangements for deferred payment for capital goods. It enhanced the limit of accommodation in respect of public limited companies and cooperative societies to Rs 20 lakhs (while the limit of Rs 10 lakhs remained unchanged for other concerns), and enlarged the meaning of the term 'industrial concern' to include the hotel and transport industries. The earlier decision to allow SFCs to borrow from the Bank for up to eighteen months against specified securities was also included in the bill, with the proviso that such borrowing should not exceed 60 per cent of their paid-up capital. Corporations were allowed, besides, to borrow from state governments and notified financial institutions up to ten times their paid-up capital and reserves, act as agents of any financial institution notified by the central government for loans or advances granted by the institution or debentures subscribed by it, and accept deposits up to the extent of their paid-up capital and reserves for a minimum period of one year. The bill also provided for the establishment of the special reserve fund decided upon earlier.

The Bank was closely involved with the efforts of state corporations to raise resources by floating bonds and debentures. The new provision allowing

SFCs to borrow from the Bank against their own bonds may have even had the effect of intensifying the interest the latter took in the flotations of SFCs. The Bank played an important role in persuading banks and other financial institutions to subscribe to the bonds of SFCs, and in coordinating their investments. Bonds issued by SFCs and outstanding amounted to Rs 41 crores at the end of June 1967. Available data show that up to March 1963, commercial banks had subscribed to nearly 53 per cent of these bonds, and the Life Insurance Corporation to about 26 per cent. State governments (0.6 per cent), the Bank (1.7 per cent), cooperative banks (3.6 per cent), other insurance companies and financial and other institutions (10.6 per cent), and individuals (4.2 per cent) made up the remainder. Thanks to the fairly widespread institutional support that bond issues of SFCs evoked, their recourse to borrowing from the Bank remained modest. Corporations' outstanding borrowing from the Bank at the end of June 1967 stood at Rs 2 crores—these were almost entirely against government securities and ad hoc bonds—while outstandings against refinance availed from the Industrial Development Bank of India amounted to Rs 15 crores.

Following the eighth annual conference of SFCs in November 1961, the Bank set up a working group headed by K.C. Mitra, Chief Officer in the Industrial Finance Department, to review the working of these institutions and recommend ways to improve their usefulness. The group, which submitted its report in February 1964, regretted the proliferation of institutions, especially at the state level, which duplicated the functions of state financial corporations. Pleading for a check on this tendency, the working group underlined the need to coordinate the activities of various institutions, such as the Industrial Finance Corporation, state financial corporations, state industrial development corporations, and the Industrial Credit and Investment Corporation, which were all in the business of providing term-finance to industry. It also recommended that state governments should route all assistance provided to industrial concerns on a commercial basis through these institutions. An earlier committee set up by the 1956 conference had envisaged SFCs diversifying into underwriting and equity financing. Reiterating this recommendation, the Mitra Working Group also stressed the need to strengthen the capital base of SFCs to enable them to undertake these additional activities. The working group felt resource mobilization could be assisted if SFCs floated bonds of shorter maturities. It also proposed allowing them to borrow from the Bank to the full extent of their paid-up capital, investing a portion of provident funds in the bonds of these institutions, and establishing a National Industrial Credit (Long-term Operations) Fund at the Bank.

By June 1967, there were eighteen financial corporations, including the Madras Industrial Investment Corporation Ltd., covering all the states of the country. Their outstanding loans amounted to Rs 73 crores. In 1966–67, SFCs were the third most important term-lending agency for industry, accounting for Rs 22 crores, or 17 per cent, of the total assistance of Rs 127 crores sanctioned by all industrial term-lending institutions that year. Nine corporations had diversified into underwriting, with total investments in shares and debentures of Rs 9 crores. Four SFCs also extended deferred payment guarantees for purchase of indigenous machinery, and their outstanding guarantees aggregated Rs 4 crores. Eleven SFCs were by then acting as agents of their respective state governments for routing concessional finance to small-scale industries under the State Aid to Industries Act, the loans so outstanding under these agency arrangements amounting to Rs 3 crores.

THE BANK AND SMALL INDUSTRIES

Small-scale and cottage industries were accorded an important place in successive five-year plans. The first plan provided Rs 27 crores for the sector which the plan document regarded as being integral to the wider industrial development of the country. The plan paid particular attention to the conditions of rural artisans who, besides possessing limited resources, could offer little by way of security, and championed cooperative organization to overcome these handicaps. It envisaged a network of institutions for promoting village and small industries. As well as establishing specialized bodies to encourage handlooms, other handicrafts, khadi and village-level manufacturing, sericulture, and coir-based activities, the government also set up a National Small Industries Corporation, the Small-scale Industries Development Board, and four regional Small Industries Service Institutes to provide technical assistance and advice to small industries. The second plan too, accorded an important place to the small manufacturing sector and envisaged cooperatively organized village and small industries as major sources of employment and consumer goods. In addition to providing Rs 200 crores for the sector, it assigned key roles to the Bank and to the newly-formed State Bank of India in evolving an integrated scheme for financing the needs of small-scale industries. At the urging of the National Development Council, the Planning Commission set up a Village and Small-scale Industries (second five-year plan) Committee under D.G. Karve to advise it on how best to utilize the plan resources earmarked for the sector. This committee stressed the need for coordination between the Reserve Bank, the State Bank of India, state financial corporations, and central cooperative banks in evolving a coherent financial

policy for small industries. The Industrial Policy Resolution (1956) also underlined the role of small industries in producing consumer goods and the importance of strengthening their competitive position by improving and modernizing techniques. A working group set up by the Ministry of Commerce and Industry to evaluate small industries development programmes and make suggestions for the third plan deplored the inadequate performance of SFCs and the general preference corporations and banks showed for lending to medium-sized units. Making a bigger provision for the State Aid to Industries Act, the plan once again stressed the need for stepping up financial assistance to the sector. It envisaged an outlay of Rs 264 crores for the sector in the third plan against an actual expenditure of Rs 180 crores in the second plan and Rs 43 crores in the first.

The State Bank of India Pilot Scheme

By the middle of the 1950s, financial assistance to small industries was available, at least in principle, from a variety of agencies. Apart from specialized institutions such as SFCs and the National Small Industries Corporation set up during the decade, the central government provided grants and long-term loans to state governments to enable them to assist small-scale industries under the State Aid to Industries Act. In a broad sense, these initiatives were intended to be complementary, rather than competitive. State aid, it was mainly hoped, would partake of the nature of 'risk' capital. The Small Industries Corporation and SFCs were concerned with medium and long-term loans. While industries in the cooperative sector could approach their apex institutions for working capital needs, commercial banks continued to be regarded as the proper source of working capital for other small industries. In practice, however, commercial banks did not lend much to small industries. In addition, a variety of factors, not the least of which was the absence of coordination between the many agencies involved, persisted in impeding the flow of finance to small-scale industries. Small industrial borrowers were also often in the situation of having to approach different sets of agencies or lenders for equipment loans and for funds to meet working capital requirements. This resulted in needless duplication of effort by the borrower and of credit investigation by the various lending agencies. Not only did all this push up the cost of loans, the multiplicity of credit agencies led to different types of capital being provided in a 'haphazard manner' and discouraged lenders from taking an integrated view of the financial requirements and prospects of their small borrowers. Finally, neither SFCs nor the National Small Industries Corporation possessed a well dispersed network of branches. Consequently, their services were mainly

confined to the larger centres and were not easily available to units in the more remote areas.

Two solutions were advanced to the problem of making institutional credit widely available to small industrial borrowers in a coordinated manner. One solution proposed in 1956, somewhat on the analogy of the measures taken to expand the availability of rural credit, was to disburse credit to small industry through urban cooperative banks which were either to be established or strengthened for the purpose with liberal assistance from the government. This proposal made little headway despite a measure of support for it in the Small-scale Industries Development Board and within the Agricultural Credit Department of the Bank. The principal opposition to the idea came from the Reserve Bank's Division of Banking Research, which pointed out that urban banks played such a small role in financing industry that government assistance towards setting up or strengthening these institutions was unlikely to be of much benefit to small industries. Non-scheduled banks and smaller scheduled banks, in contrast, advanced a greater proportion of their loans to small industries. The resources required to support urban banks, the Division maintained, could be better used to encourage non-scheduled banks and the smaller scheduled banks to enlarge their lending to small industries, if necessary, in collaboration with the State Bank of India. Non-scheduled banks were so far superior, in the Division's view, to existing or new urban banks as a channel for routing resources to small industries, that its note adverted to the advantages of amending the Reserve Bank of India Act to enable the Bank to extend credit to these institutions. The Banking Research Division's dim view of the potential of urban banks was confirmed by a sample survey conducted by the Bank in 1957 which found urban cooperative banking poorly developed in large parts of the country outside Bombay, Madras, Andhra Pradesh, and Mysore. Loans to small industries by these institutions, the survey revealed, also constituted a relatively meagre proportion of their total advances. In September 1957, however, the Small-scale Industries Development Board decided to utilize six urban banks in each state to route government funds. Even this plan made little headway outside Mysore state. Organizationally weak and critically dependent on government assistance, urban banks were not viable vehicles for financing small industries. But these institutions also faded into the background following the relative success of the second of the two solutions advanced to tackle the problem of delivering credit adequately to the small sector, namely the State Bank of India's pilot scheme for lending to small industries. The scheme's success paved the way, in due course, for greater participation by commercial banks in financing small industries.

The State Bank pilot scheme owed largely to the initiative of the Bank, and to that of the Deputy Governor, B. Venkatappiah, in particular. By early 1956, officials within the Bank had come round to the view that a promising approach to solving the problem of coordinating lending to small industrialists lay in a 'package approach' that enabled borrowers in this category to avail of all types of credit from a single agency. The State Bank of India was the obvious candidate to implement such a programme, and it was decided in April 1956 to utilize this institution to provide credit to small industries in a limited, but coordinated, manner. The pilot scheme required the borrowing firm to apply to the local branch of the State Bank of India or to the concerned cooperative bank, if it belonged to the cooperative sector, for its credit requirements. The application was considered by a local committee comprising representatives of the agencies working the scheme and, depending upon the type of credit required, it was referred to the appropriate lending agency. It was proposed to take up applications for loans below Rs 20,000 with the Director of Industries of the state government. Applications for loans above this amount were to be handled by the State Bank or cooperative banks if they were for working capital and by the state financial corporation if they were for medium- or long-term credit. Where credit of both types was required, it was proposed that the agencies concerned would act in coordination. The State Bank or the cooperative bank concerned assessed the borrower's creditworthiness while the technical appraisal of his proposal was provided either by the Director of Industries or by Small Industries Service Institutes. The State Bank also entered into agreements with some SFCs under which it acted as their agent in collecting credit reports, disbursing loans, and collecting instalments.

Initially introduced in 1956 at three centres in each of the State Bank's three circles, the scheme evoked a good response, with the number of applications under it rising from 161 in 1956 to 986 in 1957 and 2,165 in 1958. At the end of December that year, the State Bank had sanctioned Rs 2.4 crores, the Director of Industries of state governments Rs 58 lakhs, and SFCs Rs 74 lakhs under the scheme. The scheme was extended to fifty-three centres at the end of December 1959. With experience gained in working the scheme revealing that it would not be possible to assist small-scale units to any appreciable extent unless lending procedures and practices were liberalized, the State Bank initiated more liberal lending policies at the pilot centres. These included advancing unsecured working capital loans to small industries provided their products had an assured market or the unit agreed to undertake technical and organizational improvements under the supervision of small industry experts from the state government or from service institutes.

Small industries securing government orders through the National Small Industries Corporation were also provided finance for the full value of raw materials, with a guarantee from the corporation towards the margin. The latter arrangement was of particular assistance to engineering units.

A study initiated by the Reserve Bank evaluated the scheme as it operated until the end of 1957 at the nine centres where it was first introduced. It concluded that although the scheme's progress was not remarkable or uniform, it had, on the whole, worked well enough to be assured of a 'place in the field of providing improved credit facilities to small-scale industries'. It was also sceptical about the extent to which industrial activity could be organized along cooperative lines and about the ability of urban cooperative banks to meet the credit requirements of small-scale units. The study recommended the extension of the scheme to all branches of the State Bank. Little time was lost in implementing the suggestion. The State Bank also simplified and liberalized certain aspects of the scheme. The list of goods acceptable as security was enlarged and interest fixed at an all-inclusive rate of 6 per cent without imposing any additional charges on borrowers. The bank also agreed to consider extending medium-term loans for up to seven years to finance expansion and renovation plans of small industrial units.

The Credit Guarantee Scheme

Encouraged by the results of the State Bank pilot project, the Development Commissioner for Small Scale Industries in the Government of India, Ashfaq Hussain, wrote to thirty scheduled banks in June 1958 suggesting that they consider adopting similar schemes. A majority of the banks addressed wrote back to report that they were either already financing small industries or were willing to implement the government's suggestion. The Bank too was convinced of the necessity for measures to augment the flow of bank credit to small units. An ad hoc survey it conducted of advances extended by a selected number of offices of scheduled and non-scheduled banks to medium- and small-scale industrial units up to the end of September 1957 showed that industries in the latter category accounted for a mere 12 per cent of the industrial advances of the banking system. The Department of Banking Development held some reservations about commercial banks being made an 'important source of finance for ... small industries' at the cost of SFCs in whose establishment the Bank and the government had invested 'considerable planning ..., much thought and financial effort'. But the Bank itself had little hesitation, when the Development Commissioner approached it with his proposal in October 1958, in endorsing the principle of involving more commercial banks in financing small industries. It preferred, however, to

defer taking any steps in that direction until the conference of SFCs, which was scheduled to convene in December 1958, had had an opportunity to review the working of the State Bank's pilot scheme.

The Bank's survey also found that a major impediment remaining in the way of expanding commercial banks' involvement with small industries was the perception of the latter as poor credit risks. Even as the Bank was considering the findings of its survey, in October 1958 it received a proposal from the Government of India for introducing a scheme to guarantee commercial bank loans to small industries along the lines of a similar scheme which was reportedly working well in Japan. Though emanating from the Ministry of Commerce and Industry, this proposal was born directly of the State Bank's experience in running the pilot scheme and the recollection by its Chairman, P.C. Bhattacharyya, at a meeting of the central committee coordinating the scheme, of a suggestion made some months earlier by T.T. Krishnamachari. It was premised on the observation that lack of adequate security presented the 'main difficulty' in financing small industries. While government agencies, and even the State Bank of India, could 'at least up to a point take a promotional view and advance loans at some risk', commercial banks would not be willing to 'accept any but the normal trade risks; indeed in the beginning it will be a task to persuade them to lend money to small industrialists at all'. In these circumstances, the Commerce Ministry argued, a credit insurance scheme 'will perhaps do more to promote the growth of small industries than any other single concession so far granted by Government'. The working estimate in the proposal of the insurance premium on loans to small industries was of the order of two per cent per annum, i.e. a third or more of the interest that was then charged on such loans. This substantial additional burden, the proposal clarified, should not be passed on to borrowers but should largely be borne by the government. Forwarding the proposal, the Finance Ministry sought the Bank's views on the magnitude of the credit risk involved in lending to small industries, the necessity for insuring lending institutions against the risk, and the proper method of guaranteeing credit to the small sector.

The Commerce Ministry proposal sparked off numerous ideas within the Bank, not all of them unequivocally in its support. The Department of Banking Development, as noted above, was not altogether enthusiastic about turning to commercial banks to deliver credit to small industries if that meant bypassing state financial corporations. Nor was it in favour of the government taking upon itself 'additional (unlimited) risks or setting up new organizations' for the purpose and endowing them with financial resources. Much better, in its view, to direct attention towards improving the functioning of SFCs, assist them

financially to play an expanded role, and modify those provisions of their statute which had 'served in the past to retard their rapid development'. Should credit insurance be thought essential to encourage commercial banks to lend to small industries, the department maintained, the responsibility must be entrusted to SFCs after suitably amending their constitutions and placing the necessary funds at their disposal. SFCs, Banking Development's note pleaded, were in any case better suited than the government or a new central agency to act as credit guarantors since they had the necessary resources and expertise to investigate credit risks and maintain close contact with borrowers.

The Department of Research and Statistics, on the other hand, framed the issues underlying the guarantee proposal in a more hopeful light. Its note pointed out that the problem of inadequate bank credit to small industries arose both from the greater risks involved in making such loans and the relatively meagre resources at the command of the smaller banks which were willing to lend to the sector. The availability of finance (or refinance) and doubts over the liquidity of loans to small borrowers were the two factors constraining commercial banks from lending more actively to small industries. Hence, apart from making more finance available to this sector through new and specialized institutions, widening existing institutional facilities through guarantees and participation loans also represented a possible means of helping to meet the 'special needs of this fringe of unsatisfied borrowers'. The department's review of special facilities available to small borrowers in Japan, the United States, and the Netherlands revealed that the emphasis in these countries was as much on 'financing facilities to the primary lender as on the liquidity of the transaction'. Policy could thus take the form of either a simple insurance of the risks on a loan or of an undertaking to meet any financial inadequacy a primary lending institution may face as a result of its loans to small borrowers. The Commerce Ministry proposal, the note argued, attributed commercial banks' unwillingness to lend to small industries to their unwillingness to bear the additional risk on such loans.

If this were true, then the solution to this problem would indeed be on the lines of an insurance agency. It is, however, not clear that this is the main difficulty It would seem that the problem is as much one of finance as of liquidity; in other words, not merely must the reluctance of banks to accept such business be overcome but also steps would need to be taken to enable banks to lend by providing them more finance.

This was particularly necessary in the case of the smaller scheduled and non-scheduled banks which were more willing to lend to small industrialists but

had not benefited from the general increase in the deposits of the banking system in the past few years. Of greater relevance under Indian conditions, this memorandum urged, was a scheme which combined elements of credit insurance and, should the need for it arise, refinancing either directly or on the principle of deferred participation. The institution to undertake the twin responsibilities should bring together the government, the Bank, commercial banks, and specialized financial institutions.

The Chairman of the State Bank of India, P.C. Bhattacharyya, whose views were sought in the matter, favoured a credit guarantee corporation, with liberal support from the government, working broadly on the Japanese model. Credit guarantees, Bhattacharyya argued, were necessary to encourage banks to expand their lending to small industrial borrowers despite their inability to come up with adequate security. The Bank also despatched a team to Japan to study the practices of Japanese credit institutions in financing small industries. The report of this study team and the government's proposal for a credit insurance scheme were debated at the conference of SFCs held in December 1958. Opinion at the conference generally favoured a system of credit guarantees, but a formal decision was postponed until the following year when the Bank proposed, at the conference's instance, to convene a seminar devoted to the problems of financing small industries and ways of overcoming them.

This seminar was held in Hyderabad in July 1959. Bringing together central and commercial bankers, officials from central and state governments and specialized industrial lending agencies, and representatives of chambers of commerce and small industrialists, the Hyderabad seminar represented an important landmark in efforts to meet the financing needs of small industry. Inaugurated by the Chief Minister of Andhra Pradesh, N. Sanjiva Reddy, the seminar was presided over by Venkatappiah who set the tone for its deliberations by highlighting the paradox of the small industrial sector not developing much momentum despite abundant goodwill and an impressive network of institutions and policies to cater to its needs. Small industrial units tended to grow in a haphazard way, they suffered from high rates of mortality, a majority of them were still at the mercy of moneylenders or traders, and productivity standards remained very low, the Deputy Governor pointed out. The seminar constituted four working groups dealing with the causes of borrower resistance, factors inhibiting credit institutions from lending more freely to small industries, the role of the government in assisting small industries, and finally the resources of credit institutions and related issues. These groups were chaired respectively by R.S. Bhatt, R.G. Saraiya, A.S.E. Iyer, and B.K. Madan. Each of the groups produced elaborate reports and

made a number of suggestions which were discussed at an open session of the seminar. The seminar formulated, in all, twenty-one recommendations intended to strengthen the small industrial sector and boost institutional financial and other assistance to it.

Important as the Hyderabad seminar was, little purpose is served by attempting to summarize its deliberations or even its main recommendations here. The principal proposition to emerge from the seminar, for our purposes, related to ways in which risks of lending to small industries could be minimized. The most important recommendation to this end was the one for introducing a system of guaranteeing loans to small industries, to begin with on an experimental basis in selected areas. After deliberating on the models of small business credit risk insurance schemes operating in the US and in Japan, the seminar concluded that it was necessary, under Indian conditions, to combine features of both institutions and formulate a guarantee scheme the 'essence of which was a sharing of risks'. The guarantee, the seminar proposed, should apply to banks such as the State Bank, selected scheduled and other commercial banks, state cooperative banks, cooperative urban banks, and other cooperative banking institutions. For obvious reasons the seminar insisted that the guarantee should ordinarily not exceed 50 per cent of the loan, with the primary lending institution bearing the risk on the remainder. In exceptional cases, however, loans could be guaranteed to the extent of 75 per cent. The offer of the guarantee on a loan was also to be conditional upon the borrowing unit being inspected by the staff of the Director of Industries or of Small Industries Service Institutes and a local guaranteeing association, endowed with the necessary share capital, undertaking part of the risk. 'On the whole the request for guarantee must be supported both by local knowledge and a financial stake', the seminar recommended. In order further to spread the risks of lending to small industries, the seminar supported the idea of SFCs and banks entering into agency arrangements with each other. Banks and institutions could also extend loans to cooperative and other commercial banks on the basis of participation, whether immediate or deferred. Besides spreading risk, such arrangements, the seminar urged, would enable borrowers to deal with a single institution instead of with several agencies.

The principle of a credit guarantee on loans to small industries was thereafter quickly endorsed by the government, the State Bank of India, and several of the commercial banks. Although the seminar had envisaged the possibility of more than one guaranteeing organization, the Bank itself undertook to operate the credit guarantee scheme on behalf of the government. Following an amendment to the Bank Act in April 1960 and an exchange of letters, the Government of India designated the Bank as the guarantee organization and

authorized it to act as its agent in offering guarantees and administering the scheme. Loans to small industrial units with capital investment of less than Rs 5 lakhs and having satisfactory ratings from the Development Commissioner for Small Scale Industries were eligible for guarantees under the scheme. Up to half a loan ordinarily, and in some cases up to three-quarters, could be guaranteed against the payment of a nominal guarantee fee of 0.25 per cent, provided no guarantee was for a sum exceeding Rs one lakh. The Credit Guarantee Scheme came into operation in twenty-two districts on 1 July 1960 for an experimental period of two years. Within a year the number of districts covered by the scheme was increased to fifty-two. At the time the Credit Guarantee Scheme was introduced, ninety-five credit institutions were eligible to take advantage of it. These included, besides the State Bank of India and its eight subsidiaries, forty-nine scheduled banks, twenty-two state cooperative banks, and fifteen state financial corporations (including the Madras Industrial Investment Corporation Ltd.).

The Bank undertook a review of the guarantee scheme towards the end of the experimental period. The review showed that up to the end of March 1962 the guarantee organization had received over 2,500 applications from almost all the districts where the scheme was implemented, for a total amount of Rs 8.93 crores. Of this, the organization issued guarantee certificates for nearly 2,350 applications involving an aggregate sum of Rs 7.63 crores. Over two-thirds of the guarantees issued were for advances below Rs 25,000, suggesting that 'comparatively small units constituted the largest group to reap the benefits' of the scheme. At the end of March 1962, a total of 1,830 guarantees for a sum of Rs 5.96 crores were in force. During this period, a single claim had been admitted for the princely sum of Rs 539.55 against a guarantee for Rs 1,000.

However, a disquieting feature of the working of the scheme revealed by the review was that only twenty-two of the ninety-five specified institutions had taken advantage of it. Of these, fourteen were commercial banks. The State Bank of India alone accounted for nearly 2,350 applications covering a sum of over Rs 8 crores. The review attributed this imbalance to the excessive caution shown by the State Bank of India which had covered all its advances to small units in the eligible districts under the scheme. In contrast, other banks did not ask for cover except in cases where they considered their advances 'sub-standard or marginal' and as involving 'greater than normal risks'. State financial corporations too did not apply for cover to any great extent because their normal advances were for periods above seven years and these were, for much of the review period, ineligible for guarantees under the scheme.

The review was, however, generally positive in its evaluation of the scheme and took comfort in the observation that a 'promotional measure' such as this was 'bound to be slow in casting its influence on the minds of banks'. Two years were not long enough to 'bring about a significant change in the policies and attitudes of credit institutions whose prejudices against ... small scale industries were deep-rooted'. Commercial bankers and state financial corporations had, in general, welcomed the scheme which, they maintained, encouraged them to sanction loans to small industries where previously they might have refused. State financial corporations might be expected to make greater use of the scheme's facilities, the review anticipated, since it was now proposed to permit cover to all loans made to small industrial borrowers, irrespective of their currency, for a period up to seven years. Thanks to the scheme, the review noted, the State Bank now contemplated making clean advances for processing purposes, while several SFCs were willing to reduce their margin requirements from 50 per cent to 25 per cent for guaranteed advances. The Union Cabinet, which examined the scheme, also endorsed it and called for its extension throughout the country. Seconding the latter suggestion, the review also recommended putting the guarantee scheme on a permanent footing.

Both suggestions were implemented from the beginning of 1963. Despite the earlier optimism, however, the domination of the State Bank of India and its subsidiaries abated only slightly. They accounted for nearly 95 per cent by value of all guarantees issued by the guarantee organization since its inception up to November 1964; other commercial banks and SFCs accounted between them for about 4 per cent. Hence, despite some internal reservations within the Bank, it was decided in 1965-66 to cast the guarantee net wider to include central cooperative banks and specified non-scheduled banks. This move, which in one stroke raised the number of eligible institutions from fewer than 100 to 452, was motivated partly by the hope that smaller non-scheduled banks would be more interested in lending to small industries and by the recognition that the larger commercial banks which were already eligible for guarantee facilities were not keen to enter into participation arrangements with these institutions. At the same time as this modification was adopted, the guarantee cover was also enhanced from Rs one lakh to Rs 2 lakhs. Loans up to ten years were now eligible for cover, with the primary lender having the option of availing of it for the entire period of the loan. The definition of small industry was also revised and the maximum investment in plant and machinery raised to Rs 7.5 lakhs in March 1967.

These reforms were not altogether without effect. Between July 1960, when the scheme was introduced, and December 1967, the guarantee

organization received 64,274 applications for Rs 276 crores, and issued guarantees for 57,071 applications for a total sum of Rs 231 crores. Of the latter amount, guarantees for all but Rs 48 crores were issued in the three years after November 1964.

Special Refinancing Arrangements

A survey by the Bank in July 1961 revealed that advances to small industries by scheduled banks amounted to Rs 27 crores at the end of June 1961. This constituted less than 2.5 per cent of total scheduled bank credit. The question of providing special refinancing facilities to banks against their loans to small borrowers cropped up when the Government of India's proposal for a credit guarantee scheme was under discussion in the Bank. The issue was also raised at the Hyderabad seminar where it was suggested that while large commercial banks could substantially increase their lending to small industries without additional resources being made available to them by way of refinancing, the resources of smaller banks might need to be augmented before they could expand their involvement with the small industrial sector. Refinancing cropped up, besides, in discussions about the role of commercial banks in extending medium-term loans to small industries. The seminar, however, confined itself to recommending some relaxations in the bill market scheme, wider membership of the Refinance Corporation for Industry to include other commercial banks, cooperative banks, and SFCs, and provision by larger banks of rediscounting facilities to smaller banks along the lines of the facilities they afforded to Multani shroffs.

The expectation nurtured in the seminar that commercial banks would not be constrained by shortage of resources in lending to the small industrial sector was not borne out by subsequent developments. As the Bank tightened its credit policies in the early 1960s, particularly through the introduction of the 'quota-slab' system, it was feared that 'fringe borrowers' such as small industries would be particularly badly affected.¹ Hence it allowed commercial banks to borrow from it at the Bank rate, an additional amount, over and above its basic quota, equivalent to their incremental average lending to small industries in the first half of 1961 over the corresponding period in 1960.

Thanks, no doubt, to some of these measures, the volume of credit provided by scheduled banks to the small industrial sector, in addition to equipment finance provided by specialized institutional agencies, the State Bank of India, and its subsidiaries, increased from Rs 32 crores at the end of December 1961 to Rs 54 crores at the end of June 1964. But this growth barely outpaced the

¹ For details of the 'quota-slab' system, see chapter 3.

overall growth in industrial advances, the share of the small sector in the latter rising only marginally from 4.8 to 4.9 per cent. The number of small industry accounts rose from 13,517 to 22,800. Outstanding advances of scheduled commercial banks to small industries rose further to Rs 74 crores (26,000 accounts) in 1965 and Rs 91 crores (28,500 accounts) in 1966. They rose steeply thereafter to Rs 178 crores (51,000 accounts) in March 1967, but a considerable part of this increase was due, admittedly, to the fact that the definition of small industrial units having undergone a change in the meantime, the latter set of figures were compiled on the new basis.

Financing Handloom Cooperatives

The Reserve Bank of India Act was amended following the informal conference (on rural credit) in 1951, to enable the Bank to finance production and marketing activities of approved cottage and small industries. A conference of Development Secretaries of state governments, representatives of the Bank, and officials of the central government which was convened in July 1955, recommended that the Bank should provide concessional credit for the cooperative production and marketing of handloom cloth on the analogy of facilities it extended towards agricultural cooperatives. It also set up a committee on credit facilities for the handloom industry on which the Bank was represented by the Chief Officer of its Agricultural Credit Department. This committee estimated that primary weavers' cooperatives required working capital of about Rs 21 crores to meet their second plan production target and suggested that these funds should be obtained from the Bank. The Central Board of the Bank approved this recommendation after the Governor underlined the employment potential of the handloom sector, its higher working capital requirements, and the need to shift the main source of support to the handloom sector from the cess fund to institutional financing agencies. Following the Central Board's decision, which included making accommodation available to apex banks at 1.5 per cent below the Bank rate, the central government took steps to phase out the cess fund scheme and replace it with the Bank's scheme from April 1957. The government notification clarified that apex banks should finance weavers' societies at 3 per cent, with a subsidy of 2 per cent from the cess fund. The Bank also advised state governments that it would lend to central cooperative banks, under section 17(2)(bb) of the Bank Act, against their guarantee up to the limit of such banks' owned funds and to state cooperative banks up to thrice their owned funds. This accommodation was made available for financing solvent weavers' societies for the production and marketing of handloom cloth at the rate of Rs 300 per loom. This rate was raised to Rs 500 per loom in 1960. From April 1966 the Bank adopted a

production-oriented, rather than capacity-based, method of determining working capital requirements and societies' credit limits, with the latter being fixed at a fifth to a third of the value of the cloth produced by a society in the previous year.

Apex banks' utilization of these limits, however, fell below expectations. While the latter were of the order of Rs 1.8 crores in 1957–58, Rs 2.27 crores in 1958–59, and Rs 2.33 crores in 1959–60, actual limits utilized during these three years amounted to Rs 49 lakhs, Rs 1.74 crores, and Rs 1.73 crores respectively. The Bank therefore decided to select nine major handloom centres, in consultation with the All-India Handloom Board and state governments, where its financing programme could be promoted in a concerted manner. The Bank also constituted an Advisory Committee on Handloom Finance, with the Deputy Governor in charge of rural credit as its chairman, to review the progress of its scheme to finance weavers' societies.² The Bank attempted, besides, to simplify and liberalize the procedures apex banks were required to follow in order to avail of this facility. It advised state governments, for example, to issue blanket guarantees in advance for a period of one year rather than on an individual case basis; further in a significant departure from past practice, the Bank agreed to accept the total cash credit limits sanctioned by central cooperative banks to weavers' societies, instead of outstanding amounts, as cover for their borrowing from the apex bank. Seminars were also conducted in as many as ten centres during 1960–61 to promote the scheme and secure some feedback on its working. These steps achieved the intended effect—actual utilization in 1960–61 and 1961–62 amounting to Rs 2.4 crores and Rs 3.54 crores respectively against limits of Rs 2.95 crores and Rs 3.69 crores. So much so, by April 1965 the Bank could contemplate with equanimity the gradual reversal of some of these measures in order to prevent borrowed funds accumulating unnecessarily with central and state cooperative banks and their diversion to other uses.

The Bank's interest in artisans' and producers' cooperatives during this period was not confined to organizations of weavers. Its officials conducted extensive surveys to explore the possibility of extending similar types of accommodation to small producers in the leather, coir, fishing, and sericulture industries. But their studies revealed that these industries required to be substantially reorganized before producers, rather than middlemen, could take advantage of the type of facilities available to weavers who had had the benefit of a longer history of cooperative organization.

² This committee was merged with the rechristened Standing Advisory Committee on Rural and Cooperative Credit in April 1965.

FINANCING EXPORTS

It is widely recognized that exports did not receive much attention from the country's planners in the early years. Apart from substantial sterling balances and the relatively modest external financing needs of the development programme in the early years of planning, the emphasis of the country's policy-makers on the home market also derived from the export pessimism that dominated their outlook during these years. An Export Promotion Committee (chaired by A.D. Gorwala) was no doubt set up in 1949 to examine measures needed to achieve balanced trade particularly with hard currency areas. But the background to this was largely filled in by Britain's efforts to ration the supply of dollars to India whose external reserves were held at this time in non-convertible sterling. Besides, this committee was generally content to recommend relaxing controls on exports and reducing export duties. Even these modest reforms became hostage to the winds blowing from Korea—as India too, came under the grip of inflation, policy-makers grew keen to conserve supplies of exportables for domestic consumption. Far from being relaxed, therefore, export controls were tightened during 1951.

A number of committees were constituted after 1956 by the Bank and the government to study various aspects of export promotion and financing. Thanks to the recommendations of these committees, export credit facilities were liberalized gradually. An Export Risks Insurance Corporation (ERIC) was set up in July 1957, which was later converted into the Export Credit and Guarantee Corporation in January 1964.

The Bank's role in the export arena remained modest until the 1960s. Rediscounting facilities under the bill market scheme were extended to export advances, but little actual progress was made since the procedures, involving the creation of usance bills and their physical transfer, proved cumbersome and complicated. The Reserve Bank of India Act had, therefore, to be amended in 1962 to enable the Bank to lend for up to six months against export bills on the basis of declarations made by banks. Following the changed procedure, the volume of refinance assistance extended by the Bank increased substantially. The cost of export credit was also regulated, and this was subsequently formalized by the Export Credit (Interest Subsidy) Scheme. The scheme to refinance export credit on concessional terms was continued even during periods when the Bank was otherwise attempting to rein back its refinancing of general bank credit. In addition, pre-shipment credit was introduced and, as discussed earlier, the Refinance Corporation for Industry also stepped in to refinance medium-term export credits.

The First Steps

With the Government of India beginning to shed its earlier indifference towards exports, it set up an Export Promotion Committee in February 1957 with V.L. D'Souza as its chairman, to study all aspects of export promotion. Two recommendations of this committee were of particular interest to the Bank. The first related to popularizing the system of making advances to exporters in the form of 'packing credits' against 'trust receipts' which could be recovered, if necessary, by instituting criminal proceedings against defaulting borrowers; and the second to the possibility of the Bank refinancing or rediscounting export bills at preferential rates of interest.

These recommendations, which represented virtually the first effort to outline its role in promoting exports, evoked a mixed, and on the whole a low-key, response from the Bank. The Bank had examined the legal status of 'trust receipts' in 1954 and found it rather ambiguous. Even in 1958, it was for many officials at the Bank 'a matter of doubt whether an obligation in the nature of trust can be created over unidentified goods or goods which have not come into existence'. Despite doubts over the legal rights of those holding such securities, banks persisted in the practice of advancing packing credits against 'trust receipts' to exporters 'of undoubted creditworthiness and integrity' who had firm export orders or had bought goods to service such orders. In 1954 the Bank had rejected moves to subject trust receipts to special legislation on the ground that it would give 'undue' precedence to the rights of banks as lenders and neglect the rights of other parties dealing with defaulting borrowers. But with the Export Promotion Committee coming to the conclusion that the ambiguous legal status of trust receipts inhibited banks from advancing packing credits more liberally and widely to exporters, the Bank expressed itself willing to take a positive view of the step pressed by this committee so long as the 'adverse effects on third parties' of the special legislation were not 'large'.

The proposal to rediscount export bills sparked off a more intense debate within the Bank. The Department of Banking Operations pointed out the legal and operational difficulties that came in the way of handling bills drawn or negotiated under a letter of credit and extending refinance against export bills. Besides it was not convinced that banks experienced any special difficulty in financing exports. Foreign bills purchased and discounted by Indian scheduled banks amounted to Rs 22 crores at the end of January 1958; on the other hand, Indian banks' outstandings under the bill market scheme stood at Rs one crore against limits of Rs 82.76 crores. 'Thus the banks can without difficulty raise additional funds under the Scheme without approaching us for ... rediscounting ... export bills', this department maintained.

The Department of Research and Statistics, in contrast, advocated a wider and more positive approach. A note by V.G. Pendharkar in May 1958 pointed out that with nearly 70 per cent of the country's export bills being drawn in sterling, London remained the most important centre for financing Indian exports. While finance for Indian exports was easily available, its cost depended on the London discount rate which tended, of late, to be high and prone to frequent changes. A rise in the London discount rate lowered the earnings of Indian exporters 'for no fault of theirs' and was similar in its effect to 'the exchange rates of a number of countries' moving 'suddenly ... against ... Indian exporters' who exported to third countries 'via [the] sterling'. The memorandum argued that the mechanism for financing Indian exports should be capable of absorbing 'extraneous' shocks. Several remedies were available 'to undo the mischief' caused by shocks such as devaluation of major currencies, or against import restrictions and export subsidies implemented by other countries, but none whatever against a London discount rate hike which was 'capable of inflicting greater damage on India's exports than other more direct measures'

A possible solution was to bar (exchange) banks from fixing 'a disproportionately high rate for sterling bills' so long as the Bank rate in India was low and the Reserve Bank was ready to supply sterling to them. If the Bank satisfied exchange banks' need for sterling in a 'timely and inexpensive manner' they could not make the plea that a high rate on export bills presented by Indian exporters arose from the necessity of having to discount them in London. If banks persisted in charging high rates despite access to the Bank, it would be 'nothing short of ... profiteering ... at the expense of exporters and ... of the country' The alternative solution was for the Bank to provide a cheap source of export refinance to banks along the lines suggested by the Export Promotion Committee, provided the benefit was passed on to exporters. The practical difficulties raised by the Department of Banking Operations, Pendharkar argued, were not so serious as they appeared 'at first sight'. Drawing attention to the liberal credit facilities available to exporters in Japan and West Germany, he reiterated the necessity for India to follow the lead of these countries and take some 'bold steps' to promote exports.

The urgency of the arguments pressed by Pendharkar receded somewhat with the lowering of the Bank of England discount rate to 5 per cent, and the Bank decided, in the event, to adopt the course of action advanced by the Department of Banking Operations. While the practical difficulties in the way of rediscounting export bills would take 'considerable time' to remove, it was not necessary, the Bank felt, to accept the Export Promotion Committee's

suggestion since the 'liberal limits' granted to banks under the bill market scheme 'remained unutilized'. However, the Bank expressed its willingness to make advances under the bill market scheme against bills arising out of exports at a concessional rate of 0.5 per cent below the usual rate on its advances under the scheme. The Export Promotion Committee recommended that the State Bank of India should advance credit to commercial banks on the strength of export bills. The State Bank too turned down the suggestion, arguing that the 'grant of such a facility to other commercial banks cannot be considered ... one of its legitimate functions'. But it agreed to devote more attention to financing exports and to intensify its campaign to handle a larger share of the country's foreign exchange business.

The question of providing liberal credit facilities to exporters did not, however, go away. Even as the Bank was considering the Export Promotion Committee's recommendations, S.L. Kirloskar, noted industrialist and chairman of the Engineering Export Promotion Council, addressed the government, among other things about the adverse effects on machinery exports of the absence of any provision for medium-term export credits. Some weeks later in July 1958, another industrialist, K.K. Birla, raised the same issue in a letter to the Governor and argued that Indian engineering exporters would lose markets to foreign competitors unless they matched their medium-term credit facilities. Soon thereafter, the Finance Ministry sent the Bank a letter from the Ministry of Commerce and Industry urging the provision of adequate credit facilities for exporters and underlining an earlier recommendation of the committee of economic Secretaries of the Government of India proposing the formation of a 'committee of experts' to study the issue.

The Bank was, of course, constrained by the fact that it was only permitted to rediscount bills maturing within ninety days. Scheduled banks, on the other hand, were prevented by the absence of suitable refinancing facilities from locking up their resources in bills maturing later than six months. In considering Birla's plea, officials at the Bank took the view that refinancing export bills of longer durations did not 'legitimately fall within the purview' of central banking. This task was best left to a specialized financial institution which the Bank could, at best, support by subscribing to its shares or bonds. The State Bank of India too, maintained that it was not in a position to discount bills with usance periods longer than six months; while the Export Risks Insurance Corporation pointed out that the Export Credit Guarantee Committee, following whose report it had been set up, had not been in favour of the corporation rediscounting insured bills. It expressed its readiness, however, to undertake this activity to the extent permitted by its resources if the government instructed it to do so.

Rather than set up another committee for the purpose, the Bank and the Finance Ministry agreed that a better course would be for senior Bank officials to meet representatives of leading Indian and exchange banks to ascertain the difficulties they faced in financing exports and to discuss solutions. At this meeting, which was held towards the middle of August 1958, banks agreed to extend packing credits more freely to exporters provided policies of the Export Risks Insurance Corporation were extended to cover pre-shipment risks and the violation of trust receipts undertakings was made a criminal offence. However, as the meeting revealed, there was a further hurdle to be crossed. Exporters, it turned out, often did not declare to the corporation shipments to countries such as the UK or the USA where the risk of default was negligible, and preferred to confine declarations to shipments made to less 'creditworthy' countries or importers. This meant, firstly, that exporters could not avail of packing credits to finance exports to the more creditworthy borrowers. More importantly, banks were uncertain about the validity of the cover in such cases since the corporation might, in the event of concealed shipments coming to its notice, declare the entire policy of an exporter 'null and void'. Alive to this problem, the corporation proposed, subject to the government's consent, to cover all exports up to the limits of an exporter's policy for a specified period, whether or not the latter declared shipments to it. Backing this suggestion, the Bank informed the government that it would, if adopted, render it easier for banks to extend packing credits to exporters on the strength of their ERIC policies. The meeting also recommended that the Reserve Bank should arm itself with powers to grant to banks, in case of need, credit facilities for a period corresponding to the usance of export bills discounted with it.

Extension of the Bill Market Scheme to Export Bills

Communicating the outcome of his meeting with bankers, Ram Nath informed the government that the Bank was actively working out a 'practicable scheme' to extend the bill market scheme to cover export bills. There were certain 'technical difficulties' in the way but these 'should not prove insuperable', the Deputy Governor assured the government. Within weeks of the letter, in October 1958, the Bank decided to extend the bill market scheme to export bills for one year on an experimental basis. Scheduled banks which were authorized dealers in foreign exchange and eligible to borrow under the main scheme were allowed to avail of the facility against demand loans granted to exporters on the basis of documentary export bills with usance up to ninety days. The interest rate was the same as under the bill market scheme. The minimum advance to the borrowing bank and the value of an individual

usance promissory note acceptable as security under the bill market scheme were Rs 5 lakhs and Rs 50,000 respectively. But these were fixed at Rs 2 lakhs and Rs 20,000 respectively in the case of export credits, and were soon lowered to Rs one lakh and Rs 10,000. In January 1961 the latter threshold was lowered further to Rs 5,000. The Bank also agreed to bear half the stamp duty on the transaction, and soon afterwards the entire burden of the duty. In January 1959 the Bank withdrew the condition that exporters should obtain cover against exchange risk, and instead allowed banks to enforce a margin of 25 per cent. Even the latter stipulation was withdrawn in January 1961. The Bank also allowed borrowing banks to rediscount export bills abroad and accept export bills drawn by parties without recourse to them, provided usance promissory notes were obtained from borrowers. A further package of measures was approved in January 1961 to liberalize credit to exporters under the bill market scheme. Apart from the two reforms mentioned above, the Bank decided, as part of this package, to relax the limit of ninety days for the usance of export bills held as security provided the usance of promissory notes lodged with it did not exceed ninety days. Despite these measures, the extension of the bill market scheme to export bills evoked a poor response principally because borrowers were reluctant to execute usance promissory notes; nor was any acceptable solution in sight to the problem of having to physically transfer and re-transfer export bills held as security.

Study Group on Credit Facilities for Exporters

In the early part of 1960, Lala Shri Ram, industrialist and a member of the Central Board, raised with the Bank the possibility of relaxing exchange control regulations to allow exporters of engineering goods up to a year to realize their earnings, and making export credit available to them for the longer period. He also suggested covering the exchange risk for forward deals extending beyond six months. Fearing malpractice and delays in repatriating export earnings home, the Exchange Control Department opposed the first suggestion. However the Division of Banking Research was in favour of allowing exporters of 'a few specified items' of engineering goods a longer period within which to bring home their export earnings. The Bank was also in favour of the third suggestion, believing that since nine-tenths of India's exports were invoiced in sterling, rupees, and US and Canadian dollars, the loss to the Export Risks Insurance Corporation from covering the additional risk was unlikely to be significant.

The Division of Banking Research was more sceptical about the need for special measures to extend credit to engineering exporters for periods as long as one year. Commercial banks' deposits, it argued, had grown so rapidly in

recent years and financing foreign trade was so much more lucrative to them than financing domestic trade that banks appeared not to be in need of additional refinancing facilities for lending to exporters even for periods up to two years. The former might be far happier, the division pointed out, if the Export Risks Insurance Corporation extended to them a direct and unconditional guarantee, as was the practice in the UK and some other countries, in respect of exports of selected engineering goods. Should the need arise at a later stage to advance or refinance medium-term export credit, the division maintained, the responsibility should be entrusted to the Refinance Corporation for Industry rather than to the Bank. In any case, its memorandum argued, the availability of export finance was not so great a problem for exporters of engineering goods as the price of steel and levels of taxation.

Even as the Bank was examining Shri Ram's suggestions, the government constituted a study group in April 1960 under T.C. Kapur, Managing Director of the Export Risks Insurance Corporation, on credit facilities for exporters. The Bank was represented on this group by K.N.R. Ramanujam from the Division of Banking Research. The study group's report, submitted in February 1961, made a number of major recommendations. These included extending the usance period of export bills eligible for grant of advance by the Bank to 180 days, amending the Reserve Bank of India Act to enable the Bank to lend to scheduled banks on the security of their promissory notes, exempting export bills and packing credits from credit control measures, taking steps to grant credits to exporters of capital and engineering goods for periods up to five years, and refinancing of medium-term export credit by the Refinance Corporation. At the Governor's instance, Ramanujam returned to examining issues related to the cost and availability of export credit even before the formal receipt of the study group's report from the government. Endorsing its principal recommendations, he proposed sanctioning additional credit limits to banks at the Bank rate both against export bills and packing credit advances, and amending the Bank Act to facilitate such refinancing up to 180 days without banks having to physically lodge eligible usance bills. Departing from his earlier views, Ramanujam also underlined the need to amend the constitution of the Refinance Corporation for Industry to enable it to refinance medium-term export credits. Both the Indian Banks' Association and the Exchange Banks' Association supported these proposals, while as already pointed out, in 1962 the Refinance Corporation began refinancing export bills for up to five years.

Swift steps also followed to amend the Reserve Bank of India Act to enable the Bank to grant advances against export bills. In July 1961 the Committee of the Central Board approved the proposal to amend the Act so

as to enable the Bank to grant advances against export bills maturing within ninety days against promissory notes issued by banks supported by a declaration that they held eligible export bills of matching value. At the government's instance, the acceptable period of usance of eligible bills was extended to 180 days. These amendments, among others, were approved by the Central Board in June 1962 and, together with amendments to the State Bank of India Act to enable it to provide term finance, particularly to exporters, passed by both houses of Parliament in September the same year. The amendments to the Reserve Bank of India Act paved the way for the Bank to introduce the Export Bills Credit Scheme in March 1963. At the same time the Bank also introduced a special dispensation for export bills drawn in Indian rupees, making available to banks, under the prevailing quota-slab system of regulating their access to the central bank, an additional quota at the Bank rate against such bills, provided they passed on the concession to their borrowers. When the system of quotas was replaced in September 1964 by one of differential interest rates based on the net liquidity position of the banks, the Bank continued to allow scheduled banks to borrow from it against rupee export bills at the Bank rate.³ The Export Bills Credit Scheme made steady progress, advances to banks under it rising from Rs 12 crores in 1963 to Rs 44 crores in 1967.

Cost of Export Credit

While successive steps were taken to increase the availability of credit to exporters, banks were free, except in the case of short-term rupee export bills, to fix the interest rate on their export credits. The effective cost of export credit was reported to be higher in India than in other countries and was seen as a factor eroding the competitiveness of Indian exporters. Hence the government set up a working party on Cost of Export Credit in February 1964, under S.P. Chablani, Kapur's successor as Managing Director of the recently rechristened Export Credit and Guarantee Corporation. This committee had a strong presence from the Bank. V.G. Pendharkar and M. Narasimham were its members, while D.G. Borkar, another officer of the Bank, acted as its Secretary. Its report, submitted in October 1964, pointed out that the rate of interest on export credit, which was fixed according to the Inter-Bank Agreement at a minimum of 2 per cent above the Bank rate, was often as high as 7 to 9 per cent and sometimes even exceeded the prime domestic lending rate. The cost of medium-term export finance too, worked out to 8.5 per cent after taking into account the stamp duty, commission, exchange, and

³ The new accommodation regime is discussed in chapter 4.

other charges. The working party had little hesitation in endorsing the view that export credit cost more in India than in other countries and more than domestic credit. The Committee on Export Finance (or the Mathrani Committee), which had reported earlier, also suggested offering cheaper credit to exporters both at the pre-shipment and post-shipment stages. On the other hand, as the working party recognized, it was not possible merely to cap the interest rate on export credit: not only did banks need to provide a reasonable spread between the cost of funds to them and the rate at which they lent them out, a cap might merely lead to banks cutting back on export credit and diverting resources to more profitable uses. Hence it underlined the necessity of complementing the cap by bringing pre-shipment credit too, under the purview of the Bank's concessional refinance facilities. The latter, it proposed, could be granted against bills drawn up by the local producer against a firm export order and discounted by his bank. It proposed a ceiling of 1.5 per cent above the Bank rate on pre-shipment export credit and one per cent above the Bank rate on post-shipment credit against export bills of up to six months. It also proposed putting the Rupee Export Bills Scheme, with its provision of concessional refinance from the Bank, on a permanent footing and extending the scheme to cover usance bills in sterling, dollar, and other foreign currencies. The maximum lending rate, the working party ventured to suggest, should no longer depend on whether or not a bank chose to refinance its advances under the scheme. As a further step towards reducing the effective cost of export credit, this committee also recommended abolishing stamp duty on all usance export bills.

The Bank was amenable to the working party's suggestion to impose a uniform ceiling on banks' advances against rupee export bills irrespective of whether they were refinanced. The Foreign Exchange Dealers' Association supported the proposal to extend the ceiling, which it wanted fixed at 2 per cent above the Bank's lending rate, to advances against usance export bills drawn in foreign currencies. But the Bank balked at the suggestion, feeling such facilities could wait until a clearer view emerged of their likely effects on the country's credit and foreign exchange situation. On the other hand, despite apprehensions that pre-shipment finance was liable to misuse and that it might prove difficult in practice to distinguish finance utilized by a borrower for exports from that for other purposes, the Bank agreed to refinance packing credit advances backed by letters of credit or firm export orders from the 1965-66 busy season. However, apart from the usual documents, it demanded and obtained from the borrowing bank an assurance that its advances towards packing credit would be extinguished by the negotiation of bills arising from the relevant exports. Besides, borrowing under this facility was placed on par

with non-priority refinancing for computing a bank's net liquidity ratio, and refinance of pre-shipment credit was included as part of a bank's total borrowing for the purpose.

These conditions, particularly the latter which pushed up the cost to banks of pre-shipment finance, and the relatively easy money market conditions, appear to have discouraged banks from making use of this refinance facility. In response, the Bank liberalized the conditions for packing credit refinance under the bill market scheme to a great extent in August 1967. Not only was pre-shipment refinance no longer taken into account whilst computing a bank's net liquidity ratio, the Bank also agreed to provide concessional finance against packing credits advanced to some categories of exporters. Thus refinance of packing credit advanced to exporters of engineering and metallurgical products attracted a concessional rate of 4.5 per cent (which was then 1.5 per cent below the Bank rate); while that of packing credit advances to other exporters was made at the Bank rate. The Bank also stipulated that interest rate charged to the borrower on these two categories of packing credit should not exceed 6 and 8 per cent respectively. The maximum usance period of the export bills lodged with the Bank as security, however, remained unchanged. Finally, in a related piece of reform, the Bank decided to continue the Rupee Export Bills Credit Scheme, and to make available to banks, without regard to their net liquidity ratio, refinance facility at the Bank rate against export bills denominated in foreign currencies. The latter facility was conditional on banks' charges on such bills not exceeding 8 per cent.

Despite these measures, complaints persisted about the cost and availability of credit to exporters, and a feeling appeared to be growing that procedural bottlenecks lessened the impact of efforts to liberalize credit facilities for this sector. Responding to such complaints the Governor, P.C. Bhattacharyya, agreed to the suggestion made in the closing weeks of 1965 to set up a committee of bankers to simplify banking procedures for exporters. About the same time, the Ministry of Commerce mooted the idea of a standing committee which would meet on a monthly basis to deal with matters relating to export finance and the impact of credit controls on exporters. Bhattacharyya turned down the government's invitation to nominate a representative to the proposed body since he felt it was inappropriate for the Bank to have to justify its credit policies to a 'roving' committee. Following the Bank's rejection of its idea for a standing committee, the government decided in March 1966 to set up another working group to consider steps to improve the utilization of facilities provided by the Bank. Five of the eight members of the group were senior bankers. In its report submitted in August 1967 this group recommended, among other things, a credit insurance scheme for export finance, simpler

procedures for refinancing packing credits, extending the period of medium-term export finance provided by the Industrial Development Bank of India from five to seven years, and a dual pricing policy enabling banks to subsidize pre-shipment credit by charging higher rates on their other, i.e. domestic, loans.

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